Court finds arbitration legislation trumps insolvency rules

Contributed by **Clifford Chance LLP**

August 06 2015

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Introduction

The recent High Court decision in *Philpott v Lycée Français Charles de Gaulle School* ([2015] EWHC 1065 (Ch)) explores the interaction between arbitration and insolvency procedures.

If a claim is brought against an insolvent party, questions may arise over whether the dispute, or parts of it, should be determined by the insolvency practitioner, an arbitral tribunal or the court. The decision in *Philpott* answers these questions in the context of a claim against a company in voluntary liquidation that was party to an arbitration agreement.

Facts

The applicants were the liquidators of the company WGL Realisations 2010 Limited. The respondent was Lycée Français Charles de Gaulle School, which had entered into a building contract with the company. The contract contained an arbitration clause. As a result of insolvency, the company went into administration and then into creditors' voluntary liquidation.

A dispute arose as to the moneys owed under the contract. The school claimed that the company owed it just over £270,000 and put in a formal proof of debt for that amount. The school maintained that the arbitration clause in the contract continued to apply after an administration or liquidation, and argued that the liquidators should refer any dispute over the amount owed to arbitration.

The liquidators disputed the amount, claiming that the school owed the company approximately £615,000. The liquidators argued that they could not accept or reject the school's proof of debt until the underlying dispute as to the amounts owed had been resolved. They argued that it was for the court to give directions as to the taking of an account of the balance due between the company and the school, and made an application for such directions.

Decision

Finding in favour of the school, the court held that the dispute over the amount owed should be resolved by arbitration.

Proof of debt procedure under Insolvency Rules
Where proceedings are brought against a company in voluntary liquidation, litigation in the ordinary form is substituted by the proof of debt procedure. The claimant lodges a verified proof of debt with the liquidator, which admits or rejects it, and whose decision can be appealed to the court. Proofs of debt in liquidation are subject to the Insolvency Rules 1986.

In the present case, the liquidators maintained that they could not accept or reject the school's proof of debt until an account had been taken of what was due from each party pursuant to Rule 4.90 of the Insolvency Rules. Rule 4.90 provides that where there have been mutual dealings between a company and any creditor before the company goes into liquidation, an account must be taken of what is due from each party to the other and the sums due must be offset against each other.

The court observed that it was common ground that Rule 4.90 applied to the dispute. The issue was how that dispute was to be resolved – a point on which Rule 4.90 is silent.

The liquidators suggested that the court has power under the Insolvency Rules to give directions as to the taking of an account of the balance between the company and the school in connection with the proof of debt process.

Mandatory stay provisions under Arbitration Act
The school argued that if the liquidators chose to pursue any form of court proceedings to establish

the balance of the account between the parties, those proceedings must be stayed pursuant to Section 9 of the Arbitration Act 1996. Section 9(1) provides that a party to an arbitration agreement against which court proceedings are brought in respect of a matter which, under the agreement, is to be referred to arbitration may apply to the court for a stay of those proceedings. Section 9(4) provides that the court must stay the proceedings unless it is satisfied that the arbitration agreement is null, void, inoperative or incapable of being performed.

The court found that if the liquidators were to seek directions from the court as to the taking of an account, they would be bringing legal proceedings against the school within the arbitration clause. Therefore, those proceedings would have to be stayed. The arbitration agreement did not become inoperative following the company's liquidation and none of the other exceptions to the requirement to stay listed in Section 9(4) of the act applied.

The court also considered whether Section 9(3) of the act was engaged. Section 9(3) precludes an application to stay court proceedings once the person wishing to enforce the arbitration clause has taken "any step in those proceedings to answer the substantive claim". The court dismissed the liquidators' suggestion that the school's making of a proof of evidence or an appeal by the school from any rejection by the liquidators to accept that proof would amount to a 'step' for the purposes of Section 9(3).

Finally, the court addressed the liquidators' argument that the taking of an account under court directions would be more economical than resolving the dispute by arbitration. In this context, the court observed that arbitration may not be such a speedy process and "is certainly not cheap". However, the court further observed that if the resolution of the underlying dispute were left to the taking of an account under directions given in the context of an appeal from the rejection of a proof of debt, that could also potentially be an expensive process which would be no speedier than arbitration.

The real issue was whether the Arbitration Act trumped the taking of an account under the court's directions as envisaged by the Insolvency Rules. In the court's judgment, it did.

Comment

The decision extends the availability of mandatory stays in arbitration to applications directions made by liquidators. It confirms the courts' tendency to construct narrowly the exceptions to mandatory stays of court proceedings commenced by parties to an arbitration agreement; in the absence of the statutory exceptions, the arbitration clause will prevail.

Insolvency practitioners will need to consider carefully the circumstances in which to apply to the court for directions where the contract under which the creditor has a claim provides for disputes to be resolved by arbitration.

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