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Newsletter

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What's inside?

Updates on Practice Direction regarding Bankruptcy and Winding-up Proceedings

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The Judiciary announced updates to some Practice Directions on 4 July 2023, which include updates to Practice Direction 3.1 regarding Bankruptcy and Winding-up Proceedings. These updates have taken effect on 17 July 2023.

This article highlights the salient updates in the new Practice Direction 3.1 ("**New PD 3.1**").

Lodging of bankruptcy petition

Under Rule 49(9) of the Bankruptcy Rules, the Court may decline to file the bankruptcy petition if it is not satisfied that the creditor has discharged his obligation in respect of the service of statutory demands imposed by Rule 46(2) of the Bankruptcy Rules.

Under the New PD 3.1, for a bankruptcy petition based on the failure to comply with a statutory demand, apart from the bankruptcy petition and the affidavit(s) proving service of the statutory demand, the petitioner is further required to lodge a new document, which is a completed checklist in the form of Appendix A of the New PD 3.1 (paragraph 1.2). It should be noted that all sections of the checklist should be completed; if not, detailed explanation should be provided. In the absence of satisfactory explanation, requisition will be raised, which may also delay the processing of the application.

The New PD 3.1 (paragraph 1.3) specifies that generally the solicitors lodging the petition will receive leave to file the petition or requisition(s) raised by the Master within 28 days; if not, they may return to the High Court Registry or write to the Master in charge of the Bankruptcy and Winding-up List to ascertain the status.

Service of statutory demand

Rule 46(2) of the Bankruptcy Rules requires the creditor to do all that is reasonable for the purpose of bringing the statutory demand to the debtor's attention. The New PD 3.1 (paragraph 2.1) prescribes the following new steps which are normally regarded as compliance with such obligation:

1. If the debtor has agreed with the creditor to use any electronic means (which includes emails, WhatsApp, WeChat or other similar means of communications ("**Electronic Means**")) to receive any documents relating to the debt, the subject of the statutory demand, or

2. The debtor has during the period of 12 months immediately preceding the date of the statutory demand used any of the Electronic Means to communicate with the creditor, and

3. The creditor has sent the statutory demand to the debtor through the Electronic Means.

Application for certificate of compliance

Under Rule 29 of the Companies (Winding-up) Rules, the petitioning creditor has to obtain a certificate of compliance from the Registrar before any winding-up order will be made by the Court. Under the New PD 3.1 (paragraph 11.3), in addition to the requirement that the petitioning creditor should obtain the certificate of compliance without undue delay, it is expressly stated that in the absence of any good reasons, failure to obtain such certificate within 3 months from the date of the petition may result in the dismissal of the petition.

Service of winding-up petition

The New PD 3.1 (paragraph 12.1) specifies how service of the winding-up petition is to be effected, depending on the type of the subject company in question:

Type of company	How is service effected?
Hong Kong company	At its registered office in Hong Kong
Registered non-Hong Kong company	On the authorized representative of the company, or The place of business established by the company in Hong Kong
Non-Hong Kong company with an established place of business in Hong Kong	At the place of business
Non-Hong Kong company which no longer has a place of business in Hong Kong	Service should be effected in accordance with s.803(5)(b) of the Companies Ordinance
Unregistered company which has no place of business in Hong Kong and is not registered under s.777 of the Companies Ordinance	Leave to serve the petition out of jurisdiction must be obtained from the Court

Bankruptcy and winding-up proceedings (other than winding-up petitions on "just and equitable" grounds)

For bankruptcy and winding-up petitions which are uncontested (i.e. no notice of intention to appear has been served, or no notice to show cause has been filed), the New PD 3.1 indicates that it will not be necessary for the petitioner or his representative to attend the hearing; rather, the Court will announce at the hearing of the petition that a bankruptcy or winding-up order is made (paragraphs 13.1 and 13.2). Please note, however, that the above does not apply to a debtor's petition for self-bankruptcy (paragraph 13.3).

The New PD 3.1 provides further guidance on how contested bankruptcy and winding-up petitions are to be dealt with, depending on the type of order to be sought (paragraphs 14.2 to 14.5).

Where the Petitioner intends to seek a substantive order from the Court

If the parties are represented, they shall lodge the requisite documents with the Court electronically via the e-Lodgement platform and serve the same on the Respondent and the Official Receiver in accordance with the requirements and deadlines set out in the New PD 3.1. Failure to do so may result in an adjournment

of the petition and the defaulting party may be ordered to pay any wasted costs to the other party irrespective of the merits of the petition.

An unrepresented Petitioner is given an additional option of lodging his skeleton arguments with the Court in hard copy. It should be noted that an unpresented Petitioner is subject to the same deadlines as a represented Petitioner.

Where the Petitioner intends to seek directions on further conduct of the petition

The parties should comply with the requirements of and deadlines for lodging and service of skeleton arguments.

Where the parties seek an order to dismiss or strike out the petition

If, after a winding-up petition has been advertised and/or gazetted, the parties reach an agreement that the petition be dismissed or struck out, the petition shall be listed for hearing in court and the Court may dismiss or strike out the petition without the parties' attendance if:

1. A consent summons signed by all parties (including all supporting and opposing creditors who have filed a notice of intention to appear in the petition) is lodged 2 clear days prior to the hearing; and

2. Such consent summons makes provision for the costs of the Official Receiver.

Where the parties wish to adjourn a winding-up petition and vacate the Court hearing

If the parties wish to jointly apply to adjourn a winding-up petition and vacate the hearing, the Petitioner shall lodged a consent summons (signed by all parties), together with a letter providing brief reasons or justification for seeking an adjournment.

Case management of creditor's bankruptcy or winding-up petition

The New PD 3.1 further provides guidance on case management matters relating to a creditor's bankruptcy or winding-up petition, including:

1. A respondent opposing the petition shall file a notice to show cause or affidavit in opposition in accordance with rule 68 of the Bankruptcy Rules or rule 32(1) of the Companies (Winding-up) Rules, as the case may be;

2. No discovery of documents or cross-examination of deponents will be ordered, unless good grounds are shown to justify departure;

3. Expert evidence may only be filed with the Court's leave. Filing expert evidence in the absence of Court's leave may risk the Court expunging such expert evidence and penalizing the party in default with costs; and

4. Where there are Chinese exhibits to an affidavit, the party exhibiting such documents should obtain (i) an English translation of the documents which are essential to his case and (ii) the agreement of the other party or submit the same to the Court for certification within the prescribed timeframe. Alternatively, parties may consider seeking the Court's directions to dispense with preparation of the English translation.

The updates in the New PD 3.1 seek to streamline certain aspects of bankruptcy and winding-up proceedings and bring certain requirements up-to-date with modern communication practices (e.g. allowing service of statutory demand by Electronic Means and lodging of documents electronically). Parties to bankruptcy and winding-up proceedings should familiarize themselves with the New PD 3.1 to avoid complications and/or delay to the proceedings and adverse costs consequences.

Series on Family disputes relating to mental capacity issues: Testamentary capacity and potential challenges to Wills

Sherlynn Chan and Hazel Wong

How do we break the Asian taboo on the topic of death and Wills? With the increase in highly publicised contentious probate proceedings among tycoons, more people in Hong Kong are open to considering and talking about end-of-life issues, including succession planning and Will preparation.

However, when there is a Will, there is a way to challenge it. Testamentary capacity is one of the grounds of such challenges.

In Hong Kong, the Courts adopt the test for assessing testamentary capacity established in the UK landmark authority, *Banks v Goodfellow (1870) LR 5 QB 549,* which provides that a testator shall:

- understand the nature of the act and its effects;
- understand the extent of the property of which he is disposing;
- be able to comprehend and appreciate the claims to which he ought to give effect; and
- be free from disorder of mind or delusion that would poison his affections, pervert his sense of right, or prevent the exercise of his natural faculties, which would influence his will or bring about a disposal of his property that would not have been made if the mind had been sound.

Furthermore, the "golden rule" was introduced in a later UK case, *Kenward v Adams (1975) The Times 29 November 1975,* to provide guidance to solicitors in preparing Wills. It was held that when a solicitor is drawing up a Will for an aged testator or one who has been seriously ill, it should be witnessed or approved by a medical practitioner, who ought to record his examination of the testator and his findings. If there was an earlier Will, it should also be examined and any proposed alteration should be discussed with the testator.

In the Hong Kong decision of *Re Estate of Au Kong Tim [2018] 2 HKLRD 864*, the Court of Appeal also highlighted the importance of ascertaining the testamentary capacity of testators and following the "golden rule". The testator in this case had made two Wills in 2002 and 2008 respectively while the latter's validity was in question in relation to the testator's testamentary capacity due to severe illnesses. Under the 2002 Will, the testator's residuary estate was given to his 6 grandchildren (being 2 grandsons and 4 granddaughters) in equal shares. However, in the 2008 Will, the residuary estate was left to the testator's 2 sons and 2 grandsons in equal shares.

The Court held that the solicitors, while handling the 2008 Will, failed to follow the "golden rule" and the checklist set out in "Assessment of Mental Capacity: A Practical Guide for Doctors and Lawyers" published by the British Medical Association and the Law Society designed to ascertain whether the testator had the relevant *Banks v Goodfellow* testamentary capacity. As a result, the Court was not prepared to draw an inference that the testator was able to understand the relevant matters of his Will. As testamentary capacity was not established, the 2008 Will was therefore rendered invalid and the 2002 Will was accordingly upheld.

The "golden rule" does not lay down the law, it provides a guidance of prudence for solicitors. Thus, the mere failure to follow the Checklist or the "golden rule" would not automatically render a Will invalid. The Court would decide on the facts and evidence on a case by case basis[1].

As illustrated in a widely publicised case in Hong Kong, *Re Estate of Lam Chok Wai [2020] HKCFI 3047*, a challenge to the testamentary capacity of the testator can be a long battle with significant impact on the outcome of the distribution of the estate.

[1] Re Estate of Wong Yin Sheung [2019] HKCA 452

In this case, Mr. Lam, the owner of the well-known Tai Lin chain of retail shops for electrical and electronic appliances, passed away in 2005. Mr. Lam had 2 children with his wife, and 3 children with a Madam Tam, his co-habitee.

In 1987, Mr. Lam made a Will naming his wife and their 2 children as the beneficiaries. However, in 1999 and 2005 respectively, Mr. Lam made two other identical Wills giving his entire estate to Madam Tam, to the exclusion of his 5 children. The wife and her 2 children challenged the validity of the 1999 and 2005 Wills based on the lack of testamentary capacity of Mr. Lam at the time of execution.

The High Court held that Mr. Lam had no capacity to make the 1999 and 2005 Wills as he lacked the capacity to appreciate his moral responsibility to look after his children. In doing so, the Court referred to medical evidence that Mr. Lam had 2 strokes which affected his memory, and the assessment by the neurologist that he had no ability to manage a large company business.

This judgment made 15 years after Mr. Lam's passing, is being appealed by Madam Tam. The decision on the appeal is still pending at the time of writing this article.

In order to minimise the risk of prolonged and costly litigation after the passing of a testator, it is important to seek legal advice on how to execute a proper and well thought-out Will. It is also prudent to involve medical practitioners in the assessment of testamentary capacity of elderly or seriously-ill testators, with full medical history provided to the doctor.

Our award-winning Family and Private Wealth team at Deacons is experienced in handling vulnerable client and contentious Wills and probate matters. Please reach out to us if you would like to know more.

Hong Kong Courts' Approach to bankruptcy / winding-up proceedings involving arbitration clauses

Vivien Wong

The interaction of arbitration clauses and bankruptcy/winding-up proceedings has been subject to much legal discussion and debate. As the Courts in Hong Kong and other common law jurisdictions have taken different approaches in tackling the issue, the legal community has been hoping for further guidance from the appellate courts.

The opportunity came when ***Re Guy Kwok-Hung Lam [2023]*** HKCFA 9 ("***Re Guy Lam***") came before the Court of Final Appeal ("CFA"). In the much anticipated judgment handed down on 4 May 2023, the Court of Final Appeal unanimously affirmed the Court of Appeal ("CA")'s majority position that in an ordinary case of a foreign exclusive jurisdiction clause ("EJC"), the Court should give effect to the EJC and dismiss the bankruptcy petition, unless there were countervailing factors, such as the right of the debtor's insolvency impacting third parties or the dispute bordering on frivolous or abuse of process. In the judgment, the Court of Final Appeal held that the "Established Approach" that a petitioner will ordinarily be entitled to a bankruptcy or winding up order if the petition debt is not subject to a *bona fide* dispute on substantial grounds is not appropriate in cases where an EJC is involved.

However, the Court of Final Appeal expressly left open the issue whether the same approach would apply to an arbitration clause.

It did not take long before that issue appeared before the Courts again in ***Re Simplicity & Vogue Retailing (HK) Co., Limited*** [2023] HKCFI 1443. This is the first case in which the Companies Court considered the principles in *Re Guy Lam* in the context of arbitration clauses. In this case, The Honourable Madam Justice Linda Chan emphasized that the Court maintains a discretion to dismiss or stay a bankruptcy or winding-up petition despite the presence of an arbitration clause. The Court should not adopt a mechanistic approach or fetter the exercise of its discretion in cases involving arbitration clauses. The Court was of the view that the ratio in *Re Guy Lam* only applies to EJCs, not arbitration clauses, and *Re Guy Lam* did not lay down any general rule that if the underlying agreement giving rise to the petition debt contains an

arbitration clause and there are no supporting creditors to the petition, the Court must dismiss or stay the winding-up petition without considering the merits of the defence raised by the debtor company. In exercising the Court's discretion in insolvency proceedings, the Court is guided by the principles stated in the Court of Appeal's judgments in *But Ka Chon* v *Interactive Brokers LLC* [2019] 4 HKLRD 85 and *Sit Kwong Lam v Petrolimex Singapore Ptd Ltd* [2019] 5 HKLRD 646. The Court will also consider whether the requirements in *Re Southwest Pacific Bauxite (HK) limited [2018] 2 HKLRD 229* ("***Lasmos***") are satisfied. More recently, the Companies Court (the case came before The Honourable Mr. Justice Harris) was again faced with the same issue in ***Re Shangdong Chenming Paper Holdings Limited*** [2023] HKCFI 2065, although this time, Court was concerned with a disputed cross-claim rather than a disputed petition debt. In this case, the debtor company raised a cross-claim of value greater than the petition debt in an arbitration against the petitioner. The Court was therefore required to decide whether the petition should be stayed pending arbitration of the debtor company's cross-claim against the petitioner.

Having considered the reasoning from both the CA and the CFA in *Re Guy Lam*, which drew on *Lasmos* and a number of overseas authorities dealing with arbitration clauses, Harris J concluded that both the CA and the CFA were of the view that the same principles and approach applied to EJCs and arbitration clauses.

Harris J considered that in the judgments of the CA and CFA, the principle in *Re Guy Lam J* which applies to disputed petition debts also applies to cross-claims. As a general principle of insolvency law, there is no distinction between a claim and a cross-claim when considering whether a defence to a winding-up petition has been established. Harris J agreed with the judgment by the Singapore CA in *AnAn Group (Singapore) Pte Ltd v VTB Bank (Public Joint Stock Co*) [2020] SGCA 33 that when the court is faced with a cross-claim, the winding-up proceedings should be stayed or dismissed as long as (a) the cross-claim is subject to a valid arbitration agreement, and (b) the cross-claim falls within the scope of the arbitration agreement, provided that the dispute is not being raised by the debtor company in abuse of the Court's process.

Conclusion

The recent judgments discussed above are all significant decisions to bear in mind when considering the Hong Kong Courts' approach to EJCs and arbitration clauses in insolvency proceedings. The CFA affirmed in *Re Guy Lam,* the general approach in dismissing bankruptcy proceedings in favour of upholding the parties' agreed choice of forum under an EJC. The position regarding arbitration clauses remains less certain, as there appears to be conflicting views within our Companies Court as to whether the *Re Guy Lam* approach should equally apply to arbitration clauses. Further, the recent discussions by the CA and the CFA in *Re Guy Lam* on the widely-debated *Lasmos* approach are obiter and the CFA has yet to express a view on the correctness of the *Lasmos* approach. Whilst we hope that further clarification from the appellate courts will be available soon, the Companies Court's judgments in *Re Simplicity & Vogue Retailing (HK) Co., Limited* and *Re Shangdong Chenming Paper Holdings Limited* confirm that the *Lasmos* approach shall continue to apply to insolvency proceedings involving arbitration clauses.

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