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Client Alert Commentary

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Hong Kong Court Orders Winding-Up of Company Despite Parties' Arbitration Agreement

A recent ruling shows that an arbitration agreement alone is not necessarily a complete defence to a Hong Kong winding-up petition.

The Hong Kong Companies Court recently issued a winding-up order against a debtor company, despite the presence of arbitration clauses in the agreements giving rise to the debt. In *Re Simplicity & Vogue Retailing (HK) Co., Limited* [2023] HKCFI 1443, Linda Chan J refused to apply the *ratio* in the Court of Final Appeal's decision *Re Guy Kwok Hung Lam* [2023] HKCFA 9 (Guy Lam) (discussed in a previous Client Alert), in which the underlying dispute over the petition debt was the subject of an arbitration clause.

Background

Following the debtor company's failure to satisfy the statutory demand of the subject debt, the petitioner issued a winding-up petition on 6 December 2022 and filed the verifying affidavit the next day. The company purported to file its affidavit in opposition four months later, although it was required to do so within seven days of filing the verifying affidavit.

The court granted leave to the company to file the affidavit in opposition on the condition that the company shall pay the debt into court. However, the company failed to comply with the condition and sought an extension of time and an adjournment of the petition for three months.

Decision

The court found that there was no credible evidence to show that if given time, the company would be able to comply with the condition, and that the court had no proper basis to extend the time for the company to comply with the condition or to adjourn the petition. The petitioner was therefore entitled to a winding-up order as of right.

The court moved on to address the other arguments for completeness, i.e., (1) there were a bona fide dispute as to whether the guarantee has been discharged by reason of variation of the principal contract; and (2) there were arbitration clauses in the principal agreements in which the debt arose, and hence the dispute over the debt should be referred to arbitration.

The court rejected the first argument, given the express provision in the guarantee that provided otherwise.

The court also rejected the second argument based on the following reasons:

1. The company did not take steps required under the arbitration clause to commence the contractually mandated dispute resolution process, and therefore was not entitled to rely on the approach established in *Re Southwest Pacific Bauxite (HK) Limited* [2018] 2 HKLRD 449 (*Lasmos*). *Lasmos* provides that the court would generally dismiss winding-up petitions if three requirements are met:

    a) the company disputes the debt relied on by the petitioner;

    b) the contract under which the debt is alleged to arise contains an arbitration clause that covers any dispute relating to the debt; and

    c) the company takes the steps required under the arbitration clause to commence the contractually mandated dispute resolution process and demonstrates this to the court through affirmation evidence.

2. The company could not rely on the Court of Final Appeal's decision in *Guy Lam* as this ruling concerned the effect of an exclusive jurisdiction clause in the insolvency context, and its *ratio* does not apply to an arbitration clause.

3. As far as an arbitration clause is concerned, the court is guided by the established principles including the considerations in *Lasmos*, of which *Guy Lam* did not disapprove.

4. The Companies Court, in the face of an arbitration clause, should not invariably refuse to consider the merits of the defence that the company raised and require the parties to resolve their dispute in arbitration.

5. If the company raises a substantive defence to the petition debt, the court should consider whether the defence can readily be shown to be wholly without merit. In the present case, the court reached that conclusion without considering any detailed arguments or disputed evidence and held that the defence that the company raised "borders on the frivolous or abuse of process" even if the *Guy Lam* approach applied.

6. In the absence of a genuine dispute over the debt, no proper basis existed to require the parties to refer their dispute to arbitration.

Commentary

While the Court of Final Appeal in *Guy Lam* was careful not to extend the reasoning to arbitration clauses, this case provides direct guidance as to the Hong Kong courts' approach when the petition debt contract contains an arbitration clause. Despite a tendency to uphold the parties' express choice of dispute resolution process, the court will not invariably let the arbitration agreement bypass its power to wind up a company if the company's defence can readily be shown to be wholly without merit. Parties should keep in mind that the mere existence of an arbitration agreement will not automatically trump a winding-up petition. Pending further authority on this issue, if a company intends to rely on the approach in *Lasmos* to request the Companies Court to dismiss the winding-up petition, it should at least comply with the three requirements in *Lasmos* set out above, including taking steps to commence arbitration.

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