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SPECIAL ALERT!

Dispute Resolution

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21 NOVEMBER 2024

Can Liquidation Render an Arbitration Agreement Inoperative?

An arbitration agreement is a clause in a contract that requires any disputes arising out of the contract to be resolved through arbitration (as opposed to court proceedings). Arbitration agreements are common in standard form construction contracts. It is also common for construction contracts to include a clause allowing an employer to terminate the contract in the event the contractor goes into liquidation. If the contract containing the arbitration agreement is terminated on grounds of liquidation, does this also render the arbitration agreement inoperative?

The Court of Appeal in ***Peninsula Education (Setia Alam) Sdn Bhd (previously known as Segi International Learning Alliance Sdn Bhd) v Biaxis (M) Sdn Bhd (in liquidation)*** [2024] 5 MLJ 388 recently addressed this question.

In this case, the employer appointed a contractor under a PAM Contract 2007 to carry out a construction project. The contractor went into liquidation, and the employer terminated the PAM Contract on grounds of liquidation. The contractor, with the liquidator acting in its name, commenced a suit against the employer to claim outstanding sums under the project. The employer disputed the claim and applied under Section 10 of the Arbitration Act 2005 ("**AA**") for a stay of the court proceedings pending reference to arbitration, arguing that there was a valid arbitration agreement in the PAM

Contract. The High Court, in dismissing the stay application, concluded that liquidation rendered the arbitration agreement 'inoperative'. The High Court relied on the Canadian Supreme Court case of ***Peace River Hydro Partners v Petrowest Corp*** [2022] SCJ No 41 ("**Peace River**"), which held that a party in liquidation is subject to insolvency protection and with that, the arbitration agreement had become inoperative[1]. The High Court was further enamoured not to grant a stay of the court proceedings after considering the prohibitive costs of arbitration that a company in liquidation would have to surmount[2].

Aggrieved by the decision, the employer appealed to the Court of Appeal. The Court of Appeal considered the following issues:

a) **Issue 1:** Whether the liquidation of the contractor renders the arbitration agreement 'inoperative', having regard to the acute factors of costs and efficiency in resolving the matter;

b) **Issue 2:** Whether the insolvency regime takes precedence over the arbitration agreement, such that all disputes must now be resolved in the courts and more so when there is allegedly no dispute in the debt claimed;

c) **Issue 3:** Whether there are issues pending, which require resolution by an Insolvency Court, as these are non-arbitrable; and

d) **Issue 4:** Whether, in spite of the arbitration agreement, the court may have regard to prohibitive costs of arbitration in refusing a stay under Section 10 of the AA when the party suing is in liquidation[3].

The Court of Appeal reversed the High Court's findings.

Issue 1

The Court of Appeal held that the doctrine of separability, enshrined in Section 18 of the AA, allows arbitration

[1] Para [18]. Grounds of Judgment ("**GOJ**")
[2] Para [8], GOJ
[3] Para [11]. GOJ

agreements to have a life of their own. Arbitration agreements will survive challenges made to the contract, including termination on grounds of liquidation[4]. The arbitration agreement in *Peace River* was rendered inoperative based on the special facts and circumstances of the case:

a) The Supreme Court of Canada held, on policy grounds, that enforcing the arbitration agreement would compromise the orderly and efficient resolution of the receivership, as there were multiple arbitration agreements and the wording of each of the arbitration agreement differs. Each arbitration agreement applies to a different set of disputes and provides for different arbitration procedures.

b) There were purchase orders that did not contain arbitration clauses. To refer the matter to arbitration, the receiver would have to participate in and fund at least four different arbitrations involving seven different sets of counterparties, and this would also involve entities that were not subject to any of the arbitration agreements.

c) Fundamentally, there was an admission by all parties that proceedings through the courts would be a more expeditious option.[5]

These special facts and circumstances were not present in the ***Peninsula Education*** case.

Issue 2

The Court of Appeal found that the insolvency regime does not take precedence over the arbitration agreement. An arbitration agreement cannot be ignored simply because one of the parties is in liquidation[6]. Liquidation does not change the mode of resolving a dispute[7].

There is no need to determine whether there is a genuine dispute before a stay is granted. The test is whether the

[4] Para [20], GOJ
[5] Para [21] – [25], GOJ
[6] Para [48], GOJ
[7] Para [60], GOJ

matter before the court is the subject matter of an arbitration agreement[8].

Issue 3

Section 4 of the AA recognises that there are certain non-arbitrable subject matters. One such example would be issues arising out of liquidation[9].

The Court of Appeal found that the present dispute arose pre-insolvency and is not an insolvency dispute that requires the court's determination under the Companies Act 2016, where Parliament had carved out these issues from arbitration and made it non-arbitrable as a matter of public policy[10].

Issue 4

The Court of Appeal found that time and expense are not sufficient reasons to refuse a stay. Instead, precedence should be given to upholding the parties' freedom of contract and their choice to refer matters to arbitration. Courts should lean in favour of non-interference in arbitration matters, consistent with Section 8 of the AA[11].

Conclusion

The key takeaway is that an arbitration agreement is a robust creature that must be respected. As long as a matter is subject to an arbitration agreement, it must be arbitrated. The exception is where the matter is non-arbitrable under Section 4 of the AA.

The grounds of judgment can be accessed here.

If you have any queries, please contact the Senior Associate **Andrew Chang Weng Shan** (cws@lh-ag.com), or his team Partner **Andrew Chiew Ean Vooi** (ac@lh-ag.com).

[8] Paras [54] – [56], GOJ
[9] Para [65], GOJ
[10] Para [68], GOJ
[11] Para [79] – [83], GOJ

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Published by Dispute Resolution