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Court of Appeal finds that the court's exclusive jurisdiction can trump an arbitrator's ability to determine a just and equitable winding up

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In an important decision, *Re China CVS (Cayman Islands) Holding Corporation* (**China CVS**),[1] the Cayman Islands Court of Appeal (the **CICA**) has provided welcome clarification on the tension between the exclusive jurisdiction of the court to determine whether it is just and equitable to wind up a company and a private agreement between a company's members to submit disputes *inter se* to arbitration.

Background

China CVS (Cayman Islands) Holding Corporation (the **Company**) is a Cayman Islands holding company which, through its subsidiaries, runs a convenience store business in the People's Republic of China under the "FamilyMart" brand. It has two shareholders: a majority shareholder, Ting Chuan (Cayman Islands) Holding Corporation (**Ting Chuan**) and a minority shareholder, FamilyMart China Holding Co. Ltd (**FMCH**). The Company was established as a joint venture vehicle and the relationship between Ting Chuan and FMCH is governed by a restated shareholders agreement (the **Shareholders Agreement**) that contains an arbitration agreement.

On 12 October 2018, FMCH presented a petition (the **Petition**) seeking to wind up the company on the just and equitable basis pursuant to section 92(e) of the Companies Law (2018 Revision) (the **Companies Law**). The Petition was, *inter alia*, based on allegations that the majority directors of the Company had engaged in dealings with unrelated parties without making full disclosure of those dealings to the minority directors of the Company. The Petition sought an order for the winding up of the Company on the basis that (i) FMCH had a justifiable lack of confidence arising from the lack of probity in the conduct of the Company's affairs; and (ii) on the grounds of a breakdown in the fundamental relationship between the shareholders and a breach of an underlying understanding that governed that relationship.

Ting Chuan applied to the Grand Court to strike out the Petition on grounds that the Petition failed to disclose a reasonable cause of action and was an abuse of process of the court. Alternatively, Ting Chuan applied for the Petition to be dismissed or stayed in reliance on the arbitration agreement contained in the Shareholders

[1] *Re China CVS (Cayman Islands) Holding Corporation* (unreported, 23 April 2020) on appeal from *Re China CVS (Cayman Islands) Holding Corporation* [2019] (1) CILR 266.

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Agreement and pursuant to section 4 of the Foreign Arbitral Awards Enforcement Law (1997 Revision) (the **FAAEL**)[2] or pursuant to the court's inherent discretion to grant a stay.

At the heart of the appeals was the conflict between the exclusive jurisdiction of the court to determine whether it was just and equitable to wind up the Company and the provisions within the Shareholders Agreement under which the parties agreed that all disputes in connection with, or arising out of, that agreement be submitted to arbitration.

Grand Court Decision

Kawaley J held that the Petition should not be struck out in its entirety, but identified inadequacies in the drafting of the Petition (in relation to which he granted FMCH leave to amend the Petition). Kawaley J found in particular that the petition was badly drafted, lacking in particularity and unclear, concluding that it was "*tactical pleading*" to side step the arbitration agreement.

The Grand Court granted a stay of the Petition pursuant to section 4 of the FAAEL until the disputes between the parties grounding the Petition had been arbitrated. The Grand Court took the view that the underlying disputes between the parties came within the scope of the arbitration agreement in the Shareholders Agreement and could be "hived off" relying on the *obiter* comments of Patten LJ in *Fulham Football Club (1987) Ltd v Richards* (***Fulham***)[3] that such matters of fact could be determined by an arbitrator.[4] If FMCH was ultimately successful in the arbitration, it could subsequently return to the Grand Court to seek relief which only the Grand Court could order, relying on the findings reflected in the award.

Ting Chuan appealed the strike out decision and FMCH appealed the stay of the Petition.

Court of Appeal Decision

Strike Out Appeal

Ting Chuan's appeal of the refusal to strike out the Petition was dismissed by the CICA (Moses JA, Martin JA and Rix JA). The CICA did not agree with the Grand Court's criticism of the Petition's drafting. The CICA considered the Grand Court, in determining whether the Petition (or parts of it) should be struck out, to have (incorrectly) sought to identify a cause of action, the breach of which would form the basis of a winding up. In other words, if the matters pleaded did not disclose a reasonable cause of action justifying a winding up order, they should be struck out. This resulted in the Grand Court misunderstanding and mischaracterising the bases on which the Petition was brought. The two bases of the Petition – loss of confidence on the basis of a lack of probity and a breakdown in the fundamental relationship between the main shareholders – were not causes of action. They were a description of the assertions relied upon in the Petition that the Company should be wound up on just and equitable grounds. In doing so, the Grand Court overlooked that the pleadings *amounted to no more nor less than those which a petition for winding up is required to disclose*: "*a concise statement of the grounds upon which the Petitioner claims to be entitled to a winding up order*".[5] The CICA found that the

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[2] Section 4 of the FAAEL provides that *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 matter 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 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 not in fact any dispute between the parties with regard to the matter agreed to be referred, shall make an order staying the proceedings*.

[3] *Fulham Football Club (1987) Ltd. V Richards* [2011] EWCA Civ 855; [2012] Ch 333.

[4] Patten LJ was making the point that the allegations of unfair prejudice as a matter of fact could be determined by an arbitrator (as is now widely accepted) but that there were certain orders that an arbitrator did not have jurisdiction to make including a winding up order or orders regulating the affairs of the company which bind shareholders who are not parties to the arbitration agreement. It did not however follow that the inability of an arbitrator to make a winding up order affecting third parties would make it impossible for members of a company, for example, to submit disputes *inter se* as shareholders to a process of arbitration. Rather, it would be necessary to consider in relation to the matters in dispute whether they engage third party rights or represent an attempt to delegate to the arbitrators what is a matter of public interest which cannot be determined within the limitations of a private contractual process Fulham at [40], discussed in *China CVS* at paragraphs 70 *et seq*.

[5] Paragraph 51.

arguments raised by Ting Chuan came no-where near to justifying for the Petition to be struck out: *[t]here was and is no basis for consideration of these appeals other than on the basis that the facts asserted are true. Whether the evidence is adequate and whether it justifies winding up on the just and equitable ground is a matter for the hearing of the Petition, subject to the question of arbitration.*[6]

Stay Appeal

The crucial issue before the CICA was whether the issues raised in the Petition were arbitrable, that is, if the issues were capable of being determined by arbitration. If the issues were not capable of being so determined then a mandatory statutory stay could not be ordered and a stay could only be ordered pursuant to the inherent discretion of the court.

The CICA began with the proposition that under section 92 of the Companies Law the court's consideration of whether a company can be wound up on just and equitable grounds is a threshold question, it is not a question of relief. It is only once the court has decided that it is just and equitable to wind up the company that it may then determine relief, i.e. whether to make a winding up order or whether one of the alternative remedies available under section 95(3) of the Companies Law should be ordered.[7] In considering this point, the CICA referred to another of its decisions, *Tianrui (International) Holding Company Limited v China Shanshui Cement Group Ltd (**Tianrui**)*[8] which described section 92 as the *sole gateway to obtaining alternative relief set out in section 95(3)*. In that decision the CICA noted that in the absence of an unfair prejudice regime in the Cayman Islands, the only way a shareholder could complain of unfairly prejudicial conduct and unlock the alternative remedies in section 95(3) was by a winding up petition brought on just and equitable grounds. It followed that the petitioning shareholder was entitled to have those matters investigated in the context of a winding up petition which it was entitled to bring under statute, and if it was successful in making out its complaints, it was entitled under the statutory scheme to have the court determine whether a winding up order or alternative relief was the appropriate remedy.[9]

Tianrui, though not concerned with reconciling an arbitration agreement with the court's jurisdiction to wind up companies on the just and equitable ground, demonstrates that the threshold question for the court to decide is whether the company should be wound up on just and equitable grounds. It is only then that the court can decide whether an alternative remedy should be ordered. This is important in the context of arbitrability because where there is an arbitration agreement, the scope of which covers disputes of fact raised on a just and equitable petition, the question of whether a stay should be granted turns on whether it is possible to submit such disputes to arbitration without trespassing upon the exclusive jurisdiction of the court.

The CICA undertook a detailed analysis of international case authorities, including *Fulham* and common law decisions decided after it, and observed that those decisions (confirming the arbitrability of shareholders' disputes) did not require an encroachment onto the exclusive jurisdiction of the court: once unfair prejudice was made out, the way was clear for other forms of relief to be granted that did not involve the court's exclusive jurisdiction to wind up a company. The identification of discrete issues for the consideration by the arbitrator, distinct from questions of relief, maintained the primacy of the arbitration agreement while respecting the court's exclusive jurisdiction to order that a company be wound up. For example, in a winding up petition brought on the ground that the company was unable to pay its due debts, the question whether the disputed debt was in fact owed could be answered, as a discrete issue of historical fact, in arbitration without having to answer the question about whether the company should be wound up.[10]

[6] Paragraph 63.

[7] The alternative remedies include the making of an order regulating the future affairs of the company, share buy out orders, mandatory and prohibitory orders ordering the company to refrain from doing something or to do something it has omitted to do.

[8] *Tianrui (International) Holding Company Ltd v China Shanshui Cement Group Ltd* (CICA, 5 April 2019) at [14], cited at paragraph 94.

[9] *Tianrui at* paragraphs 14 and 37, cited in *China CVS* from paragraph 94.

[10] Paragraph 85, citing *Salford Estates (No 2) Ltd v Altomart Ltd (No 2)* [2014] EWCA Civ 1575; [2015] Ch 589.

Given the CICA's decision in *Tianrui*, the CICA in *China CVS* found there to be a statutory right to invoke the exclusive jurisdiction of the court to wind up the Company on the grounds of misconduct of its directors. It held that *where the underlying issues are central and inextricably connected to determination of the statutory question whether the company should be wound up on just and equitable grounds, the possibility of hiving off those issues [to an arbitrator] becomes more difficult.*[11]

The CICA held that the weight to be attached to the events relating to the course of the joint venture of the Company, how one set of facts might cast light on others and their significance were all relevant to the threshold issue of whether a just and equitable winding up would be justified. It was difficult, if not impossible, to see how discrete issues could be identified and "hived off" to be determined by arbitration.[12] Accordingly, there were no grounds to grant a mandatory stay of the Petition pending determination of the underlying issues in an arbitration.[13]

The CICA reached this view even though the Petition sought alternative relief pursuant to section 95(3) of the Companies Law, rather than an order to wind up the Company. This is because, as set out above, the question of whether it was just and equitable to wind up the Company was a threshold question to granting alternative relief pursuant to section 95(3).[14]

Implications for Just and Equitable Petitions

The decision of the CICA provides clarity on the interrelationship between a just and equitable winding up petition and agreements for shareholders' disputes to be determined in arbitration. The court has exclusive jurisdiction to determine whether to wind up a company on the just and equitable basis. It is only where a discrete issue can be identified, that doesn't involve the exclusive jurisdiction of the court, that a petition can be stayed while the issue is submitted to arbitration. Given that just and equitable winding up petitions are common before the Cayman Islands courts and that arbitration clauses are increasingly wide in scope, this is a welcome clarification to the law.

[11] Paragraph 109.

[12] Paragraph 116.

[13] The CICA was asked to stay the Petition pursuant to section 4 of the FAAEL and in the exercise of its case management discretion. It declined to order a stay pursuant to FAAEL on the basis that the directors were not parties to the petition and, insofar as it was appropriate to stay the claims against Ting Chuan, given the CICA's decision that those matters were not arbitrable, the arbitration agreement so far as it concerned Ting Chuan was inoperative. As to the discretionary stay, the CICA declined to order a stay in the exercise of its case management discretion, notwithstanding Ting Chuan had issued arbitration proceedings, because, again, it did not consider the allegations of loss trust and confidence to be discrete issues which could properly be decided in arbitration.

[14] Paragraph 94, citing *Tianrui (International) Holding Company Ltd v China Shanshui Cement Group Ltd* (CICA, 5 April 2019) at [14].

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