

Insights

RECENT DECISION BY THE HONG KONG COURT OF APPEAL ON THE THRESHOLD FOR RESISTING A WINDING-UP PETITION BASED ON A DEBT OWED UNDER AN ARBITRAL AWARD

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SUMMARY

It is well-established in Hong Kong that the test for determining the validity of an opposition to a winding-up petition is whether the petition debt is disputed in good faith on substantial grounds. In *Sun Fung Timber Company Limited and 廣東順德展燁商貿有限公司* [2021] HKCA 1660, the Hong Kong Court of Appeal confirmed that the same test applies in respect of a petition debt that is based on an arbitral award.

BACKGROUND

The petition debt in question arose under an arbitral award (the Award) that concerned a contract for the sale of marble by Sun Fung Timber Company Limited (the Company) to 廣東順德展燁商貿有限公司 (the Petitioner). The Petitioner commenced arbitration against the Company after the Company allegedly failed to deliver the marble in accordance with the contract. The Award was made by consent four days after the arbitration was commenced, without full trial of merits. Under the Award, the Company was ordered to pay the Petitioner the sum of RMB 59 million and legal costs.

The Petitioner petitioned to wind-up the Company on the ground of the Company's non-payment of the debt owed under the Award. Upon receiving a letter from the Official Receiver regarding the petition, a shareholder-contributory of the Company (the Contributory) opposed the petition.

In December 2018, the High Court dismissed the petition on the basis that the Contributory successfully had demonstrated a *bona fide* case that the Contract was a sham transaction to deprive the Company of valuable assets.^[1] The Petitioner appealed against the dismissal.

DISMISSAL OF THE APPEAL

The Court of Appeal dismissed the Petitioner's appeal and provided guidance on various important legal issues, including the following:

- The applicable test for determining an objection to a winding-up petition based on an arbitral award.
- The nature of the court's power in winding-up proceedings to inquire into the validity of a judgment (or an arbitral award) on which the petition is based, and the extent of the court's review in exercising such power.
- Whether a winding-up petition based on an arbitral award, where there are pending proceedings to challenge the award, should be stood over rather than dismissed pending the outcome of the challenge proceedings.

APPLICABLE TEST WHERE A WINDING-UP PETITION IS BASED ON AN ARBITRAL AWARD

The Petitioner submitted that the court should apply the threshold of "real prospect of success" in determining an objection to a winding-up petition based on an arbitral award. Specifically, the Petitioner contended that the presentation of such a petition and the application for leave to enforce an arbitral award were "*two sides of the same coin*" and, therefore, the same threshold should apply.

Rejecting the Petitioner's submissions, the Court of Appeal held that the usual test of "*bona fide* dispute on substantial grounds" will apply even if the petition debt arises under an arbitral award. In particular, the Court of Appeal emphasised that winding-up petitions must not be abused for the purpose of debt collection and the court would exercise its winding-up jurisdiction only in very clear cases. Likewise, given that the presentation of a winding-up petition is the exercise of a class right and does not constitute an enforcement of an arbitral award, the Court of Appeal rejected the argument that the threshold for determining a winding-up petition based on an award debt should be the same as setting aside an arbitral award.

INQUIRY INTO THE VALIDITY OF THE JUDGMENT DEBT THAT FORMS THE BASIS OF THE PETITION

It is well-established that, in a winding-up proceeding, the court has the power to "go behind" a judgment and inquire into the validity of the judgment debt where there is evidence that the judgment is obtained by fraud, mistake, collusion or that there has been some miscarriage of justice.

As explained by the Court of Appeal, a judgment for a sum of money normally will be treated as *prima facie* evidence of indebtedness, and the court's inquiry is to assess whether such *prima facie* evidence of indebtedness is rebutted. Therefore, in its inquiry into the judgment debt, the court's role

is limited to assessing whether there is a *bona fide* dispute on the judgment debt based on the evidence available before it, and does not extend to making findings of fact in relation to fraud or collusion.

Accordingly, the Court of Appeal rejected the Petitioner's submission that the first instance judge had failed to consider that there was a high threshold for establishing allegations of fraud. The Court of Appeal held that there was sufficient evidential basis in this case to justify going behind the Award.

APPROPRIATE COURSE TO TAKE

The Petitioner submitted that the first instance judge should have (i) required the Company or the Contributory to take steps to set aside the Award in mainland China and (ii) ordered the petition to be stood over for the time being. The Court of Appeal refused to impose such an obligation because (among other things) the proposed requirement was inconsistent with the "choice of remedies" principle, which permits a party to choose between the passive remedy of resisting enforcement of an arbitral award in Hong Kong and the active remedy of setting aside the award in the supervisory court.

The Court of Appeal also pointed out that the dismissal of a winding-up petition does not prevent a petitioner from enforcing the underlying judgment or arbitral award in the usual way, and that there is no hard-and-fast rule for the court to stand over a winding-up petition where the underlying judgment or arbitral award is being challenged.

KEY TAKEAWAYS

The present judgment confirms that the applicable test for determining an opposition to a winding-up petition based on an arbitral award is whether there is a *bona fide* dispute on substantial grounds. This clarifies any uncertainty that previously might have existed as to whether a different, more stringent test would apply to such a petition.

There have been recent judicial developments internationally and in Hong Kong regarding the interaction between insolvency and arbitration proceedings. Specifically and as explored in [our previous post](#), Hong Kong courts have adopted varying approaches in exercising the discretion to dismiss or stay winding-up proceedings where a relevant arbitration clause exists. It remains to be seen whether and how the present judgment will contribute to such a wider discussion.

That said, the judgments speak with one voice in emphasising that the court's insolvency jurisdiction must not be misused (or abused) as a debt collection tactic. Therefore, creditors are reminded not to use winding-up proceedings as an improper means of exerting pressure to obtain payment of a disputed debt.

SUBSEQUENT DEVELOPMENTS

Pending the determination of this appeal, the Petitioner obtained an enforcement order in respect of the Award. Subsequently, and after obtaining leave to intervene in the enforcement proceedings, the Contributory applied successfully to set aside the enforcement order. We will discuss the setting aside judgment in [our next post](#).

[1] [2021] HKCFI 2756.

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