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## HONG KONG COURT CLARIFIES APPLICATION OF THE GUY LAM APPROACH TO ARBITRABLE CROSS-CLAIMS

To Our Clients and Friends:

In the recent decision of *Re Shandong Chenming Paper Holdings Ltd* [2023] HKCFI 2065[1] (“*Re Shandong*”), the Court of First Instance (the “CFI”) held that the principle in *Guy Kwok-Hung Lam v Tor Asia Credit Master Fund LP* [2023] HKCFA 9[2] (“*Guy Lam*”) (namely, that the Court will generally dismiss a bankruptcy petition where the debt under dispute was subject to an exclusive jurisdiction clause (“EJC”)) was equally applicable where the debtor had raised a cross-claim, in an amount exceeding the petitioning debt, which was subject to an arbitration agreement.

### **1. Background**

On 15 June 2017, Arjowiggins HKK 2 Limited (the “**Petitioner**”) issued a petition (the “**Petition**”) seeking the winding up of Shandong Chenming Paper Holdings Limited (the “**Company**”) on the grounds of insolvency arising from non-payment of an arbitration award (the “**Award**”).

On 20 June 2022, the Company commenced an arbitration against the Petitioner (the “**2nd Arbitration**”) advancing claims under the same agreement which had given rise to the arbitration that resulted in the Award (the “**Cross-Claim**”). The amount of the Cross-Claim exceeds the debt established by the Award. The substantive hearing of the 2nd Arbitration is due to take place in May 2024.

On 25 October 2022, the Company issued an application seeking the dismissal or adjournment of the Petition. The Company argued that, as the amount of the Cross-Claim exceeds the debt established by the Award and such Cross-Claim will be determined in an arbitration, the Petition should be dismissed or stayed.

### **2. The CFI’s Decision**

As noted in our previous article, the Court of Final Appeal (the “CFA”) in *Guy Lam* held that where the underlying dispute of the petition debt was subject to an EJC, the court should generally dismiss the petition absent countervailing factors and the determination of whether the debt was *bona fide* disputed on substantial grounds was a threshold question which might or might not be engaged when the Court decided whether to exercise its bankruptcy jurisdiction; in such circumstances, the debtor is not required to demonstrate a *bona fide* defence on substantial grounds in order to defeat the petition.

The issue in *Re Shandong* was whether the same principle applies in the context of an arbitrable cross-claim raised by the debtor against the petitioner.

The CFI held that the same principle applies in these circumstances – the Court should therefore dismiss or stay a petition where the debtor has raised a cross-claim that is subject to an arbitration clause which exceeds the amount of the petition debt. The CFI examined the relevant authorities and observed that:

- a. As a general principle of insolvency law, in examining whether the debtor can establish a defence to a winding-up petition, no distinction is drawn between a claim and a cross-claim.
- b. The Singapore Court of Appeal in *AnAn Group (Singapore) Pte Ltd v VTB Bank (Public Joint Stock Co)* [2020] SGCA 33 had examined this issue and held that “when a court is faced with either a disputed debt or a cross-claim that is subject to an arbitration agreement, the prima facie standard should apply, such that the winding-up proceedings will be stayed or dismissed as long as (a) there is a valid arbitration agreement between the parties; and (b) the dispute falls within the scope of the arbitration agreement, provided that the dispute is not being raised by the debtor in abuse of the court’s process”. Such a decision is consistent with the established principles.
- c. Even though the Petitioner argued that there is no merit in the Cross-Claim, it did not go so far as to suggest that the Cross-Claim obviously constituted an abuse of process such that the Court should disregard the Company’s objection. Merits of and delay in bringing the Cross-Claim are not of themselves capable of bringing a case within that category.
- d. Nothing in the CFA’s judgment in *Guy Lam* suggested that a defence and a cross-claim should be treated differently or should engage different principles. The CFI should not be invited to strain to find ambiguities in appellate judgments.

Whilst the Court would normally dismiss the Petition in these circumstances, given the lengthy and torrid history of this particular case, the CFI considered it appropriate to stay the Petition so as to preserve the current date of presentation of the Petition in case it becomes relevant in the future.

### **3. Comments**

The CFI’s decision in *Re Shandong* provides welcomed clarity to the application of the approach in *Guy Lam*. In addition to clarifying that the *Guy Lam* approach extends to cross-claims raised by a debtor, the CFI helpfully confirmed that such approach applies to arbitration clauses (and not just EJs).

As such, when entering into commercial agreements, parties should bear in mind that the existence of EJs or arbitration clauses may have a material bearing on the conduct of winding-up or bankruptcy proceedings in Hong Kong.

[1] Available here.

[2] See our article on this judgment at: <https://www.gibsondunn.com/hong-kong-court-of-final-appeal-upholds-dismissal-of-bankruptcy-petition-debt-under-dispute-was-subject-to-exclusive-jurisdiction-clause/>.



*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 following authors in the firm's Litigation Practice Group in Hong Kong:*

*Brian W. Gilchrist OBE (+852 2214 3820, [bgilchrist@gibsondunn.com](mailto:bgilchrist@gibsondunn.com))*

*Elaine Chen (+852 2214 3821, [echen@gibsondunn.com](mailto:echen@gibsondunn.com))*

*Alex Wong (+852 2214 3822, [awong@gibsondunn.com](mailto:awong@gibsondunn.com))*

*Andrew Cheng (+852 2214 3826, [aocheng@gibsondunn.com](mailto:aocheng@gibsondunn.com))*

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