U.S. COURT ENJOINS ASIAN INVESTOR FROM INVOKING SHAREHOLDER PURCHASE RIGHTS IN AN ASIAN JOINT VENTURE

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A U.S. Bankruptcy Court (the "Bankruptcy Court") recently enjoined a Hong Kong-based investor from exercising its shareholder purchase rights in an Asian joint venture.[1] The Bankruptcy Court's order also prevents the investor from proceeding with litigation to enforce its rights in a Hong Kong court. Neither of the joint venture partners, or the joint venture itself, are debtors in a domestic or foreign insolvency proceeding. Nevertheless, the Bankruptcy Court ruled that injunctive relief was warranted because the investor's actions were disrupting a sale process for the U.S. company's interests in the Asian joint venture.

This case stands as a stern warning to foreign companies that may be considering joint ventures with U.S. partners. In this case, the parties structured the joint venture in a way that should have insulated the partners from U.S. legal entanglements. In particular, the joint venture partners agreed that any dispute between them would be resolved under Hong Kong law in a Hong Kong arbitration. Despite this, the Bankruptcy Court has now taken control of the sale of one partner's interest in the joint venture, effectively overriding express terms of the shareholders' agreement.

The dispute arose in the Chapter 11 bankruptcy cases involving Toys "R" Us, Inc.[2] ("TRU"). One of TRU's subsidiaries, TRU (UK) Asia Limited, owns approximately 85% of a joint venture called Toys (Labuan) Holding Limited (the "Joint Venture"). The remaining 15% of the Joint Venture is owned by Fung Retailing Limited ("Fung"), a Hong Kong company. The Joint Venture is a British Virgin Islands entity headquartered in Hong Kong. Notably, neither TRU (UK) Asia Limited nor the Joint Venture are debtors in the U.S. bankruptcy proceedings for TRU. The Joint Venture, through its own subsidiaries, operates Toys R Us stores throughout Asia.

A written shareholders' agreement (the "Shareholders Agreement") governs the rights and responsibilities of TRU (UK) Asia Limited and Fung in the Joint Venture. The Shareholders Agreement is governed by Hong Kong law and requires that any dispute between the shareholders will be resolved by arbitration in a Hong Kong forum. The genesis of the present dispute with TRU (UK) Asia Limited pertains to a right of first refusal, specifically Fung's right to purchase the interests owned by TRU (UK) Asia Limited in the Joint Venture if TRU (UK) Asia Limited decides to sell its interest.

TRU's reorganization efforts failed in the spring of 2018, at which point TRU began a process to liquidate its assets. When TRU solicited bids for its interests in the Joint Venture, Fung participated in several rounds of bidding, but another party was selected as the winning bidder.

When TRU sought bankruptcy court approval for its sale of the Joint Venture interests owned by TRU (UK) Asia Limited, Fung objected arguing that the proposed sale should not prevent Fung from exercising its right of first refusal under the Shareholders Agreement. Fung also commenced an arbitration in Hong Kong in accordance with the Shareholders Agreement. Fung also sought (and received) an order from the Hong Kong High Court enjoining TRU (UK) Asia Limited, the TRU subsidiary that owns 85% of the Joint Venture, from completing the proposed sale. The order entered by the Hong Kong High Court required TRU (UK) Asia Limited TRU to deposit money with the High Court sufficient to cover a possible arbitration award to Fung.

TRU responded by asking the Bankruptcy Court to enjoin Fung from taking any further action in Hong Kong. TRU argued that Fung was merely a disappointed bidder and that its actions were disrupting TRU's sale process. Fung objected, contesting the jurisdiction of U.S. courts to enjoin it from exercising its contractual rights under an agreement with a foreign entity that is not a debtor in bankruptcy.

Fung contends the Bankruptcy Court lacks the authority to enjoin Fung's actions in Hong Kong. Fung argues the dispute about its right of first refusal has no connection with the United States or TRU's bankruptcy cases and that Fung itself has no significant connections with the United States. Like the Joint Venture entity, Fung is not a US company and has neither assets nor operations in the United States.

In a ruling on September 27, the Bankruptcy Court sided with TRU and enjoined Fung from continuing its actions in Hong Kong until after TRU completes its sale of the Joint Venture interest owned by TRU (UK) Asia Limited. The Bankruptcy Court ruled that Fung's participation in TRU's auction process created sufficient connections between Fung, TRU and its U.S. insolvency proceedings to give the Bankruptcy Court jurisdiction over Fung. Once the sale closes, Fung's litigation in Hong Kong will be moot because TRU (UK) Asia Limited is expected to have no remaining assets with which to pay a monetary award to Fung.

Fung promptly appealed the Bankruptcy Court's order, arguing again that the Bankruptcy Court lacks the power to enjoin Fung because the dispute in Hong Kong over the Joint Venture is not sufficiently connected to the United States. On October 25, the United States District Court affirmed the Bankruptcy Court's ruling. Fung immediately sought further appellate review by the U.S. Court of Appeals for the Fourth Circuit. The Fourth Circuit's decision is likely to be the final word on this dispute in the United States, as it is unlikely the U.S. Supreme Court would hear an appeal by Fung. We will provide an update following a decision by the Fourth Circuit.

Notes:
[1] *See Toys "R" Us, Inc. v. Fung Retailing Ltd.* (*In re* Toys "R" Us, Inc.), Case No. 17-34665, Adv. Proc. No. 18-03090, Docket No. 25 (Bankr. E.D. Va.).
[2] *In re* Toys "R" Us, Inc., Case No. 17-34665 (Bankr. E.D. Va.).

