

May 2023

CFA decision: exclusive jurisdiction clauses generally trump insolvency proceedings



Re: GUY KWOK-HUNG LAM [2023] HKCFA 9 (date of decision: 4 May 2023)

Introduction

In the recent decision in *Re Guy Kwok-Hung Lam*, the Hong Kong Court of Final Appeal set out the proper approach to a bankruptcy petition where the parties had agreed to submit to the exclusive jurisdiction of a specified foreign court.

The Hong Kong Court of Final Appeal unanimously reaffirmed¹ the approach adopted by the Court of Appeal. It was held that in an ordinary case where the underlying dispute of the debt was subject to an exclusive jurisdiction clause, the court should dismiss the petition unless there were countervailing factors such as the risk of the debtor's insolvency impacting third parties, the debtor's reliance on a frivolous defence, or an occurrence of an abuse of process.

¹ Mr Justice French NPJ delivering the judgment

Background

The Appellant (Petitioner) is an exempted limited partnership formed and registered in the Cayman Islands. The Respondent (Debtor) is the personal guarantor under a credit agreement between the Appellant (as Lender) and the Respondent's company (as Borrower).

The Respondent agreed to guarantee, as primary obligor, the payment in full of all amounts due and owed by the Borrower without any demand or notice. The credit agreement was governed by New York law and the parties submitted to the exclusive jurisdiction of New York Courts in relation to "all legal proceedings arising out of or in relation to" the credit agreement.

The Appellant considered that the Borrower had defaulted and commenced bankruptcy proceedings against the Respondent in Hong Kong in respect of the unsecured part of the debt. Thereafter, the Respondent brought proceedings in New York seeking a declaration that there was no event of default and consequential relief.

The Court of First Instance's approach

The Court of First Instance granted the bankruptcy order. The Judge did not regard the existence of an exclusive jurisdiction clause in the agreement would prevent a creditor from presenting a bankruptcy or winding up petition against a debtor. Instead, the Judge considered that the approach of the courts was to ask whether the debtor had demonstrated by evidence that the debt was *bona fide* disputed on substantial grounds.

The decision of the Court of Appeal

The Court of Appeal allowed the Respondent's appeal and dismissed the bankruptcy petition. The decision of the majority of the Court of Appeal proceeded on the basis that if the dispute about the debt fell within the scope of an exclusive jurisdiction clause, the bankruptcy petition should not be allowed to proceed without strong reasons.

The principal judgment was delivered by G Lam JA and His Lordship considered that even if the class remedy (i.e. the winding up order) was available only in Hong Kong, it would not follow that the anterior question relating to the debt relied upon for the petition should not be determined through the agreed dispute resolution mechanism. His Lordship concluded that the same approach should be applied to an exclusive jurisdiction clause in winding up and bankruptcy petitions as in ordinary actions. The policy of the law requires parties to abide by their contracts. His Lordship rejected the proposition that an exclusive jurisdiction clause should be treated simply as a factor to be taken into account, which would likely give rise to uncertainty.

G Lam JA did not go so far as to say that an exclusive jurisdiction clause required the stay or dismissal of the petition. But where the debt is disputed the petition should not be allowed to proceed, in the absence of strong reasons, pending the determination of the dispute in the agreed forum. Therefore, G Lam JA considered that the Appellant should be held to its agreement and the petition should be dismissed.

The ruling of the Court of Final Appeal

Leave to appeal to the Court of Final Appeal was granted by the Court of Appeal on the following question:

Where:

1. parties to an agreement have agreed to submit to the exclusive jurisdiction of a specified foreign court for the purposes of all legal proceedings arising out of or relating to their agreement or the transactions contemplated thereby,
2. one of the parties has petitioned in Hong Kong for the bankruptcy of another party on the basis of a debt arising under the agreement; and
3. the debt is disputed by the latter party,

What is the proper approach of the Hong Kong court to the petition?

The Court of Final Appeal explained that the Court of First Instance's jurisdiction in a bankruptcy matter is conferred by the Bankruptcy Ordinance (Cap. 6), and is not amenable to exclusion by contract. Therefore, the parties' agreement to refer their disputes to a foreign court only influenced the Court of First Instance's discretion to decline to exercise its jurisdiction and did not oust its jurisdiction.

The Court of Final Appeal explained that the determination of whether the debt is *bona fide* disputed on substantial grounds is a threshold question (the "**Threshold Question**"), and the Court has the discretion to decline to exercise its jurisdiction to determine the Threshold Question. One situation was where the parties has agreed to determine all their disputes under an agreement giving rise to the debt exclusively in another forum.

As for public policy considerations behind the bankruptcy regime, the Court of Final Appeal observed that where the debt is disputed, the engagement of the bankruptcy process is on hold and the public policy considerations may be relevant only in an attenuated form. The significance of such policies is further diminished when the petition is brought by one creditor with no evidence of a creditor community at risk.

The Court of Final Appeal further considered that the so-called "Established Approach" (i.e. absent the exclusive jurisdiction clause or an arbitration provision, a petitioner will ordinarily be entitled to a bankruptcy order or winding up order if the debt is not subject to a *bona fide* dispute on substantial grounds) is not appropriate where an exclusive jurisdiction clause is involved.

Endorsing the approach adopted by the majority of the Court of Appeal, the Court of Final Appeal held that in the ordinary case of an exclusive jurisdiction clause, absent countervailing factors such as the risk of insolvency affecting third parties and a dispute that borders on the frivolous or abuse of process, the petitioner and the debtor ought to be held to their contract. The appeal was therefore dismissed.

How about arbitration clauses?

The Court of Final Appeal did not express its view on the applicability of this approach to arbitration clauses even though cases concerning the interaction between arbitration clauses and insolvency proceedings have been analysed in great detail in both the Court of Appeal judgment and the Court of Final Appeal judgment. The Lasmos approach [[here](#)] based on party autonomy was commented in obiter on various occasions by the Court of Appeal [[here](#)]. However, it would appear that the approach on exclusive jurisdiction clauses should arguably apply to the arbitration clauses as well.

Takeaway points

Parties should take the Court of Final Appeal's judgment into consideration and consider carefully when incorporating exclusive jurisdiction clauses into dispute resolution provisions. In this particular case, the parties are required to resolve their dispute in New York as a result of the exclusive jurisdiction clause before the creditor can proceed with bankruptcy proceedings in Hong Kong.

We expect the decision will have further impact on other classes of cases interacting with bankruptcy and insolvency proceedings, such as where the petition is based on a debt arising out of an agreement containing an arbitration clause.

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