UPDATE

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Will a just and equitable winding up petition render an arbitration agreement inoperative?

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The Privy Council has considered the question of whether an agreement to settle disputes arising out of a shareholders' agreement by arbitration prevents a party to the agreement pursuing a petition to wind up the company on just and equitable grounds.

Background

The case relates to an ongoing dispute between the Appellant, Ting Chuan (Cayman Islands) Holding Corporation (Ting Chuan), and the Respondent, FamilyMart China Holding Co Ltd (FMCH), the minority and majority shareholders respectively of China CVS (the Company) trading as FamilyMart in the PRC.

As a result of the dispute, FMCH presented a just and equitable winding up petition alleging various wrongdoing by Ting Chuan. The relationship between Ting Chuan and FMCH was governed by a shareholders' agreement, which provided that disputes should be settled by way of arbitration. Given the Company was solvent and hugely profitable, the purpose of the petition was to seek an order requiring Ting Chuan to sell its majority stake in the Company to FMCH.

Ting Chuan applied for an order dismissing or staying the winding up petition pursuant to section 4 of the Foreign Arbitral Awards Enforcement Act (1997 Revision) (FAAEA), which allows the Court to stay proceedings where a matter is subject to an operative arbitration agreement.

The judgments of the Cayman Islands Courts

At first instance, the Grand Court granted the application for a mandatory stay under section 4 of the FAAEA, holding that it was '*clear beyond sensible argument*' that the underlying allegations in the petition related to the subject matter of the shareholders' agreement and fell within the ambit of the arbitration agreement.

The Court of Appeal overturned the Grand Court's decision and held that the Court had exclusive jurisdiction to determine whether a company should be wound up on the just and equitable ground and that as a result the underlying issues raised by the petition were not susceptible to arbitration.

The Privy Council

It was accepted that the winding up petition raised five matters -

1. whether FMCH had lost trust and confidence in Ting Chuan and management;
2. whether the relationship between FMCH and Ting Chuan had irretrievably broken down;
3. whether it was just and equitable that the Company should be wound up;
4. whether Ting Chuan should be ordered to sell its shares to FMCH pursuant to the statutory remedy; and
5. if not, whether an order winding up the Company should be made.

Ting Chuan submitted that matters (1) to (4) were arbitrable and therefore entitled it to a mandatory stay of the winding up petition, FMCH maintained that none were capable of arbitration.

The approach to arbitration agreements

The Board had little hesitation in finding that the Courts should give priority to the autonomy of the parties to agree to arbitration agreements. Accordingly, effect should be given to an arbitration agreement unless the agreement is contrary to public policy or there is a rule of law or statutory provision which makes a matter incapable of resolution by arbitration.

The interpretation of section 4 of the FAAEA

To resolve the appeal the Board undertook an extensive analysis of the case law to interpret section 4 of the FAAEA.

Section 4 states that '*If any party to an arbitration agreement … commences any legal proceedings in any court against any other party to the agreement … in respect of any matter agreed to be referred [to arbitration], any party to the proceedings may at any time after the appearance … apply to the court to stay the proceedings; and the court, unless satisfied that the arbitration agreement is … inoperative …, shall make an order staying the proceedings*.' [our emphasis]

In coming to its conclusion, the Board found it necessary to focus on the words underlined.

Legal proceedings

In respect of '*legal proceedings*' the Board saw no reason to question that a legal proceeding could include a petition.

Matters

In respect of the meaning of the word '*matter*' the Board concluded that to determine whether a matter fell within an arbitration agreement, a two-stage process should be adopted:

(i) first, the Court must determine what the matters are that the parties have raised or foreseeably will raise in court proceedings; and
(ii) second, the Court must determine if a matter falls within scope of the arbitration.

The Board warned, however, that the Court should not be too reliant on pleadings which seek to plead around matters which may be susceptible to arbitration. The Board also warned that '*matters*' which were peripheral or tangential to the subject matter of the legal proceedings should not be the basis for a stay under section 4. As always, a common-sense approach was required.

As to the disadvantages of some '*matters*' in a dispute being subject to arbitration and others requiring determination by the Court, the Board was unconcerned, suggesting that such fragmentation can be mitigated by effective case management.

Orders staying the proceedings

The Board dealt with this issue at the same time as dealing with '*matters*'. The question at hand was whether an order '*staying the proceedings*' under section 4 allowed for the possibility of a stay of certain parts of the proceedings or only a stay of the proceedings as a whole. Similar legislation in other countries (which are signatories to the New York Convention)[1] make express provisions for a stay either of proceedings or so much of the proceedings as involves the determination of the matter subject to arbitration. To get around this absence in the Cayman Islands legislation, the Board (with a freedom only a final Court of Appeal enjoys) simply relied on the maxim that '*the legislature is presumed to intend an enactment to be read in the light of the principle that the greater includes the lesser*'. Accordingly, '*staying of proceedings*' is to be read as including the lesser ie '*staying the proceedings or any part of them*'.

Agreement inoperative

Having decided (i) that legal proceedings included the petition; (ii) what a matter might be and (iii) that parts of a proceeding could be stayed, the Board went on to deal with the threshold question, namely whether the arbitration agreement could trespass on winding up proceedings.

[1] UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958).

The Board resolved this issue by drawing a distinction between subject matter non-arbitrability and remedial non-arbitrability.

In respect of the former, the Court cited examples where statute prevented certain subject matter being capable of arbitration in the UK such as employment rights and cases concerning discrimination. The Board held that subject matter that would not be capable of arbitration would be those that touched on issues of public rights or concern or interests of third parties, neither of which could be the subject of a private arbitration.

In respect of remedial matters, the Board found that an arbitration award could not confer on the tribunal the power to make an order to wind up a registered company. That was a power of the Courts alone.

However, having drawn the distinction between subject matter and remedial matters, the Board found that the Court of Appeal had erred in its determination. There was no reason why the factual issues or subject matter issues such as breach of duty or loss of trust and confidence could not be dealt with by arbitration with the remedial issue, ie the making of a winding up order, reserved for the exclusive jurisdiction of the Court.

In winding up proceedings, is the Court bound by a decision of an arbitration tribunal?

This finding led to the interesting question of whether a Court could be bound by the decision of an arbitral tribunal as to the facts when deciding whether to exercise its discretion to wind up a company. The case law suggested that the bifurcation of facts and remedy would not be possible. In other words, the Court could not determine a remedy on the one hand without having first determined the facts.

The Board found that a Court would be bound on two bases: First, it found that a Court would be bound as to the facts where the parties submitted an agreed statement of facts. The Board considered that if a Court were bound by such an agreed statement there was no reason why it should not be bound by a finding of a tribunal to which the parties had voluntarily submitted. Second, as a matter of law, the parties to the arbitration are bound by the decision and hence the parties to the arbitration may not, even if they wished, seek to go behind the findings of the tribunal and seek to persuade the Court otherwise. Obviously interested parties in the petition not bound by the arbitration would be under no such restriction.

Case management stay

Having reached these conclusions the Board found that matters (1) and (2) were matters capable of arbitration within the terms of section 4 of the FAAEA and ordered a mandatory stay of the winding up proceedings. Grounds (3) to (5) were not capable of arbitration.

The Board also allowed a case management stay of the winding up proceedings pursuant to section 95(1) of the Companies Act (2023 Revision). The Board found that the general rule that such stays should only be granted in rare and compelling circumstances to be inconsistent with the support the Court gives to arbitration.

Conclusion

The decision of the Board reaffirms the positive approach the Courts take to arbitration and is an excellent example of how the Court will hold parties to the agreements they have made. The Board was not troubled by some of the procedural difficulties raised and looked for pragmatic solutions to give effect to the agreement reached. The effect of the Board's decision is that whilst an arbitration agreement does not prevent the issuing of a winding up petition, it is likely that where any factual dispute between parties is subject to an arbitration agreement, it will need to be resolved there first. The judgment is also a clear signal that in any proceedings, a party seeking to avoid an arbitration agreement will have to work hard to try and persuade the Court that relevant matters should be determined anywhere other than in front of an arbitration tribunal.

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