HCB 1498/2019

[2020] HKCFI 361

IN THE HIGH COURT OF THE

HONG KONG SPECIAL ADMINISTRATIVE REGION

COURT OF FIRST INSTANCE

BANKRUPTCY ROCEEDINGS NO 1498 OF 2019

IN THE MATTER OF THE BANKRUPTCY ORDINANCE (CHAPTER 6)

AND

IN THE MATTER OF LI XIAOMING (李曉明)

Before: Hon Mimmie Chan J in Court

Date of Hearing: 25 September 2019

Date of Judgment: 4 March 2020

J U D G M E N T

Background

1. This is the substantive hearing of the bankruptcy Petition filed by the Creditor, UBS AG, against the Debtor, Mr. Li Xiaoming. The ground of the Petition is that the Debtor failed to comply with a Statutory Demand

dated 21 June 2018 which had been served on him, for payment of a sum of US $1,541,161.99, and interest of US $103,529.83 ("**Debt**").

2. The Debtor was the guarantor of a loan extended under a Loan Agreement made between the Petitioner and Business Universe Limited as Borrower. On 23 September 2014, the Borrower and the Petitioner entered into an aircraft mortgage agreement ("**Mortgage**"), whereby the Borrower mortgaged its interest in a Gulfstream G550 corporate aircraft ("**Aircraft**") to the Petitioner in order to secure the performance of the Borrower's obligations under the Loan Agreement.

3. The Borrower defaulted under the Loan Agreement, and consequently, the Petitioner exercised its right under the Mortgage to sell the Aircraft at US $17.2 million. The Petitioner claims that after applying the proceeds from the sale of the Aircraft, a sum of US $1,541,161.99 ("**Amount**") remained outstanding. A Statutory Demand for the Amount was issued on 21 June 2018. After unsuccessful attempts were made by the Petitioner to serve the Statutory Demand on the Debtor, the Statutory Demand was eventually advertised in 2 newspapers in Hong Kong and 1 newspaper in Hebei on the Mainland, on 31 August 2018. The Petition was filed on 14 March 2019, on the ground that the Statutory Demand had not been complied with. The Petition was opposed by the Debtor on the ground that there is a bona fide dispute on the Debt.

4. It is not disputed that, in deciding whether or not there is a bona fide dispute on a debt which is the basis of a bankruptcy petition, the burden is on the Debtor to establish that there is a genuine dispute of the Debt on substantial grounds. Applying the judgment of the Court in *Re Hong Kong*

Construction (Works) Ltd unreported, 7 January 2003, HCCW 670/2002 in a winding up case:

> "(1) The burden is on the company to establish that there is a genuine dispute of the debt on substantial grounds. In this context, "substantial" means having substance and not frivolous. An honest belief in an insubstantial ground of defence is not sufficient to avoid a winding-up order.
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> (2) The court should look at the company's evidence against so much of the background and evidence that is not disputed or not capable of being disputed in good faith; in other words, the evidence is not to be approached with a wholly uncritical eye.
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> (3) The court would caution itself against unsubstantiated and unparticularised assertions, especially where particulars and information have been sought by the other side. It is incumbent on the company to put forward "sufficiently precise factual evidence" to substantiate its allegations.
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> (4) The court does not try the dispute on affidavit but is to determine whether a substantial dispute exists. In so doing, the court necessarily has to take a view on the evidence, to see if the company is merely 'raising a cloud of objections on affidavits' or whether there really is substance in the dispute raised by the company. Even where the company has obtained unconditional leave to defend in an application for summary judgment, the Companies Court is not precluded from examining the evidence and taking a view on whether the debt is disputed on substantial grounds."

5. The Debtor claims that the Petitioner had failed to discharge its duty to obtain the best price reasonably obtainable for the Aircraft. The Debtor claims that the principal outstanding under the Loan Agreement and

the Mortgage could have been discharged in full if the Aircraft had been sold at the market price.

6. The Debtor also argued that the Statutory Demand had not been properly served on him, such that the ground of the Petition relied upon under s6A(1)(a) of the Bankruptcy Ordinance has not been made out for any bankruptcy order to be made.

The service ground

7. The Petitioner argued that the Debtor had never disputed service of the Statutory Demand until shortly before the substantive hearing. He should have complied with Rule 68 of the Bankruptcy Rules, which states that where a debtor intends to show cause against a petition, he shall file a notice with the Official Receiver specifying the ground on which he intends to show cause, and post a copy of the notice to the petitioner 3 days before the date on which the petition is to be heard. On behalf of the Petitioner, it was argued that since the Debtor did not state his intention to show cause against the Petition on the ground of improper service of the Statutory Demand, he should not be permitted to argue this ground.

8. In *Re Lorea Solabarrieta Cheung* [2015] 6 HKC 343, the Court observed:

> "It is for the petitioner to establish the grounds for his petition under section 6 of the Bankruptcy Ordinance (Cap 6). A creditor's petition may only be presented in respect of a debt if, inter alia, at the time the petition is presented, the debt is one which the debtor appears either to be unable to pay or to have no reasonable prospect of being able to pay: s6(2)(c). By virtue of s6A (1)(a) and s6A(2)(a), this requires, so far as relevant here, that a statutory demand has been 'served' on the debtor and it has neither

> been complied with nor set aside. The first question that arose is whether on the facts, there had been proper service of the statutory demand on the respondent."

9. In the case of *Re Lam Chik Sing* [2009] 2 HKLRD 107, the Court held that proper service of a petition is not a technical matter, but a matter which goes to the heart of the ground for the petition. In her judgment, Kwan J (as Her Ladyship then was) set out the principles which require a strict approach on service:

> "Proper service of the statutory demand is a prerequisite for the commencement of bankruptcy proceedings under s6A of Cap 6. The requirements as to service of the statutory demand must be strictly adhered to (*Re Lam Lai Wah Susanna* [2004] 4 HKC 334 at pp 340C and 341F-G, paras 16 and 20 and on appeal in *Lam Lai Wah v Pacific Century Insurance Co Ltd* [2003] 2 HKC 520 para 20.
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> ...
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> Failure to serve the statutory demand properly is an extremely serious matter. That the petitioning debt is apparently not in dispute is wholly immaterial. Failure to serve the demand is not just a formal defect or irregularity, it renders defective the petition founded on the demand. It does not appear to me it would be at all appropriate to exercise the discretion not to annul the bankruptcy order where service of the statutory demand was defective." (Emphasis added)

10. Leading Counsel also referred to the decision of the Court in *Re Ms Cheung Choi Chu* HCB 865/1998, unreported 24 December 1988, where it was argued that so long as the statutory demand came to the attention of the debtor, it should not matter how this came about. In rejecting such argument, the Court explained thus:

> "If this submission is correct, one wonders why the rules go to such elaborate lengths specifying requirements as to service as well as to what is required by proof of service. I do not agree that rules as to service can be flouted with impunity so long as by some lucky happenstance the statutory demand at some point falls into the hands of the debtor. In my

> judgment, requirements as to and proof of service must be strictly adhered to because of the importance of establishing with certainty the period within which a debtor has to comply with the statutory demand. Non-compliance gives rise to consequences which go far beyond those that would flow from an ordinary action. As stated in *Fletcher on the Law of Insolvency*, 1988 edition at 129,
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> > 'Procedurally, the act of service is one of the most vital steps of all, and the court will scrutinize its execution, and the attending circumstances, with the utmost strictness.'"

11. I respectfully agree with the explanation given by the Court in *Re Ms Cheung Choi Chu* and can add little to the rationale stated for applying the strict approach advocated. A bankruptcy order has serious and important consequences and effects on a person, and it is necessary to ensure that a statutory demand is properly and effectively brought to the attention of the person to be served as it triggers the steps which leads to the bankruptcy order.

12. Since the service of a statutory demand is a prerequisite for the commencement of the bankruptcy proceedings, and the Petition must be proved before a bankruptcy order can be made on the basis of the Petition and the ground relied upon under s6A, I do not agree that the Debtor can or should be barred from disputing the proper service of the Statutory Demand in this case. As the Court already explained in *Re Lam Chik Sing*, it is not a mere technical irregularity. At most, the Petitioner may complain of late notice of this argument being raised, and if there was any prejudice, seek an adjournment of the hearing, but the Petitioner did not do so.

13. The defect complained by the Debtor in this case is that there has been failure on the part of the Petitioner to comply with Rule 46 (1) and (2) and Rule 49(1) and (5) of the Bankruptcy Rules.

14. Rule 46 provides as follows:

> "(1) Rule 49 has effect as regards service of the statutory demand, and proof of that service by affidavit to be filed with a bankruptcy petition.
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> (2) The creditor shall do all that is reasonable for the purpose of bringing the statutory demand to the debtor's attention and, if practicable in the particular circumstances, to cause personal service of the demand to be effected." (Emphasis added)

15. Rule 49 sets out requirements as to proof of service of a statutory demand:

> "(1) Where under section 6A of the Ordinance the petition must have been preceded by a statutory demand, there must be filed in court, with the petition, an affidavit proving service of demand.
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> ...
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> (5) ... the affidavit must be made by a person having direct personal knowledge of the means adopted for serving the statutory demand, and must –
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> (a) give particulars of the steps which have been taken with a view to serving the demand personally;
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> (b) state the means whereby (those steps having been ineffective) it was sought to bring the demand to the debtor's attention; and
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> (c) specify a date by which, to the best of the knowledge, information and belief of the person making the affidavit, the demand will have to come to the debtor's attention."

16. In essence, what is contended on behalf of the Debtor is that the Petitioner failed to show that it had done all that was reasonable for the purpose of bringing the Statutory Demand to the attention of the Debtor, and that the Petitioner's affidavit of service failed to specify a date, as required by Rule 49 (5) (c) of the Bankruptcy Rules, which the Statutory Demand would have come to the attention of the Debtor in this case.

17. The Petitioner relies on Practice Direction 3.1 ("**PD**") in its contention that reasonable steps had been taken to discharge its obligation under Rule 46 (2) in respect of the service of the Statutory Demand. Paragraph 2.5 of the PD states that for the guidance of practitioners, the steps set out are considered to be reasonable steps that should normally be taken by a creditor. The Petitioner argued that it had taken all the steps set out in paragraph 2.6 of the PD, which would in most cases suffice to justify an order for substituted service of a petition, and be considered as reasonable steps to discharge the obligation under Rule 46 (2) for service of a statutory demand.

18. Needless to say, the steps set out in the PD are for guidance only, and whether or not the steps taken constitute proper and effective service of a statutory demand depend on all the applicable facts and circumstances in any particular case.

19. It cannot be disputed that on the face of the affidavits filed on behalf of the Petitioner relating to the service of the Statutory Demand, all attempts made to serve the Statutory Demand at the known addresses of the Debtor had failed. These included the last known residential addresses of the Debtor in Hong Kong, at Mid Levels, Tuen Mun and Kowloon Tong, and at the registered addresses of companies in Hong Kong of which the Debtor was a director. When the process server made visits, in 2018, to these addresses of the Debtor in Hong Kong, the process server was informed either that the Debtor had moved out of the address for some time, or had not been in Hong Kong for a long time, or was no longer at the address, or that the Debtor or his whereabouts were not known. The Mid Levels address and the Tuen Mun address had been provided by the Debtor to the Petitioner

in 2014 and 2015. The attempts to serve the Statutory Demand at the Debtor's residential address in Hebei on the Mainland, in July 2018, were likewise unsuccessful. The process server was informed that the flat in question had been empty for more than a year, that the owner of the flat was not the Debtor and that no one knew any person by the Debtor's name there.

20. Letters sent to the Debtor's known addresses in Hong Kong were all returned, unopened, marked with the words "no such person". One letter sent to an address in Kowloon Tong was not returned, but a visit made to such address did not result in any successful service, as the process server was informed that the Debtor had not been in Hong Kong for a long time.

21. In these circumstances, even the Petitioner's solicitors conceded, when they answered requisitions raised by the Master as to service in January 2019, and later applied for substituted service of the Petition in May 2019, that the Debtor could not be located at the Mid Levels address, the Tuen Mun address and the Hebei address (2nd affidavit of Karen Chan) and that the last known addresses of the Petitioner at Mid Levels, Tuen Mun and Hebei could ***not*** be treated as valid addresses of the Petitioner (4th affidavit of Karen Chan).

22. The Petitioner only relies on the substituted service of the Statutory Demand by advertisement of the same on 31 August 2018, in one English and one Chinese newspaper in Hong Kong, and one newspaper in Hebei.

23. On behalf of the Debtor, Counsel argued that since the Petitioner's solicitors had been informed during their attempts to serve the

Statutory Demand on the Debtor that he had not been in Hong Kong for a long time, and further, that he could not be located at the address in Hebei, there was no basis for the alleged knowledge, information and belief, as stated in the 2nd affidavit of Karen Chan, that the Statutory Demand "should have come to the Debtor's attention" by 31 August 2018, being the date of the advertisement of the Statutory Demand in Hong Kong and on the Mainland.

24. It is true that Rule 46(1) and Rule 49 provide for the manner of proof of service of the Statutory Demand. However, Rule 46 (2) itself sets out the requirement for the service of the statutory demand, namely, that the creditor "shall do all that is reasonable for the purpose of bringing the statutory demand to the debtor's attention and, if practicable in the particular circumstances, to cause personal service of the demand to be effected". First, Rule 46 (2) does not make personal service of the statutory demand mandatory. It is stated to be required only where it is "practicable in the particular circumstances" of the case. Secondly, what is required under Rule 46 (2) is for the creditor to do "all that is reasonable" to bring the statutory demand to the attention of the debtor.

25. As illustrated in the earlier part of this Judgment, a statutory demand is an important document with serious consequences, such that service thereof on the debtor should be given careful attention. Although Rule 46 (2) does not make personal service a prerequisite in every case, in all cases, the creditor is required to do "all that is reasonable" in order to bring the statutory demand to the attention of the debtor to be served. Where the creditor asserts that it is impracticable to cause personal service of the statutory demand, it must satisfy the Court that personal service is

impracticable for the reasons stated, and that the steps actually taken were all that was reasonable to bring the statutory demand to the debtor's attention, in the actual circumstances of the case. It is not sufficient for the creditor to blindly adopt the same steps, whatever the prevailing situation and outcome of the facts.

26. In Karen Chan's 2nd affidavit, it was claimed that when the Debtor had dealings with the Petitioner, Hong Kong was the center of his business and his main source of wealth was through a company which had an address in Hong Kong. Presumably the time when the Debtor had dealt with the Petitioner was the time of the Mortgage, which was in September 2014. That was over 4 years prior to the making of the 2nd affidavit of Karen Chan. Apart from the fact that the Hebei address had been provided from the Petitioner's internal due diligence file on the Debtor of an unknown date, the Petitioner did not state any further fact which may show the Debtor's connection with Hebei, and how permanent or tenuous such connection was, or to show that the advertisement of the Statutory Demand in Hebei on 31 August 2018 would have brought it to the attention of the Debtor.

27. Having carefully considered the affidavits of service, including the information given to the process server on the different occasions, that the Debtor had left Hong Kong and was not seen in Hong Kong for a considerable period of time, and that he could not be located and was not known at the Hebei address, the unsuccessful attempts to effect service of either the letters of appointment or the Statutory Demand at the Hong Kong and the Hebei addresses, I agree with Leading Counsel for the Debtor that there was no factual basis for the statement made in the 2nd affidavit of Karen Chan, that the Statutory Demand should have come to the attention of

the Debtor on 31 August 2018, by virtue only of the advertisement of the Statutory Demand in the two newspapers in Hong Kong, and the one newspaper in Hebei. Even on the state of the evidence filed by the time of the hearing in September 2019, there was no factual basis from which the Court can find that the Statutory Demand would have been brought to the attention of the Debtor on 31 August 2018.

28. On the facts of this case, when those acting for the Petitioner had knowledge that the Debtor to be served with the Statutory Demand was not in Hong Kong, and had no factual basis to support their belief that the Debtor was in Hebei, my finding is that the Petitioner and its solicitors had not done all that was reasonable to bring the Statutory Demand to the attention of the Debtor, by merely advertising the Statutory Demand in the newspapers for one day on 31 August 2018.

29. It is neither necessary nor helpful for the Court to set out what could have been done by the Petitioner to discharge its duty to do all that was reasonable, as what is reasonable depends on the particular facts of each case. However, as Leading Counsel for the Petitioner pointed out, the solicitors for the Petitioner had by March 2019 learned that there was another petition filed for the bankruptcy of the Debtor, and they had ascertained that Livasiri & Co acted for the Debtor in those proceedings. In my view, for the purpose of bringing the Statutory Demand to the Debtor's attention, the Petitioner should have sent a copy of it to those solicitors, or should have applied to the Court for substituted service by sending the Statutory Demand to those solicitors. A Petition based on these additional efforts might have assisted the Petitioner in satisfying the Court that the relevant Statutory Demand had been effectively served.

30. On the basis of the decision in Re *Lam Chik Sing* [2009] 2 HKLRD 107, failure to serve the Statutory Demand properly renders the Petition on which it is founded defective. The fact that the petitioning debt is not in dispute is wholly immaterial, but the Debtor in this case disputes the Debt as well.

Whether bona fide or genuine dispute of the Debt on substantial grounds

31. Bankruptcy proceedings are not intended to be used for the purpose of debt collection. If there is a bona fide dispute on the debt which involves disputed questions of fact necessitating viva voce evidence, such a dispute should not be decided on a bankruptcy petition, which petition should be dismissed for the debt to be resolved by trial in the usual way (*Re Cheung Chi Mang* [2018] HKCFI 984).

32. The Debtor claims that the Petitioner had failed to obtain the best price reasonably obtainable, in selling the Aircraft for US $17.2 million.

33. The Petitioner's position is that it had discharged its duty as a mortgagee, by taking reasonable steps in the sale process. The Petitioner took possession of the Aircraft in August 2016, after the Debtor's default, and engaged a remarketing agent to launch a series of advertising campaigns and to market the Aircraft commencing from the last quarter of 2016. The advertised asking price for the Aircraft was US $19.85 million at the start of the marketing campaign. The offers received by the Petitioner for the Aircraft ranged from US $16.5 million in December 2016, to US $15 million in January 2017, to US $17 million by 9 February 2017. These offers were

rejected as they were lower than the advertised asking price. The asking price for the Aircraft was then reduced to US $17.5 million in February 2017, when no acceptable offer was received. The Petitioner explained that there were various drawbacks in relation to the Aircraft which made it unattractive to potential buyers. These included the fact that the Aircraft lacked on-flight Wi-Fi services, did not have a proper bulkhead cabin divider, there was no crew rest area, and the Aircraft had a high density configuration of 18 passengers. An offer from a potential buyer was received in March 2017, at US $17.2 million. Thereafter, the Petitioner received 5 other offers, but they were all lower than the offer of US $17.2 million received. The Aircraft was ultimately sold to the highest bidder at US $17.2 million ("**Price**") under a sale and purchase agreement dated 25 April 2017, and the sale was completed in May 2017.

34. On behalf of the Petitioner, it was argued that it is for a mortgagee to decide whether the sale of the mortgaged property should be by public option, or by private treaty. The Petitioner also relies on the fact that in offering the Aircraft for sale, and in determining the Price, the Petitioner had referred to the Aircraft Bluebook Price Digest ("**Bluebook**") which is the authoritative benchmark and market standard reference used in the business aviation industry to value an aircraft, and also used in the Loan Agreement as one of the reference points for the determination of the Current Market Value of the Aircraft, as defined in the Loan Agreement.

35. On the available evidence, there is a substantial dispute as to whether the Price represented the reasonable or current market value of the Aircraft at the relevant time. Even using the Bluebook reference, the "average retail price" of a Gulfstream G550 in fall and winter 2016 was US

$21.44 million and US $20.42 million respectively, as opposed to the "average wholesale price" of US $19.03 million and US $18.12 million, and adjusted to US $19.03 million and US $18.12 million by the Petitioner. I agree that there is also insufficient evidence of the details of the advertising campaigns carried out for the sale of the Aircraft, to show that the Petitioner had made reasonable efforts to obtain the market price.

36. There is sufficiently precise and believable evidence, from which a defence of substance may be established as to whether the Petitioner had taken reasonable care to discharge its duty to sell the Aircraft at a reasonable market price, such that the dispute as to the Debt should be tried. There is also an arguable defence that clause 6.2.7 of the Mortgage, relied upon by the Petitioner, does not on construction absolve the Petitioner from any liability to the Debtor in negligence, in respect of its failure to obtain a reasonable market price on the sale of the Aircraft (*Bishop v Bonham* [1988] 1 WLR 742).

Disposition

37. The Debtor's application on both the service ground and the disputed Debt is made out. The Petition is accordingly dismissed, with costs to the Debtor and certificate for Counsel.

(Mimmie Chan)
Judge of the Court of First Instance
High Court

Mr Wilson Leung, instructed by Hogan Lovells, for the petitioner

Mr Johnny Mok SC and Mr David Chen, instructed by Livasiri & Co, for the debtor

Attendance of the Official Receiver was excused