Dispute Resolution Hotline

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THE UK PRIVY COUNCIL RECALIBRATES ARBITRATION VS INSOLVENCY DEBATE

- The UK Privy Council overturned the Salford Estates decision, ruling that winding-up proceedings should only be stayed for arbitration if the debt is genuinely disputed on substantial grounds.
- This decision rebalances insolvency law and arbitration, preventing misuse of arbitration clauses to delay legitimate insolvency proceedings.
- The judgment aligns with other common law jurisdictions and provides clarity for insolvency cases involving arbitration clauses.

INTRODUCTION

Recently, the UK Privy Council's ("**Board**") in an appeal from Court of Appeal (British Virgin Islands) in *Sian Participation Corp (In Liquidation) v. Halimeda International Ltd.*[1] redefined the intersection of insolvency law and arbitration. Overturning the UK Court of Appeals decision in *Salford Estates (No. 2) Ltd. v. Altomart Ltd. (No. 2)*[2] ("**Salford Estates**"), the Board held that winding-up proceedings should only be stayed for arbitration if the debt is genuinely disputed on substantial grounds. Earlier, Salford Estates had set a lower bar, requiring a stay of winding up proceedings if the debt was merely not admitted, even without substantial grounds for dispute. The judgement is a welcome step and is likely to prevent misuse of arbitration clauses to delay legitimate insolvency proceedings going forward.

FACTUAL BACKGROUND

The respondent, Halimeda International Ltd ("**Halimeda**") lent USD 140 million to the appellant, Sian Participation Corp ("**Sian**"). By 2020, the unpaid debt had grown to over $226 million. The loan agreement between the parties included an arbitration clause stipulating that any disputes between them shall be resolved through arbitration under the rules of the London Court of International Arbitration ("**LCIA**"). Sian did not repay the loan. As a result, Halimeda applied to the British Virgin Islands ("**BVI**") court to liquidate Sian.

Sian claimed it had reasons for not paying the debt but in fact, had a cross-claim against Halimeda. Specifically, Sian alleged that a "corporate raid" had been conducted against it with the active participation of Halimeda. As a consequence Sian initiated proceedings against Halimeda before the BVI courts ("**BVI Proceedings**") seeking to recover amounts exceeding Halimeda's debt. These proceedings were ongoing during the initial liquidation hearing and the appeal. Later on, a claim was also filed in the English High Court alleging unlawful conspiracy and other torts related to this dispute ("**English Proceedings**").

Sian argued that the court should not decide on the liquidation until the dispute over the debt was resolved through arbitration.

At first instance, BVI High Court (Wallbank J), held that Sian had failed to show that the debt was genuinely disputed on substantial grounds and appointed liquidators in the winding up proceedings. Sian appealed this decision to the BVI Court of Appeal, which also dismissed the appeal. Sian then appealed this decision to the Board, both as a matter of right under the BVI (Appeals to Privy Council) Order 1967 and on the basis that the appeal raised a point of law of great general or public importance.

Insolvency v. Arbitration

The Board's decision considers the interpretation of arbitration law, particularly the provisions mandating stays of court proceedings in favor of arbitration. In this regard, Article 8 of the UNCITRAL Model Law, which is identical to Section 18 of the BVI Arbitration Act 2013, states:

"*A court before which an action is brought in a **matter** which is the subject of an arbitration agreement shall... refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.*"

Section 9 of the UK Arbitration Act 1996 is also similar to the above provision.

Both UK and BVI courts have recognized that winding-up proceedings are not a "*matter*" that can be referred to arbitration. In the UK, this principle was established in Salford Estates, where it was explained that a creditor's winding-up petition is not a claim for payment of the debt, but rather evidence that the company is unable to pay its debts. Similarly, in the BVI, the Court of Appeal in *Jinpeng Group Ltd v Peak Hotels and Resorts Ltd*[3] affirmed this view ("**Jinpeng**"). In Jinpeng, the court held that a creditor's application for the appointment of a liquidator did not fall

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within Section 18 of the BVI Arbitration Act, as it was not subject to a mandatory stay.

However, the UK courts in Salford Estates took a divergent path. In Salford Estates, having acknowledged that Section 9 of the UK Arbitration Act did not apply to winding-up petitions, it was held that the courts should still exercise their discretion to stay such petitions in favor of arbitration, save in 'wholly exceptional circumstances.' This basically meant that even a whisper of dispute was good enough to seek a stay in favor of the arbitration. In contrast, the BVI courts, as seen in Jinpeng, maintained that a creditor's statutory right to apply for a company's winding up should not be impeded by an arbitration agreement unless the debt was disputed on genuine and substantial grounds.

Global Criticism of Salford Estate

Other common law courts have expressed their reservations about Salford Estate approach. In Hong Kong, in *Dayang (HK) Marine Shipping Co Ltd v Asia Master Logistics Ltd,*[4] the court rejected the Salford Estates approach, on the ground that it improperly fettered the court's discretion in winding-up proceedings. The court emphasized that presenting a winding-up petition does not breach an agreement to arbitrate disputes, as it doesn't seek to determine the debt's existence. Similarly, the Eastern Caribbean Court of Appeal in Jinpeng also maintained that a creditor's statutory right to apply for winding-up should not be easily displaced by an arbitration agreement.

Another common criticism of Salford Estate was that it would hinder rather than promote a pro-arbitration policy, since prospective creditors might resist the inclusion of an arbitration clause in their contracts if this has the effect of reducing, or making slower and more expensive, their remedies in the event of an insolvency of the debtor.

Judgment

The Board overturned the decision in Salford Estate and held that the appropriate criterion for deciding whether to order liquidation is to check if the debt in question is genuinely disputed on substantial grounds. This approach ensures that winding-up petitions are not dismissed merely because an arbitration agreement exists. The Board highlighted that the presence of an arbitration agreement does not automatically preclude liquidation if the dispute is not substantial. The Board highlighted that a winding-up petition does not adjudicate the underlying dispute but focuses on whether the company can pay its debts as they fall due. Therefore, the presence of a genuine dispute must be evaluated based on its substantive grounds rather than the mere existence of an arbitration agreement.

INDIAN PERSPECTIVE

The Supreme Court of India in *Indus Biotech Private Limited vs Kotak India Venture (Offshore) Fund*[5] ("**Indus Biotech**"), had the occasion to deal with the intersection of arbitration and insolvency proceedings. In the judgment, the court clarified that before admitting a Section 7[6] petition under the Indian Insolvency and Bankruptcy Code, 2016 ("**IBC**"), the NCLT must be satisfied that there is a default by the corporate debtor. The court observed that the corporate debtor at this juncture is entitled to point out that a default has not occurred or that the debt is not due. Having said this, if an application under Section 8 of the Arbitration and Conciliation Act (seeking referral to arbitration) is filed while a Section 7 IBC petition is pending admission, the NCLT must first decide on the Section 7 petition by determining if there is a default.[7] It is only if and when the NCLT finds that there is no default and dismisses the Section 7 petition, the parties can proceed with arbitration. Thus, while there are similarities, the Indian position seem to diverge somewhat from the Board's approach. The Indian Supreme Court's focus on "default" as the key determinant, rather than explicitly requiring the dispute to be "genuine and substantial," potentially allows for easier commencement of insolvency proceedings in the face of arbitration clauses.

CONCLUSION

The Board's decision in the present case marks a significant recalibration of the relationship between arbitration and insolvency laws. By overturning *Salford Estates*, it has restored a more balanced approach. This will provide much needed clarity and predictability in cross-border insolvency scenarios, particularly where arbitration clauses are also involved. However, the judgment leaves room for further judicial interpretation as to what constitutes a 'genuine dispute on substantial grounds'.

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You can direct your queries or comments to the relevant member.

[1][2024] UKPC 16.

[2][2014] EWCA Civ 1575.

[3]BVIHCMAP2014/0025 (*8 December 2015*)

[4][2020] HKCFI 311

[5](2021) 6 SCC 436

[6]Section 7(1) of IBC: *A financial creditor either by itself or jointlywith other financial creditors, or any other person on behalf of the financial creditor, as may be notified by the Central Government may filean application for initiating corporate insolvency resolution process against a corporate debtor before the Adjudicating Authority when a default has occurred.*

[7](2021) 6 SCC 436 at para 29

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