Hong Kong Court of Final Appeal Explains Sufficient Connection to Wind Up a Foreign Company on the Just and Equitable Ground

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Introduction

The Hong Kong Court of Final Appeal (CFA) delivered its judgment in the Yung Kee Restaurant case[1] on November 11, 2015. The CFA overturned the decisions of the courts below in relation to the appellant's winding up petition and held that there was sufficient connection between the BVI ultimate holding company and Hong Kong to wind up the company on the just and equitable ground. Significantly, the CFA stated that:

- in the case of a shareholders' winding up petition, the presence of the other shareholders within the jurisdiction is an extremely weighty factor in establishing the sufficiency of the connection between the company and Hong Kong;
- the interposition of a foreign intermediate holding company between the ultimate holding company and the Hong Kong subsidiaries does not necessarily, and did not in this case, remove or reduce that connection; and
- whilst the factors relevant to establishing the connection is different in the case of a shareholders' petition as compared to a creditors' petition, a "more stringent" connection is not required in the former case.

The CFA made a winding up order against the BVI ultimate holding company with a 28-day stay to allow the parties to consider buy-out options.

This is a welcome decision to shareholders in Hong Kong seeking to wind up foreign holding companies with underlying businesses and/or assets in Hong Kong. The CFA's judgment provides important guidance on the approach to be taken when a court is called upon to exercise its discretion to make a winding up order against a foreign company on the just and equitable ground. The CFA's approach seeks to reflect the nature of the dispute and the purpose for which the proceedings are brought in a shareholders' petition.

Background

This case concerned two brothers' disputes over their family business founded by their late father. The family business, including the well-known Yung Kee Restaurant, is operated through a group of companies. The two brothers each holds directly or indirectly 45% of the shares in a BVI holding company (**Ultimate Holdco**). Their sister owns the remaining 10% of the shares. Ultimate Holdco holds 100% of the shares in another BVI company (**Intermediate Holdco**) which in turn holds substantive shares in two operating subsidiaries both of which are incorporated and carry on business exclusively in Hong Kong.

The two brothers had fallen out and the older brother brought proceedings in the Hong Kong court to seek (i) an order pursuant to s.168A of the Companies Ordinance[2] for his younger brother to buy his shares out on the ground that the affairs of Ultimate Holdco were being conducted in a manner which was unfairly prejudicial towards him; or alternatively, (ii) an order that Ultimate Holdco be wound up on the just and equitable ground under s.327(3)(c) of the Ordinance[3].

Both the Court of First Instance and the Court of Appeal refused to make either orders, finding that:

- the courts had no jurisdiction to make an order under s.168A as Ultimate Holdco had not established a place of business in Hong Kong; and
- Ultimate Holdco did not have "sufficient connection" with Hong Kong to justify the courts exercising their jurisdiction under s.327(3)(c).

CFA Decision

Unfair prejudice application under s.168A

Ultimate Holdco was incorporated outside Hong Kong, and accordingly the court's jurisdiction to make an order under s.168A depends on whether it had established a place of business in Hong Kong. The CFA affirmed the decision of the lower courts that it had not.

"Place of business" connotes a place where or from which the company either carries on or possibly intends to carry on business. Whilst "business" is not confined to commercial transactions or transactions which create legal obligations, there is no reason to suppose that it covers purely internal organisational changes in the governance of the company itself.

As the sole function of Ultimate Holdco was that of a holding company, it carried on no business of any kind. The CFA remarked that there was nothing (in fact or law) which requires a company that does not carry on business to have a place of business, and there is nothing strange in finding that such a company has not established one anywhere.

Winding up petition under s.327(3)(c)

The starting point

The CFA accepted that the most appropriate jurisdiction in which to wind up a company is generally the jurisdiction where it is incorporated and acknowledged that it is necessary to impose some constraints on the courts' discretion to make a winding up order against a foreign company.

Core requirements

The appeal focused almost entirely on the first of the three "core requirements" summarised in *Re Beauty China Holdings Ltd*[4] , namely, whether there is a sufficient connection with Hong Kong[5].

The CFA confirmed that these core requirements are not statutory but self-imposed constraints adopted by the courts, and should be treated as a part of the court's discretion.

Sufficient connection

No "more stringent" connection than in a creditors' petition – The CFA disagreed with the courts below that a "more stringent" connection is required in the case of a shareholders' petition as compared to a creditors' petition. The factors which are relevant to establish the connection are different in the two cases but the test is the same – whether there is sufficient connection between the company and the jurisdiction to justify the court in ordering the company to be wound up despite the fact that it is incorporated elsewhere.

Shareholders' presence – Given the nature of the dispute in the case of a shareholders' petition and the fact that it is a dispute between shareholders, the CFA took the view that the presence of the shareholders within the jurisdiction is highly relevant and usually the most important single factor in establishing the sufficiency of the connection.

Other connecting factors – Other connecting factors which the CFA considered compelling in the present case include: the fact that Ultimate Holdco was merely a holding company with all its underlying assets in Hong Kong; the business was carried on exclusively in Hong Kong; all income was derived

from Hong Kong; all the directors were resident in Hong Kong; all board meetings were held in Hong Kong; and crucially, the dispute was a family dispute between parties all of whom were resident in Hong and the events giving rise to it all took place in Hong Kong.

Interposition of an intermediate holding company – Both courts below found that the interposition of Intermediate Holdco effectively cut off the connection between Ultimate Holdco and Hong Kong because the shares in the Hong Kong subsidiaries belonged to Intermediate Holdco and not to Ultimate Holdco. The CFA disagreed with this. Firstly, while a company and its shareholders are separate and distinct legal entities, it does not follow that there is no connection between them. Secondly, there is no doctrinal reason to exclude a connection through a wholly owned subsidiary. Thirdly, given the petitioner's purpose in a shareholders' winding-up petition is to realise his investment in the company (and in the case of a holding company, the value of its underlying assets), giving effect to the close connection between a holding company and the assets of its direct or indirect subsidiaries reflects the nature of the dispute and the purpose for which the proceedings are brought.

Merits

Having concluded that the company had sufficient connection with Hong Kong, the CFA proceeded to consider the merits of the petition.

The question for the court was whether, on the facts of the case, it was just and equitable to wind up the company. The CFA held that it was, adopting the trial judge's findings that (i) there was a mutual understanding between the brothers that each should fully participate in the running of the business and be properly consulted; and (ii) this understanding had been breached by the younger brother.

Conclusion

Hong Kong is now a more accessible forum for aggrieved local shareholders to seek winding up order against foreign companies. As the CFA noted, there had only been 8 reported cases in the past concerning shareholder's petition to wind up a foreign company. The number is anticipated to increase substantially soon. In particular, winding up petitions are now a viable option to seek to resolve shareholders' disputes in Hong Kong-based family run businesses with corporate structures involving offshore jurisdictions.

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[1] ***Kam Leung Sui Kwan v Kam Kwan Lai & Ors FACV 4/2015.***

[2] Now superseded by ss.722 to 726 of the new Companies Ordinance Cap.622 which came into effect on March 3, 2014.

[3] This provision is retained as s.327(3)(c) of the new Cap.32, now renamed the Companies (Winding Up and Miscellaneous Provisions) Ordinance, which came into effect on March 3, 2014. These final notes are not automatic footnotes. They must be entered and formatted manually.

[4] [2009] 6 HKC 351

[5] The three core requirements summarised in *Re Beauty China Holdings Ltd* are:

(1) there is a sufficient connection with Hong Kong

(2) there is a reasonable possibility that the winding up order would benefit those applying for it; and

(3) the court is able to exercise jurisdiction over one or more persons in the distribution of the company's assets.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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