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The Leading Hong Kong Case of *LCYP v JEK*

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Part One

LCYP v JEK (Ancillary relief, s17, prenuptial agreements and trusts) [2019] HKFLR 238; [2019] HKCFI 1588: clarifying the law on "real need"

The decision in *LCYP v JEK* is one of the most important family law decisions to be handed down in Hong Kong in the nine years after the Court of Final Appeal's landmark decision in *LKW v DD* in 2010, which brought in the "equal sharing" principle. It is the leading prenuptial agreement (PNA) case in Hong Kong alongside the Court of Final Appeal case of *SPH v SA* (Forum and marital agreements) [2014] HKFLR 286.

It has provided much-needed clarification of the law relating to PNAs. The decision confirms that signing a properly drafted and negotiated PNA has material consequences for a financially weaker spouse: the court ordered that 21.4% of the wife's award was to be returned to the husband or his estate at a later date. Prior to this judgment, the law in Hong Kong on PNAs was unclear and often misunderstood.

Key background facts

The case involved six years of litigation. The wife was from Hong Kong. The financially stronger husband was a US citizen from New Jersey, represented by the author throughout all the Hong Kong proceedings. It involved a PNA signed in New Jersey. The family lived in New Jersey until cracks began to appear in the marriage when the wife moved to Hong Kong with the children. The litigation commenced in April 2014 and ended in March 2020. It involved the petitioner wife's application for financial relief against the husband, JEK. There was also an application by the wife to set aside a number of dispositions by the husband made in favour of a trust that he settled pursuant to s17 of the Matrimonial Proceedings and Property Ordinance (identical to s37 Matrimonial Causes Act 1973 applications in England and Wales).

The trustee, a Delaware company, was the Second Respondent. Having been served with the proceedings, it took the position that the court had no jurisdiction over it, and it did not make an appearance.

The judge, Mr Justice Anthony Chan, in the High Court stated in his judgment that was handed down on 8 July 2019: "*There is an interesting point of law involved in these matters, namely, the standard at which the Wife's needs are to be assessed in the context of an unvitiated Pre-Nuptial Agreement.*" In a footnote, he described the word "*unvitiated*" as "*a convenient label to describe a nuptial agreement which is not tainted by any vitiating factor, for example, lack of full disclosure of assets prior to the agreement being made*".

In December 2012, the assets of the family business and five of its affiliates were sold to a subsidiary of a Hong Kong listed company for US$70,067,872. The amount of proceeds received from the sale of the family business was in dispute, as was the husband's share of the proceeds. The husband said that his shareholding in the family business was increased to 30% shortly before the completion of the sale by way of gifts from his parents. Shortly before the completion of the sale, the husband set up the Delaware trust, and in which he later injected much of his share of the proceeds. These injections were the subject matter of the wife's s17 application. In June 2013, the second matrimonial home was transferred into a company. Later, 99% of the shares in that company were also injected into another trust. The remainder 1% share was held by the husband.

In mid-2013, the wife and the children moved to Hong Kong. It was disputed whether the move was intended to be temporary or permanent. The wife's case was that although the move to Hong Kong was initially intended to last one to two years, she was determined to stay in Hong Kong permanently after the breakdown of her marriage.

The wife petitioned for divorce on 17 April 2014. A jurisdictional challenge was immediately launched by the husband against the petition in New Jersey on the basis that the appropriate forum was the New Jersey court. He also made an application in Hong Kong to have the children returned to the US under the Hague Convention, see below. Those challenges were eventually decided against the husband after two years of litigation.

The key issues

First, with regard to the husband's assets, there were a number of sub-issues: his non-disclosure; his share of the proceeds of sale of the company; whether the assets in a number of trusts should be regarded as his financial resources; the s17 application; and whether certain sums should be added back as part of the assets of the husband.

However, the judge held, "*it is unnecessary to determine each of the disputes because the Husband clearly has sufficient assets to meet the appropriate award for the Wife*".

Second, there was the issue of the financial needs of the wife, bearing in mind the existence of the PNA, the validity of which was not then in dispute.

The judge held that the asset totalled approximately HK$187.5 million, which included a significant add-back (due to the fact that the husband's legal costs were significantly higher than the wife's). He also said that, "*[i]n light of the finding on the Husband's non-disclosure, the above figure is likely to be an underestimate*", but, he held, "*on the other hand, given the open offer of the Wife, the precise amount of assets is unimportant*".

This was effectively a needs case, or rather a case of real need. The two elements to determine the wife's needs were the amount of (a) a housing fund, and (b) an income fund on a clean-break basis.

Key clarification of the law

The case clarifies the meaning of "real need" (when the Hong Kong Court of Final Appeal case of *SPH v SA*, which confirmed that *Radmacher* applied in Hong Kong, had not done so) in the context of determining whether financial terms of a PNA are to be treated as "fair".

It clarifies that, in certain circumstances, where the financially weaker party receives for the benefit of the children during their minority more than his or her real need, the court will order that some capital should be returned to the financially stronger party at a future date: the court agreed with the husband that a substantial amount of the financial capital award for his wife should be returned to him or his estate upon the occurrence of certain future triggering events – when the wife was against any capital being returned at all. Such a condition had not previously been imposed by a court in Hong Kong in any reported case involving a PNA.

The judge held: "*Mr Nagpal [who was counsel for the husband] submitted that there is a consistent theme in the outcome of various English authorities, including and since Radmacher, of the payee having to return capital to the payer.*"

The judge footnoted the following English cases: (i) the judgment of Mostyn J in *N v F* [2011] 2 FLR 533; (ii) the judgment of Holman J in *Luckwell v Limata* [2014] 2 FLR 168; and (iii) the judgments of Nicholas Cusworth QC (sitting as a Deputy High Court Judge) in *Hopkins v Hopkins* [2015] EWHC 812 (Fam) and *WW v HW* [2016] 2 FLR 299.

He went on, "*[t]here is an obvious fairness of the payee having to return capital when it is not needed if that party has been provided capital to meet his or her needs in circumstances where that capital is in excess of what was agreed in an unvitiated nuptial agreement*". "*On balance I agree with Mr Nagpal that there is nothing in the facts of this case which militates in favour of the Wife receiving capital outright over and above that which she is entitled to, in circumstances where it was agreed that she would not have claim to such capital. I therefore agree with the chargeback in favour of the Husband.*"

The chargeback amounted to 21.24% of the wife's award.

A similar arrangement occurred in *Radmacher*, where the husband was the financially weaker party, in which the UK Supreme Court held at paragraph 112 that, "*the sum of £2.5m for housing should not be the husband's absolutely but should be held-by-him-only-for-the-years-of-parenting. The income fund should be capitalised at a rate to cover his needs only until the younger child's 22nd birthday. Thus, while he would not interfere with the awards for the car, for the payment of the husband's debts, for housing in Germany and the periodical payments for the children, the major funds should be provided for his role as a father rather than as a former husband*". Ms Radmacher will, in fact, get her £2.5 million back in 2024 on the younger child's 22nd birthday, unless it has been repaid early.

The *JEK* case – like *Radmacher* – powerfully demonstrates the impact on, and the material financial consequences for, a financially weaker spouse on divorce when parties sign up to an unvitiated PNA – while still achieving fairness.

Housing fund

On the question of accommodation, the judge took into account the significantly lower cost of real estate in New Jersey compared with Hong Kong:

> "*164. I agree with Mr Nagpal that in this case the court should not lose sight of the fact that the House in New Jersey which the Husband continues to reside is worth only HK$14.43 million. In coming to a fair decision, the court should balance the interest of both the payer and the payee.*
> *165. Unfortunately, the Wife did not adduce any evidence on the kind of properties which can be acquired at HK$35 million (inclusive) because of her position that it would be reasonable for her to stay at OO indefinitely. A property there will cost no less than HK$40 million to buy. I am unable to agree with the Wife that it would be fair to require the Husband to fund an indefinite stay by her at OO, which admittedly is located at one of the most expensive areas in Hong Kong.*
> *166. There is evidence adduced by the Husband of properties in the HK$30 million region and HK$20 million region. Mr Nagpal had asked the court to infer from such evidence that a property in the region of HK$25 million would be suitable for the Wife given that X will be leaving in September, and the likelihood is that Y will follow his brother's footstep. Such a property can accommodate the children when they return on holiday. I agree.*
> *167. However, Ms Yip had pointed out that, judging by the evidence before the court, the available choice is likely to be an older property which will require higher renovation expenses. I accept Ms Yip's calculation that to acquire a HK$25 million property will require the payment of tax and expenses of HK$2.3125 million 24. I round up the total to HK$27.5 million.*"

That was £2.58 million, or £110,000 more than the husband proposed.

The judge further held, "*170. On the basis of a housing fund of HK$27.5 million, a charge in the sum of HK$13 million in favour of the Husband is, in my view, fair. In the event that the Wife decides to live in the US, she will have HK$14.5 million at her disposal from the housing fund after paying off the charge. She will be able to buy a property in the US which is comparable to the House*".

Duxbury capitalised income fund for the wife

On the question of a Duxbury capitalised income fund for the wife, the judge held:

> "*172. The Husband had offered an income fund of HK$20 million, whereas the Wife is asking for HK$35 million.*
> *174. First of all, it is not unreasonable for older people to have fewer or lower expenses. Secondly, it would not be fair to ignore the Wife's earning capacity (see W v W [2005] 1 HKFLR 53, [39]). Thirdly, the court should not lose sight of the fact that under the PNA the Wife would only be entitled to 5 years of maintenance. Fourthly, the maintenance for the children would indirectly provide a cushion for the Wife (see Radmacher, [119]).*
> *175. Taking all relevant matters into consideration, the fair balance is to provide the Wife with an income fund of HK$30 million. I should make it clear that I disagree with the Husband that the Wife should not be provided with a whole life award because she is handicapped with a reduced earning capacity for the rest of her life.*"

The final capital award

The final capital award was therefore HK$61.2 million. After deducting the charge of HK$13 million (21.2% of the total award), the wife would be left with HK$48.2 million. Comparing the open offers, the wife's open offer was for HK$70 million with no charge. She was therefore requesting HK$21.8 million or £2.048 million more than the final court award.

The husband's open offer was a total of HK56.312 million, subject to a charge of HK$12.266 million. After the mortgage was repaid, the wife would be left with HK$44.046 million. This was HK$4.154 million or £390,240 lower than the court award.

The wife was not awarded her reasonable needs generously interpreted as she had claimed. She was awarded her "real need". The PNA was therefore successful to a material degree.

Key further lessons of the case

There are lessons that can be drawn from the case as to how PNAs with an international element should be drafted and negotiated. What is not apparent from the judgment is that the wife did not initially accept that the PNA was unvitiated. She conceded the point at the time of the hearing for the first-instance determination of the forum issue.

The importance of keeping detailed file records and correspondence file records when a PNA is negotiated and signed cannot be overstated. The husband had never been advised to obtain any international advice outside the US at any stage by his New Jersey lawyers when the PNA was negotiated.

The husband made the following statement, for which he has given authorisation to publicise. He said, "*I want to highlight the need to create effective international PNAs that work. If I had known at the time I signed my PNA in New Jersey what I know now – that it is vital to obtain international legal advice – things could have turned out differently, and I might have avoided 6 years of litigation*".

Trust issues

This was also the first reported Hong Kong divorce case involving US discretionary trusts. The trusts were based in Delaware, New York, Florida and New Jersey.

Applying the "likelihood test" from the 2014 Hong Kong Court of Final Appeal case of *Otto Poon* (in which the author led the team representing the trustee, HSBC Trustee International Limited), Mr Justice Chan held that the assets of the main high-value Delaware discretionary trust "*are the [financial] resources of the Husband*".

The husband was successful in defeating the wife's claim to set aside the substantial transfers totalling US$11.6 million into the Delaware trust and therefore defeating the assertion that he had the intention of defeating the wife's claim for financial provision.

However, it is likely that he would not have been successful had the original evidence produced by the trustee been relied upon. A major difficulty was that the US trustee did not keep trust accounts in the same way that a trustee, say, in Jersey, Guernsey, the Cayman Islands or the BVI, would have done.

In the end, trust accounts had to be hastily prepared at the last minute – and in material respects they were wrong. Some of the further information provided by the trustee, for example, indicated that substantial transfers had been made into the account just after the petition was served. Subsequent investigation revealed that these substantial transfers were, in fact, inter-account transfers in respect of funds that had already been put into the trust well before the divorce petition was filed, and fully legitimate.

Had this major error not been spotted just in time, it is highly likely that information provided by the trustee of large injections into the trust just a few days after the divorce petition was served would have been treated as transfers made with the intention of defeating the wife's claims and the wife would have won her s17 application.

It also made a significant difference that the husband, unlike in many international divorces, responsibly made no alteration whatsoever to any of the trust structures, all of which were in place well before the wife's divorce petition was filed.

Part Two

LCYP v JEK [2015] HKCA 407; [2015] 4 HKLRD 798; [2015] 5 HKC 293, the leading case on Habitual Residence in Hague applications with a touch of Ruth Bader Ginsburg

Habitual residence in respect of Hague applications and issues as to removal of children from Hong Kong were also considered in *LCYP v JEK* in the Hong Kong Court of Appeal, as well as more recently in *BMC v BGC* (Hague) [2020] HKCA 317, making *LCYP v JEK* the leading case on habitual residence. Justice Ruth Bader Ginsburg also cited *LCYP v JEK* in the US Supreme Court (USSC) case of *Monasky v Taglieri* [2020].

Relevant legal principles

The Court of Appeal in *LCYP v JEK* ruled that: "*In respect of the Hague Convention jurisprudence on habitual residence, impetus for change first came from the Court of Justice of the European Union in Proceedings brought by A (Case C-523/07) [2010] Fam 42 and Mercredi v Chaffe (Case C-497/10PPU) [2012] Fam 22 and recently adopted in the United Kingdom by a series of Supreme Court judgments, namely, A v A and another (Children: Habitual Residence) (Reunite International Child Abduction Centre and others intervening) [2014] AC 1; In re L (A Child) (Custody: Habitual Residence) (Reunite International Child Abduction Centre intervening) [2014] AC 1017; In re LC (Children) (Reunite International Child Abduction Centre intervening) [2014] AC 1038 and In re R (Children) (Reunite International Child Abduction Centre and others intervening) [2015] 2 WLR 1583 which was also reported under the title of AR v RN [2015] UKSC 35. The Supreme Court also departed from the approach of Lord Scarman.*"

Cheung JA set out the relevant legal principles on habitual residence at paragraph 7.7:

"(1) *Habitual residence is a question of fact which should not be glossed with legal concepts which would produce a different result from that which the factual inquiry would produce (Re L (A child) at [20]);*

(2) *The factual question is: has the residence of a particular person in a particular place acquire the necessary degree of stability (permanent is the word used in the English versions of the *810 two CJEU judgments) to become habitual? It is not a matter of intention: one does not acquire a habitual residence merely by intending to do so; nor does one fail to acquire one merely by not intending to do so (Re LC (Children) at [59]);*

(3) *The concept corresponds to the place which reflects some degree of integration by the child in a social and family environment (Re L (A child) at [20]);*

(4) *The question is the quality of the child's residence, in which all sorts of factors may be relevant. Some of these are objective: how long is he there, what are his living conditions while there, is he at school or at work, and so on? But the subjective factors are also relevant; what is the reason for his being there, and what is his perception about being there? (Re LC (Children) at [60]);*

(5) *There is no legal rule, akin to that in the law of domicile, that a child automatically takes the habitual residence of his parents (Re L (A child) at [21]); and*

(6) *Although a child could lose his habitual residence without a parent's consent, nevertheless, it is clear that parental intent does play a part in establishing or changing the habitual residence of a child; not parental intent in relation to habitual residence as a legal concept, but parental intent in relation to the reasons for a child's leaving one country and going to stay in another. This will have to be factored in, along with all other relevant factors, in deciding whether a move from one country to another has a sufficient degree of stability to amount to a change of habitual residence (re L (A child) at [23].*"

Monasky v Taglieri, USSC

In the case of *Monasky v Taglieri*, Justice Ginsburg confirmed that the USSC had "*granted certiorari to clarify the standard for habitual residence in cases concerning the Hague Convention on the Civil Aspects of International Child Abduction [The Hague Convention]*" and that there was "*an important question of federal and international law, in view of differences in emphasis among the Courts of Appeals*" in the US.

In her judgment, which was affirmed 9-0: "*In accord with decisions of the courts of other countries party to the Convention [she included the UK, New Zealand, Australia, Canada, the European Union as well as Hong Kong] we hold that a child's habitual residence depends on the totality of the circumstances specific to the case. An actual agreement between the parents is not necessary to establish an infant's habitual residence*"; "*Intermediate appellate courts in Hong Kong and New Zealand have similarly stated what 'habitual residence' imports. See LCYP v. JEK, [2015] 4 H. K. L. R. D. 798, 809–810, ¶7.7 (H. K.).*" She stated, "*[t]he bottom line: There are no categorical requirements for establishing a child's habitual residence – least of all an actual-agreement requirement for infants*".

Keeping the court entertained, Chief Justice Roberts joked during the December 2019 hearing, "*that eight-week-old infants don't have habits, … well, other than one or two*".

The impact of the USSC decision in *Monasky* and the two Hong Kong *LCYP v JEK* judgments for foreign and expat clients divorcing in Hong Kong

The old "actual-agreement" approach, which was found not to apply by the USSC in *Monasky* and by the *LCYP v JEK* Court of Appeal decision in Hong Kong in 2015, had, in fact, previously been an effective and useful deterrent against forum shopping and divorce tourism. A mere four months of "integration" of the children at school in Hong Kong or England can now be enough to switch the children's habitual residence from a foreign jurisdiction to Hong Kong or England, making it impossible to force their return through a Hague Convention application and strengthening the chances of the divorce proceeding in Hong Kong or England – where the level of financial provision for the financially weaker party might well be millions of dollars higher than in the home US State.

There is all the more need now to enter into an unvitiated and fair PNA.

Marcus Dearle is a Partner at Miles Preston, Chair of the International Bar Association Family Law Committee, and a Fellow of the International Academy of Family Lawyers. He is a 26-year veteran of Withers in London and Hong Kong and has over 34 years of experience acting in complex domestic and international family law cases. Marcus has specialist expertise, in particular acting for trustees in HNW and UHNW divorce and trust cases, advising on UHNW pre- and post-nuptial agreements (PNAs) and dealing with international divorce litigation involving PNAs and trusts. He also has recognised pioneering expertise in international surrogacy law and medico-legal/fertility law issues. In addition to being admitted in England and Wales, he uniquely practises in Hong Kong family law from London. He is also admitted, but not practising in, the BVI. Marcus is recognised as a leading trusts and divorce litigation practitioner, advising UHNW clients in Legal Week's *Private Client Global Elite* directory: the directory is entirely reliant on peer nominations. He currently represents Sir Frederick Barclay in his divorce – defending him in complex committal proceedings involving international trusts. He took over the case just after the family remedy trial judgment on 31 March 2021: see the reported judgments – *Barclay v Barclay* [2021] EWFC 40, 5 July 2021, and *Barclay v Barclay* [2022] EWHC 2026 (Fam), 28 July 2022.

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The firm has acted in a number of the highest value and most complex international cases in London and Hong Kong, and has been a pioneer in making groundbreaking new law – including on financial, surrogacy and medico-legal/fertility law issues.

The firm is a leader in the field acting for trustees in divorce and trust cases, where divorce proceedings are filed either in London or Hong Kong: in the landmark Hong Kong Court of Final Appeal case of *Otto Poon* – in which a member of the team acted for the trustee – the *Financial Times* reported that the case had 'Rattled the Trust Industry'. The firm is also currently acting for Sir Frederick Barclay in his divorce.

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