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Hong Kong Court of Final Appeal Confirms That ‘Leverage’ Satisfies the ‘Benefit’ Requirement for Winding Up Foreign Companies

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The Hong Kong Court of Final Appeal (the **“CFA”**) [1] has recently confirmed that for the purpose of winding up foreign companies in Hong Kong, the requirement that the winding up must benefit the petitioner can include commercial pressure (in other words, leverage) to achieve the repayment of an undisputed debt.

The CFA’s reaffirmation of the threshold requirements for the court to exercise its jurisdictions, and in particular its clarification regarding the benefit requirement, is welcome. It demonstrates the court’s willingness in adopting a pragmatic approach in assessing whether it would be useful to entertain a winding-up petition in respect of a foreign company.

1. Factual Background and Procedural History in Hong Kong Courts

The Appellant was a PRC company listed in Hong Kong, and the Appellant and Respondent entered into a joint venture agreement. Following a dispute that led to an arbitral award against the Appellant, the Respondent served a statutory demand on the Appellant for the debt payable under the award. The Appellant failed to pay any part of the amounts demanded and sought an injunction to prevent the Respondent from presenting a winding-up petition as a creditor.

The Appellant’s case was that the Respondent could not satisfy the three core requirements for the court to exercise its jurisdiction to wind up a foreign-incorporated company when it is unable to pay its debts. The Appellant did not accept that the 2nd requirement was met, namely whether the winding-up order would benefit the petitioner. In particular, it did not accept that leverage (namely commercial pressure to achieve the repayment of an undisputed debt) could satisfy the 2nd requirement, as any benefit does not arise *“as a consequence of the winding-up order being made”*, but rather, would only be realised *“if the winding-up order is either avoided or discharged”*.

At the Court of First Instance, the Judge held that leverage created by the prospect of a winding-up petition constitutes sufficient benefit for the petitioner for the purposes of the 2nd requirement. The Court of Appeal upheld the Judge’s decision that there was a *“real possibility of benefit”* for the petitioner in making a winding-up order against the Appellant.

2. Nature of the Three Requirements for Winding Up Foreign-Incorporated Companies

The three *“core requirements”* previously approved by the CFA [2] which must be satisfied before a Hong Kong court will exercise its jurisdiction to wind up a foreign-incorporated company are that:

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There must be a sufficient connection with Hong Kong;

There must be a reasonable possibility that the winding-up order would benefit those applying for it; and

The court must be able to exercise jurisdiction over one or more persons in the distribution of the company's assets.

The CFA noted that the three requirements are not derived from statutory provisions and should not be approached through the ordinary rule of statutory construction. Rather, they are self-imposed judicial restraints on the exercise of the court's jurisdiction (discretion) but not on the existence of the jurisdiction (which is entirely statutory). The CFA therefore considered that it would be more appropriate to characterise these requirements as *"threshold requirements"* rather than *"core requirements"*.

3. "Benefit" under the 2nd Threshold Requirement

3.1. General Nature of 'Benefit' under the 2nd Threshold Requirement

The CFA held that a *"pragmatic approach"* should be adopted in assessing whether it would be useful to entertain a winding-up petition in respect of a foreign company. Whilst the benefit the petitioning creditors can rely on will vary case-by-case, the CFA made the following observations:

- There is no doctrinal justification for confining the relevant benefit narrowly to the distribution of assets by the liquidator in the winding up of the company;
- It is sufficient that the benefit would be enjoyed solely by the petitioner;
- There is also no doctrinal justification requiring the relevant benefit to come from the assets of the company;
- There are cases where even though there was nothing for the liquidator to administer, the courts did not find any difficulty in finding benefit so long as some useful purpose serving the legitimate interest of the petitioner can be identified;
- The benefit need not be monetary or tangible in nature; and
- The fact that a similar result could be achieved by other means does not preclude a particular benefit from being relied upon.

3.2. Leverage as a Legitimate Benefit

With this *"pragmatic approach"* in finding benefit in mind, the CFA held that leverage is a relevant benefit as it is a proper purpose for a creditor's winding-up petition. The benefit is derived from the invocation of the court's winding-up procedures. In finding leverage as a legitimate benefit, the CFA also made a few observations:

Undisputed/Disputed Debt

The distinction between disputed and undisputed debt is important. The presentation of a winding-up petition, where the debt is disputed, may amount to an abuse of process of the court given that there is often a real and substantial dispute of facts.

Statutory Demand Mechanism

Additionally, the CFA observed that the statutory demand mechanism [3] provides a convenient method for creditors to seek repayment of an undisputed debt through presenting a winding-up petition. Non-compliance with the statutory

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demand operates as conclusive proof of the company's inability to pay its debts (irrespective of whether the company is, in fact, insolvent) for the purpose of establishing the court's jurisdiction to make a winding-up order, and the CFA observed that case law recognises the propriety of the use of a winding-up petition as a means of applying commercial pressure to seek payment of undisputed debt. Thus, there is no reason to exclude leverage as a relevant benefit under the 2nd requirement.

"Real" Leverage

The CFA also held that the leverage must be "real" and its significance depends on the potential impact of a winding-up order. Where the foreign company has no incentive to avoid a winding-up order, there is not much leverage. However, in this case, the leverage stemmed from the adverse consequences on the listing status of the foreign company which the court found to be real and significant.

4. Comity Argument: *Forum Conveniens Only a Factor but Not a Requirement*

The Appellant also raised a further comity argument arguing that winding up a foreign company is only justified when the jurisdiction of incorporation cannot fulfil its function making it necessary to *"fill the lacuna"*. The CFA observed that the Appellant was attempting to impose an additional requirement for the court to exercise its jurisdiction and held that if sufficient connection is established under the 1st requirement, any such *forum conveniens* issue should only be a factor (rather than an essential requirement) that the court can consider in deciding if a winding-up order should be made.

5. Conclusion

It is clear from the CFA's judgment that for the purpose of winding up foreign companies in Hong Kong, the 2nd requirement that the winding up must benefit the petitioners can include commercial pressure to achieve the repayment of an undisputed debt.

On the other hand, the CFA also usefully clarifies that whilst the court is prepared to adopt a pragmatic approach, any such leverage must be real and significant and that contrary to the view of the Court of First Instance, any moderation of this 2nd requirement is not appropriate.

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[1] *Shandong Chenming Paper Holdings Limited v Arjowiggins HKK 2 Limited* [2022] CFA 11. A copy of the judgment of the Court of Final Appeal is available here. The judgment in the Court of Appeal ([2020] HKCA 670) is available here. The judgment in the Court of First Instance (HCMP 3060/2016) is available here.

[2] In *Kam Leung Sui Kwan v Kam Kwan Lai* (2015) 18 HKCFAR 501, more commonly referred to as the *"Yung Kee"* case.

[3] Section 327(4)(a) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap.32). Under this section, a company is deemed unable to pay its debts if the company has failed to respond satisfactorily to a creditor's written demand (by way of payment or otherwise) after 3 weeks of its service.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact the Gibson Dunn lawyer with whom you usually work, or the authors and the following lawyers in the Litigation Practice Group of the firm in Hong Kong:

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