

# High Court upholds stay of winding-up petition where debt was subject to arbitration agreement

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## [Introduction](#)

## [Legal background](#)

## [Facts](#)

## [Decision](#)

## [Comment](#)

### **Introduction**

In *Telnic Ltd v Knipp Medien Und Kommunikation GmbH (Re Telnic Ltd)*,<sup>(1)</sup> the High Court upheld an order that a petitioner should be restrained from proceeding with a winding-up petition on the basis that the petition debt in question was disputed by the alleged debtor and was subject to an arbitration agreement.

In so doing, the court approved the earlier decision in *Salford Estates (No 2) Limited v Altomart Limited (No 2)*<sup>(2)</sup> that in the absence of "wholly exceptional circumstances", the court should not "conduct a summary judgment type analysis of liability", but should defer to the relevant arbitral tribunal's jurisdiction to determine the alleged debt's validity.

While the normal course would have been for the court to dismiss the winding-up petition, in the particular circumstances of *Telnic*, Chancellor of the High Court Sir Geoffrey Vos agreed with the court's first-instance decision to stay the petition.

### **Legal background**

Under Sections 122(1)(f), 123 and 124 of the Insolvency Act 1986, a creditor may petition the court to have an English company wound up on the grounds that the company cannot pay its debts. If the debt on which the creditor's petition is based is subject to a valid arbitration agreement and disputed by the alleged debtor in good faith and on substantial grounds, such a winding-up order will generally not be granted, pending the resolution of the dispute.

In *Salford Estates*, the court held that when exercising its discretion to wind up a company in such circumstances, it should act consistently with the legislative policy embodied in the Arbitration Act 1996. The court should aim to avoid a situation whereby parties might be encouraged, as a standard tactic, to seek to bypass the arbitration agreement by presenting a winding-up petition, thereby exerting pressure on the alleged debtor to pay up immediately or face the possibility of imminent liquidation. Following *Salford Estates*, when a debt which is the subject of a winding-up petition falls within the scope of a valid arbitration agreement and is disputed then, absent wholly exceptional circumstances, the court will not go on to consider whether the dispute in relation to that debt was raised in good faith and on substantial grounds.

In *Telnic*, the judge described the rationale of the *Salford Estates* decision not to conduct a summary judgment type of analysis as to liability in respect of the alleged debt. The judge held that the court must exercise its discretion so as to:

- uphold the policy of the Arbitration Act;
- discourage parties to an arbitration agreement from bypassing it as a tactic by presenting a winding-up petition;
- prevent one party applying pressure on an alleged debtor to pay up immediately or face the burden of satisfying the court that the debt was *bona fide* disputed on substantial grounds; and
- require the parties to adhere to their agreement as to the proper forum for the resolution of such an issue.

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## Facts

In 2009 Knipp Medien und Kommunikation GmbH entered into a services agreement with Telnic Limited, by which it would provide Telnic with data hosting and software development services. That services agreement contained an arbitration clause which provided that "any dispute, controversy or claim arising out of or relating to this agreement... or the breach, termination or validity thereof" would be referred to arbitration upon either party's request.

Subsequently, Knipp and Telnic engaged in negotiations concerning a potential joint venture, which did not come to fruition. Telnic alleged that under the term sheet relating to the proposed joint venture, Knipp had agreed to waive the service fees owed to it under the original services agreement.

Knipp later alleged that Telnic had failed to settle invoices in respect of the service fees with a value totalling £263,777.28 and that Telnic was balance-sheet insolvent. In 2019 Knipp presented a petition to wind up Telnic on the grounds that Telnic could not pay its debts.

At first instance, Insolvency and Companies Court Deputy Judge Schaffer restrained Knipp from proceeding with its winding-up petition. Schaffer's order stayed Knipp's winding-up petition on the basis that the debt was not admitted and was subject to an arbitration agreement.

In its appeal, Knipp argued that:

- there were "exceptional circumstances" of the sort described in *Salford Estates*, with the consequence that the first-instance court should have considered the merits of Telnic's non-admission of the petition debt, notwithstanding the arbitration agreement; and
- having considered the merits of Telnic's non-admission of the petition debt, the court should have concluded that it was not in good faith or on substantial grounds, such that the petition should have been allowed to proceed.

Conversely, Telnic argued at appeal that the petition should have been dismissed rather than stayed at first instance, on the basis that Knipp's original application was a deliberate abuse of process.

## Decision

***Was the first-instance judge right to decide that he was bound by Salford Estates to consider whether there were wholly exceptional circumstances before moving to ask whether the debt was disputed in good faith and on substantial grounds?***

The judge agreed that the decision in *Salford Estates* had bound the lower court.

This conclusion was a necessary consequence of the fact that the petition debt was alleged to have arisen under an agreement containing a binding arbitration agreement and that debt was disputed or not admitted. For the reasons explained above, the judge held that the arbitration agreement should have primacy and that the dispute relating to the petition debt should be determined by arbitration before the matter could come back to court by way of a winding-up petition.

***Was the court right, in effect, to decide that there were no wholly exceptional circumstances?***

The lower court had correctly exercised its discretion to stay the petition given the absence of wholly exceptional circumstances, which Vos had identified as being an exacting standard that was rarely satisfied.

Knipp had sought to rely on various alleged factors as evidence of the wholly exceptional circumstances required by *Salford Estates* in order for the court to consider the merits of Telnic's non-admission of the petition debt, including:

- prior admissions of the petition debt by or on behalf of Telnic;
- Telnic's alleged balance sheet insolvency;
- an alleged unlawful distribution by Telnic to its shareholders; and
- Telnic's alleged attempts to slow the arbitration or not participate in it in good faith.

However, the judge found these points to be insufficient to take the case out of the ordinary because:

- the alleged prior admissions had been heavily caveated;
- Telnic's balance sheet solvency was unclear (as is so often the case) and would not, by itself, give Knipp *locus standi* to pursue a winding-up petition;
- the alleged unlawful distribution was disputed and raised complex issues of law and fact which were not amenable to summary determination; and
- while Telnic's approach to the arbitration "may have been unfortunate", it was not a wholly exceptional

circumstance.

***Should the court have dismissed the petition, stayed the petition or allowed the petition to proceed?***

The judge upheld the first-instance decision to stay the petition. Noting that Sir Terence Etherton C in *Salford Estates* appeared to view a stay as being open to the court, and the limited number of authorities in this area, the judge agreed that the order of a stay could be considered justified and consistent with the policy underlying the Arbitration Act.

The first-instance judge had considered relevant factors in making his determination, including the desire to:

- encourage Telnic to cooperate in the arbitration process;
- protect Knipp by allowing it to lift the stay if it succeeded in the arbitration; and
- prevent Telnic from disposing of its assets.

**Comment**

By confirming the decision in *Salford Estates*, *Telnic* provides assurance that in the context of a winding-up petition, the court will consider the merits of a dispute relating to a petition debt which is subject to an arbitration agreement only in rare circumstances.

Following *Salford Estates*, such circumstances must be wholly exceptional; *Telnic* provides some useful examples of circumstances which will not satisfy that test, including an alleged lack of willingness on the part of the debtor to engage constructively with the arbitration process.

The decision also confirms the court's discretion to stay a winding-up petition in favour of arbitration, rather than dismiss the petition entirely, in appropriate circumstances.

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**Endnotes**

(1) *Telnic Ltd v Knipp Medien Und Kommunikation GmbH (Re Telnic Ltd)* [2020] EWHC 2075 (Ch).

(2) *Salford Estates (No 2) Limited v Altomart Limited (No 2)* [2015] Ch 589.

Fraser Eccles, trainee solicitor, assisted in the preparation of this article.

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