HCCW 116/2015

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE
COMPANIES (WINDING-UP) NO 116 OF 2015

IN THE MATTER OF the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32)

and

IN THE MATTER OF Fonfair Company Limited

BETWEEN		
HARBOUR FRONT LIMITED		Petitioner
and		
MONEY FACTS LIMITED		1st Respondent
LEUNG YUET WAH, LEUNG YUET KEUNG and LEUNG YUET HOI		2nd Respondent
LEUNG YUET KEUNG		3rd Respondent
MARCON INVESTMENT LIMITED		4th Respondent
FONFAIR COMPANY LIMITED		5th Respondent

Before: Hon Harris J in Chambers
Date of Hearing: 19 January 2016
Date of Decision: 14 February 2017

DECISION

1. I have before me a summons dated 8 July 2016 seeking a validation order in respect of the renewal of a lease of Fonfair Company Limited's ("**Company**") sole asset, which is a parcel of land at Yau Tong Marine Lot nos 2, 3 and 4 ("**Property**"). The Property was let to Good Swift Limited ("**GSL**") on a lease, which expired on 30 June 2016. In addition sanction is sought of an agreement to retain Savills to market the Property with a view to selling it. The Company is currently the subject of an unfair prejudice petition, which includes as alternative relief a prayer for a winding-up order and hence the need for a validation order.

2. The Company has two shareholders, Harbour Front Limited and Marcon Investment Limited, which are owned respectively by two brothers, Leung Yat Tung ("**YT Leung**") and Leung Yuet Keung ("**YK Leung**"). The disputes between the brothers about management and control of the Company has a long history. YT Leung issued petitions in 2001 and 2002 against Money Facts Limited and the Company. Both were dismissed by Kwan J (as she then was) on 2 February 2004 after a full trial. YT Leung presented fresh petitions on 2 April 2015. Predictably there exists between the two brothers suspicion and hostility, which colours their views of each other's motivation and conduct.

3. The Company's financial statement for the year ending 31 March 2015, which is the most recent year available, values the Property at cost less depreciation, which produces a figure of HK$6,771,961.

Note 13 to the financial statement contains, as one would expect, a note with an estimation of the Property's value at HK$6,771,961. As I understand the position it is common ground that the Property is worth over HK$400,000,000 and, therefore, the note would seem to be clearly wrong. This perhaps explains, although there is no evidence about this, why there is a general disclaimer in the audit report.

4. It seems to me that given the value of the Property the Company is clearly solvent on a balance sheet basis. The statement of profit and loss shows a net profit for 2014/2015. The Company is carrying forward accumulated losses, which it would appear from the notes to the financial statement, particularly note 26, arise historically from borrowing from a director and an associated company possibly to finance legal costs referred to in the notes. It seems to me that the Company should be viewed for present purposes as also solvent on a cash flow basis as it has no bank borrowing. I will, therefore, proceed to determine the application on the basis that the Company is solvent and that its business is leasing and managing the Property. The agreements that the Company wishes to sign are, therefore, in the ordinary course of its business. I note at this point that Mr Fung contended that the agreement to market the Property for sale was not within its ordinary course of business, because the Property is normally let. With respect it seems to me that this is specious. The Company's sole activity is holding the property for profit. Both letting and selling it in my view clearly fall within any sensible definition of what is in its ordinary course of business.

5. I considered how applications for validation orders should be approached in the context of shareholder petitions to wind up solvent

companies with on-going businesses in paragraphs 4 to 7 of my decision in *Emagist Entertainment Ltd* [1]:

> "4. As Susan Kwan J (as she then was) explains in para.15 of her judgment in *Re Wah Ying Cheong Co Ltd* (unrep., HCCW 225/1996, [2003] HKEC 892), the weight to be attached to the opposition of a contributory to an application for validation order in the case of a solvent company is very different from the situation where a petition is presented on the ground of insolvency. Kwan J set out the following commonly quoted passages from Slade J's judgment in *Re Burton & Deakin Ltd* [1977] 1 WLR 390:
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> > '[15] The weight to be attached to the opposition of a contributory to an application for a validation order in the case of a solvent company is very different from the situation where a petition is presented on grounds of insolvency. As stated by Slade J in *Re Burton and Deakin Ltd* [1977] 1 All ER 631 at 636g-j:
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> > "… the responsibility of managing the business of the company is entrusted by its articles of association to its directors. At least so long as a winding-up petition has not been presented, the court will not generally, save in the case of proven bad faith or other exceptional circumstances, interfere with the exercise of the discretion conferred on the directors by a company's articles of association at the instance of a shareholder. Thus, if before the presentation of a petition a shareholder were to come to the court in an attempt to restrain a particular disposition of the company's property contemplated by the board of directors and falling within their powers, he would not generally succeed, unless he could prove bad faith or other exceptional circumstances. He would not be able, merely by adducing *prima facie* grounds for criticising the wisdom or beneficial nature of a particular transaction, to place on the company or its board of directors the onus of

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[1] [2012] 5 HKLRD 703.

> justifying the proposed disposition by detailed evidence."

The broad guidelines were stated at p.637d-e:

> "Taking all these considerations into account and in the absence of any authority demonstrating the contrary, I thus reach these conclusions on the question of principle raised by the present application: If on an application under s.227 [equivalent to our s.182] relating to a solvent company, (a) evidence is placed before the court showing that the directors consider that a particular disposition falling within their powers under the company's constitution is necessary or expedient in the interests of the company; and (b) the reasons given for this opinion are reasons which the court considers that an intelligent and honest man could reasonably hold, it will, in the exercise of its discretion normally sanction the disposition notwithstanding the opposition of a contributory, unless the contributory adduces compelling evidence proving that the disposition is in fact likely to injure the company." '

5. It seems to me to be implicit in Slade J's judgment that where the Court is faced with a shareholder's petition in respect of a solvent company which has a valuable ongoing business that the directors should be allowed to continue to operate that business normally and without close supervision by the Companies Court. In practice this means that one would normally expect a company to obtain without any difficulty a validation order in respect of "payment of expenses made in the ordinary course of business". Such an order I would expect normally to be readily made once the Court is satisfied of the solvency of the company and the fact that it has an active and ongoing business.

6. The Companies Court would not be concerned to check with precision the nature and the amount of the expenses. There may be, however, particular items of expense which those in control of a company consider to be sufficiently exceptional that there may be some question as to whether or not they are incurred in the ordinary course of business and in such circumstances I would expect prudent lawyers to advise

that a validation order be sought in respect of those specific items of expense.

7. In my view a petitioning contributory should not approach an application for a validation order on the basis that there is an adversarial application before the Court. I would expect normally for a petitioning contributory to be advised that it is not only normal but necessary for a company to obtain a validation order and that it would only be if the shareholder has specific concerns which he can support by credible evidence that he should actively contest any part of the application. I appreciate that in practice where the relationship between shareholders has reached such a stage that a petition has been issued it is likely that there will be suspicions on the part of a petitioner about the way in which those in charge of the company are conducting its affairs, but such a shareholder needs to be advised that this in itself does not justify trying to turn what should be a straightforward application into something more adversarial and complicated than is necessary. A practical way of alleviating the concerns of a petitioning shareholder may be by doing, as the company has agreed in the present case, to provide a regular summary to the petitioning shareholder of the expenses that are being paid by the company."

6. It follows that an application for a validation order is not an opportunity to argue about the wisdom of a proposed transaction. The court is not concerned to adjudicate a dispute about what is the best commercial course for a company to take. Mr Fung argued that there was an exception to that general rule. If the grounds for opposing a validation order arose from the matters giving rise to the substantive dispute between the parties a validation order should not be granted until those disputes have been resolved. In the present case he submitted that the way in which YK Leung had dealt with the leasing of the Property was a matter relied on as constituting unfair prejudice. In short YT Leung suggests that the lease with GSL, which the Company wishes to renew is not an arm's length transaction and they point to a number of matters, which although not direct evidence, form a basis for inferring

this. Mr Fung suggested that the decision of Kwan J (as she then was) in *Nu-West Natural Products Corp Ltd (in liquidation)* [2] demonstrated this. The particular passage relied on are paragraphs 11 and 12, which follow a discussion of Slade J's judgment in *Burton and Deakin Ltd* referred to in the passage from my judgment in *Emagist Entertainment* quoted above:

> "11. Mr Samuel Chan submitted on behalf of the petitioner that the court should exercise its discretion to dismiss the application, owing to exceptional circumstances here. He also relied on this proposition in *Gore-Browne on Companies*, (45th Ed) para 58[17A]:
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> > 'If the court considers the reasons given to be such as an intelligent and honest man could reasonably hold, it will normally grant relief; but if the company's solvency is in serious doubt, and especially if the real issues concern the interests of contributories rather than creditors, relief may be refused.'
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> 12. I would accept as correct the proposition in *Gore-Browne*, citing as support the decision of Mervyn Davies J in *Re A Company* [1987] BCLC 200. As noted by Mervyn Davies J at 203a to c, in *Burton and Deakin*, the party opposing the validation order was not a director of the Company but merely a contributory. The objection was taken only to certain particular transactions to be validated, *not* in respect of payments made in the ordinary course of business. So the judgment in *Burton and Deakin* dealt with objections as to particular transactions and Slade J had expressed his views in that context, stating that he was unable to see why shareholders should be able to interfere with directors' decisions merely because a petition was presented."

7. *Re A Company* was an application by a company that was trading and over which there was demonstrated to be doubts about both its solvency and profitability. As Mervyn Davies J observes at 205B in these circumstances the court in considering whether to grant a validation order can take a "*broad view of the nature of the dispute*". I quite accept

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[2] [2006] 4 HKC 302

that where there is a dispute between shareholders that goes to whether or not a business should continue in its current form and it is possible that if it is permitted to continue trading the value of its assets will be depleted, that the court can properly have regard to such factors in deciding whether or not to grant an order. Whether or not a case falls into this category is most likely to be determined by first identifying clearly what the nature of the decision is that the court is by the granting of a validation order being invited to approve. In the present case it is the renewal of a lease to an existing tenant, which has paid the rent during the course of its previous tenancy. There is no suggestion that the rent is materially out of line with the market rent. Indeed there was a dispute between the Company and Mega Yield International Holdings Ltd, which went to trial[3], the latter arguing that it had been granted in January 2007 an option to lease the Property in late 2008, which was not honoured because YK Leung decided instead to let it to GSL for a higher rent than the previous tenant was willing to pay.

8. Letting the Property is clearly in the course of the Company's ordinary business. It seems to me artificial to view it as anything other than a straightforward commercial decision to continue with an existing commercial arrangement, which is likely to enhance the value of the Company by increasing its assets. I can see no reason to refuse to validate it because of YT Leung's underlying concerns about whether or not his brother has some connection to the tenant and might be making a secret profit out of the transaction because of his belief that the Property was previously sub-let for a greater rent than GSL has paid.

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[3] *Mega Yield International Holdings Ltd v Fonfair Company Ltd*, unreported, HCA 948/2009, DHCJ Woo, 5 March 2013

9. Mr Fung relied on two further matters as justifying the court refusing a validation order. The first is that various rectification work is required to the Property to ensure that it complies with the Government lease. The Petitioner has obtained a report from a consultancy, BMI, identifying various failures to maintain the Property. However, in a letter in response to the report Fonfair's solicitors have explained that a number of the defects identified by BMI are in the adjacent site rather than the Property and so far as other defects are concerned they have offered to discuss them with the consultants. Ms Lok also points out that the proposed new lease contains a right of entry to carry out any necessary work and that some of the complaints relate to work done by UDL, a company owned by the Petitioner, during the time that it occupied the site.

10. The Petitioner's last objection concerns UDL, which it says, correctly, has made an offer to rent the Property and provide a materially greater deposit than GSL. This I can deal with very shortly. As I have mentioned UDL has previously been a tenant of the Property. It was the way in which YT Leung dealt with problems that arose with UDL's occupancy that were amongst the reasons why Kwan J determined the previous petitions against Harbour Front. It seems to me perfectly reasonable in the circumstances for the Company not to wish to let the Property to UDL when there is another party willing to do so.

11. I will, therefore validate the new lease to GSL.

12. So far as the second item is concerned, namely, the retainer for Savills. In principle I am prepared to validate this subject to the following qualifications. The retainer is to be limited to advising on the

pricing of the Property, the best methods of marketing it for sale and the preparation of material for marketing the Property. An agreement should be prepared and submitted for the court's approval. Alternatively the matter can be stood over until the hearing of the Petitioner's application for the appointment of Receivers.

(Jonathan Harris)
Judge of the Court of First Instance
High Court

Mr Daniel Fung SC & Mr David Chen, instructed by Tsang & Lee, for the petitioner

Ms Frances Lok, instructed by Ho & Ip, for the 1st & 5th respondents

The 2nd respondent was not represented and did not appear

The 3rd respondent was not represented did not appear

The 4th respondent was not represented and did not appear

Attendance of the Official Receiver was excused