

David Hague

Appellant

v.

**(1) Nam Tai Electronics Inc
(2) Tele Art Inc (In liquidation)
(3) Bank of China (Hong Kong) Limited**

Respondents

FROM

**THE COURT OF APPEAL OF
BRITISH VIRGIN ISLANDS**

JUDGMENT OF THE LORDS OF THE JUDICIAL
COMMITTEE OF THE PRIVY COUNCIL

Delivered the 20th November 2006

Present at the hearing:-

Lord Bingham of Cornhill
Lord Hoffmann
Lord Rodger of Earlsferry
Lord Walker of Gestingthorpe
Lord Mance

[Delivered by Lord Hoffmann]

1. The chief point in this appeal concerns the construction of a provision in the articles of association of Nam Tai Electronics Inc (“Nam Tai”), a company incorporated in the British Virgin Islands, listed on the New York Stock Exchange and carrying on business in China. Mr Robert Yuen, a resident of Hong Kong, and Tele-Art Inc (“TAI”), a BVI company with which he was associated, were respectively the registered owners of 122,727 and 700,908 shares in Nam Tai. On 10 November 1993, by two separate deeds, each charged their shares to the Bank of

China (“the Bank”) in support of a guarantee of the repayment of advances by the Bank to Tele-Art Limited (“TAL”), a Hong Kong subsidiary of TAI.

2. TAI seems to have been in some financial difficulties at the time when it charged its shares to secure TAL’s indebtedness, because on the very same day as the charges were executed an Irish government agency obtained a judgment against TAI in the BVI High Court for US\$799,079. In 1996 TAL defaulted on its payments to the Bank and on 5 August 1996 the Bank called TAI on its guarantee.

3. Events then took an unusual turn. Nam Tai took an assignment of the judgment debt, which had become vested in Forfás, another Irish government agency, and on 27 June 1997 presented a petition to the BVI Court to wind-up TAI on the grounds of insolvency. On 17 July 1998 the court made a winding up order. The appellant Mr David Hague was appointed liquidator. The position was therefore that both the Bank and Nam Tai were creditors of TAI, the Bank holding security over its shares in Nam Tai and Nam Tai itself being unsecured.

4. Nam Tai then devised a scheme to destroy the Bank’s security. On 16 October it altered its articles of association to create a special power to redeem the shares of judgment debtors. The International Business Companies Ordinance 1984, under which Nam Tai is registered, provides in section 9 that “subject to any limitations or provisions to the contrary in...this Act” a company may “purchase, redeem or otherwise acquire and hold its own shares”. There is a limitation on this power in section 33(1A), which provides that a company may not redeem its own shares “without the consent of the member whose shares are to be...redeemed” unless the company is permitted by its articles to do so “without that consent”. Regulation 13 of Nam Tai’s articles, as it stood before amendment, provided in general terms that, subject to the provisions of the Act, any shares might be redeemed “on such terms and in such manner as the directors may determine”. But it said nothing which could be construed as permitting redemption without the consent of the member. The directors of Nam Tai resolved to add such a power as regulation 13.1. Paragraph (a) of this new regulation contains definitions and the substantive power is contained in paragraph (b):

“Without limiting the generality of Regulation 13 of these Articles, in the furtherance thereof and in addition to any other rights or remedies available to the Company at law or in equity, the Company may at any time and from time to time redeem, at the Redemption Price per share, all or any of

its outstanding shares beneficially owned by any Person or registered in the name of any Person whose name is entered as a member in the share register, against whom the Company has a judgment. At least 30 calendar days before the date fixed for redemption as determined by the resolution of the directors (the "Date Fixed for Redemption"), a written redemption notice ("the Notice") shall be sent to each beneficial owner and registered holder (if different from the beneficial owner) whose shares are to be redeemed by first-class mail, postage prepaid, at the address of the beneficial owner and registered holder (if different from the beneficial owner) as shown on the records of the Company, stating: (i) the class(es) of shares and the number of shares in each such class to be redeemed from the beneficial owner, (ii) the Date Fixed for Redemption, (iii) information on the method to be used to determine Redemption Price in accordance with Regulation 13(1)(a) of these Articles, (iv) the Judgment Amount and (v) the address of the place where the certificates for the shares to be redeemed shall be surrendered for redemption. On or before the Date Fixed for Redemption, each beneficial owner and registered holder (if different from the beneficial owner) of the shares to be redeemed shall surrender the certificates representing these shares to the Company at the place so designated therefore in the Notice unless the judgment amount has theretofore been satisfied in full. On the Date Fixed for Redemption the Company shall pay the Redemption Price for the shares redeemed by offsetting the Fair Market Value of the shares redeemed against the Judgment Amount. If the Fair Market Value of the shares redeemed exceeds the Judgment Amount, then new certificates representing the number of shares determined by dividing such excess by the Redemption Price (and rounding the quotient down to the nearest whole share) shall be issued to the Person whose shares were redeemed. In lieu of any fractional shares otherwise issuable, the Company shall pay an amount equal to the Redemption Price multiplied by the fraction. If the Fair Market Value of the shares is insufficient to fully satisfy the Judgment Amount, the Company shall retained the right to pursue all of its rights and remedies otherwise available to satisfy the deficiency. If the Notice is given in the manner provided in this Regulation, whether or not the certificates covering these shares are surrendered, all rights with respect to the redeemed shares shall terminate except for the right of the Person whose shares are so redeemed to receive credit by

offset against the Judgment Amount as herein provided. Unless the certificates covering these shares are received by the Company at the place so designated the Judgment Amount will not be deemed to have been satisfied in full.”

5. On 18 December 1998 Nam Tai gave TAI notice of a resolution to redeem 138,500 of the shares registered in its name to satisfy the Forfás debt, which (with interest and costs) was said to amount to US\$1,617,083. Nam Tai determined the Redemption Price at US\$11.188 a share, resulting in a Redemption Price for the shares of US\$1,549,538, rather less than the amount alleged to be owing. On 22 January 1999, pursuant to this notice, Nam Tai purported to cancel the redeemed shares and to treat the Redemption Price as set off against the Forfás debt.

6. Mr Hague, the liquidator of TAI, applied to court for a declaration as to the priorities of Nam Tai and the Bank in respect of TAI's shares in Nam Tai and an order setting aside the redemption and restoring TAI to the register. At the hearing before d'Auvergne J, counsel for Nam Tai contended that TAI held the shares subject to the articles of association as they might be amended from time to time. Regulation 13.1 conferred a right of redemption and TAI therefore held the shares subject to that right. The Bank derived its security interest from TAI and could be in no better position. d'Auvergne J rejected this argument, set aside the redemption and ordered that the shares be restored to the liquidator.

7. Nam Tai appealed. The Court of Appeal distinguished between the validity of the redemption and the set-off of the Redemption Price against the Forfás debt. The set-off was ineffective but that did not affect the validity of the redemption. The result was that TAI's shares had been converted into a right to receive the Redemption Price. Nam Tai had no right of set-off but had to prove in the liquidation for the Forfás debt. The Court of Appeal also declared that the liquidator was entitled to any dividends declared on the shares before redemption (or in respect of unredeemed shares) and that the Bank was a secured creditor.

8. There is no appeal against the decisions of both the judge and the Court of Appeal that the attempt to recover the Forfás debt in full by redemption of TAI's shares and set-off against the the Redemption Price was ineffective. The scheme failed for at least two separate and sufficient reasons; possibly there are more. First, Nam Tai was not entitled, after the commencement of the liquidation, to convert TAI's shares into a debt for the purpose of setting it off against the Forfás debt. Set-off is allowed only in respect of mutual debts which existed before the company went into liquidation. To allow Nam Tai to create a set-off in this way would infringe the paramount principle of *pari passu* distribution of the insolvent

company's assets: see *British Eagle International Airlines Ltd v Compagnie Nationale Air France* [1975] 1 WLR 758. Secondly, Nam Tai had notice of the Bank's charge and any rights it acquired over the shares (whether by way of redemption and set-off or any other form of interest) were subject to the rights of the Bank: see *Bradford Banking Co Ltd v Henry Briggs Son & Co Ltd* (1886) 12 App Cas 29.

9. There is however an appeal by Mr Hague against the ruling of the Court of Appeal that the actual redemption was valid and had the effect of converting TAI's interest from ownership of the shares to a right to be paid the Redemption Price. Their Lordships should mention that Mr Hague is no longer liquidator, having resigned with the leave of the BVI court on 17 December 2002, but there has been no objection to his *locus standi* to pursue this appeal. His successor as liquidator, Mr Harrigan, appeared by counsel before the Board and took a neutral position, stating that (so far as he was able) he would comply with whatever decision the Board should make.

10. Gordon JA, who gave the only substantive judgment in the Court of Appeal, dealt with the validity of the redemption very briefly. He noted that there was no dispute that the alteration of the Articles of Association to introduce Regulation 13.1 was lawful. The question was whether the power to redeem could be used against a shareholder in liquidation. He said (at paragraph 17):

“I am of the view that once it is conceded that a company may alter its articles at any time...then it must follow logically that the company can act in pursuance of those altered articles to the extent that the contemplated act is not against the law. I am therefore of the view...that Nam Tai could properly redeem the Nam Tai shares from the ownership of [TAI].”

11. Their Lordships see no objection to the principle stated by Gordon JA but consider that the question which needed further consideration was whether the redemption of TAI's shares without any set-off against a judgment debt could be said to be, in the judge's words, “in pursuance of those altered articles”. This, as their Lordships indicated at the outset of this opinion, involves construing regulation 13.1 to ascertain exactly what form of redemption it permits. It is declared to be without prejudice to the generality of the original regulation 13, but since that is subject to the statutory proviso that it cannot be used without the shareholder's consent, it does not assist in construing the special provisions of regulation 13.1. This allows redemption only against a judgment debtor and provides that

“on the Date Fixed for Redemption the Company shall pay the Redemption Price for the shares redeemed by offsetting the Fair Market Value of the shares redeemed against the Judgment Amount.” There is no provision for any payment in money. Even if the Fair Market Value exceeds the Judgment Amount, the shareholder is not entitled to be paid the difference in money. The difference is (apart from fractions) returned to him in new shares. And regulation 13.1 goes on to provide that if a Redemption Notice is given —

“all rights with respect to the redeemed shares shall terminate except for the right of the Person whose shares are so redeemed to receive credit by offset against the Judgment Amount as herein provided.”

12. It therefore appears to their Lordships that the only form of redemption which can be described as pursuant to the amended articles is a redemption for the purposes of a set-off against a judgment debt. As such a redemption against an insolvent company is conceded to be impossible, the result in their Lordships’ opinion is that in such a case regulation 13.1 cannot be used at all. That does not mean that the alteration to the articles was ineffective. There is, so far as their Lordships can see, no reason why regulation 13.1 cannot be used against a solvent shareholder, at least if the shares are not subject to a prior charge which leaves no equity against which the set-off can operate. But they agree with d’Auvergne J that in the present case the attempt to use it was a nullity.

13. The next question is what the consequences should be. Mr Todd QC, who appeared for Nam Tai, did not dispute that the court had power under section 29 of the Act to order that the register be rectified and the cancelled shares reinstated. But he submitted, correctly, that the power is discretionary and invited the Board to order payment of some form of compensation instead. Their Lordships consider that rectification is the natural remedy. The shares have been wrongfully cancelled and should be given back. There do not appear to be any grounds for departing from this simple principle of *restitutio in integrum*. On 30 June 2003, since the purported redemption, there has been a one for three share exchange and on 7 November 2003 Nam Tai declared a one for ten stock dividend. Rectification must therefore reinstate the number of shares which represent the original redeemed parcel together with the proceeds of the share exchange and stock dividend.

14. Who should be registered as owner of the reinstated shares? Ordinarily, this would be TAI, which was registered owner when the

shares were cancelled. But the Bank, which obtained special leave to intervene in the appeal, submits that it should be registered instead. Under the terms of both charges (which are in this respect identical) the registered owners covenant to charge the shares “by way of first legal charge”. If there is an event of default (which happened in 1996) the bank has a power of sale and under clause 11.2 the shareholder covenants to do whatever is needed to perfect the Bank’s security. There is a standard covenant for further assurance. There is accordingly no doubt that the Bank is entitled to perfect its security by having the charged shares registered in its name. It can then proceed at its discretion to exercise the power of sale.

15. Mr Todd submitted that for two reasons TAI (acting by its liquidator Mr Harrigan) should be registered instead. The first was that the Bank had not previously applied to be registered. That is true, but the explanation is that until now the Bank has been heavily involved in litigation to protect its priority and the question of rectification has been raised for the first time before the Board. The right of the Bank to be registered is clear and there is no reason why the Board should not finally dispose of the matter rather than sending it back to the BVI.

16. Secondly, Mr Todd said that certain questions about the amount of the debts due to the Bank were in dispute and that Mr Harrigan should be allowed to sell the shares, pay the undisputed sums out of the proceeds of sale and obtain further directions from the BVI courts as to whether he should pay any more. But their Lordships consider that such a course would be to deprive the Bank of one of its most important rights as mortgagee, namely the right to take possession of the security and exercise the power of sale at its own discretion. To take the power of sale out of the hands of the bank would in their Lordships’ opinion damage the confidence which bankers should have in the willingness of the courts to uphold their security rights. The bank will of course have to account to the liquidator for any surplus after payment of its own debt, interest and costs and if there is any dispute over this account, it can be decided in the courts of Hong Kong, which have non-exclusive jurisdiction under the terms of the charge and would appear to their Lordships to be the natural forum for a dispute which is in substance between the Hong Kong branch of a Chinese bank and company trading in China.

17. It is unnecessary to say anything about the matters which are said to be in dispute concerning the indebtedness of TAI to the Bank, save for the suggestion by Nam Tai that the Bank’s entitlement to interest and costs terminated upon the liquidation of TAI. This appears to their Lordships to be entirely misconceived and Mr Todd, unsurprisingly,

made no submissions to support it. A winding up has no effect upon the debts owed by the insolvent company but only upon the extent to which those debts can be enforced against the assets available for distribution. The Bank, as a secured creditor, is not concerned to enforce its claims against the assets available for distribution and the amount which it can recover out of its security is therefore unaffected by the liquidation.

18. Finally, their Lordships were told that on 12 August 2002 after the hearing before d'Auvergne J but before she had given judgment, Nam Tai purported to redeem and cancel a further 169,727 shares, of which 47,000 had been subject to the TAI charge and 122,727 subject to the charge given by Mr Robert Yuen. In this case, the set-off purported to be against a judgment for US\$34 million against TAI which had been obtained in the High Court of the BVI a few days earlier. Nothing was said about this purported redemption in the Court of Appeal. Mr Todd did not advance any arguments as to why this redemption should have been any more valid than the first one and their Lordships therefore consider that the register should be similarly rectified to restore these shares, as augmented by the share exchange and stock dividend and to register the Bank as owner.

19. Their Lordships will therefore humbly advise Her Majesty that the appeal of Mr Hague should be allowed and that it should be declared that the purported redemptions of 22 January 1999 and 12 August 2002 were nullities and that the register of members of Nam Tai should be rectified to reinstate the purportedly redeemed shares together with any other shares which have since accrued by way of exchange or dividend and that the Bank of China should be registered as owner of the reinstated shares. Nam Tai must pay the costs of Mr Hague and the Bank of China before their Lordships' Board. Mr Harrigan is entitled to his costs out of the assets of TAI available for distribution.