Winding-up proceedings: further challenge to *Lasmos*

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The case of ***Lasmos Limited v. Southwest Pacific Bauxite (HK) Limited***[1] ("**Lasmos**") has been widely discussed as it departs from the traditional approach towards the dismissal of winding-up petitions.

Under the *Lasmos* approach, so long as (i) the debtor disputes the petitioning debt, (ii) the underlying contract from which the debt arises contains an arbitration clause and (iii) the debtor takes steps to commence arbitration accordingly, the winding-up petition would generally be dismissed. This approach has also been considered by the Court of Appeal on two occasions last year – for more details on this, read our earlier article "Arbitration or winding up: Debt collection in Hong Kong following *Lasmos*".

In ***Dayang (HK) Marine Shipping Co., Limited v. Asia Master Logistics Limited***[2], a recent judgment handed down by the Court of First Instance earlier this month, Deputy High Court Judge William Wong SC provided in-depth analysis of the *Lasmos* approach.

In this case, the petitioner had chartered its vessel to the debtor and petitioned for the winding-up of the debtor for US$360,919.76 due under a Fixture Note between the petitioner and the debtor. There is a clause for arbitration in Hong Kong with English law to apply in the Fixture Note. The debtor did not deny that the debt is due and owing, but raised a counterclaim against the petitioner for an alleged breach of the Fixture Note in connection with, *inter alia*, the condition of the vessel and the performance of its captain, and submitted that the dispute should be dealt with by way of arbitration.

The court found that the *Lasmos* principle was not engaged as the debtor had not commenced any arbitration proceedings and therefore failed to satisfy the third requirement in *Lasmos*. While a letter was issued to the petitioner after issuance of the winding-up petition proposing to resolve all disputes by arbitration, it cannot be regarded as a proper notice of an intention to arbitrate as it is a mere gauge of an interest to resolve a dispute by arbitration. No notice of arbitration was sent. The form of request for arbitration was also insufficient as it was still in draft, unsigned and not sent.

As the *Lasmos* principle was not engaged and the debtor opposed the petition in reliance on a cross-claim, it has the burden to prove that its cross-claim is genuine, serious and of substance. However, as there was no *prima facie* dispute to the debt and the debtor was unable to quantify or substantiate its counterclaim, the court formed the view that the debt was not being disputed in good faith on substantial grounds. A winding-up order was therefore made against the debtor.

Despite the court's finding that the *Lasmos* principle was not engaged, Deputy High Court Judge William Wong SC considered and analysed decisions in various jurisdictions, and made some observations on the *Lasmos* principle in the hope of assisting in the future determination of its correctness at the appellate level.

Among others, the court pointed out that winding-up is a discretionary remedy. This means that the courts retain a wide discretion to act flexibly and may still wind up a company notwithstanding the existence of a *bona fide* dispute

on substantial grounds (for example, where a creditor would probably be left without an effective remedy if the petition were to be struck out). As such, the *Lasmos* approach, where the courts are generally to dismiss or stay a winding-up petition as long as the three conditions have been satisfied, would be an unprecedented fetter on the court's discretion.

Contrary to the principle in *Lasmos*, the court was of the view that the commencement of arbitration proceedings, or that arbitration would be commenced, does not necessarily mean that the debt is *bona fide* disputed on substantial grounds. In ***But Ka Chon v. Interactive Brokers LLC***[3] the Court of Appeal questioned the appropriateness of substantially curtailing the rights of a creditor to present a petition and doubted that the court should invariably stay or dismiss the winding-up petition if it is satisfied that there is no *bona fide* dispute on substantial grounds. There may also be practical implications which may be prejudicial to the interests of the creditors, such as the assets of the debtor may already have been dissipated by the time the dispute of the debt is adjudicated by arbitration.

Having discussed and analysed different approaches to the effect of the existence of an arbitration clause on the court's consideration of whether the debtor has shown a *bona fide* dispute of substance in relation to the debt on which a winding-up petition is based, the court summarised the present state of law as follows:

- where a debtor-company intends to dispute the existence of a debt, it must show that there is a *bona fide* dispute on substantial grounds, irrespective of whether or not the debt had arisen from a contract incorporating an arbitration clause;
- the existence of an arbitration agreement should be regarded as irrelevant to the exercise of discretion;
- the fact that arbitration proceedings have commenced or would be commenced may be relevant evidence that there is a *bona fide* dispute. However, this alone would not be sufficient to prove the existence of a *bona fide* dispute on substantial grounds; and
- where the creditor-petitioner petitions in circumstances where it knows there to be a *bona fide* dispute over the debt on substantial grounds, it runs the risk of being liable to pay the debtor-petitioner's costs on an indemnity basis. It would also be at risk of liability under the tort of malicious prosecution.

Key takeaways

Despite various decisions on the *Lasmos* principle, there is yet to be any ruling on appellate level on its correctness. It remains to be seen whether the appellate court would agree with the *Lasmos* approach or the position as summarised by Deputy High Court Judge William Wong SC in this case.

As matters stand and subject to any further rulings on appellate level, parties to any commercial contracts, in particular lenders, should be aware of the implications of an arbitration clause when seeking to wind up the debtor.

Creditors should be mindful that a winding-up petition should not be used as a means to apply improper pressure on the debtor to pay as there may be a risk of abuse of process. For example, if the petition was presented at the time when the creditor knew that the debt was genuinely disputed on substantial grounds, the court may order the creditor-petitioner to pay the debtor's costs on an indemnity basis and the debtor-company may even have a claim against the creditor for damages for malicious presentation of the winding-up petition.

Contrary to the *Lasmos* principle, the court's view in this judgment is that a debtor who wishes to contest any winding-up proceedings has to show that there is a *bona fide* dispute of the debt on substantial grounds. The fact that steps have been taken under the arbitration clause to commence the contractually mandated dispute resolution process as required in *Lasmos* would not be sufficient to prove the existence of a *bona fide* dispute on substantial grounds. It would only be relevant evidence that there is a *bona fide* dispute.

1. [2018] HKCFI 426 ↩
2. [2020] HKCFI 311 ↩
3. [2019] HKCA 873 ↩

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