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ARTICLE

The Interplay between Insolvency and Arbitration and Contrasting Approaches Pre- and Post-*Sian Participation*

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Synopsis

The landmark decision by the Privy Council in *Sian Participation Corp v Halimeda International Ltd* ('*Sian*'),[1] handed down in June 2024, is of significance for insolvency and arbitration practitioners alike because, amongst other matters:

It confirms that a winding-up petition should not be stayed or dismissed merely because the underlying debt is subject to a broadly worded arbitration agreement, thereby endorsing the approach adopted by the courts in the British Virgin Islands ('BVI'). The debt must be disputed on genuine and substantial grounds, which contrasts with the position reached by the English Court of Appeal in *Salford Estates (No. 2) Ltd v Altomart Ltd (No. 2)*[2] ('*Salford Estates 2*').

It marks the first instance of the Privy Council (as the BVI's highest appeal court) using its powers under *Willers v Joyce (No. 2)*[3] to declare a previously leading English authority (*Salford Estates 2*) as having been wrongly decided.

This article explores the evolution of judicial approaches to the interplay between arbitration clauses and winding up proceedings in England and Wales, the BVI and Hong Kong, both before and after *Sian.*

Pre-*Sian*: English approach vs BVI approach

In the BVI, as in England and Wales, the Arbitration Act 2013[4] ('BVI Arbitration Act') requires that if a dispute arises between parties subject to a valid arbitration agreement, any court proceedings must be referred to arbitration unless the agreement is 'null and void, inoperative, or incapable of being performed', to allow the resolution of the dispute by an arbitral tribunal in accordance with the parties' pre-existing contractual arrangement.

In the context of class remedies such as winding up proceedings, other considerations come into focus such as matters of public interest in ensuring efficient and transparent procedures for liquidating companies that are insolvent.

England and Wales position

In *Salford Estates 2*, the English Court of Appeal demonstrated a strong pro-arbitration stance by establishing that the court's discretionary power under section 122(1) of the English Insolvency Act 1986 (the 'IA 1986') to wind up a company must be exercised in accordance with the parties' prior agreement regarding the appropriate forum for resolution of the underlying dispute. The fact that a debt was not admitted was sufficient to constitute a dispute irrespective of merits.

Sir Terence Etherton C emphasised this point in paragraph 39 of *Salford Estates 2*, stating that:

> 'My conclusion that the mandatory stay provisions in section 9 of the [Arbitration Act] do not apply in the present case is not, however, the end of the matter. IA 1986 s.122(1) confers on the court a discretionary power to wind up a company. *It is entirely appropriate that the court should, save in wholly exceptional circumstances which I presently find difficult to envisage, exercise its discretion consistently with the legislative policy embodied in the 1996 [Arbitration] Act*'[5] (emphasis added).

He made the following observation at paragraph 40:

> '... It would be anomalous, in the circumstances, for the Companies Court to conduct a summary judgment type analysis of liability for an unadmitted debt, on which a winding up petition is grounded

Notes

1 [2024] UKPC 16.
2 [2014] EWCA Civ 1575.
3 [2016] UKSC 44; [2018] AC 843.
4 Section 18.
5 It provides for a mandatory stay in favour of arbitration in section 9(1) of the English Arbitration Act 1996.

when a creditor has agreed to refer any dispute in relation to the debt to arbitration…'.

BVI approach

The BVI court has demonstrated a more creditor-friendly approach, as illustrated by, in particular, in *C-Mobile Services Ltd v Huawei Technologies Co Limited*[6] ('*C-Mobile*') and *Jinpeng Group Limited v Peak Hotels and Resorts Limited.*[7]

In *C-Mobile*, Huawei Technologies Co. Limited ('Huawei'), the respondent, served a statutory demand on C-Mobile, a mobile telecommunications operator incorporated in the BVI, based on a debt arising under a supply contract that contained an arbitration clause (the 'Arbitration Clause').

C-Mobile applied to set aside the statutory demand on the basis that the debt was subject to a substantial dispute as to whether it was due. C-Mobile relied, *inter alia*, on the existence of the Arbitration Clause. However, its application to set aside the statutory demand was dismissed. The first instance judge concluded that there was no good basis for setting aside the statutory demand, as he was not satisfied – applying the test in *Sparkasse*[8] that there was any real dispute regarding the debt. Huawei subsequently applied to appoint liquidators and wind-up C-Mobile pursuant to the BVI Insolvency Act.

C-Mobile then applied for a stay of the liquidation proceedings, arguing that the Arbitration Clause in the supply contract required the liquidation proceedings to be stayed under section 6(2) of the Arbitration Ordinance[9] in favour of arbitration. The first instance Court dismissed the application for a stay, finding that the commencement of the winding up proceedings did not engage the Arbitration Clause because the winding up proceedings:

> '…do not seek the resolution of dispute arising out of or in connection with the formation, construction, or performance of the supply contract. Those proceedings seek a class remedy available under statute to an Applicant with locus standi to seek it, if certain of the conditions set out in the statute are satisfied, and if the court in its discretion considers it just and equitable to appoint liquidators … In my judgment therefore, the commencement of the winding up proceedings did not engage the Arbitration Clause in the contract. Section 6(2) of the Arbitration Ordinance accordingly has no application.'[10]

With the leave of the court, C-Mobile appealed the dismissal of its application for a stay.

On appeal, C-Mobile relied heavily on the English approach in *Salford Estates 2*, arguing that it was inappropriate for Huawei to bypass the parties' chosen method of dispute resolution and seek to wind up the company.

C-Mobile's appeal was subsequently dismissed. The Eastern Caribbean Court of Appeal (the 'Court of Appeal'), while expressing 'full agreement with the sentiments' in paragraph 18 in *Salford Estates 2*, made three material observations at paragraphs 13-15. These included that the first instance court had already investigated whether the debt was disputed in good faith on substantial grounds (on the application to set aside the statutory demand) and found that it was not subject to such a dispute. The Court of Appeal essentially agreed with the first instance Court's conclusion that the dispute fell outside the Arbitration Clause, and therefore, there was no basis for compelling the parties to resolve their dispute through arbitration. In other words, the mandatory stay was not engaged.

C-Mobile demonstrated a departure from the English approach by confirming that a creditor would not need to show "exceptional circumstances" for the Court to exercise its discretion to windup a company despite the existence of an arbitration clause. The Court will exercise its discretion based on whether there is a dispute on genuine and substantive grounds.

In *Jinpeng Group Limited v Peak Hotels and Resorts Limited*,[11] the judge rejected the approach in *Salford Estates 2*, stating at [47] as follows:

> '… 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 [to wind up] is satisfied once the creditor is applying on the basis of a debt that is not disputed on genuine and substantial grounds.'

The Court continued at [49]:

> 'The debt in the case at bar is not disputed on genuine and substantial grounds and it falls under the terms of the arbitration clauses. Therefore, the court has a

Notes

6 BVIHCMAP 2014/0006 and BVIHCMAP 2014/0017.
7 BVIHCMAP2014/0025 (8 December 2015) at paras [45]-[49].
8 *Sparkasse Bregenz Bank AG v Associated Capital Corporation* (BVIHCVAP2002/0010)(delivered 18 June 2003).
9 Being the precursor to the mandatory stay under section 18 of the BVI Arbitration Act.
10 See para [3] of BVIHCMAP 2017/0017.
11 BVIHCMAP2014/0025 (8 December 2015) at paras [45]-[49].

wide discretion under section 162 of the Insolvency Act, 2003 to stay or dismiss the Originating Application and to force the parties to resolve the dispute by arbitration. *However, the appellant does not have to prove exceptional circumstances to invite the court to exercise its discretion to make a winding up order. It has to show that the dispute is not on genuine and substantial grounds and leave it to the court to exercise its discretion under section 162 on the usual bases*' (emphasis added).

Sian approach

In *Sia*n, the respondent company argued that the BVI Court of Appeal should have followed the English position in *Salford Estates 2*, asserting that there is no difference between England and Wales on the one hand and the BVI on the other concerning public policies on enforcing arbitration agreements and liquidation proceedings.

One of the central issues was whether a creditor's petition for winding up should be stayed in favour of arbitration when the debt, arising from an agreement containing an arbitration clause, is not disputed on substantial grounds?[12]

The Privy Council held that the English Court of Appeal erred in introducing a discretionary stay of winding up petitions 'where an insubstantial dispute about the creditor's debt was raised by parties to an arbitration agreement'. In doing so, the Privy Council held that there was 'an impermissible and unexplained leap in the reasoning of the Court of Appeal as to the extent of the legislative policy behind the [arbitration legislation]'

The Privy Council's rationale was as follows:

1. The policies underlying the UNCITRAL Model Law on International Commercial Arbitration (1985) which the BVI Arbitration Act is based on, are not undermined by pursuing the liquidation of a company that has failed to settle a debt. Stays would still be available if it could be shown that there was a genuine dispute as to the underlying debt on substantial grounds, which could be resolved by way of arbitration.
2. Liquidation applications do not ordinarily trigger the mandatory stay provisions of section 18 of the BVI Arbitration Act. This is because winding up petitions do not seek to resolve the petitioner's claim to be owed money by the company. Therefore, they simply do not engage the negative obligation implied in arbitration clauses not to seek to resolve the claim in court. The fact that section 18 of the Arbitration Act 2013 was not engaged was critical to the appeal and the rejection of *Salford Estates 2*.
3. An arbitration agreement is an agreement between parties to resolve a dispute through arbitration rather than through the courts. Liquidation proceedings fall outside the scope of this agreement, in the absence of clear language to that effect.

The Board determined that: '... as a matter of BVI law, the correct test for the court to apply to the exercise of its discretion to make an order for the liquidation of a company where the debt on which the application is based is subject to an arbitration agreement or an exclusive jurisdiction clause and is said to be disputed is whether the debt is disputed on genuine and substantial grounds. This conclusion applies to a generally worded arbitration agreement or exclusive jurisdiction clause. Different considerations would arise if the agreement or clause was framed in terms which applied to such a liquidation application.'

The Board distinguished *FamilyMart China Holding Co. Ltd and Ting Chuan (Cayman Islands) Holding* ('*FamilyMart*'[13]), handed down in September 2023, which broadly endorsed the *Salford Estates 2* approach. In *FamilyMart*, a dispute arose between shareholders of a successful convenience store business in the People's Republic of China under the '*FamilyMart*' brand. The petitioner sought to wind up the company in the Cayman Islands on just and equitable grounds, alleging misconduct and loss of trust. The parties' relationship was governed by a shareholders' agreement, which provided that 'any and all disputes in connection with or arising out of [the SHA shall be] submitted for arbitration'.

The Privy Council in *FamilyMart* emphasised that there was no fundamental principle preventing the court from being bound by an arbitral tribunal's determination. The Privy Council also established that when determining whether a matter should be referred to arbitration, the court should first identify the issues raised in the court proceedings. Subsequently, for each identified issue, the court must assess if it falls within the scope of the arbitration agreement.

In *Sian, FamilyMart* was distinguished on the basis that 'in the present case [*Sian*] ... it was not disputed that an application to wind up a company on the just and equitable ground were "legal proceedings" so as to fall within the mandatory stay provisions'. However, the Board endorsed FamilyMart's pro-arbitration and expansive approach to interpreting arbitration agreements, observing at [52] that 'The Arbitration Agreement should be interpreted in a pro-arbitration and

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12 Whether the debt was disputed on substantial grounds was not in issue in the Privy Council. There was no appeal from the prior determination to that effect.

13 JCPC 2020/0055.

expansive manner and whether a "matter" is subject to that agreement should be approached following the guidance set out in FamilyMart.'

Hong Kong approach post Sian

The leading case in Hong Kong on the interplay between insolvency and arbitration is *Re Guy Kwok-Hung Lam v Tor Asia Credit Master Fund LP* [2023] HKCFA 9 ('*Re Guy 2023*') By a majority, the Hong Kong Court of Final Appeal ('HK Court of Final Appeal'), in upholding the Court of Appeal's decision in *Re Guy Kwok- Hung Lam v Tor Asia Credit Master Fund LP* ('*Re Guy 2022*'),[14] held that a petition should ordinarily be stayed or dismissed pending the determination of the dispute in the foreign court, where the dispute is subject to an exclusive jurisdiction clause unless strong reasons to the contrary are shown ('Strong Cause Approach').

The Court of Appeal in *Re Guy 2022* at [86] cited the following examples that could constitute 'strong causes':

> '… cases where the debtor may be incontestably massively insolvent quite apart from the disputed petition debt, or it may for other reasons be a menace to commercial society if allowed to continue to trade, or there may be other creditors seeking a winding up whose debts are not subject to any jurisdiction agreement, or the assets may be in jeopardy, or there may be a need to investigate potential wrongdoings, or the effect of a dismissal or stay of the petition would be to deprive the petitioner of a real remedy or would otherwise result in injustice …'

The HK Court of Final Appeal observed at [104] that '… While a "strong cause" test is indicative it should not obscure the range of considerations relevant to the court's discretion'. The Court of Final Appeal further ruled at [105] that the 'Established Approach', which requires a debtor to demonstrate a *bona fide* dispute on substantial grounds to stay or dismiss a petition, is not appropriate where an exclusive jurisdiction clause is involved and that 'in the ordinary case of an EJC [exclusive jurisdiction clause], absent countervailing factors such as the risk of insolvency affecting third parties and a dispute that borders on the frivolous or abuse of process, the petitioner and the debtor ought to be held to their contract'.

Re Guy 2023 was subsequently applied in *Re Simplicity & Vogue Retailing (HK) Co Ltd* [2024] 2 HKLRD 1064 ('*Re Simplicity*'), where Kwan VP held that the approach in *Re Guy* 2023 (the Strong Cause Approach) is equally applicable to arbitration clauses such that the parties' arbitration agreement should be respected and upheld, such that a petition should ordinarily be stayed or dismissed pending the determination of the dispute via arbitration unless strong reasons to the contrary are shown.

In *Re Mega Gold Holdings Limited* [2024] HKCFI 2286 (30 August 2024) ('*Mega Gold*'), the Hong Kong Court of First Instance declined to follow *Sian*. Instead, it followed the reasonings in *Re Guy 2023* and *Re Simplicity* and endorsed the Strong Cause Approach and that the approach of the court in exercising its discretion is 'multi-factorial' which depends on a 'range of considerations' [63].

At [71], the judge observed:

> '… there is a stark difference between the approach taken by the Privy Council and that adopted by the Hong Kong courts … the Privy Council's approach was apparently not accepted in *Guy Lam (CA)* (§§82-87), *Guy Lam (CFA)* (§105) and *Re Simplicity (CA)* (§37). In relation to the approach which should be taken here, as a matter of *stare decisis* and given the analysis provided in the authorities discussed above, I agree with the Company and the Debtor that this Court should follow the reasoning in *Guy Lam (CFA)* and also in *Re Simplicity (CA)*.'

The court further clarified at [72] that:

> '… there is no hard and fast rule on whether a winding-up or bankruptcy order would or would not necessarily "offend" the parties' arbitration agreement. This essentially turns on the basis of the underlying debt for the purpose of the petition and whether the debt and the alleged dispute fall within the scope of the arbitration agreement. For example, if the debt arises from a sum payable under the agreement containing an arbitration clause and the debtor raises a dispute over creditor's performance of the terms of the agreement, there is no reason why the debt and also the dispute, in light of their nature and substance, would not constitute a "matter" which should be subject to the arbitration agreement'.

The judge also distinguished between '(1) whether a dispute is *bona fide* disputed on substantial grounds in an ordinary winding up or bankruptcy petition with (2) whether a dispute "borders on the frivolous or an abuse of process"'. The latter threshold, being the relevant question in HK following *Re Guy 2023*, is significantly higher. As noted at [75], failing to maintain this distinction could undermine the enforceability of arbitration clauses in insolvency proceedings.

The Court found that the petitioner failed to demonstrate that the waiver/estoppel defence borders on the frivolous or amounts to an abuse of process.

Accordingly, the key distinction between the approaches in England/BVI and Hong Kong is as follows:

Notes

14 [2022] HKCA 1297 (*Re Guy 2022*).

- In Hong Kong, the courts adopt a 'multi-factorial approach', whereby winding-up proceedings against a debtor company will generally be dismissed or stayed in favour of arbitration unless strong causes to the contrary are shown including, but not limited to, if the dispute is deemed either frivolous or an abuse of process.
- In England and Wales and in the BVI, where the agreement giving rise to the debt includes an arbitration clause, winding-up proceedings will only be dismissed or stayed in favour of arbitration if the debtor can *bona fide* demonstrate a genuine dispute over the debt on substantial grounds.

Conclusion

It is interesting to see the evolution of the approach in England and Wales and in the BVI when contrasted with that of Hong Kong in balancing the importance of upholding private arbitration agreements versus the public and commercial interest in efficiently winding up companies unable to pay their debts without unnecessary delay.

Although the Privy Council in *Sian* emphasised that 'there is nothing anti-arbitration' in the decision, the requirement to demonstrate a 'genuine and substantial dispute' is likely to benefit creditors, offering them a more straightforward path to apply to appoint a liquidator where there is a debt outstanding. This approach will help to limit opportunistic attempts to delay legitimate and well-founded creditor liquidation proceedings. This may lead to an increase in liquidation applications going forward notwithstanding the existence of an underlying arbitration clause.

Indeed, finance parties may now be more prepared to use arbitration clauses if they are confident that a liquidator can be appointed in the event of a default on their debt.

On the other hand, it remains to be seen whether a more 'pro-arbitration' outcome will be possible with the inclusion of appropriate wording following the Board's view that the *Sian* decision may not apply where the arbitration clause itself excludes a liquidation application or a creditor's winding up petition.

Whether *Sian* will result in a more consistent approach in the common law world will also be interesting to observe following the divergent approach taken in Hong Kong.

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