

"Abuse of process" is the touchstone for injunction restraining a winding-up petition

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In *Hung Yip (HK) Engineering Company Limited v. Kinli Civil Engineering Limited* [2021] HKCFI 153, the Honourable Mr Justice Harris reiterated the test governing when the court will restrain the presentation of a winding-up petition. This is a timely reminder amidst the COVID-19 crisis, which has sparked disputes between companies and their creditors.

Presenting a winding-up petition is a common debt collection method. The starting point is that a creditor may serve a statutory demand on a debtor for repayment of a debt. If the debtor fails to repay the entire debt or raise defences within the specified period (usually 21 days), the creditor may issue a winding-up petition against the company, thereby commencing winding-up proceedings. If the company wishes to restrain the presentation of a petition, it may apply to the court for an injunction. The requirement is to demonstrate that the petition will be an abuse of process; for example, if the company can produce evidence that the creditor knows when presenting a petition that the company has a *bona fide* defence to the debt claim based on substantial grounds.

Harris J emphasised that this test is not equivalent to proving a *bona fide* defence on substantial grounds, which the company would be required to prove to resist a petition. The key is "abuse of process". Where the creditor knows or should have known that a debt is genuinely disputed, it should not have presented a petition, which would be an abuse of process. Winding-up proceedings are not the appropriate process to determine substantive disputes. For assessing whether there is an abuse, the learned Judge highlighted the following factors: (1) the debt and how it is alleged to arise; (2) when and how the debt has been disputed; (3) what is said to be the *bona fide* defence on substantial grounds; (4) the solvency of the company; (5) any prejudice that will be caused by the presentation of a petition; and (6) whether the creditor is consciously using the threat of presenting a petition improperly.

A winding-up petition can create commercial pressure, due to its dire consequences for the company. It formally initiates the court winding-up proceedings, which is a standard event of default under loan agreements, security instruments and finance documents. This will trigger cross-defaults, which may result in acceleration of loan repayments, enforcement of securities and termination of finance arrangements. As to listed companies, there will be public announcement or other reporting obligations. Moreover, since winding-up hearings are conducted in open court, they may attract negative publicity and the attention of other creditors. Other creditors may support the petition by participating in the proceedings, and may even "step in" as the petitioning creditor after the original petitioner withdraws. This means that, even if the company settles with the original petitioning creditor, other creditors can jump on the bandwagon and ask for settlement deals.

In view of these potential ramifications, creditors should devise a proper strategy and plan carefully. From a legal perspective, there are two points which an intended petitioner should bear in mind. First, if the creditor knows or should have known that a debt is genuinely disputed on substantial grounds, it should refrain from presenting a petition. If the court considers the creditor to be abusing the insolvency process, it may order it to pay the company's costs on an indemnity basis. Secondly, the company may even have a claim against the creditor for damages for malicious presentation of the petition, as Deputy High Court Judge William Wong SC highlighted in *Dayang (HK)*

Marine Shipping Co., Limited v. Asia Master Logistics Limited [2020] HKCFI 311. Accordingly, before issuing a petition, the creditor should satisfy itself that the company has no genuine dispute and that it is insolvent.

From the company's perspective, when served with a statutory demand, it should respond properly to the creditor and its legal representatives. The grounds of objection and defence to the whole debt must be sufficiently explained. The aim is to affix the creditor with knowledge of its *bona fide* defence based on substantial grounds. On that basis, the company can request the creditor to confirm that it will not present a winding-up petition, failing which the company may apply for an injunction.

As COVID-19 continues to ravage the global economy, we anticipate that commercial and insolvency disputes will continue to surge. A winding-up petition is a powerful tool, but it is not a cure for all ills. *Hung Yip* demonstrates that each particular claim requires a bespoke solution, which parties should review regularly based on changing circumstances. The use of judicial process will be subject to scrutiny by the court. Properly-advised creditors and companies should handle the court procedure appropriately, in order to resolve their disputes in a timely and efficient manner.

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