Cayman Islands: Just and equitable winding up petitions in the face of an agreement to arbitrate

Briefing Summary: In a decision that has been keenly anticipated in Asia, the Judicial Committee of the Privy Council has now handed down its decision on the appeal by Ting Chuan (Cayman Islands) Holding Corporation (Ting Chuan) against the Cayman Islands Court of Appeal's decision to set aside a stay of the winding up proceedings commenced against it by Family Mart China Holdings Co Ltd (FMCH). This addresses the interplay between arbitration agreements and winding up proceedings, an issue of particular relevance to parties in the region given the prevalence of offshore structures and the widespread incorporation of arbitration clauses into agreements between stakeholders, particularly in shareholders agreements.

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Executive summary

The Board overturned the Court of Appeal's decision, holding that an aggrieved shareholder who has agreed to have disputes amongst the shareholders resolved by way of arbitration, must first have such disputes that fall within the ambit of the arbitration agreement determined accordingly before the threshold question of whether the company should be wound up on just and equitable grounds to obtain alternative relief may be addressed. Further it found that there is no reason, in principle, to suggest that the Court should not be bound by an arbitral tribunal's determination of the underlying dispute in making that assessment. The Board also stated that the Court continues to retain jurisdiction to determine the threshold question and an agreement to arbitrate does not amount to non-petition agreement.

Background

Briefly, Ting Chuan and FMCH are the shareholders of China CVS (Cayman Islands) Holding Corp (**Company**). The relationship between Ting Chuan and FMCH is governed by a shareholders' agreement (**SHA**) which provided that any and all disputes in connection with or arising out of the SHA shall be resolved by arbitration.

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On 12 October 2018, FMCH petitioned to wind up the Company (**Petition**) in the Grand Court. In the Petition, FMCH alleged, ***inter alia***, that Ting Chuan caused, permitted and/or procured the majority directors of the Company to act in breach of their duties to the Company. In the result, FMCH lost trust and confidence in the conduct and management of the Company's affairs and asserted that its relationship with Ting Chuan had irretrievably broken down such that it was just and equitable that the Company be wound up. In the alternative, FMCH sought an order that Ting Chuan sell its majority stake in the Company to it.

In response, Ting Chuan applied to strike out the Petition or, in the alternative, for an order dismissing or staying the Petition under section 4 of the Foreign Arbitral Awards Enforcement Act (1997 Revision) (**FAAEA**) or under the inherent jurisdiction of the Court on the basis that the dispute between the parties should be resolved by way of arbitration.

Appellate history

The Grand Court (Kawaley J) granted Ting Chuan's application to stay the winding up proceedings under section 4 of the FAAEA.

The Court of Appeal, however, overturned Kawaley J's decision and found that the assessment under section 92 of the Cayman Islands Companies Act (**Act**) of whether a company should be wound up is a threshold question and a gateway to relief, not one of relief.

In determining the threshold question, not only did the Court have to consider questions of primary fact, but it also had to evaluate all the circumstances of the case and decide whether the conduct of the majority directors and the breakdown of the relationship between the shareholders justified the winding up of the Company. If certain matters were hived off to arbitration, there would be a risk of inconsistent decisions where there would first be a decision of the tribunal and then a further decision by the Court taking into account the award in circumstances where some of the parties to a petition would not be bound by the tribunal's award (not being parties to the arbitration agreement). This outcome could only be avoided if the parties agreed not to present a winding up petition, which was not the case here. As neither the majority directors nor the Company were parties to the SHA, and thereby to the arbitration agreement, it was not permissible to apply the mandatory provisions of section 4 of the FAAEA to the Petition in its entirety. Further, because the allegations against Ting Chuan could not be separated from the threshold issue, section 4 could not operate to that extent. The Court of Appeal thus found the arbitration agreement to be inoperative and there was no basis for it to grant a discretionary stay in the exercise of its case management powers.

Ting Chuan appealed.

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Privy Counsil's Decision

Interpretation of the FAAEA

The Judicial Committee of the Privy Council allowed Ting Chuan's appeal.

In so doing, the Board addressed the interpretation of section 4 of the FAAEA, in particular, the meaning of (i) "legal proceedings", (ii) "matters", and (iii) "the arbitration agreement is ... inoperative" and considered whether the Petition is an unum quid (i.e. one thing), or whether there should be a partial stay under the FAAEA so that matters within the scope of the arbitration agreement can (and should) be hived off for arbitration. The Board also considered the application for a discretionary stay of the Petition and the submission on non-petition agreements.

On the interpretation of section 4 of the FAAEA, the Board noted that it gives effect to Article II(3) of the New York Convention and considered it appropriate to, and did in fact, review the jurisprudence of jurisdictions with provisions that are worded similarly to section 4 of the FAAEA.

Turning to each question of interpretation arising out of section 4 of the FAAEA:

1. *The meaning of "legal proceedings" commenced by a party to an arbitration agreement*

The Board concluded that legal proceedings can include a petition to wind up a company of which the parties to an arbitration agreement are members.

2. *The meaning and ascertainment of "matter"*

The Board reviewed the international authorities and opined that there was a general consensus that where a country is a signatory to the New York Convention, its courts take a pro-arbitration approach and primacy is given to the parties' agreement to arbitrate.

In ascertaining what "matters" are referrable to arbitration, the Board noted that the Supreme Court of the United Kingdom's decision in ***Republic of Mozambique (acting through its Attorney General) v Privinvest Shipbuilding SAL (Holding) and others*** handed down on the same day adopted a similar approach to the two-stage test adopted by the Board: first, the Court determines what the matters are which the parties have raised, or foreseeably will raise, in the court proceedings and, secondly, the Court determines in relation to each such matter whether it falls within the scope of the arbitration agreement.

The approach taken involves ascertaining the substance of the dispute(s) and consideration of the defences, including reasonably foreseeable ones. A "matter" is substantial issue that is legally relevant to a claim, defence, or foreseeable defence and susceptible to be determined by the tribunal; it does not extend to a peripheral or tangential issue.

The judicial evaluation of the substance and relevance of what the "matter" entails is a matter of judgment and the application of common-sense; it is not a mechanistic exercise.

Equally, a practical and common-sense approach should be taken on an application for a stay under section 4 of the FAAEA and no juridical formula encapsulating the meaning of "matter" should be treated as if it were a statutory text. The Court must respect the agreement of the parties to arbitrate their dispute; therefore, any substantial matter in the legal proceedings which is relevant to the claim or (foreseeable) defence, and which is within the scope of the arbitration agreement, will give rise to a mandatory stay of the legal proceedings to that extent.

Such an approach may result in the fragmentation of the parties' disputes with some matters being arbitrable and others not, but the disadvantages that come with such fragmentation can be managed with effective case management by both the Court and tribunal.

3. *The meaning of "the arbitration agreement is … inoperative"*

The Board held that the fact that a tribunal cannot make a winding up order does not render an arbitration agreement inoperable. Matters, such as whether one party has breached its obligations under a shareholders' agreement or whether equitable rights arising out of the relationship between the parties have been flouted, are arbitrable in the context of an application to wind up a company on the just and equitable ground.

The application of the FAAEA

With the above principles of interpretation in mind, the Board considered the application of the FAAEA to the facts of the case.

The Board agreed with Moses JA in the Court of Appeal that the Court's consideration under section 92 of the Act of whether it was just and equitable that the Company be wound up is a threshold question which is to be answered before the petitioner can get access to any of the remedies available under section 95 of the Act. The Board also accepted, as Moses JA held, that the Court had exclusive jurisdiction to make a winding up order. The Board agreed with FMCH's submissions that an arbitral tribunal does not have the power to make a ruling on whether it is just and equitable that a company should be wound up or whether the remedy of a share buyout should be granted under section 95 of the Act.

However, in an application to wind up a company where there are matters in dispute (such as allegations of breaches of a shareholders' agreement) that fall within the ambit of an arbitration agreement, such dispute may be referred to arbitration notwithstanding the fact that only a Court has jurisdiction to make a winding up order.

The Board therefore found that the question of whether (1) FMCH had lost trust and confidence in Ting Chuan and the management of the Company, and (2) the parties' relationship had irretrievably broken down (**Matters 1 and 2**) were controversies relating to legal or equitable rights of substance lying at the heart of the legal proceedings for an order under section 95 of the Act. They were also matters which, the parties accept, fell within the scope of the arbitration agreement.

Further, in the exercise of the equitable jurisdiction under section 92 of the Act, the Board opined that the Court must have regard to a party's contractual obligations, which may include an agreement to refer to arbitration disputes which fall within the scope of the relevant arbitration agreement. The Board added that the Court, in exercising its jurisdiction, would be bound by an agreed statement or admission as between the parties, and therefore there was no reason in principle why it should not be so bound by a decision of an arbitral tribunal (setting out its reasoning and findings of fact) on a dispute between Ting Chuan and FMCH.

The Board therefore allowed Ting Chuan's appeal and held that Matters 1 and 2 were substantive disputes between FMCH and Ting Chuan which provided the factual basis for a winding up petition on the just and equitable ground. Those matters fell within the scope of the parties' arbitration agreement and must therefore be determined by an arbitral tribunal unless the parties waived their right to arbitration. They were also "matters" for the purposes of section 4 of the FAAEA mandating a pro tanto stay of the winding up proceedings.

A discretionary stay of the winding up proceedings insofar as they were formally directed against parties other than Ting Chuan was also ordered under section 95(1)(d) of the Act.

The determination of the stayed matters was an essential precursor to the assessment of whether it is just and equitable to wind up the Company.

Finally, the Board confirmed that the agreement to arbitrate did not amount to an agreement not to present a winding up petition which would otherwise trigger section 95(2) of the Act requiring a dismissal or adjournment of the petition.

Parting comments

The Board's decision is likely to be closely scrutinised across the region and stands as the latest word on this contested area of law, an area which has provoked much debate in many jurisdictions. The market will no doubt play close attention to its ramifications and any further developments.

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