

Yat Tung Investment Company Limited - - - *Appellants*

v.

Dao Heng Bank Limited and Another - - - *Respondents*

FROM

THE SUPREME COURT OF HONG KONG

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF
THE PRIVY COUNCIL, DELIVERED THE 27TH JANUARY 1975

Present at the Hearing :

LORD MORRIS OF BORTH-Y-GEST

LORD CROSS OF CHELSEA

LORD KILBRANDON

[*Delivered by* LORD KILBRANDON]

In 1968 a building was in course of construction in Hong Kong. The owners of the site, in order to finance the building operations, had borrowed, in two separate transactions, \$1,400,000 from the first respondents, ("the Bank") which loans were charged upon the property. The work of building was being carried out by contractors, a company ("the Construction Company") for practical purposes owned by one Lai Yung-Kwong ("Mr. Lai"). The owners got into difficulties and absconded, leaving interest on the bank loans in arrear and owing money to the Construction Company. The Bank therefore, in exercise of its rights, sold the premises by auction, on 13th May 1968, to the appellants, ("Yat Tung") for \$880,000. Yat Tung was another company effectively owned by Mr. Lai. On 23rd May 1968 the Bank assigned the property, pursuant to the sale, to Yat Tung, and on the same day Yat Tung borrowed from the Bank on the security of the property the sum of \$1,000,000. This sum was devoted largely to satisfying the purchase price. Yat Tung defaulted on the payment of interest under the mortgage, the Bank exercised its right of sale thereunder, and on 26th November 1969 sold the property by auction to the second respondents ("Choi Kee").

The substance of the first dispute which arose between Mr. Lai and the Bank out of these not, on their face, complicated transactions, was this. Mr. Lai maintained that the sale by the Bank to Yat Tung was a sham, at a figure agreed upon beforehand, and that Yat Tung, as had been agreed, bought the property as trustee for the Bank. The mortgage was accordingly a nullity. It is not at all necessary to go into the reasons given for such an alleged transaction, since the Full Court of Hong Kong have

in a final judgment decided that the sale was a genuine transaction, and that the allegations made by Mr. Lai in that connection were unfounded. It is, however, necessary, in order to understand the limited character of the dispute which has been brought to their Lordships, to examine the nature and to some extent the chronology of the various legal proceedings to which the relationships between the parties have given rise.

969 is the official number of the action in which Yat Tung and the Construction Company, (that is, as has been explained, effectively Mr. Lai,) claimed a declaration that the property was conveyed to Yat Tung "as a nominee and/or trustee of" the Bank, a declaration that the related mortgage (\$1,000,000) was void, and also a payment in respect of certain construction costs not relevant to the present dispute. The Writ of Summons was issued on 8th August 1969, the Statement of Claim on 27th December, that is, a month after the subsequent sale to Choi Kee. The Bank's defence and counterclaim are dated 27th February 1970. The defence is substantially a traverse of the allegations of a sham sale. The terms of the counterclaim are of crucial importance, and so far as relevant they are now set out:—

"16. Under the building mortgage referred to in paragraph 5 hereof the Defendant advanced to the 1st Plaintiff a total of \$995,000·00 which was reduced by \$111,795·74 being the balance of the proceeds of sale referred to in paragraphs 9 and 10 hereof bearing interest at 1·1% per month. The 1st Plaintiff therefore on the 15th day of January 1969 owed the Defendant \$883,204·26 as principal under the said mortgage. The 1st Plaintiff defaulted in payment of interest wherefore the Defendant exercised its power of sale under the said mortgage and sold the said property by public auction to Choi Kee Limited for the price of \$1,040,000·00 on the 26th day of November, 1969, at which time interest on the said mortgage amounted to \$185,576·09 less the sum of \$3,388·88 referred to in paragraph 7 hereof leaving a total of \$182,187·21. The Defendant therefore suffered a loss of \$25,391·47.

17. By reason of the 1st Plaintiff's aforesaid default and the consequent exercise of the said power of sale by the Defendant, the Defendant was put to the following expense:—

- | | |
|---|--------------|
| (a) Expenses of auction including advertising | \$16,840·50 |
| (b) Legal costs | \$ 3,000·00. |

Together with the loss of \$25,391·47 referred to in paragraph 16 hereof, the Defendant therefore suffered a total loss of \$45,231·97."

The reply to the portion of the counterclaim quoted above, dated 4th May 1970, was in the following terms:

"3. It is admitted that the Defendant sold the property to one Choi Kee Limited on 26th November, 1969. It is denied that the 1st Plaintiff owed any interest to the Defendant at that or any date. It is denied that the Defendant suffered any loss on the sale. The said Choi Kee Limited is a related company of the Defendant, and they have common directors and shareholders.

4. None of the expenses and costs pleaded in paragraph 17 of the Counterclaim is admitted and the Plaintiffs deny any liability to the Defendant for the sum of \$45,231·97 or any sum."

In the Supreme Court Pickering J. on 23rd April 1971 rejected the claim and, except in an unimportant particular, sustained the counterclaim. His judgment was affirmed on the 4th February 1972 by the Full Court, against whose decision no appeal has been sought.

Before discussing the important consequences which flow from 969, it will be convenient to refer to the two other actions which arose out of these transactions.

While 969 was awaiting hearing, on 16th June 1970 a Writ of Summons in No. 909 was issued by Choi Kee against the Construction Company, an associated company, Yat Tung and an individual who turned out to be a caretaker in the building erected on the property, and has now disappeared from the proceedings.

This was a claim for possession of the property, based on the sale to them by the Bank on 26th November. The defences set up, on 15th August 1970, were, first, that the defendants were in possession before the date of the sale, so were not in trespass. Secondly a substantive defence was based on the same ground as was the claim in 969, namely that the sale and mortgage were sham transactions, that the mortgage was void, that 969 had been registered as a *lis pendens* before the sale to Choi Kee, that Choi Kee being a company related to the Bank knew that the mortgage was void, and that accordingly Choi Kee had no title in virtue of which it could claim relief. In these circumstances it was reasonably agreed, on 2nd January 1971, that 909 should be stayed pending the trial of 969.

One month after the final judgment in 969, that is on 3rd March 1972, the writ was issued in No. 534, an action at the instance of Yat Tung against the Bank and Choi Kee, claiming a declaration that the auction sale by the Bank to Choi Kee "should be set aside as fraudulent and/or in breach of the 1st Defendant's duty as Mortgagee and/or was otherwise improper", together with an injunction to restrain the defendants from entering the property, and other consequential reliefs. In the Statement of Claim the plaintiffs refer to 969, and say that, accepting the decision therein, they base their claim upon it. They say that they were at the material time the legal, beneficial and registered owner of the property, and, as to the mortgage of \$1,000,000, entitled to the equity of redemption. It is now conceded by the appellants that the claims as stated are, for a reason to be noted, not maintainable, and that 534 could only proceed after the writ had been amended to the effect of claiming damages.

The basis of the claim that the sale was void (or voidable) is that it was a collusive sale; the Bank and Choi Kee "were in fact essentially one certain interest and/or alternatively acting in concert with a common design calculated to obtain the . . . said property at a low price and to extinguish the Plaintiff's interest therein". So the Bank gave too short a notice of the sale, the advertisements were misleading and calculated to frighten off buyers, and the auction was a mock auction mostly attended by servants or agents of the defendants; the consequence was that the sale was made at a gross undervalue, to the prejudice of the equity of redemption.

The next step was that on 13th June 1972 the defendants in 534, the Bank and Choi Kee, took out a Summons for an order that the Statement of Claim be struck out as being vexatious, frivolous and/or otherwise an abuse of the process of the Court, or alternatively on the ground that the plaintiff had elected in 969 to sue upon the ground that he was *not* the beneficial owner of the property, whereas in 534 he was claiming that he *was*. It is the first of these alternatives with which the subsequent proceedings, and the present appeal, are primarily concerned, and in order to understand the ground upon which the order was sought it is necessary to go back and look at, in particular, the counterclaim in 969 and the reply thereto.

The counterclaim bears to be a statement of the losses which the Bank suffered through the default of Yat Tung; the purchase price received from Choi Kee is set down, and against it is put the principal sum under

the Yat Tung mortgage, the net interest outstanding thereon, and the costs of the sale. The balance in favour of the Bank comes out at \$45,231.97, and that is the sum for which judgment was given. The whole counterclaim depended on the regularity of the sale under the mortgage. If that sale were tainted with fraud, and were in breach of duties owed by the Bank to Yat Tung, resulting in damage to Yat Tung—and that is the basis of 534—then two consequences would follow. First, and by way of defence to the counterclaim, whatever might on an accounting have been due to the Bank upon the actual transaction, that would have been swallowed up or in any event reduced by the claim, as yet illiquid, to be maintained by Yat Tung against the Bank. Secondly, and by way of counterclaim against the counterclaim, so far from there being a balance in favour of the Bank there would have been a substantial balance in favour of Yat Tung; in the application by Yat Tung for leave to appeal to the Board it is alleged that the true value of the property, as at the date of the sale to Choi Kee, was at least \$1,950,000, as compared with the sum obtained in the simulated auction.

The matters which came before Briggs J. in 534 related both to 909 and to 969. All that it is now necessary to say about 909 is that, as has been pointed out above, it stood or fell with 969. If 909 was to survive, accordingly, it was necessary for Yat Tung to amend, so as to bring their defence into line with their claim in 534. Such an amendment, however, would be open to all the objections which could be stated to that claim. In the result Briggs J. refused leave to amend in 909, and in 534 struck out the claim as vexatious, frivolous and an abuse of the process of the Court. No appeal was taken in 909; the result is that Choi Kee are in indefeasible possession of the property. It is for that reason that any claim by Yat Tung against the Bank in respect of the transaction with Choi Kee would have to be limited to one for damages.

Having said so much by way of explanatory introduction, it becomes possible to go straight to the clear and valuable statement made by McMullin J. in the Full Court of the real substance of the present appeal.

“The real issue to be decided is whether it be true to say that the allegation of fraud and the voidability of the sale to Choi Kee were matters available for litigation in 969 and that Mr. Lai chose not to rely on them and whether they are to be regarded as *res judicata* in the sense that they ought to have been so litigated.”

There arise therefrom two questions:

- (a) whether there was any procedure by which, in 969, Yat Tung could have pleaded as a reply to the Bank's counterclaim what was to be the basis of their own claim in 534, and
- (b) if there was, what consequences flow from their failure to have done so.

The tendency, today, in all jurisdictions, is so far as possible to simplify the technical rules of pleading. Rules have to exist for the orderly conduct of litigation and especially for the prevention of surprise, which is injustice. But pleading and the rules of pleading are servants, not masters. In the present series of actions all the interested parties, that is Mr. Lai, the Bank and Choi Kee, have been in some sense arrayed against one another ever since the counterclaim was stated in 969. It is true that Choi Kee were not a party in that suit, although the counterclaim caused their inclusion among the *dramatis personae*, but, as has been pointed out, the suit in which they were plaintiffs, 909, raised issues dependent on those raised in 969. So soon, accordingly, as their interests in the property became identifiable, it was essential, if there was to be due economy of

litiscontestation, for those interests to be challenged, were challenge to be brought. It would therefore have been deplorable if any technical obstacle had been effective to defeat that objective. McMullin J., in his careful and elaborate judgment, found none. It had been submitted in the Full Court that, since the "cause of action" which would have founded a claim in fraud against the Bank by Yat Tung, (in whatsoever mode it was to be stated,) namely the sale to Choi Kee, did not arise until after the date of the writ in 969, it would have been incompetent to have amended the claim in 969 in order to challenge the sale itself. That may be so, but by no means concludes the first question. Their Lordships would, in a matter of pleading, always be inclined to follow the opinions as given in the Court in which the matter had been in issue, even where the rules of pleading in that Court had been derived from those obtaining in this country. They therefore readily adopt, since they agree with, the following summary which is extracted from the judgment of McMullin J.:

"As it seems to me the root of the matter is concerned with the vital issue of the counterclaim in 969 . . . That counterclaim . . . squarely put before the court the correctness of the defendant bank's manner of accounting for the sum which it said was owed to it by the plaintiff. . . . That being the case, . . . it was necessary to plead that the defendant's manner of accounting, which left the plaintiff owing a sum of \$45,000, was, aside from all the other complaints concerning the bogus nature of the mortgage between the bank and the plaintiff, itself wholly erroneous. It should not have been difficult to plead that at current market prices, if the sale to Choi Kee Ltd. had been a valid sale, a sum would have been realised which would not only obliterate the debt owing to the defendant (even accepting the defendant's account of the facts) but which would, in addition, leave the defendant in possession of a balance in favour of the plaintiff. No compelling reason has been advanced to show that this matter could not have been pleaded by way of defence to the counterclaim. It would not have been a question of the plaintiff company taking up contradictory postures in relation to its own cause of action but simply of meeting the defendant upon his own ground in the event that the court disbelieved the plaintiff on the substance of its claim. But whether pleaded by way of defence to counterclaim or by way of defence and counterclaim to counterclaim, (and no especial difficulty in the way of such a pleading has been shown) it was, to my mind, so clearly a matter necessary and proper to be litigated at the same time with all the other issues between the parties that it would have been wholly wrong for the judge in chambers to have permitted the amendment."

This applies, of course, to 909, but the learned judge goes on:

"What has been said already applies with equal force to the appeal to strike out the statement of claim in 534."

Their Lordships can see no reason why a defence impugning the *bona fides* of the auction sale to Choi Kee could not have been pleaded as a counterclaim to the counterclaim in 969; it does not appear that any argument to the contrary was presented to the Full Court. Nor do the appellants, in the reasons annexed to their printed case, take any point to the effect that the rules of pleading would have made it impossible for them to raise the substance of 534 in 969. That disposes of the first of the two questions to which the appeal can be reduced.

The second question depends on the application of a doctrine of estoppel, namely *res judicata*. Their Lordships agree with the view expressed by McMullin J. that the true doctrine in its narrower sense cannot be discerned in the present series of actions, since there has not

been, in the decision in 969, any formal repudiation of the pleas raised by the appellants in 534. Nor was Choi Kee, a party to 534, a party to 969. But there is a wider sense in which the doctrine may be appealed to, so that it becomes an abuse of process to raise in subsequent proceedings matters which could and therefore should have been litigated in earlier proceedings. The *locus classicus* of that aspect of *res judicata* is the judgment of Wigram V.C. in *Henderson v. Henderson* (1843) 3 Hare 100 at 115, where the learned judge says:

“ . . . where a given matter becomes the subject of litigation in, and of adjudication by, a Court of competent jurisdiction, the Court requires the parties to that litigation to bring forward their whole case, and will not (except under special circumstances) permit the same parties to open the same subject of litigation in respect of matter which might have been brought forward as part of the subject in contest, but which was not brought forward, only because they have, from negligence, inadvertence, or even accident, omitted part of their case. The plea of *res judicata* applies, except in special cases, not only to points upon which the Court was actually required by the parties to form an opinion and pronounce a judgment, but to every point which properly belonged to the subject of litigation, and which the parties, exercising reasonable diligence, might have brought forward at the time.”

The shutting out of a “subject of litigation”—a power which no Court should exercise but after a scrupulous examination of all the circumstances—is limited to cases where reasonable diligence would have caused a matter to be earlier raised; moreover, although negligence, inadvertence or even accident will not suffice to excuse, nevertheless “special circumstances” are reserved in case justice should be found to require the non-application of the rule. For example, if it had been suggested that when the counterclaim in 969 came to be answered Mr. Lai was unaware, and could not reasonably have been expected to be aware, of the circumstances attending the sale to Choi Kee, it may be that the present plea against him would not have been maintainable. But no such averment has been made.

The Vice-Chancellor’s phrase “every point which properly belonged to the subject of litigation” was expanded in *Greenhalgh v. Mullard* [1947] 2 All E.R. 255 by Somervell L. J. at 257:

“*res judicata* for this purpose is not confined to the issues which the court is actually asked to decide, but . . . it covers issues or facts which are so clearly part of the subject matter of the litigation and so clearly could have been raised that it would be an abuse of the process of the court to allow a new proceeding to be started in respect of them.”

Again, a phrase used by Lord Shaw of Dunfermline in delivering the opinion of the Board in *Hoystead v. Commissioner of Taxation* [1926] A.C. 155 at 171,

“the present point was one which, if taken, went to the root of the matter on the prior occasion”;

appears precisely apposite to the failure, in answer to the counterclaim in 969, to raise the matters founded on in 534 which, if then substantiated, would have been then decisive. An instance of a hard case in which the rule was applied is *In Re Koenigsberg* [1948] Ch. 727.

Their Lordships are, accordingly, of opinion that the Full Court was right in ordering that the Statement of Claim in 534 be struck out as an abuse of the process of the Court; they will therefore humbly advise Her Majesty that the appeal be dismissed with costs.



In the Privy Council

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Printed by Her Majesty's Stationery Office
1975