



SHIPPING INSOLVENCIES: A HONG KONG PERSPECTIVE

As the bankruptcy of OW Bunker has shown, insolvency in a shipping context can cause significant, far reaching and immediate legal uncertainty. The interaction of insolvency procedures, jurisdictional issues, and the complex web of contractual relationships involved in shipping insolvencies creates unique practical and legal challenges. In this Briefing, we consider from a Hong Kong perspective some of the practical issues that commonly arise.

Insolvency in the Hong Kong Courts

In Hong Kong, insolvency proceedings are issued out of and supervised by the Companies Court. The Court has been well attended recently by shipping companies both fighting winding up petitions and surrendering to liquidations.

The Companies Court has jurisdiction to wind up both domestic and foreign companies. To commence liquidation proceedings against a company incorporated outside Hong Kong, the petitioner must show a sufficient connection with Hong Kong. This is usually demonstrated by the presence of company assets in Hong Kong.

From a creditor's perspective, although the Court's jurisdiction must not be used as a 'debt collecting' mechanism, the use of statutory demands and winding up petitions remains a popular tactic to enforce hire obligations upon charterers. Creditors choosing this path should be aware that because the consequences of insolvency proceedings are far reaching, the Court will ensure that creditors strictly comply with all procedural requirements. The most important of these is the requirement that the debt that forms the basis of the claim is for a liquidated sum that is not disputed by the debtor on any substantial grounds. If the debt is disputed in good faith, then the winding up petition will likely be dismissed, with the creditor being liable for the debtor's costs.

From a debtor's perspective, receiving a statutory demand for payment of a debt carries significant implications under Hong Kong law. The debtor will have 21 days to pay the debt, or secure or compound for the debt to the reasonable satisfaction of the creditor. Debtors should also be aware that a creditor may commence



insolvency proceedings without relying on a statutory demand. Although usually done first, service of a statutory demand is not a strict requirement under Hong Kong law. Once a winding up petition is issued, the next step is usually to advertise the petition in the Government Gazette and various newspapers and other publications. A shipping company served with notice that a winding up petition has been issued against it should seek immediate legal advice, as the advertisement of a petition could trigger enormous inconvenience to operations, including the freezing of bank accounts. In certain circumstances (such as where there is a triable defence or cross claim), it may be possible to obtain from the Court an injunction to restrain the presentation of the petition.

After a winding up petition has been presented, there will usually be plenty of opportunity to settle the debt without further adverse consequences. However, if the petition has been advertised, there is a chance that another creditor may substitute itself into the position of the original creditor and carry on with the insolvency proceedings. The Court will permit this because insolvency proceedings are a class right available for the benefit of all creditors of the company.

***In rem* proceedings**

When a shipowning company goes into liquidation, creditors with maritime liens and/or statutory maritime claims may have an advantage over unsecured creditors. Maritime law tends to be creditor friendly in this regard, with established mechanisms available to secure claims at an early stage. If the vessel is present in Hong Kong, it is often possible for a creditor to commence proceedings against the vessel and obtain an arrest. Once the vessel is under arrest, the shipowning



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company will be forced to post bail or provide other satisfactory security, such as a bank guarantee or letter of undertaking to secure the release of the ship. As often occurs in insolvency proceedings, if no security is provided then a creditor may apply to the Court for a judicial sale of the vessel. Once the vessel is sold by the Court, the proceeds of sale are distributed among the creditors of the company in accordance with strict rules of priority. If the ship is sold by way of judicial sale, the new purchaser will obtain a clear title to the vessel. These procedures may be used by a creditor with a statutory maritime claim or maritime lien even after a shipowning company has gone into liquidation.

Termination of charterparties

The insolvency of one of the parties to a charterparty, or the appointment of liquidators or receivers, does not automatically amount to a repudiation

or a renunciation of the charterparty under English law, unless expressly provided for in the charterparty. In most cases, the innocent party will only have a right to terminate if (i) the inevitable consequence of the event of insolvency is a repudiation of the charterparty; or (ii) a liquidator, or similar officer, has clearly stated that the charterparty will not be performed in some respect which goes to the root of the contract, thereby amounting to a renunciation. It is not always clear whether such circumstances exist. An innocent party may be entitled to terminate if the insolvent party is prevented by a Court Order from making any payments at all, or a notice is issued expressly stating that the charterparty will not be performed. In contrast, if the insolvent shipowner merely fails to confirm that a contract will be performed and states that investigations are pending, this may not be sufficient to confer a right to terminate on the innocent party.



Third party hire payments

When a charterer becomes insolvent, a recurrent question is whether a third party, such as a related company, may continue to perform the charterparty. In general, a debt will be discharged on payment by a third party if the payment is made as an agent of the debtor with either his prior authority or subsequent ratification. Thus, payments of hire by a third party will stand as contractual hire payments so long as they have been authorised by the charterer. However, upon the appointment of a liquidator or receiver, the directors will lose their powers to the liquidator. It would then be up to the liquidator to authorise or ratify any third party payments. A creditor is entitled to reject payment from a third party if it is made without the authority of the liquidator.

Arbitration proceedings

Quite often the shipping company that is the subject of insolvency proceedings in Hong Kong is involved in arbitration proceedings in other jurisdictions. The claimant in the arbitration may attempt to issue a petition in Hong Kong to wind up the company while the arbitration is on foot. It has been argued that this constitutes a breach of the agreement to arbitrate. There is law to suggest that the existence of an arbitration clause and/or arbitration proceedings does not (without more) mean there is a *bona fide* dispute in relation to the debt such as to justify dismissal of the petition in Hong Kong. However, English arbitrators have been known to uphold a claim for breach of the agreement to arbitrate, awarding damages against claimants who petition to wind up the respondent in Hong Kong, even when the debt has been settled as a result of the winding up petition. Care must be taken to ensure that Hong Kong insolvency proceedings would not prejudice arbitrations on foot elsewhere in the world.

Once a winding up order is made, there will be an automatic stay of all proceedings, including arbitration. This means that arbitrations cannot be commenced or continued against the insolvent company or its property except with the permission of the Court. Permission is usually granted if there are substantial issues of fact which would best be dealt with in separate proceedings rather than in the liquidation. In certain circumstances, it is also possible to make an application to stay arbitral proceedings before the winding up order has been made.

Conclusion

In conclusion, it is important for shipping companies to be aware of both the benefits and risks involved when a counterparty is close to or goes into liquidation. Careful consideration should be given to jurisdictional, legal and practical implications of any particular course of action. Legal advice should be sought promptly in order to put in place a strategy that will maximise chances of recovery or survival.



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