Petition vs Arbitration: Cayman Islands Court of Appeal Rules that the Subject Matter of a Winding Up Petition is not Arbitrable

In a significant judgment delivered on 23 April 2020, the Cayman Islands Court of Appeal ("**CICA**") allowed an appeal against a 2019 decision of the Grand Court to stay a 'just and equitable' winding up petition on the grounds that the subject-matter of the dispute must be referred to arbitration. The CICA judgment, which concerns China CVS (Cayman Islands) Holding Corp ("**CVS**"), addresses the tension between arbitration agreements and the Court's exclusive jurisdiction to determine winding up petitions.

In summary, the CICA held that since the threshold question of whether to wind up a company is to be determined by the Court alone, the subject-matter of such a petition is not capable of being determined by arbitration. The position would have been different if the underlying contract had contained a no-petition clause, which clauses are valid and enforceable pursuant to section 95(2) of the Companies Law.

The judgment swims against the tide in modern times in favour of enforcing arbitration agreements, even when the ultimate relief sought can only be granted by the Court (consequent upon the arbitration award). The decision is an important development for insolvency practitioners and other users of the Cayman courts, particularly in light of the ever-increasing prevalence of arbitration agreements.

Background

CVS was a Cayman Islands holding company for nine subsidiaries operating some 2,400 convenience stores in China. CVS had two shareholders; the majority shareholder, Ting Chuan (Cayman Islands) Holding Corporation ("**Ting Chuan**"), and the minority shareholder, FamilyMart China Holding Co. Ltd ("**FMCH**"). The company had seven directors; four appointed by Ting Chuan (the "**Majority Directors**") and three appointed by FMCH (the "**Minority Directors**").

In May 2011, Ting Chuan and FMCH entered into a Shareholders' Agreement which contained an entire agreement clause and an arbitration agreement pursuant to which any and all disputes were to be referred to arbitration. The shareholders operated CVS as a joint venture, whereby Ting Chuan and FMCH and their respective affiliates each brought different skills and expertise to the enterprise. According to a winding up petition brought by FMCH in October 2018 (the "**Petition**"), the shareholders also entered into other contracts dating back to 2003, including a sub-license of the FamilyMart trademark, and developed an "agreed understanding" for the expansion of the company's business.

According to the Petition, the terms of the agreed understanding were satisfied between 2004 and 2012, but this changed in April 2012 such that FMCH was excluded from the operation of the business and no longer received full financial reporting. The Petition alleges that the shareholders lost trust and confidence in each other, including on account of alleged (i) failures by the company to honour royalty payments due to FMCH for the use of the FamilyMart trademark (ii) diversion of profits to Ting Chuan and/or its affiliates.

The Petition sought the winding up of CVS on the 'just and equitable' ground pursuant to section 92(e) of the Companies Law (2018 Revision), on two distinct bases: first, that FMCH had a justifiable lack of confidence arising from a lack of probity in the conduct of the company's affairs and, secondly, that there

had been a breakdown in the fundamental relationship between the shareholders and breach of the understanding which governed that relationship. The Petition sought alternative relief in the form of an order for Ting Chuan to sell its shares in CVS to FMCH. However, as a matter of Cayman Islands law (unlike the unfair prejudice provisions of English law), such alternative relief is only available if the threshold test for a winding up is satisfied.

Ting Chuan sought to strike-out the Petition on the grounds it was an abuse of the process of the Court. Alternatively, Ting Chuan sought an order that the Petition be dismissed or stayed pursuant to:

- section 4 of the Foreign Arbitral Awards Enforcement Law (1997 Revision) (the "**FAAEL**"), which provides that any party to an arbitration agreement may apply to the Court to stay any Court proceedings brought by another party to that agreement in respect of any matter agreed to be referred to arbitration, and that the Court shall make an order staying those proceedings *"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 [to arbitration]…*";
- section 95(1) of the Companies Law, which provides that upon the hearing of a winding up petition the Court may dismiss or adjourn the petition, make a provisional order, or make any other order that it thinks fit; and/or
- the inherent jurisdiction of the Court.

Grand Court decision

In a judgment delivered in February 2019,[1] Kawaley J refused to strike out the entire Petition, holding that it did not constitute an abuse of process, although he struck out certain parts of the Petition on the grounds that the subject-matter did not disclose any reasonable cause of action, and granted leave for some parts of the Petition to be amended.

The judge also granted a stay of the Petition under section 4 of the FAAEL,[2] since it was:

> *"… clear beyond sensible argument that the allegations raised in the petition related to the subject-matter of the shareholders' agreement, which had a broadly drafted mandatory arbitration clause… the petition includes matters which, shorn of their thinly veiled drafting disguise, clearly constitute claims falling within the arbitration agreement. They can properly be "hived off" for determination by the arbitral tribunal, and the present proceedings can be stayed. Should the petitioner succeed and need to seek relief which only this court can grant, it can apply to lift the stay and rely upon the findings reflected in the award."*

In granting a stay, the judge rejected FMCH's submission that the subject-matter of the Petition was not arbitrable because only the Court could grant the relevant statutory relief (*i.e.* a winding up order). Citing

[1] [2019 (1) CILR 266].
[2] Which decision meant that it was unnecessary for the judge to decide whether a stay should be granted on other grounds.

a leading English Court of Appeal authority, *Fulham Football Club (1987) Ltd v Richards*, the judge held that:

> *"… there is a fundamental distinction between the question of whether the underlying disputes are arbitrable and the question of whether only the court can grant the statutory relief or, inter alia, winding up… In these circumstances it is quite straightforward to conclude that the arbitral tribunal can decide the relevant contractual disputes and that, if the petitioner's complaints are vindicated, the petition could (if appropriate) [seek to lift the stay of the Petition and/or enforce any arbitral award]."*

Explaining his decision by reference to public policy, the judge remarked that *"The purpose of the mandatory stay provisions of the FAAEL is to give effect to 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."*

The first instance judgment was appealed by FMCH and cross-appealed by Ting Chuan, which renewed its attempt to strike-out the entire Petition.

CICA judgment

The CICA allowed FMCH's appeal and overturned the first instance judgment, holding that the Petition should not have been stayed on account of the arbitration agreement.

In a lengthy judgment delivered by Moses JA, with whom Martin JA and Rix JA concurred, the CICA provided a detailed rationale for its decision, including the following key points.

First, the subject-matter of the Petition is not arbitrable. In reaching this conclusion, the starting point was the Court's consideration of whether it is just and equitable that a company should be wound up is a *threshold* question, rather than a question of *relief*. It is only if the Court decides that it is just and equitable to wind up the company that it may then determine whether a winding up order should be made or whether one of the alternative available remedies should be granted. This feature distinguishes Cayman law from English law, which permits standalone alternative remedies where a petitioner can establish unfair prejudice under section 994 of the UK Companies Act 2006. It follows that *Fulham* was distinguishable since, in that case, there had been no need to establish grounds for winding up the company.

Secondly, a petitioner has a statutory right to petition for a winding up, as confirmed by the CICA in *Tianrui (International) Holding Company Ltd v China Shanshui Cement Group Ltd.*[3] In the judgment of Moses JA in *CVS*:

> *"This right can only be taken away in circumstances where it is plain at an early stage that the petition will fail because there exists an adequate alternative remedy which the petitioner has unreasonably failed to pursue… Thus FMCH's statutory right persists like that of Tianrui, despite*

[3] [2019 (1) CILR 481.

> *the fact that under the statutory scheme, if FMCH establishes that the Company should be wound up, alternative remedies to winding up will be available… FMCH has a statutory right to invoke the exclusive power of the court to wind up the Company…"*

Thirdly, the judge erred in being heavily influenced by a perceived need to find contractual causes of action contained within the Petition, and to regard such causes of action as being "foundational" matters that had to be established at the outset. Rather, in order to determine the threshold question as to whether there are sufficient grounds to justify a winding up on just and equitable grounds, the Court must evaluate all of the circumstances of the case. In the judgment of Moses JA:

> *"The factual questions which the court has to determine are not mere questions of primary fact but require evaluation, both in relation to the gravity and significance of those facts and where responsibility for any breaches of duty or a breakdown of the relationship between the parties lies… All the primary and secondary facts… 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 "hived off" to arbitration."*

Fourthly, any reference of such matters to arbitration would create duplication and a risk of inconsistent decisions between the arbitral tribunal and the Court. Further, any findings of the arbitral tribunal would not bind third parties to the arbitration: *"Absent any agreement to be bound by findings of fact which go to that issue, the Court would be entitled, in the exercise of its exclusive jurisdiction to form a fresh and, if necessary, wholly contrary view of the evidence...".*

Fifthly, these concerns about duplication and possible inconsistency of findings could only be avoided where the parties have agreed that the matters which go to the question of any winding up on just and equitable grounds should be arbitrated because they have agreed not to present a petition. Such agreements are valid and enforceable pursuant to section 95(2) of the Companies Law, however in the CICA's judgment the mere existence of an arbitration agreement does not amount to an implied agreement not to petition.

Sixthly, a mandatory stay of the petition was not available under section 4 of the FAAEL since the relevant arbitration agreement would be *"inoperable"* insofar as it concerned the matters pleaded in the Petition, which were not arbitrable.

Finally, although the Court had a discretionary power to grant a stay, the CICA declined to do so since FMCH had not agreed not to present a petition.

Conclusion

The first instance judgment of Kawaley J and the CICA judgment, each given in emphatic terms, reached opposite conclusions about how to resolve the tension between arbitration agreements and the Court's exclusive jurisdiction to determine winding up petitions. By its judgment, the CICA has resolved this tension in a clear ruling, such that companies, investors, insolvency practitioners and their advisors will

be better placed to assess whether a winding up petition is a viable option despite the existence of an arbitration agreement. The case also highlights the importance of including a no-petition clause within such contracts, if it is the parties' intention to preclude a petition ever being brought.

More broadly, though, the Cayman Islands remains a pro-arbitration jurisdiction that upholds and enforces arbitration agreements save where, as here, they are found to be in conflict with the exclusive jurisdiction of the Court.

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