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Hong Kong Court Resolves Conflicting Authority on Trust Claims

This resolution is important for contractors' rights to retention monies in construction contracts.

The Hong Kong Court of First Instance (CFI) held in a [recent judgment](#) that, whilst the absence of segregation is not necessarily fatal to a trust, a valid trust cannot be formed due to lack of certainty of subject matter unless the money in question is part of a “sufficiently identifiable bulk”. This decision clarifies the nature of a contractor’s rights over retention monies in construction contracts, particularly when the employer becomes insolvent.

This case arose against the background of the restructuring of Hong Kong Airlines Ltd (HKA), which completed in April 2023, and concerned a claim by one of its creditors, Hip Hing Construction Company Ltd (HH), that was made prior to the effective date of the restructuring. Latham & Watkins LLP acted for HKA both in relation to the restructuring and in successfully defending this claim in the CFI.

Background

In 2017, the parties entered into a construction contract (the Contract) with HH as main contractor and HKA as employer. The Contract incorporated clause 32.5 of the General Conditions of the Standard Form of Building Contract (2005) Private Edition (GCC 32.5), which stated that retention monies (Retention Monies) shall be “*held upon trust by [HKA] for [HH] ... subject to the rights of [HKA] to have recourse to it ...*”. Although Retention Monies were withheld by HKA, they had never been paid into any separate bank account of HKA, nor segregated from the rest of HKA’s receipts and funds held prior to the commencement of the action.

HKA defaulted in payment of sums due to HH under the Contract. Subsequently, in December 2022, a scheme of arrangement (the Scheme) and a restructuring plan, comprising more than 90% of HKA’s debts (including the claims of HH), were sanctioned by the Hong Kong and English Court respectively, and became effective on their terms on 26 April 2023.

HH commenced this action arguing that the Retention Monies were held on trust, and hence, fall outside the statutory compromise under the Scheme. HKA defended the claim on the basis that HH should not be permitted to bypass the *pari passu* treatment for unsecured creditors under the Scheme by making a trust claim, when no fund had ever been set aside as Retention Monies.

The key issue for the CFI was whether a trust with sufficient certainty of subject matter was validly created over the Retention Monies immediately before the Scheme became effective.

Decision

The CFI carefully analysed two lines of conflicting authorities in English and Hong Kong courts. The first concerns authorities finding no certainty of subject matter to create a trust when no apportioned fund can be identified for the trust to attach, and the second that whilst segregation is normally an indicator of the creation of a trust, the absence of segregation is not fatal as there may be other indicators of a trust.

The CFI noted that, upon analysis of the authorities, while segregation of assets was neither the only factor nor a conclusive factor when determining whether there was sufficient certainty of subject matter, at the very minimum, there must be a “sufficiently identifiable bulk” of which the trust money is said to form part. If there is no identified bulk, or the property is completely unspecified, problems as to uncertainty may arise. In the context of a property transfer, if the transferor is free to select the relevant property from any source, then the transferee cannot possibly acquire an ownership in any particular bulk, as the situation is simply one of an intended transfer of property that is completely unidentified until the transferor makes the necessary choice. Indeed, until such identification, the transferee cannot obtain a property interest.

In the present case, undisputedly, HKA had not at any time paid Retention Monies into any specific account that can be identified. HH argued only that HKA held a certain sum (the amount of Retention Monies) “of its money and funds” on trust for HH. The CFI observed that HH’s argument would lead to the conclusion that HH is the co-owner of all HKA’s “money and funds”, and that HKA may, at different times, even allocate particular assets such as its receivables or other debts, of a value equivalent to the Retention Monies, to the trust. This rendered the subject matter of the purported trust too vague and uncertain and it would be difficult, if not impossible, for the Court, at the beneficiary’s request, to enforce or regulate the trust, by tracing or otherwise. As such, although the CFI recognised the importance of giving weight to the words used in GCC 32.5 (i.e., “shall be held upon trust”), it nevertheless came to the conclusion that no valid trust was created over the Retention Monies at the time of the Scheme. Thus, those monies formed part of HKA’s general assets, to be dealt with in accordance with the terms of the Scheme.

Key Takeaway

This case reinforces the basic principle of trust law, in particular, the requirement for certainty of subject matter. Whilst a contractual clause providing for creation of a trust may evidence an intention to create a trust, it is still necessary to have a “sufficiently identifiable bulk” for a trust to attach. This is important to contractors in construction contracts, as contractors would only stand as unsecured creditors in respect of retention money claims, unless a valid trust exists over an insolvent employer’s assets prior to its insolvency.

As noted by the CFI, contractors should be vigilant and proactive in safeguarding their rights early on in a project, to ensure that the assets over which they are asserting a proprietary claim (such as retention monies) are safeguarded by a valid trust mechanism, rather than wait until the employer becomes insolvent or the trust property is otherwise dissipated. When in doubt, contractors may consider applying for injunctive relief promptly to require the employer to comply with its obligation to segregate and set aside retention monies, before it is too late.

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