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Singapore Apex Court Lays Down Clear Framework for Arbitrability of Insolvency-Related Claims

Darius Chan (Norton Rose Fulbright) · Monday, May 23rd, 2011 · YSIAC

The Singapore Court of Appeal issued a decision recently articulating a principled framework for the arbitrability of insolvency-related claims. It provides useful guidance on when an insolvency-related claim would be considered non-arbitrable under Singapore law. In seeking to strike the delicate balance between its robust pro-arbitration stance and its insolvency regime, the Court's underlying philosophy strives to give the private consensual model of arbitration as much effect as possible, whilst using the tool of non-arbitrability to draw a clear line in the sand only when third-party interests are implicated under the insolvency regime.

In *Larsen Oil and Gas Pte Ltd v Petroprod Ltd (in official liquidation in the Cayman Islands and in compulsory liquidation in Singapore)* [2011] SGCA 21, the Singapore liquidators of an insolvent Cayman Islands company, Petroprod, sought to avoid a number of payments made by Petroprod to the appellant, Larsen, on the statutory grounds that those payments amounted to unfair preferences or undervalue transactions and/or was made with the intent to defraud. Larsen applied for a stay of those avoidance proceedings on the basis of an arbitration agreement between the parties that stipulated Singapore as the seat of arbitration.

After a comparative jurisprudential analysis characteristic of prevailing judicial practice, VK Rajah JA writing for the Court of Appeal astutely laid down three key principles:

1) Disputes involving an insolvent company that arise only upon the onset of the insolvency regime, such as disputes concerning transaction avoidance and wrongful trading, are non-arbitrable.

2) Disputes involving an insolvent company that stem from its pre-insolvency rights and obligations are non-arbitrable when the arbitration would affect the substantive rights of other creditors.

3) Disputes involving an insolvent company that stem from its pre-insolvency rights and obligations are arbitrable when the arbitration is only to resolve prior private *inter se* disputes between the company and other party.

In so far as the first principle is concerned, the Court incisively reasoned that many of the statutory provisions in the insolvency regime are enacted to recoup for the benefit of the company's creditors losses caused by the former management, and this objective would be compromised if a

company's pre-insolvency management had the ability to restrict the avenues by which the company's creditors could enforce the very statutory remedies which were meant to protect them against the company's management. Some of these remedies may include claims against former management who would not be parties to any arbitration agreement.

There is perhaps another way the Court could have arrived at the same result. One could say that the insolvency provisions the Court was concerned about, such as transaction avoidance due to unfair preference, are not claims that are derivative of the debtor's rights; they can only be brought by a liquidator (or a trustee or debtor in possession; or one of their assignees), none of whom were parties to the arbitration agreement: see *In re Bethlehem Steel Corp. v. Moran Towing Co.*, 390 B.R. 784 (Bankr. S.D.N.Y. 2008), citing *Allegaert v. Perot*, 548 F.2d 432 (2d Cir. 1977); *Hagerstown Fiber Ltd. P'ship v. Carl C. Landegger*, 277 B.R. 181 (Bankr. S.D.N.Y. 2002); *Hays and Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149 (3d Cir. 1989); *OHC Liquidation Trust v. American Bankers Insurance Co. (In re Oakwood Homes Corp.)*, 2005 WL 670310 (Bankr. D. Del. 2005); *Pardo v. Pacificare of Tex., Inc. (In re APF Co.)*, 264 B.R. 344 (Bankr. D. Del. 2001).

This is not novel and has already been foreshadowed by the Court in its earlier precedent of *Ho Wing On Christopher and ors v ECRC Land Pte Ltd* (in liquidation) [2006] SGCA 25, albeit in a different context concerning the recovery of costs by a successful litigant against an insolvent company in liquidation.

Indeed, in the present case the Court expressly considered the origin of the claim in elucidating the next two principles set out above. The Court observed that there were two policies militating against giving effect to arbitration agreements for disputes stemming from pre-insolvency rights and obligations.

First, because the insolvent regime is for the benefit of creditors who are not parties to the arbitration agreement, it is difficult to justify why the liquidator (or trustee) who represents the creditors should be compelled to arbitrate instead of pursuing the statutory remedies.

Second, allowing an insolvent company's creditor to arbitrate its claim against the company in effect allows the creditor to contract out of the proof of debt process. It arguably falls foul of the principle that a company cannot contract with some of its creditors for the non-application of certain insolvency rules.

Weighing the competing policies, the Court took the final position that the right balance to be struck for disputes involving an insolvent company that stem from its pre-insolvency rights and obligations was to hold that if the resolution of a dispute through arbitration would "affect the substantive rights of other creditors", then the dispute is non-arbitrable. Conversely, the dispute is arbitrable when it does not.

The Court reasoned that circumvention of the proof of debt process is tolerable because the process does not create new rights in the creditors or destroy old ones. Even if the claim is subsequently proved to be valid and enforceable against the liquidator (or trustee), the pool of assets available to all creditors at the time of the liquidation of the company is not affected.

The Court's view that the proof of debt process should not operate as a complete barrier against arbitrability must be right as a matter of legal symmetry and consistency, since the Court has been granted the statutory power to permit certain actions or proceedings against a company in a

liquidation, thereby allowing those creditors to derogate from the proof of debt process: see s 262(3) Companies Act (Cap. 50, 2006 Rev. Ed.) and s 148A Bankruptcy Act (Cap. 20, 2009 Rev. Ed.).

Darius Chan (Wilmer Cutler Pickering Hale & Dorr, London) &amp

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