

June 2024

## CA decisions: Guy Lam principles apply to arbitration clauses



[Re: SIMPLICITY & VOGUE RETAILING \(HK\) CO., LIMITED \[2023\] HKCFI 1443 \(date of decision: 23 April 2024\)](#)

[Re: SHANDONG CHENMING PAPER HOLDINGS LIMITED \[2023\] HKCFI 2065 \(date of decision: 23 April 2024\)](#)

### Introduction

The Court of Final Appeal's decision in *Re Guy Kwok-Hung Lam* [here](#)<sup>1</sup> 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.

There have been different approaches as to the applicability of the Guy Lam principles on arbitration clauses. In two recent judgments, the Court of Appeal has confirmed that the Guy Lam principles apply equally to arbitration clauses.

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<sup>1</sup> [2023] HKCFA 9 (date of decision: 4 May 2023)

### *Simplicity & Vogue Retailing (HK) Co., Limited*

China Everbright Securities Value Fund SPC as petitioner applied for the winding up of the Simplicity & Vogue Retailing (HK) Co., Limited ("Simplicity HK") based on a debt owed by Simplicity HK arising out of a corporate guarantee.

Pursuant to the corporate guarantee, Simplicity HK guaranteed the obligations of a related company in a bond instrument entered into between the petitioner (as beneficiary) and the related company (as issuer). Both the bond instrument and the corporate guarantee contained basically the same arbitration clause.

Upon the default of the related company, two subsidiaries of Simplicity HK had respectively made some payments of interest and partial payment of the amount due. Simplicity HK did not satisfy the statutory demand within the time limit and only made another part payment via a subsidiary at a later date. When the winding up petition was presented, the amount due is about USD 30.4 million.

Simplicity HK failed to file its affidavit in opposition within the prescribed time, and did not make payment into court as requested in order that time can be extended for filing the affidavit. The first instance judge made a winding up order, and took the view that the ratio in the Guy Lam case only apply to an exclusive jurisdiction clause, not an arbitration clause.

Simplicity HK appealed against the winding up order, and the main ground is that the judge's approach is against the Guy Lam principles which stress the importance of party autonomy and holding parties to the agreement.

#### **The Court of Appeal's decision**

The Court of Appeal dismissed the appeal and confirmed that the Guy Lam principles apply to arbitration clauses, and of note are that:

1. The effect of arbitration clauses on insolvency petitions is of central importance to the reasoning of the majority decision in the Court of Appeal and the Court of Final Appeal in the Guy Lam case. The cogent reasons in the Court of Appeal decision in Guy Lam apply equally in the context of arbitration clauses.
2. It is clear that the "Established Approach"<sup>2</sup> would not be appropriate where the petition debt is covered by an arbitration clause.
3. The approach of the court in exercising its discretion is "multi-factorial". The court retains flexibility to deal with the case as the circumstances require.
4. It is sensible for the court to require itself to be satisfied of the genuine intention so as to hold the parties to their agreed dispute resolution mechanism<sup>3</sup>. Such genuine intention may be shown by the steps required under the arbitration clause including preliminary stages such as mediation. The court may also exercise its discretion to grant a short adjournment for the debtor to commence arbitration with an undertaking that the arbitration will be proceeded with all due dispatch.

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<sup>2</sup> The "Established Approach": A petitioner will ordinarily be entitled to a bankruptcy order / winding up order if the petition debt is not subject to a bona fide dispute on substantial grounds.

<sup>3</sup> Lasmos Ltd v South Pacific Bauxite (HK) Ltd [2018] HKCFI 426

### *Shandong Chenming Paper Holdings Limited*

This matter has been ongoing for a number of years. Arjowiggins HKK 2 Limited ("Arjowiggins") and Shandong Chenming Paper Holdings Limited ("Shandong Chenming") are parties to a joint venture agreement. Based on an arbitral award which the Court had granted leave to be enforced in Hong Kong, Arjowiggins served a statutory demand on Shandong Chenming. Shandong Chenming then sought an interim injunction to prevent Arjowiggins from presenting a winding up petition. The first instance court dismissed the injunction application and thereafter Arjowiggins presented a winding petition. Shandong Chenming appealed to the Court of Appeal and the Court of Final Appeal, during the course of which it was required to make payment into court.

The Court of Final Appeal dismissed the appeal<sup>4</sup> [here](#), with an order for the money in court to be paid out to Arjowiggins with interest. After the payment out, a sum of over HKD 53 million still remained outstanding on the petition debt with daily interest accruing. Arjowiggins then applied for the petition to be restored for hearing.

Meanwhile, two other arbitrations were commenced by Shandong Chenming and one of which involved potential damages against Arjowiggins to be claimed by Shandong Chenming. Shandong Chenming did not dispute the petition debt but seeks to refer to arbitration its cross claim which is greater than the amount of the petition debt.

Applying Guy Lam, the court of first instance ordered the petition be stayed pending the arbitration relating to the cross claim. Arjowiggins was granted leave to appeal.

#### **The Court of Appeal's decision**

The Court of Appeal decided that the Guy Lam decision is applicable whether a dispute that falls within the scope of an exclusive forum agreement has been raised by a dispute of the petition debt, a claim of set-off or a cross claim that does not give rise to set-off.

While agreeing that the rationale of Guy Lam decision does not cover a mere cross claim, the Court of Appeal explained that the court does not look only at the petition debt but has regard to the entire relationship between the parties.

Although only the petition debt is relevant to a petitioner's locus (in the absence of set-off), it is only part of the overall picture about the exercise of the court's powers. The court does not ignore the debtor's cross-claims against the petitioner, and indeed regards them as practically equivalent to disputes of the debt, and "reverse cross claims" by the petitioner against the debtor are also relevant.

In cases with claims in both directions, the question arises whether the petitioner is a net creditor having an interest in having the debtor wound up or bankrupted. The proper approach to the resolution of this question, though not necessarily strictly one of locus of the petitioner, is clearly a matter to which a forum agreement between the parties is likely to be relevant. Cross-claim cases in the law reports shows that the determination by the court is essentially a summary judgment type analysis.

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<sup>4</sup> [2022] HKCFA 11 (date of judgment 14 June 2022)

Further, in appropriate circumstances, delay in putting forward a cross claim may support a finding that it was raised in abuse of the court's process. However, it was explained that Shandong Chenming was unable to put forward the cross claim earlier because of the failure to make available the JV documents on the part of Arjowiggins.

### Takeaway points

Parties, especially lenders, should take into account the Guy Lam decision and its effect when negotiating terms in their exclusive jurisdiction clauses / dispute resolution clauses under Hong Kong law in future.

Debtors should note that the court will now take into account countervailing factors (in addition to the Lasmos approach focusing mainly on the genuine intention to arbitrate) when deciding a winding up petition of which the underlying contract contains an arbitration clause.

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