
# British Virgin Islands dispute resolution and insolvency client update

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Welcome to our March 2016 BVI dispute resolution and insolvency bulletin, co-authored by Ben Mays, Andrew Chissick and Jevaughn Rhymer. This edition of the bulletin contains reports on four recent cases:

- A Court of Appeal judgment distinguishing the approach of the BVI Court from the English Court in respect of judicial discretion when determining whether to stay winding up proceedings in favour of arbitration. The judgment also considers the applicable test for determining whether a debt is disputed on genuine and substantial grounds.
- A notable decision of the Privy Council discussing the extent to which parties to a dispute are entitled to a stay under the Arbitration Ordinance 1976 (the "Arbitration Ordinance") without themselves having initiated arbitration proceedings.
- A judgment of Mr Justice Leon of the BVI Commercial Court on whether the court can intervene in a valuation process conducted by appraisers pursuant Section 179(9) of the BVI Business Companies Act (the "Act"), which provides for the calculation of the fair value of a shareholder's shares where a company seeks, amongst other things, to compulsorily effect a share redemption.
- A Court of Appeal decision discussing the correct test for considering whether a claim is likely to succeed when the court evaluates whether to permit a derivative action to proceed in accordance with Section 184C of the Act.

## Jinpeng Group Limited v Peak Hotels and Resorts Limited – BVIHCMAP2014/0025 and 2015/0003

The inter-relationship between disputed debts, arbitration agreements and winding up proceedings has come up before the BVI Court of Appeal again in the context of a dispute relating to the luxury hotel chain Aman Resorts. At the heart of the case is the balance to be struck by the courts when addressing the tension between contractual counterparties' agreements to arbitrate and the statutory rights of creditors to invoke the collective remedy of an application for the appointment of liquidators.

The basic facts of this Court of Appeal case were that the appellant ("Jinpeng") lent $35million to the respondent ("Peak Hotels") to assist with the purchase of the luxury hotel chain Aman Resorts. The loan was convertible at the option of Jinpeng, so as to give Jinpeng an 8.75% indirect equity interest in Aman Resorts.

In September 2014, Jinpeng applied to the BVI Commercial Court to appoint liquidators over Peak Hotels (the "originating application"). Jinpeng's application was made in its capacity as a creditor of Peak Hotels, albeit that the statutory ground of the application was that it was just and equitable that a liquidator should be appointed, rather than being based on Peak Hotel's insolvency. Jinpeng also applied ex parte on notice to appoint provisional liquidators over Peak Hotels. That application was granted and provisional liquidators were

appointed because the Judge found that the assets of Peak Hotel were "in some jeopardy"[1].

The "return date" (as the Court of Appeal described it[2]) of the application to appoint provisional liquidators was used to hear an application by Peak Hotels to strike out the originating application. The Commercial Court granted that application, struck out the originating application and discharged the provisional liquidators. Jinpeng then appealed the order striking out the originating application, resulting in this judgment.

The Judge's basis for striking out the application at first instance was that the debt on which the originating application was based was disputed on genuine and substantial grounds. It is well established that, generally speaking and subject to certain exceptions, an application to appoint liquidators based on a debt which is disputed on genuine and substantial grounds will be struck out or dismissed. However, the Court of Appeal found that the court hearing such an application nonetheless has a duty to carry out a preliminary investigation in order to determine whether the dispute raised by the alleged debtor does reach the threshold of being a genuine and substantial dispute.

In this case, the Court of Appeal found that the Judge at first instance had not applied this test. The Judge's decision to dismiss the originating application was made on the basis that "serious doubts" about the respondent's case are "not enough" to allow the originating application to proceed, and that an application to appoint liquidators risks failure "should anything other than a hopeless challenge be made to the [applicant's] standing as creditors". By adopting that approach, the Court of Appeal found, "[t]he Judge did not assess the dispute by the tried and tested expression that the debt and the appellant's status as a creditors 'are disputed on genuine and substantial grounds'". Rather, he set the bar for the respondent to clear somewhat lower than that, and impermissibly so. The Court of Appeal therefore overturned his decision.

Furthermore, on its own assessment of the facts the Court of Appeal also found that the dispute raised by the respondent did not, in fact, rise to the level of a genuine and substantial dispute. Peak Hotels had sought to argue that Jinpeng had converted its debt into shares and was no longer a creditor. The Court of Appeal essentially found that not only was there no evidence that this had happened, the evidence actually controverted the suggestion.

Having found that the debt was not disputed on genuine and substantial grounds such that the originating application could proceed, the Court of Appeal then went on to consider a number of further issues that the court below had not needed to determine after it struck out the originating application.

In particular, the relevant contractual arrangements were subject to arbitration clauses in favour of HKIAC arbitration (and indeed, the parties had resorted to arbitration proceedings in parallel with the court proceedings – although the Court of Appeal noted that the outcome of the arbitration was still pending). Peak Hotels argued that the court proceedings should therefore be stayed and the action be referred to arbitration under section 18(1) of the Arbitration Act, 2013 which provides that:

> "A court before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so requests not later than when submitting his first statement on the substance of the dispute, refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed."

The Court of Appeal noted that equivalent wording in the Arbitration Act 1996 in England "has been interpreted to mean that the court will grant a stay of court proceedings once the defendant raises the issue of dispute, regardless of the level or quality of the dispute".

Nevertheless, the Court of Appeal found that although the facts of the dispute fell within the arbitration clauses, "once the appellant submitted this dispute to the court as the basis of a creditor's winding up application it became an issue between the respondent and its creditors over the company's ability to pay its debts as they fall due", the winding up process being a collective remedy for the benefit of all creditors, and not a private one. On that basis the Court of Appeal concluded that "this form of proceeding" (i.e. a winding up proceeding brought by a creditor) is not covered by section 18(1) of the Arbitration Act, following recent English and BVI Court of Appeal authority[3].

That is not, however, the end of the matter, because in the Salford case the English Court of Appeal went on to observe that even if the nature of the proceedings was not caught by

*1 These concerns appear to have been well-founded, as approximately $35 million of treasury bonds subsequently went missing from an account held in Peak Hotel's name after the Judge at first instance made an order striking out the originating application and setting aside the appointment of the provisional liquidators.*
*2 Whilst it is not clear from the judgment what happened as a matter of procedure in the first instance proceedings, the concept of a "return date" on an ex parte application to appoint provisional liquidators is something of a misnomer. A return date usually refers to the date on which an ex parte application is required by the Civil Procedure Rules to come back before the court to be heard on an inter partes basis, ordinarily in the context of an injunction. There is no equivalent concept in respect of an ex parte application to appoint provisional liquidators and the application will not automatically return to Court inter partes. Rather, if the respondent company wishes to challenge the application to appoint provisional liquidators, it is incumbent on the company to issue its own application to set aside the ex parte order. Whilst this may appear to be a distinction without a difference, it can give rise to important procedural differences.*
*3 Salford Estates (No 2) Ltd v Altomart Ltd [2015] 3 WLR 491 and C-Mobile Services Limited v Huawei Technologies Co. Limited BVIHCMAP2014/0017*

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the automatic stay in the arbitration law (in BVI, section 18(1) of the Arbitration Act), the court retains its wide discretion under the insolvency legislation whether to make a winding up order, and should exercise that discretion in favour of a stay or dismissal so as to compel arbitration rather than require the court to investigate whether or not the debt is bona fide disputed on substantial grounds. That essentially had the effect of reintroducing through the back door (the discretion in the insolvency legislation) the policy of primacy of access to arbitration which the court had shut out at the front door (the mandatory stay in the arbitration legislation).

In Peak Hotel's case, however, the BVI Court of Appeal differed from its English counterpart. The English Court of Appeal felt that the court's discretion under the insolvency legislation should be exercised in favour of a stay where there is an operative arbitration agreement unless exceptional circumstances apply. The BVI Court of Appeal, in contrast, took the view that a creditor should not have to prove exceptional circumstances in order to invite the court to exercise its discretion in favour of making a winding up order. The creditor has (only) to show, said the Court of Appeal, that "the dispute is not on genuine and substantial grounds and leave it to the court to exercise its discretion under section 162 [of the Insolvency Act] on the usual bases".

In other words, where a creditor applies for a winding up order on the basis of an unpaid debt (whether on the grounds of insolvency or the just and equitable basis) in circumstances where the debt is disputed and the dispute falls within the scope of an agreement to arbitrate, the BVI Court is bound to first conduct an analysis of whether the dispute is genuine and substantial. If the dispute is genuine and substantial then the court will stay the winding up proceedings in favour of arbitration proceedings. If, however, the court determines that the dispute is not genuine and substantial, the court will not automatically stay the dispute in favour of arbitration. Rather, it will determine the application to appoint liquidators in the usual way, and exercise its discretion under the Insolvency Act accordingly. As a consequence, in the current proceedings the Court of Appeal determined that the originating application should proceed and that the provisional liquidators be re-appointed. Although the court identified the extant arbitration proceedings as a factor in favour of exercising its discretion to stay the originating application pending the outcome of that arbitration, it ultimately found that the absence of a genuine and substantial dispute together with the respondent's failure to account for the missing treasury bonds meant that it was incumbent upon it to make an order for the appointment of "independent persons to be responsible for investigating what has happened with a view to recovering the company's assets".

The Court of Appeal's findings suggest that although the presence of nominally operative arbitration provisions may be persuasive to the court when considering whether to stay winding up proceedings in the absence of a genuine and substantial dispute as to the debt, it will not necessarily be the dominant factor. Other material issues (not least suggestions of the inappropriate distribution of the company's assets) may well lead the court to favour the continuation of a court led process over a contractually agreed arbitration procedure.

## Anzen Limited & Ors v Hermes One Limited [2016] UKPC 1

This was an appeal to the Privy Council of a decision by Mr Justice Bannister, upheld by the BVI Court of Appeal, that the appellants were not entitled to a stay under the Arbitration Ordinance without having themselves initiated arbitration.

The parties were both shareholders of a BVI company with a shareholder's agreement that contained an arbitration clause providing that where a dispute remained unresolved for longer than 20 days,"any party may submit the dispute to arbitration". Instead, Court proceedings were commenced by the respondent and the company "claiming inter alia statutory remedies in relation to the appellants' alleged unfairly prejudicial conduct in the management of the affairs of the company, damages and/or the appointment of a liquidator over the company amongst other forms of relief". The appellants applied for a stay in accordance with the Arbitration Ordinance on the basis that the arbitration clause is a binding provision.

The main issue was whether the appellants were entitled to stay, under Section 6(2) of the Arbitration Ordinance, without themselves having commenced an arbitration. This turned on the construction of the words "any party may submit a dispute to binding arbitration" and three potential positions were identified and examined by the Privy Council, namely:

- The words are not only permissive but exclusive, if a party wished to pursue the dispute by any form of legal proceedings (Analysis 1); or

The words are purely permissive allowing one party to commence litigation, but giving the other party the option of binding arbitration, exercisable either by:

- commencing arbitration under the International Chamber of Commerce arbitration rules (as held by the courts below) (Analysis 2); or
- requiring the party commencing litigation to submit the dispute to arbitration, by making unequivocal request to that effect and/or by applying for a corresponding stay, as done by the appellants (Analysis 3).

Analysis 1 was rejected for a number of reasons, primarily (i) the Privy Council's own construction of the clause, (ii) English and Commonwealth authority and, as a further background factor, the frequent use of the word "may" in the commercial community when arbitration is intended as an express alternative to litigation; and the absence in any common law jurisdiction outside of the United States of authority suggesting

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that it has been viewed as mandatory prior to a party insisting on arbitration.

Analysis 2 was rejected because, according to the Board, it was "capable of giving rise to evident incongruity". This position allows one party to commence litigation but only requires the dispute to be arbitrated if the other party commences arbitration in which that party may seek no other positive relief. The Board held that this analysis was not commercially sensible and per Lord Clarke in *Rainy Sky SA Kookmin Bank*, "... where a term of a contract is open to more than one interpretation, it is generally appropriate to adopt the interpretation which is most consistent with business common sense".

The Privy Council preferred Analysis 3. It held that the decisions of the courts below were wrong, that the appeal should be allowed and a stay granted. In reaching this conclusion the Privy Council noted that in *Bremer Vulkan Schiffbau und Maschinenefabrik v South India Shipping Corp Ltd* the distinction was drawn between litigation and arbitration and that parties agreeing to arbitration are under mutual obligations to one another to cooperate in the pursuit of the arbitration. Analysis 3 enables a party to commence arbitration or to insist on it, before or after the other party commences litigation, without itself having to commence arbitration if it does not wish to.

## Olive Group Capital Limited v Gavin Mark Mayhew BVIHC (COM) 2015/115

The BVI Commercial Court (Mr Justice Leon) has clarified the scope of its jurisdiction to interpret or give directions in respect of a valuation process by appraisers under Section 179(9) of the Act. The court found that where appraisers have not been impeded from carrying out their share valuation work and have not sought assistance from the court, then the court has no jurisdiction to intervene or otherwise impose its interpretation of the Act on the appraisers.

Section 179 entitles a member of a company to payment of the fair value of their shares where that member dissents from the company, amongst other things, entering into a merger or a sale or other disposition of more than 50% of the company's assets, or, as is the case in the current proceedings, redeeming that member's shares under Section 176 of the Act (which provides that members holding 90% of the votes of the outstanding shares or each class of outstanding shares may direct the company to redeem the shares held by the remaining members). Under Section 179(9), where the member and the company are unable to agree on the price of the shares, then each shall appoint an appraiser. The appraisers must then jointly designate a third appraiser and together the three appraisers fix the fair value of the shares.

In the current case, Mr Mayhew, a minority shareholder of Olive Group Capital Limited (the "Company"), was subject to a forced share redemption under Section 176 of the Act. Mr Mayhew exercised his right to dissent under Section 179 and demanded payment for the fair value of his shares. The parties were unable to agree the fair value of the shares and appraisers were appointed pursuant to the terms of Section 179(9). There was an agreement (reflecting the statutory provision) that the appraisers' determination would be "final and binding for all purposes".

Whilst the valuation process was ongoing, the Company applied to the court seeking a number of declarations, including the meaning of "fair value"; the facts to be taken into account by appraisers; the process to be adopted by the appraisers; and whether the valuation of the shares would include a "minority discount". In short, the effect of such declarations, if granted, would effectively frame the appraisers' approach to the valuation exercise.

In response, Mr Mayhew sought a declaration that the court had no jurisdiction to interfere in the valuation process in the manner sought by the Company.

The court found in Mr Mayhew's favour. It concluded that the appraisal process under Section 179 of the Act constituted an "Expert Determination" procedure and in line with the extant body of law governing such Expert Determinations, there is limited scope for the court to interfere. The court had no jurisdiction to interfere in circumstances where the appraisers are not impeded from completing their analysis and have not approached the court for assistance. As the Judge explained, "the House of Assembly has deliberately implemented a process for valuation that puts it almost entirely in the hands of the appraisers". The court also gave weight to the fact that appraisers appointed under the provisions of Section 179 will not be "people picked randomly off the street" but rather "experts with professional training".

The court further determined that the court may be entitled to intervene once the appraisers had concluded their evaluation, but only where there was a "serious and fundamental matter" in respect of the appraisal process which may include fraud, collusion or jurisdictional error (such as a significant departure from the appraisers' instructions). Such extreme circumstances did not arise in the current case.

The court's finding demonstrates that, other than where there has been some fundamental issue which demands the intervention of the court at the conclusion of the appraisal process, the court should not impose upon or otherwise interfere with the scope of appraisers' work or the process by which the determination is ultimately reached. The decision may well comfort parties to a dispute that there is limited scope for opponents to challenge or fetter the approach of an appraiser and accordingly help ensure the process is completed in a "cost effective, efficient and expeditious" manner.

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## Basab Inc. v Accufit Investment Inc. and Double Key International Limited BVICHCMAP 2014/0020

Section 184C of the Act stipulates that a shareholder of a company wishing to bring or intervene in a derivative action (i.e. an action on behalf of and in the name of the company in which it holds shares) must first obtain the permission of the court. This is a substantive requirement – the court will not simply "rubber stamp" an application seeking permission. Rather, the court is required to carry out a detailed evaluation of a number of factors in determining whether to exercise its discretion and grant leave for the derivative action to proceed. Among those factors is whether the proposed derivative action proceedings "are likely to succeed".

In this judgment, the court of Appeal partially overturned a first instance decision of the BVI Commercial Court on the construction of that wording. The Court of Appeal found that the Commercial Court had imposed an inappropriately high threshold for a potential Claimant to satisfy and emphasised that it was incumbent upon the court to carry out a "full and proper examination of the evidence before it" when evaluating a claim's likelihood of success.

The proceedings concerned a dispute between two BVI incorporated companies: Basab Inc. ("Basab") and its wholly owned subsidiary, Accufit Investment Inc. ("Accufit").

In September 2012, Accufit entered into a loan agreement, pursuant to which it granted a charge over 131 million shares in a company called Kith Holdings Limited (the "Sale Shares"). Basab guaranteed that debt and subsequently granted a fixed and floating charge over all of its assets, including its shareholding in Accufit.

There was a default of the loan and, pursuant to the terms of the security granted in its favour, the loan creditor appointed receivers to Basab. The receivers appointed themselves directors of Accufit and removed Basab's representatives from Accufit's board. The receivers, in their capacity as directors of Accufit, then arranged and completed the sale of the Sale Shares to a third party.

Basab asserted that this disposal of the Sale Shares had been conducted at a significant undervalue. It sought to bring a derivative action on behalf of Accufit against the receivers in their capacity as directors seeking a variety of remedies, including damages as a result of the directors' purported breach of their fiduciary duties. In accordance with Section 184C of the Act, Basab was required to obtain the leave of the court before commencing the proceedings.

The Judge at first instance examined each of the factors the court is required to evaluate in accordance with Section 184C(2) of the Act when considering whether to permit a derivative action to proceed. The Judge explained that subject to the court's "overriding discretion", the nature of the matters listed at Section 184C(2) was such that "failure" of any one of the factors, would "point, prima facie, towards a refusal of permission" by the court. The court found that Basab had failed to make out that its claim was "likely to succeed" and accordingly refused permission for Basab to proceed with the derivative action.

In evaluating what was required for a potential claim to be "likely to succeed" within the meaning of the Act, the Judge found that where a claim fell between the two extremes of "evidently hopeless" or "self-evidently strong" then the court "should not attempt to conduct an inquiry similar to that which might be conducted on an application of summary judgment – still less a mini trial". In addition, the Judge considered that the question of whether a claim was likely to succeed "connotes obviousness" inasmuch that when the cause of action is explained and the surrounding facts presented the court should readily be able to see that a claim was likely to be successful. If there was a debate on the factual merits of the claim, it would push the court to a form of "half-baked adjudication" rather than a consideration of the question of likelihood of success. As such, the Judge concluded that "if the merits of the proposed derivative action cannot be clearly and simply expounded, the court should resist pressure... to conduct an evaluation of the materials in order to see whether some sort of viable claim can be extracted from them". In essence, the Commercial Court found that if a detailed examination of the claim's merits is needed to establish whether it is likely to succeed, then it is likely that it will fail to satisfy the requirements under Section 184C(2).

Basab appealed, arguing that the Judge at first instance had erred in holding that a claim "must appear to be strong from a cursory examination and without debate on the merits". The Court of Appeal examined in detail how the term "likely to succeed" should be construed. It concluded that the correct interpretation was whether "it is more probable than not that the proceedings will succeed". To the extent the Judge at first instance had, in his reference to "obviousness", suggested that the proceedings should require a strong likelihood of success for the requirements of Section 184C to be satisfied, the Court of Appeal found that he was incorrect.

In addition, the Court of Appeal concluded that the potential nature of derivative claims, especially those which may be both complex and defended, do not predispose themselves to a "cursory review". As a consequence it was difficult to envisage how the test of whether a claim was likely to succeed could be properly applied without the court carrying out a proper evaluation of the evidence before it. Accordingly, the concern expressed by the Commercial Court Judge that any evaluation would be "half-baked" was a misconception – the court must conduct a full and thorough examination of the facts of the proposed claim.

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Nevertheless, the Court of Appeal's decision was a pyrrhic victory for Basab. Having determined that the Commercial Court's previous approach had been incorrect, the Court of Appeal found that it was incumbent upon it to carry out the evaluation of facts to determine whether Basab's claim was likely to succeed. The Court of Appeal found that, upon review of the evidence before it, the claim was not likely to succeed. It accordingly upheld the Commercial Court's decision to refuse permission for the derivative action to be brought.

This judgment represents a shift away from the onerous test applied by the Commercial Court. However, as the Court of Appeal's ultimate refusal to grant leave for the derivative action demonstrates, on an application under Section 184C for leave to bring a derivative claim the court will closely scrutinise and thoroughly evaluate a claim's likelihood of success before determining whether permission should be given.

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