INSOLVENCY ISSUES IN ARBITRATION IN A CROSS BORDER CONTEXT

INTRODUCTION TO THE ISSUES

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TERMINOLOGY USED

Insolvency

- Liquidation, bankruptcy (voluntary or compulsory)
- Re-organisation proceedings (i.e. legal insolvency)

Insolvent party

- Debtor, party subject to insolvency proceedings
  - i.e. company in liquidation, under administration, or personal bankrupt (as Claimant or Respondent)

Trustee

- Liquidator, administrator, receiver
SCENARIOS

• Claimant and Respondent **parties to an arbitration agreement**

• Claimant or Respondent **subject to insolvency proceedings**

  At different points in time “X”
WHY DOES INSOLVENCY INTERFERE WITH ARBITRATION? (1)

Different policy objectives:

**Insolvency**
- Equality of creditors:
  - Centralization of claims
  - Prohibition of individual claims
- Rescue of insolvent party
- State control

**Arbitration**
- Upholding arbitration agreement
- Certainty in commercial transactions
WHY DOES INSOLVENCY INTERFERE WITH ARBITRATION? (2)

Insolvency law (*lex concursus*)
substantive and procedural provisions:

- Rights and obligations of insolvent party/trustee
- Notification, filing and verification of claims
- Identification of assets
- Enforcement of securities
- Priority amongst creditors
- Fate of fraudulent transactions
- Fate of pending legal (including arbitral) proceedings

Impact on arbitration agreement and arbitral proceedings
WHY DOES INSOLVENCY INTERFERE WITH ARBITRATION? (3)

Arbitral Tribunal applies different national laws:

- Law of contract (dispute on merits as to performance and breach of contract)
- Personal law of the parties (legal capacity, authority?)
- Law of seat of arbitration
- Law of arbitration agreement
- (Possibly) law of (potential) place of enforcement

Where does insolvency law fit in?
HOW DOES INSOLVENCY INTERFERE WITH ARBITRATION? (1)

Potential impact of insolvency law
... on arbitration agreement

• Arbitration agreement entered into by insolvent party without approval of all creditors

• Arbitration agreement null and void *ipso facto* upon opening of insolvency

• Trustee opts out of arbitration agreement with approval of insolvency courts

• Arbitration agreement “inoperative” or “incapable of being performed” because no funds to arbitrate

• Arbitration agreement voidable and set aside by insolvency courts
HOW DOES INSOLVENCY INTERFERE WITH ARBITRATION? (2)

… on arbitral procedure
- No authority of insolvent party to commence / continue arbitration
- Insolvency courts issue “anti-arbitration injunction”
- Insolvent party requires stay of arbitration
- Trustee asks for time to review file / file submissions or wants to appoint new arbitrator
- Insolvent party cannot pay advance on costs
- Non-insolvent party applies for security for costs
HOW DOES INSOLVENCY INTERFERE WITH ARBITRATION? (3)

... on underlying claim
- Non-insolvent party’s monetary claim not arbitrable
- Order for payment of money against insolvent party prohibited

... on arbitral award
- Award against defaulting insolvent party
- Award contested by other creditors
- Claim not registered in the insolvency
HOW TO RECONCILE INSOLVENCY AND ARBITRATION? (1)

No obvious solutions because:

- Few international instruments
  - EC Regulation 1346/2000
  - Nordic Bankruptcy Convention
- Variety of national laws
  - Insolvency (UNCITRAL Model Law)
  - Arbitration
  - Private international law
- No uniform approach by state court
- No uniform approach by arbitrators
HOW TO RECONCILE INSOLVENCY AND ARBITRATION? (2)

Solutions adopted depend on:

• Characterisation of the issues
• Which law applies to the Arbitral Tribunal
• Parties’ good faith and requirements

In practice, in most cases arbitration can proceed but a pause is required
WHICH LAW APPLIES? (1)

Insolvency law will apply:

- If mandatory or part of public policy of law of the seat
  - Insolvency in country of the seat
  - Insolvency and seat in EU (EC Regulation) except when arbitration pending?
    - Judgement of insolvency recognised in country of the seat?
- If issue legal capacity?
- To satisfy due process and notice requirements

If non compliance

annulment and/or unenforceable award
WHICH LAW APPLIES? (2)

Insolvency law may apply:

• If law of the (possible) place of enforcement
• Not binding
• But should not be ignored
  – Duty to render an enforceable award?
  – Duty of professional diligence

if non compliance

unenforceable award
CHECK LIST
For arbitrators

• Pause to consider impact of insolvency
• Assess what insolvency law really provides

• Check authority
• Notify Trustee
• Identify potential issues
  – Applicable law(s)
  – Validity of arbitration agreement
  – Procedural issues for both parties

• Even if insolvency law not binding, assess
  – Parties’ good faith
  – Parties’ interests
  – Parties’ requirements
  – Impact on enforcement
CHECK LIST
Counsel for the non-insolvent party

- Impact of insolvency on:
  - Arbitration
    - Authority of insolvent party
    - Capacity
    - Validity of arbitration agreement
  - Creditor’s claim
    - Enforcement
    - Advantage of insolvency proceedings
    - Procedural requirements

- Steps required in arbitration
  - New relief
  - Stay
  - Security for costs
CHECK LIST
Counsel for the insolvent party

• Power of representation
• Legal costs covered
• Impact of insolvency on arbitration:
  – Authority to start / continue
  – Capacity
  – Validity of arbitration agreement
• New arbitration
  – Advance on costs
• Pending arbitration
  – Notification
  – Stay
  – Composition of Tribunal
  – Time to file new submissions
THANK YOU

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