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Resolving Unresolved Relationship Problems – the Case of Cross Border Insolvency and Pending Arbitrations

by

JASON CHUAH*

The relationship between arbitration and insolvency in a cross border context is fraught with difficulties which can blight transnational insolvency practice. This article is concerned with the judicial constructs applied (in the EU, civil law and common law traditions) to resolve the conflict between a pending arbitration in one country and forthcoming insolvency proceedings in another. Should the arbitration be allowed to continue and what law should be used to determine the issue? In the EU, it might be said that the question is largely determined by the EU Insolvency Regulation. A comparative law and teleological discussion would highlight the different imperatives adopted in the different judicial approaches to the problem.

The debate has sometimes been reduced to a pro or anti arbitration dispute. This article is less concerned with that direct confrontation. Instead, it is interested in the debate about the public interest which is claimed to be maintained when arbitration is allowed or disallowed to proceed in the light of impending insolvency. It thus draws on case examples from different jurisdictions to examine the perceived judicial role to protect the public interest by controlling arbitrations in this context.

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I. Introduction

The relationship between arbitration and insolvency in a cross border context is fraught with difficulties which can blight transnational insolvency practice.

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One difficulty might be the enforceability of an arbitration agreement made prior to the insolvency of one of the parties. A second might be whether and to what extent the insolvency matters or bankruptcy issues could be made the subject of the arbitration. A third could be whether a stay of the arbitral proceedings could be given when insolvency proceedings have commenced. A fourth relates to the enforceability or challenge of an arbitral award on substance pending or after insolvency. A fifth might be the role of the judiciary in controlling insolvency proceedings against the background of arbitral proceedings having been commenced. The list of different contextual settings and issues can go on¹. In this article, the discussion takes on some of these issues in a cross border context. In particular, we examine what should happen to arbitration proceedings pending in one EU Member State whilst insolvency proceedings relating to one of the parties have commenced in another Member State. Civil and common law traditions and practice not influenced by EU law will serve as a comparative backdrop. The debate has sometimes been reduced to a pro or anti arbitration dispute. This article is less concerned with that direct confrontation; instead, the interest is in the role of public interest when deciding to allow or disallow a pending arbitration to proceed in the light of forthcoming insolvency action.

The problem arose before the English court recently. In *Jozef Syska (acting as administrator for Elektrim SA (in bankruptcy)) v Vivendi Universal SA*², Elektrim, a company established in Poland, had entered into a number of investment contracts with two Vivendi companies in 2001. The two Vivendi companies were incorporated in France. The investment agreement was expressed to be governed by Polish law but contained an arbitration agreement referring to arbitration in England before the London Court of International

- 1 There is a good amount of literature, albeit in varying depths, on the relationship between arbitration and insolvency; see, for example, Gary B. Born, *International Commercial Arbitration* 809-17 (2009); Jean-Francois Poudret & Sébastien Besson, *Comparative Law of International Arbitration* 305-09 (2007); Julian D.M. Lew et al., *Comparative International Arbitration* 206-08 (2003); Philippe Fouchard et al., Emmanuel Gaillard & John Savage (eds.), *On International Arbitration* 345, 355-56 (1999); Nigel Blackaby et al., *Redfern and Hunter on International Arbitration*, M 2.128-132 (5th ed. 2009); W. Laurence Craig et al., *International Chamber of Commerce Arbitration* 68-69 (3d ed. 2000).
- 2 [2009] EWCA Civ 677 (before the English Court of Appeal) on appeal from the Commercial Court's decision in [2008] EWHC 2155 (Comm). Hereafter referred to as "*Elektrim*". This case generated some discussion in Baizeau, *Compétence de l'arbitre et faillite à la lumière des arrêts anglais et suisse dans l'affaire Vivendi/Elektrim [Arbitrator's Jurisdiction And Insolvency in the light of the English and Swiss Decisions in the Vivendi v Elektrim Case]*, 3 *Gazette Du Palais (Spécial Arbitrage)* 5 N.2 (2009) and Markat, "Arbitrating in the Financial Crisis: Insolvency and Public Policy versus Arbitration and Party Autonomy – Which Law Governs?" (2009) 2(2) *Contemp. Asia Arb. J.* 217.

Arbitration (LCIA). The arbitration agreement was expressed to be governed by English law. Following a dispute, Vivendi instituted arbitration proceedings in London against Elektrim for the sum of €1.9 billion in August 2003. A hearing date was fixed by the arbitrators for 15–19 October 2007.

In August 2007, Elektrim petitioned for bankruptcy in Poland³ and was declared so under Polish law on 21 August 2007. At the arbitration hearing in October 2007, Elektrim argued that the arbitration agreement was annulled following its bankruptcy. The arbitral tribunal ruled by a majority of 2-1 that it had jurisdiction under the arbitration agreement and proceeded to find Elektrim liable for breach of the investment agreement. An award was made against Elektrim.

Elektrim then issued proceedings before the English court asking for the award to be set aside on the basis that there was failure or substantive jurisdiction⁴. Much depended on whether the Polish law⁵ which provided that “any arbitration clause concluded by the bankrupt shall lose its legal effect as at the date bankruptcy is declared and any pending arbitration proceedings shall be discontinued” was applicable. It was common ground that if the Polish law applied, the arbitration process would be invalid.

The answer to this somewhat complicated question lies in how two articles in the European Insolvency Regulation⁶ (EIR) should be interpreted and applied. Article 4.2(e) of the EIR requires that the effect of the opening of the bankruptcy proceedings on ‘current contracts’ be determined in accordance with the law of the bankruptcy (the *lex concursus*). Elektrim argued that the arbitration agreement was a ‘current contract’ and, as such, applying Polish law as the *lex concursus*, the arbitration should come to an end because under Polish law the arbitration agreement was now void. On the other hand, Vivendi relied

3 Before the Warsaw District Court. Initially, the petition was on the basis that Elektrim was to remain a debtor in possession with Mr Syska acting as court supervisor; the Warsaw District Court saw it fit to revoke Elektrim’s self-administration on 5 February 2008 and formally appointed Mr Syska as administrator.

4 The application was based on s 67, Arbitration Act 1996 (UK). The section reads: “(1) A party to arbitral proceedings may (upon notice to the other parties and to the tribunal) apply to the court—

(a) challenging any award of the arbitral tribunal as to its substantive jurisdiction; or
(b) for an order declaring an award made by the tribunal on the merits to be of no effect, in whole or in part, because the tribunal did not have substantive jurisdiction.”

It was argued that there was failure of substantive jurisdiction because the tribunal lacked the substantive competence to hear the claim following Elektrim’s bankruptcy under Polish law.

5 Art. 142, Polish Bankruptcy Law Act.

6 Council Regulation (EU) No. 1346/2000 of 29th May 2000 on Insolvency Proceedings which came into force on 31 May 2002.

on art 15, EIR. Article 15 provides that “the effects of insolvency proceedings on a lawsuit pending ...shall be governed solely by the law of the Member State in which that lawsuit is pending”. Indeed, art 4(2)(f) explicitly states that “*the effects of the insolvency proceedings on proceedings brought by individual creditors, with the exception of lawsuits pending*”⁷. The argument was thus that since the arbitration was a ‘lawsuit pending’, reference should be had to the *lex arbitri*. The *lex arbitri* is English law since England is the seat of the arbitration. Under English law⁸, there is no automatic mandatory stay or *vis attractiva* (ie forcing the dispute to be decided by the court administering the main insolvency proceeding).

The Commercial Court, the court at first instance, declined to set aside the arbitral award. It held that there was a conflict between the general provisions of art 4 of the Regulation and the specific provision of art 15. In a conflict between the general and the specific, the specific should prevail. It therefore ruled that English law should determine the effect of the insolvency on the arbitration and, since, there was no provision under English law annulling the arbitration agreement, the award should be endorsed. On appeal, the Court of Appeal⁹ agreed with the outcome made by the lower court but disagreed with its reasoning. The Court of Appeal stated that it was generally accepted that ‘lawsuit pending’ (as used in art 15) included references to arbitration. Therefore, the arbitration was properly covered by art 15 which serves as an exception to art 4. As such, the question of the effect of Elektrim’s bankruptcy on the arbitration proceedings should be resolved using English law. The arbitral award was therefore confirmed.

The object of this article is not merely to discuss the approaches taken by the two English courts but to explore in a wider context, drawing from the legal norms in other European countries, how as a matter of principle or policy such issues of conflict between the need to support arbitration and the imperative to provide for a systematic way of dealing with cross border EU insolvencies might be better understood.

II. The Competing Imperatives

An important starting point in our discussion has necessarily to be the rationale between the different applicable laws available under the Regulation. Article 4(2) makes it plain that as a general rule, the law of the state in which insolvency proceedings are opened should govern “the opening of those pro-

7 Emphasis added.

8 Schedule B1, para 43(6) of the Insolvency Act 1986.

9 Permission to appeal to the Supreme Court was refused on 6 November 2009 (see <http://www.supremecourt.gov.uk/docs/pta-0910-1002.pdf>).

ceedings, their conduct and their closure”. It is quite appropriate for the law of that state to address all matters relating to meeting the creditor’s debt and the available assets to meet those debts. Indeed, recital 23 of the Regulation states

“unless otherwise stated, the law of the Member State of the opening of the proceedings should be applicable (*lex concursus*). This rule on conflict of laws should be valid both for the main proceedings and for local proceedings; the *lex concursus* determines all the effects of the insolvency proceedings, both procedural and substantive, on the persons and legal relations concerned. ...”

By a similar token, it is not surprising to see why pending lawsuits would be excluded from the *lex concursus*. A lawsuit (including a reference to arbitration) is vital to determine the existence or validity of any claims involving the creditors and debtors. Once these claims have been declared upon, they could be taken into account in the relevant insolvency proceedings. Recital 24 of the Regulation states that automatic recognition of insolvency proceedings to which the law of the opening state normally applies may interfere with the rules under which the transactions are carried out in other Member States. In order to protect legitimate expectations and the certainty of transactions in Member States other than that in which the proceedings are opened, the same recital goes on to provide that a number of exceptions to the general rule should be provided for. It is not a stretch beyond the reasonable to construe the reference in this recital to “protect legitimate expectations and certainty of transactions” as including the commercial expectation that lawsuits or arbitral proceedings already commenced in a Member State other than that where the insolvency proceedings are opened to be fully completed and resolved by the former Member State¹⁰.

On this reading, it might be natural to assert, contrary to the finding of the English Commercial Court, that there is effectively no direct conflict between art 4 and art 15. Indeed, it may be said that as matter of general precept, the link between the two articles support the policy of the Regulation to reduce conflict of laws. However and regardless, all this still does not entirely help matters – so what if there is no direct conflict? The two articles would need to be interpreted in a complementary manner.

As a matter of interpretation, it is thus useful for us to remind ourselves of the recommended approach. The Regulation is intended to lay down common rules to be uniformly applied throughout all Member States¹¹. It is intended to form a single legal order. It therefore exists in texts in each of the languages of the Union, all of which are equally authentic. As such, its terms and concepts

10 Of course different considerations would apply where the lawsuit or arbitration has not yet been commenced but merely contemplated. In such a case, it should be the *lex concursus* that should determine whether the lawsuit or arbitration should actually commence or proceed.

11 With Denmark having opted out.

should not be interpreted by reference to any particular national legal system – whether it is of a state which is involved in the proceedings in question¹². The concepts contained in the Regulation should be treated as being autonomous. In the words of the Virgos-Schmit Report, “an autonomous interpretation implies that the meaning of its concepts should be determined by reference to the objectives and system of the Convention, taking into account the specific function of those concepts within this system and the general principles which can be inferred from all the national laws of the Contracting States”¹³. There is also another imperative. The Regulation as a unifying legislation should be interpreted with a view of promoting uniformity throughout the Union¹⁴ and meeting its declared objectives.

On that basis it is vital when construing words like “lawsuit pending” to refer to the languages of the text and seek out an autonomous definition. Article 15 states that the effects of insolvency proceedings on a lawsuit pending concerning an asset or right of which the debtor has been divested shall be governed solely by the law of the Member State where that lawsuit is pending. In the UK, a lawsuit is frequently thought to refer to judicial proceedings. The Collins Dictionary defines it as “a proceeding in a court of law brought by one party against another, especially a civil action”. Similarly, the American Heritage Dictionary defines it as an action or a suit brought before a court, as to recover a right or redress a grievance”. Whilst a number of the other official texts also use the term “lawsuit”, the following languages are more capacious. The translation of art 15 from the Hungarian version reads “the effects of insolvency proceedings on ongoing proceedings concerning an asset etc...”¹⁵. The Bulgarian version of art 15 translates into “the consequences of insolvency proceedings on pending legal disputes...”¹⁶ whilst the French version “*Les effets de la procédure d’insolvabilité sur les poursuites individuelles, à l’exception des instances en cours*” could well designate either court or arbitral proceedings. The Portuguese¹⁷ version of art 4(2)(f) refers to the ex-

12 See the Virgos-Schmit Report para 43. The EU had negotiated for a Convention on bankruptcy but the convention lapsed when the UK failed to sign it. The Virgos-Schmit report was to have been the Official Report of that Convention. Parts of the report had subsequently found their way into the Recitals of the Regulation. As such, although it is not prescribed as an interpretative guide, it is pragmatic to use it as one.

13 *ibid*.

14 Uniformity is essential in a statute applicable to throughout the Union because the citizens of the Union who are guaranteed parity and equality of treatment should benefit from the same rights and processes.

15 The heading in art 15 reads: “A fizetésképtelenségi eljárások hatása a folyamatban lévő peres eljárásokra”.

16 The heading reads: “Последници от производството по несъстоятелност по отношение на висящи правни спорове”.

17 The words are : “Os efeitos do processo de insolvência nas acções individuais, com

ception of “*pending proceedings*” which could also be read as including arbitral proceedings. The same seems to be true of the German¹⁸, Spanish¹⁹ and Italian²⁰ versions. On the other hand, the Finnish²¹ and Latvian²² translations are more narrow – referring specifically to “proceedings in court”²³.

It might be useful to allude to an important text by Profs. Virgo and Garcimartin²⁴ where with reference to art 4(2)(f), the authors commented that

“... Insolvency proceedings are designed to provide a collective forum, a solution that avoids competition by creditors for the debtor’s assets and allows for the orderly examination of the debtor’s and the creditor’s rights. Article 4.2.f protects this function. The *lex fori concursus* will therefore decide to which extent individual actions by creditors to enforce their claims through collection efforts, adjudication, execution or otherwise are to be suspended or enjoined. The term “proceedings” is broad enough to encompass all kinds of procedures brought about by individual creditors, *including arbitration proceedings* and enforcement measures initiated by creditors outside the court system, where allowed.”²⁵

Although the text was originally in Spanish, there is little doubt that the authors did intend to include arbitration proceedings within “lawsuit pending”. At one level, it should be said that there are no good grounds for giving “lawsuit pending” a narrow construction. Arbitration has been increasingly recognised in the EU as a central plank to the need to provide access to justice for the EU citizen. Excluding arbitration proceedings from the scope of art 4(2)(f) and consequently, art 15, would merely relegate the arbitral process to a lower status than judicial process for no reason serving the wider public policy and interest. Indeed, as the English High Court judge said,

“Parties to a commercial arbitration have a legitimate expectation that the reference will not grind to a halt upon an insolvency... if the law of the place where the arbitration is pending would not have that effect.”²⁶

excepção dos processos pendentes”; its art 15 is less clear: “efeitos do processo de insolvência em relação a acções pendentes”.

18 The German text states: “Wirkungen des Insolvenzverfahrens auf anhängige Rechtsstreitigkeiten”.

19 The Spanish text uses these words: “Efectos del procedimiento de insolvencia sobre procedimientos en curso”.

20 The Italian version uses these words: “Effetti della procedura di insolvenza sui procedimenti pendenti”.

21 The Finnish text refers to “Maksukyvyyttömyysmenettelyn vaikutukset vireillä oleviin oikeudenkäynteihin”.

22 Like the Finnish text, it reads quite specifically, “Maksātnespējas procedūru sekas attiecībā uz tiesvedībā esošām lietām”.

23 Emphasis added.

24 *The European Insolvency Regulation: Law and Practice*, Kluwer (2004).

25 Para 121(g); emphasis added.

26 Para 97 of the judgment.

On the other hand, despite the laudable teleology, there is some anomaly in this approach where the *lex concursus* provides that arbitration cannot commence once insolvency proceedings have started (as was the case in Poland for *Syska*). The argument goes something like this – the arbitration agreement will continue to exist if arbitral proceedings have been commenced prior to the COMI (centre of main interest) seising jurisdiction but it stops having any effect if the arbitral proceedings have not yet been started at the time insolvency proceedings commence²⁷. The problem is then exacerbated by the question as to whether the *lex arbitri* (in *Elektrim's* case, English law) would treat the enforceability of the arbitration agreement which by then for all intents and purposes has become invalid under the *lex concursus*. The *lex arbitri* would normally recognise the role of the *lex concursus* but how should it respond in these circumstances?

Perhaps the solution would be to turn a blind eye to the perceived conflict between art 15 and art 4(2)(e). If these provisions are deemed to be two entirely distinct, independent and autonomous rules, the question of reconciling the two does not need arise. The issue would then merely whether the arbitration constitutes a lawsuit pending – which was what the Court of Appeal did and once it is concluded that it is, then the *lex arbitri* will determine what would happen to the arbitration but also and more importantly, the issue of validity of the arbitration agreement. This is by and large a good solution because it is simple and avoids the problem of trying to reconcile art 4(2)(e) and art 15. It also seems to support the principle of party autonomy which is largely deemed essential in arbitration.

However, this masks the problem that there is in effect a conflict – giving eminence to the *lex arbitri* by virtue of art 15 means to compel the *lex concursus* to accommodate an arbitration agreement which in normal circumstances it would not have recognised.

More crucially, art 15 does not provide an answer to the question of what is the effect of insolvency on the arbitration agreement. So in the *Syska's* scenario this might well occur. The *lex arbitri* is to apply, as directed by art 15. In order to decide the effect of the insolvency on the arbitration, the *lex arbitri* (English law) then will turn to art 4(2)(e) which forms part of its laws. Article 4(2)(e) will then require the application of Polish law which as we know will invalidate the arbitration agreement. Hence, a *renvoi* could effectively arise. One way round this is to treat art 15 as implicitly preventing *renvoi* although this is not stated in the text of the regulation. In other words, once English law is mandated under art 15, English law will apply its own substantive laws to deter-

27 See for example Millett, Cross-border insolvency: the effect of insolvency proceedings on pending arbitrations (2009) 8 Journal of International Banking and Financial Law 456 – Mr Millett was one of the barristers acting for the claimants in *Syska v Vivendi*.

mine what happens to the pending lawsuit without reference to its conflict of laws rules, and thus will not rely on art 4.2(e) to apply Polish law²⁸.

These are difficult problems with the two provisions where arbitral proceedings are involved. Further debate is surely needed. The arguments going either way are persuasive – perhaps one way forward would be for Member States to consider removing their objections to recognising the validity of arbitral agreements once insolvency proceedings have commenced.

In this connection, it might be useful to draw some guidance from the German experience. In Germany, the position is that the opening of the insolvency proceedings will not affect the arbitrability of existing disputes or, indeed, the validity of the arbitration agreement. In a recent Federal Court case involving two ICC (International Chamber of Commerce) awards²⁹, some very important and interesting observations were made by the court. The facts were fairly straightforward. Arbitration proceedings were instituted on the ground that some provisions of the contract for the construction and delivery of parts of a compost plant had been breached. A few months later, insolvency proceedings were instituted with reference to both defendants. The arbitral panel was informed and in the meantime, the claimant lodged a number of claims with the insolvency administrators. These claims were not entirely identical to the ones raised in the arbitration. The Dutch arbitrator continued with the arbitration proceedings. The administrators objected and refused to participate³⁰ in the insolvency. The arbitrator then made two awards which the claimant applied to the Higher Regional Court in Cologne for recognition and enforcement³¹. The Cologne court held that whilst arbitration proceedings may continue during insolvency proceedings, the award nevertheless was contrary to public policy for failure to conform to the basic principles of German insolvency law³²; the policy rationale being the need to protect the principle of equal treatment of all creditors of the same class. The claimant thus appealed to the Federal Court of Justice. The appellate court held that whilst it is right that s 240 Code of Civil Procedure (Zivilprozessordnung-ZPO)³³ does require a

28 *ibid.*

29 OLG Köln, SchiedsVZ 2008, 152; as discussed in Int. A.L.R. 2004, 7(4), N52-53; on appeal to the Bundesgerichtshof, in its decision of 29. 1. 2009 (III ZB 88/07; BGHZ 179, 304).

30 By refusing to pay towards the costs.

31 *Supra* n 29.

32 s.87 Insolvency Act (Insolvenzordnung – InsO) provides:

“Claims held by the Creditors of the Insolvency Proceedings

The creditors of the insolvency proceedings shall only be permitted to enforce their claims under the provisions governing the insolvency proceedings.”

33 In 1998, the provisions of the ZPO relating to arbitration were amended and adapted to international standards. Until then, under s.1025(1) ZPO, both pecuniary claims and

stay of court proceedings after the opening of insolvency proceedings, it did not apply to arbitration proceedings. On that basis it could not be said that the continuation of arbitration proceedings when insolvency proceedings had commenced was a *prima facie* violation of public policy.

On further appeal to the Bundesgerichtshof, the superior court reiterated that under German law, the insolvency of a party to an arbitration agreement does not nullify the arbitration agreement. As such, the administrator of the insolvent continues to be bound by the arbitration agreement as the insolvent's legal successor. Similarly, when a party upon becoming insolvent and loses his capacity as a party to the agreement, the arbitration cannot proceed with him. Public policy requires that the arbitration could only be continued with the administrator of his estate. If the arbitration proceeded with no substitution of the insolvent as a party, the arbitration runs foul of German public policy.

Although this example is essentially about domestic arbitration and domestic insolvency proceedings, a few useful lessons might be learnt. First, the emphasis on the sanctity of the insolvency proceedings is pivoted on the perceived public interest to protect the principle of equality of treatment for all creditors. However, the German courts did not think there was an assault on the public interest where the arbitration had already been commenced; the assault was only where the party had been allowed to continue to arbitrate as a party when he should have been replaced by the administrator. It should be said though that given that this was within a domestic context, it might be suggested that the court was fairly secure in thinking that as the arbitral process would nevertheless be open to judicial scrutiny at some stage, control was never really relinquished. Naturally the same premise might not be so convincing where a cross border element is involved. That said, in an EU context where there should be a presumption of a level playing field and a high degree of mutual judicial and administrative cooperation³⁴, the cross border argument might be less potent.

On the substance of the public policy and interest factor, other than the mere restatement of the need to protect assets and in turn the *pari passu* principle, the public interest defence is not, perhaps quite rightly, not fully fleshed out. That leaves a degree of discretion to the controlling court. It should never-

non-pecuniary claims were only arbitrable if the dispute was open to settlement by the parties. The amendment was to extend the scope of arbitrability of disputes by limiting this test to non-pecuniary claims, whereas pecuniary claims are now generally arbitrable. See editor's note in Int. A.L.R. 2004, 7(4), N52-53.

34 For a list of the current and forthcoming initiatives under the auspices of the EU on judicial and administrative cooperation, please see http://ec.europa.eu/justice/policies/civil/policies_civil_intro_en.htm.

theless be said that the scope of the *pari passu* principle has been under much scrutiny, especially within the common law system³⁵. The argument is essentially that the principle has been given more weight and emphasis than need be³⁶ – it does not adequately guarantee fair treatment of creditors and fails to accommodate the wider societal interest.

It is submitted that these are useful reference points in the cross border context – especially as regards the EU Insolvency Regulation. Given the increasing recognition that an arbitration agreement is enforceable against the liquidator or administrator³⁷, it might be useful to consider whether there should better consistency where cross border situations and the EU Insolvency Regulation come into play.

III. Framing the question in terms of corporate capacity

It might be of interest to note that the dispute between Vivendi and Syska was also repeated in Switzerland. The Swiss case³⁸ should be interesting because the EU Regulation did not apply. Vivendi argued there that it was for the *lex arbitri* to decide whether the tribunal had jurisdiction over Elektrim despite its bankruptcy. The Swiss Supreme Court referred to art 154 and art 155(c) of the Swiss Private International Law which provided in effect that corporations are governed by the law of the state under which they are established. That law shall also, under the law, “govern in particular . . . (c) the legal capacity and the capacity to act”. The Swiss Supreme Court thus agreed with the lower tribunal in Geneva that the effect of art 142 of the Polish Bankruptcy and Reorganisation Law was that Elektrim ceased, upon the commencement of insolvency

35 See Mokal, *Priority as Pathology: The *Pari Passu* Myth* (2001) Vol. 60 Cambridge LJ 581.

36 *ibid.*

37 See the discussions in French legal commentaries, for example, *Société Soules c/Société Henry – Maître Texier, Syndic*, Cass. com. 4 février 1986, Rev. Arb. (1988), p. 718; *Société Technique d’avant-garde (T.A.G.) c/Société Entertainment Media France Corp. (B.M.P.C.) et autres*, Cass. com., 12 février 1985, Rev. Arb. (1985), p. 275, Note P. Ancel. See also, P. Ancel, ‘Arbitrage et procédures collectives après la loi du 25 janvier 1985’, Rev. Arb. (1987), pp. 127–132, at p. 128. For Dutch sources, see M. Ynzonides, ‘De invloed van faillietverklaring op arbitrage’, *Weekblad voor privaatrecht, notariaat and registratie* (WPNR), No. 6008, (1991), pp. 389–396; P. Sanders, ‘Arbitrage en faillissement’, *Tijdschrift voor arbitrage (TvA)* (1988) 6, pp. 167–170; W. van Rossem/R.P. Cleveringa, *Verklaring van het Nederlands Wetboek van Burgerlijke Rechtsvordering*, 4th edn. (Zwolle: W.E.J. Tjeenk Willink, 1972), Art. 620, No. 4, n. 22. p. 1327. More generally, Lazic, *Arbitration and Insolvency Proceedings*, (1999) Vol. 3.3 *Electronic Journal of Comparative Law*.

38 Decision 4A_428/2008 (31 March 2009) (Swiss Supreme Court) accessible at <http://www.bger.ch>.

proceedings, to have the capacity to participate in the arbitration. All pending arbitration which the corporation had agreed to must be discontinued. What is interesting about this approach is that without the fetters of the EU Regulation, the question could be framed in the terms of corporate capacity. On that premise the Swiss decision is quite opposed to the English position.

The Swiss approach clearly places much more importance on the law of the place of incorporation or establishment. In some ways, this solution should not be seen as purely mechanistic but as preserving a high degree of neutrality because the court would not engage in asking the teleology of cross border insolvency regimes which those countries applying the EU Regulation must necessarily ask. In the English case of *Syska v Vivendi*, for example, both the High Court and the Court of Appeal were at pains to stress that they were interpreting the Regulation using the teleological method. On the contrary, the Swiss Supreme Court merely had to ask where Elektrim was incorporated and turned then to Polish law for a resolution. It should not however be thought the Swiss court treated the *lex concursus* as having trumped over the *lex arbitri*³⁹. It was merely interested in giving legal sovereignty to the country of incorporation. Of course, the Swiss tribunal, unlike the English court, did not have the problem of trying to reconcile arts 4(2) and 15 of the EIR since the EIR does not form part of Swiss law.

It is not the object of this article to critique the correctness of the Swiss decision in the light of Swiss law or to comment on the correctness of the arbitral tribunal's decision/s⁴⁰; our object is to consider the implications of an approach based on capacity in resolving the issue of the arbitration agreement's validity.

The reference to the place of incorporation on the question of capacity however raises the criticism as to why the law of the place of incorporation should necessarily prevail. In commercial relationships, modern corporate thinking is, for the most part, that a person dealing with the company is entitled to assume that it had the legal capacity to contract. In the UK, for example, the doctrine of corporate *ultra vires* has been largely abolished⁴¹ with the emphasis

39 Markat (supra fn 2) points out, "In light of the approach taken, the solution is also not *contradictory* to the "English Case". Both cases were simply decided on different legal bases – the "English Case" focusing on the validity of the arbitration agreement and the "Swiss Case" on the procedural capacity of a party to the proceedings. It is therefore not surprising that the outcome differs accordingly." That said, it might be said that in fact both cases focussed on the validity issue, except that with the English case the solution was deemed to be found in a choice between the *lex concursus* or the *lex arbitri* whilst the Swiss case had the "easier" task of simply inquiring into the law of the place of incorporation.

40 For such a criticism, see Markat (supra n2).

firmly placed on the contract's applicable law. The law of the place of incorporation should govern matters of internal capacity (such as the relationship between the company and its shareholders) but in matters of external relations, a more nuanced approach is called for⁴².

The place of incorporation test presupposes that one is able to identify the contracting party with certainty. That may not always be a straightforward question in today's world of large multinational corporate groups. Additionally, there may not be a sufficient link between the place of incorporation and the transaction or agreement or factual matrix in question. Would it be right to use the law of the place of incorporation as a reference point under these circumstances?

As far as the Single Market is concerned, giving the law of the place of incorporation such prominence might result in a derogation of the principles of free movement. It is not untenable to suggest that this may encourage some degree of shopping for a most condign place of incorporation and creates uncertainty and loss of legitimate expectation of cross border business dealings within the Single Market.

Lastly even if the law of place of incorporation is relevant, should it not be relevant only at the time the parties were making the arbitration agreement rather than the time when the arbitration is intended to occur? An analogy might be made with the position under the New York Convention⁴³. Article V(1)(a) of the Convention which provides for "incapacity" as a vitiating factor preventing the enforcement of a foreign award links incapacity to the making of the agreement by an express reference to art II (which deals with the making of the arbitration agreement)⁴⁴.

41 Section 39 of the UK Companies Act 2006 provides that "the validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's constitution."

42 This point is especially forcefully argued by Profs. Willis Reese and Edmund Kaufman in their article "The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit" (1958) 58 Colum LR 1118. Prof Reese was responsible for writing the US Second Restatement on Conflict of Laws and was a key member of the US delegation to the Hague Conference on Private International Law.

43 The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958. (33 UNTS 3 (1958)).

44 Article V(1)(a) provides, "Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that: (a) The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made." As for the text of art II, please see n. 57. See in

IV. The common law angle

It might be useful to evaluate how common law jurisdictions⁴⁵ might approach the question of choice between the *lex arbitri* and the *lex concursus* where pending arbitral process impinge on the national bankruptcy court's jurisdiction to deal with cross border insolvencies. A sampling of US⁴⁶, Canadian⁴⁷, Australian⁴⁸ and Hong Kong⁴⁹ law and practice suggests a preparedness of the bankruptcy courts to allow pending arbitrations to resolve themselves before the insolvency process will continue. In that regard, it would also seem to follow that the validity of the arbitration agreement (and its proceedings) would thus be determined by the *lex arbitri* instead of the *lex concursus*.

Where the insolvency proceedings have commenced, the position is fairly similar to that amongst EU Member States. A straightforward example might be the new Spanish Insolvency Law. The new Insolvency Act provides that arbitration agreements to which the debtor is a party to will have no legal

particular an important US decision where this interpretation of art V was discussed and endorsed – *Concoran v AIG Multi-Line Syndicate Inc* 143 Misc. 2d 62, 539 N.Y.S. 2d 630, 636 (S Ct N.Y.Co 1989), rev'd 562 N.Y.S. 2d 933 (1990). Also, Westbrook, *The Coming Encounter: International Arbitration and Bankruptcy* (1983) 67 Minn. L. Rev 595, 614–616. Article V was recently made the subject matter of an important English decision, *Dallah Estate and Tourism Holding Company v The Ministry of Religious Affairs, Government of Pakistan* [2010] UKSC 46. In that case, the Supreme Court held controversially that the court where enforcement was sought could rule on the competency of the arbitration contrary to the *kompetenz-kompetenz* doctrine. There, the Government of Pakistan had set up a trust which had entered into an arbitration agreement with Dallah. The ICC tribunal in Paris, France, decided that it had competency because the Government of Pakistan was the successor of the trust when the trust ceased operating. The Supreme Court disagreed with that finding. What is noteworthy in that case was not the disagreement over the question of capacity but the fact that the Supreme Court had interfered with the tribunal's own finding on competency or jurisdiction.

45 England and Wales, of course, may not apply pure common law principles where the EIR applies.

46 See Sentner, *Arbitration/Bankruptcy/Appeal: Where Rules collide* (2006) 7 Business Law International 12.

47 See Crozier, *Status of International Arbitration Awards under Canadian Insolvency Law* (1991) 18 Canadian Business Law Journal 18.

48 See Jones, *Recent Developments in International Commercial Arbitration* (2008) 11 International Trade and Business Law Rev 83.

49 See Soo, *External Impact on Arbitration: Company Insolvency on International Arbitration* http://www.hkiarb.org.hk/PDF/e_news_20060821_doc9.pdf; also *Re Sinom (Hong Kong) Limited* (HCMP73/2009, 5 August 2009); *Re Jade Union Investment Limited* HCCW 400/2003, 5 March 2004; *Re B+B Construction Company Limited (In Liquidation)* HCCW114/2001.

effect whilst insolvency proceedings carry on⁵⁰. The courts set up to deal with insolvency issues will have exclusive jurisdiction over all questions including those which would ordinarily be governed by the arbitral agreement. The law however makes an allowance where there is an international convention which might provide otherwise. In such a case, the *lex concursus* may allow the arbitration in a foreign country to proceed but even so, Spanish law will prevent any enforcement of an award made in these circumstances in its territory⁵¹. As one commentator says, “The new rules contained in the [Insolvency Act] shows the mistrust of the Spanish legislature towards arbitration agreements and proceedings, which are seen as a potential vehicle to defraud creditors and escape from the strict rules of insolvency proceedings”⁵².

In common law jurisdictions too, there seems to be a rise in the use of the public interest exception to restrain arbitrations where insolvency proceedings have been commenced in parallel.

In a recent decision from Singapore⁵³, for example, it was held by the Singaporean High Court that an application to stay insolvency proceedings in favour of arbitration could not be granted because the issue in question was about whether certain transactions were unfair preferences or transactions made at undervalue was one best left to the courts of law and not private arbitrations. The Singaporean jurisdiction is often perceived as pro-arbitration but in this regard, the Singapore High Court was swift to stress the importance of the public interest involved. The question which would have been referred to arbitration was specifically one about the insolvent’s assets and the court was thus disinclined to allowing it to go to arbitration. What is especially noteworthy in this case (the first of its kind in Singapore) is that the question was framed in terms of whether the matter was arbitrable. As far as the court was concerned, it was best placed to protect the creditor interest generally. It thus decided that it was contrary to public policy or the public interest⁵⁴ to allow the matter to be arbitrated once insolvency proceedings have commenced. It did not think it fit to allow the arbitral tribunal to decide on this issue of competency. This approach mirrors that in an Australian case, *New*

50 Art. 52(1).

51 Lopez Ortiz, “Spain: the new Spanish Insolvency Act and Arbitration” (2005) *International Arbitration Law Review* N22.

52 *ibid.*

53 *Petroprod Ltd (in official liquidation in the Cayman Islands and in compulsory liquidation in Singapore) v Larsen Oil and Gas Pte Ltd* [2010] SGHC 186.

54 The Singapore International Arbitration Act (Cap 143A) 2002 provides, in s 11(1), that that any dispute which the parties have agreed to submit to arbitration under an arbitration agreement may be determined by arbitration, unless it is contrary to public policy to do so.

*Cap Reinsurance Corporation Limited v A E Grant & Ors, Lloyd's Syndicate No. 991*⁵⁵.

In the common law system, generally, there is much responsibility vested in the judicial role to ensure the balance when there is a collision of rules in this context. Leave or permission from the courts will usually be required before an action may be taken in arbitration against a person who is insolvent. Although the common law world is usually assumed to be arbitration friendly, the public interest argument seems to be gaining increasing traction as an exception to arbitrability of disputes involving domestic and foreign insolvents. How and to what extent this would spread to the *Elektrim*-type situation (where arbitration had already been commenced) in the common law world makes for an intriguing question, noting of course that English position would only be guided by pure common law principles where the EIR does not apply (namely in a non-EU context).

V. The New York Convention

The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards⁵⁶ is the primary instrument relied on by modern states for the enforcement and recognition of international arbitration awards and agreements. The question as to the perceived conflict between the *lex concursus* and the *lex arbitri* might also be examined from the perspective of the convention rules. We know that the Convention lays down, in art II⁵⁷, certain exceptions when a court of law may refuse to recognise or enforce an arbitral agreement or award. There are two provisions in art II which pertain to an insolvency context. First, art II(1) provides that an arbitration agreement shall be recognised if it concerns “subject matter capable of settlement by arbitration”. Second, art II(3) provides that an arbitration agreement is enforceable unless the court finds the agreement itself “null and void, inoperative or incapable of being performed”. The Convention however leaves it to the courts seized to

55 [2009] NSWSC 62.

56 Supra n 43.

57 Art II reads:

“(1) Each Contracting State shall recognise an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration.

(2) ...

(3) The court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this Article shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed.”

decide what law governs the determination of these issues, including the reliance on applicable conflict rules.

It could thus be argued that the declaration of insolvency would exclude the subject matter of the liquidator's dispute from settlement by arbitration and the placing of the dispute into the hands of the insolvency tribunal exclusively. This is fairly uncontroversial as we have seen above. However the Convention is clearly less explicit when it comes to the situation where there is an arbitration pending and the party then becomes insolvent as is the case in *Elektrim*.

In the context of states which have made a "commercial dispute" reservation to the New York Convention, the implications when a party to the arbitration becomes insolvency can be especially interesting. Article I of the New York Convention allows contracting states to enter a reservation or limitation to the applicability of the Convention. Article I(3) states that,

"when signing, ratifying or acceding to this Convention, or notifying extension under article X hereof, any State may . . . declare that it will apply the Convention only to differences arising out of legal relationships, whether contractual or not, which are considered as commercial under the national law of the State making such declaration."

EU Member States which have made such a reservation are Poland, Romania, Hungary, Greece, Denmark, and Cyprus. China and USA are two important trading nations which have also made such a reservation. The question is namely this – when a company is liquidated does the relationship between the company and its counterparty in the arbitration change from commercial to a regulatory one? The issue was considered in a US case *Corcoran v Ardra Insurance Co*⁵⁸. The New York Appellate Division held that the dispute between the insurer (established in New York) and reinsurer (established in Bermuda)⁵⁹ was no longer of a commercial nature under art I(3) of the Convention once the insurer was liquidated⁶⁰. Before the court of appeals though,

58 77 N.Y.2d 225, 566 N.Y.S.2d 575 (1990), *cert denied* 111 S Ct 2260 (1991); commented on in Diaconis, *Corcoran v Ardra: The Impact of Insolvency on International Reinsurance Arbitration* (1992–1993) 28 Tort & Insurance Law Journal 109.

59 It might also be noted that both companies were owned by members of the DiLoretto family.

60 In the US, a court-appointed receiver (the Superintendent of Insurance) is authorised to either rehabilitate or liquidate a domestic insurer that meets the definition of "insolvency" as defined by Insurance Law § 1309.

Insurance Law §§ 7402(a), 7404: An order of rehabilitation directs the Superintendent to take possession of the property of such insurer and to conduct the business thereof, and to take such steps toward the removal of the causes and conditions which have made such proceeding necessary as the court shall direct.

Insurance Law § 7403(a): Should the Superintendent determine that attempts to rehabilitate a distressed insurer would be "futile," he may apply to Supreme Court for an order of liquidation.

it was held that the nature of the relationship between the two entities should be determined at the inception of the agreement and not at the time enforcement of rights and obligations are being sought. Thus, the dispute was a commercial dispute because there was a commercial relationship which gave rise to the dispute.

However, the subject matter was not one which was capable of settlement by arbitration when the nature of the commercial relationship changed. Judge Simons⁶¹ said:

As a result of Nassau's insolvency, and plaintiff's substitution to liquidate its assets, the contractual parties and their relationship have changed. Nassau no longer exists. Plaintiff steps into its shoes, in the sense that he succeeds to its property, but he is a fiduciary, appointed by the court, subject to its exclusive jurisdiction and possessing only the powers authorized by the Legislature. . . . He holds office as liquidator solely to protect the interests of policyholders, stockholders and the public and has no authority to pursue the commercial interests which motivated the original parties to conclude the reinsurance agreements (. . . see, *Matter of Knickerbocker Agency [Holz]*, 4 N.Y.2d 245, 250, (1958))⁶²

It is submitted that the decision on art I(3) by the court of appeals is preferable to that of the Appellate Division. It is surely correct that the nature of dispute in question needs to be referred to the nature of the contract at the time when it was made. On whether the change in legal status (following the liquidation) incapacitating the dispute from being settled by arbitration, the reasoning though understandable is more controversial. The issue of legal status might remind us about the Swiss decision on Elektrim but there is one notable distinction – in *Corcoran*, the court went a little further in holding that the lack of capacity meant that the dispute was incapable of being settled by arbitration under art II(1).

In *Corcoran v Ardra*, the appellate court also held that the Superintendent (state appointed liquidator) was not empowered to arbitrate under the law of the New York (*lex concursus*) – art V, it might be recalled provides that recognition and enforcement may be denied if “the subject matter of the difference is not capable of settlement by arbitration under the law of that country”. The practical implications as consequence of the New York Convention would be that as the party was seeking to arbitrate and then enforce the award

Insurance Law § 7403(c): Such order directs the Superintendent to take possession of the property of such insurer; liquidate its business, deal with such property and business of such insurer; and give notice to all creditors to present their claims.

Insurance Law § 7405(a): An order of liquidation terminates the distressed insurer's existence, and the Superintendent for all practical purposes takes the place of the insolvent insurer.

61 Judge Simons' judgment was approved by all seven justices who heard the appeal.

62 See section III of the report.

in New York, the whole arbitration would have been futile because the award would have been unenforceable in New York.

Although the court of appeals recognised that in the interest of international comity the foreign arbitration should be allowed to take place, the court felt that there were many factors which rendered the circumstances more akin to those of a domestic rather than transnational case. For one thing, the parties were both owned by individuals who were US residents. For another, the underlying contracts were expressed to be governed by New York law. Thus, the case was not one involving “an international merchant [being] subjected to unfamiliar judicial proceedings and the vagaries of foreign law requiring [the US court] to exercise a ‘sensitivity to the need of the international commercial system for predictability in the resolution of disputes’”⁶³. Hence, although the reinsurance agreements fell within the broad terms of the New York Convention, the party concerned was excused from arbitration because the arbitration clause and the dispute alleged to be subject to it were not capable of performance and settlement under the law of New York. There was interestingly no explicit discussion about whether the *lex concursus* or *lex arbitri* would permit the arbitration to proceed in a case of insolvency.

On the argument that when the liquidator assumes control over the company there was no longer a dispute which could be settled by arbitration, it might be said that that ignores the fact that the liquidator’s rights are consistent with the insolvent’s⁶⁴. Even if the liquidator by stepping into the shoes of the insolvent has become a fiduciary, it does not mean that he loses the responsibility the company has in respect of the original contracts. It is also difficult to see how going to arbitration would undermine the liquidator’s legal duty to protect the interests of creditors, shareholders and the general public. Moreover, if the insolvency does not convert the commercial relationship to a regulatory relationship, neither should the intervention of the liquidator change the arbitration provisions of that commercial relationship.

The New York court of appeals also seems to have a problem with relinquishing control over the insolvency to arbitrators. Judge Simons said:

“Arbitrators are private individuals, selected by the contracting parties to resolve matters important only to them. They have no public responsibility and they should not be in a position to decide matters affecting insureds and third party claimants after the contracting party has failed to do so. Resolution of such disputes is a matter solely for the Superintendent, subject to judicial oversight, acting in the public interest.”⁶⁵

63 *Mitsubishi Motors Corp. v Soler-Chrysler-Plymouth, Inc.*, 473 US at 629; also *Cooper v Ateliers De La Motobecane, S.A.*, 57 NY2d at 410–411.

64 *Supra*, n. 58 at p 131.

65 See Section III of the report; or 566 N.Y.S.2d at 579.

The judge was concerned over allowing arbitrators to assume a role which might result in the loss of judicial control of the distribution of the insolvent's assets. Perhaps such a rationale was also behind the Swiss decision in *Elektrim*. Whilst it is outside the purview of this article to consider empirically how valid this hostility towards arbitration is, it is obvious that until the courts recognise that supporting arbitration is not the loss of judicial control⁶⁶ the tension between insolvency and arbitration will remain. This thus remains a cultural issue for many countries.

Despite the legal controversies, it also seems clear that the court was swayed by the fact that other than comity, there were other principles at play – “economy, convenience, and fairness”⁶⁷. The decision not to allow the arbitration to proceed was largely based on the fact that the award would subsequently be sought to be enforced in New York.

In this light, it follows thus that situations where insolvency and arbitration collide, there are also issues (especially for the pragmatic courts of the common law world) about recognition and enforcement of the arbitral award which was subsequently made if the arbitration agreement is enforced despite the party's insolvency.

VI. A way forward as regards art 15

Returning to the EU context, what is crucial to bear in mind is that the debate as to the scope of art 15 is not about how the substantive legal issues arising from the insolvency proceedings should be resolved. The issue at hand is essentially procedural. It has to do with stay of proceedings, *vis attractiva* and legal standing. These are matters therefore for the *lex fori* to deal with. To the contrary, the English Court of Appeal had, in essence, perceived art 15 as guiding the substantive applicable law. That seems to go against the trite rule of private international law that it should conventionally be the *lex fori* to assume jurisdiction over procedural matters.

It thus should follow that if the *lex concursus* permits the enforcement of arbitration agreements on insolvency, then it is up to the procedural law of the seat to determine the question. On the other hand, if the *lex concursus* invalidates the arbitration agreement then there is no question for the procedural law of the seat to attend to. The arbitral tribunal should find, in such an

66 It is after all permissible for the courts to intervene both before and after the making of an arbitral award.

67 Kears J, the presiding judge at the Appellate Division, citing *Carnegie-Mellon University v. Cohill*, 108 S.Ct. 614, at 621; 98 L.Ed.2d 720 (1988).

instance, that there was no “lawsuit pending” simply because the arbitration has ceased when the arbitration agreement was nullified by the *lex concursus*.

VII. Conclusion

It is all too easy to see the problem in *Elektrim* as a debate between those favouring a reading of the law which supports arbitration and those who do not. The controversy is much more nuanced than that. As we have seen in examples and judicial practice from a number of countries, most are keen to preserve sanctity of the arbitration agreement but at the same time not prepared to allow the assets of the insolvent to be dissipated and thus breach a cardinal rule of insolvency principle. The law, whether at common law, civil law or EU law, however does not always provide a satisfactory answer. Both the English and Swiss courts in *Elektrim* did not express a policy reason for their application of the law (be it the Regulation or Swiss national law). In contrast, the New York courts were careful to justify their decisions on the basis of pragmatic justice and an invocation of the distrust of arbitral processes to safeguard the insolvent’s estate.

The Regulation’s main aim is to ensure and promote a proper functioning of the internal market by ensuring that cross-border insolvency proceedings operate efficiently and effectively, and by avoiding “incentives for the parties to transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favourable legal position (forum shopping)”⁶⁸. It would appear that some Member States might construe this as a disinclination for the loss of control for the courts controlling the insolvency and as arbitration might be seen as derogating from this control, the English court’s approach in *Elektrim* would be deemed recalcitrant.

We have seen in this article the different ways different courts have attempted to deal with the conflict question. In the context of the Regulation, they have tried to reconcile art 4 with art 15 by using creative legislative interpretation techniques. They have also tried to rely on the public interest to vest control in the insolvency court. They are also not averse to using legal capacity of the place of incorporation to guide their decisions. There is also a hint of reliance on so-called notions of pragmatism. The legal tapestry is not seamless and there is no real consensus as to what should guide the shape of the principles. The conflict will thus remain not only as a source of irritation but also, an encumbrance for the efficient and effective operation of cross border insolvency proceedings.

68 See recital 4 of the Preamble.

Perhaps one way forward is to stick as closely as possible to the widely recognised convention in private international law where the law of the seat should decide procedural matters arising from insolvency proceedings but whether there is a lawsuit (or arbitration) pending is a question for the *lex concursus*.