Hogan Lovells

A strong statement – Hong Kong court says arbitration agreement is "irrelevant" to the exercise of courts discretion in a winding-up

22 April 2020

Another Hong Kong court decision has questioned whether the judgment in the leading case of *Lasmos Limited v. Southwest Pacific Bauxite* (HK) Limited [2018] HKCFI 426, may have gone too far when it suggested that an arbitration clause in an agreement should generally take precedence over a creditor's right to present a winding-up petition.

The decision in *Dayang (HK) Marine Shipping Co., Limited v. Asia Master Logistics Limited* [2020] HKCFI 311, follows similar comments made obiter by the Hong Kong Court of Appeal last year in *But Ka Chon v. Interactive Brokers LLC* [2019] 4 HKLRD 85 which underlined that a winding-up petition may only be dismissed by establishing a *bona fide* dispute on substantial grounds to the claim for the underlying debt (see Hogan Lovells client alert, *Back to basics – Hong Kong Court of Appeal queries approach to winding-up petitions where arbitration is involved*).

In this case, Dayang had chartered its vessel to Asia Master. The fixture note relating to this charter contained a number of obligations that Dayang, as owner of the vessel, had to comply with. The fixture note also contained an arbitration clause, providing that any disputes be resolved by arbitration in Hong Kong under English law.

Dayang filed a winding up petition against Asia Master for unpaid debts amounting to US$360,919.76. Asia Master did not dispute the existence of the debt, however, instead counterclaimed for alleged breaches of the fixture note. Asia Master submitted that the winding-up petition should be stayed to allow for the dispute to be resolved by arbitration, pursuant to the terms of the fixture note.

Lasmos principle

When applying for a stay of the winding up proceedings, Asia Master attempted to rely on the principles set out in *Lasmos* that the Court should generally dismiss a winding-up petition if:

1. A company disputes the debt relied upon by the winding-up petitioner.
2. The contract under which the debt is alleged to have arisen contains an arbitration clause that covers any dispute relating to the debt.

3. The company takes the steps required under the arbitration clause to commence the contractually mandated dispute resolution process and files an affirmation in accordance with Rule 32 of the companies (winding up) rules (Cap 32H) demonstrating this.

(See Hogan Lovells client alert, *Winding-up petition v. arbitration clause: Hong Kong court dismisses winding-up petition in favour of arbitration clause*).

Deputy High Court Judge (DHCJ) William Wong, senior counsel, held that the principle in *Lasmos* had simply not been engaged as Asia Master had not taken the requisite steps to commence the arbitration proceedings. The court held that simply sending a letter to Dayang confirming its willingness to resolve the dispute via arbitration was not sufficient to formally initiate the arbitration proceedings, and as such the third limb of Lasmos was not satisfied.

The traditional approach

Having confirmed that the *Lasmos* principle should not apply in this case, the court reverted to the traditional approach in order to determine whether to continue the winding-up proceedings. The court considered, at length the relevant authorities in England, Singapore, and Australia in reaching its decision.

The court thought it unnecessary to give more "weight" to the arbitration factor. The existence of the arbitration agreement was, "...neither here nor there. If the commencement of winding-up proceedings does not come within the scope of an arbitration clause, it is not for the courts to improve the bargain for the debtor-company to the prejudice of the creditor-petitioner."

Any invitation to give greater emphasis to arbitration begged the question of how much greater emphasis should be given and the Court acknowledged that there were practical difficulties in attempting to do so. The *Lasmos* approach also risked acting as an unjustified fetter on the court's discretion.

William Wong DHCJ summarised his view of the law as follows:

a) Where a debtor-company intends to dispute the existence of a debt, it must show there is a *bona fide* dispute on substantial grounds. The test should apply in all cases whether or not the debt had arisen from a contract incorporating an arbitration clause.

b) The existence of an arbitration agreement should be regarded as irrelevant to the exercise of the court's discretion to make a winding-up order.

c) The fact that arbitration proceedings have commenced or would be commenced may be relevant evidence that there is a *bona fide* dispute, but is not alone sufficient to prove the existence of a *bona fide* dispute on substantial grounds.

d) Where the creditor-petitioner petitions in circumstances where it knows there to be a *bona fide* dispute over the debt on substantial grounds, it risks being liable to pay the debtor-petitioner's costs on an indemnity basis and at risk of liability under the tort of malicious prosecution.

The court therefore refused to grant the stay on the basis that Asia Master did not have a *bona fide* counterclaim on substantial grounds.

Where next?

The case once again reaffirms the traditional Hong Kong position, namely that a winding-up petition in relation to a liquidated debt may only be dismissed where there is a *bona fide* dispute on substantial grounds, despite there being an arbitration clause in the agreement.

Creditors with legitimate grounds to petition to wind up a company may take comfort that there is less risk that their petition would be delayed or derailed due to the existence of an arbitration clause in the underlying agreement. However, creditors should be wary of the risk of indemnity costs and potential liability under the tort of malicious prosecution if they proceed with petitions where they are aware that the debt is subject to a *bona fide* dispute on substantial grounds.

Authors

Karen Chan
Senior Associate, Hong Kong
T +852 2219 0888
karen.chan@hoganlovells.com

Nigel Sharman
Knowledge Lawyer, Hong Kong
T +852 2840 5637
nigel.sharman@hoganlovells.com