Arbitration clauses and the just and equitable winding up jurisdiction – tension relief from CICA

Insights - 14/05/2020

In a comprehensive judgment published on 23 April 2020, the Cayman Islands Court of Appeal, comprising Moses JA, Martin JA and Rix JA, has provided welcome clarification of the interplay between a contractual agreement to arbitrate disputes arising between shareholders and the exclusive jurisdiction of the Court to determine whether a company should be wound up on the just and equitable ground.

Having regard to an extensive compilation of authorities from England, Hong Kong, Singapore, Australia and the Cayman Islands, the Court of Appeal unanimously concluded that the underlying dispute in a Cayman Islands just and equitable winding up petition is not capable of being determined by an arbitrator, as it would amount to a trespass upon the Court's exclusive jurisdiction to decide whether it is just and equitable to make a winding up order. As such, it is not appropriate for a just and equitable winding up petition to be stayed in favour of arbitration.

The Legal Issue

There has been a broad international trend by the Courts in recent years towards adopting an expansive approach to the application of arbitration clauses, in order to give effect to what has been described as "*the strong legal policy that where parties to a contract have agreed to exclusively refer a suite of disputes to arbitration, they should be held to their contractual bargain*".[1]

Arbitration clauses are readily applicable to ordinary civil disputes; the extent to which insolvency proceedings should be stayed by virtue of a private contractual agreement to arbitrate has, however, been harder to define. This is due to the Court's exclusive statutory jurisdiction to make winding up orders, which cannot be delegated to an arbitrator, irrespective

of the terms of a private agreement between the parties. While it may be possible to identify a simple issue to be "hived off" for determination by an arbitrator in the case of an application to wind up a company in insolvency (such as the question of whether the debt is due and payable), the same cannot be said for just and equitable winding up petitions.

This distinction arises, in part, from the wording of section 92(e) of the Companies Law, which empowers the Court to make a winding up order if "*the Court is of the opinion that*" it is just and equitable for the company to be wound up. The requirement that the Court form an opinion as to whether it is just and equitable to wind up the company in the circumstances as they exist at the time of the winding up hearing, means that the Court must consider all of the circumstances of the case itself, and cannot simply rely on a prior determination of an arbitrator on a discrete factual issue.

Background

China CVS (Cayman Islands) Holding Corp (the "**Company**") is a Cayman Islands holding company which operates a convenience store business in the People's Republic of China under the "FamilyMart" brand. The Company is a joint venture between the majority shareholder, Ting Chuan (Cayman Islands) Holding Corporation ("**Ting Chuan**") and the minority shareholder, FamilyMart China Holding Co. Ltd (the "**Petitioner**"). The relationship between the two shareholders is governed by a shareholders agreement which contains an arbitration clause.

On 12 October 2018, the Petitioner presented a petition to wind up the Company on the just and equitable ground (the "**Petition**"). The Petition is, in part, based on allegations that the majority directors, nominated by Ting Chuan, had caused the Company to engage in extensive related party dealings, which potentially conferred significant financial benefits on the majority directors and Ting Chuan, without disclosing the related party dealings (or at least the extent of those dealings) to the minority directors appointed by FMCH or to FMCH itself in its capacity as minority shareholder.

On 25 February 2019, Kawaley J ordered (on the application of Ting Chuan) that the Petition be stayed pursuant to section 4 of the Foreign Arbitral Awards Enforcement Law (1997 Revision) (the "**FAAEL**") until the complaints in the petition had been arbitrated. Ting Chuan had also sought to strike out the Petition in its entirety. While this application was dismissed, Kawaley J identified what he considered to be inadequacies in the Petition and granted permission to the Petitioner to amend. The Petitioner appealed the stay of the Petition under the FAAEL and Ting Chuan appealed the decision not to strike out the Petition in its entirety.

Court of Appeal's Findings on the Arbitration Question

There are three grounds on which the Court was empowered to stay the Petition pending determination of the underlying disputes by an arbitrator:

(a) a mandatory stay under section 4 of the FAAEL[2];

(b) a mandatory stay under section 95(2) of the Companies Law[3]; and/or

(c) a discretionary stay under the Court's inherent case management powers.

The critical issue before the Court of Appeal was whether the issues raised in the Petition were arbitrable (as, if the underlying dispute was not arbitrable, there were no grounds to enforce a mandatory statutory stay and the only residual question would be one of case management discretion).

After undertaking an extensive review of the international case law, the Court of Appeal concluded that the subject matter of a just and equitable winding up petition is not arbitrable. In coming to this view, the Court of Appeal observed (at [115]) that "*All the primary and secondary facts, i.e. those facts which are a matter of deduction, go to resolution of the statutory threshold question whether it is just and equitable that the company should be wound up. That being the width of the court's determination, it is difficult, if not impossible to see how discrete issues may be identified and "hived off" to arbitration*."

The Court came to this view, notwithstanding that the Petition in question sought alternative relief under section 95(3) of the Companies Law (a buy-out order) and not an order to wind up the Company. The prayer for alternative relief did not alter the Court's view on the arbitrability of the underlying disputes as the Court's power to grant relief under section 95(3) required it to first address the threshold question of whether it is just and equitable to wind up the company, before considering the appropriateness of alternative relief. In circumstances where the gateway to relief itself requires determination of the question whether winding up on the just and equitable basis is justified, the CICA reiterated the impossibility of referring any underlying dispute to an arbitrator.

It is important to note that the findings of the CICA in this case do not cast doubt on the approach adopted by the Courts in England and the Cayman Islands on unfair prejudice petitions addressed by the English Court of Appeal in *Fulham Football Club (1987) Ltd v Richards [2011] EWCA Civ 855*. Patten LJ distinguished winding up and unfair prejudice petitions and made obiter observations on just and equitable petitions. This was before it had become clear how rare just and equitable petitions are in England (see Hawkes v Cuddy). Unlike just and equitable relief, unfair prejudice proceedings look primarily to discrete misconduct.

Thus, the CICA noted (at [108]) that: "*The cases which have followed and developed **Fulham** have all depended upon the court's ability to identify discrete, substantive issues which do not invoke the exclusive jurisdiction of the court. 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 becomes more difficult."

Court of Appeal's Ancillary Findings

In addition to clarifying the non-arbitrability of a just and equitable winding up petition, in dismissing the application to strike out the Petition in its entirety, the Court of Appeal also provided useful guidance on a number of additional matters which frequently arise in the context of just and equitable petitions in the Cayman Islands. In particular:

(a) The Court of Appeal confirmed that Kawaley J's criticism of the drafting of the Petition was unjustified and based on a "*significant misunderstanding and mischaracterisation of the Petition*" as he had erroneously sought to identify a cause of action and in so doing, overlooked the pleadings which "*amounted to no more or 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*".

(b) A director's duty to disclose any conflict of interests requires a full disclosure of the nature and extent of a director's interest and approval or acquiescence by the company's shareholders; it may not be excluded other than by express wording; see *Gwembe Valley Development Co Ltd* (No. 3) [2003] BCLC 131 at 151 and *Movitex v Bulfield* [1988] BCLC 104.

(c) The Court of Appeal re-stated that the conduct of the affairs of a subsidiary is a proper basis of complaint against a parent company; see In the matter of *Fortuna Development Corporation* [2004-5] CILR 197 and *Rackind v Gross* [2005] 1 WLR 3505, both following *R v Board of Trade, ex parte St Martins Preserving Co Ltd* (1965) 1 QB 603.

(d) A just and equitable petition may be based on an irretrievable breakdown of a relationship of trust and confidence, which need not be based on a contract. It is sufficient for the petitioner to establish a mutual understanding and an entire agreement clause does not preclude the imposition of an overriding duty of good faith; see *In Re Fildes Bros Ltd [1970] 1 LWR 592, Ross River v Waverly Commercial [2014] 1 BCLC 545 and Sheikh Tahnoon Al Neyhayan v Kent [2018]* EWHC 333.

Relevance of Decision

The decision of the Court of Appeal provides welcome clarity to Cayman Islands practitioners, shareholders and company officers on the interplay between the provisions of shareholders agreements and governing documents, and the statutory right of shareholders to present a petition to wind up a company on the just and equitable ground.

Ogier represented FMCH in its successful application to the Cayman Islands Court of Appeal.

[1] In the matter of China CVS (Cayman Islands) Holding Corporation [2019] (1) CILR 266 per Kawaley J.

[2] Section 4 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 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 the court to stay the proceedings, and the court, unless satisfied that the arbitration is... inoperative.... shall make an order staying the proceedings".

[3] Section 95(2) provides that "the Court shall dismiss the winding up petition or adjourn the hearing of a winding up petition on the ground that the petitioner is contractually bound not to present a petition against the company."

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