Arbitration clauses and winding up applications: Part II

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This update considers two recent BVI decisions, considering the availability of arbitration stays in winding up proceedings, under the Arbitration Act 2013.

In our previous update, we considered the impact of two recent BVI Court of Appeal decisions[1] and the potential impact of those decisions on the future of arbitration stays in winding up proceedings. Both of those decisions were decided under the 1976 Arbitration Ordinance.

This update considers two more recent decisions handed down the by BVI Courts. They are:

- *Jinpeng Group Limited v Peak Hotels and Resorts Limited* (**Peak Hotels**) BVIHCMAP 2014/0025, BVIHCMAP 2015.0003; and
- *Retribution Limited v L Capital KDT Limited* (BVIHCMAP 2015/78 and 2015/89) (**Retribution**).

In contrast to the cases considered in our earlier update, both of these recent cases were decided under the new BVI Arbitration Act 2013.

Arbitration Act 2013

As stated by the Commercial Court in *Retribution*, the new Act was designed to provide a:

'comprehensive legal and modern framework for attracting and dealing with arbitral disputes from around the world, and to provide the platform from which to launch the BVI as an international arbitration centre.'

Section 18 of the BVI Arbitration Act 2013 became effective on 1 October 2014. Section 18(1) provides as follows:

'A court before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so requests not later than when submitting his first statement on the substance of the dispute, refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.'

As observed by the Court of Appeal in Peak Hotels, this section is wider in scope than the repealed section 6(2) of the 1976 Arbitration Ordinance in at least two ways:

'Firstly, the new section covers all matters that are 'the subject of an arbitration agreement' and not simply matters the parties 'agreed to be referred' to arbitration as in section 6(2) of the Repealed Act. Secondly, the words 'or that there is not in fact any dispute between the parties' in section 6(2) are not included in section 18(1). This brings section 18(1) in line with the provisions of the English Arbitration Act 1996 and the UNCITRAL Model law on arbitration.'

[1] *C-Mobile Services Limited v Huawei Technologies Co. Limited* BVIHCMAP 2014/0006 and BVIHCMAP 2014/0017(**C-Mobile**).

Peak Hotels and *Retribution* are the first two cases to consider how the new, wider, provision will affect the availability of arbitration stays in winding up proceedings.

Peak Hotels

Peak Hotels involved two consolidated appeals. This update focuses on the first of them, which was an appeal against an order striking out a winding up application.

The appellant lent the company US$35 million, pursuant to a loan agreement under which it had the option of converting the loan into equity. When the appellant commenced proceedings to wind up the company on the basis of that outstanding loan, the company argued that the option had been exercised and accordingly the loan had been converted into shares.

Overturning the first instance decision, the Court of Appeal held (by reference to the well-established test that there was a debt which was not disputed on genuine and substantial grounds[2]) that the appellant was a creditor, within the meaning of section 162(1)(b) of the BVI Insolvency Act 2003. Therefore, the Court of Appeal reversed the decision to strike out the application.

The Arbitration Clause

However, matters did not end there, because the loan agreement contained the following arbitration clause:

'Any dispute, controversy, difference or claim arising out of or relating to this Agreement, including but not limited to that regarding the existence, validity, construction, performance, breach or termination hereof, or any non-contractual dispute arising out of or relating to this Agreement, shall be submitted to the Hong Kong International Arbitration Centre (HKIAC) and finally and conclusively settled under the HKIAC Administered Arbitration Rules in force at the time when a notice of arbitration is submitted.'

The Court of Appeal considered the effect of this arbitration clause on the application to appoint liquidators. It started by determining whether the dispute between the parties was caught by the arbitration clause, holding that it was, by virtue of (it appears) the words highlighted above, stating:

'The issue of the conversion of the loan or the time for repayment thereof is a pure contractual dispute between the parties while the appellant's status to apply for the winding up of the respondent can be classified as a non-contractual dispute arising out of or in relation to the Loan Agreement. '

Having made this determination, the Court of Appeal then went on to hold, in line with the approach taken by the Court of Appeal in C-Mobile, that a creditor, in bringing a winding up application, is seeking a collective remedy on behalf of *all* creditors of the company. This form of proceeding is not covered by section 18 of the Arbitration Act and the relevant arbitration clauses in the parties' agreements. Therefore, the Court of Appeal held that it should not grant an automatic stay of this application under section 18(1).[3]

The Court of Appeal held that this question was not affected by the fact that the application to wind up the company was based on the just and equitable ground (as opposed to an assertion that the company was insolvent).

Having reached this conclusion, the Court of Appeal went on to consider whether it should exercise its discretion under section 162(1)(b) of the Insolvency Act 2003 to stay or dismiss the application. It noted the approach taken by the English Court of Appeal in *Salford Estates*[4] when exercising its similar discretion under section 122 of the English Insolvency Act 1986. The English Court of Appeal had observed:

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[2] The Court of Appeal reiterated the applicability of *Sparkasse Bregenz Bank AG v Associated Capital Corporation BVI* Civ App 10/2002, namely that the court will only strike out a petition if the respondent to that petition can demonstrate that the alleged debt on which the petition is founded is genuinely disputed on substantial grounds.

[3] In reaching this conclusion, the Court of Appeal relied on the English Court of Appeal in the case of *Salford Estates (No.2) Limited v Altomart Limited* [2014] EWCA Civ 1575, in which the English Court of Appeal held that a winding up petition relating to a disputed debt does not become a claim falling within section 9 of the English Arbitration Act 1996.

[4] Ibid.

'...it is entirely appropriate that the court should, save in wholly exceptional circumstances ... exercise its direction consistently with the legislative policy embodied in the 1996 [Arbitration] Act.'

Because, in the English Court's view:

'Exercise of the discretion otherwise than consistently with the policy underlying the 1996 Act would inevitably encourage parties to an arbitration agreement – as a standard tactic – to bypass the arbitration agreement and the 1996 Act by presenting a winding up petition ... that would be entirely contrary to the parties' agreement as to the proper forum of the resolution of such an issue and to the legislative policy of the 1996 Act.'

The Eastern Caribbean Court of Appeal took a different approach to the one adopted by the English Court of Appeal, concluding that, as a matter of BVI law, a creditor should not have to prove exceptional circumstances to obtain a winding up order. This was because, in the Court of Appeal's view, the BVI court's statutory jurisdiction to wind up a company based on its inability to pay its debts as they fall due unless the debt is disputed on genuine and substantial grounds, is:

'too firmly a part of BVI law to now require a creditor exercising the statutory right belonging to all the creditors of the company to apply to wind up the company, to prove exceptional circumstances to establish his status to apply.'

Having determined that the debt in *Peak Hotels* was not disputed on genuine and substantial grounds, and notwithstanding the fact that there was an ongoing arbitration in Hong Kong, the Court of Appeal chose to exercise its discretion under section 162 of the Insolvency Act 2003 to wind up the company.

In exercising its discretion, the Court of Appeal appears to have been heavily influenced by the fact that the US$ 35 million of treasury bonds initially lent by the appellant to the company had gone missing almost a year earlier and that the company could not account for them. In those circumstances, the Court of Appeal viewed it as necessary to appoint liquidators to investigate what had happened and to try to recover those assets.

The Court of Appeal concluded by saying that, even if it had been wrong to conclude that the appellant did not need to prove exceptional circumstances in order to obtain a winding up order, it would have found, in light of the missing treasury bonds, such exceptional circumstances existed in this case.

Retribution

Less than a month after the decision in *Peak Hotels* had been handed down, it was considered by the BVI Commercial Court in *Retribution*.

Retribution concerned an application to wind up the company on the grounds of a disputed debt. At the hearing, the company argued that, in line with the decision of the English Court of Appeal in *Salford Estates*, if the BVI Court was satisfied that there was a dispute that fell within the terms of the arbitration agreement, the court should exercise its discretion under section 162 of the Insolvency Act 2003, to dismiss the application to appoint liquidators and grant an arbitration stay.

In its judgment the Court noted that section 18 (1) of the Arbitration Act was:

'intended specifically to limit further the jurisdiction and power of the court to intervene in and determine matters which clearly fall within the four corners of an arbitration agreement, by which the parties have decided, as a matter of contract, to have all disputes determined only by arbitration, however minor or indefensible their dispute or difference may be.'

The Court stated that whilst it had sympathy with the company's submissions that an automatic arbitration stay should be granted, it was bound by the Court of Appeal's decision in *Peak Hotels* and therefore had to consider whether the debt was disputed on genuine and substantial grounds.

After reviewing the relevant agreements, the BVI Court found that the debt was disputed on genuine and substantial grounds. However, it went on to say that, even if this conclusion was wrong, the Court nevertheless would have exercised its discretion under section 167(1)(b) of the BVI Insolvency Act 2003, and refused to appoint liquidators over the company.

In the Court's view, unlike the position in *Peak Hotels*, there were no circumstances which required the immediate appointment of liquidators to investigate the affairs of the company. Furthermore, the Court stated that, as the BVI has now moved into the international arena as 'a new and emerging centre for international arbitration', the role of the courts to decide disputes caught by arbitration agreement 'has proportionately been diminished and limited' and in the view of the Court it behoves the courts, 'including this Commercial Court, to support this process and not to hinder, in any way, its development and concretization, except in the most clearest of circumstances, which this case is not.'

Conclusion

In summary:

- In *Peak Hotels*, the Court held that there was not a genuine and substantial dispute as to the underlying debt, and went on to decline to exercise its discretion to stay or dismiss that winding up application. It commented that if its analysis was wrong, so that exceptional circumstances were required to decline to stay or dismiss this application, such exceptional circumstances existed in this case.
- In *Retribution*, the Court held that there was a genuine and substantial dispute as to the underlying debt, but that if there had not been such a dispute, the Court nevertheless would have exercised its discretion to stay or dismiss that winding up application.

On the facts of *Peak Hotels* it is easy to see why the Court of Appeal considered it appropriate to exercise its jurisdiction to wind up the company and appoint independent liquidators. However, the decision in *Retribution* shows that, in less unusual cases, the BVI Court may well be mindful of the parties' original agreement to resolve their disputes by arbitration, and conscious of the English Court of Appeal's warning that, unless arbitration stays are made available in winding up proceedings, parties will inevitably be encouraged to present winding up applications as a standard tactic to bypass their arbitration agreements.

It will be very interesting to see how the courts deal with similar cases in future. In particular, we have yet to see whether the BVI Court will be prepared to follow the approach taken by the English Court of Appeal in *Salford Estates*, by staying or dismissing winding up applications in favour of arbitration, where there is no genuine or substantial dispute as to the underlying debt.

If the BVI Court declines to follow the English Court's approach, then the presence or absence of arbitration clauses may end up having little practical effect in winding up proceedings.

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