Stay Pending Arbitration : Arbitration Agreement Becomes Inoperative After Company Wound Up? – Revisited

PENINSULA EDUCATION (SETIA ALAM) SDN BHD V BIAXIS (M) SDN BHD [B-02(IM)(C)-1834-11/2023]

28th August 2024

ISSUES

Where the underlying contract in the disputes before the Court contains an arbitration clause / agreement, the Defendant may apply for a stay of proceedings pending reference to arbitration pursuant to section 10 of the Arbitration Act 2005 ("**AA 2005**"). A stay of proceeding is mandatory unless the party applying has taken steps in the proceedings or the arbitration agreement is "*null and void, inoperative or incapable of being performed*".

However, if the Plaintiff is wound-up, would the arbitration agreement survive the winding-up? Or would the winding-up of the Plaintiff renders the arbitration agreement to be "*inoperative*" for the purposes of section 10 of AA 2005?

The High Court in this matter held that the winding up of the Plaintiff renders the arbitration agreement inoperative and hence, section 10 of AA 2005 cannot be invoked to stay the proceedings pending reference to arbitration (Read our update on the High Court decision here). Dissatisfied with the decision, the Defendant appealed to the Court of Appeal.

The Court of Appeal revisited these questions in case of **Peninsula Education (Setia Alam) Sdn Bhd v Biaxis (M) Sdn Bhd [B-02(IM)(C)-1834-11/2023].**

BRIEF FACTS

The brief facts of the case are as follows:-

(a) The Appellant / Defendant is the employer and the Respondent / Plaintiff is the Contractor in a construction project ("**Project**").

(b) The contract in question is the PAM Contract 2007 (With Quantities) ("**PAM Contract**"). The arbitration agreement is housed in Clause 34.5 of the PAM Contract.

(c) The Respondent had gone into liquidation. The Appellant terminated the employment of the Respondent.

(d) The Respondent commenced a civil suit in the High Court to claim for amount due under some interim payment certificates.

(e) In response, the Appellant applied under section 10 of AA 2005 for a stay of proceedings pending reference to arbitration on the basis that there is a valid arbitration agreement in the PAM Contract.

(f) The Respondent's primary ground of objection is that the arbitration agreement became inoperative with the liquidation of the Respondent. The Respondent further reasoned that the high costs and expenses in arbitration would justify the Court refusing a stay in preference to a less expensive method of dispute resolution in view of the Respondent's cash flow problem.

(g) On the other hand, the Appellant contended that the arbitration agreement remains intact and subsisting. The liquidation does not alter the pre-agreed mode of dispute resolution via arbitration.

PROCEEDINGS BEFORE THE HIGH COURT

Having considered cases from other jurisdiction, the High Court dismissed the stay application on the basis that the liquidation renders the arbitration agreement inoperative. The High Court was also not inclined to grant stay in view of the prohibitive costs of arbitration considering that the Respondent was in liquidation:-

> *"[8] The High Court found much justification for concluding that a liquidation renders the arbitration agreement "inoperative" in its reading of the cases cited from other jurisdictions. It was further enamoured not to grant a stay of the Court proceedings after considering the prohibitive costs of arbitration that a company in liquidation would have to surmount, thus not justifying a stay of the Court proceedings."*

Dissatisfied with the High Court's decision, the Appellant appealed to the Court of Appeal.

PROCEEDINGS BEFORE THE COURT OF APPEAL

The issues before the Court of Appeal are as follows:-

> *"(i) whether the liquidation of the Contractor renders the arbitration agreement "inoperative" having regard to the acute factor of costs and efficiency in resolving the matter;*

(ii) whether the insolvency regime takes precedence over the arbitration agreement such that all disputes must now be resolved in the Courts and more so when there is allegedly no dispute in the debt claimed;

(iii) whether there are issues pending which require resolution by an Insolvency Court ("Insolvency Issues") as these are non-arbitrable;

(iv) whether in spite of the arbitration agreement the Court may have regard to prohibitive costs of arbitration in refusing a stay under s 10 AA when the party suing is in liquidation."

Liquidation Renders Arbitration Agreement Inoperative?

Having considered the doctrine of separability, the Court of Appeal held that the winding-up of a company may have the effect of terminating agreements that the liquidator does not want to affirm, but the arbitration agreement would survive such termination:-

"[20] Under the doctrine of separability governing arbitration agreements, the arbitration agreement has a life of its own and survives the challenges made to the contract on ground of fraud, duress and even illegality unless the matter is not arbitrable on ground of public policy of the State. ***Therefore, even though a winding-up of a company has the effect of terminating agreements which the liquidator may not want to affirm and continue with, the arbitration agreement would survive such a termination."***

The Court of Appeal also distinguished the Canadian Supreme Court case of Peace River Hydro Partners v Petrowest Corp [2022] SCJ No.41 ("**Peace River**"), which the High Court relied upon and find that the decision in the Peace River case is confined to the special circumstances of that case. The Peace River case involves multiple arbitrations and multiple parties and fundamentally, all parties therein admitted that it is more expeditious to have the matter litigated in Courts.

"[23] It would thus appear that the Supreme Court of Canada had, in the special circumstances of the case, held on policy grounds that to enforce the arbitration agreement would compromise the orderly and efficient resolution of the receivership as there were multiple arbitration agreements and the wording of each of the arbitration agreement differs. Each arbitration agreement applies to different set of disputes and provides for different arbitration procedures as observed in para 13 of its judgment…

[26] The fact that the decision in Peace River case is not authority for the proposition that upon liquidation, the arbitration agreement becomes immediately inoperative can be clearly seen in the many passages of the Supreme Court of

> *Canada reproduced below where it was careful to confine its findings to the special and unique facts and circumstances of the case…*
>
> *[27] Unlike Peace River (supra), the present case is a single dispute over what the Contractor said is payment due to it under some certifications..."*

Having considered the doctrine of separability and having found that the arbitration agreement survives the liquidation, the Court of Appeal concluded that the arbitration agreement would not become "*inoperative*", even if one of the contracting parties is wound-up, on the ground that the arbitration fees are beyond the wound-up party's means or that arbitration may cause delay:-

> *"[40] **We are not prepared in the circumstances of this case to say that the arbitration agreement has become "inoperative" upon the Contractor going into liquidation on ground that the fees for arbitration would be beyond the reach of the Contractor in liquidation or that there would be unnecessary delay caused by the matter going forward to arbitration**. With the bottleneck of cases traceable to the pandemic days, proceedings in the Courts are not necessarily faster than in arbitration. Whilst arbitral awards are final (save for the limited grounds for setting aside), judgments of the Court are subject to often a few tiers of appeal."*

Insolvency vs. Arbitration Regime

Considering that a winding-up petition is not a "*matter*" within the context of section 10 AA 2005, the Court of Appeal held that the question of whether the insolvency proceedings or arbitration regime take precedence does not arise:-

> *"[41] **The insolvency regime operates on a different plane when compared to a claim for an amount due for breach of contract via litigation or arbitration. There is no need and indeed no basis to pit one against the other. The question of which would trump the other or take precedence and priority over the other does not arise**. In fact, an insolvency or winding-up petition is not a "matter" within the meaning of "matter" in s 10(1) AA 2005 where reference is made to: "A court before which proceedings are brought in respect of a matter which is the subject of an arbitration agreement shall, where a party makes an application before taking any other steps in the proceedings, stay those proceedings..."*

The Court of Appeal reasoned that the Winding-Up Courts will only determine whether the debt is genuinely or bona fide disputed on substantial grounds. Where there is no bona fide dispute and the presumption of inability to pay debts is not rebutted, then the company would be wound up. Where the debt is bona fide disputed on substantial ground, the Winding-Up Courts does not

proceed to decide whether the debt is owing and if so, how much. That is under the purview of "*matter within the arbitration agreement*" in the context of section 10 AA 2005.

> *"[42] Thus, the issue raised in a winding-up petition is whether a sum claimed for example by the Contractor is a sum that is not bona fide or genuinely disputed and on substantial ground. If the winding-up Court so finds and if the Employer company has not rebutted the presumption of inability to pay its debts, then a winding-up order would be made.*
>
> *[43] The winding-up Court does not, in a case where the debt claimed is bona fide being disputed and on substantial ground, then proceed to decide on whether there is any debt owing to the Contractor and if so how much. That is a "matter which is the subject of an arbitration agreement" within the meaning of s.10(1) AA 2005."*

In the upshot, the Court of Appeal held that liquidation does not change the mode of resolving the dispute as the mode of dispute resolution, be it arbitration or litigation in Court, is only to determine if liability is established and if so, what is the quantum payable.

> *"[60] Liquidation does not change the mode of resolving a dispute, whether it is via a pre-agreed arbitration or absent that, litigation in Court. Neither is liquidation opposed to arbitration for arbitration is nothing more than a way of determining if liability is established arising from a matter the subject of the arbitration agreement and if so what is the quantum when damages are being assessed."*

Non-Arbitrable Matters

Having considered section 4 the AA 2005 on "*Arbitrability of subject matter*", the Court of Appeal held that the dispute between the Appellant and the Respondent, i.e. whether there is any monies owing by an employer to a contractor under a construction contract, is not an issue that is peculiarly within the purview of the Winding Up Court and hence, it is not a non-arbitrable matter:-

> *"[70] …In brief, both parties are at the stage of setting forth their claims against each other. The issue is purely on whether there are monies owing by the Employer to the Contractor under the PAM Contract and it so, what is the amount.*
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> *[71] As and when the claim is brought the Employer may raise the defence of set-off and a counterclaim with respect to the delay and defects if any and the amount of the LAD claim as well as damages for the Contractor's failure to complete the Works under the PAM Contract as a result of a determination of its employment due to its insolvency.* ***These are not issues peculiarly within the province of a winding-up Court but rather issues for the Arbitral Tribunal to***

decide and if there is no arbitration agreement, then it would be the civil Courts that would hear and decide the matter.

[72] ***There are no issues that have encroached onto the winding-up Court for its decision,*** *be it the issue of whether if a set-off is raised by the Employer, should it be allowed to reduce the Contractor's claim accordingly or whether the amount owing by the Contractor to the Employer should be treated as unsecured and falling into the general pool of unsecured creditors to be distributed pari passu.*

[73] As and when these issues have to be decided, the arbitral tribunal should be able to decide as matters falling within the terms of reference to arbitration as was so decided by the arbitrator in UDA Land case (supra)."

Prohibitive Costs

The Court of Appeal held that the "*prohibitive costs of arbitration*" is not a ground to refuse stay under section 10 AA 2005, even when the Plaintiff is in liquidation.

"[79] ***It is not enough for the Liquidator to say that the arbitration process would be slow and expensive, draining away the limited fund and/or assets of the Company and holding up distributions to creditors*** *in the liquidation proceedings which would compromise the orderly and efficiency of the liquidation process and/or insolvency regime.*

[80] ***The PAM Contract with its arbitration clause has been around for quite a while and no parties can claim that they were unaware of the costs of arbitration****. The benefits of party autonomy, confidentiality, speed and finality would be what parties generally subscribe to when they agree to arbitrate rather than litigate."*

To this end, the Court of Appeal concluded that the Courts cannot rewrite the terms of the contract for the parties in view of the curial hands-off approach, as provided in section 8 of the AA 2005.

"[83] ***The Court cannot rewrite the terms of the contract in the arbitration agreement for the parties.*** *In fact, the Court cannot intervene in matters covered by an arbitration agreement unless expressly provided for under the AA 2005. Section 8 has this curial hands-off approach to arbitration as follows:*

"Extent of court intervention

8. No court shall intervene in matters governed by this Act, except where so provided in this Act."

KEY TAKEAWAY

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

(a) The arbitration agreement would not become “inoperative”, even if one of the contracting parties is wound-up, on the ground that the arbitration fees are beyond the wound-up party’s means or that arbitration may cause delay;

(b) Liquidation does not change the mode of resolving the dispute as the mode of dispute resolution, be it arbitration or litigation in Courts, is only to determine if liability is established and if so, what is the quantum payable; and

(c) Whether there is any monies owing by an employer to a contractor under a construction contract, is not an issue that is peculiarly within the purview of the Winding-Up Court and hence, it is not a non-arbitrable matter.

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

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