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Hong Kong Court refuses to grant an anti-suit injunction to stay a winding-up petition where an arbitration agreement existed

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The Hong Kong Court of First Instance has dismissed an application by a British Virgin Islands (BVI) company (C) for an interim anti-suit injunction against proceedings commenced by a Cayman Islands company (D) for the winding-up of the BVI company in the High Court of the BVI.

C's application in *C v. D* [2020] HKCU 2374 was unsuccessful despite the fact that C had commenced arbitration proceedings against D in relation to D's allegation against C for failure to buy back shares of a Cayman Island company, H, which formed the basis of D's winding-up proceedings against C in the BVI courts.

The background

C and D entered into a share sale and purchase agreement, which was subsequently amended (the agreement) in or around late December 2017, in respect of C's sale of H's shares to D. The agreement contained an arbitration clause, providing for arbitration in Hong Kong as administered by the Hong Kong International Arbitration Centre (HKIAC) in accordance with the HKIAC Procedures for the Administration of International Arbitration, in respect of "[a]ny disputes or claims arising out of or in connection with this Agreement".

Subsequently, a dispute arose out of a clause in the agreement, which gave D the right to require C to buy back H's shares if, inter alia, H had not completed an initial public offering (IPO) by the end of 2018. D exercised its right to require C to buy back H's shares in September 2019, when it was undisputed that H did not complete an IPO in 2018.

As C failed to buy back H's shares, D commenced winding-up proceedings against C in the BVI and to appoint liquidators on 4 March 2020 (BVI proceedings). The first hearing of those proceedings took place on 11 May 2020.

It was C's position that its buyback obligation was subject to the condition that the shares must be held by D and that, in late 2019, D had transferred those shares to third parties. As such, C initiated arbitration proceedings against D in Hong Kong on 16 June 2020 seeking to clarify that C was no longer obliged to buy back H's shares on the basis that they were no longer held by D.

On 19 June 2020 C filed a notice of an application in the BVI proceedings asking for the winding-up application to be adjourned to 27 July 2020 or, alternatively, to be stayed pending final

determination of the arbitration just commenced. On 22 June 2020 the BVI court granted a further adjournment of the substantive hearing of the BVI proceedings, but only to 13 July 2020.

On 7 July 2020 C issued an originating summons for anti-suit relief and an inter partes summons for interim anti-suit relief for the substantive hearing of the BVI proceedings fixed for 13 July 2020. The summons for the interim anti-suit relief was returnable on 10 July 2020. However, the application was only served on D after close of business on 8 July 2020.

The court's decision

C's application was dismissed on two major grounds, namely:

a) C's failure to satisfy the court to a high standard that its case was a proper case to grant an anti-suit injunction.

b) The late service of documents pursuant to Order 65, rule 7 of the Rules of the High Court (Cap 4A).

Where an interim anti-suit injunction is being sought on the basis of a contractual promise not to sue in a foreign jurisdiction, the applicant must show to a high probability that its case is right given the impact of the injunction if granted on the proceedings before the foreign court: *Giorgio Armani SpA v. Elan Clothes Co Ltd.* [2019] 2 HKLRD 313, paragraph 31.

C argued the urgency of the matter due to the upcoming substantive hearing in the BVI proceedings. However, the court opined that the urgency was self-induced because C had been aware of the July substantive hearing since 22 June 2020 but did not take out the summons for the anti-suit injunction until 7 July 2020. C's position was exacerbated by its late service of the judicial documents on D, which resulted in D's inability to file all the evidence it wished to place before the court if it had ample time.

Given the hearing for the BVI proceedings was to be held on 13 July 2020, comity was a consideration given the considerable wastage of resources that would be caused by such an injunction: *Ecobank Transnational Incorporated v. Tanoh* [2015] EWCA Civ 1309, quoted by the Honorable Madam Justice Kwan, JA in *Sea Powerful II Special Maritime Enterprises (ENE) v. Bank of China Ltd.* [2016] 3 HKLRD 352.

C's argument for the anti-suit injunction was substantively based on D's breach of the arbitration clause in the agreement by pursuing an application for winding-up in the BVI courts. D, in response, submitted that an application for winding-up was not seeking to "finally resolve" any disputes in connection with the agreement, and that to commence a winding-up proceeding in C's place of incorporation was D's statutory right under BVI law.

Although the merits of D's arguments were not considered by the court, they were sufficient in proving the case was not plainly in C's favor. Hence, C did not satisfy the court to a high standard, as stipulated in Giorgio Armani, that its case was right.

On account of the reasons above, the court dismissed C's application for an anti-suit injunction.

Practical implications

An injunction is a coercive remedy and an anti-suit injunction is a particularly intrusive form of relief, barring a party from access to justice in the forum that it would prefer.

The Hong Kong courts are arbitration friendly and, if the parties have agreed on resolving their disputes by arbitration, are willing to grant anti-suit injunctions to give effect to what the parties have agreed (*Ever Judger Holding Co Ltd. v. Kroman Celik Sanayii Anonim Sirketi* [2015] 2 HKLRD 866).

There are two interesting points arising out of *C v. D*: first, how comity and delay affect an application for an anti-suit injunction; and secondly, the interplay between a winding-up petition and an arbitration clause.

Delay may be fatal, and comity is relevant too

An injunction is an equitable remedy. English and Hong Kong courts in previous cases have emphasised that delay in making an application alone may be a sufficient ground for refusing an anti-suit injunction, even without the comity considerations — see for example, *Essar Shipping Ltd. v. Bank of China Ltd.* [2015] EWHC 3266 (Comm).

In *Sea Powerful II*, the Hong Kong Court of Appeal was of the view that delay and comity are related (referring to *BNP Paribas SA v. Open Joint Stock Company Russian Machines* [2012] EWCA Civ 644 at paragraph [66]: "the question of delay and that of comity are linked").

The subject of delay and comity was discussed at some length in *Ecobank*, and considered by the Hong Kong Court of Appeal in *Sea Powerful II*.

Before granting an anti-suit injunction, the court must consider whether it is appropriate to do so having regard to all relevant considerations, which will include the extent to which the respondent has incurred expense prior to any application being made, the interests of third parties, including, in particular, the foreign court, and the effect of making such an order in relation to what has happened before it was made.

Whether the party seeking an injunction has acted with appropriate speed is related to comity in two ways:

- The longer a respondent continues doing that which the applicant (to an anti-suit injunction) seeks to prevent it from doing, the greater the amount of labor and cost that it will have expended which could have been avoided.
- If foreign courts have held hearings and produced judgments, this is a consideration in a court refusing to exercise its discretion in granting an injunction even though there was an arbitration agreement (see for example *Sea Powerful II*).

The longer an action continues without any attempt to restrain it, the less likely a court is to grant an injunction and considerations of comity have greater force (*Sea Powerful II*).

In *C v. D*, the court observed that the parties as well as the BVI court might well have been preparing for the hearing that was due to take place in three days' time, and it would be a very strong thing for the court to grant an injunction on the eve of that hearing to bring it to a grinding halt. In those circumstances the court had to be satisfied to a high standard that C's case was right before granting any such interim injunction.

Interaction between arbitration and winding-up

Parties to a Hong Kong seated arbitration can apply to the Hong Kong courts for an anti-suit injunction to enforce their contractual bargain if one of the parties commences court proceedings abroad, under section 45(2) of the Arbitration Ordinance, section 21L of the High Court Ordinance (for an application of the principles see: Ever Judger). This is to enforce the

contractual bargain that the parties agreed on — namely to resolve their disputes by arbitration. The situation is more complicated if those court proceedings entail the presentation of a winding-up petition.

The Hong Kong courts have previously upheld the contractual bargain of the parties to arbitrate by dismissing a winding-up petition (*Southwest Pacific Bauxite (HK) Ltd.* [2018] 2 HKLRD 449 (the Lasmos case)). Under this approach, a debtor company was no longer required to show a bona fide dispute on substantial grounds when applying to stay or dismiss winding-up proceedings.

Save in exceptional cases (where the petition would be stayed), a winding-up petition would be dismissed as long as three requirements were met: (a) the debtor disputes the debt relied on by the winding-up 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 debtor company takes the steps required under the arbitration agreement 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 (Lasmos).

However, from the perspective of creditors, this is a potential barrier to winding up a company if there is a liquidated debt and the agreement giving rise to the debt contains an arbitration clause. The position changed with more recent Hong Kong judgments that 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 (*But Ka Chon v. Interactive Brokers LLC* [2019] 4 HKLRD 85; *Asia Master Logistics Ltd.* [2020] 2 HKLRD 423).

One of the arguments made by D is that by commencing and pursuing an application for winding-up in the BVI, D was not seeking to have any dispute arising out of or in connection with the contract "finally resolved" and determined otherwise than by way of arbitration, and was therefore not in breach of the arbitration agreement. Accordingly, it was argued by D that the principles relied upon by C for an anti-suit injunction, based on a breach of the arbitration agreement, were not applicable to the present case.

Furthermore, D argued that the initiation of winding-up proceedings against C in its place of incorporation was a statutory right that D enjoyed under BVI law that should not be readily fettered by an anti-suit injunction. In *C v. D*, the court did not find it necessary to decide these points but commented that the matter did not seem to be so plainly in C's favor that an interim injunction should be granted.

Proceedings precluded?

Is a court precluded from proceeding with a winding-up petition if a dispute is governed by an arbitration clause? There has been a divergence of approaches adopted by different jurisdictions.

In the United Kingdom, where a debt subject to an arbitration agreement is not admitted, the court should stay or dismiss the winding-up petition in favor of arbitration unless there are wholly exceptional circumstances (*Altomart Ltd. v. Salford Estates (No 2) Ltd* [2014] EWCA Civ 1575).

In Hong Kong an arbitration agreement does not protect a company from winding-up — the mere existence of an arbitration agreement is regarded as irrelevant to the exercise of the court's discretion to make a winding-up order (Asia Master Logistics Ltd.).

The debtor in *Asia Master Logistics Ltd.* did not dispute the unpaid debt on which the winding-up petition was premised, but instead alleged a counterclaim. The court held that in order to

validly oppose the winding-up petition, the debtor must show that its counterclaim gives rise to a bona fide dispute on substantial grounds.

So, the current law in Hong Kong is where a debtor intended to dispute the existence of a debt, it must show that there was a bona fide dispute on substantial grounds. It could not merely deny the debt. This test applied whether or not the debt had arisen from a contract incorporating an arbitration clause, and the existence of an arbitration agreement was irrelevant to the exercise of the discretion. The fact that arbitration proceedings had or would be commenced may be relevant evidence of a bona fide dispute on substantial grounds, but this alone was not sufficient to prove such dispute.

Furthermore, the court in *Asia Master Logistics Ltd.* held that the presentation of a petition for winding-up did not entail a submission of a dispute for the determination and/or resolution by the Companies Courts. They neither resolve nor determine disputes when ruling on a creditor-petitioner's locus to wind-up a debtor-company. Instead, disputes over the debt are only finally resolved upon determination by the liquidator (subject to the possibility of appeal).

Given that a creditor-petitioner was only obliged by an agreement to arbitrate to submit to arbitration for resolution or determination, the presentation of a winding-up petition did not come within the scope of an agreement to arbitrate. The court was not obliged to stay or dismiss the winding-up proceedings as the mandatory stay proviso in section 20 of the Arbitration Ordinance only applied to actions and not to petitions for winding-up.

The creditor and debtor perspectives

The impact of COVID-19 will continue to batter economies around the world, increasing the likelihood of companies being in precarious financial distress. Parties to cross-border transactions will likely have agreed arbitration clauses to resolve their disputes, so the presentation of a winding-up petition and whether such a petition can be stayed by an anti-suit injunction will likely be encountered by creditors and debtors in future.

Creditors enjoy a statutory right to petition for winding-up of a company unable to pay its debts. As observed by the court in *Asia Master Logistics Ltd.*, the presentation of a winding-up petition can as a matter of practical reality put considerable pressure on the debtor to pay in lieu of arbitration, given the risk of reputational damage to the debtor-company arising from the commencement of the winding-up process. To that extent, there is a risk of debtor companies being strong-armed into settling disputes.

Winding-up proceedings are public compared to the private and confidential nature of arbitration. Furthermore, if compelled to establish the existence of a debt through arbitration, the creditor might be deprived of all tangible remedies if the assets of the debtor have been dissipated by the time the action for debt has been completed by arbitration. From the perspective of creditors, *C v. D* is a welcome judgment.

From a debtor's perspective, if there is a bona fide dispute on substantial grounds, they can still take their dispute to the agreed contractual forum to resolve by arbitration. It was undecided by the court in *C v. D* whether demonstrating to the court that there was a bona fide dispute on substantial grounds and acting without delay in applying for an anti-suit injunction where the foreign winding-up proceedings were not too advanced, would sway the court's discretion in granting one.

A debtor is also protected in circumstances where the creditor petitions 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's costs on an indemnity basis, and also be at risk of liability under the tort of malicious prosecution (*Asia Master Logistics Ltd*.).

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