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.

It is worth remembering, 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 difficult. 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 recently 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 rather than, as would ordinarily be the case, for the court to investigate whether the debt was bona fide disputed on substantial grounds.

The Cayman Islands (and the BVI) has not, thus far, adopted the same approach. 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".

The BVI Court of Appeal has also set its face against forcing a creditor to arbitrate prior to instituting winding up proceedings even where there is no bona fide dispute. In *C-Mobile Services Limited v. Huawei Technologies Co Limited* [2015] ECCA (BVI) BVIHCMAP 2014/006 and BVIHCMap 2014/017 the BVI Eastern Caribbean 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 dispute was bona fide disputed on substantial grounds where there was an arbitration clause. In December 2015 the BVI Eastern Caribbean Court of Appeal in *Jinpeng Group Ltd v. Peak Hotels and Resorts Limited* (BVICMAP 2014_0025 and 2015_0003) reached the same conclusion.

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, the outcome would be different and the parties would be sent off to arbitrate.

Further, 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.

Given the uncertainty surrounding the law in this area the Bank would need to be given a serious health warning about the risks associated with presenting a petition based on debts that are subject to arbitration agreements. That said, at the moment Cayman law remains in the Bank's favour so that there are reasonable prospects that, at least at Grand Court level, 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.

Nevertheless, 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 Grand 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 Cayman. If the Bank ignored the injunction it would be in contempt of court and at risk of having its assets seized in England.

Accordingly, there would be serious risks for the Bank if it presented a petition based on the UK Loan. Those risks are not present in relation to the Cayman Loan, which is governed by Cayman law and where the arbitration clause provides for arbitration in the Cayman Islands. In such circumstances the Commercial Court is unlikely to intervene, leaving it to the Grand Court to decide whether to insist on arbitration or permit the petition to proceed.

It follows that the Bank would be advised to present a petition only in relation to the Cayman Loan. By restricting the petition to the Cayman Loan, the Bank stands the best chance of avoiding the need to arbitrate the dispute first.

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.104(2)(a) of the Companies Law (2016 Revision) if there is a *prima facie case* for making a winding up order and (i) in order to prevent dissipation or misuse of the company's assets or (iii) prevent mismanagement or misconduct on the part of the company's directors.

Accordingly, the Bank will need to satisfy the Court, with evidence, not only that its concerns are well founded, but also that there is (at least) a good prima facie case that at the hearing of the petition the court will accept that there is no substantial ground upon which to dispute the debt.

In *Re Asia Strategic Capital Fund LP* (unreported 30 April 2015) Segal J referred to the English 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. However, the English law jurisdiction to appoint a provisional liquidator derives from s.135 of the Insolvency Act 1986 which contains no reference to the test to be applied. By contrast, the Companies Law does set out the test and it must be applied. Accordingly, in so far as the English law test is now stricter than the "prima facie case" threshold, it should have no application in Cayman where the statute makes clear what the test is.

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 as the Bank would be able to rely on ground (i) or (iii) above to support its application.

If, contrary to existing authority, a judge of the Grand Court decided not to determine whether the dispute was bona fide disputed on substantial grounds but to refer the dispute to arbitration, would it be open to the Bank to hold on to the appointment of provisional liquidators?

In *Salford Estates* the Court of Appeal referred (at §41) to the power of the court to dismiss or <u>stay</u> the petition in favour of arbitration. Based on this approach, the Bank might argue that even if the Grand Court refers the dispute to arbitration the petition should only be stayed, not dismissed, and the provisional liquidators should remain in place as long as there is a good prima case that at the eventual hearing of the petition a winding-up order will be made. This would be a novel argument and one which the court might not accept because, in theory, it would involve the petition remaining in place until the dispute was resolved in the arbitration proceedings - even if it turned out to be a substantial dispute. Also, the Bank would need to be reminded of its need to provide an undertaking in damages in relation to the appointment of the provisional liquidators. In the event that the dispute was decided against the Bank, the damages could be very substantial.

<u>Other protection available</u>

An alternative, and perhaps less controversial, means by which the Bank might protect its position would be to refer both disputes to arbitration in Cayman and in London and to apply in the Grand Court for orders in aid under the Arbitration Act 2012.

S.43(1)(d) of the Arbitration Act 2012 provides the Grand Court can grant interim injunctions and other interim measures in support of the arbitration. S.54 provides that the Grand Court is to have the same power to issue interim measures in relation to arbitration proceedings irrespective of whether the seat of the arbitration is the Cayman Islands, as it has in relation to court proceedings. Accordingly, the Bank could apply to the Grand Court for injunctions restraining Hotels from disposing of its assets to any connected party, including Management, 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 146 of the Companies Law (2016 Revision)
   (2) A misfeasance/breach of trust claim against HP under
   (3) A dishonest assistance/knowing receipt claim against Management.
   (4) A claim in restitution/unjust enrichment against Management.

2. The preference claim is probably not arbitrable and the liquidator would be free to bring a claim in the liquidation under section 146. 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.

   See *Re Cybernaut Growth Fund LP*, FSD 73 of 2013. There are no private contractual rights to be determined, see *Re the Sphinx Group of Companies* CICA No 6 of 2015, per Sir Richard Field.

   Interestingly, in *Larsen Oil and Gas PTE v Petropod Ltd* 2011] SGCA 21 (which 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 held 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[1].

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 ordinary proceedings against HP in Cayman on the company's behalf. But query - if HP was to argue that the payments were all properly made within the four corners of the HMA and that there was no overcharging because the services had been properly provided in accordance with the HMA, could he insist on that issue being arbitrated in London and seek a stay of the Cayman proceedings under section 4 Section 4 Foreign Arbitral Awards Enforcement Law (1997 Revision) **("FAA"),** relying on (and extending) *Sphinx*? No he could not. He is not a party to the arbitration agreement or a person claiming "though or under" Management.

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

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 Cayman 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 an 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?

[1]This case provides 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.

(3) How can the liquidator best position himself to hang on to the stay?

7. Whilst the effect of the winding-up order will, under Cayman law, stay proceedings against Hotels, 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 Cayman 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 is 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 Cayman 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 Cayman 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 Cayman 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 Cayman 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.

Statutory Materials.

Section 4 Foreign Arbitral Awards Enforcement Law (1997 Revision):

"If any party to an arbitration agreement, or any person claiming through or under him commences any legal proceedings in any court against any other party to the agreement or any person claiming through or under him, in respect of any matters agreed to be referred, any party to the proceedings may at any time after appearance and before delivering any pleadings or taking any other steps in the proceedings, apply to the court to stay the proceedings; and the court, unless satisfied that the arbitration agreement is null and void, inoperative or incapable of being performed or that there is in not in fact any dispute between the parties with regard to the matter agreed to be referred shall make an order staying the proceedings"

Section 9 Arbitration Act 1996 (UK)

Cross Border Insolvency Regulations 2006, arts 17 to 21. (UK)

Section 426 Insolvency Act 1986