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Cross border insolvency – The Court of Final Appeal clarifies the second core requirement in Shandong Chenming case



Shandong Chenming Paper Holdings Limited v Arjowiggins HKK 2 Limited [2022] HKCFA 11 (date of judgment 14 June 2022)

Introduction

The three core requirements are the Court's self-imposed restraints which must be satisfied before the Court will exercise the statutory jurisdiction to wind up a foreign incorporated company. The last occasion in which the Court of Final Appeal (the "**CFA**") considered the three core requirements is the Yung Kee case. Disputes arising from winding up foreign incorporated companies in recent years are often related to the second core requirement. In this case, the CFA confirmed that the leverage created by the prospect of a winding-up (as opposed to the making of a winding-up order) is a legitimate form of benefit under the second core requirement.

The three core requirements

The Court's jurisdiction to wind up a foreign incorporated company under statute¹ is discretionary, and the three core requirements are the Court's self-imposed restraints relevant to the exercise of such discretion.

The three core requirements as approved by the CFA in the case of *Kam Leung Siu Kwan v Kam Kwan Lai* (2015) 18 HKCFAR 501 (the "**Yung Kee case**") (see our previous article [here](#)) are as follows:

1. There must be a sufficient connection with Hong Kong, but this does not necessarily have to consist in the presence of assets within the jurisdiction;
2. There must be a reasonable possibility that the winding up order would benefit those applying for it; and
3. The court must be able to exercise jurisdiction over one or more persons in the distribution of the company's assets.

In *Re China Medical Technologies Inc* [2018] HKCA 111, the Court of Appeal concluded that the third core requirement could be dispensed with in a suitable case². That conclusion was based on the obiter expressed by the Court of Final Appeal in the *Yung Kee case* that the second core requirement is always essential and often sufficient.

Background of the case

Shandong Chenming Paper Holdings Limited ("**Shandong Chenming**") is a PRC company listed in both Shenzhen and Hong Kong. It is a registered non-Hong Kong company but has no assets and/or business in Hong Kong. Based on an arbitral award which the Court had granted leave to be enforced in Hong Kong, Arjowiggins HKK 2 Limited ("**Arjowiggins**") served a statutory demand on Shandong Chenming. Shandong Chenming then sought an interim injunction to prevent Arjowiggins from presenting a winding up petition. When the injunction application failed, leave was granted to allow the application to be amended to seek a declaration that the three core requirements were not satisfied. There is no dispute that the first and third core requirements are satisfied and the only issue is the second core requirement. The declaration, if granted, would effectively restrain Arjowiggins from issuing a winding up petition against Shandong Chenming in Hong Kong.

Shandong Chenming was able to show it was solvent with substantial assets and business in the PRC. It did not dispute that the arbitral award was payable, and only contended that the second limb of the three core requirements was not satisfied (namely that Arjowiggins would benefit from a winding up order in Hong Kong). It argued that a Hong Kong liquidator would achieve nothing of value in the PRC and that a winding up order in Hong Kong would be a futile exercise. It argued that the proper course for Arjowiggins would be to enforce the arbitral award in the PRC.

Harris J held that (1) the Arjowiggins's leverage against Shandong Chenming arising out of the prospect of a winding up order is capable of satisfying the second core requirement; and (2) the circumstances of the case would justify moderation of that requirement. Please see our previous client alert on Harris J's decision (see our previous article [here](#)).

¹ The statutory jurisdiction of the Hong Kong Courts to wind up a foreign incorporated company is found in sections 327(1) and (3) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32)

² Based on the view expressed by the Court of Final Appeal in *Kam Leung Siu Kwan v Kam Kwan Lai* (2015) 18 HKCFAR 501

The Court of Appeal (Barma JA delivering the judgment) agreed with Harris J that there was a real possibility of benefit to the respondent in the making of a winding-up order against Shandong Chenming, but does not agree that the second core requirement was capable of moderation. Please see our previous client alert on the Court of Appeal's decision (see our previous article [here](#)).

In light of Harris J's decision, Arjowiggins presented a winding up petition against Shandong Chenming. The winding up petition was adjourned upon Shandong Chenming's undertaking to procure a third party to make a payment into Court for the sum due under the statutory demand with interest.

Decision of the CFA

The question of law before the CFA

Should the Hong Kong Court exercise its winding-up jurisdiction over foreign companies on the basis that a "benefit" is made out under the second core requirement if such "benefit" does not arise as a consequence of the winding-up order being made, but rather, would only ever be realized if the winding-up order is either avoid or discharged?

Shandong Chenming's arguments:

- (1) **Need for the making of a winding up order argument:** The benefit must result from the making of a winding up order³, and the nature of the benefit must be property which is money or something convertible to money, rather than an intangible benefit; and
- (2) **Comity argument:** The core requirements are jurisdictional restraints based on comity and the concomitant presumption against extra-territoriality. Hence, the proper interpretation of the core requirements must be informed by their limitations and the principle of non-interference. In particular, comity militates against leverage as a proper benefit.

What benefit can a petitioning creditor rely on to satisfy the second core requirement?

The CFA explained that the benefit that a petitioning creditor can rely upon to satisfy the second requirement will vary from case to case. Upon considering a series of English and Hong Kong authorities, the CFA made the following observations:

- (a) 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;
- (b) It is sufficient that the benefit would be enjoyed solely by the petitioners;

³ The principle basis of this argument is paragraph [24] of the Yung Kee decision which provides that "...there is a reasonable prospect that the petitioner will derive a sufficient benefit from the making of a winding-up order, whether by the distribution of its assets or otherwise, will always be necessary and will often be sufficient."

- (c) There is also no doctrinal justification requiring the relevant benefit to come from the assets of the company;
- (d) There are cases where even though there was nothing for the liquidator to administer the courts did not find any difficulty in holding that the second requirement was satisfied so long as some useful purpose serving the legitimate interest of the petitioner can be identified;
- (e) The benefit need not be monetary or tangible in nature; and
- (f) The fact that a similar result could be achieved by other means does not preclude a particular benefit from being relied upon for the purposes of fulfilling the second requirement.

The CFA's answer to the question

The CFA's unanimous judgment was delivered jointly by Lam PJ and Fok PJ. The CFA answered the question of law in the affirmative and explained that:

- (1) Benefit does not necessarily have to flow directly from the making of a winding up order
 - (i) The statutory demand mechanism is an important basis for establishing the jurisdiction to petition for the winding up of a company. As commercial pressure to achieve the repayment of an undisputed debt is an entirely proper purpose for a creditors' winding-up petition, there is no basis for excluding commercial pressure as a relevant benefit for the purposes of the second core requirement.
 - (ii) The Court in Yung Kee examined the consequences of the making of a winding-up order because the case was a shareholders' petition to wind up a company on the just and equitable grounds, the focus of which is different from that of a creditor's petition.
 - (iii) The essential consideration is whether a reasonable possibility exists of a sufficient benefit accruing to the petitioner from being permitted to set in motion winding-up procedures in Hong Kong in respect of a non-Hong Kong company. That benefit will exist when setting those procedures in motion result in payment of an undisputed debt. Benefit does not necessarily have to flow directly from the making of a winding up order.
 - (iv) Since the requirement of benefit is to ensure that some useful purpose will be served, there is no justification in principle to exclude significant leverage benefit arising as an incident to the presentation of a petition from the assessment of the second requirement even though such benefit may also have a useful impact prior to the making of the winding-up order. If the appellant remained recalcitrant, the leverage would continue to have an effect after the making of a winding-up order.

- (2) There is no issue of comity
- (i) The second requirement only comes into play after sufficient connection (i.e. the first requirement) is established and it addresses the utility of winding-up proceedings in respect of foreign as well as domestic companies. Comity is obviously relevant in the assessment of the first requirement, but it has less relevance under the second requirement.
 - (ii) While comity may arise if the benefit relies on by a petitioner depends on the liquidator exercising his authority in a foreign jurisdiction, this is not the situation in the present appeal. As the leverage in the present case hinges on the potential impact on the listing of the shares, there is no possible issue of comity.

The CFA agrees with both the Court of First Instance and the Court of Appeal that the second core requirement is satisfied in this case, but considered the benefit is derived from the invocation of the court's winding-up procedures over the Shandong Chenming by Arjowiggins presenting the petition. The CFA does not agree that the second core requirement can be moderated.

The CFA dismissed the appeal and order that the sum paid into Court by Shandong Chenming together with accrued interest be paid out to Arjowiggins.

Takeaway points

1. This is the first CFA case after Yung Kee which considered the three core requirements.
2. The CFA confirmed that the leverage created by the prospect of a winding-up (as opposed to the making of a winding-up order) is a legitimate form of benefit under the second core requirement, and that the second core requirement cannot be moderated. It is a welcoming decision for creditors that the test for the second core requirement is a low one.
3. In appropriate circumstances, foreign companies with sufficient connection to Hong Kong (even though without presence of assets and/or business locally) seeking to evade payment of a judgment debt and/or arbitral award may risk being wound up by the Hong Kong Court.

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