Insolvency or arbitration – which route prevails?

A landmark decision given by the UK Privy Council on 19 June 2024 directs that English Courts abandon the rule applied for the last 10 years: that where a debt claimed is subject to an arbitration agreement, arbitration must be pursued as of right and a winding petition must be rejected – irrespective of whether a genuine or substantial dispute in relation to the debt can be proved.

Following the judgment in Sian, a winding up petition (an application to make a company insolvent) can now be pursued without reference to arbitration or first obtaining an award, unless the debt is disputed on genuine or substantial grounds.

What is the issue?

The issue determined by the Privy Council in Sian was whether, if a contract contains an agreement for disputes to be resolved by arbitration (an "arbitration agreement"), a winding up petition may be issued by a creditor in relation to an undisputed debt whether or not genuine grounds of substantial dispute exist.

The appeal concerned the dividing line between two areas of public policy in the British Virgin Islands ("the BVI"), namely insolvency and arbitration, and where this could be drawn.

At first glance it is hard to see how the requirements for each policy and procedure could conflict – simply on the basis that a winding up petition, and a statutory demand that precedes the same, can only be issued, and upheld, on the basis of an undisputed and unequivocal debt. Arbitration on the other hand, is the appropriate forum within which to resolve disputes relating to that debt. If there are no disputes relating to the debt, it follows that commencement of an arbitral procedure would be unnecessary.

However, for the last 10 years, following the Court of Appeal's decision in Salford Estates (No.2) Ltd v Altomart (No.2) [2014] EWCA Civ 1575 ("Salford Estates") the English Courts have applied the rule that where the underlying contract contains an arbitration agreement, this must be followed, and an arbitration award obtained on the substantive debt before any winding up petition can be granted. This was so, even if the debt itself was not disputed on either genuine or substantial grounds. Creditors therefore had no easy or comprehensive way of committing a debtor company to insolvency for a bad debt – even when this was not refuted or the existence and scope of a debt was indisputable – and were forced to incur the cost and time of first pursuing an arbitral award for the debt itself.

The approach taken by the English Courts in Salford Estates has been followed and applied in a number of common law jurisdictions, including Malaysia and Singapore. The BVI, however, rejected the approach taken in Salford Estates and its domestic Court held the position that unless the debt claimed by the creditors is disputed on "genuine and substantial grounds", the arbitration agreement is irrelevant, as there are no genuine disputes that relate to the debt itself. In such instances, a winding up petition may be issued and pursued to insolvency, without first obtaining an arbitral award.

The Privy Council considered the two positions, on appeal, and agreed with the BVI Courts, taking the unprecedented step of directing the English Courts to follow its judgment as if it were domestic law and precedent.

How has the case been decided and what impact does this have on English law?

The Privy Council has issued its ruling in Sian following an appeal from the BVI, via the Court of Appeal of the Eastern Caribbean Supreme Court. Whilst the Privy Council and its judgments are not usually binding on domestic Courts, under authority granted in Willers v Joyce [2016] UKSC 44, the Privy Council is able to give direction to the English Courts where it considers that a decisions of any Court (including the House of Lords or Supreme Court) is wrong or defective, to follow the judgment of the Privy Council as domestic law. The decision in Sian is the first time the Privy Council has used its authority to give such a direction.

The Privy Council has overturned the ruling in Salford Estates that an arbitration agreement within a contract must automatically be pursued as of right, irrespective of whether a genuine or substantial dispute in relation to the debt can be proved. The Privy Council held that the reasoning in Salford Estates contained "an impermissible and unexplained leap" and agreed with judicial and academic criticism that followed this decision, including the concern that application of this rule was likely to discourage parties from including arbitration clauses or agreements in their contracts, if this would later impede their remedies in an insolvency event.
In making its decision the Privy Council carefully considered the public policy implications of and came to the conclusion that "none of the general objectives of arbitration legislation…are offended by allowing a winding up to be ordered where the creditor's unpaid debt is not genuinely disputed on substantial grounds." Further, it was held that a creditor should not be required "to go through an arbitration where there is no genuine or substantial dispute as the prelude to seeking a liquidation just adds delay, trouble and expense for no good purpose".

The Privy Council went further and also considered the question of exclusive jurisdiction, and whether an exclusive jurisdiction provision within the underlying contract, which allocated jurisdiction to a foreign court, was sufficient on its own to mandate rejection of a winding up petition. The Privy Council also concluded in this respect that unless the debt was disputed on "genuine and substantial grounds" a winding up petition could not be deferred simply on account of the existence of an exclusive jurisdiction clause.

Summary

The appropriate test for the Company Court to apply where a winding up application has been issued, when the debt is subject to an arbitration agreement or an exclusive jurisdiction clause, is therefore whether it "is disputed on genuine and substantial grounds".

Only if the "genuine and substantial grounds" test is satisfied should the petition be rejected and the matter referred to arbitration. This has been determined as good law to be followed in both the English domestic Courts, the BVI and in the common law jurisdictions that follow and defer to the Judicial Committee of the Privy Council as the Court of final appeal.

How we can help

For further help and advice on arbitration agreements and their application and/or issues with disputed debts and the application of the "genuine and disputed debts" test please contact our arbitration team who will be able to provide advice and assistance.

We also have a specialist insolvency team that can guide you through any wider issued relating to the issue of a winding up petition, and the wider process of corporate insolvency.

Moya Faulkner

Legal Director