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Does an arbitration agreement protect a debtor from the threat of liquidation?

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In several Commonwealth jurisdictions, the corporate legislation allows creditors to petition a court to order the winding up of a debtor in circumstances where that debtor is unable to pay its debts as they fall due. Such legislation generally presumes that the debtor is insolvent if it has failed to comply with a statutory notice requiring the debtor to pay a certain debt within a given period of time (a *statutory demand)*. Where the debtor disputes that debt, the court ordinarily determines whether that dispute is genuine; that is, whether the debtor has a substantial and *bona fide* defence to the creditor's claim. If the dispute is genuine, the court sets aside the winding up petition. The purpose of the exercise is to ensure that a statutory demand or winding up petition is not defeated by a debtor's spurious or frivolous defences.

The question arises, however, whether the court is precluded from proceeding with that determination where the alleged dispute is governed by an arbitration agreement. The judgments recently delivered in different Commonwealth jurisdictions show that the matter is far from being settled. Even where courts in different jurisdictions have reached the same conclusion, their reasoning differed to some extent. This article, which is co-authored by arbitration practitioners from different jurisdictions, considers the approach taken by the courts in some parts of the Commonwealth, as well as the practical commercial implications of the current case law.

The English Court of Appeal's invariable stay of winding up proceedings in favour of arbitration

In *Salford Estates (No.2) Limited v Altomart Limited* [2015] Ch. 589 [2014] EWCA Civ 1575, the alleged debtor invoked section 9 of the English Arbitration Act in its application for an order to stay a winding up petition. That provision requires a court to stay legal proceedings which are brought before a court in respect of a matter which is governed by an arbitration agreement, unless the court is satisfied that the arbitration agreement in question is null and void, inoperative, or incapable of being performed. The English Court of Appeal held that this provision is inapplicable to stay a winding up petition, which is not in itself a claim for payment due under a contract.

The Court nevertheless upheld the original stay order on alternative grounds. Because the Court's power to order the winding up of a company under the English Insolvency Act (as in other Commonwealth jurisdictions) is discretionary in nature, the Court considered that it should exercise that discretion by taking into account the legislative policy behind the Arbitration Act, which is to uphold the principle of party autonomy and exclude a court's summary determination

of a dispute that is the subject of an arbitration agreement. As a result, the English Court of Appeal concluded that where a debt subject to an arbitration agreement is not admitted, the Court should stay or dismiss the winding up petition unless there are *"wholly exceptional* circumstances"[1], which the Court could not envisage.

In overturning the first instance decision granting a mandatory stay of proceedings, the English Court of Appeal endeavoured to uphold the policy of the Insolvency Act to a certain extent, noting that the intention of the Arbitration Act would not have been "*to confer on a debtor the right to a non-discretionary order [to stay a winding up petition] striking at the heart of the jurisdiction and discretionary power of the court to wind up companies in the public interest where companies are not able to pay their debts*."[2] Inspite of this, the English Court also concluded that the Court should not encourage parties to use "*the draconian threat of liquidation*" as a method for bypassing an arbitration agreement, concluding that to do so "*would be entirely contrary to the parties' agreement as to the proper forum for the resolution of such an issue and to the legislative policy of the 1996 Act.*"[3]

The reasoning in *Salford Estates* does not provide a comprehensive answer to all of the issues that can arise from the interaction between insolvency and arbitration. Further, no clear guidance was given as to in what "*wholly exceptional circumstances*"[4] the policy aims of the Insolvency Act might be favoured over those of the Arbitration Act, other than where there was another debt not subject to an arbitration agreement that could be used as evidence of inability to pay in support of the winding up petition.

Hong Kong's departure from the English approach

In *Dayang (HK) Marine Shipping Co Ltd v Asia Master Logistics Ltd* [2020] HKCFI 311, the Hong Kong Court of First Instance rejected the reasoning applied by the English Court of Appeal in *Salford Estates*, which the Hong Kong courts had previously adopted. In *Dayang*, the debtor did not dispute the unpaid debt on which the winding up petition was premised, but instead alleged that it had a cross-claim. The Court held that in order to validly oppose the winding up petition, the debtor must show that its cross-claim gives rise to a *bona fide* dispute on substantial grounds. The existence of an arbitration agreement should be regarded as irrelevant to the exercise of the court's discretion to make a winding-up order.

In particular, the Court rejected the contention that the presentation of a winding up petition *per se* amounts to a breach of an arbitration agreement and contravenes party autonomy: according to the Court, in petitioning for a winding up, a creditor is not submitting a dispute for the determination and/or resolution of the Court. That debt is ultimately determined by the liquidator to whom the creditor submits its proof of debt, and it might be possible for the creditor to refer a liquidator's rejection of the proof of debt to arbitration.[5]

On that basis, the Hong Kong Court also disagreed with the English Court of Appeal's analysis that the determination of a winding up petition results in a summary judgment, which undermines the legislative policy behind the arbitration legislation. The Court held that summary judgments are final and conclusive judgments on the merits, whereas winding up proceedings do not involve a determination of disputes over liability.[6]

Referring to the English Court of Appeal's concern that the Court should not encourage an abuse of the liquidation regime, the Hong Kong Court held that the Court is conferred with other powers to deal with such tactics, for example, by awarding costs orders on an indemnity basis or damages for malicious prosecution if they proceed with petitions where they are aware that the debt is subject to a *bona fide* dispute on substantial grounds.[7]

For a more detailed review of the position in Hong Kong as it has developed, see the following Hogan Lovells publications:

- Back to basics - Hong Kong Court of Appeal queries approach to winding up petitions where arbitration is involved
- Winding-up Petition v Arbitration Clause: Hong Kong Court Dismisses Winding up Petition in Favor of Arbitration Clause
- A strong statement – Hong Kong court says arbitration agreement is "irrelevant" to the exercise of courts discretion in a winding up
- Singapore Court of Appeal ruling opens door for Hong Kong decision on arbitration / winding up priority

Singapore's partial acceptance of the English approach

In *AnAn Group (Singapore) Pte Ltd v VTB Bank (Public Joint Stock Company)* [2020] SGCA 33, the Court of Appeal of Singapore considered that whereas a company should ordinarily show that there exists a substantial and *bona fide* dispute (the *"triable issue"* test) in order to obtain a stay of dismissal of a winding up petition, the standard of review of the disputed debt should be lowered where it is subject to an arbitration agreement. Taking a "pro-arbitration" approach, the Court decided to apply a *prima facie* standard, pursuant to which the Court will stay a winding up petition where the debt is not *bona fide* disputed and the application for a stay amounts to an abuse of process. As observed by the Hong Kong Court in *Dayang* in relation to the same approach taken in other Singapore cases, it is unclear how the *"bona fide"* or *"abuse of process"* test can be meaningfully distinguished from the apparently higher *"triable issue"* test.

The Singapore Court in *AnAn* adopted almost the same approach as the English Court in *Salford Estate*, that is, to stay or dismiss a winding up petition where the allegedly disputed debt falls within the scope of an arbitration agreement unless there are exceptional circumstances.

The Singapore Court's reasoning was two-fold. First, it held that it should apply the same standards to the question of whether a dispute subject to an arbitration exists when considering whether to set aside a winding up petition on the ground that the debt is disputed and subject to an arbitration agreement as it would when considering whether to stay court proceedings (under the arbitration legislation) in relation to a matter that is the subject of an arbitration agreement. Secondly, the Court held that there are no competing policies behind the arbitration and insolvency regimes when it comes to a dispute involving pre-insolvency rights and obligations that ought to be determined by arbitration. According to the Court, the contrary view assumes that the company against whom the petition is lodged, is in fact a debtor, which is precisely the question that the parties had agreed to refer to arbitration.

The Singapore Court's reasoning on both scores contradicts the analysis of the Hong Kong Court in *Dayang*. The English Court of Appeal in *Salford Estates* held similar views to the Singapore Court, but expressed itself differently, focusing on different aspects of the argument to those analysed in either *Dayang* or *AnAn*. Hence, it is impossible to say that there is any consistency in the approach taken by the Commonwealth courts.

India's distinctive approach

In India, the legislative policy has created a distinct divide between *in rem* remedies (such as winding up / liquidation / insolvency proceedings) that are exclusively vested within the

jurisdiction of specialised tribunals (like the National Company Law Tribunal (NCLT)) and other matters that arise out of *in personam* rights (such as recovery of monies), which are arbitrable.[8] Courts and tribunals typically refuse to stay or postpone winding up proceedings or insolvency applications in favour of arbitration on the grounds that the nature of legal remedy sought and the subject matter of two proceedings tend to be different.[9]

Until recently, winding up and liquidation of companies was governed solely by the provisions of the Indian Companies Act. However, in 2016, India introduced a special law – the Insolvency and Bankruptcy Code, 2016 (IBC) – that provided a time-bound manner to resolve issues relating to non-payment of debt taken by corporate debtors. IBC has put in place a mechanism where creditors have the option to initiate a recovery mechanism which either involves revival of the corporate debtor (where the company can pay its debt), restructuring or liquidation.

In cases where the underlying debt relates to a contract in which parties have agreed to submit their disputes to arbitration, an overlap between insolvency proceedings and arbitration can arise. In order to admit an insolvency petition, the NCLT would have to determine whether there is a "debt" and a "default". Where a debt is disputed, the petition would not be admitted. In determining whether a debt is disputed, the NCLT has to decide if the dispute is "*real and not spurious, hypothetical, illusory or* misconceived".[10]This does not mean that the NCLT is required to examine the merits of the dispute. Rather, as in Hong Kong and Mauritius (see below), the NCLT decides, on a *prima facie* basis, whether there exists any evidence in support of the allegation that the debt is disputed; if such evidence exists, the insolvency petition is not admitted.[11]

An illustrative case is *Indus Biotech Private Limited v. Kotak India Venture Fund-I,* where the NCLT (Mumbai bench) recently dismissed a petition for initiation of insolvency proceedings and referred the parties to arbitration.[12] The parties had entered into share subscription and shareholders agreements under which Indus had subscribed to certain optionally convertible and redeemable preference shares. These agreements contained arbitration clauses. Kotak argued that there was a default by Indus as it had failed to redeem these preference shares. Accordingly, Kotak sought to commence insolvency proceedings against Indus. When considering whether there was a disputed debt, the NCLT referred the dispute to arbitrationbecause the parties' dispute related to valuation of shares, conversion formula andfixing of IPO dates, all of which are matters that are arbitrable under Indian law.

The divided approach across the Commonwealth

While Malaysia seems to side with the English and Singaporean approach,[13] other jurisdictions such as the Eastern Caribbean Court of Appeal[14] and the Northern Irish Court of Appeal[15] have declined to adopt *Salford Estates* for the same reasons as advanced by the Hong Kong Court in *Dayang*.

Interestingly, the Supreme Court of Mauritius recently held that where a winding up petition is made on the basis that a company is unable to pay a given debt, the existence of an arbitration agreement does not prevent the Court from determining whether there is a bona fide dispute in respect of that debt.[16] In particular, the Court did not consider whether a lower standard of review should apply or whether the legislative policy behind the arbitration legislation requires a varied approach to its well-established case law in respect of insolvency proceedings. However, the relevant petition in that case preceded the coming into operation of the Mauritius International Arbitration Act, and the Court considered that the new arbitration legislation was inapplicable in the circumstances of the case before it. It is unclear whether the policy behind that new enactment (based on the UNCITRAL Model Law) and the standard of review of a matter for

referral to arbitration under it would change the Court's approach to the determination of a winding up petition.[17] Going forward, can the uncertainty in the courts' approach be contractually mitigated?

It is undeniably important for commercial parties to understand with certainty the procedure that will apply under their contracts and the legislative framework for the recovery of debts owed to them by a counterparty. Where the parties agree to refer their disputes to arbitration but do not intend to waive their rights to initiating insolvency proceedings upon a counterparty's default under the contract, it is strongly recommended that such intention be expressed in their contractual provisions. However, merely including provisions to deal with disputes by arbitration may not provide a sufficient defence. In *Sit Kwong Lam v Petrolimex Singapore Pte Ltd [2019] HKCA 1220*, the Hong Kong Court of Appeal agreed that "it would make no sense to dismiss or stay an insolvency petition on the mere existence of an arbitration agreement when the debtor has no genuine intention to arbitrate".

What is unclear, however, is whether the parties can contractually exclude the application of an insolvency regime. The Hong Kong Court of Appeal held *obiter* that public policy precludes the contractual fettering of a creditor-petitioner's statutory right to petition for winding up[18], whereas the Hong Kong Court of First Instance disagreed with that view in *Dayang*.

[1] *Salford Estates (No.2) Limited v Altomart Limited* [2015] Ch. 589 [2014] EWCA Civ 1575, [39].

[2] Ibid., [35].

[3] Ibid., [41].

[4] Ibid., [39]

[5] *Dayang (HK) Marine Shipping Co. Ltd v Asia Master Logistics Ltd* [2020] HKCFI 311, [71] and [76]

[6] Ibid., [81] to [83]

[7] Ibid, [86]

[8] *Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd.*, (2011) 5 SCC 532. S*ee also Shalby Ltd. v. Dr. Pranav Shah*, 2018 SCC OnLine NCLT 137; and *HDFC Bank Ltd. v. Satpal Singh Bakshi,* 193 (2012) DLT 203.

[9] *Corporate Ispat Alloys Ltd. v. Jayaswal Neco Industries Ltd, Nagpur*, (2016) 4 Bom CR 462; and *Shalby Ltd. v. Dr. Pranav Shah*, 2018 SCC OnLine NCLT 137.

[10] *Mobilox Innovations (P) Ltd. v. Kirusa Software (P) Ltd.*, (2018) 1 SCC 353, ¶37 (*Mobilox*). *See also K. Kishan v. Vijay Nirman Co. (P) Ltd.*, (2018) 17 SCC 662.

[11] *Id., Mobilox* case, ¶51. *See also Karpara Project Engineering Private Limited Vs. BGR Energy Systems Ltd.*, 2019 SCC OnLine NCLAT 239).

[12] *Indus Biotech Private Limited v. Kotak India Venture Fund-I*, IA No. 3597/2019 in CP (IB) No. 3077/2019, NCLT (Mumbai Bench) decision dated 9 June, 2020.

[13] *Awangsa Bina Sdn Bhd v Mayland Avenue Sdn Bhd* (WA-28NCC-1146-12/20018)

[14] *Jinpeng Group Ltd v Peak Hotels and Resorts Ltd* (BVIHCMAP2014/0025 and BVIHCMAP2015)

[15] *The City Hotel (Londonderry) Limited v Stephenson* [2003] NICA 47

[16] *Tostee v Property Partnerships Holdings (Mauritius) Ltd* [2015 SCJ 41], upheld on appeal in *Property Partnership Holdings (Mtius) Ltd v Tostee* [2020 SCJ 65]

[17] The question as to whether insolvency laws superseded the otherwise applicable provisions of the Mauritius International Arbitration Act was also discussed in *Trikona Advisers Limited v Sachsenfords Asset Management GMBH* [2011 SCJ 440A], but the Court decided that the Act was not applicable on the facts of that case.

[18] *But Ka Chon v Interactive Brokers LLC* [2019] HKCA 873

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