THE BANKING LITIGATION LAW REVIEW

Fifth Edition

Editor
Deborah Finkler

THE LAWREVIEWS

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PREFACE

This year's edition of the *The Banking Litigation Law Review* highlights that litigation involving banks and financial institutions shows little sign of slowing. The legal and procedural issues that arise in banking litigation continue to evolve and develop across the globe, in the context of both domestic and cross-border disputes.

The covid-19 pandemic continued to loom large in 2021, with judicial systems taking part in a forced experiment of embracing new technology to minimise the disruption caused by pandemic restrictions; in some jurisdictions we may see the permanent adoption of measures taken up in response to the restrictions imposed by the pandemic, as well as a general shift towards the greater use of new technology in dispute resolution. This extends to the increased use of virtual hearings (as well as electronic trial bundles and filing systems), although we can expect that physical hearings will continue to play a prominent role, particularly in complex cases. While it is too early to predict the future with any certainty, it seems likely that some form of hybrid approach is here to stay.

Outside the court room, the effects of the pandemic continue to be felt throughout the wider economy. As various restrictions and financial interventions by governments are scaled back, the early signs of the long-term, negative economic effects of the pandemic are now beginning to emerge in many parts of the world. From the perspective of the financial sector, these conditions are likely to translate into an increase in loan arrears and defaults, debt restructurings, bankruptcies and insolvencies affecting banks, their customers and counterparties. These conditions typically presage an uptick in banking litigation and it seems likely that disputes arising from the economic fallout of the pandemic will feature in future editions of this Review.

A continuing trend this year has been the broadening of obligations placed on financial institutions in the name of improving consumer protection. Faced with the challenge of increasing bank fraud and other illicit transactions, governments and courts alike have continued to develop the nature and scope of duties imposed on banks to protect their customers. Claimants will no doubt continue testing the limits of these obligations and duties in the courts.

Last year's preface highlighted the political and economic uncertainty produced by Brexit as the transition period drew to an end. Since then, some welcome clarity has emerged around the foundations of the United Kingdom's new relationship with the European Union, including in the area of jurisdiction and enforcement of judgments. However, the new relationship will take time to bed down, with additional complexities (and potentially disputes) likely to emerge as parties navigate the new reality. That said, there is little evidence that commercial parties, including banks and financial institutions, have been deterred from choosing the United Kingdom as a forum for litigating their disputes.

While 2021 has been another challenging year for many, there has been some cause for optimism: globally stock markets have continued to perform well as economic recoveries gather pace in many parts of the world, while the roll-out of the covid-19 vaccine has allowed many jurisdictions to emerge from a period of seemingly endless lockdowns and suppressed economic activity. Despite these positive signs, however, the global economy is likely to feel the effects of the covid-19 pandemic for some time and in various (and often unexpected) ways, as highlighted by the recent emergence of a crisis in the global supply chain. At the same time, other global challenges, such as climate change, will increasingly dominate the political and economic agenda. Given the various headwinds and challenges ahead, the high volume and broad nature of litigation in the financial sector look set to continue.

Deborah Finkler
Slaughter and May
London
November 2021

Chapter 5

HONG KONG

Wynne Mok and Kathleen Poon[1]

I OVERVIEW

For the past year, courts in Hong Kong have tirelessly heard and decided on cases related to the banking industry. They range from cyber fraud cases, in which the courts found that fraudsters held misappropriated funds in bank accounts on constructive trusts for the victims, to insolvency cases, which give creditors helpful guidance as to which jurisdiction they should go when seeking to wind up foreign companies. The Hong Kong government has put in great efforts to ensure that the city maintains its status as a leading financial centre by creating new laws and updating existing ones to align with international standards. The city is also building on and benefiting from its indivisible tie with mainland China, including mutual arrangements in relation to the enforcement of arbitral awards, availability of interim measures in aid of arbitration proceedings, and recognition of and assistance to cross-border insolvency proceedings.

II SIGNIFICANT RECENT CASES

Financial institutions remain at the forefront of the battle against fraud and money laundering. They face applications by victims of fraud for interim relief measures, such as *Norwich Pharmacal* orders and *Mareva* injunctions. In *A1 and Another v. R1 and Others*,[2] the Court of First Instance (CFI) granted a *Norwich Pharmacal* order for disclosure relating to bank accounts held in overseas branches of Hong Kong incorporated banks. Since the Hong Kong incorporated banks were regulated by the Hong Kong Monetary Authority (HKMA) and required to ensure that their overseas branches comply with the extensive record-keeping requirements imposed by the HKMA, it was reasonable to infer that the banks might have possession or custody of documents and information relating to the bank accounts in question, or that such documents and information might be within their power.

There is also developing case law concerning recovery of funds in a cyber fraud or phishing attack by seeking a vesting order pursuant to Section 52(1)(e) of the Trustee Ordinance (Cap 29) (TO). The TO empowers the court to make a vesting order 'where stock or a thing in action is vested in a trustee whether by way of mortgage or otherwise' and if it appears to the court to be expedient. Pursuant to the vesting order, the right to claim the balance in the bank account, which originally vested in the fraudster being the actual bank

1 Wynne Mok is a disputes and investigations partner and Kathleen Poon is a disputes and investigations associate at Slaughter and May.

2 [2021] HKCFI 650.

account holder, would be vested in the victim as the equitable or beneficial owner of the funds in the account. The court may then direct the bank to release the balance to the victim immediately. The CFI, in *Wismettac Asian Foods, Inc v. United Top Properties Limited & Ors*,[3] held that it has jurisdiction to make a vesting order in favour of the victim, whereby the bank would have to directly transfer the fund to the victim. The reason is that a constructive trust came into existence by operation of law when the victim's fund went into the fraudster's bank account, which is a scenario that the TO is intended to cover by the inclusion of the words 'or otherwise'. The *Wismettac* approach was adopted by the CFI and the district court in subsequent cases.[4] It has been considered that obtaining a vesting order under the TO is a faster way to recover stolen funds than the conventional way of obtaining a default judgment against the fraudster and then applying for a garnishee order under the Rules of the High Court (Cap 4A) (High Court Rules). However, the legal position should not be considered as settled. In *800 Columbia Project Company LLC v. Chengfang Trade Ltd and others*[5] and *Tokic DOO v. Hongkong Shui Fat Trading Ltd*,[6] the CFI decided that its jurisdiction under Section 52(1)(e) of the TO would not be engaged in cyber fraud cases.

In *Luk Wing Yan v. CMB Wing Lung Bank Limited*,[7] the CFI held that the *Quincecare* duty would only arise in circumstances where misappropriation of a customer's funds occurred due to a payment instruction from an authorised or trusted agent on behalf of its customer, instead of from the customer itself. On this basis, the defendant bank was not liable for losses suffered by a customer who gave payment instructions to the bank as a result of fraudulent investments offered by an employee of the bank.

There has been a surge in arbitration-related cases in Hong Kong. These cases demonstrate that, in general, Hong Kong courts remain arbitration-friendly. For instance, the courts would grant anti-suit injunctions to restrain the pursuit of foreign proceedings in breach of arbitration clauses and would exercise their jurisdiction to ensure that the losing party honours the terms of an arbitral award by making available a full range of remedies in a common law action. It is indeed hard to convince a court to set aside an arbitral award on the ground of invalidity of an arbitration agreement. Hong Kong courts have also confirmed that whether pre-conditions to arbitration had been fulfilled before the commencement of arbitral proceedings should be decided by the arbitral tribunal appointed by the parties, not by the courts. The question relates to whether a claim referred to arbitration should or should not be admitted by the tribunal and does not go to its jurisdiction.[8] Nevertheless, the courts have shown their readiness to interfere and set aside an arbitral award if there is inconsistency in material factual findings made by the same arbitrator.[9] The well-balanced approach to arbitration adopted by the courts could be an assurance to banks when considering what would be an appropriate dispute resolution mechanism for their purposes.

3 [2020] HKCFI 1504.

4 *Star Therapeutics, Inc v. Leabon Technology (HK) Ltd & Another* [2021] HKCFI 1715 and *Donald Henry Case v. Profitling International Ltd and Another* [2021] HKDC 172.

5 [2020] HKCFI 1293.

6 [2020] 4 HKLRD 189.

7 [2021] HKCFI 279.

8 *C v. D* [2021] HKCFI 1474.

9 *W v. AW* [2021] HKCFI 1707.

III RECENT LEGISLATIVE DEVELOPMENTS

Since July 2017, Hong Kong has implemented a regime for the orderly resolution of financial institutions in the event that they cease to be viable and threaten the stability and effective working of the financial system of Hong Kong. The responsible resolution authorities, mainly the HKMA, have been given the powers to decide whether to initiate the resolution of a financial institution and which stabilisation options to apply. Under the Financial Institutions (Resolution) Ordinance (Cap 628), the HKMA has the power to temporarily suspend the termination right of a counterparty to a contract that the failing financial institution has entered into, if it considers that the termination of the contract would frustrate the resolution actions taken. However, it was uncertain as to whether the HKMA could effectively suspend the termination rights in a non-Hong Kong law governed contract. This uncertainty has now been resolved by the Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights – Banking Sector) Rules (Cap 628C) (Stay Rules), which came into effect on 27 August 2021. The Stay Rules require that any contract that (1) is entered into by an authorised institution incorporated in Hong Kong or its holding company or related company; (2) is governed by non-Hong Kong law; and (3) contains a termination right exercisable by a counterparty should contain a provision that the parties to the contract will be bound by any suspension of termination rights imposed by the HKMA.

The Hong Kong government has been putting in efforts to attract existing foreign investment funds to set foot in Hong Kong and strengthen Hong Kong's position as an international asset and wealth management centre. As part of the efforts, the Limited Partnership Fund Ordinance (Cap 637) and the Securities and Futures Ordinance (Cap 571) will be amended to allow re-domiciliation of foreign funds set up outside Hong Kong as limited partnership funds or open-ended fund companies in Hong Kong.[10] The re-domiciliation process will allow existing foreign funds to set up new fund vehicles in Hong Kong and transfer their assets and shareholders to the same.

IV CHANGES TO COURT PROCEDURE

There were major reforms to the civil procedural rules under the High Court Ordinance (Cap 4) back in 2009, which empowered the courts to proactively manage the progress of court cases with the aim to increase procedural economy and efficiency.

Summary judgment is one way to expedite court processes where a plaintiff may apply for judgment against a defendant without going through a full trial on the basis that the defendant has no arguable defence. It is currently not available for claims based on an allegation of fraud. The Rules of the High Court (Amendment) Rules 2021 and Rules of the District Court (Amendment) (No. 2) Rules 2021, which will come into operation on 1 December 2021,[11] will make summary judgment available for these claims.

In the past year, Hong Kong has made substantial efforts in transforming the judiciary into a paperless system with a view to further increasing efficiency of the court process. The Court Proceedings (Electronic Technology) Ordinance (Cap 638), which enables

10 The Limited Partnership Fund and Business Registration Legislation (Amendment) Ordinance 2021 and the Securities and Futures (Amendment) Ordinance 2021 were gazetted on 2 July 2021. The amendments will come into operation on 1 November 2021.

11 These will amend Order 14 of the High Court Rules and the Rules of the District Court (Cap 336H).

court-related documents to be filed and served and payments to be handled electronically, will come into operation on 1 October 2021. In the meantime, the courts have been using technology on an individual case basis. In *Hwang Joon Sang & Anor v. Golden Electronics Inc & Ors*,[12] the CFI approved the use of a data room for ordinary service of documents under the High Court Rules, noting that the underlying objectives of case management pointed strongly towards the use of available technology.

In addition to regular court procedures, since June 2012, the Financial Dispute Resolution Centre (FDRC) has been operating as a forum for relatively low value disputes between banks and other financial intermediaries, on the one hand, and retail customers, on the other hand.[13] In the spirit of 'mediation first, arbitration next', the FDRC aims to provide a more economic, expeditious and amicable means of resolving disputes that would otherwise have been pursued in the small claims tribunal or the district court. According to the FDRC's latest annual report dated 27 July 2021, it has achieved a mediation success rate of over 70 per cent for the year ended 31 December 2020.[14] The FDRC has also issued Guideline No. 5,[15] outlining the prescribed procedure to enable the FDRC to handle more efficiently cases in which one of the parties concerned is uncontactable.

V INTERIM MEASURES

The court has jurisdiction to issue various interim measures. For example, *Mareva* injunctions for both Hong Kong and overseas proceedings are commonly used to prevent defendants from dissipating assets pending conclusion of those proceedings.

Hong Kong became the first and only jurisdiction outside the Mainland where parties to arbitral proceedings can apply to the mainland courts for interim measures in aid of arbitral proceedings. Under the Arrangement Concerning Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region (Interim Measures Arrangement), which took effect on 1 October 2019, where an arbitration is seated in Hong Kong and administered by designated arbitral institutions (including the Hong Kong International Arbitration Centre (HKIAC)), parties to the arbitration can apply to the mainland courts for orders to preserve property or evidence, or to prohibit a party from conducting in certain ways pending conclusion of the arbitral proceedings in Hong Kong. It should be noted, however, that different procedures are applicable depending on whether the parties apply for interim measures before or after acceptance of the case by an eligible arbitral institution. The mainland courts might require the applicant to provide security pending its determination and the applicant would be responsible for any related fees of the mainland courts.

Within two years from the implementation of the Interim Measures Arrangement, the HKIAC has already processed 50 applications made to the mainland courts for interim measures. In all cases, the HKIAC issued a letter of acceptance certifying the HKIAC's acceptance of an arbitration as required by the Interim Measures Arrangement, typically

12 [2020] HKCFI 1084.

13 The maximum claim is HK$1 million.

14 The '2020 Annual Report' (FDRC, 27 July 2021) <https://www.fdrc.org.hk/en/annualreport/2020/files/download/FDRC_annual_report.pdf>.

15 'Guideline No. 5: Procedure on terminating a case with an un-contactable party at the mediation stage' (FDRC, 1 June 2020) <https://www.fdrc.org.hk/en/doc/FDRC_Guideline_No.5_en.pdf>.

within 24 hours from its receipt of the application. In total, 47 of the 50 applications were for the preservation of assets, and 23 different mainland courts have issued preservation orders, which together cover approximately US$1.7 billion worth of assets.

VI PRIVILEGE AND PROFESSIONAL SECRECY

Legal professional privilege is considered fundamental in the judicial system in Hong Kong. It protects from disclosure confidential communications between a client and its lawyer for the dominant purpose of giving or receiving legal advice (legal advice privilege), and communications between parties and their lawyers and third parties for the purpose of obtaining information or advice in connection with existing or contemplated litigation (litigation privilege).

Under Hong Kong law, legal advice privilege does not extend to cover legal advice given by professionals other than practising lawyers in light of the Court of Appeal (CA) decision in *Super Worth International Ltd v. Commissioner of Independent Commission Against Corruption*,[16] which followed an English Supreme Court's decision.[17]

Legal advice privilege only protects confidential client–attorney communications. In *CITIC Pacific Ltd v. Secretary for Justice (No. 2)*,[18] the CA interpreted 'client' broadly so as to cover the client's employees and not only employees specifically authorised to seek and receive legal advice on behalf of the client. Communications sent by an employee within the client organisation for the dominant purpose of obtaining legal advice are therefore protected by legal advice privilege. This represents a significant departure from the definition of 'client' adopted by the English Court of Appeal in *Three Rivers v. Governor and Company of the Bank of England (No. 5)*.[19] In a subsequent case,[20] the English Court of Appeal considered the authorities in Hong Kong (including CITIC Pacific) and acknowledged concerns with the narrow definition of 'client' adopted in *Three Rivers*. The issue, however, was left open and, as such, the interpretation of 'client' in *Three Rivers* remains valid. The difference in the approach between English courts and Hong Kong courts remains.

VII JURISDICTION AND CONFLICTS OF LAW

i Anti-suit injunctions

Section 45 of the Arbitration Ordinance (Cap 609) (AO) and Section 21L of the High Court Ordinance (Cap 4) empower the CFI to grant anti-suit injunctions to restrain the pursuit of court proceedings in breach of an agreement to resolve disputes by arbitration. In *Cheung Shing Hong Ltd v. China Ping An Insurance (Hong Kong) Co Ltd*,[21] the CFI reaffirmed that it must stay the proceedings in favour of arbitration if it is satisfied of the following:

a there is a valid and enforceable arbitration agreement;

b there is, in reality, a dispute or difference between the parties; and

16 [2016] 1 HKLRD 281.

17 *R (on the application of Prudential plc & Anor) v. Special Commissioner of Income Tax & Anor* [2013] UKSC 1.

18 [2015] 4 HKLRD 20.

19 [2003] QB 1556.

20 *Director of the Serious Fraud Office v. Eurasian Natural Resources Corporation* [2018] EWCA Civ 2006.

21 [2020] HKCFI 2269.

c the dispute or difference in question is within the scope of the arbitration agreement.

The court may also grant an interim anti-suit injunction to restrain the pursuit of foreign proceedings in favour of an arbitration in Hong Kong. In *Capital Wealth Holdings Limited & Ors v. Nantong Jiahe Technology Investment Development Co., Ltd*,[22] the defendant was restrained from pursuing court proceedings before the Nantong Intermediate People's Court in favour of an arbitration administered by HKIAC. Although the relevant arbitration clause was faulty in multiple respects, the court held that there is a sufficiently strongly arguable case that the arbitration agreement concerned is governed by Hong Kong law and the arbitral tribunal shall have the power to rule on the validity of the arbitration agreement under the competence-competence principle. Comity and delay are also relevant considerations. In *C v. D*, [23] the CFI refused to grant an interim anti-suit injunction on the grounds that the applicant had delayed in making the application and considerable resources had already been used to prepare for the substantive hearing before the foreign court.

ii Recognition and enforcement of foreign judgments (including Mainland judgments) and awards

Foreign judgments are generally enforceable either under the Foreign Judgments (Reciprocal Enforcement) Ordinance (Cap 319) or at common law. Notably, the Mainland Judgments (Reciprocal Enforcement) Ordinance (Cap 597) (Reciprocal Enforcement Ordinance), which gives effect to the Arrangement on Reciprocal Recognition and Enforcement of Judgments of Civil and Commercial Matters by the Courts of the Mainland and of Hong Kong Special Administrative Region Pursuant to the Choice of Court Agreements between the Parties Concerned 2006 (2006 Choice of Court Arrangement), allows Mainland judgments to be enforced in Hong Kong, and vice versa.

Where a mainland court or Hong Kong court has made a final monetary judgment in a civil and commercial case, any party concerned may apply to a mainland court or Hong Kong court for recognition and enforcement of the judgment. To rely on the 2006 Choice of Court Arrangement, the judgment must have been made by the court, pursuant to a written agreement between the parties to submit their dispute to the sole jurisdiction of a mainland court or a Hong Kong court. A judgment so recognised shall have the same force and effect as one being made by a court of the place where the enforcement of the judgment is sought. This means that parties to cross-border contracts can confidently choose to have disputes resolved in either mainland China or Hong Kong, knowing that there is an avenue to enforce a judgment in the other jurisdiction without incurring significant costs and time in initiating new proceedings.

Asymmetrical jurisdiction clauses are widely used in financial documents with cross-border elements because they give lenders the optionality as to where to enforce their rights depending on the location of the borrowers' assets while having the certainty that the borrowers can only sue in a designated jurisdiction. In *ICBC (Asia) Ltd v. Wisdom Top International Ltd*,[24] the CFI held that such a clause did not qualify as a 'choice of Hong Kong

22 [2020] HKCFI 3025.

23 [2020] HKCU 2374.

24 [2020] HKCFI 322.

court agreement'[25] under the Reciprocal Enforcement Ordinance because the plaintiff lender had the option to commence proceedings elsewhere and the choice of forum was therefore at large. As such, the plaintiff could not benefit from the more efficient statutory regime to enforce the Hong Kong judgment against a debtor in mainland China. The 2006 Choice of Court Arrangement is expected to be replaced by an arrangement between mainland China and Hong Kong for the mutual recognition and enforcement of judgments signed on 18 January 2019, which will expand the scope of the reciprocal enforcement mechanism to cover non-monetary judgments and remove the strict requirement of an exclusive jurisdiction clause. It is still not yet known when it will take effect.

As for the enforcement of foreign arbitral awards, Hong Kong is a party to the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention). Awards made in the territory of another contracting state to the New York Convention may be enforced in Hong Kong. There has been an Arrangement Concerning Mutual Enforcement of Arbitral Awards between the Mainland and the Hong Kong Special Administrative Region since 2000 (Original Arrangement), which provides for mutual enforcement of arbitral awards between the two jurisdictions on terms largely similar to the New York Convention. An applicant has to apply to the court at the place of domicile of the respondent by submitting a written application, the arbitral award and the arbitration agreement. Enforcement may be refused if under the law of the place of enforcement the dispute is not arbitrable (i.e., incapable of being settled by arbitration) or it is contrary to public policy.

On 27 November 2020, 20 years after the implementation of the Original Arrangement in 2000, the Vice President of the Supreme People's Court of mainland China and the Secretary for Justice of the Hong Kong Special Administrative Region agreed to enhance the Original Arrangement by way of the Supplemental Arrangement Concerning Mutual Enforcement of Arbitral Awards between the Mainland and the Hong Kong Special Administrative Region (Supplemental Arrangement). It is a welcome addition to the Interim Measures Arrangement. While the Interim Measures Arrangement enables parties to arbitral proceedings seated in Hong Kong to apply for interim measures from mainland courts and vice versa before an arbitral award is made, it does not provide for interim measures to address the risk of dissipation of assets during the period after an arbitral award is made and before it is enforced. Effective enforcement is often a key concern for parties in international arbitration, and the lack of post-award interim measures may deprive the winning party in whose favour the arbitral award is made of any meaningful remedy. By making interim measures available before and after the court's acceptance of the application for enforcement, the Supplemental Arrangement fills the existing legal void and enhances the effectiveness of arbitration.

Furthermore, the Supplemental Arrangement has broadened the scope of mutually enforceable arbitral awards to cover any arbitral awards rendered pursuant to the Arbitration Law of the People's Republic of China (PRC).[26] Previously, to benefit from the Original Arrangement, the mainland award should be rendered by one of the designated arbitral authorities, which are effectively local arbitration institutions in mainland China. With the Supplemental Arrangement, which has been incorporated in local law, as long as an

25 It is defined under the Reciprocal Enforcement Ordinance to mean an agreement concluded by the parties in Hong Kong or any of them as the court to determine a dispute that has arisen or may arise in connection with the specified contract to the exclusion of courts of other jurisdictions.

26 Article 2 of the Supplemental Arrangement.

arbitral award is made in an arbitration seated in mainland China, it may be enforced under the AO, whether or not the award is made by a local arbitral authority or an international arbitration institution. Another significant development brought about by the Supplemental Arrangement is that a winning party to an arbitral process can now apply to enforce an arbitral award in the courts of mainland China and Hong Kong simultaneously, which was not possible under the Original Arrangement.

VIII SOURCES OF LITIGATION

i Banks' obligations in respect of anti-money laundering, counterterrorism financing and fraud

Where authorities are investigating alleged money laundering or receipt of proceeds of crime, they may require banks to freeze the relevant bank accounts. If customers find that, without explanation, their accounts are frozen, banks are placed in a difficult position because their response to customers' demand for reasons may constitute tipping off.[27] The CFI has clarified that, at the very least, a bank is entitled to unconditional leave to defend in a summary judgment action for release of the frozen assets.[28]

Where a fraudster successfully elicits funds from a victim, the victim may apply for interim measures against banks to protect his or her position. In cases of forged instructions to direct banks to transfer funds out of a victim's bank account, an injunction to freeze funds in the hands of third-party recipients is not uncommon.[29] In addition, where a victim is unaware of the identity of the recipients, a *Norwich Pharmacal* order is particularly helpful to trace the movement of misappropriated funds.[30] As noted above, the case of *A1 and Another v. R1 and Others*[31] demonstrates that a *Norwich Pharmacal* order can be made for disclosure by overseas branches of a Hong Kong incorporated bank.

A restitutionary claim against a third-party recipient is not unusual, even if the recipient is innocent. The recipient may raise the defences that he or she is a bona fide purchaser for value or has changed his or her position by acting to his or her detriment in good faith after the receipt of such funds, thus warranting protection under equity. In *Tti Global Resources v. Hongkong Myphone Technology Co Ltd*,[32] the CFI allowed an appeal against a master's order to dismiss the plaintiff's summary judgment and rejected the defendants' defence that they were bona fide purchasers for value without notice. It was held that the defendants engaged in underground foreign currency matching arrangements, which were illegal under PRC laws and, accordingly, cannot in law be considered to have provided value for the property received.

Banks have become even more exposed to fraud and its repercussions in light of the English Supreme Court's decision to uphold the first successful claim in negligence for breach of the *Quincecare* duty of care owed by financial institutions to their customers.[33]

27 *Crown Aim Ltd v. Uco Bank* [2020] HKCFI 212.

28 ibid.

29 *Cheung Hon Kuen v. Hang Seng Bank Ltd* [2019] HKCFI 2874.

30 *Malayan Banking Berhad, Singapore Branch v. Legend Six Holdings Ltd & Anor* [2020] HKCFI 990; *Cinatic Technology Ltd v. Hongkong and Shanghai Banking Corp Ltd* [2020] HKDC 278.

31 [2021] HKCFI 650.

32 [2021] HKCFI 306.

33 *Singularis Holdings Ltd (In Official Liquidation) (A Company Incorporated in the Cayman Islands) v. Daiwa Capital Markets Europe Ltd* [2019] UKSC 50.

The *Quincecare* duty refers to a bank's duty to exercise reasonable skill and care in executing the customer's orders. While banks are not expected to question every payment instruction from their clients, they cannot turn a blind eye to signs that would be obvious and glaring to any reasonable banker that their clients' trusted agents are perpetrating a fraud. The *Quincecare* duty has been recognised by Hong Kong courts. In *PT Tugu Pratama Indonesia v. Citibank NA*,[34] the CFI found that the bank had been put on inquiry in the light of the pattern of payments together with the lack of apparent business connection between the disputed payments and the customer, and the fact that the payment instructions were signed by those who would benefit from them. The CFI therefore held that the bank was negligent in failing to make any inquiry and hence breaching the *Quincecare* duty. The action failed eventually as it was time-barred. In *HSBC v. SMI Holdings Group Ltd*,[35] the CFI reaffirmed that the *Quincecare* duty applies in Hong Kong, noting that the required threshold to put banks on inquiry is high. However, as noted above, the CFI has refused to expand the scope of the *Quincecare* duty in *Luk Wing Yan v. CMB Wing Lung Bank Limited*[36] to cases where misappropriation of a customer's funds occurred due to a payment instruction from the customer itself, notwithstanding the customer was defrauded into making the payment instruction.

ii Debt enforcement and insolvency

In the past year, the Hong Kong courts have seen many attempts to wind up foreign companies in Hong Kong. The courts are requested to exercise their jurisdiction to wind up these companies, rather than simply recognising and assisting the insolvency proceedings in these companies' place of incorporation. In many cases, creditors sought to wind up a Hong Kong listed company that was incorporated in offshore jurisdictions, such as the Cayman Islands, but had core business and assets in mainland China held through intermediate holding companies incorporated in another offshore jurisdiction (Offshore Structure). Such structure is prevalent among groups listed in Hong Kong. There has been a developing body of case law on Hong Kong courts' jurisdiction to wind up these foreign incorporated companies.

In general, the most appropriate place to wind up a company is its place of incorporation. There are three core requirements that have to be satisfied for a Hong Kong court to exercise jurisdiction to wind up a foreign company:

a the foreign company must have a sufficient connection with Hong Kong;
b there must be a reasonable possibility that the winding-up order would benefit those applying for it; and
c the court must be able to exercise jurisdiction over one or more persons in the distribution of the company's assets.

Of the three core requirements, the second core requirement has proven to be the most problematic. In *Re China Huiyuan Juice Group Ltd*,[37] the Court held that the group that employs the Offshore Structure could not be wound up in Hong Kong as the petitioner could not demonstrate real benefit of winding up the company in Hong Kong. This was because the company's main assets were located in mainland China, but the laws of mainland China and

34 [2018] HKCFI 2233.
35 [2019] HKCFI 1948.
36 [2021] HKCFI 279.
37 [2020] HKCFI 2940.

other offshore jurisdictions did not recognise the liquidators appointed in Hong Kong where Hong Kong was not the place of incorporation. This meant that even if the Hong Kong court were to make a winding-up order, the Hong Kong-appointed liquidators would not be able to take control of the subsidiaries and ultimately reach the assets in mainland China.

However, the difficulties illustrated in *Re China Huiyuan* may be of less concern going forward. On 14 May 2021, mainland China and Hong Kong entered into an Arrangement on Mutual Recognition of and Assistance to Insolvency Proceedings (Cooperation Mechanism), which allows Hong Kong-appointed liquidators to be formally recognised and assisted by a mainland court, and thereby exercise powers available to them under Hong Kong law within mainland China. Under the Cooperation Mechanism, three pilot courts (Intermediate People's Courts in Shanghai, Xiamen and Shenzhen) will consider applications for recognition of, and assistance to, insolvency proceedings commenced in Hong Kong, in respect of companies that have their centre of main interest (COMI) in Hong Kong for at least six months prior to application and have principal assets or business operations or representative offices in one of these pilot areas. Once recognised, Hong Kong-appointed liquidators may take over the property of the debtor in mainland China and investigate the debtor's affairs. A first letter of request was issued under the Cooperation Mechanism by the Hong Kong court to the Shenzhen Bankruptcy Court in *Re Samson Paper Co Ltd*[38] to seek the Shenzhen court's recognition of the Hong Kong liquidation proceedings and the appointment of the liquidators, as well as the granting of powers to the liquidators.

Companies in financial distress may want to effect debt restructuring in Hong Kong to avoid winding up the company. Complications may arise where such debtor company is incorporated in a foreign jurisdiction. Whereas other common law jurisdictions allow a mechanism known as soft-touch provisional liquidation, whereby provisional liquidators (PLs) are appointed to facilitate corporate restructuring while the board maintains the day-to-day management of the company, this mechanism is not available under Hong Kong law. Therefore, there has been an emerging trend of offshore-incorporated debtor companies that commence insolvency proceedings in their place of incorporation and seek the appointment of soft-touch PLs, and then apply for recognition and assistance in Hong Kong with a view to implementing a scheme of arrangement in Hong Kong. This approach has faced increasing scrutiny from the courts in the past year, particularly in cases where soft-touch PLs are appointed after a winding-up petition has been issued in Hong Kong, as a justification for adjourning the petition.[39] The Hong Kong court would only adjourn the winding-up petition if the debtor company can demonstrate that it has a concrete proposal to address its financial difficulties that is in the best interests of the general body of unsecured creditors. The court would have great regard to the views of unsecured creditors in deciding whether to adjourn the petition in favour of a restructuring attempt. Furthermore, where the COMI is in Hong Kong, the court may not give primacy to the insolvency proceedings in the company's place of incorporation (including any restructuring attempt commenced there) and, instead, order the company to be wound up in Hong Kong.

Where foreign incorporated companies seek to restructure debt through a scheme of arrangement in Hong Kong, they should avoid pursuing a parallel scheme of arrangement in their place of incorporation as a matter of course. Where the debtor company is listed in Hong

38 [2021] HKCFI 2151.

39 *Re China Bozza Development Holdings Ltd* [2021] HKCFI 1235; *Li Yiqing v. Lamtex Holdings Ltd* [2021] HKCFI 622.

Kong, whose debt is very largely governed by Hong Kong law, the debtor company should pursue a scheme of arrangement in Hong Kong. It is only necessary to introduce a scheme in the place of incorporation if there is good reason to think that without such scheme there is a genuine risk of the company being wound up there. In *Re China Oil Gangran Energy Group Holdings Limited*,[40] the court considered that the parallel scheme in the Cayman Islands (where the company was incorporated) was unnecessary as the company had only minimal debts not governed by Hong Kong law. Where parallel schemes are introduced unnecessarily, the debtor company faces the risk of the court refusing to sanction the Hong Kong scheme.

Traditionally, the court would not dismiss a winding-up petition unless it is satisfied on the evidence that the debt is genuinely disputed on substantial grounds.[41] Courts have recognised that the right to present a winding-up petition in appropriate circumstances is a right conferred by statute that should not be restricted except on clear and persuasive grounds.[42] However, in *Lasmos Ltd v. Southwest Pacific Bauxite (HK) Ltd*,[43] the CFI held that a statutory demand should be set aside or a winding-up petition should generally be dismissed if:

a the company debtor has a genuine dispute over the debt relied on by the petition;
b the contract under which the debt is alleged to arise contains an arbitration clause that covers any dispute relating to the debt; and
c the company has complied with the contractually agreed dispute resolution process by commencing action and files an affirmation for this purpose.

The *Lasmos* approach is a departure from the traditional approach above and has been queried in *obiter dicta* by the CA, which is of the view that public policy mandates that the statutory right of winding up a company should not be fettered or precluded.[44] In another case, the CA has also expressly discouraged debtors from making opportunistic attempts to invoke the *Lasmos* approach in the future.[45] More recently, the CFI has held that where there is no real intention to resolve the dispute by arbitration, the *Lasmos* approach may not be available to the company debtor.[46]

IX EXCLUSION OF LIABILITY

While the wording varies, anti-Bartlett provisions are commonly found in trust deeds for the purposes of relieving trustees from any duty to exercise control over or interfere with, or become involved in, the management or conduct of the trust-owned investment company that primarily remains in the hands of the settlors. The effectiveness of anti-Bartlett provisions has been subject to judicial consideration in *Zhang Hong Li v. DBS Bank (Hong Kong) Ltd & Ors*.[47] The current position, as a result of the Court of Final Appeal decision, is that if an anti-Bartlett provision consciously agreed by contracting parties was clearly drafted to relieve

40 [2021] HKCFI 1592.
41 *Hollmet AG v. Meridian Success Metal Supplies Ltd* [1997] 4 HKC 343.
42 *Synergy Lighting Limited v. HSBC* [2020] HKCFI 2490.
43 [2018] HKCFI 426.
44 *But Ka Chan v. Interactive Brokers LLC* [2019] HKCA 873.
45 *Sit Kwong Lam v. Petrolimex Singapore Pte Ltd* [2019] HKCA 1220.
46 *Dayang (HK) Marine Shipping Co, Ltd v. Asia Master Logistic Ltd* [2020] HKCFI 311.
47 [2019] HKCFA 45.

trustees of any duty to interfere with the management of the company, including querying or objecting to the transactions entered into by the company, the provision would generally absolve the trustee from liability for failing to intervene. The court would not impose a high level supervisory duty on the trustee.

X REGULATORY IMPACT

Sustainable finance is increasingly a regulatory focus, in light of the 2020 Policy Address where the Chief Executive announced that Hong Kong would strive to achieve carbon neutrality before 2050.[48] In May 2020, the HKMA and the Securities and Futures Commission (SFC) initiated the establishment of the Green and Sustainable Finance Cross-Agency Steering Group (Steering Group) co-chaired by the two regulators[49] to accelerate the growth of green and sustainable finance in the city. In July 2021, the Steering Group announced that it will focus on climate-related disclosures and sustainability reporting, carbon market opportunities and the launch of the new Centre for Green and Sustainable Finance.[50] In particular for climate-related disclosures and sustainability reporting, the Steering Group would make progress towards mandating climate-related disclosures aligned with the Task Force on Climate-related Financial Disclosures framework by 2025 across relevant sectors.

On 21 May 2021, the Hong Kong government released the conclusions of its public consultation on a proposed licensing regime for virtual asset services providers (VASP).[51] The Financial Services and the Treasury Bureau (FSTB) proposed to require that any person who is seeking to engage in the business of operating a 'virtual asset exchange' is to obtain a VASP licence from the SFC. It is proposed that virtual asset exchange will include virtual asset trading platforms but not pure peer-to-peer trading platforms.

The FSTB initially proposed that only locally incorporated companies with a permanent place of business in Hong Kong could obtain a VASP licence. The FSTB has indicated that it will revise the proposal to permit foreign companies registered in Hong Kong to apply for VASP licences in light of market preference. Similar to licences for other activities regulated by the SFC, an applicant for a VASP licence will have to pass a fit-and-proper test. The applicant will also have to appoint at least two responsible officers to ensure compliance with anti-money laundering, counterterrorist financing and other regulatory requirements. A licensed VASP will only be allowed to offer services to professional investors. The FSTB is targeting the introduction of the amendment bill into the Legislative Council by July 2022.

48 The Chief Executive's 2020 Policy Address (25 November 2020) <https://www.policyaddress.gov.hk/2020/eng/p125.html>.

49 The Group also comprises the Financial Services and the Treasury Bureau, the Environment Bureau, Hong Kong Exchanges and Clearing Limited, the Insurance Authority and the Mandatory Provident Fund Schemes Authority.

50 'Cross-Agency Steering Group announces next steps to advance Hong Kong's green and sustainable finance strategy' (HKMA, 15 July 2021) <https://www.hkma.gov.hk/eng/news-and-media/press-releases/2021/07/20210715-4/>.

51 By amending the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap 615).

XI OUTLOOK AND CONCLUSIONS

The global economy continues to suffer from the effects of the covid-19 pandemic. Debt recovery and insolvency remain burning issues for creditors, including financial institutions. Cross-border insolvency is an area that has seen significant judicial development, both on the common law front and in terms of the cooperation mechanism as introduced by the governments of Hong Kong and mainland China to facilitate mutual recognition of, and assistance to, the insolvency proceedings in the other jurisdiction. Financial institutions as creditors will encounter complex issues in dealing with debtor companies in financial distress, such as deciding the most effective way to recover their funds, whether by way of restructuring or winding up the debtor company, and the jurisdiction in which to bring any insolvency proceedings. In the past year, Hong Kong courts have demonstrated a pragmatic approach in developing the case law on cross-border insolvency, one that is attuned to commercial realities in Hong Kong, and which seeks to protect the interest of unsecured creditors of debtor companies, in particular listed companies that adopt an offshore corporate structure.

While it is anticipated that the covid-19 pandemic will continue to take a toll on the global economy in general, financial institutions can be assured by a number of factors. First, Hong Kong has a pro-arbitration legal system that appeals to business communities. Second, the pandemic has demonstrated Hong Kong regulators' ability to respond swiftly in times of crisis. Third, Hong Kong has witnessed important legislative developments, with changes to the legal framework for banking and insurance regulations that will strengthen Hong Kong's standing as an international financial centre.

Appendix 1

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Prior to joining Slaughter and May, Wynne was a Director of Enforcement of the SFC, where her principal responsibilities included managing litigation involving the Enforcement Division, giving advice on operational issues encountered by the SFC's Enforcement Division and participating in the management of the division.

Prior to the SFC, Wynne was a dispute resolution partner at a global law firm where she handled cases in a broad range of areas with a particular focus on commercial litigation, securities investigations, business ethics and anti-corruption, contentious trust and probate, and employment disputes. Her previous practice had a focus on PRC corporations and individuals.

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