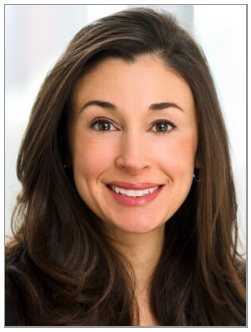
3 Cases Show Tensions Between Arbitration And Insolvency

By **Jennifer Permesly, Sharmistha Chakrabarti and Liz Downing** (October 26, 2023, 5:06 PM EDT)



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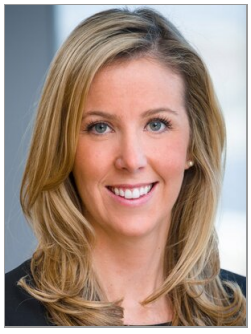

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A trio of recent cases addressing matters of arbitration and insolvency highlight the tension that continues to exist between these two types of proceedings.

Insolvency proceedings seek to bring all creditors under the umbrella of a single domestic insolvency proceeding to ensure orderly administration of the estate. Meanwhile, arbitration proceedings provide disputing parties with their right to be heard individually in a forum of their choosing.

In 2021, the International Bar Association's Arbitration Committee published the IBA Toolkit on Insolvency and Arbitration.[1] The IBA Toolkit surveys the varying approaches across jurisdictions as to whether and when an arbitration can proceed in circumstances where one of the parties has entered into insolvency proceedings. Among other things, the IBA Toolkit advises arbitrators and counsel to consider the relevant local insolvency law and their approaches in determining whether the arbitration should proceed, acknowledging that enforcement of the award could be at risk in circumstances where the arbitration had proceeded in a manner at odds with the approach of the local court administering the insolvency.

Two recent decisions, however, highlight the inherent unpredictability in the way local insolvency courts approach these matters, and the challenges that parties may face if they choose to pursue arbitration in the face of pending insolvency proceedings.

Take, for example, the U.K. Privy Council's Sept. 20 judgment in the matter of FamilyMart China Holding Co Ltd. v. Ting Chuan (Cayman Islands) Holding Corp.

The court considered whether an International Chamber of Commerce International Court of Arbitration action brought to resolve certain contractual disputes arising out of a shareholders' agreement could proceed against Cayman Islands-incorporated China CVS (Cayman Islands) Holding Corp, which was also the subject of a petition to wind up the company on just and equitable grounds.

The central issue in dispute was whether the majority shareholder had mismanaged the company. The minority shareholder pursuing the winding-up argued that the insolvency court had exclusive jurisdiction to decide whether such mismanagement had occurred and constituted just and equitable grounds for winding up the company, thus rendering the issue nonarbitrable.

The majority shareholder, on the other hand, argued that the mismanagement issue had to first be decided in arbitration in light of the contractual clause providing for arbitral jurisdiction over that dispute, ICC arbitration seated in Beijing, and sought to stay the winding-up petition while the issue was arbitrated.

The Privy Council issued a stay of the winding-up proceedings and allowed the arbitration to proceed, overturning a decision of the Cayman Islands' Court of Appeal. It agreed that the disputed issues were threshold questions that were precursors to the winding-up petition, but nonetheless held that the existence of the arbitration clause required these disputes to be resolved in arbitration.[2]

The Privy Council was comfortable that a reasoned decision of the arbitrators on these matters could then be considered in connection with the winding-up petition.[3] The court rejected arguments that bifurcating the two matters in different fora would add complexity or unduly delay the winding-up petition, and instead focused on the importance of respecting the agreed arbitration clause.[4]

Compare this holding with the Sept. 25 decision of a Hong Kong court in China Evergrande Group v. Triumph Roc International Ltd., in connection with the insolvency proceedings of Evergrande, a Cayman-incorporated, Hong Kong-listed company.

One Evergrande investor filed a winding-up petition in the Court of First Instance of the Hong Kong High Court seeking repayment of a $110 million debt issued pursuant to an investment agreement.

In parallel, another investor initiated an arbitration before the Hong Kong International Arbitration Center under its own version of that very investment agreement with Evergrande, seeking recovery of its own debt in the same amount.

Evergrande applied to the court to restrain the HKIAC arbitration pursuant to Hong Kong law permitting a court to restrain post-petition actions filed outside the insolvency court while a winding-up petition is pending.[5]

The Hong Kong High Court granted Evergrande's application and stayed the arbitration, holding that exceptional circumstances would be needed to justify not granting the restraint.

It focused on the importance of preserving assets and avoiding unnecessary expenditures in connection with the winding-up proceedings, and found that permitting the arbitration to go forward would conflict with these goals.

It rejected, as insufficiently compelling, arguments that (1) Hong Kong law generally requires deference to an arbitration clause and (2) the arbitration would not jeopardize other creditors' rights because it would deal with questions of contractual liability rather than enforcement of an award, which could thereafter be pursued as part of the orderly administration of the estate.

The court also found that the arbitration would be procedurally incompatible with, and unduly delay, the winding-up proceedings.

These decisions demonstrate that the approach that domestic courts take on the intersection of arbitration and insolvency can vary widely and will continue to present unique and often perplexing challenges for arbitrating parties.

The IBA Toolkit provides a survey of national insolvency regimes that demonstrate that these matters often turn on the discretion of the insolvency court, which may choose, depending on the circumstances, to allow arbitration to be pursued while winding-up proceedings are also pending.[6]

The FamilyMart and Evergrande decisions reveal how different the results of the exercise of that discretion can be. Both decisions involved contractual matters that were subject to arbitral jurisdiction but were also relevant inquiries for the insolvency court in the context of deciding a winding-up petition.

Both courts considered arguments that the arbitration proceedings would delay, disrupt and add expense to the winding-up petition, thereby harming other creditors. Yet the Privy Council prioritized the arbitration clause, while the Hong Kong court prioritized the winding-up proceedings.

There may be ways to try to reconcile these two cases, and the published decisions do not provide all the facts or necessarily disclose every consideration that the judges may have contemplated.

For example, one could imagine the Privy Council leaned in favor of arbitration because the

mismanagement issue — which was the precursor of the winding-up petition and admittedly within the arbitration clause's scope — involved disputes of predicate facts that were well-suited to be decided by an arbitral tribunal.

By contrast, the Hong Kong High Court decision focuses primarily on the orderly administration of two parallel claims for money on the debtor-company's assets without delving in any great detail into the factual bases of those claims.

The takeaway however, if there is any, for future litigants in proceedings involving insolvency and arbitration, is that there continues to be great uncertainty with respect to how a court's discretion may be exercised. Thus, a creditor's ability to pursue arbitration, and the strategic value in pursuing arbitration in light of pending or threatened insolvency, must be approached on a case-by-case basis.

A third recent decision reflects the ways in which arbitration and insolvency may sometimes be pitted against each other for strategic gain.

In June, an ICC tribunal awarded over $1 billion to Colombian state-owned company Refinería de Cartagena S.A.S. in a contractual dispute against Colombian, Dutch and U.K. entities collectively referred to as Chicago Bridge & Iron Company.[7]

CB&I is attempting to set aside that arbitral award, and in September 2023, the parent company of the CB&I entities, McDermott International Holdings B.V. announced that it would initiate restructuring proceedings before the Dutch and U.K. courts, admittedly to discharge the ICC award debt.[8]

Reficar, in turn, petitioned the New York court in which the arbitral set-aside proceedings are pending to order prejudgment attachment of CB&I's U.S. assets and disclosure of CB&I's worldwide assets in order to protect the ICC award.[9]

Reficar also sought Section 1782 discovery from the U.S. District Court for the Southern District of Texas, where McDermott International is based, to try to obtain financial and legal information relating to the CB&I claimants, arguing that the restructuring proceedings are abusive in that they appear designed to "target and eliminate" the ICC award and frustrate its enforcement.[10]

McDermott International countered back with further insolvency proceedings, this time seeking relief in the U.S. Bankruptcy Court for the Southern District of Texas under chapter 15 of the U.S. Bankruptcy Code, which could provide for recognition and enforcement of the Dutch and U.K. proceedings within the U.S.[11]

Reficar is expected to oppose final recognition and enforcement by the U.S. court of the foreign restructuring proceedings on public policy grounds, in that they would violate the absolute priority rule under the U.S. Bankruptcy Code, by enabling McDermott International to keep its equity in place while discharging the ICC award.

The U.S. bankruptcy court entered a provisional order including extending the automatic stay to prevent Reficar from advancing its attachment proceedings in the U.S.[12]

As the restructuring proceedings continue to unfold in the U.K. and the Netherlands, those courts will need to consider whether the arbitration award can or should effectively be discharged through those proceedings.

The U.S. bankruptcy court, in turn, may be asked to decide whether recognizing and enforcing foreign proceedings that diverge from the absolute priority rule are contrary to public policy, a standard that is seldom met. Each of these decisions could have significant impact on Reficar's ability to enforce the previously granted arbitration award.

The increasingly global nature of insolvency proceedings, together with the prevalence of arbitration clauses in contracts entered by companies transacting internationally, means that these areas of law will continue to intersect in myriad ways.

As the three cases canvassed in this article demonstrate, this intersection of international arbitration

and insolvency is fertile ground for debate and may influence the formulation of litigation strategy on a global scale.

The 1997 United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency[13] sought to encourage cooperation and coordination among insolvency courts in different jurisdictions. The model law did not, however, attempt a harmonization of substantive insolvency law. It is therefore incumbent upon counsel to understand the potential areas of divergence and assess the pursuit of arbitration and enforcement of arbitral awards that may be affected by insolvency proceedings with open eyes and careful consideration.

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[1] The IBA Toolkit is available at www.ibanet.org/LPD/Dispute_Resolution_Section/Arbitration/toolkit-arbitration-insolvency (last accessed Oct. 10, 2023).

[2] FamilyMart China Holding Co Ltd v. Ting Chuan (Cayman Islands) Holding Corporation , [2023] UKPC 33 ¶¶ 96-97, 103, 105.

[3] Id. ¶¶ 92-93.

[4] Id. ¶¶ 88-89.

[5] See China Evergrande Group v. Triumph Roc International Ltd , [2023] HKCFI 2432 ¶¶ 28, 45.

[6] IBA Toolkit at p. 20.

[7] Girish Deepak, Analysis: ICC Tribunal in Reficar v. CB&I Case Finds Contractual Liability of Over 1 Billion USD, While Addressing Issues of Admissibility of Evidence and Applicable Law (June 29, 203) at https://www.iareporter.com/articles/analysis-icc-tribunal-in-reficar-v-cbi-case-finds-contractual-liability-of-over-1-billion-usd-while-addressing-issues-of-admissibility-of-evidence-and-applicable-law/ (last accessed Oct. 10, 2023).

[8] McDermott Press Release (September 8, 2023) at https://www.mcdermott-investors.com/news/press-release-details/2023/MCDERMOTT-ANNOUNCES-TRANSACTION-SUPPORT-AGREEMENT-WITH-KEY-FINANCIAL-STAKEHOLDERS-TO-POSITION-COMPANY-FOR-LONG-TERM-SUCCESS/default.aspx (last accessed Oct. 10, 2023).

[9] See Respondent's Memorandum of Law in Support of Motion by Order to Show Cause for (1) Prejudgment Attachment Order and (2) Disclosure of Petitioners' Assets, Chicago Bridge & Iron Company N.V. et al. v. Refinería de Cartagena S.A.S., No. 1:23-cv-04825-GHW (S.D.N.Y. Sept. 25, 2023).

[10] See In re Application of Refinería de Cartagena S.A.S for an Order Directing Discovery from McDermott International, Ltd. Pursuant to 28 U.S.C. § 1782, No. 4:23-cv-03607 (S.D. Tex. Sept. 22, 2023).

[11] In re: CB&I UK Ltd., et al., No. 23-90795 (Bankr. S.D. Tex. Oct. 10, 2023).

[12] In re: CB&I UK Ltd., et al., No. 23-90795 (Bankr. S.D. Tex. Oct. 10, 2023).

[13] The UNCITRAL Model Law is available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/1997-model-law-insol-2013-guide-enactment-e.pdf (last accessed Oct. 10, 2023).
