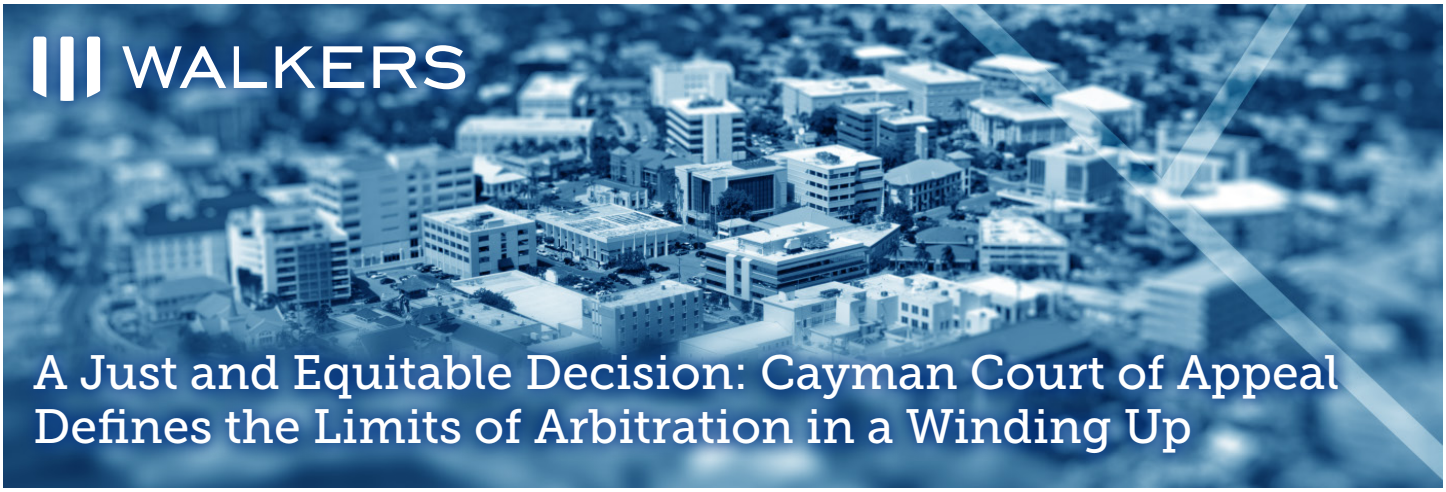

A Just and Equitable Decision: Cayman Court of Appeal Defines the Limits of Arbitration in a Winding Up

On 23 April 2020, the Cayman Islands Court of Appeal ("CICA") delivered an important decision in the case of Re China CVS (Cayman Islands) Holding Corp., which focussed on the question of arbitrability of shareholder petitions for the winding up of a company on the just and equitable ground. The CICA (Moses JA, Martin JA and Rix JA) unanimously determined that the petition in question was not arbitrable, thus overturning the first instance decision of Kawaley J, which formed the subject of our bulletin "Court Grants Mandatory Arbitration Stay in Winding Up Proceedings".

Background

Family Mart China Holding Co., Ltd, a Japanese company (the "Petitioner"), petitioned in its capacity as minority shareholder to wind up China CVS (Cayman Islands) Holding Corp. (the "Company") on just and equitable grounds under Section 92(e) of the Cayman Islands Companies Law (2018 Revision) (the "Companies Law"). Specifically, the grounds were that the Petitioner claimed a justifiable lack of confidence arising from the lack of probity in the conduct of the Company's affairs, and that there had been a breakdown in the fundamental relationship between the shareholders and the breach of the underlying understanding which had governed that relationship. As an alternative, the Petitioner also sought an order requiring the majority shareholder, Ting Chuan (Cayman Islands) Holding Corporation ("Ting Chuan"), to sell its shares in the Company to the Petitioner pursuant to Section 95(3) of the Companies Law. Ting Chuan responded in November 2018 seeking orders, inter alia, that the petition be struck out, or in the alternative, that the petition be dismissed or stayed pursuant to Section 4 of the Foreign Arbitral Awards Enforcement Law (1997 Revision) ("FAAEL") and/or the inherent jurisdiction of the Court. Importantly, the Petitioner and Ting Chuan were the only shareholders in the Company and had entered into a shareholders agreement which contained an arbitration clause (see further below).

In the first instance decision, Kawaley J held that the petition should not be struck out, but that Ting Chuan's alternative application for a stay under Section 4 of the FAAEL should be granted, since the Restated Shareholders Agreement ("SHA") contained a broadly drafted arbitration agreement pursuant to which the underlying disputes between the parties could be "hived off" to an arbitrator. If the Petitioner was successful in the arbitration, it could then, if appropriate, apply to lift the stay on the petition or enforce the arbitral award and obtain appropriate statutory relief (i.e. winding up or a share buyout order).

Ting Chuan appealed the decision on the strike out, maintaining that the petition should be struck out in its entirety, and the Petitioner appealed the decision granting a stay in favour of arbitration under Section 4 of the FAAEL. The appeals therefore required scrutiny of the nature of the petition on the just and equitable basis and the tension between the exclusive jurisdiction of the court to determine whether a company should be wound up pursuant to Section 92(e) of the Companies Law and the contractual obligation to arbitrate disputes arising between the shareholders, reinforced by the statutory provisions of the FAAEL and Section 95(2) of the Companies Law.

CICA Decision

Ting Chuan's appeal of the refusal to strike out decision was dismissed and the Petitioner's appeal of the stay was allowed.

On the strike out appeal, the CICA held [at para. 51] that there had been a "significant misunderstanding and mis-characterisation of the Petition and its two bases. Neither of those two bases are a cause of action, rather, they are a description of the foundations on which the Petition relies in support of its assertions that the Company should be wound up on the just and equitable ground" (i.e. the grounds referred to above) and that the pleadings "amounted to no more nor less than those which a petition for winding up is required to disclose:

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"a concise statement of the grounds on which the Petitioner claims to be entitled to a winding up order".

According to the CICA, none of the submissions of Ting Chuan came anywhere near justifying striking out the petition, and whether the evidence was adequate and whether it justified winding up on the just and equitable ground was a matter for the hearing of the petition. That therefore left the critical issue to be determined – was the petition arbitrable?

The issue of arbitrability came down to the question of whether the underlying disputes are themselves susceptible to arbitration and should, in accordance with the SHA, be submitted to arbitration before the court exercises its jurisdiction to decide whether it is just and equitable to make a winding up order. Following a detailed analysis of the applicable authorities, the CICA held [at para. 109] "Where the underlying issues are central and inextricably connected to determination of the statutory question whether the company should be wound up on just and equitable grounds, the possibility of hiving off those issues becomes more difficult." In the CICA's judgment, the judge at first instance was wrong to regard the allegations against Ting Chuan as being formulated in contractual terms, and that "in order to determine the threshold issue as to whether there are sufficient grounds to justify winding up on just and equitable grounds, the court must evaluate all the circumstances of the case; it is not "so simple and uncomplicated as an ordinary creditor's winding-up petition" (per Dankwerts LJ in In Re David Investment (East Ham) Ltd.). 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" [para. 115].

Cases such as Fulham Football Club (1987) Ltd v Richards [2011] EWCA Civ 855 could be distinguished from the present case because in those cases the court did not need to consider relief that invoked the "exclusive jurisdiction of the court, namely whether the company should be wound up. The identification of discrete issues for the consideration of the arbitrator, distinct from questions of relief, avoided any clash."

The CICA further held that even though alternative relief was sought under Section 95(3) of the Companies Law, that did not change CICA's view because it was first necessary to decide whether it was appropriate to refer the winding up matter to arbitration. If not, seeking an alternative route of relief would not change that decision. The CICA also held that since the SHA did not contain any express agreement not to present a winding up petition, and because in this instance such an agreement could not be implied, the non-petition provisions of Section 95(2) of the Companies Law would not be applicable.

Implications of the Decision

This decision provides important clarity on the appropriate forum for shareholder petitions on the just and equitable ground in circumstances where an agreement to arbitrate exists in the company's governing documents. Given that such petitions are often sought in the Cayman Islands, and that arbitration agreements covering an expansive scope of disputes are becoming increasingly common, the decision provides welcome clarity on the court's exclusive jurisdiction to wind up companies on the just and equitable basis and the limits of arbitration agreements in company matters.

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