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UPDATE

Liquidate or arbitrate – a balancing act

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The interplay between arbitration and insolvency proceedings has been a recurring theme across common law jurisdictions in recent months. It is therefore timely to consider the conflict between parties' contractual rights to arbitrate and their statutory rights to present a winding up petition and how a balance can be struck when determining which should prevail.

Introduction

In *A Creditor v Anonymous Company Ltd* (**AC v ACL**),[1] the petitioning creditor filed an application in the Commercial Division of the High Court of the British Virgin Islands (the **Court** and the **BVI** respectively) seeking the appointment of liquidators over a BVI company (**ACL**) under section 8 of the BVI Insolvency Act 2003 (the **Insolvency Act**). ACL argued that the debt was disputed and the matter ought to be referred to arbitration, per the parties' prior agreement, pursuant to section 18 of the Arbitration Act 2013 (the **Arbitration Act**). The matter was heard by Jack J (the **Judge**), who refused to appoint liquidators in similar circumstances in *Rangecroft Holdings Ltd v Lenox International Holdings Ltd*[2] (**Re Lenox**) and *IS Investment Fund Segregated Portfolio Company v Fair Cheerful Ltd*[3] (**Fair Cheerful**) (together, the **Earlier Cases**). By contrast, in AC v ACL the Judge was persuaded to wind up ACL given the circumstances of that case.

Background

In the Earlier Cases, the companies objected to the appointment of liquidators on the grounds that the debts were disputed and the parties had agreed to arbitrate any such disputes. Section 18 of the Arbitration Act (**Section 18**) provides that where proceedings are commenced by a party who has agreed to arbitrate, the Court must grant a stay of those proceedings in favour of arbitration. In the Earlier Cases, the Judge was persuaded that Section 18 applied and that it was appropriate to stay Re Lenox pending the outcome of the arbitration and to dismiss the application in Fair Cheerful.

However, a prior agreement to arbitrate does not automatically ensure that any winding up application will be stayed or dismissed. Arbitration is designed to resolve party-to-party disputes whereas liquidation is a collective remedy whereby a single creditor commences winding up proceedings in which a body of creditors participates. As such, winding up proceedings tend to fall outside the scope of the Arbitration Act.[4]

[1] BVIHC (COMC) [REDACTED].

[2] BVIHC (COM) 37/2020 (6 July 2020).

[3] BVIHC (COM) 34/2020 (16 July 2020).

[4] See Eastern Caribbean Court of Appeal in *CMobile Services Ltd v Huawei Technologies Co Ltd* BVIHCMAP 2014/0017 (determined 15 September 2015, unreported); *Jinpeng Group Ltd v Peak Hotels and Resorts Ltd*, BVIHCMAP 2014/0025 and 2015/0002 (unreported, 8 December 2015).

Nevertheless, the Court is afforded a wide discretion by section 162 of the Insolvency Act and may stay, or refuse, winding up applications if, for example, it is of the view that there is a dispute which ought to be arbitrated. The Court has held that whether the parties had agreed to arbitrate such disputes is an '*important consideration*' which the Court ought to consider when deciding whether to exercise that discretion.[5]

AC v ACL – a balancing act and the exercise of the Court's discretion

Although there was no dispute as to the existence of the debt, ACL disputed to whom monies were owed and argued that the winding up application should be dismissed or stayed pending the outcome of an arbitration in Hong Kong. When deciding whether to appoint a liquidator or refer the matter for arbitration, the Judge held that whilst it would undermine the policy of the Arbitration Act if the 'substantial dispute' test which is normally applied in winding up applications[6] was applied without any regard to Section 18, he still had to consider whether there was any substance to ACL's proposed defence:

> '*...the Court should still examine whether a proposed defence is advanced with any real belief in its substance. The Court should look at the reality of the matter before blindly staying or dismissing the application for the appointment of a liquidator in favour of arbitration*'.[7]

On the facts, the Judge was not persuaded that the debt was genuinely in dispute and did not find any substance to ACL's defence. Accordingly, notwithstanding the fact that arbitration was already on foot in Hong Kong, the Judge declined to stay (or dismiss) the application and appointed liquidators to wind up ACL.

Commentary

It is clear that whilst the Court will respect and uphold a prior agreement to arbitrate, it will exercise its discretion in appropriate circumstances to wind up a company under the Insolvency Act when the proposed dispute, which a debtor argues ought to be arbitrated, is '*simply a put up job*' of no substance.[8]

The Arbitration Act is relatively new law and these cases, plus the earlier decisions of the Eastern Caribbean Court of Appeal in *CMobile Services Ltd v Huawei Technologies Co Ltd*,[9] which we discussed in our update of February 2016: 'Arbitration clauses and winding up petitions: The future of arbitration stay applications in the BVI', provide welcome guidance on the Court's approach when both the Insolvency Act and the Arbitration Act apply. The decision in AC v ACL demonstrates that the BVI Court will carefully balance the competing interests of creditors and debtors and will not allow Section 18 to be abused by debtors in order to avoid a winding up.

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[5] n1 at [13].

[6] Being the test established by the Eastern Caribbean Court of Appeal in *Sparkasse Bregenz Bank AG v In the Matter of Associated Capital Corp* Civil Appeal No 10 of 2002 (determined 18 June 2003, unreported), namely whether the alleged debtor's belief in the existence of the dispute is honestly held and the debt is disputed on substantial or reasonable grounds.

[7] n1 at [15].

[8] n1 at [16].

[9] BVIHCMAP 2014/0006 (determined 15 September 2015, unreported), and BVIHCMAP 2014/0017 (determined 15 September 2015, unreported).

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