WOULD PARTY AUTONOMY TRUMP WINDING-UP PETITIONS? AN ANALYSIS OF HONG KONG’S POSITION

Soo Khim Keoy, Sherlin Tung & Alex Ye*

ABSTRACT

Due to the impact of COVID-19 pandemic on the global economy, an increasing number of companies are facing the risk of being wound up. This article aims to ascertain Hong Kong’s position as to whether a petition to wind up a company may be stayed or dismissed in favor of arbitration with a focus on two common grounds on which a winding-up petition is issued, i.e., a just and equitable ground and an insolvency ground. This article argues that, when deciding the issue of stay or dismissal of a winding-up petition in favor of arbitration, Hong Kong courts should adopt a coherent approach in just and equitable petitions and insolvency petitions, focusing on identifying the substance of the dispute in the petition rather than the nature of the relief sought.

KEYWORDS: winding-up, arbitration, just and equitable, insolvency, Hong Kong, substance of the dispute, nature of the relief sought

* Soo Khim Keoy is a dispute resolution specialist and a partner at Withers. He heads the litigation and arbitration team in Hong Kong. Sherlin Tung is an international arbitration specialist. She is a partner at Withers in the litigation and arbitration team in Hong Kong. Alex Ye is an international arbitration lawyer at Withers in the litigation and arbitration team in Hong Kong. The views expressed in this article are those of the authors and do not reflect the views of Withers. Email: sookhim.keoy@withersworldwide.com; sherlin.tung@withersworldwide.com; alex.ye@withersworldwide.com.
I. INTRODUCTION

The impact of COVID-19 pandemic on the global economy is unprecedented. With many countries in lockdown, the global economy has been and will likely continue experiencing sharp contraction in the short term despite the massive financial support from governments worldwide. For business hubs like Hong Kong, the prosperity of which depends on international trade and travel, the impact is even direr. Hong Kong’s economy shrank by 8.9% year on year in the first quarter of 2020, the biggest quarterly decline on record.1

The unfortunate ripple effect of a declining economy is that many companies are facing difficulties in their daily operations. Inevitably, a company’s creditor might be more anxious about security of his or her debts owed by the company. Similarly, shareholders of a company might not be happy with the conduct of company’s affairs during these difficult times if they feel that their interests would be unfairly affected. To secure their interests, some creditors might take a drastic approach and issue a winding-up petition against the company based on the ground that the company is unable to pay its debts; while some shareholders might do so on a just and equitable ground.

Given the increasing use of arbitration as the preferred dispute resolution mechanism in commercial contracts, one of the arguments frequently deployed in winding-up petitions is that the court should stay or dismiss the proceedings and refer the underlying dispute to arbitration. In particular, a creditor might face an argument that the alleged debt arose from a contract incorporating an arbitration clause. The dispute over the debt should therefore be referred to arbitration before a winding-up petition could be issued. Similarly, a shareholder might face an argument that the alleged grounds on which he or she relied to issue a winding-up petition is covered by a contract to which the shareholder is a party. As this contract (e.g. shareholders agreement, share subscription/purchase agreement or joint venture agreement) has an arbitration clause, the dispute should first be determined by an arbitral tribunal.

The validity of these arguments has far-reaching consequences. If these arguments can be successfully invoked, it will alleviate the pressure from the company and/or its controlling shareholders to a large extent, as the company will not be facing the threat of immediate liquidation. On the other hand, the additional time earned by the company would erode the bargaining power of creditors or minority shareholders when they lose the

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ability to pursue their statutory rights to issue winding-up petitions immediately.

It is therefore critical to understand the legal position as to whether a petition to wind up a company may be stayed or dismissed in favor of arbitration. This article aims to ascertain Hong Kong’s position in situations where a winding-up petition was issued on two common grounds, i.e., a just and equitable ground issued by a shareholder and an insolvency ground (company unable to repay its debts) issued by a creditor. This article also endeavors to provide a possible coherent approach in the winding-up proceedings in light of the uncertainty of Hong Kong’s current position, which calls for a determination by the higher court.

II. HONG KONG COURTS’ DISCRETION TO STAY OR DISMISS A WINDING-UP PETITION

Before diving into the legal position in Hong Kong as to whether a petition to wind up a company may be stayed or dismissed in favor of arbitration, it is important to understand the legal basis under which Hong Kong courts could stay or dismiss a winding-up petition.

Article 8(1) of the UNCITRAL Model Law on International Commercial Arbitration (hereinafter “Model Law”), which has effect by virtue of Section 20(1) of the Hong Kong Arbitration Ordinance (Cap. 609), states that:

(1) A court before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so requests not later than when submitting his first statement on the substance of the dispute, refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed (emphasis added).

Section 20(5) of the Hong Kong Arbitration Ordinance further states that if the court refers the parties in an action to arbitration, it must make an order staying the legal proceedings in that action.

Thus, Hong Kong courts must stay court proceedings relating to “an action brought in a matter which is the subject of an arbitration agreement” upon an application for referring the parties to arbitration. The only exceptions are where the court is satisfied that the arbitration agreement is null and void, inoperative or incapable of being performed.

Hong Kong authorities are clear that a winding-up petition, being insolvency proceeding, does not come within the wording of Article 8(1) of the Model Law in that it is not “an action brought in a matter which is the
subject of an arbitration agreement”. Similarly, the court seems to have confirmed (although not expressly) that the position that winding-up proceedings are not an “action” is applicable to petitions issued on a just and equitable ground.

Despite lack of automatic and mandatory stay in Hong Kong’s arbitration legislation, there is no controversy that Hong Kong courts have the discretion to stay or dismiss a winding-up petition under Section 180(1) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32). The real issue is how this discretion is to be exercised in a principled manner. The following section examines how the Hong Kong courts exercised this discretion under two types of winding-up petitions, i.e., just and equitable petitions and insolvency petitions.

III. DIFFERENT APPROACHES FOR TWO TYPES OF WINDING-UP PETITIONS

A. Just and Equitable Ground

Section 177(1)(f) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance allows the Hong Kong court to make an order for the winding up of a company if it is of the opinion that it is just and equitable to do so. The just and equitable remedy enables the court to subject the exercise of legal rights to equitable considerations, i.e., considerations of a personal character arising between one individual and another, which make it unjust, or inequitable to insist on legal rights or to exercise them in a particular way.

One typical example where it may be just and equitable for a company to be wound up is where there are sufficiently serious breaches of the

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4 Quiksilver, supra note 3; Dayang (HK) Marine Shipping Co., Ltd. v. Asia Master Logistics Ltd, [2020] 2 H.K.L.R.D. 423 (C.F.I) [hereinafter Dayang], ¶ 56. Section 180(1) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance reads:

On hearing a winding-up petition the court may dismiss it, or adjourn the hearing conditionally or unconditionally, or make any interim order, or any other order that it thinks fit, but the court shall not refuse to make a winding-up order on the ground only that the assets of the company have been mortgaged to an amount equal to or in excess of those assets, or that the company has no assets.

shareholders’ joint venture agreement. If a party under a joint venture agreement which contained an arbitration clause issues a winding-up petition in respect of the joint venture, the issue that whether it is permissible or appropriate to stay such petition and to require the underlying dispute to be determined in accordance with the arbitration agreement becomes very relevant. This exact issue was considered by Harris J of the Hong Kong Court of First Instance (hereinafter “CFI”) in Quiksilver Greater China Ltd v. Quiksilver Glorious Sun JV Ltd & Another (hereinafter “Quiksilver”) and Champ Prestige International Ltd v China City Construction (International) Co Ltd & Anor (hereinafter “Champ Prestige”).

1. Quiksilver — Quiksilver and Glorious Sun Overseas Limited (hereinafter “Glorious Sun”) established two joint ventures with each holding 50% of the shares in these two companies. The two joint ventures were established based on a comprehensive joint venture agreement between Quiksilver and Glorious Sun which contained an arbitration clause. Quiksilver presented winding-up petitions on the just and equitable ground pursuant to Section 177(1)(f) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance. Glorious Sun applied for a stay of the winding-up petitions in favor of arbitration. It was the first case in Hong Kong which requires the court to consider the extent to which it is permissible or appropriate to stay or dismiss a petition issued by a shareholder of a solvent company to wind up a company on the just and equitable ground and require the underlying dispute to be determined in the first instance in accordance with an arbitration agreement in a shareholders agreement between the petitioner and the respondent shareholders.

The CFI first acknowledged that a winding-up order cannot be granted by an arbitrator regardless of what the arbitration clause says. This is because a company is a creature of statute and can only be liquidated through the mechanism provided under the Companies Ordinance (Cap. 622). The court nevertheless held that the question of whether or not the conduct of a shareholder is inconsistent with the terms of a shareholders’ agreement clearly can be determined by an arbitrator and to that extent the determination of the facts and matters which found a petition to wind up a company are arbitrable.

In this regard, the court made a distinction between a winding-up petition issued by a creditor on the ground of insolvency (company unable

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8 Quiksilver, supra note 3, ¶ 12.
9 Id. ¶ 14.
10 Id.
to repay its debts) and a just and equitable petition issued by a shareholder. In the court’s view, the former invokes a class right available to all creditors, and the creditor does not seek to recover the sum due to him under the agreement containing the arbitration clause; rather he seeks to put an insolvent company into liquidation for the benefit of all its creditors.\(^\text{11}\)

On the other hand, in a case of just and equitable petition, a shareholder must demonstrate a sufficient interest in the winding up, which is commonly satisfied by the shareholder asserting that the company is solvent and that he will be entitled to a distribution following the liquidation of its assets by a liquidator.\(^\text{12}\) In the court’s view, it would normally be the case in shareholder disputes that the “class” interested in the petition is limited to the two shareholders both of who are parties, rather than affecting persons other than the parties.\(^\text{13}\)

Following this line of reasoning, the court further held that in determining the arbitrability of a given claim, it is not a critical consideration if the precise relief sought in a petition is not available from an arbitrator, although it is relevant. The correct approach is to identify the substance of the dispute between the parties and ask whether or not that dispute is covered by the arbitration agreement.\(^\text{14}\)

On the facts of the case, the court considered the disputes over the basis for the winding-up petition, i.e., whether Quiksilver should sell its shares and grant a new trademark license and whether the joint ventures should be wound up, are covered by the arbitration agreement and ought to be determined by arbitration.\(^\text{15}\) If the arbitrators find in favor of Quiksilver, an application can then be made to the court for winding-up orders.\(^\text{16}\) The court therefore made the order that the petitions be stayed, pending the outcome of the arbitration on the underlying disputes.\(^\text{17}\)

2. Champ Prestige — In the recent case of Champ Prestige, Harris J of the CFI considered the issue of whether the matters in the dispute are the subject of an arbitration clause so that a winding-up petition on a just and equitable ground should be stayed.

In that case, Champ Prestige and China City Construction (International) Co Limited (hereinafter “China City”) entered into a share sale and purchase agreement (hereinafter “SPA”) pursuant to which China City, being the sole shareholder of Dingway Investment Limited (hereinafter “Company”), transferred 45% of the Company’s shares to Champ Prestige. The SPA contained financing arrangement for the

\(^\text{11}\) Id. ¶ 17-18.
\(^\text{12}\) Id. ¶ 19.
\(^\text{13}\) Id.
\(^\text{14}\) Id. ¶ 22.
\(^\text{15}\) Id. ¶ 23.
\(^\text{16}\) Id.
\(^\text{17}\) Id.
development of land in Miami which contained a put option that Champ Prestige could exercise in the event that China City did not fulfil its funding obligations, as well as an arbitration clause. The parties later entered into a supplemental agreement (hereinafter “Supplemental Agreement”), which altered the financing arrangements largely by pushing back relevant dates, and a cooperation agreement (hereinafter “Cooperation Agreement”) containing further terms dealing with the development of the land. The Cooperation Agreement also contained an arbitration clause.

China City began to experience financial problems in the middle of 2016, which prevented the parties agreeing the financial matters they were required to agree. Champ Prestige later exercised its put option, but China City did not pay the sums due on its exercise. In June 2017, the parties entered into a framework agreement to resolve the problems that had arisen, which provided for the sale of the loan or the sale of one party’s shares to other party (hereinafter “Framework Agreement”). Champ Prestige alleged that China City had failed to honor its obligation under the Framework Agreement, which did not contain an arbitration clause.

Champ Prestige issued a petition seeking the winding up of the Company on the just and equitable ground pursuant to Section 177(1)(f) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance. The complaint was that the Company was unable to progress its intended business purpose, namely, to develop land in Miami. China City applied to strike out the petition. One of the grounds was that the dispute should be referred to arbitration.

China City analyzed Champ Prestige’s complaints as falling into four heads:

1. China City breached the SPA and the Supplemental Agreement by failing to submit a financing proposal and not honoring the put option.
2. China City breached the Framework Agreement by failing to implement the agreed routes for exiting the venture.
3. China City is in poor financial condition and is unlikely to able to continue with its investment in the Company and the development of the land in Miami.
4. The breakdown of the relationship between the parties’ respective parent companies.

China City acknowledged the second, third and fourth grounds did not arise under either the SPA or the Cooperation Agreement, both of which contained arbitration clauses, but alleged that they were of no relevance to the determination of whether or not there had been a break down in trust and confidence.

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18 Champ Prestige, supra note 7, ¶ 11.
19 Id. ¶ 12.
The CFI first reaffirmed its position in *Quiksilver* that the correct approach to determine whether or not the complaints in a shareholders petition should be referred to arbitration, is to identify the substance of the dispute between the parties and ask whether or not that dispute is covered by the arbitration agreement.\textsuperscript{20} The court acknowledged that there might be cases in which part of a dispute can sensibly be hived off and referred to arbitration and perhaps the balance of the complaints stayed until the arbitration is complete following which the petition continues to determine the outstanding issues.\textsuperscript{21} However, the court held that it would be reluctant to exercise its discretion to stay a petition on the grounds that some, but not all the factual matters in dispute were the subject of an arbitration clause unless it is clear and obvious that a dispute which was the subject of an arbitration clause would be central and probably determinative of the factual issues raised by the petition.\textsuperscript{22} In the court’s view, as the complaints all formed part of one continuing narrative, the case at hand was not such a case.\textsuperscript{23}

3. *Position in Hong Kong* — Hong Kong’s position appears to be that the complaints raised in a winding-up petition on the just and equitable ground would generally be arbitrable. If the underlying dispute is the subject of an arbitration agreement, Hong Kong courts would likely be willing to give effect to such arbitration agreement, and to allow proceedings to be stayed in favor of arbitration. In this regard, the fact that the relief sought in a petition is not available from an arbitrator is a not critical consideration in determining whether the complaints raised in such petition could and should be determined by an arbitrator.

If only part of the complaints raised is covered by an arbitration agreement, Hong Kong courts would more likely stay the whole proceedings and refer part of the dispute to arbitration if it is clear and obvious that the dispute which was the subject of an arbitration agreement would be central and probably determinative of the factual issues raised by the winding-up petition.

If the court is not certain whether the dispute covered by an arbitration agreement would be central or determinative of factual issues raised by the winding-up petition, the court is unlikely to stay the proceedings as a whole. In such case, the CFI in *Champ Prestige* did not expressly state whether it would sever parts of the complaints that are covered by an arbitration agreement, and continue with the winding-up proceedings based on the complaints that are not the subject of the arbitration agreement. However, if the dispute covered by an arbitration agreement is not

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\textsuperscript{20} Id. ¶ 10.
\textsuperscript{21} Id. ¶ 12.
\textsuperscript{22} Id.
\textsuperscript{23} Id.
Determinative of factual issues raised by the winding-up petition, the court would likely be able to determine the petition purely based on issues that are not the subject of the arbitration agreement and determine the petition based on such issues.

**B. Insolvency Ground**

The most common ground for a compulsory winding-up at the instance of creditors is under Section 177(1)(d) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance, *i.e.*, if the company is unable to pay its debts. A company is deemed to be unable to pay its debts where its creditor served statutory demand on the company and the company failed to pay for three weeks.24 If a debtor-company fails to satisfy a statutory demand for payment of a debt, the creditor-petitioner may petition to wind up the debtor-company pursuant to Section 177(1)(d). Usually, the debtor-company may apply to (i) restrain the presentation of the winding up petition, or (ii) dismiss or stay the petition on the ground that there is a *bona fide* dispute on substantial grounds.25 It is not sufficient for the debtor-company to merely deny, without more, the existence of the debt. Where the court based on the traditional approach, is satisfied that there is such a genuine dispute, injunction will be granted to restrain the presentation of petition or the petition will be dismissed.26

However, when a contract from which the debt arises contains an arbitration agreement covering any dispute relating to the debt, the question whether the court can stay or dismiss the winding-up proceedings in favor of arbitration arises for consideration.

As detailed above, Harris J in *Quiksilver* held that a just and equitable winding-up petition should be stayed to allow the underlying dispute between the shareholders to be determined in accordance with the arbitration agreement, and which covered the subject matter of the complaints in the petition, although an arbitrator could not order the relief sought by the petitioner. Interestingly, in rendering such decision, Harris J distinguished between winding-up petitions on (i) a just and equitable ground and (ii) an insolvency ground. For the latter, Harris J considered in the *obiter* that it is necessary for the court to be satisfied that a debtor-company has a *bona fide* defence on substantial grounds to the claim to the underlying debt before the petition will be stayed for arbitration.27 In Harris J’s view, this approach is consistent with the nature of winding-up

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26 *See generally* Re a Company No. 003079 of 1990 & Ors [1991] Ch 683 (Eng.).
27 *Quiksilver, supra* note 3, ¶ 18.
proceedings in the context of insolvency, *i.e.*, the creditor does not seek to recover the sum due to him under the agreement containing the arbitration clause; rather he seeks to put an insolvent company into liquidation for the benefit of all its creditors.\(^{28}\)

Harris J’s *obiter* in *Quiksilver* was consistent with previous authorities, *i.e.*, the interposition of an arbitration clause does not detract the debtor-company’s need to show a *bona fide* dispute on substantial grounds in its application to stay or dismiss a winding-up petition.\(^{29}\) Such position, however, has not been settled in Hong Kong. Harris J in a later case *Re Southwest Pacific Bauxite (HK) Ltd* (hereinafter “Lasmos”)\(^{30}\) departed from his own *obiter* in *Quiksilver* and previous authorities. Later, such departure was questioned on an *obiter* basis by the Hong Kong Court of Appeal (hereinafter “CA”) in *But Ka Chon v. Interactive Brokers LLC* (hereinafter “*But Ka Chon*”) and Deputy High Court Judge William Wong SC of the CFI in *Dayang (HK) Marine Shipping Co., Ltd v. Asia Master Logistics Ltd* (hereinafter “*Dayang*”).\(^{31}\)

1. Lasmos — Lasmos petitioned for the winding-up of Southwest Pacific Bauxite (HK) Ltd for failure to pay a debt under a statutory demand. The statutory demand related to a debt Lasmos alleged had arisen under a management services agreement which contained an arbitration clause.

In his judgement, Harris J concluded that previous Hong Kong authorities (including his *obiter* in *Quiksilver*) incorrectly assumed that, as a winding-up order is a class remedy, the normal consequences of the parties having agreed that any dispute between them be resolved by arbitration should not apply once the court’s insolvency jurisdiction is invoked.\(^{32}\) In Harris J’s view, a creditor issues a petition for the purpose of recovering his debt, not out of some altruistic concern for the creditors of the company generally.\(^{33}\) In this regard, there is a material distinction between the purpose for which a creditor presents a petition and the interests of the general class of unsecured creditors, who have an interest in a potential winding-up.\(^{34}\) The question of whether or not the debt is owed to the petitioner is not relevant to the question of whether a class remedy of winding-up order should be granted.\(^{35}\) On this basis, he found that the fact

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\(^{28}\) Id.
\(^{31}\) *Dayang*, supra note 4.
\(^{32}\) *Lasmos*, supra note 30, ¶ 24.
\(^{33}\) Id. ¶ 25.
\(^{34}\) Id.
\(^{35}\) Id. ¶ 27.
that the relief sought is a class remedy should not be relevant to the method of determining whether or not the debt in question is owed.\textsuperscript{36}

Harris J therefore concluded that save for exceptional cases the court should generally dismiss a winding-up petition:\textsuperscript{37}

1. if a company disputes the debt relied on by the petitioners;
2. the contract under which the debt is alleged to arise contains an arbitration clause that covers any dispute relating to the debt; and
3. the company takes the steps required under the arbitration clause to commence the contractually mandated dispute resolution process and files an affirmation demonstrating this. (hereinafter “Lasmos Approach”)

On the basis that Southwest Pacific Bauxite (HK) Ltd satisfied these conditions, Harris J dismissed the petition.

2. But Ka Chon and Dayang — Subsequent to the Lasmos case, in But Ka Chon, the CA expressed its reservation about the Lasmos Approach on an obiter basis. The CA raised its “reservation” on whether the discretion under the insolvency legislation should be excised only one way as set out in the Lasmos case. The CA’s reservation was based on the following factors: (i) a statutory right is conferred on a creditor to petition for bankruptcy or winding up on the ground of insolvency, and it is contrary to public policy to preclude or fetter the exercise of this statutory right; In this regard, the CA considered the Lasmos Approach is a substantial curtailment of a creditor’s statutory right;\textsuperscript{38} and (ii) the insolvency proceedings are not the means of enforcing a contract, that the petitioner invokes a class remedy available to all the creditors, that there is no adjudication as to the parties’ respective rights and liabilities as between themselves.\textsuperscript{39}

Despite its reservation on the Lasmos Approach, the CA did acknowledge that considerable weight should be given to the factor of arbitration in the exercise of the discretion, otherwise parties to an arbitration agreement would be encouraged to bypass the arbitration agreement and the arbitration legislation by presenting a winding-up petition.\textsuperscript{40} The CA also acknowledged that it may well be that insufficient weight had been given to the arbitration factor pre-Lasmos.

In the recent case of Dayang, Deputy High Court Judge William Wong SC of the CFI noted the importance of determining the correctness of the Lasmos Approach at the appellate level and made his observations on an obiter basis.

\textsuperscript{36} Id.
\textsuperscript{37} Id. ¶ 31.
\textsuperscript{38} But Ka Chon, supra note 2, ¶ 63.
\textsuperscript{39} Id. ¶ 69.
\textsuperscript{40} Id. ¶ 70.
The court acknowledged the importance of protecting contractual bargain, which is reflected by the policy behind the arbitration legislation.\textsuperscript{41} In the court’s view, however, the correct question to ask is whether the presentation of a winding-up petition \emph{per se} would amount to a breach of an agreement to resolve dispute by way of arbitration. In other words, does the presentation of a petition for winding-up entail a submission of a dispute for the determination and/or resolution by the courts?\textsuperscript{42} In this regard, William Wong SC stated that the court neither resolves nor determines disputes when hearing a petition for winding-up. Instead, disputes over the debt are only finally resolved upon determination by the liquidator, who will assess \emph{de novo} whether to accept proof of debt submitted by the petitioner.\textsuperscript{43} The court’s role is simply to consider the prospective merits and ascertain whether the debtor-company had proven a triable case on the defence.\textsuperscript{44} As such, a creditor does not, by the mere presentation of a winding-up petition, breach his obligation to arbitrate.\textsuperscript{45}

The court further commented that the \textit{Lasmos Approach} is antithetical to the nature of a discretion and represents an unprecedented fetter on the court’s discretion.\textsuperscript{46} He also considered that the \textit{Lasmos Approach} might also be prejudicial to the interests of creditor-petitioner as he might be deprived of all tangible remedies if the assets of the debtor-company have been dissipated by the time the action for debt (either through court proceedings or arbitration) has been completed.\textsuperscript{47}

Despite echoing the CA’s general reservation about the \textit{Lasmos Approach} in \textit{But Ka Chon}, William Wong SC did not agree with the CA’s public policy consideration. In his view, there is nothing against public policy for a creditor to voluntarily agree, by contract, to fetter its own rights to petition for winding-up of a debtor-company.\textsuperscript{48} In this regard, William Wong SC held among other things that (i) the relationship between a creditor and a debtor-company is defined by the scope of the contract not by statute and there is no reason why a creditor cannot voluntarily modify its right \emph{vis-à-vis} a company by way of an agreement;\textsuperscript{49} (ii) undertakings by creditors not to petition for winding-up have been accepted by the courts;\textsuperscript{50} (iii) Hong Kong courts do have the power to stay petitions for unfair prejudice and/or winding-up for just and equitable grounds until such time when the underlying substantial dispute have been resolved by arbitration,
which is also a “fetter” on shareholder’s rights to petition for unfair prejudice or winding-up; and (iv) it is erroneous to imply a non-derogable right to petition for winding-up from Section 179 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance as the provision is essentially procedural and permissive in nature.

Based on the above analysis, William Wong SC presented his view on the correct position:

1. Where a debtor-company intends to dispute the existence of a debt, it must show that there is a *bona fide* dispute on substantial grounds. It should not suffice for the debtor-company to merely deny the debt. This test would apply in all cases whether or not the debt had arisen from a contract incorporating an arbitration clause.

2. The existence of an arbitration agreement should be regarded as irrelevant to the exercise of discretion.

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

4. Where the creditor-petitioner petitions in circumstances where it knows there to be a *bona fide* dispute over the debt on substantial grounds, it runs the risk of being liable to pay the debtor-petitioner’s costs on an indemnity basis. It would also be at risk of liability under the tort of malicious prosecution.

3. Position in Hong Kong — Hong Kong’s position on the threshold of whether a petition to wind up a company on an insolvency ground should be dismissed or stayed in favor of arbitration remains unsettled. The Lasmos Approach that save in exceptional cases, the winding-up petition will be dismissed so long as the three requirements are satisfied, has not been formally overruled. Both the CA’s reservations on the Lasmos Approach in *But Ka Chon* and the CFI’s newly formulated position in *Dayang* were raised on an obiter basis, and thus technically lack binding force.

That said, if the CA gets the opportunity to formally rule on this issue, it may depart from the Lasmos Approach, given its own reservation on this approach expressed in *But Ka Chon*. However, whether the CA would confirm the newly formulated position in *Dayang*, and if not, what position would CA take, remain unclear.

In this regard, the fact that the CA in *But Ka Chon* and the CFI in *Dayang*, despite both having questioned the Lasmos Approach, disagreed on public policy as a relevant factor further fuels the uncertainty of Hong Kong’s position. It is important to bear in mind that the position formulated

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51 Id. ¶ 122.
52 Id. ¶ 123.
in *Dayang* did not take public policy as a relevant consideration. It remains to be seen, if the CA in a later case follows its *obiter* in *But Ka Chon* and confirms the relevance of public policy in formulating Hong Kong’s position, whether the position formulated in *Dayang* would be amended by the CA as a result.

Notwithstanding the foregoing, in order for the court to dismiss a winding-up petition on an insolvency ground, whether the arbitration proceedings have commenced would likely be a relevant consideration. This is the third requirement under the *Lasmos* Approach and was regarded as relevant consideration in both *But Ka Chon* and *Dayang*. The consensus under various approaches appears to be that if the debtor-company has not commenced an arbitration for the disputed debt when the creditor-petitioner issued a winding-up petition, the court would be unlikely to dismiss the petition in favor of arbitration.

### IV. POSSIBLE COHERENT POSITION IN THE WINDING-UP PROCEEDINGS

#### A. Two Competing Factors

As demonstrated above in Section III, in determining whether a petition to wind up a company should be stayed or dismissed in favor of arbitration, the different positions adopted by Hong Kong courts appear to be driven by the courts’ focuses on either the nature of the relief sought by the petitioner or the substance of the underlying dispute.

For a just and equitable petition, Hong Kong courts’ focus was on the latter. Whether or not the precise relief sought, *i.e.*, a winding-up order, is not available from an arbitrator is not a relevant consideration and the correct approach is to identify the substance of the dispute between the parties and ask whether or not that dispute is covered by an arbitration agreement.53

For a winding-up petition on an insolvency ground, Hong Kong courts’ focus varied in different cases, resulting in inconsistent positions.

Pre-*Lasmos*, the courts’ focus was on the relief sought by the petitioner and less weight was given to the nature of the underlying dispute and the agreement between the parties as to how any dispute between them is to be resolved. This approach focuses on what a creditor is doing when presenting a petition, namely, invoking a class right to have an insolvent company wound up. The underlying logic behind this approach is that the nature of winding-up proceedings is that the creditor does not seek to recover the sum due to him under the agreement containing an arbitration

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53 *Quiksilver*, supra note 3, ¶ 22.
clause; rather he seeks to put an insolvent company into liquidation for the benefit of all its creditors.\textsuperscript{54} Following this line of reasoning, whether or not the dispute over the unpaid debt is covered by an arbitration agreement is of less relevance, as long as the court is satisfied that the company is insolvent.

Harris J in \textit{Lasmos} took a different approach and considered that the focus placed on just and equitable petitions, \textit{i.e.}, substance of the underlying dispute, should also be relevant in the insolvency context.\textsuperscript{55} He stated that although it is correct to say winding-up petitions are not the means of enforcing a contract, but this statement is misleading. In his view, a petitioner is seeking to recover a debt. He does not do so by suing for a judgement, he does so by invoking the court’s insolvency jurisdiction, which will allow him to prove for the debt in a liquidation. The difference between the two routes does not go to the substantive nature of what the petitioner is seeking. The question of whether or not a winding-up order should be made is not arbitrable. But it does not follow that a dispute between a petitioner and a company over a debt relied on to establish \textit{locus} to present a winding-up petition is not.\textsuperscript{56} On this basis, he found that the fact that the relief sought is a class remedy should not be relevant to the method of determining whether or not the debt in question is owed.\textsuperscript{57}

The CA in \textit{Bu Ka Chon} did not appear to address the fundamental argument of the \textit{Lasmos} Approach, \textit{i.e.}, since the substantive nature of what a petitioner is seeking is to recover a debt, upon which the petitioner relies to present a winding-up petition, the dispute over the debt should be resolved by the method agreed by the parties. Instead, the CA appeared to switch the focus back to the relief sought, considering that it is contrary to public policy to fetter the exercise of the statutory right to petition for winding up on the ground of insolvency\textsuperscript{58} and endorsing the pre-\textit{Lasmos} Approach which focuses on the insolvency proceedings being an invocation of a class remedy available to all the creditors.\textsuperscript{59}

William Wong SC in \textit{Dayang}, however, addressed the fundamental argument of the \textit{Lasmos} Approach directly. In William Wong SC’s view, the parties’ contractual bargain—their agreement to resolve their dispute by way of arbitration—needs to be respected. But the question is—does the presentation of a petition for winding-up entail a submission of a dispute for the determination and/or resolution by the courts, hence amounting to a breach of the parties’ agreement to resolve dispute by way of arbitration?\textsuperscript{60}

\textsuperscript{54} \textit{Id.} ¶ 18.

\textsuperscript{55} \textit{Lasmos, supra} note 30, ¶ 12.

\textsuperscript{56} \textit{Id.}

\textsuperscript{57} \textit{Id.} ¶ 27.

\textsuperscript{58} \textit{But Ka Chon, supra} note 2, ¶ 63.

\textsuperscript{59} \textit{Id.} ¶ 69.

\textsuperscript{60} \textit{Dayang, supra} note 4, ¶ 71.
The answer is a clear no, as the dispute over the debt is not determined by the court when hearing a petition for winding-up, but by the liquidator, who assess de novo whether to accept proof of debt submitted by the petitioners. The court’s role is simply to ascertain whether the debtor-company has proven a triable case on the defence. Since presenting a winding-up petition would not amount to a breach of the creditor’s obligation to arbitrate, it is not necessary for the court to refer the parties’ underlying dispute to arbitration.

**B. Possible Coherent Approach**

If Hong Kong courts continue to swing between the two competing factors (nature of the relief sought and substance of the underlying dispute), the uncertainty of Hong Kong’s position as to whether a petition to wind up a company should be dismissed or stayed in favor of arbitration would likely remain unresolved. As detailed above in Section IV. A., the courts’ emphasis on the competing factors in different cases has resulted in contradictory positions.

Instead, for the following reasons, Hong Kong courts should focus on identifying the substance of the dispute between the parties in both just and equitable petitions and the insolvency petitions, hence providing a coherent approach in winding-up proceedings.

For starters, relying on the nature of the relief sought, i.e., a winding-up order, to formulate the courts’ position on whether or not to stay or dismiss winding-up petitions in favor of arbitration is not satisfactory for both just and equitable petitions and insolvency petitions.

In an insolvency context, the pre-Lasmos approach and the CA in But Ka Chon took the view that when a creditor presents a petition, he is invoking a class right to have the insolvent company wound up and he is not seeking to recover the sum due to him but rather to put an insolvent company into liquidation for the benefit of all its creditors. Thus, a petition to wind up a company on an insolvency ground will not be stayed to arbitration. However, this argument is hardly genuine. It artificially places an altruistic concern that does not necessarily exist into a creditor-petitioner. It should be apparent and uncontroversial that although all the creditors of a company would potentially be affected by a winding-up petition, a petitioner is most likely only seeking to recover his own debt by presenting the petition.

In a just and equitable petition, Harris J in Quicksilver argued that “class” interest is normally limited in a just and equitable petition to two

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61 Id. ¶ 71-72, 76.
62 Id. ¶ 72.
63 Quicksilver, supra note 3, ¶ 17-18; But Ka Chon, supra note 2, ¶ 69.
shareholders that are parties in the dispute.\footnote{Quicksilver, supra note 3, ¶ 19.} Admittedly, in Quicksilver, the “class” interest concerned was only limited to the two parties in the dispute as the joint ventures only had these two shareholders. However, this argument appears to ignore the fact that there are cases where a company has more shareholders than the two who were in dispute and subject to an arbitration agreement. For example, a dispute can arise from a shareholders agreement incorporating an arbitration clause between two shareholders; while the company has many other shareholders that are not parties to that shareholders agreement. All shareholders’ interests would unavoidably be affected once a winding-up order is issued based on the dispute arising out of the shareholder agreement between two shareholders.

A genuine view should be that there is no material difference between these two types of petitions in terms of the nature of the relief sought. Both would potentially affect third parties that are not privy to the arbitration agreement although the petitioner’s concern would most likely be to protect his own interests. Bearing in mind this genuine view, there appears to be no justifiable reason to differentiate approaches under these two grounds. The general approach adopted in just and equitable petitions, which is relatively certain under Hong Kong law, should thus be extended into the insolvency context. That is to say, the fact that precise relief sought, i.e., a winding-up order, is not available from an arbitrator should not be a relevant consideration in the insolvency context and the correct approach is to identify the substance of the dispute between the parties in a winding-up petition and ask whether or not that dispute is covered by an arbitration agreement.

However, extending the same approach for a just and equitable petition into an insolvency context does not mean that the court should always dismiss a creditor’s winding-up petition and refer the dispute over the debt to arbitration. The first step is to identify what the “substance of the dispute” in a winding-up petition is and whether that dispute is covered by an arbitration agreement.

As William Wong SC pointed out in Dayang, the role of the court in a winding-up petition is not to resolve or determine the dispute over the debt. This issue is determined by the liquidator. The court’s role is simply to ascertain whether the debtor-company has proven a triable case on the defence. Accordingly, the “substance of the dispute” the court needs to determine in a winding-up petition is only limited to whether the debtor-company has proven a triable case. Since it is the determination and/or resolution of the dispute over the debt that is covered by an arbitration agreement, the court’s determination on whether the debtor has proven a triable case on the defence in insolvency proceedings would not be covered
by the arbitration agreement. Consequently, it would not be necessary for the court to dismiss the petition and to refer the parties to arbitration.

Following this line of reasoning, the issue of whether to refer the dispute over the debt to arbitration would potentially arise when the liquidator rejects a proof of debt submitted by the petitioner. William Wong SC in *Dayang* acknowledged that this issue remains untested in Hong Kong but noted the Australian position that a liquidator could be bound by an arbitration clause between the debtor-company and the creditor-petitioner insofar as the liquidator’s rejection of proof is based on the general law because the liquidator who defends his decision to reject a proof is cast in the role of an adversary in defending the assets available for distribution.\(^{65}\) If same approach is adopted in Hong Kong, the argument that a court, by allowing a petition for winding-up would frustrate the parties’ agreement to arbitrate would be futile, given that the dispute can still be referred to arbitration following the rejection of the proof of debt.\(^{66}\)

On the other hand, the “substance of the dispute” in a just and equitable petition is not on the basis of a triable case. The court would need to determine and/or resolve the underlying dispute between shareholders in order to decide whether the company could be wound up on a just and equitable ground. If such dispute is covered by an arbitration agreement, the court would likely be willing to give effect to the arbitration agreement, and allow the winding-up petition to be stayed in favor of arbitration.

Thus, a coherent approach is possible if Hong Kong courts, in deciding whether or not to stay or dismiss a winding-up petition in favor of arbitration, focus on the substance of the dispute *in the petition* and whether that dispute is covered by an arbitration agreement (emphasis added). The actual position would then depend on what the court is asked to determine on the substance of the dispute in that particular petition and whether that determination has been assigned to arbitrators by the parties’ agreement.

In a just and equitable petition, in order for the court to decide whether to wind up the company, it needs to evaluate the grounds raised by the petitioner, which might include certain disputes between shareholders. As such, the court would need to determine these disputes between the shareholders before it can make a decision on whether to issue a winding-up order. If the disputes between the shareholders are the subject of an arbitration agreement, the court would likely respect the parties’ agreement and stay the winding-up proceedings and refer the disputes to arbitration.

When hearing a petition for winding-up on an insolvency ground, the court only needs to determine whether the company-debtor has a triable case on the defence. The court does not need to make a decision on the

\(^{65}\) *Dayang*, supra note 4, ¶ 78 (citing *Tanning Research Laboratories v O’Brien* (1990) 169 CLR 332).

\(^{66}\) *Id.*
parties’ dispute over the debt. Thus, if the dispute over the debt is the subject of an arbitration agreement, the court’s determination in the winding-up petition would not frustrate the parties’ arbitration agreement. Consequently, without violating the principle of party autonomy, the court can proceed to wind up the company if it is not satisfied that the company-debtor has proven a triable case on the defence.

V. CONCLUSION

In Hong Kong, the legal position as to whether a petition to wind up a company may be stayed or dismissed in favor of arbitration appears to vary depending on the ground for the petition and remains unsettled.

This article argues that Hong Kong courts should focus on identifying the substance of the dispute between the parties in both just and equitable petitions and insolvency petitions, hence provide a coherent approach in the winding-up proceedings. Adopting this approach, however, does not mean that the court should always dismiss a creditor’s winding-up petition and refer the dispute over the debt to arbitration.

Under this coherent approach, Hong Kong courts, when deciding whether or not to stay or dismiss a winding-up petition in favor of arbitration, should focus on the substance of the dispute in the petition and whether that dispute is covered by an arbitration agreement (emphasis added). The actual position taken by the court would depend on what the court is asked to determine on the substance of the dispute in that particular petition.

In a just and equitable petition, as the court would need to determine the disputes between the shareholders in order to make a decision on whether to issue a winding-up order, the court would likely be willing to stay the petition in favor of arbitration if the shareholder dispute is the subject of an arbitration agreement.

In an insolvency petition, as the court is not required to determine the dispute over the debt but only whether the company-debtor has a triable case on the defence, the court should be less willing to dismiss the petition in favor of arbitration even if the dispute over the debt is the subject of an arbitration agreement.

The coherent approach could resolve the potential conflict between the policy concerns of the arbitration legislation and the statutory winding-up regime. It respects the principle of party autonomy to the extent that the statutory right of winding-up is not usurped.

By focusing on identifying the substance of the dispute, the coherent approach also provides a simplistic and consistent approach among different types of winding-up petitions. It further provides certainty to the parties in formulating their legal strategy prior to issuing a winding-up
petition. All they need to ask is (i) what kind of determination would the court make? (ii) Whether such determination is subject to an arbitration agreement?
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