FACV No. 9 of 2016

IN THE COURT OF FINAL APPEAL OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION

FINAL APPEAL NO. 9 OF 2016 (CIVIL)
(ON APPEAL FROM CACV NO. 36 OF 2015)

BETWEEN

TANG YING LOI	**Plaintiff (Respondent)**
and	
TANG YING IP alias TANG YING YIP	**1st Defendant (1st Appellant)**
YEUNG FOOK MUI	**2nd Defendant**
TRI-STRONG INVESTMENT LIMITED	**3rd Defendant (2nd Appellant)**

Before:	Chief Justice Ma, Mr Justice Ribeiro PJ, Mr Justice Fok PJ, Mr Justice Chan NPJ and Lord Millett NPJ
Date of Hearing:	16 January 2017
Date of Judgment:	8 February 2017

J U D G M E N T

Chief Justice Ma:

1. I agree with the judgment of Lord Millett NPJ.

Mr Justice Ribeiro PJ:

2. I agree with the judgment of Lord Millett NPJ.

Mr Justice Fok PJ:

3. I agree with the judgment of Lord Millett NPJ.

Mr Justice Chan NPJ:

4. I agree with the judgment of Lord Millett NPJ.

Lord Millett NPJ:

5. This is an appeal by the 1st and 3rd Defendants ("D1" and "D3") from the unanimous judgment dated 6th November 2015 of the Court of Appeal (Cheung, Kwan and Barma JJA) dismissing their appeal from the judgment of Chow J dated 7th January 2015. The trial judge adjourned the case against the 2nd Defendant who suffers from senile dementia, and she has played no part in the proceedings.

6. D1 and D2 are the administrators of the estate of the late Tang Pui King ("the deceased") who died intestate on the 4th July 1978. D1 is the son of the deceased, and D2 is his tin fong wife. The next of kin consisted of the five sons of the deceased, one of whom has since died. The Respondent, who was the Plaintiff in the action, is another son. The estate was a large one, and between 1985 and 2012 each of the sons received over HK$86 million by way of cash distribution from the estate. Despite the passage of nearly 40 years, it seems that the estate has not yet been fully administered.

The facts

7. The facts, which are not in dispute, are set out at length in the judgments below and it is not necessary to repeat them. They can be shortly stated as follows.

8. In 2003 D1 bought a property in Yuen Long ("the Property") for $27.3 million. On completion of the purchase he executed a declaration of trust stating that he held the Property in trust for his corporate vehicle D3 and that it had provided the whole of the consideration for the purchase. He later assigned the Property to D3.

9. It is common ground that D1 used $11.48 million of the estate's money, representing 40.4% of the total purchase price, in payment of the amount due on completion, and that he never informed the Plaintiff that he had done so or sought his consent or that of his surviving brothers, though he says that he informed the executors of his deceased brother that he had borrowed the money from the estate.

10. In October 2003, some seven months after completion, D1 repaid the amount which he had taken from the estate with interest at approximately 3% per annum, a rate which compared favourably with the rates currently obtainable from the banks, though less than D1 would have had to pay to borrow from a bank. The trial judge accepted D1's evidence that he had always intended to repay the money, which he regarded as a bridging loan, and that he could have raised the money from other sources but had chosen to resort to the estate's money "as a matter of convenience".

11. The Plaintiff became aware of D1's use of the estate's money in 2005, and commenced the present proceedings in 2009 to recover the

profit which he had made by his breach of fiduciary duty. D1 continued to insist that he had discharged his liability to the estate in full by repaying the loan. By the time the case came to trial, however, the value of the Property had increased substantially, and the Plaintiff claimed to be entitled to his share of the increased value of the Property.

The judgments below

12. The trial judge held that the transaction should be regarded as a loan and that this precluded the Plaintiff from tracing the money. This, he said, was because tracing requires the claimant to show that he had title to the original asset, whereas in the case of a loan legal title passes from the lender (the estate) to the borrower (D1)[1]. However, he also held that the loan was a misuse of the estate's funds and that the Plaintiff was entitled to recover his share of the profit made by D1 in breach of his fiduciary duty. He considered that it would be inappropriate to grant a proprietary remedy[2], largely because of the existence of other beneficiaries who were not parties to the action and whose attitude to D1's use of the estate's money was not known. He held that D1 was liable to account to the estate for the profits which he derived from the acquisition and holding of the Property, and directed all necessary inquiries to enable the Plaintiff to recover his share of the profits, including the increase in the Property's value, giving credit for the repayment in 2003 and other payments made by D1 in respect of the Property.

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1 This would preclude following, not tracing, and then only because the borrower would normally be a *bona fide* purchaser for value without notice. But there is no need to follow the property where the lender and the borrower are the same person, and in any case D1 can hardly claim to be a *bona fide* purchaser without notice.

2 He refused "to impose a constructive trust". Strictly speaking, this would not have been necessary. If he had decided to grant proprietary relief, he should simply have declared that an appropriate share of the Property formed part of the estate and was held on the original trusts.

13. The Court of Appeal disagreed with the judge's conclusion that the transaction was a loan, but confirmed his finding that it was a misapplication of money belonging to the estate. D1 had not appealed against the judge's refusal to grant proprietary relief, and the Court of Appeal confirmed the accounts and enquiries directed by the judge, ordered D1 to pay the Plaintiff one fifth of the amount found due on taking the account, and dismissed the appeal.

The nature of the claim

14. With all due respect to the courts below, they have made heavy weather out of a very simple case. Induced to do so by counsel, they have treated it as a claim to secret profits. This expression is normally used to describe the principal's claim when a fiduciary, in breach of his fiduciary duty, exploits the fiduciary relationship to divert a business opportunity from his principal or to obtain a benefit for himself from a third party. The paradigm case is that of the agent who receives a bribe from a party with whom he is negotiating on behalf of his principal, giving rise to the receipt of an unauthorised profit and a conflict of interest and duty. It is precisely because the principal had no previous interest in the money or property obtained by the fiduciary in such a case that his right to bring a proprietary claim, though well established by authority, has until recently been questioned.

15. But the present case is concerned with a fiduciary who made a profit by applying his principal's money for his own benefit. D1 did not take advantage of the fiduciary relationship or put himself in a position where his interest conflicted with his duty. He simply helped himself to money belonging to the estate and applied it for his own benefit. It is a straightforward case where a trustee or person in an analogous position has

committed a breach of trust. As will appear, not only is the factual context different, so is the underlying policy which drives equity's response.

16. The confusion of the two distinct kinds of claim led to a citation of much irrelevant authority[3], and a prolonged argument about causation. True cases of secret profits, particularly those concerned with the diversion of a business opportunity, may involve very difficult questions of causation. But in the present case questions of causation simply do not arise. The right to benefit from an increase in the value of a property (or to suffer from a reduction in its value) is not "caused" by the ownership of the property; it is an incident of ownership. Where property is acquired with the help of a loan, any increase in its value is attributable to the ownership of the property, not to the existence of the loan. D1 contended for the "but for" test of causation; but if that were applicable the relevant question would not be whether the property would have been acquired but for the loan, in many cases a hopelessly speculative enquiry, but whether the purchaser would have profited from the increase in value had he not acquired the property, to which the answer is obviously "no".

17. Nor is the case concerned with difficult questions of tracing. A purchaser who buys and pays for property does not trace his money into the property. He obtains title by contract or conveyance. In the present case there is a modicum of tracing, for the Plaintiff must show that the Property was acquired at least in part with the estate's money, and D1 paid the money into his own bank account before withdrawing money from the account to buy it. But that he used the estate's money to finance part of the cost of the Property is not disputed.

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[3] Such as *Regal (Hastings) Ltd. v Gulliver* [1967] 2 AC 134; and *Kao Lee & Yip v Koo Hoi Yan* [2003] 3 HKLRD 296

Taking the account

18. The facts are not in dispute and there are only two relevant transactions to consider. The dispute concerns their characterisation and financial consequences. These questions are easily solved if seen through the prism of an account and if two basic principles are observed. First, the characterisation of a transaction is a question of law; and secondly, where a trustee or a person in an analogous position has committed a breach of trust by misapplying trust money, the beneficiaries have the right to elect whether to reject or affirm the transaction.

The first transaction

19. D1 contends that the first transaction, by which he took money belonging to the estate and applied it towards the purchase of a property for himself, was a (voidable) loan. He relies on *Rowley Holmes & Co v Barber*[4] to show that a person who has two capacities may make a loan from himself in one capacity to himself in another. But the defect in D1's use of the money is not want of capacity but want of authority. It was an unauthorised disbursement of money belonging to the estate which D1 applied for his own purposes. He has labelled the transaction a loan; but it is for the court to characterise the transaction, not the parties, still less one of them. The fact that D1 intended to repay the money and did so within a very short time does not overcome his want of authority or convert his misappropriation of the money into a loan.

20. When the Plaintiff received the accounts and discovered the disbursement, he had the right to elect whether to reject or affirm it[5]. Had he elected to reject it, he would have asked for the disbursement to be

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[4] [1977] 1 WLR 371.

disallowed and would have disclaimed any interest in the Property by treating it as bought with D1's own money. This would have produced a deficit in the estate account which D1 would have been obliged to make good had he not already done so.

21. As the Property had substantially increased in value, however, the Plaintiff has naturally elected to affirm the transaction, ie to treat it as an authorised investment of the estate's money in or towards the purchase of the Property for the benefit of the estate. This has prevented there from being any deficit in the estate account, for the amount of the debit (the disbursement) is matched by the credit (the value of the Property which it was used to acquire).

The second transaction

22. Seven months later D1 repaid the estate the amount he had misappropriated with interest. By insisting that this discharged his liability to reimburse the estate for the money he had taken, he is effectively claiming the right to choose whether to affirm the use of the money to purchase the Property or reject it, a right which belongs to the beneficiaries not to the trustee. Given the Plaintiff's decision to affirm the purchase, there was no deficit in the estate account which D1 was obliged to make good, but the estate had acquired an interest in the Property. D1's payment must, therefore, be treated, not as a repayment of a loan or money wrongly taken from the estate, but as an attempt to buy out the estate's interest, an attempt which the Plaintiff has elected to reject.

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[5] See *Libertarian Investments Ltd. v Hall* (2013) 16 HKCFAR 681 pp732-3.

Principle

23. The principle that the beneficiaries can elect to treat property purchased by an unauthorised but profitable application of trust money as part of the trust fund has been established for at least 200 years. In *Scott v Scott*[6] the High Court of Australia said[7] that there was

> "of course, abundant authority for the proposition that if trust moneys have been exclusively used in the purchase of property the beneficiary may elect to take the property itself"

and cited the statement of Sir John Stuart in *Mathias v. Mathias*[8] where he said:

> "Lord Eldon and Lord Redesdale, in the case of *Phayre v. Peree*[9], in the House of Lords, laid it down as clear law that the trustees can never deal with the trust fund for their own benefit. Lord Redesdale said that the father, who was only tenant for life, could not take the purchase for his own benefit solely, and that his purchase of leasehold property, although unauthorised by the trust, being a beneficial purchase, the benefit must belong to the trust fund".

24. The facts in *Scott v Scott* correspond closely to those of the present case. A trustee applied trust money together with his own in the purchase of a property for himself. Shortly before his death he repaid the trust money used by him in the purchase, having previously executed a declaration of trust by which he declared that he held the property in trust for the beneficiaries but limited their interest to the amount of the trust money which he had used to purchase the property, in effect creating an

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6 [1963] 109 CLR 649
7 At p. 660.
8 (1858) 3 Sm & Giff 552 at p. 563-4
9 (1815) 3 Dow 116.

equitable lien for the repayment[10]. He contended that he had discharged his liability to the beneficiaries. By the time of the proceedings, however, the property had substantially increased in value, and the beneficiaries claimed a share in the increase. The issue was thus the same as in the present case.

25. The High Court of Australia[11] upheld the plaintiff's claim. In a judgment of the court they said[12]

> "We may, for instance, take the case of a trustee who, in breach of trust, purchases shares for £2,000 by the use of £1,000 of trust moneys together with £1,000 of his own. There is no doubt that the beneficiaries might elect, either, to take one-half of the shares or, alternatively, to claim a lien on the shares for £1,000. But they may not know of the purchase and do neither. Then suppose that prior to any election[13] by the beneficiaries the trustee sells the shares for £3,000 and retains the proceeds in his hands. Is it to be thought that the right of the beneficiaries at this stage will be limited to a claim on those moneys for the specific sum of £1,000?[14] ..... But there can be no doubt that they would be entitled not only to have the sum originally misapplied made good but also to[15] obtain one-half of the resultant profit. We think the same conclusion must inevitably follow even if the property purchased with the mixed fund is property which is not "specifically severable" and that the argument to the contrary must be rejected."

Policy

26. A claim by a principal to recover secret profits made by a fiduciary by exploiting the fiduciary relationship for personal gain and a claim by a beneficiary against a trustee or person in an analogous position for breach of trust give rise to similar remedies, both personal and

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10 There was no need to provide for interest, as the trustee was life tenant.

11 McTiernan, Taylor and Owen JJ.

12 At p 662

13 It had been argued that the trustee had remedied the breach before the beneficiaries made their election, and that this was sufficient to exonerate the trustee. The same argument was raised by D1 in the present case.

14 A rhetorical question which plainly expects the answer "no".

15 Ie. to (£1,000 + £500) = £1,500, or more simply one half of the value of the property realised by the sale as if the purchase were a proper investment of the trust money.

proprietary, but they raise different factual issues and their underlying policy is different. A claim to secret profits may involve difficult questions of causation as to the extent of the fiduciary relationship or of the business opportunity in question. The policy behind the claim is to enforce the trust which the principal places in the undivided loyalty of his fiduciary by preventing the fiduciary from deriving a personal benefit from the relationship in the absence of his principal's informed consent. Equity's response is to require the fiduciary to disgorge the benefit.

27. The policy behind a claim by a beneficiary for a breach of trust of the present kind is to deter the trustee from using the trust fund as his personal bank account, borrowing from it for his own private purposes and merely repaying the amount he has borrowed. Such conduct puts the trust fund at risk without hope of gain. Equity's response is to insist that any profit is for the beneficiaries and any loss for the trustee.

Conclusion

28. In the absence of any argument about the form of the order made below, the appeal should simply be dismissed. As to costs, I would make an order *nisi* that the appellants pay the costs of the respondent, such costs to be taxed if not agreed. Should any party or parties wish to have a different order as to costs, written submissions should be served on the other party or parties and lodged with the Registrar of the Court within 14 days of the handing down of this judgment, with liberty on the other party or parties to serve and lodge written submissions in reply within 14 days thereafter. In the absence of such written submissions, the order *nisi* will stand absolute at the expiry of the time limited for such submissions.

Chief Justice Ma:

29. For the above reasons, the appeal is dismissed and an order *nisi* as to costs is made as set out in para 28 above.

(Geoffrey Ma)
Chief Justice

(R A V Ribeiro)
Permanent Judge

(Joseph Fok)
Permanent Judge

(Patrick Chan)
Non-Permanent Judge

(Lord Millett)
Non-Permanent Judge

Mr Robert Ham QC, Mr Denis Chang SC and Ms Candy Chan, instructed by Wong, Hui & Co., for the 1st & 3rd Defendants (Appellants)

Mr Brian Green QC and Mr Benjamin Chain, instructed by Pansy Leung Tang & Chua, for the Plaintiff (Respondent)