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Is The Scope Of Arbitration Agreement In Shareholders' Agreement Wide Enough? Lessons On Drafting From A Hong Kong Case

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Introduction

In the recent Hong Kong decision of Dickson Holdings Enterprise Co Ltd v. Moravia CV and Others [2019] HKCFI 1424, the court considered whether the arbitration agreement contained in the parties' shareholders' agreement covered disputes arising from any affairs of the company. As elaborated below, the decision is instructive for how similar arbitration agreements may be interpreted by courts and also provides valuable insights to guide future drafting of arbitration agreements in shareholders' agreements, especially when the parties intend for the agreement to cover a broad range of disputes. The approach taken by the Hong Kong court is analogous to approaches taken in other jurisdictions, thereby reinforcing the soundness of the court's approach and the value of this decision as precedent for future disputes.

Background

Dickson Holdings Enterprise ("DHE") and Moravia CV ("Moravia") set up a Hong Kong company ("Company") for a property development project in China and all three parties jointly entered into a shareholders' agreement ("Shareholders' Agreement"). The relationship of the parties eventually deteriorated. In particular, DHE alleged that Moravia caused the Company's board to pass a wrongful and arbitrary resolution which resulted in the forfeiture of DHE's shares. DHE did not receive any notice for the board meeting where this result was decided. DHE thus asserted a claim for unfair prejudice based on a breach of fiduciary duties of directors (for the directors' exercise of powers for wrongful purposes) and also a claim for breach of the Company's articles of incorporation (for the failure to give notice of the board meeting and the wrongful application of the forfeiture provisions to paid-up shares).

The Arbitration Agreement in Concern

Clause IX of the Shareholders' Agreement provides the arbitration agreement:

"Any dispute, controversy or claim arising out of or relating to this Agreement, or the breach, termination or invalidity thereof, shall be settled by arbitration under the Hong Kong International Centre Administered Arbitration Rules in force at the date of this Agreement".

The Main Issue

Moravia applied to stay the court litigation in favour of arbitration. However, the argument was moot because claims on breach of fiduciary duties and the articles were not based on the Shareholders' Agreement. In fact, the court held (at [41]) that the "Shareholders Agreement makes no provision concerning notice of board meetings, payment for shares or forfeiture of shares". Instead, the Shareholders' Agreement focused mainly on how the project would be implemented. Thus, the issue was whether the disputes could still be said to be "arising out of or relating to" the Shareholders' Agreement.

The Judgement

The court recognized the approach taken by the English House of Lords (as it then was) in Fiona Trust and Holding Corporation v. Privalov [2007] UKHL 40, providing that the words "relating to" should be interpreted broadly. Nevertheless, the court found it difficult to see how these disputes could fit within the scope of the arbitration agreement. It held that the dispute was out of the scope of the arbitration agreement, and hence the application for the stay was dismissed. Persuasively, the court recognized that, apart from the Shareholders' Agreement, the parties were also "governed by the company law of Hong Kong as well as the articles of the Company arising simply from the fact that they were shareholders in the Company". This means the parties are vested with rights and obligations that do not directly arise from the shareholders' agreement, which may later result in disputes that are to be resolved. On the facts, "the Shareholders Agreement is neither relied upon for the claim nor for the defence", and the "proprietary rights of a member to its shares in the Company is not the subject matter of the Shareholders Agreement at all, but governed by ordinary company law".

The court acknowledged (at [40]) that it is possible to draft an arbitration agreement with a wider scope. Thus, the court vitally distinguished between two types of arbitration clause in a shareholders' agreement, namely (1) a broader clause providing for the right to arbitrate on any corporate affairs, and (2) a narrower one which provides only for the right to arbitrate on matters out of the shareholders' agreement.

Analysis

Hong Kong courts are well-known to have adopted a pro-arbitration approach. However, a natural concern may be whether this case, which holds that the scope of the arbitration agreement was not wide enough, would suggest the court has deviated from such an approach. It is submitted that this is not the case, because the court was seemingly mindful about this and it especially supported its decision with cases from other pro-arbitration jurisdictions.

First, the court cited the Australian decision of ACD Tridon Inc v. Tridon Australia Pty Ltd [2002] NSWSC 896 (where a claim based on the director's equitable duties was not covered by the scope of the arbitration agreement). It also cited the Singaporean case of BTY v. BUA [2018] SGHC 213 (where the court held that the dispute arose out of the articles, not from the shareholders' agreement). Thus, the court found precedent to support its holding that the scope of the arbitration agreement in concern would not necessarily cover every dispute.

This approach is not only adopted in Australia and Singapore. In Canada, the same arguments were made and the same decision reached in Bouchan v. Slipacoff, 2009 94 OR (3d) 741 — 58 BLR (4th) 96 (where the court held that the arbitration agreement in question was not wide enough to cover a claim on oppression of shareholder, but could only cover disputes on the interpretation of the shareholders' agreement).

Takeaways

It is tempting to think that just because a shareholders' agreement regulates the relationship between the shareholders themselves and the company, it will cover any disputes on corporate affairs such as unfair prejudice. This assumptive view should be abandoned. Whilst the arbitrability of unfair prejudice has long been confirmed since the English decision in Fulham Football Club (1987) Ltd v. Richards [2011] EWCA Civ 855, the scope of the arbitration agreement remains a vital issue not to be ignored (the scope was not a concern in Fulham, as it was held to be very wide, as stated at [91], which provides valuable insights on drafting).

Firstly, in terms of drafting, the Hong Kong court suggested (at [40]) that had a broader coverage to include disputes on corporate affairs been intended, a better clause could have been drafted.

An exemplar arbitration clause was analysed by the Hong Kong court in Newmark Capital Corporation Ltd and Others v. Coffee Partners Ltd and Another [2007] 1 HKLRD 718 and provided:

> "Whenever any difference arises between the Company on the one hand and any of the members or their executors, administrators or assigns on the other hand, touching the true intent and construction or the incidence or consequences of these Articles or of the Act, touching anything done or executed, omitted or suffered in the pursuance of the Act or touching any breach or alleged breach or otherwise relating to the premises or to these Articles, or to any Act or Ordinance affecting the Company or to any of the affairs of the Company such difference shall, unless the parties agree to refer the same to a single arbitrators, be referred to two arbitrators one to be chosen by each of the parties to the difference and the arbitrators shall before entering on the reference appoint an umpire".

(Readers are reminded that this clause is taken from the company's articles of incorporation, and such a clause would need to be adapted for a shareholders' agreement.)

Secondly (or alternatively), parties may consider expanding the scope of the shareholders' agreement itself (for example, incorporating provisions on corporate governance). This is because

depending on the drafting of the arbitration agreement, the scope of it is usually dependent on the scope of the shareholders' agreement. In the present case, the Hong Kong court noted that there were only "limited provisions with regard to the affairs of the Company" and hence the claims were out of the scope.

This solution has previously been adopted in a Canadian dispute. In Swanson v. Mitchell Bay Properties Ltd., 2002 BCSC 1434, the shareholders' agreement contained a number of provisions on corporate governance. Similarly, it was alleged that the claims on breach of fiduciary duties were out of the scope of the arbitration agreement. However, the court held that the shareholder's agreement was wide enough to cover those claims, because it has touched on corporate governance.

In conclusion, this important Hong Kong decision reminds parties and lawyers should pay more attention to whether the scope of the arbitration agreement contained in a shareholders' agreement is wide enough.

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