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

V Medical Services M Sdn Bhd v Swissray Asia Healthcare Co. Ltd [02(f)-1-02/2024(W)]

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ISSUES

The English Court of Appeal decision of Salford Estates (No 2) Ltd v Altomart Ltd (No 2) [2014] EWCA Civ 1575 ("**Salford**") propounds a lower threshold test when determining whether a debt is disputed before the winding up courts, if the dispute debt is the subject matter of an arbitration agreement. In such circumstances, if a debt is denied or disputed simpliciter, then the matter ought to proceed to arbitration.

However, this conflicts with the test for Fortuna Injunction, i.e. the injunction to restrain the presentation of a winding petition. To obtain a Fortuna Injunction, the applicant needs to satisfy the Courts that the debt is genuinely disputed on substantial ground. In other words, it is insufficient to merely deny / dispute simpliciter.

This give rise to the question of whether the arbitration regime, where parties to arbitration agreement are held to their bargain, should take precedence over the insolvency regime. The High Court in this case applied the lower threshold test in Salford whereas the Court of Appeal applied the conventional higher threshold test (Read our update on the Court of Appeal decision here).

The question on the applicable test was revisited again in the recent Federal Court case of **V Medical Services M Sdn Bhd v Swissray Asia Healthcare Co. Ltd [02(f)-1-02/2024(W)].**

BRIEF FACTS

The brief facts of the case are as follows:-

(a) The Respondent contends that it had supplied medical equipment to the Appellant, but the Appellant did not make full payment for the same.

(b) After attempts to resolve the dispute failed, the Respondent issued a statutory notice of demand on the Appellant.

(c) Consequently, the Appellant applied and obtained a Fortuna Injunction in the High Court. The High Court granted the Fortuna injunction by applying the lower threshold standard pronounced in the case of Salford as the debt is a subject matter of an arbitration agreement.

(d) The Respondent appealed against the granting of the Fortuna Injunction.

(e) The Court of Appeal chose not to follow the "*lower threshold*" test pronounced in **Salford** and maintained the higher threshold applied in winding up proceedings. The Court of Appeal held that the proper test to follow in deciding whether to allow, stay or dismiss a winding up petition is to consider whether there is a "*genuine or bona fide dispute*" on the debt.

(f) Applying the higher threshold test and upon examining the merits of the case, the Court of Appeal found that there was no genuine dispute on substantial grounds insofar as the debt is concerned.

(g) Consequently, the Respondent's appeal in the Court of Appeal was allowed and the Fortuna Injunction was set aside.

(h) Dissatisfied, the Appellant sought and obtained leave to appeal to the Federal Court.

ISSUES BEFORE THE FEDERAL COURT

The central issue to be determined by the Federal Court is:-

> *"[64] Of relevance to the instant appeal is the **threshold test to be applied when determining… the standard of proof or standard of assessment to be applied by a Court for the grant of a Fortuna injunction**, when the proposed petition is premised on a **'debt' which is the subject matter of an arbitration clause/agreement**? Is the threshold requirement that of a **genuinely disputed debt on substantial grounds or is it sufficient that the debt is denied or disputed simpliciter**, also commonly referred to as a '**prima facie dispute**'?"*

In other words, what is the applicable test when the disputed debt falls within the scope of the arbitration agreement? The lower test of "*prima facie dispute*" propounded in Salford or the conventional test of "*genuine or bona fide dispute*"?

The issue is not unique to Malaysia and the Federal Court observed that there is a body of conflicting case laws around the Commonwealth, with the latest case being the Privy Council case of Sian Participation Corp (In Liquidation v Halimeda international Ltd [2024] UKPC 16) ("**Sian**").

The Federal Court noted that the lower threshold test in Salford leans heavily on the legislative intent / policy consideration in support of arbitration where a mere denial / dispute simpliciter is sufficient for the matter to proceed to arbitration:-

> *"[3] …The test in **Salford** prescribes that the winding up court should, save in wholly exceptional cases, exercise its discretion consistently with the legislative policy embodied in the statute relating to arbitration, **such that upon a prima facie consideration of the matter, if it appears that the debt is denied or disputed simpliciter, then the matter ought to proceed to arbitration, in accordance with the agreement made between the parties.** This is a lower standard of review than that conventionally applied in the court hearing the winding-up petition ('Companies Court') when adjudicating on winding up."*

However, the lower threshold test was rejected in Sian, thus giving rise to a potential conflict between the legislative intent behind the arbitration and insolvency regime:-

> *"[16] The Privy Council hearing an appeal from the Court of Appeal of the Eastern Caribbean Supreme Court (British Virgin Islands) held that Salford was wrongly decided and provided extensive reasoning for the same. In essence the Board held that where an insubstantial dispute about the creditor's debt is raised between parties to an arbitration agreement it was wrong to introduce a discretionary stay of creditors' petitions…"*

- **<u>Policy Intent behind the AA 2005 and CA 2016</u>**

In determining the issue at hand, the Federal Court examined the policy intent of both the Arbitration Act 2005 ("**AA 2005**") and Winding Up provisions under the Companies Act 2016 ("**CA 2016**").

The Federal Court noted that the key feature of the AA is that it only regulates the contracting parties to the arbitration agreement and does not extend to third parties. Likewise, AA 2005 does not extend its application to other areas of law, such as insolvency:-

> *"[133] What is key to the arbitration legislation in our jurisdiction which mirrors the Model Law is that it envisages and deals with arbitration as taking place only between the parties who are party to the arbitration agreement…*
>
> *[134] It should also be pointed out that a core feature of arbitration, whether domestic or international, as we understand it, neither envisages nor admits of its enforcement being effected such that it impinges or encroaches upon other third party rights, outside of the arbitration agreement. The legislative intent therefore is to enforce compliance by the parties to the arbitration agreement both domestically and internationally but does not extend beyond that…*

[135] In like manner the Act does not purport to extend its application to other areas of the law such as insolvency, or admiralty for that matter."

On the other hand, the winding up provisions under CA 2016 has a public interest element at its core as the insolvency regime is essentially a collective proceeding for the benefit of all unsecured creditors, notwithstanding that it may be filed by a single debtor / petitioner:-

"[136] …However as has been pointed out in nearly all the judgments on this subject, a winding up proceeding is in substance a collective proceeding which, although initiated by a single creditor, is ultimately for the benefit of the body of unsecured creditors. Each creditor forgoes his right to enforce the debt owed to him and instead accepts the result of the collective proceedings which entitles the body of creditors to recover to different degrees.

[137] Public interest comes into play in the process because:

(a) It is in the public interest that the body of unsecured creditors debts are dealt with in an orderly and expeditious way. These creditors are the primary beneficiary of the proceedings initiated by the creditor presenting the winding up petition;
(b) The institution of winding up proceedings is a collective procedure to ensure that the distribution of assets to the creditors is on a pari passu basis rather than a 'first come first served' disorderly fight to the finish;
(c) Collectivism is preferred as a resolution as it ensures that not only one or two creditors receive full payment at the expense of others, who receive little or nothing;
(d) It is in the public interest that people are protected from the adverse effects which insolvency can produce."

The Federal Court held that both statutes are different and the legislative intent behind each statute should not be imported into the other:-

"[138] The point sought to be made from the exposition on the completely different fields of arbitration and insolvency law is that the object, purpose and legislative intent underlying these two statutes are entirely dissimilar. Each statute is distinct and discrete…

[139] Therefore, the legislative intent or policy behind the two statutes is entirely disparate. As such it should follow that the legislative intent underlying the AA should not be applied to the winding up provisions in the CA. Nor should the legislative intent of the latter be imported or applied in relation to the AA. There is no basis to warrant such utilization or employ of the legislative intent of one in respect of the other."

- **Stay Proceedings in Section 10 of AA 2005 does not apply to Winding Up Proceedings**

In fortifying its decision that the policy consideration in arbitration cannot be imported into the insolvency regime, the Federal Court noted that a winding up petition cannot be stayed under section 10 of the AA 2005:-

> *"[142] The second point to be made relates to the stay provisions under the **AA**. **Section 10(1) of the Act** which mirrors **Article 8 of the Model Law** provides:*
>
> > *"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 and refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed."*
>
> *[143] The key words are "…**in respect of a matter which is the subject matter of an arbitration agreement**…"*
>
> *[145] The answer is no.*
>
> *[146] The Companies Court is determining whether or not the debtor is insolvent so as to put into effect the collective and co- operative system pursuant to which there can be an orderly distribution of the assets to the creditors according to their entitlement on a pari passu basis. **The Companies Court is not adjudicating on the dispute that comprises the subject matter of the arbitration agreement**."*

To this end, the Federal Court held that it is not justifiable to import the statutory provision or legislative intent of the AA 2005 into the winding up regime under the CA 2016:-

> *"[147] As the Companies Court is not adjudicating on the "matter" which comprises the subject matter of the arbitration agreement, but is examining and determining a different issue, namely whether the defendant company is insolvent or not, it is not justifiable to import either the statutory provisions or the legislative intent of the **AA** into the statutory provisions regulating winding up petitions under the **CA**."*

- **Preferred Test**

Following the decision in the Sian's case, the Federal Court held that the preferred test is the conventional test, i.e. whether the "*debt is genuinely disputed on substantial grounds*":-

> *"[162] As we stated at the outset, we decided to follow the decision in **Sian** as its approach appeared to clarify the law while giving independent consideration to both arbitration and insolvency. Significantly the adoption of the conventionally utilized test in insolvency proceedings, namely that **it is only upon establishing that a debt is genuinely disputed on substantial grounds that a winding up petition will be stayed, even where there is an arbitration agreement**, appears to give effect to the purpose and object of the insolvency provisions under the **CA**. It also does not offend the grant of a mandatory stay to ensure that parties do not seek to resile from their obligation to arbitrate pursuant to an arbitration agreement."*

Amongst the reason advanced in favour of the higher threshold test, the Federal Court held that the need to hold the creditors to the agreement to arbitrate cannot encroach into the winding up process where there is "*no real dispute that the debt is due and the company is unable to make that payment*".

To this end, if a lower threshold test is applied, the Companies Court would be precluded from determining the issue of insolvency:-

> *"…It follows that while creditors should be held to their commitment to arbitrate a dispute that they have agreed to, this cannot encroach on the winding up process when there is no real dispute that the debt is due and the company is unable to make that payment. That inability to pay raises the presumption of insolvency which needs to be rebutted by the company. If the Companies Court is precluded from weighing up this issue, as is the case where a lesser threshold is applied, then the issue of insolvency remains unresolved. It is important that in weighing this up the Companies Court is not fettered in the exercise of its discretion and its powers, which will involve ascertaining the solvency of the company…"*

KEY TAKEAWAY

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

(a) The test for Fortuna Injunction, even if the disputed debt is the subject matter of an arbitration agreement, is the conventional higher threshold test of "*genuine dispute on substantial grounds*".

(b) In other words, a mere denial or dispute simpliciter (prima facie dispute test) is not sufficient for a Fortuna Injunction to be granted, even if the disputed debt is the subject matter of an arbitration agreement.

(c) The application of the higher threshold test "*does not offend the grant of a mandatory stay to ensure that parties do not seek to resile from their obligation to arbitrate pursuant to an arbitration agreement*".

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

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