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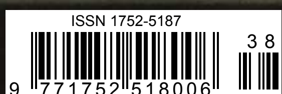

Insolvency *vs.* Arbitration: The ch

Attorney George B. Bazinas examines issues with arbitration, cross-border insolvencies and the risks of forum shopping

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Introduction

This article examines the consequences of the insolvency of a party to a pending arbitration. In particular, it considers the allocation of jurisdiction to govern arbitration agreements with emphasis on cases within the scope of the EIR. Reference is made to the recent rulings of the Court of Appeals in London and the Swiss Supreme court involving the French company Vivendi. Finally, the article highlights the risk of forum shopping in the context of insolvency to avoid an unfavourable arbitral award and the risk of negating the benefits of arbitration.

Crisis, crisis, crisis

Crisis is the word of the day, month, year or even of a considerable period to come according to the more pessimistic conjectures. It has inevitably lead to an increased number of insolvency petitions, testing the reflections of cross border cases as well as national legislation in dealing promptly and efficiently with the challenges pertinent to the financial default of legal entities. One of the current matters that courts have been asked to consider is the effect of insolvency proceedings on a pending arbitration. In a recent case involving the French company Vivendi, two different venues – one applying the EIR and the other conflict of law rules – have issued decisions which highlight the challenges in the operation of arbitration in the current economic environment.

Arbitration

In 2001, Vivendi entered into a Third Investment Agreement (TIA) with Elektrim S.A., a Polish company and owner of a substantial shareholding in *PTC*, a Polish mobile telecoms company. The TIA contained an agreement to arbitrate in London under the LCIA rules. The contract was governed by Polish law and the arbitration agreement was subject to English law. On 22 August 2003 Vivendi commenced arbitration proceedings claiming damages in excess of €1.9 billion for breach of a contractual obligation, arguing that Elektrim had failed to secure the interest that Vivendi was to obtain in *PTC*. However, on 21 August 2007, following a voluntary petition, Elektrim was declared bankrupt by the Warsaw District Court and moved to discontinue the arbitration proceedings based on a Polish law rule which provides that an arbitration clause concluded by the bankrupt has no legal effect upon the inception of insolvency. Elektrim contended that the tribunal did not have jurisdiction to determine the matter and petitioned for the termination of the arbitration proceedings.

The tribunal ruled that Polish law provisions do not affect its capacity to decide the dispute between the parties and upheld its own jurisdiction. Thereafter, Elektrim made an application to

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the High Court in London to set aside the award on the same basis. This was rejected by Justice Christopher Clark who ruled that the tribunal was correct in finding that English and not Polish law was the relevant law to apply[1]. Considering that there is no similar provision in English law preventing the arbitration the Judge permitted the award. Elektrim appealed the decision and the matter was then taken to the Court of Appeals.

The outcome of the case was particularly important for all parties given that the tribunal had awarded damages to Vivendi Universal S.A. in the amount of €1,670,180,000 and €38,971,000 as well as €166,871,000 and €600,000 to Vivendi Telecom International S.A. However, besides the significance of the judgment for the parties, this is potentially a very important case on the interrelationship of cross border insolvency proceedings and arbitration. The key issue was whether, in cases within the ambit of the EIR, the *lex fori concursus* will take precedence over the *lex arbitri* when the conclusion of the arbitration agreement and/or the opening of arbitration is antecedent to the declaration of bankruptcy. To decide the question the court had to consider the borders and limits of articles 4 and 15 of the EIR.

Elektrim contented that an agreement to arbitrate falls within the definition of a current contract and therefore according to articles 4(1) and 4(2)f of the EIR the effect of insolvency on current contracts is determined by the *lex causae*. According to the appellant, the continuance of arbitration proceedings depends on a valid arbitration agreement which in this case was governed by Polish law. This has, therefore, led to the argument that it has the effect of moving the case *"from the choice of law rule specified in article 15 into the territory covered by the general rule under article 4 (1)"* [2]. Therefore, since the arbitration agreement is void as of the day Elektrim was declared bankrupt by the Warsaw court, the tribunal has no jurisdiction and the award ought to be disregarded.

The court however took a different view. It accepted that an existing reference to arbitration is a pending law suit and therefore falls within the provisions of article 15 which reserves jurisdiction for the *lex situs*. The EIR does not make an express reference to arbitration but the court reasoned that if the Council intended to distinguish arbitration from civil litigation it could have easily used appropriate language. The court found guidance on the *Virgos-Schmit* report and on leading scholars which have taken the view that the wording of article 15 is broad enough to include arbitration proceedings[3]. Therefore, the court was not convinced that the EIR intended for a different law to apply to the arbitration agreement which is therefore governed by the *lex arbitri*[4].

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> "domestic law provisions and the views of different jurisdictions could disrupt the role of both insolvency and arbitration proceedings"

A case involving the same parties and on very similar facts was brought almost simultaneously before the Swiss courts. *Vivendi* commenced a second arbitration, this time in Geneva to settle a dispute arising from a settlement agreement with Elektrim over the ownership of shares in the Polish mobile telecommunications company. A few months into the arbitration, Elektrim was declared insolvent and, like in the case of the London arbitration, requested the tribunal to terminate the proceedings on the basis of the abovementioned Polish bankruptcy law provision. This time the tribunal found in favour of Elektrim on the grounds that the capacity of a Polish incorporated company to be a party to arbitration proceedings was solely governed by Polish law.

The case went all the way to the Supreme Court following Vivendi's petition to appeal the tribunal's interim award to terminate the arbitration[5]. Given that the EIR does not apply to Switzerland, the court had to rely on principles of private international law to determine whether the tribunal was correct in issuing and award for the termination of proceedings. The court acknowledged that although there are provisions in the Swiss arbitration law on the effect of foreign legislation regarding the capacity of sovereign entities to continue arbitration proceedings, these did not apply to non-sovereign entities. It therefore found guidance on articles 154 and 155 of the Swiss Private international Law Act which states that the capacity of an entity to act is governed by the law of its place of incorporation. Elektrim was duly incorporated in Poland. Consequently, by virtue of Polish law, the Supreme Court ruled that arbitration proceedings had to be discontinued.

Conflicting judgments

The above two cases do not merely demonstrate the possibility of having conflicting judgments on similar facts. After all, the London Court of Appeals and the Swiss Supreme Court did not apply the same legislation. However, it is an indication of how domestic law provisions and the views of different jurisdictions on the scope and operation of arbitration could disrupt the role of both insolvency and arbitration proceedings. A different decision by the Court of Appeals could have possibly operated as an incentive to forum shop. For example, in cases where a party to arbitration is facing an unfavourable award it could file for insolvency in a venue based on the expectation to take advantage of provisions like article 142 of the Polish bankruptcy law. However, the EIR explicitly prohibits venue selection practices. In addition, there has been a plethora of judgments on the interpretation of COMI on which national courts could find guidance to reject such applications in cases of manufactured forums. Nevertheless, a claim for €1.9 billion is arguably a strong incentive, especially when coupled with the problems inherent in the EIR in relation to jurisdiction allocation in cases of complex corporate group structures.

Moreover, following the Swiss court's decision, the validity of Vivendi's claim could not be ascertained by the Geneva tribunal and would most likely be determined, in the course of the insolvency proceedings, by the competent Polish court. Therefore, parties will have to incur additional expenses in defending their case, money that will come from the debtor's estate and the creditor's funds. Furthermore, the case will not be heard by a specialised tribunal to the jurisdiction and expertise of which parties have voluntary agreed to be subjected to. Moreover, this has the prospect of creating additional workload for domestic commercial courts, not the best development during times where the court dockets abound with insolvency petitions.

The effect of the above two cases is not only limited to insolvency proceedings. For instance, if the *lex concursus* does not allow an insolvent debtor to initiate or continue arbitration proceedings, and the *lex arbitri* accepts this consequence this would mean that the conclusion of future arbitration agreements would require a considerable amount of researching. Parties will have to conduct extensive due diligence on the existence of possible links with jurisdictions having similar provisions, or others that have not yet surfaced, which could potentially lead to an invalidation of the arbitration agreement or the annulment of the proceedings. This would turn an arbitration agreement from a more or less standard contractual clause to a lengthy procedure depriving it from one of its main advantages which is the certainty of the parties that future disputes will be determined by their tribunal of choice. This is manifestly crucial especially in cases of cross-border transactions which have little understanding of local laws and procedures.

Finally, *Vivendi* is not merely a decision on jurisdiction allocation. It also brings at the forefront the pressing need to institute changes at national level so that domestic laws reflect the spirit of the EIR and assist its *modus operandi*. It is up to member states to ensure that national legal codes protect the position of parties who relied on the applicability of a different legal code and not set the framework for the development of venue selection practices, which in this case infringe the provisions of the EIR but also hinder the role and operation of arbitration, especially in the current global recession environment where financial default and arbitration are bound to co-exist.

Footnotes

1. Elektrim SA v Vivendi Universal SA [2002] 2 LLR 8.
2. Syska & Anor v Vivendi Universal S.A. & Ors [2009] EWCA Civ 677, para. 31.
3. M. Virgos & F. Garcimartin, 'The European Insolvency Regulation: Law and Practice, Kluwer Law International, 2004, para. 261, p., 142.
4. Syska & Anor v Vivendi Universal, para. 33.
5. Decision 4A_428/2008 dated 31 March 2009-unpublished.