

O N A P P E A L

FROM THE COURT OF APPEAL OF HONG KONG

B E T W E E N :

TSE KWONG LAM

Appellant

- and -

WONG CHIT SEN

1st Respondent

CHING WAI SHORK (SHOOK)

2nd Respondent

CHI SEN COMPANY LIMITED

3rd Respondent

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CASE FOR THE APPELLANT

RECORD

1. This is an appeal from a judgment dated 26th November, 1980 of the Court of Appeal of Hong Kong (Huggins, McMullin, JJ.A., and Garcia, J.) allowing the 1st Respondent's appeal and setting aside a judgment dated 15th May, 1979 of the High Court of Hong Kong (Zimmern, J.) against the 1st Respondent with costs therein and in the court below and dismissing the Appellant's cross-appeal.

III, pp.176-194

III, pp.135-153

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2. The principal questions raised by this appeal are:

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(a) whether the sale by the First Respondent ("Mr. Wong") as Mortgagee of property mortgaged to him by the Appellant ("Mr. Tse") to the Third Respondent ("the Company") is liable to be set aside in equity without consideration of the fairness or otherwise of the sale because the duty of Mr. Wong to Mr. Tse conflicted with his duty to and interest in the Company as director, shareholder and principal creditor; and if not

(b) whether the Respondents discharged the onus on them of proving that the said sale was made in good faith and at a proper price.

3. The material facts relevant to this appeal may be summarised as follows :-

- I, p.29, l.33-
p.30, l.16 (a) Between 1962 and 1963 Mr. Tse bought the property known as Nos. 52 and 54 Cheung Sha Wan Road, Kowloon in the Colony of Hong Kong with the intention of redeveloping the old buildings situated thereon into a new 15-storey modern mansion subsequently called the Kwong Hing Building. In order to finance the redevelopment, Mr. Tse as mortgagor, entered into a Building Mortgage on 30th November, 1963 and three Further Charges dated respectively on 17th July 1964, 23rd July 1964 and 10th November 1965 with Mr. Wong, as mortgagee, on the security of the property 10
- IV, pp.3-11
- IV, pp.12-17
IV, pp.34-39
IV, pp.40-45
- II, p.55, l.11-23
III, p.138,
1.33-39 (b) At all material times prior to the incorporation of the Company on 29th December 1964, Mr. Wong and the Second Respondent his wife ("Mrs. Wong") carried on business in partnership in the property business. 20
- IV, p.183 (c) At all material times Mr. Wong was a permanent director of the Company and the registered holder and beneficial owner of approximately 26% of the issued share capital in the Company, the remaining shares being held by Mrs. Wong and his children. Mr. Wong largely financed the operation of the Company by means of interest free loans. Thus as at 31st March 1966 the Company's assets of HK\$2,847,749 were 30 matched by a liability to Mr. Wong of HK\$2,554,822 (approximately 89%).
- II, p.39, l.1-20
IV, p.229
- IV, p.197
- I, p.46, l.38-
I, p.47, l.30-
p.48, l.10 (d) Mrs. Wong acted throughout as the agent for Mr. Wong in collecting interest payments from Mr. Tse and in making up and sending interest demands and in keeping the mortgage account for Mr. Wong
- II, p.10, l.12-14
II, p.160, l.40-
p.161, l.13
II, p.167, l.17-1
II, p.97, l.8-10
II, p.154, l.15-2
I, pp.56-58 (e) Mr. Tse after receiving the interest demand from Mr. Wong's Solicitors on or about 28th February, 1966, arranged to have a loan from the Wing On Life Assurance Co. Ltd. for HK\$1.5 million on 26th April, 1966 intending to redeem the mortgaged property 40
- IV, p.114
- IV, p.265
- IV, p.116 (f) By a letter dated 28th April 1966 Mr. Wong's Solicitors demanded payment of the sum of HK\$1,648,941. This sum was calculated by Mrs. Wong and was subsequently found in

those proceedings to have been overstated by approximately HK\$170,000.

IV,p.134-142

- 10 (g) In June 1966 Mr. Wong determined to sell the property as mortgagee by public auction in one lot. On about 20th June 1966 Mr. Wong decided that the reserve price should be HK\$1.2 million. In determining to sell in one lot rather than unit by unit and in fixing the reserve price Mr. Wong neither sought nor obtained professional advice as to whether such mode of sale was appropriate in order to realise the true market value nor whether the reserve price would, if reached, represent the true market value or a proper price for the property.
- 20 (h) At a meeting of the directors of the Company held on 20th June 1966 and attended by Mr. and Mrs. Wong it was resolved that Mrs. Wong should attend the auction to bid on behalf of the Company "but in principle the bidding price shall not exceed HK\$1,200,000.00 and "the amount of the shortfall shall be provided by the Company." IV,p.234
- (i) On 24th June 1966 Mr. Wong lent the Company HK\$1.2 million. II,p.77,1.28-44
IV,p.261
- 30 (j) At the auction held on 26th June 1966 which had been advertised as a mortgagee's sale, Mr. and Mrs. Wong and their solicitor sat in the seats normally occupied by the mortgagee. The auctioneer announced the reserve price (which had not previously been disclosed to Mr. Tse) and Mrs. Wong openly bid HK\$1.2 million. There being no other bids the property was knocked down to Mrs. Wong or the Company. III,p.21,1.42-
p.22,1.2
p.32,1.7-
III,p.21,82
II,p.25,1.19-30
II,p.171,1.31-38
III,p.21,1.5-11
- (k) By an assignment dated 23rd July 1966 the property was conveyed by Mr. Wong to the Company. IV,pp.73-77
- 40 4. On 31st October, 1966, Mr. Wong brought this action in the Supreme Court of Hong Kong against Mr. Tse claiming the balance of the debt due under the said Building Mortgage and Further Charges. By a Defence and Counterclaim dated 15th December 1966, and subsequently re-amended Mr. Tse counterclaimed against Mr. and Mrs. Wong and the Company (amongst other relief) for an order to set aside the sale and assignment of the mortgaged property by Mr. Wong to the Company or alternatively damages for the I,pp.9-13
I,pp.14-18
I,pp.24-28
- 50

RECORD

- I,pp.19-20 true value of the property. On 16th November, 1968, the said Supreme Court (Morley-John,J.) gave judgment in favour of Mr. Wong on his claim in the sum of HK\$316,383.39 with interest and costs but further ordered a stay of execution pending the outcome of Mr. Tse's counterclaim.
- I,p.29,1.13-14 5. The counterclaim came on before Zimmern, J. on 21st November, 1978 and the hearing lasted
III,p.136,1.45- for 23 days. The "Agreed Issues" so far as
III,p.137 relevant to this appeal submitted by the parties to the learned Judge for his ruling included: 10
- "Whether the sale was a proper sale or whether, in equity, it was a sale which can be set aside and or damages awarded for collusion and bad faith (equitable fraud) and or negligence in relation to the sale."
- III,pp.135-151 6. Zimmern J. gave judgment on 15th May 1979. He first described the nature of the claim and set out certain of the facts. He then made the following findings of fact from the evidence in this action: 20
- III,p.142,1.5- (a) That Mr. Tse approached the Wing On Life
21 Assurance Co. Ltd. for another mortgage and by a letter dated 26th April, 1966, the said company agreed in principle to take on the mortgage for a loan of HK\$1.5 million at 1.2% interest per month.
- III,p.142,1.28- (b) That the amounts demanded by Mr. Wong from
35 Mr. Tse for the repayment of principal and interest were excessive and wrong. 30
- III,p.144,1.10- (c) That the Company was completely under the
p.145,1.5 control of Mr. Wong.
- III,p.145,1.25- (d) That Mr. Tse was never told about the
43 reserved price by Mr. or Mrs. Wong or Mr. Liu prior to the auction and he only first heard it when it was announced by the auctioneer at the start of the auction.
- III,p.150,1.20- (e) That the sight of Mrs. Wong bidding might
24 well deter others.
- III,p.145,1.44- (f) That the price of HK\$1.2 million obtained
p.150,1.36 by Mr. Wong for the mortgaged property at the auction was not a proper price. 40
- III,p.151 1.8- (g) That the proper price should have been
11 HK\$2.15 million.
- III,p.150,1.25- (h) That Mr. Wong acted in bad faith and the
sale was grossly unfair to Mr. Tse.

RECORD

7. The learned Judge also ruled that it was not a proper sale but it would be wrong to set aside the sale after a lapse of 13 years and Mr. Tse was at fault in delaying for so long and awarded damages instead. III,p.151,1.27-28
III,p.150,1.24-35
8. The learned Judge gave judgment for Mr.Tse in the sum of HK\$950,000 with interest at 1.2 per cent per month commencing from 1st July 1966 and dismissed Mr. Tse's counterclaim against Mrs. Wong and the Company and awarded 50% of the costs of Mr. Tse's counterclaim to be paid by Mrs. Wong. III,p.151,1.10-24
III,pp.152-153
9. By a supplementary notice of appeal dated 26th January, 1980 Mr. Wong appealed to the Court of Appeal of Hong Kong, while by an amended notice of appeal dated 8th October 1980, Mr. Tse cross-appealed to the same Court on certain parts of the judgment of Zimmern J., in particular, that the learned Judge erred in not holding that the sale by Mr. Wong to the Company was in effect a sale by Mr. Wong to himself and consequently void or voidable unless the Company could prove the bona fides and the validity of the said transaction; that having found that it was not a proper sale as Mr. Wong had acted in bad faith, should have held that the sale was void or voidable and should be set aside; in not setting aside the sale; in not awarding full costs to Mr. Tse. III,pp.157-168
III,pp.169-173
III,p.170,1.10-18
III,p.170,1.20-27
III,p.170,1.28-35
III,p.172,1.23-25
10. The appeal and cross-appeal came before the Court of Appeal (Huggins and McMullin, JJ.A. and Garcia J.) on 6th to 10th and 13th to 16th October 1980 and the unanimous judgment of the Court of Appeal was delivered by Huggins, J.A. on 26th November 1980. The said Court allowed Mr. Wong's appeal and set aside the judgment of Zimmern, J. with costs therein and in the Court below and dismissed Mr. Tse's cross-appeal with costs. III,pp.176-194
III,p.194
11. By an Order dated 15th January 1981 the said Court of Appeal granted the Appellant leave to appeal to Her Majesty in Council. III,pp.195-196
12. Mr. Tse submits that the Court of Appeal was wrong. In his submission:
- (a) the conflict between the duty owed by Mr. Wong to Mr. Tse with the duty owed by Mr. Wong to and his interest in the Company was such that the sale should be set aside without consideration of its fairness;

RECORD

- (b) if the fairness of the sale is a relevant consideration, the onus which lay on Mr. and Mrs. Wong and the Company to prove that the sale was in good faith and at a proper price was not discharged;
- (c) in neither case was the delay such as to preclude the Court from setting aside the sale;
- (d) if the sale is not set aside, Mr. Tse is entitled to damages and interest as found by Zimmern J. 10

13. First Submission (Para.12(a))

It is accepted that a sale by an individual mortgagee to a company in which he is interested is not invalid at law as a sale to himself. Although a mortgagee is not a trustee of his power of sale, Warner v Jacob (1882) 20 Ch.D.220, nevertheless he owes a duty to the Mortgagor to exercise his power of sale in good faith and so as to obtain the true market value. Cuckmere Brick Co. Ltd. v. Mutual Finance Ltd. (1971) Ch. 949. It is submitted that the principle of Aberdeen Railway Co. v. Blaikie (1854) 1 Macq 461, should be applied to sales by a mortgagee to a company controlled by him so as to entitle the mortgagor in equity to have the sale set aside because of the conflict of duty and interest irrespective of the fairness of the sale. In so far as Farrar v Farrars Ltd. 1889 40 Ch.D.395 appears to have decided the contrary it is distinguishable on the grounds that all the terms of the sale had been agreed before the mortgagee obtained his interest in the company (p.413) or alternatively was wrongly decided. 20 30

14. The Court of Appeal decided otherwise on the grounds that it had not been shown that the Company was

- (a) controlled by Mr. Wong, or
- (b) a sham or mask.

III,p.177-8

III,p.144-5

15. It is submitted that in practice as found by Zimmern J. the position of Mr. Wong as substantial shareholder, permanent director and principal creditor of the Company and husband or father of all the other directors and shareholders gave him complete control over the Company. The fact that the Company had a legitimate business of its own and so was not a mere sham or mask should not displace the principle submitted in 40

Paragraph 13. Accordingly it is submitted that the Court of Appeal was wrong and subject to the question of delay should have set aside the sale without considering its fairness.

16. The Second submission (Para. 12(b))

10 It was accepted in the Courts below that in the circumstances of this case the onus lay on the Respondents to prove that the sale was carried out in good faith and was made at a proper price. cf. Farrar v Farrars Ltd. (1888) 40 Ch.D.395, 415.

17. It is submitted that the Respondents did not discharge this onus for the following reasons:

(a) The Courts have long recognised that the sight of the seller at auction bidding for the property discourages others to bid. White & Tudor: Leading Cases in Equity Vol.II p.683. It must have been obvious from the facts summarised in Paragraph 3(1) that Mrs. Wong was or was connected with the Vendor/Mortgagee. Thus Zimmern J. was right and the Court of Appeal wrong as to the effect on the sale of Mrs. Wong's bid. Accordingly the Respondents did not establish that the price at which the property was knocked down to Mrs. Wong or the Company was the best evidence of its proper value.

III,p.150

30 (b) Zimmern J. concluded on the other evidence before him that the true value of the property was HK\$2.15 million. The Court of Appeal concluded that the evidence was insufficient to displace the Auction price as establishing the proper value. But if as submitted in sub-paragraph (a) the Auction price was not the best evidence of value then the other evidence confirmed that Mrs. Wong's bid did deter other bidders. Accordingly the Court of Appeal should not have reversed the finding of Zimmern J. It is submitted therefore that the sale was at a substantial undervalue.

III,p.151

III,p.184

40 (c) Mr. Wong took no steps to obtain professional independent advice as to whether the property should be sold in one lot or unit by unit or as to what was a proper reserve price. It is submitted that failure to take such obvious steps

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RECORD

- so as to ensure that he discharged his duty as mortgagee is further evidence that he was unfairly and wrongly disregarding the interests of Mr. Tse. Moreover the Company's advance knowledge of the reserve price which enabled it to borrow the equivalent amount from Mr. Wong in advance of the auction gave it an advantage over other potential bidders and the demand for Mr. Tse to pay more than he owed put him at a disadvantage. It is submitted that on the evidence as a whole Zimmern J. was entirely justified in finding as he did that the conduct of Mr. Wong in regard to the sale was grossly unfair and that he had acted in bad faith. It is submitted that the Court of Appeal was not entitled to disturb the finding for the reasons that they gave or at all. 10
- III,p.150
18. The Third Submission (Para. 12(c)) 20
- Mr. Tse's counterclaim was filed on 16th December 1966 and he registered a lis pendens in the Land Registry on 14th April 1970. There was no evidence that if the sale was set aside substantial restitution would be impossible, or that Mr. Tse was waiving any right he might have. In those circumstances it is submitted that no delay could render it inequitable to set aside the sale and that Zimmern J. and the Court of Appeal were wrong. 30
- III,p.150
III,p.192
19. The Fourth Submission (Para. 12(d))
- If contrary to the submission made in Paragraph 18 the sale is not set aside it is submitted that the award of damages and interest made by Zimmern J. should be restored. The Court of Appeal disallowed interest for any period after 24th December 1970 on the ground that Mr. Tse was responsible for being kept out of his money thereafter and an award of interest on any basis other than wrongful deprivation would be punitive. It is submitted that the Court of Appeal was wrong. If Mr. Wong had performed his duty to Mr. Tse there would have been surplus proceeds of sale held by him in trust for Mr. Tse on which he would have been accountable for interest not by way of punishment but to prevent him profiting from his trust. Accordingly an award of interest is justified for all periods after 24th December 1970 on the basis that Mr. Wong had the use of the money for these periods. 50
- III,p.192

20. Mr. Tse respectfully submits that the judgment of the Court of Appeal of Hong Kong was wrong and ought to be reversed, and the appeal ought to be allowed with costs, alternatively, the judgment of Zimmern, J. ought to be restored, for the following, amongst other

R E A S O N S

- 10 1. BECAUSE the duty of Mr. Wong to Mr. Tse conflicted with the duty of Mr. Wong to and his interest in the Company so that the sale should be set aside without regard to its fairness.
2. BECAUSE Mr. Wong acted in bad faith and sold the property at a substantial under-value and/or the Company failed to establish that the sale was made in good faith and at a proper price.
- 20 3. BECAUSE there was no delay such as to make it unjust to set aside the sale.
4. ALTERNATIVELY BECAUSE the award of damages of Zimmern J. should be restored.
5. BECAUSE interest should be awarded for the period since 24th December 1970 as Mr. Wong has wrongly had the use of the money for that period.

ANDREW MORRITT

LESTER KWOK

IN THE PRIVY COUNCIL

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Appellant

- and -

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CHING WAI SHORK (SHOOK)

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CHI SEN COMPANY
LIMITED

3rd Respondent

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