CROSS BORDER ISSUES IN ARBITRATION AND INSOLVENCY

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SUGGESTED ANSWERS FOR WORKSHOP 2

Part 1

There are several points to be canvassed with the Bank:

(1) Whether to petition to wind up, despite the fact that Hotels has raised a dispute as to whether or not the loans are in default
(2) The impact of the arbitration clauses on the Bank's ability to petition;
(3) The prospects of obtaining the appointment of provisional liquidators;
(4) If prospects are doubtful, what other protection is available to the Bank.

Petition to wind up

The disputes are twofold (1) there was an oral agreement at a meeting between Hotels and the Bank to defer the payments due under the loans (2) whether a letter sent by the Bank referring to the right to convert debt into equity was an exercise of the conversion right within the meaning of the loan notes.

The general rule is that a petition based on a bona fide disputed debt will be dismissed. So the question here is whether the debts are bona fide disputed. Where a petition is based on a debt which turns on a question of construction, the court will invariably determine that dispute because the determination does not require any assessment by the court of disputed evidence. Where a petition is based on a debt which turns on a dispute of fact, it is the practice of the court to dismiss the petition because it is an abuse of the winding up procedure for a petitioner to seek to push a company into insolvency in respect of a debt that turns out not to be due.

See *C-Mobile Services Limited v Huawei Technologies [2015]* and *Jinpeng Group Limited v Peak Hotels and Resorts Limited [2015] ECCA (BVI), BVIHCMAP 2014/025 (Court of Appeal).* The correct approach is that laid down in *Sparkasse Bregenz Bang AG v Associated Capital Corporation* [2003] ECarSC 65, namely whether there is a genuine dispute of the debt founding the demand, on substantial grounds. The test for disputes susceptible to be stayed in favour of arbitration in *Applied Enterprises Ltd v Interisle Holdings Ltd* does not apply to applications to set aside statutory demands under s.157(1) of the Insolvency 2003.

In essence, the presence of the arbitration clause in the loan agreements will not render the *Applied Enterprises* test applicable and winding up proceedings will not engage the arbitration agreement, if the reality is that there is no substantial dispute as to the underlying debt.

In any event for reasons similar to those expressed by the English Court of Appeal in *Salford Estates (No 2) v Altomart Ltd* [2014] EWCA Civ 1575, the mandatory stay provisions of s18 Arbitration Act 2013 have no application to winding up proceedings. No debt is being enforced and winding up is a collective, class remedy.

Remember, though, that the rule that a petition based on a disputed debt will be dismissed is one of practice only. In *Brinds Ltd v. Off-Shore Oil NL* (1986) 2 BCC 98,916, (a case that was cited by approval by the PC in a case on appeal from the Grand Cayman Court of Appeal, *Parmalat Capital Finance Ltd v Food Holdings Ltd* [2008] UKPC 23) Lord Brightman said: *"In some cases it might be difficult to determine whether or not the dispute is bona fide without determining the merits of the dispute itself".*

Brinds was a case where the Australian court did determine the dispute over a 4-week period with cross-examination and extensive documentary evidence. A winding-up order was made. The company appealed to the Privy Council arguing that the judge should have dismissed the petition, rather than determining the dispute. Not surprisingly, the PC was not prepared to overturn the course adopted by the judge.

If the point of construction is straightforward and firmly in the Bank's favour, the Bank can be advised that even if Hotels disputes the Bank's construction of the loan agreements, the existence of that dispute will not dissuade a court from determining it in the petition.

Hotel's claim that there has been an oral agreement is more problematic. Although *Brinds* can be cited in favour of a court deciding the dispute, that case is exceptional and unlikely to be applied unless, perhaps, it could be demonstrated that the dispute could be resolved at a very short hearing. However, even if there was an oral agreement, it is difficult to see what the consideration for it was.

Accordingly, the Bank can be advised that, subject to the other points mentioned below, there are good prospects that if the Bank presents a petition, the disputes that have been raised by Hotels will not be a bar to a winding up order being made.

The impact of the arbitration clauses

In England, the Court of Appeal in *Salford Estates (No 2) v Altomart Ltd* [2014] EWCA Civ 1575 held 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 exceptional circumstances, dismiss or stay the petition so as to compel the parties to resolve their dispute over the debt by their chosen method of dispute resolution (i.e. arbitration) rather than, as would ordinarily be the case, for the court to investigate whether the debt was bona fide disputed on substantial grounds.

Neither the BVI nor indeed the Cayman Islands has, thus far, adopted the same approach.

As matters stand, BVI law remains in the Bank's favour - so there are reasonable prospects that a petition based on the loans will not be stayed or dismissed in favour of arbitration, unless Hotels demonstrates that the debts are bona fide disputed on substantial grounds

The BVI Court of Appeal has set its face against forcing a creditor to arbitrate prior to instituting winding up proceedings even where there is no bona fide dispute.

In the *C-Mobile* case, the Court of Appeal refused to follow the *Salford Estates* approach and held that exceptional circumstances were not required to give the BVI court jurisdiction to decide whether a debt was bona fide disputed on substantial grounds where there was an

arbitration clause. In December 2015, the Court of Appeal reached the same conclusion in the *Jinpeng* case.

However recently, in *Anzen Ltd v Hermes One Ltd* [2016] UKPC 1, the Privy Council held, in an appeal from the BVI that where an arbitration clause provided that any party *"may"* submit a dispute to arbitration, that clause meant that if one party commenced litigation, the other party had the option of submitting the dispute to arbitration either by commencing an arbitration or by making an unequivocal request to that effect, or applying for a stay. *Anzen* provides a strong indication of the approach that the Privy Council is likely to take on an appeal where the issue is whether proceedings to wind up a company should be stayed in favour of arbitration. The strong preference for arbitration evidenced by the judgment in *Anzen* indicates that the Privy Council is likely to adopt the *Salford Estates* line of reasoning and find, in effect, that the discretion as to whether to allow the winding up proceedings to continue can only be exercised one way, namely against the continuation of the winding up proceedings and in favour of arbitration.

As for Cayman, the position is rather less certain than it currently is in the BVI (absent an appeal to the PC). In *Cybernaut Growth Fund LP* [2013] Jones J made a winding-up order in respect of a limited partnership and appointed liquidators in spite of the existence of an arbitration clause in the limited partnership agreement. Jones J said (at §7):

"I think that this type of dispute is non-arbitrable for two inter-related reasons. Firstly, a winding up order (whether relating to a company or an exempted limited partnership) is an order in rem which is capable of affecting third parties. Because the source of the arbitral tribunal's power is contractual, its scope is necessarily limited to making an order which will be binding only upon the contracting parties. Secondly, any dispute about who should be appointed as liquidator of a company or exempted limited partnership is a matter involving the public interest, especially if it is carrying on a regulated business".

However, since then, the Cayman Islands Court of Appeal in *Re SphinX* CICA 6/2015 has indicated (at §51) that it does not agree with Jones J's reasoning in *Cybernaut,* which suggests that if a similar issue came up for review before the Court of Appeal in Cayman, the outcome would be different and the parties would be sent off to arbitrate.

In so far as the Bank is minded to petition on the UK Loan, it should be warned of the risk of an anti-suit injunction. The arbitration clause in the UK Loan is for arbitration in London. Even if the BVI Court is not receptive to an argument that the petition should be stayed or dismissed by reason of the arbitration clause, the Bank, being located in England, could find itself subject to an anti-suit injunction on the application of Hotels to the Commercial Court in London.

In *AES Ust-Kamenogorsk Hydropower Plant LLP v. Ust-Kamenogorsk Hydropower Plant JSC* [2013] UKSC 35 it was held that even if the party seeking the anti-suit injunction had no intention itself of referring the dispute to arbitration, an injunction would still lie against the other party to the arbitration agreement, who, in breach of the agreement, commenced proceedings rather than referring the matter to arbitration. As the UK Loan is governed by English law and contains a London arbitration clause, and the Bank, being based in London, would be subject to the jurisdiction of the English courts, the English Commercial Court would not hesitate to grant an injunction in England to restrain the Bank from breaching the arbitration clause and continuing with the winding up proceedings in BVI. If the Bank ignored the injunction it would be in contempt of court and at risk of having its assets seized in England.

The risk of an anti-suit injunction is not present in relation to the BVI Loan, which is governed by BVI law and where the arbitration clause provides for arbitration in the BVI. In such circumstances the Commercial Court is unlikely to intervene, leaving it to the BVI Court to decide whether to insist on arbitration or permit the petition to proceed.

The prospect of obtaining the appointment of provisional liquidators

The Bank is concerned that HP, a director, and his associates may have been diverting funds out of Hotels to Management by the payment of inflated management fees and bonuses.

There is jurisdiction to appoint provisional liquidators under s.170 of the Insolvency Act 2003 if such an appointment is either necessary for maintaining the value of the company's assets or is in the public interest.

Accordingly, the Bank will need to satisfy the Court, with evidence, that its concerns as to the risk of dissipation are well founded. Additionally (although there is no statutory threshold contained in section 170), the Court will in all probability have to be persuaded that it is likely that in due course a winding up order will be made: see the position under English law in the Court of Appeal judgment in *Revenue & Customs Commissioners v Rochdale Drinks Distributors* [212] 1 BCLC 748 in which it was held that the "prima facie" case test was too low and that the test should be whether the petitioner could show that it was "likely" to obtain a winding-up order on the hearing of a petition.

The problem for the Bank, however, is that at the moment it has only "concerns" about diversion of monies by HP and no concrete evidence. If the Bank was able to find some evidence to support its concerns, the prospects of obtaining the appointment of provisional liquidators would improve.

Other protection available

An alternative, and perhaps less controversial, means by which the Bank might protect its position would be to refer both disputes to arbitration in BVI and in London and to apply in the Grand Court for orders in aid under the Arbitration Act 2013.

S.43 the Arbitration Act 2013 (supplanting Article 17 of the Model Law on International Commercial Arbitration) provides that the Court can grant interim measures, including injunctions, in support of the arbitration even if the arbitral seat is outside BVI, provided that the eventual award is capable of being enforced in the BVI.

Accordingly, the Bank could apply to the Court for injunctions restraining Hotels from disposing of its assets to any connected party, including Management, possibly coupled with an application of the appointment for a receiver-manager until the arbitration proceedings have been determined.

Part 2

A. Monies paid to Management - the $5 million management fees owed and monies diverted by HC/his associates.

1. There are 4 potential claims to be considered:

   (1) A statutory preference claim against Management under section 245 and 249 of the Insolvency Act 2003.
   (2) A statutory misfeasance/breach of trust claim against HP under section 254 of the Insolvency Act 2003.
   (3) A dishonest assistance/knowing receipt claim against Management.
   (4) A claim in restitution/unjust enrichment against Management.

2. The preference claim is not arbitrable and the liquidator would be free to bring a claim in the liquidation under section 249. This is a statutory cause of action arising between the liquidator and management and none of its components are susceptible to arbitration, whether as a matter of the proper construction of the arbitration clause or otherwise.

   For a useful summary of the approach taken by the US, English, Singaporean and Australian Courts to the arbitrability of avoidance claims and the construction of arbitration clauses, see *Larsen Oil and Gas PTE v Petropod Ltd* [2011] SGCA 21, a decision of the Singapore Court of Appeal. This involved a Cayman company (in liquidation both in Grand Cayman and in Singapore), the Court of Appeal of Singapore was receptive to the possibility that avoidance claims might (as a matter of construction) be arbitrable. It nonetheless concluded that disputes arising from the operation of the statutory provisions of the insolvency regime *per se* were non-arbitrable even if the parties expressly included them within the scope of the arbitration agreement.

3. The misfeasance/breach of trust claim. HP is not a party to the HMA and therefore prima facie there should be nothing to prevent the Liquidator bringing proceedings against HP in BVI.

4. The dishonest assistance/knowing receipt claim against Management. This would be caught by the arbitration clause. If the liquidator commences proceedings in BVI in Hotel's name, he is likely to be met by a stay application.

5. The restitution/unjust enrichment claim. This would also be caught by the arbitration clause, see paragraph 4.

   Note also, the possibility of Management seeking an anti-suit injunction in the UK, but that would only operate in personam and neither Hotels nor the Liquidator are in the jurisdiction of the Courts of England and Wales. However, any judgment obtained by

Hotels (acting by the liquidator) in BVI would not be enforceable in the UK, if obtained in the face of a UK anti-suit injunction.

See also *Bannai v Erez (no 1)* [2013] EWHC 3689 (Comm). There, an anti-suit injunction against an Israeli trustee in bankruptcy of an Israel bankruptcy was upheld, in circumstances where the contract between the applicant for the injunction and the bankrupt contained a London arbitration clause, which the trustee had ignored, choosing instead to bring proceedings in Israel.

B. ISL and its claim for $100,000

6. Consider:

   (1) What can the liquidator do to stop/stay the arbitration?
   (2) What are the prospects of any such stay being lifted?
   (3) How can the liquidator best position himself to hang on to the stay?

7. Whilst the effect of the winding-up order may, under BVI law, stay proceedings against Hotels (section 175 of the 2003 Act), that statutory stay will not of itself stop the London arbitration.

8. The Liquidator must apply to the High Court in England for an order under the Cross Border Insolvency Regulations 2006 **("CBIR")**, recognising the BVI liquidation as a foreign main proceeding (under Article 17 of the UNCITRAL Model law). On recognition, the arbitration will automatically be stayed under article 20. There is no doubt that the article 20 stay extends to arbitrations, see *United Drug (UK) Holdings Ltd v Bilcare Singapore Pte Ltd* [2013] EWHC 4335 (Ch).

7. Given that the only reason for seeking recognition would be to obtain a stay of the arbitration, whilst most CBIR applications are routinely made ex parte, on our facts, the liquidator should give notice to ISL, to enable it to make an immediate application to have the stay lifted or modified. See *Re OGX Petroleo E Gas SA* [2016] EWHC 25.

8. The onus will be on the liquidator to show why the proof of debt procedure under BVI insolvency law is the better option. For this purpose, he will have to arm himself with evidence as to how the proof of debt process “works” in BVI insolvency law. (Note, in *American Energy Group Ltd v Hycarbex Asia Pte Ltd* [2014] EWHC 1091 Ch, there was no such material before Arnold J and accordingly, he was wholly unable to form a view as to whether the proof of debt procedure in Singapore a better, worse or neutral option).

9. However, the reality is that if the issues between ISL and Hotels with regard to the debt are inherently more suitable for arbitration (for example if there are complex issues of fact or technical issues to be resolved), then the Court will lean in favour of allowing an arbitration to proceed. Other relevant factors are:

(1) How long the arbitration has been ongoing and the stage reached.
(2) How long the liquidation has been going and the stage reached
(3) How the proof of debt process in BVI works - what tools the liquidator has available and what the Court's powers are on an appeal.
(4) The relative cost of an arbitration and the proof of debt process.

See generally *American Energy Group Ltd v Hycarbex Asia Pte Ltd*. Ibid.

10. An alternative course to seeking recognition under CBIR, might be for the liquidator to apply in BVI for an order, pursuant to the inherent jurisdiction of the Court, that the UK Court be requested (pursuant to its jurisdiction under section 426 of the Insolvency Act 1986) to stay the UK arbitration.

11. Consider also the possibility of the liquidator disclaiming the arbitration clause as an onerous/unprofitable contract under section 217 of the Insolvency Act 2003 both in relation to the ISL debt and the claim against Management. Disclaiming an arbitration agreement is untested in the UK, BVI and Cayman but has been tried, with success, in Australia: see *Re CAN 103 753 484 Pty Ltd (in liq) formerly Blue chip Development Corporation Ltd* [2011] QSC 64.