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

BIAXIS (M) SDN BHD (IN LIQUIDATION) V PENINSULA EDUCATION (SETIA ALAM) SDN BHD [BA-22C-7-03/2023]

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ISSUES

Often time, contracting parties would agree to refer their contractual disputes to arbitration and an arbitration clause would be inserted into the contract. Arbitration clauses are also commonplace in most standard form of construction contracts. These arbitration clauses are known as arbitration agreement and are treated as a standalone agreement which would survive termination of the main contract.

If one of the contracting parties initiate any suit in the civil courts, the other party can apply for stay of proceedings and refer the disputes therein 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, would the arbitration agreement survive the winding up of one of the contracting parties? Or would the winding up of the contracting party renders the arbitration agreement to be *"inoperative"* for the purposes of section 10 of AA 2005? Further, would the nature of arbitral proceedings be contrary to the purpose of insolvency law?

These questions were answered in the recent Shah Alam Construction High Court case of **Biaxis (M) Sdn Bhd (In Liquidation) v Peninsula Education (Setia Alam) Sdn Bhd [BA-22C-7-03/2023]**.

BRIEF FACTS

The brief facts of the case are as follows:-

(a) Via a Letter of Award dated 28.04.2016, the Defendant appointed the Plaintiff as the contractor for a project known as *"Educity",* which was subsequently renamed *"Edusentral"* ("**Project**").

(b) Parties then entered into the Agreement and Conditions of PAM Contract 2007 (With Quantities) and Amendments, Amplifications and Supplementary Clauses to the Agreement and Conditions of Building Contract 2 ("**Agreements**").

(c) The Agreements contained an arbitration clause ("**Arbitration Agreement**").

(d) The Plaintiff was wound up on 20.04.2022 by the Penang High Court and consequently, a liquidator was appointed ("**Liquidator**").

(e) The Liquidator commenced this action, in the name of the Plaintiff, against the Defendant, claiming for the sum of RM13,100,556.25 being the alleged outstanding certified final sum (including retention) under the Project.

(f) In response, the Defendant applied to stay the suit and refer the dispute to arbitration pursuant to section 10 of the AA 2005.

ISSUES BEFORE THE HIGH COURT

The issues before the High Court are, amongst others, as follow:-

(1) Whether the Arbitration Agreement is inoperative; and

(2) Whether the nature of arbitral proceedings is contrary to the purpose of insolvency law.

Arbitration Agreement Inoperative?

Having found that there is an Arbitration Agreement and that the Liquidator is bound by the Arbitration Agreement having stepped into the shoes of the Plaintiff, the High Court ventured to consider whether the Arbitration Agreement became inoperative following the winding up of the Plaintiff.

By reference to the Supreme Court of Canada's case of **Peace River Hydro Partners v Petrowest Corp [2022] SCJ No.41**, the High Court held that the Arbitration Agreement becomes inoperative following the winding up and as such, section 10 of AA 2005 cannot be invoked to stay the proceedings:-

> *"[27] In this case,* ***Biaxis (M) Sdn Bhd has been wound up and as such is subject to insolvency protection and as such****, adopting the definition of "inoperative" in the* ***Peace River*** *case,* ***the Arbitration Agreement between Biaxis (M) Sdn. Bhd. and the Defendant is inoperative.***

[28] Since, s.10(1) AA 2005 had clearly stated that a stay of proceedings if applied shall be granted unless the agreement is found to be "null and void, inoperative or incapable of being performed", the "or" in the sentence indicates that each exception is disjunctive with the other. Hence, it is not necessary to look further into whether the agreement is null and void or whether the agreement is incapable of being performed when the findings of this court is that the agreement is inoperative.

*[29] **Therefore, having established that the agreement is inoperative is sufficient to show that s.10(1) AA 2005 cannot be invoked against the Plaintiff by the Defendant.** In the same breath, it can also be concluded that the Plaintiff is subject to the relevant insolvency proceedings having established that the arbitration agreement is inoperative against the Plaintiff."*

[Emphasis added]

Nature of Arbitral Proceedings Contrary to the Purpose of Insolvency Law?

The High Court appeared to have found that the potential increase in cost and delay in time arising from an arbitration is detrimental to the interest of the creditors and shareholders of the wound-up company:-

"[30] Although a party's reasons to avoid arbitral proceedings being the potential increase in cost and delay in time will not generally stop the reference of the same to arbitration but in a case where the party has been wound-up these reasons may give significant difference. It is safe to construe that a wound-up company has limited, if no funds at all to enable the Liquidator to carry out its role to collect debt and to pay the registered creditors accordingly.

[31] So, considering the Liquidator's primary function is to manage the wound-up company's assets and liabilities, an increase in cost and delay in time incurred in doing so would certainly be detrimental to the interest of the creditors and the shareholders of the wound-up company."

The High Court also found that, in the absence of any dispute causing the non-payment, the arbitration clause cannot be invoked and the Plaintiff has the power to commence this suit pursuant to section 486 of the Companies Act 2016:-

"[32] Additionally to the issues raised by the parties, based on the given facts, the unpaid sum by the Defendant which is subject to this suit by the Plaintiff is for a sum which had been certified as a final sum including the retention sum. It has not been brought to the court's attention the existence of a dispute which had caused for the non-payment. Hence, in the absence of any dispute, the arbitration clause cannot be

invoked and as such, the Plaintiff has the power to commence this action in order to recover the debt owed by the Defendant pursuant to s.486 of the Companies Act 2016."

DECISION OF THE HIGH COURT

In the upshot, the High Court dismissed the Defendant's application for stay pursuant to Section 10 of AA 2005.

KEY TAKE AWAY

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

(a) The winding up of a company would render the arbitration agreement(s) executed by the wound-up company to be inoperative;

(b) Arising thereof, section 10 of the Arbitration Act 2005 cannot be invoked to obtain a stay of proceedings and to refer the dispute(s) to arbitration; and

(c) The potential increase in cost and delay in time arising from an arbitration is detrimental to the interest of the creditors and shareholders of the wound-up company.

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

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