

The Hong Kong Institute of Bankers

Risk of Lending on Guarantee (A Case Study)

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Facts of the Case

A Bank lends \$90 million to a PRC Company (Borrower) secured by a guarantee provided by its Parent Company, who is the major shareholder of a HK Listed Company. The Borrower defaulted in payment and is on the verge of winding up. The Bank therefore engages lawyers to enforce the guarantee against the Parent Company. In the guarantee, there was an agreement to use arbitration to resolve dispute in PRC.

Injunction

When the Company borrowed the loan, the Parent Company had possessed over 35% stake in the Listed Company, i.e. over 800 million shares in the Listed Company. Shortly after the Company defaulted in payment, the Parent Company suddenly sold out its shares to an outsider (“Third Party Company”) and reduced to 8% stake, i.e. around 180 million shares in a Listed Company (“said Share”). After learning this from public notices, the Bank’s lawyer applied and obtained an injunction to freeze the said Share in HK Court pending enforcement of the guarantee against the Borrow by arbitration in PRC. After obtaining the HK Injunction and the PRC Arbitral Award, the lawyer applied and obtained from HK Court an enforcement order to enforce the PRC Arbitral Award in Hong Kong (as if a HK Judgment). After obtaining the Enforcement Order, the lawyer went on to obtain a Charging Order nisi on the said Shares basing on the PRC Arbitral Award and the Enforcement Order.

Contesting Third Party

At that time, a Third Party Company intervened and opposed to Bank's Charging Order being made absolute. The Third Party Company acquired from the Parent Company the controlling shares and has taken over control of the Listed Company, except the said Shares. They alleged that the Parent Company has already “pledged” the said Shares to the Third Party Company as security to indemnify the Third Party Company against any damage. They obtained a judgment in default against the Parent Company (by that time, the Parent Company was left to be wound up). It was alleged that the pledge of the said Shares took place before the Bank acquired the Charging Order on the said Shares and that the Third Party Company was entitled to the said Shares in priority over Bank.

Court Decisions

The High Court Judge held that there was no pledge on the said Shares. Despite having an agreement to pledge the said Shares, the Parent Company had not physically delivered the said Shares to the custody of the Third Party Company. The said Shares had been kept by a broker firm as a custodian for the Parent Company. By law, the pledge did NOT exist until there was a delivery of the said Shares to the pledgee, i.e. the Third Party Company. It was at most an agreement to pledge but not a pledge itself. The Bank, being a judgment creditor, had crystallized its interest on the said Shares by the Charging Order nisi and became a secured creditor. Therefore, the High Court granted the Charging Order absolute. The Third Party Company appealed against the High Court decision. On the strength of the Charging Order absolute, the Bank had applied and obtained the Sale Order to sell the said Shares during the appeal proceedings, but the Bank chose not to sell the said Shares and wait for the result of the appeal. The Appeal Court upheld the High Court decision a month after an economic downturn, the Bank then exercised its right to sell the said Shares.



Exercise

Please identify the Risks.

Possible Risks

1. Risks of dissipation of a guarantor's assets.
2. Risks of unknown ownership priorities over a guarantor's assets.
3. Risks of value fluctuation of a guarantor's assets.
4. Risks of enforcing an arbitral award of foreign jurisdiction (e.g. PRC) against a guarantor in Hong Kong compare to Risks of enforcing a foreign judgment (if not a foreign arbitration award) in Hong Kong.
5. Risks of tardiness to commence legal proceedings against a borrower and a guarantor.



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Q & A

PLEASE NOTE

The law and procedure on this subject are very specialised. This article is a general explanation for your reference only and should not be relied on as legal advice for any specific case. If legal advice is needed, please contact our solicitors.

請注意

本題目之法律及程序十分專門。此文章只屬一般性之解釋，供你參考，而不應被依賴為關於任何特定事件之法律意見。如需法律意見，請與我所律師聯絡。

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