Fortuna Injunction : Lower Threshold Test Where There Is An Arbitration Agreement?

SWISSRAY ASIA HEALTHCARE CO LTD V V MEDICAL SERVICES M SDN BHD [2023] CLJU 1358

31st July 2024

ISSUES

Prior to presentation of a winding up petition, the creditor may serve a Statutory Notice of Demand, or what is commonly known as Winding Up Notice, on the debtor. This is especially where the debt is not premised on a judgment or order.

Where the debt is disputed, the service of the Statutory Notice of Demand will prompt the counterparty to make an application to restrain the creditor from presenting the winding up petition. The order to restrain presentation of the winding up petition is commonly known as a Fortuna Injunction.

To succeed in obtaining a Fortuna Injunction, the applicant will need to show that there is a "*bona fide dispute*" on the alleged debt. However, if the underlying contract contains an arbitration clause, would the test be lower considering that the Courts will generally uphold the arbitration agreement and not investigate the merit of the dispute as parties had agreed to resolve their dispute by arbitration?

This question was answered in the recent Court of Appeal case of **Swissray Asia Healthcare Co Ltd v V Medical Services M Sdn Bhd [2023] CLJU 1358**.

BRIEF FACTS

The brief facts of the case are as follows:-

(a) The Respondent, a Malaysian company, and the Appellant, a Taiwanese company, entered into a Distributorship Agreement ("**DA**") for supply of medical machines for a period of 3 years commencing from 01.04.2016.

(b) There was an arbitration clause in the DA, where parties agreed to refer all disputes in connection with the DA to arbitration in Switzerland, in accordance with the Swiss rules of International Arbitration.

(c) Pursuant to the Appellant's quotation and the Respondent's order, the Respondent received 2 medical machines.

(d) However, dispute arose between parties when the Appellant demanded for payment. Due to non-payment, the Appellant terminated the DA. Parties attempted to resolve the dispute via discussions but failed.

(e) Crucially, the Appellant contended that a settlement was reached between parties where the Respondent made part payment of USD20,000.00 in December 2017. However, no further payments were made.

(f) Following the above, the Appellant, through their solicitors in Taiwan, issued a 2nd Notice of Demand to the Respondent. When this notice of demand went unheeded, the Respondent issued a statutory notice of demand / winding up notice on the Respondent.

(g) In response, the Respondent applied for a Fortuna Injunction to restrain the Appellant from presenting a Winding-Up Petition against it on the grounds that "*there existed a disputed debt where no award or final judgement was obtained*".

(h) The High Court granted the Fortuna Injunction. The Appellant appealed to the Court of Appeal against the High Court's decision.

PROCEEDINGS BEFORE THE COURT OF APPEAL

The main issue before the Court of Appeal is whether a lower threshold test of "*prima facie dispute*" should be applied instead of the "*bona fide dispute*" test for the Fortuna Injunction application, if parties had agreed to refer their disputes to arbitration in the underlying contract:-

> *"[4] The legal issue in this appeal revolves around whether in the event a dispute arises between contracting parties who have chosen to resolve disputes through arbitration, and where one party issues a notice under Section 466(1)(a) Companies Act 2016 against the party in alleged breach and the latter party applies for an injunction to restrain the filing of a Winding-up Petition on the grounds that the debt is disputed, is the party in alleged breach required to show;*
>
> *a) a "bona fide dispute" (higher threshold test); or*
> *b) to merely show that there exists a "prima facie dispute" (lower threshold test) given the existence of an arbitration clause?"*

In addressing this issue, the Court of Appeal reviewed the earlier cases on Fortuna Injunction and observed that part of the Court's inherent jurisdiction to restrain the presentation of a winding up petition is to prevent abuse of the Courts' process:-

"[46] A few propositions can be gleaned from the above passage as follows;

a) *When a court exercises its discretion to issue an injunction to restrain the presentation of a winding up, it exercises its inherent jurisdiction;*
b) ***part of this inherent jurisdiction is to prevent abuse of the courts process;*** *and*

c) *when deciding whether to grant an injunction to restrain a petition that is based on a statutory demand for a debt, the court must be satisfied that the debt is bona fide disputed on substantial grounds.*

[47] Granted that the inherent jurisdiction referred to in the judgement refers to a situation where the party petitioning for a winding up may be using it as an instrument of oppression (and hence abuse of process) and where in the final analysis the act of presenting the winding up petition itself may result in irreparable harm to the debtor."

The Court of Appeal further reasoned that the Court's inherent jurisdiction to prevent abuse would wither if the Courts refrains from examining whether the alleged dispute is bona fide and whether parties are required to arbitrate on the dispute the moment there is an arbitration agreement:-

"[56] So, then the question needs to be asked ***whether in such circumstances the judges are to throw up their hands in the air in abject surrender and say "there is an arbitration clause here so we have no business determining if the dispute raised is genuine or bona fide, let the parties contest it in arbitration"?***

[57] To lend credence to such a view would be in effect tantamount to saying that in the face of an arbitration clause, the judges are to abdicate their responsibility and refrain altogether from inquiring into the genuineness of the dispute.

[58] ***Whither then the courts inherent jurisdiction to prevent abuse of courts process*** *spoken of in the Fortuna case and in Tan Kok Tong (supra).*

[59] It must be recollected that in the Salford case itself the injunction to restrain from an inquiry of a summary judgment type analysis was ***subject to there being an unadmitted debt on which the winding up petition was grounded upon.***

[60] ***Where on the other hand, the debt is unequivocally admitted, are the courts hands similarly tied? I venture to say "I think not"."***

In addressing the applicable test in the presence of an arbitration agreement, question also arises as to whether the Court is entitled to conduct an examination into the merits of the dispute, especially in view of the English Court of Appeal case of Salford Estates:-

> *"[38] The resolution of this question also involves the further question of whether the court is entitled to conduct an examination into the merits of the dispute…*
>
> *[51] These developments relate to disputed debts governed by the existence of an arbitration agreement between the contesting parties.*
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> *[52] The first in the series is the English Court of Appeal in 2014 in its decision in* ***Salford Estates (No 2) Ltd v. Altomari Ltd (No 2)*** *(supra), which* ***held that the test to be applied in respect of a disputed debt governed by an arbitration agreement ought to be lowered,*** *and that, the English courts when faced with a disputed debt that was subject to an arbitration agreement, ought to dismiss or stay the winding-up application, save in "wholly exceptional circumstances" which the judge found "difficult to envisage".*
>
> *[53] It is* ***thus suggested that when faced with an arbitration clause, the courts ought to adopt a lower threshold test when deciding whether to grant a Fortuna Injunction or not."***

Having further examined the laws in Singapore, Hong Kong as well as Malaysia, the Court of Appeal held that the applicable test for the Fortuna Injunction application, even in the face of an arbitration agreement, is still the "*bona fide dispute test*" and not merely the "*prima facie dispute*" test.

> *"[65] It is to be noted that the Salford Estates approach even in pro-arbitration Singapore is subject to the dispute not being raised as an abuse of the court's process.*
>
> *[66] This can only translate into the position that* ***the party applying for a Fortuna Injunction must show the existence of a bona fide dispute and not merely a prima facie dispute even in the face of an arbitration clause.***
>
> *[67] We are constrained therefore to hold that it is* ***the bona fide dispute test which is the applicable test to be applied when dealing with the question of whether to grant a Fortuna Injunction in such circumstances****."*

In other words, to obtain a Fortuna Injunction, it is insufficient to merely assert that the debt is disputed, even when there is an arbitration agreement. The applicant would still need to demonstrate that the alleged dispute is genuine or bona fide. This is to prevent an abuse of the

court process where the arbitration clause is used as a mechanical mantra to evade a legitimate debt due and owing.

> ***"[72] The mere assertion of the existence of an arbitration clause cannot simply be recited as if it is some mechanical mantra in order to evade what would otherwise be a legitimate claim to a debt due and owing.***
>
> *[73] In as much as parties are to be held bound to an arbitration clause as a chosen mechanism for the resolution of their disputes, the parties must equally be held to the terms of the agreement that they have chosen to enter…*
>
> *[83]* ***The phrase ("dispute") therefore has to refer to a genuine or a bona fide dispute if the court process is not to be abused.***
>
> *[84] To countenance* ***the lower threshold test advocated by Salford Estates****, would open the door to parties in breach of their contractual obligations* ***subjecting the system to abuse by the mere assertion of a dispute no matter how frivolous in nature, just in order to derail or to defeat the legitimate presentation of a winding up petition*** *and in so doing, abuse the process."*

The Court of Appeal cautioned that in determining the genuineness of the dispute, the Courts would not carry out a minute examination of the merits of the dispute. However, where there is an unequivocal admission, such as the facts of this case, there would not be much examination needed.

> *"[76] Notwithstanding the above, it still of course* ***does not behove the courts to indulge in a minute examination of the merits of any dispute****,* ***but where*** *the circumstances of the case clearly indicate, as in the present case, that* ***there have been unequivocal admissions as to the sum due and owing, not much in the way of an examination needs to take place anywa****y."*

KEY TAKEAWAY

Following the decision, it is important to note that:-

(a) The applicable threshold test for Fortuna Injunction, even if the underlying contract contains an arbitration clause, is still the "*bona fide dispute*" test and not the "*prima facie dispute*" test;

(b) In other words, the mere assertion of a dispute on the debt, coupled with the presence of an arbitration clause are insufficient to obtain a Fortuna Injunction. The Applicant will still need to demonstrate that the alleged dispute is genuine or bona fide notwithstanding that parties had agreed to resolve their disputes in arbitration; and

(c) This is to prevent an abuse of the court process where the arbitration clause is used as a mechanical mantra to evade a legitimate debt due and owing.

If you have any questions or comments on this article, please contact:-

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