UPDATE

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The Continuing Tension between Arbitration Agreements and Liquidation Proceedings

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Two decisions handed down on the same day – one by the Eastern Caribbean Court of Appeal and the other by the Commercial Division of the High Court – illustrate the approach of British Virgin Islands Courts to applications to appoint liquidators in circumstances where the subject matter of a dispute as to the existence of a debt falls within the scope of an arbitration agreement.

Introduction

In recent years there has been a steady stream of British Virgin Islands decisions that have considered the impact of arbitration agreements on liquidation proceedings. On 11 November 2022, two further decisions were delivered: a decision of the Commercial Division of the High Court in *Kenworth Industrial Limited v Xin Gang Power Investments Limited*[1], and a decision of the Eastern Caribbean Court of Appeal in *Sian Participation Corp. (in liquidation) v Halimeda International Limited*[2].

The Statutory Context

The Automatic Stay

The Arbitration Act, 2013 gives statutory effect to the UNCITRAL Model Law on International Commercial Arbitration. Section 18(1) of the Arbitration Act (which gives effect to article 8 of the Model Law) provides that:

'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.'

The Liquidation Jurisdiction

A BVI Court has jurisdiction under sections 159 and 162 of the Insolvency Act, 2003 to appoint a liquidator of a company if:

(a) the company is insolvent; or

(b) the Court is of the opinion that it is just and equitable that a liquidator should be appointed.

If a company intends to oppose an application for the appointment of a liquidator on the ground that it is insolvent, it is required by rule 164 of the Insolvency Rules, 2005 to file with the Court and serve on the applicant a notice setting out the grounds on which it opposes the application, and an affidavit verifying the matters stated in the notice, not less than 7 days before the date fixed for the hearing of the application.

[1] Claim Nos. BVIHC (COM) 2022/0053 & 2022/0065.

[2] BVIHCMAP2021/0017.

The Divergent Approach of English and BVI Courts to Arbitration Agreements and Insolvency Proceedings

The BVI Courts have taken a different approach to those of the English Courts in relation to the impact of arbitration agreements on liquidation proceedings.

The English Approach

In England, the Court of Appeal in *Salford Estates (No 2) v Altomart Ltd (No 2)*[3], held in considering the equivalent English legislation that where parties had agreed to refer disputes to arbitration, if a dispute as to the existence of a petition debt came within the scope of the arbitration clause, the court should, save in wholly exceptional circumstances, exercise its discretion so as to dismiss or stay the petition so as to compel the parties to resolve their dispute by arbitration.

The BVI Approach

However, in *C-Mobile Services Limited v Huawei Technologies Co. Limited*[4], the Eastern Caribbean Court of Appeal in considering the statutory predecessor to section 18(1) of the Arbitration Act held that an applicant for the appointment of liquidators did not need to demonstrate exceptional circumstances before a BVI Court could determine the question as to whether a debt was bona fide disputed on substantial grounds where the subject matter of the dispute fell within the scope of an arbitration agreement.

Subsequently, in *Jinpeng Group Limited v Peak Hotels and Resorts Limited*[5], the Eastern Caribbean Court of Appeal said in relation to the *Salford Estates* approach:

'The position outlined by the Chancellor in these passages comes close to the automatic stay position which is now firmly a part of the learning in connection with section 18 of the Arbitration Act. He is saying in very clear terms that a winding up application based on a debt that is covered by an arbitration agreement will be stayed unless there are exceptional circumstances. However, I do not think that a creditor should have to prove exceptional circumstances. This Court's judgment in the C-Mobile case sets out and distinguishes 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. This principle 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. The statutory jurisdiction under section 162(1)(b) is satisfied once the creditor is applying on the basis of a debt that is not disputed on genuine and substantial grounds.'

Kenworth Industrial Limited v Xin Gang Power Investments Limited

In this case, the respondent company sought an order staying proceedings brought by the applicant seeking the appointment of liquidators of the company on just and equitable grounds. The application to appoint liquidators was made on the basis of a lack of probity on the part of the company's management giving rise to a lack of trust and confidence. The applicant relied upon a number of specific grounds to make out its complaint including the purported forfeiture of its shares.

The company contended that the question of whether it was entitled to forfeit the applicant's shares should be referred to arbitration in accordance with an arbitration agreement found within the company's articles of association.

A preliminary argument raised by the applicant in opposition to the stay to the effect that the company had waived its right to refer the forfeiture issue to arbitration as it had taken steps in the proceedings was dismissed by the Court on the basis that the company had commenced its arbitration the day before filing its first affidavit in the proceedings.

As regards the question of whether a stay should be granted, the Court stated that there were three propositions of law that were not in dispute:

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[3] [2015] 3 WLR 491.

[4] BVIHCMAP 2014/0017, 15 September 2015.

[5] BVIHCMAP2014/0025 & BVIHCMAP2015/0003, 8 December 2015.

1. An order appointing liquidators can only be made by the Court. The power to make such an order is not arbitrable;
2. The automatic stay which applies to an action under section 18 of the Arbitration Act does not apply to applications for the appointment of liquidators; and
3. The Court has a discretion whether or not to appoint liquidators. However, the existence of an arbitration agreement is relevant to whether to grant a stay of the application to appoint liquidators.

After reviewing the relevant authorities including *Salford Estates*, *C-Mobile* and *Jinpeng*, the Court held that, in general, the existence of an arbitration agreement will favour the dismissal or stay of an application to appoint liquidators; but not always, for example, where a defence is an obvious 'put-up job'.

Ultimately, the Court accepted that it would be inappropriate to hive off the forfeiture issue to arbitration given that it was but one of a number of issues that arose in the proceedings. In addition, the Court was mindful that if it was found in the arbitral proceedings that the company was entitled to forfeit the applicant's shares, then the applicant would lose its standing as a shareholder to pursue its application for the appointment of liquidators. A stay was therefore refused as a matter of discretion.

Sian Participation Corp. (in liquidation) v Halimeda International Limited

This case involved an appeal against an order appointing liquidators to the appellant company on the basis that it was insolvent, having failed to repay a $150 million loan due to the respondent. The company had contended in the court below, amongst other things, that it had a cross-claim under the loan agreement which was equivalent to or exceeded the value of the loan. The company had argued that the liquidation proceedings should be stayed in favour of arbitration on the basis that the loan agreement contained an arbitration agreement.

The court below found that:

1. the arbitration point had been raised too late;
2. following *Jinpeng*, it was not the law that the existence of an arbitration agreement precluded a creditor from applying for a winding up order; and
3. there is no mandatory stay of liquidation proceedings in favour of arbitration.

On appeal, it was argued by the company that the judge had erred by holding that the arbitration point had been raised too late. It was contended that there was no requirement for the company to have commenced arbitration in order to rely on the arbitration agreement since the parties were bound to resolve their dispute by arbitration, irrespective of whether or not any arbitration had actually been commenced.

The Court of Appeal confirmed that the Court had a discretion as to whether to stay liquidation proceedings in favour of arbitration. However, it upheld the judge's finding that the arbitration point had been raised too late on the basis that the company's first statement on the substance of the dispute, being its notice of opposition under rule 164, did not contain any request for a referral to arbitration. It was not until an amended notice of opposition was filed some months later that the arbitration issue was raised for the first time. The appeal was accordingly dismissed.

Conclusion

Both decisions confirm that:

1. Unlike the position in England, where the subject matter of a dispute as to the existence of a debt falls within the scope of an arbitration agreement, an applicant for the appointment of liquidators in not required to prove exceptional circumstances before a BVI Court will determine the question as to whether the debt is bona fide disputed on substantial grounds;
2. The automatic stay under section 18 of the Arbitration Act does not apply to applications for the appointment of liquidators; and
3. The Court retains a discretion whether to appoint liquidators or not, although the existence of an arbitration agreement is a relevant consideration in the exercise of that discretion.

Both decisions also illustrate the importance of a company wishing to refer a dispute to arbitration making a request for a referral in its first statement to the Court on the substance of the dispute. A failure to do so may result in the company being unable to obtain a stay, as was the case in *Sian Participation Corp*.

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