Nair & Co.

LEGAL UPDATE

November 2018

Arbitration clause in shareholders' agreement does not preclude Court proceedings for same relief under Articles

Introduction

Two investors set up a joint venture company and enter into a shareholders' agreement which governs the relationship between them on similar terms to those contained in the company's Articles of Association ("**Articles**"). The shareholders' agreement contains an agreement to arbitrate and a clause that provides that in the event of inconsistency between the terms of the shareholders' agreement and the company's Articles, the terms of the shareholders' agreement shall prevail. The Articles themselves however do not have an arbitration clause.

One investor alleges that the other has breached the company's Articles. However, the obligation that has allegedly been breached is found in both the shareholders' agreement and the Articles. Should the matter proceed to litigation or arbitration?

This was the issue which arose in the case of *BTY v BUA and other matters [2018] SGHC 213.*

Facts

The Plaintiff was an investment fund and the minority shareholder in a joint venture with another company, which was the "**majority shareholder**". The majority shareholder was a listed company.

The Defendant was the joint venture company itself.

The Defendant entered into a shareholders' agreement with its shareholders (i.e. including the Plaintiff), which governed the shareholders' relationship with each other as well as their relationship with the Defendant as joint venture vehicle. However, it also governed the terms on which the Plaintiff was to make its investment in the Defendant, which is why this agreement was entitled the "**Investment Agreement**".

Clause 29.2 of the Investment Agreement contained an arbitration clause. The said clause read as follows:

> *Any dispute, controversy or conflict arising out of or in connection with **this Agreement** including any question regarding its existence, validity or terminology (a "Dispute"), shall be referred to and finally resolved by arbitration in Singapore and administered by the Singapore International Arbitration Centre (the "SIAC") in accordance with the Arbitration Rules of the SIAC for the time being in force which rules are deemed to be incorporated by reference into this clause 29.*

Clause 29.2 (the "**Arbitration Agreement**" or "**Clause 29**") was not restated in the Defendant's Articles. However, the Investment Agreement also contained a supremacy clause at clause 23 which provided that, in the event of inconsistency, the terms of the Investment Agreement shall prevail (the "**Supremacy Clause**").

The Court Proceedings

The Plaintiff commenced proceedings in Court seeking inter alia an injunction restraining the Defendant from relying on its audited accounts for 2015 (the "**2015 Audited Accounts**"). The Plaintiff alleged that the 2015 Audited Accounts were inaccurate and that the Articles had been breached as the Plaintiff's consent to the accounts had not been obtained pursuant to a "reserved matters" provision in the Articles. The same provision appeared in the Investment Agreement.

The Defendant applied for a stay of the litigation in favour of arbitration pursuant to the Arbitration Agreement. At first instance, the learned Assistant Registrar granted the stay. The Plaintiff appealed.

The Honourable Justice Vinodh Coomaraswamy allowed the appeal. Thereafter, on the Defendant's application, the learned Judge granted the Defendant leave to appeal to the Court of Appeal.

Decision of the Singapore High Court

Pursuant to section 6(1) *International Arbitration Act (Cap. 143A)* ("**IAA**"),[1] the Court considered whether the "matter" in respect of which the Plaintiff brought the litigation was the "subject" of the Arbitration Agreement.

Following the decision of the Court of Appeal in *Tomolugen Holdings Ltd and*

another v Silica Investors Ltd and other appeals [2016] 1 SLR 373, the learned Judge adopted a "granular" approach to the inquiry, such that a "matter" was deemed to be "each issue which is material to the relief sought and/or is capable of settlement as a discrete controversy".

The Court considered (among other things) the fact that the Plaintiff had framed its case without reference to the Investment Agreement and observed that a breach of the Articles was the sine qua non of each of the Plaintiff's claims for relief. The Court thus determined that the "matter" in the litigation was this: *Has the Defendant adopted or approved the 2015 Accounts in breach of the Articles?* The Court held that if the Plaintiff was right, the Defendant's act would be ultra vires, without having regard to the provisions of the Investment Agreement.

The Court then considered if the "matter" fell within the scope of the Arbitration Agreement.

The learned Judge first opined that shareholders' agreements and Articles were of fundamentally different legal characters and operated on separate "planes". Shareholders' agreements such as the Investment Agreement operated on the "private law plane" and Articles operated on the "company law plane". The learned Judge also observed that shareholders' agreements, which are private agreements, are subordinate to company law. His Honour held that the Investment Agreement recognised this concept of separate planes for the following reasons:

- The Investment Agreement stated in its recital that it was the parties' *"wish to enter into this [Investment] Agreement to, among other things, regulate the rights and obligations … between them as shareholders of [the Defendant] and certain aspects of, and their dealings with, [the Defendant]".* The learned Judge observed that the parties thus recognised that their rights and obligations originate elsewhere;

- The Investment Agreement also explicitly provided that it yields to company law as clause 27.19 stated therein that *"[the Defendant] … shall not be bound by any provision of this [Investment] Agreement to the extent that it would constitute an unlawful fetter on any of its statutory powers".* The learned Judge viewed this as a clear acknowledgement that the Investment Agreement operates on a plane subordinate to company law as far as issues of company law are concerned and that it is company law which decides the extent to which the Investment Agreement can bind the Defendant on matters of company law.

Since the Investment Agreement and the Articles were of a fundamentally different character, absent bad faith, the Court held that the Plaintiff was entitled to pursue its claim under the Articles even if the same claim could be made and the same relief could be granted by an arbitral tribunal under the Arbitration Agreement.

The Court then went on to analyse whether the objectively ascertained intention of the parties was for the Arbitration Agreement to apply to disputes under the Articles. In considering this, the Court made reference to the Australian case of *Robotunits Pty Ltd v Mennel [2015] VSC 268* ("**Robotunits**"). That case involved a director who was alleged to have breached his duties as a director. The director was party to both a shareholders' agreement and an employment agreement. The shareholders' agreement contained an arbitration clause while the employment agreement did not. The company commenced court proceedings against the director and the director applied to stay the court proceedings in favour of arbitration under the shareholders' agreement. The court in Robotunits held that a reasonable person in the position of the parties in that case would not have understood the arbitration agreement to operate to extend to matters arising outside the shareholders' agreement. Matters arising under the employment agreement did not therefore fall within the arbitration clause, because the employment agreement governed the parties' relationship as employee and employer and thus relates to a separate transaction altogether."

The Honourable Justice Vinodh Coomaraswamy held that the instant case was similar because the Investment Agreement and the Articles created two separate legal relationships between the parties, and hence a reasonable person in the position of the parties would not have understood the Arbitration Agreement to extend to the disputes arising under the Articles.

For the above reasons, the learned Judge concluded that the "matter" did not fall within the scope of the Arbitration Agreement.

Arbitrability

Notwithstanding the above findings, the Court also considered whether the "matter" was one which was arbitrable. The learned Judge observed that it could be argued that an application to challenge the filing of documents on ACRA's register is not arbitrable because the outcome could affect a public register and thereby could affect third parties who may have acted in reliance on the accuracy of that register.

The Court noted that the company's obligation to lodge its accounts under the *Companies Act (Cap. 50)* is of a public character given that creditors and potential creditors access the accounts to assess the creditworthiness of the company. Thus, although the "matter" in this litigation was whether the defendant had adopted or approved the 2015 Accounts in breach of the Articles, the issue over the accuracy of the accounts engaged the public interest in the "matter" which was at the heart of the litigation.

As the learned Judge decided the appeal on the proper construction of section 6(1) of the IAA and the Arbitration Agreement, His Honour did not find it necessary to decide the question of arbitrability.

The Supremacy Clause

In reaching its decision, the Court considered (among other things) the Defendant's submission that, by the Supremacy Clause, the parties specifically agreed that the Articles were to be controlled by the Investment Agreement. However, the learned Judge rejected this argument for 3 reasons.

First, the Court held that the Supremacy Clause operated on the private law plane and not on the company law plane. The intention of the Supremacy Clause was to create a contractual obligation requiring parties to adhere to the Investment Agreement and disregard their rights and obligations under the Articles which were in conflict or inconsistent.

Second, the learned Judge found that the parties could not have intended a "conflict or inconsistency" within the meaning of the Supremacy Clause to arise simply because a provision which is present in the Investment Agreement is absent from the Articles. The effect would be to make the Articles identical in content to the Investment Agreement, making the entire scheme of having the two separate agreements run in parallel on their separate planes entirely redundant. This, the Court found, would have been contrary to the expressly-stated purpose of the Investment Agreement, which was to supplement the Articles.

Third, the Court found that if the Supremacy Clause did have the effect as argued by the Defendant, then the entire Investment Agreement would have constituted an impermissible attempt to amend the Articles without making such amendments public on ACRA's register as required by the *Companies Act (Cap. 50).*

Hence, the learned Judge found that the Supremacy Clause did not allow the Arbitration Agreement (which was contained only in the Investment Agreement) to "prevail" over the absence of an arbitration agreement in the Articles.

Practical implications

It is common for shareholders' agreements to contain arbitration clauses. It is however not common for Articles (or the constitution of a company) to do so.

It may be that drafters of shareholders' agreements and Articles have up to now assumed that in the event of dispute, an agreement to arbitrate contained in a shareholders' agreement, together with a supremacy clause providing that the shareholders' agreement would prevail in the event of inconsistency with the Articles, would mean that all disputes arising out of the commercial relationship would be resolved by way of arbitration.

This decision suggests that this is not the case, and that if parties intend for their disputes to be resolved in arbitration, they should include the appropriate dispute resolution clause in the Articles as well.

It should be noted that, on the Defendant's application, the learned Judge subsequently granted leave to appeal to the Court of Appeal against His Honour's decision, and in the meantime granted a stay of the proceedings. The appeal has not yet been fixed for hearing.

The Defendant was represented by **Mr Suresh Nair** and **Mr Bryan Tan** of M/s Nair & Co LLC.

[1]Section 6(1) IAA: Notwithstanding Article 8 of the Model Law, where any party to an arbitration agreement to which this Act applies institutes any proceedings in any court against any other party to the agreement in respect of any matter which is the subject of the agreement, any party to the agreement may, at any time after appearance and before delivering any pleading or taking any other step in the proceedings, apply to that court to stay the proceedings so far as the proceedings relate to that matter.

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