Article

Statutory demands and agreements to arbitrate

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A creditor ought not be allowed to avoid a statutory demand by belatedly serving a notice to arbitrate, unless the debt is genuinely disputed on substantial grounds. The New Zealand Courts have not yet been asked to decide whether the standard test of "substantial dispute" ought to be applied where any such dispute is the subject of an arbitration clause. When the issue does arise, the test should be the same regardless of whether the parties have agreed to submit disputes to arbitration.

There is overseas authority that suggests an application to wind up a company ought to be dismissed if the debtor can show there is a dispute in relation to the debt which is the subject of an arbitration agreement, provided the dispute is not being raised in abuse of the court's process.[1] In the United Kingdom, it is also necessary to show that the creditor has taken steps to begin an arbitration in accordance with the agreement.[2] In most New Zealand cases, this means serving a notice of dispute or notice to arbitrate.

However, these authorities arise in the context of applications to liquidate companies and are not universally accepted. While the United Kingdom, Malaysia and Singapore authorities favour dismissing applications to liquidate if these requirements are met, the Eastern Caribbean Court of Appeal refused to follow this line of authority because the need to establish that the debt is disputed on genuine and substantial grounds is "too firmly a party of BVI law".[3] The most recent Hong Kong judge to comment on the debate speaks firmly in favour of the traditional approach such that a debtor resisting a winding up petition must establish a bona fide dispute on substantial grounds, regardless of whether the debt is the subject of an arbitration clause.[4]

Whatever the overseas position to applications to liquidate a company, the traditional approach must be applied by the New Zealand courts in applications to set aside a statutory demand under s 290(4) of the Companies Act 1993 (CA). As a matter of statutory interpretation, the New Zealand courts cannot allow service of a notice to arbitrate to override the requirement that a creditor establish a genuine and substantial dispute that the debt is due, which is expressly mandated by s 290(4)(a).

The legislation

The relevant statutes in the context of applications to set aside statutory demands are the Arbitration Act 1996 (AA) and the CA. Section 9(1) and sch 1 art 8(1) of the AA provide:

> **9 Arbitration under other Acts**
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> (1) Where a provision of this Act is inconsistent with a provision of any other enactment, that other enactment shall, to the extent of the inconsistency, prevail.

> **8 Arbitration agreement and substantive claim before court**
>
> (1) A court before which proceedings are brought in a matter which is the subject of an arbitration agreement shall, if a party so requests not later than when submitting that party's first statement on the substance of the dispute, stay those proceedings and refer the parties to arbitration unless it finds that the agreement is null and void, inoperative, or incapable of being performed, or that there is not in fact any dispute between the parties with regard to the matters agreed to be referred.

Section 290(4) CA provides the court may grant an application to set aside a statutory demand if it is satisfied that:

(a) there is a substantial dispute whether or not the debt is owing or is due; or

(b) the company appears to have a counterclaim, set-off, or cross-demand and the amount specified in the demand less the amount of the counterclaim, set-off, or cross-demand is less than the prescribed amount; or

(c) the demand ought to be set aside on other grounds.

Section 290(4)(a) requires a substantial dispute to be established, but not proven, before the court will set aside a statutory demand. The courts have held that mere assertion is not enough.[5] A dispute must be shown to be a real and

1. *An An Group (Singapore) Pte Ltd v VTB Bank (Public Joint Stock Company)* [2020] SGCA 33.
2. *Salford Estates (No 2) Ltd v Altomart Ltd (No 2)* [2014] EWCA Civ 1575, [2015] 3 WLR 491.
3. *Jinpeng Group Ltd v Peak Hotels and Resorts Ltd* BVIHCMAP2014/0025 and BVIHCMAP2015/003.
4. *Re Asia Master Logistics Ltd* [2020] HKCFI 311; see also *Sit Kwong Lam v Petrolimex Singapore Pte Ltd* [2019] HKCA 1220, *But Ka Chon v Interactive Brokers LLC* [2019] 5 HKC 238, [2019] 4 HKLRD 85.
5. *Confident Trustee Ltd v Garden and Trees Ltd* [2017] NZCA 578 at [16].

not a fanciful or insubstantial dispute.[6] This is consistent with the policy behind the CA that the condition of the privilege of being a separate legal entity is that the company be able to pay its due debts.[7]

The New Zealand courts have not yet expressly addressed the question of whether an application to set aside a statutory demand is "a proceeding" to which sch 1 art 8 AA applies or the circumstances under which an application to set aside a statutory demand ought to be stayed and any dispute referred to arbitration. In particular, must a creditor asserting a debt is disputed establish a real and not a fanciful or insubstantial dispute before the application will be set aside, consistent with the established application of s 290(4) (the traditional approach)? Or must the creditor only show that he or she has issued a notice to arbitrate for the Court to set aside the demand and refer any dispute to arbitration, consistent with sch 1 art 8 AA (the contrary approach)?

Preliminary comments

Before considering this question, it is worth noting two points. First the mere existence of an arbitration agreement cannot be grounds to set aside a statutory demand. The existence of an arbitration agreement does not amount to a dispute or to the commencement of an arbitral proceeding. Arbitral proceedings in respect of a particular dispute only commence when a request for the dispute to be referred to arbitration is received by the respondent.[8] Until a notice to arbitrate has been issued, parties are free to resolve the dispute in any way they see fit, including by issuing proceedings in the High Court. This is entirely consistent with party autonomy, a foundational principle of contract and arbitration law.

Setting aside a statutory demand because of the existence of an arbitration agreement would also be contrary to arts 8 and 21 of sch 1 AA which together require the parties to arbitrate a dispute only when a notice to arbitrate has been given and there is a real, bona fide dispute to be the subject of an arbitration.

Second, it is arguable that there is no or very little difference between the thresholds in sch 1 art 8(1) AA and s 290(4)(a) of the CA. Section 290(4)(a) is not equivalent to a summary judgment application.[9] The hearing of an application to set aside a statutory demand is to be short and to the point and the test in s 290 is a review with a low threshold.[10] Only if it is accepted that s 290(4)(a) creates a higher threshold for establishing a dispute than art 8(1) does the interplay between the two sections need to be resolved.

A matter of statutory interpretation

Where an application to set aside a statutory demand is made on the basis that the debt is disputed, s 290(4)(a) of the CA expressly requires the creditor to satisfy the court that there is a "substantial dispute", as to whether the debt is owing, before the application be granted. This express wording in the section must apply even when a notice to arbitrate has been issued.

In some New Zealand cases it is suggested that if parties have submitted their dispute to arbitration, sch 1 art 8 AA requires a stay of proceedings and a statutory demand has to be set aside under s 290(4)(c).[11] However, if a notice to arbitrate constitutes "other grounds" for the statutory demand to be set aside under s 290(4)(c), without any enquiry into the genuineness of the dispute raised in the notice to arbitrate, that would result in s 290(4)(c) being interpreted in a way that is inconsistent with s 290(4)(a). A statutory provision is to be interpreted consistently. Section s 290(4)(c) cannot be interpreted as allowing a lower threshold to establishing a dispute than the standard test for which s 290(4)(a) expressly provides.

A statutory provision should be interpreted to apply in the same way in all circumstances. There should not be a different threshold for establishing a dispute when the statutory demand relates to a debt that is subject to an arbitration agreement than when it relates to a debt that is not subject to an arbitration agreement.

Applying the technical principles of statutory interpretation, s 290(4)(a) and (b) are examples of specific instances in which a court may grant an application to set aside a statutory demand. Subsection (c) is a more general provision. The general provision in s 290(4)(c) ought not to be interpreted so as to derogate from the more specific provisions in s 290(4)(a) and (b).[12]

Expecting parties to an arbitration agreement to comply with s 290(4)(a) of the CA is also consistent with the AA. Section 9(1) provides that where there is an inconsistency between any provision of the AA and any other enactment the other enactment is to prevail. If there is any inconsistency between s 290(4)(a) of the CA and sch 1 art 8(1) of the AA, then s 290(4)(a) of the CA must prevail.

Contrary approach

There is some support for the contrary approach of making the notice to arbitrate paramount in New Zealand in the

6. *AAI Ltd v 92 Lichfield Street Ltd (in rec and in liq)* [2015] NZCA 559 at [21]–[22].
7. *Commissioner of Inland Revenue v Chester Trustee Services Ltd* [2003] 1 NZLR 395 (CA) at [42].
8. Arbitration Act 1996, sch 1 art 21.
9. *Industrial Group Ltd v Bakker* [2011] NZCA 142 at [24]–[25] cited in *AAI Ltd v 92 Lichfield Street Ltd (in rec and liq)* [2015] NZCA 559 at [21].
10. *Industrial Group Ltd v Bakker*, above, at [25].
11. *TransDiesel Ltd v MTU America Ltd* [2016] NZHC 280 at [47]; *LRM Builders Ltd v Jamon Construction & Civil Ltd* [2016] NZHC 1058 at [10].
12. Ross Carter *Burrows and Carter Statute Law in New Zealand* (5th ed, LexisNexis, Wellington, 2015) at 465.

decision of the Supreme Court in *Zurich Australian Insurance Ltd t/a Zurich New Zealand v Cognition Education Ltd*.[13] *Zurich* concerned competing applications for summary judgment and for a stay of proceedings under sch 1, art 8 of the AA. The Supreme Court held that a stay ought to be granted unless the Court found the arbitration agreement was null and void, inoperative or incapable of being performed or, more relevant for present purposes, it was immediately demonstrable either that the defendant was not acting bona fide in asserting that there is a dispute or that there was in reality no dispute.[14]

Zurich has subsequently been considered in relation to applications to set aside a statutory demand by the Court of Appeal and the High Court. In those cases, although reference was made to the *Zurich* principles applying to s 290, the references were obiter only and the principles of *Zurich* were not determinative. Although the Court of Appeal and the High Court seemed to accept *Zurich* applied, there was no explanation as to why.[15]

Traditional approach still correct

The analysis in *Zurich* does not automatically apply to s 290(4). *Zurich* was a decision about the interpretation of "dispute" in sch 1, art 8(1) of the AA. Section 290(4) contains subs (a), which expressly requires a *substantial* dispute to be established before a statutory demand is set aside.

Zurich involved a contest between a stay under art 8 and an application for summary judgment. It concerned private rights between the parties in relation to the different processes of arbitration and summary judgment. As already said, an application to set aside a statutory demand is quite different to an application for summary judgment.[16] In *Zurich*, the Supreme Court expressly referred to the fact that a court could properly determine questions of law, including contractual interpretation on an application for summary judgment.[17] It would be less likely for such determinations to be made on an application to set aside a statutory demand.

The different policies behind the insolvency provisions of the CA and the AA also mean the *Zurich* reasoning cannot automatically be introduced into applications to set aside statutory demands. The purposes of the AA include facilitating the recognition and enforcement of arbitration agreements.[18] The insolvency policy of the companies legislation is that: (1) insolvency results in winding up, and (2) insolvency is proved by inability to establish a substantial dispute over the debt or by way of cross-claim.[19] Applying *Zurich* to applications under s 290 would be contrary to this policy.

The insolvency processes in the CA are also for the benefit of creditors generally, not only the creditor party to the debt which is the subject of the statutory demand. Another creditor is able to apply to be substituted as the plaintiff in an application to put a company into liquidation and to rely on the failure to comply with the statutory demand, although it was not a party to the debt which is the subject of statutory demand.[20] It is appropriate for the insolvency processes to be given priority in the context of a statutory demand.

The importance of contractual bargains is frequently put forward as the justification for requiring parties to submit disputes to arbitration. It is said that the parties have agreed to do so by contract and a party ought not be able to bypass that agreement by issuing a statutory demand. However, an agreement to arbitrate requires parties to have disputes *determined* in the arbitration forum.[21] A court is not making any determination of the parties' dispute in the context of an application to set aside a statutory demand. The court's task is to make a prompt judgment as to whether or not there is a substantial dispute.[22]

The Court of Appeal has said that the "exceptional power" to allow a company that is unable to pay its debts to continue to operate must be confined to cases which clearly justify departure from the fundamental principle that insolvency, evidenced by a failure to pay debts, should bring the end of a company's existence.[23] An example is where there is an abuse of the statutory demand process.[24] The mere issue of notice to arbitrate does not justify departure from this fundamental policy unless the debt is genuinely disputed on substantial grounds.

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13. *Zurich Australian Insurance Ltd t/a Zurich New Zealand v Cognition Education Ltd* [2014] NZSC 188, [2015] 1 NZLR 383.
14. *Zurich*, above, at [52].
15. *Soil Research Ltd v Outdoors and Beyond Ltd* [2017] NZHC 145 at [18]-[19]; *Manchester Securities Ltd v Body Corporate 172108* [2017] NZCA 527 at [29]-[32].
16. *Industrial Group v Bakker*, above n 9, at [24]-[25].
17. Zurich, above n 13, at [37]-[38].
18. Arbitration Act 1996, s 5(e).
19. *Commissioner of Inland Revenue*, above n 7, at [45].
20. High Court Rules 2016, r 31.24.
21. *Re Asia Master Logistics Ltd*, above n 4, at [66]-[71].
22. *Industrial Group v Bakker*, above n 9, at [24].
23. *Commissioner of Inland Revenue*, above n 7, at [48].
24. *Commissioner of Inland Revenue*, above n 7, at [60].

The Court of Appeal's interpretation of "substantial dispute" in *AAI Ltd v 92 Lichfield Street Ltd (in rec and in liq)* adequately protects parties to an arbitration agreement.[25] There is no need to require a lesser test. A party that genuinely wishes to commence arbitration to dispute a debt will readily establish that it has a substantial and genuine dispute so as to set aside a statutory demand. A party that belatedly seeks to rely upon an arbitration clause will invariably fail to establish a substantial dispute.

To allow such a party to avoid the statutory demand process by the mere service of a notice to arbitrate would invite recalcitrant debtors with arbitration clauses in their underlying agreements to issue notices to arbitrate as a tactic to avoid the operation of the insolvency process. Even if it were possible, the statute ought not be interpreted in a way that would encourage such a ploy.

25. *AAI Ltd*, above n 6, at [21]–[22]:

> What the applicant must show is that the dispute it raises has substance; the applicant must explain to the court what the dispute is; and the dispute so shown must be a real and not a fanciful or insubstantial dispute.