Cross-Border Insolvency and International Commercial Arbitration

Characterisation and choice of law issues in light of *Elektrim S.A (in bankruptcy) v Vivendi S.A*

*Mark Robertson*

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Supervisor 1: Dr. Stefan M. Kröll
Supervisor 2: Professor Clifford Larsen.
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Mark Robertson
Wellington
New Zealand.

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INTRODUCTION

This paper addresses the effects that insolvency of a party to an arbitration agreement may have on a pending international arbitration in a cross-border context. In particular it is concerned with what, if any, attention an arbitral tribunal seated in one country must pay to the corporate insolvency laws of another country that are applicable to a party to a pending arbitration when insolvency proceedings are opened against that party. Conflicting decisions on the continuation of pending arbitration proceedings in Switzerland and the United Kingdom, both involving the insolvency of Elektrim S.A under Polish insolvency law has given rise to two important issues. The first is how foreign law rules that arguably affect capacity of the insolvent party and its ability to be bound by the arbitration agreement should be characterised by the arbitral tribunal. The second issue, important for European Union member states, is whether or not the choice of law rules set out in Article 4 of the EC Regulation on Insolvency 1346/2000 are mandatory and override ordinary choice of law rules in a pending arbitration proceeding.

Part I provides a brief overview of the major differences in objectives between international arbitration and corporate insolvency laws. Part II provides a summary of the general effects that insolvency laws in different jurisdictions may have on arbitration proceedings seated within that jurisdiction, in particular looking at the effects of mandatory stays on legal proceedings. Part III identifies the problem of recognition and effect of foreign insolvency laws on the pending arbitration in a cross border context from the perspective of the arbitral tribunal as a choice of law problem and discusses the particular issues that can arise when a party’s capacity is affected. Part IV introduces the European Union Insolvency Regulation 1346/2000 (‘the Regulation’). The characterisation and choice of law questions outlined above are examined in light of the Elektrim decisions. Part V briefly discusses enforceability issues that arise in light of the general movement in insolvency practice towards universal recognition of insolvency proceedings opened in a foreign country as provided for in the Regulation and the UNCITRAL Model Law on Cross Border Insolvency.
PART I – INTERNATIONAL COMMERCIAL ARBITRATION AND INSOLVENCY PROCEEDINGS

1. Comparison of main features of International Commercial Arbitration and Insolvency

1.1. International commercial arbitration is a dispute resolution mechanism that utilises private rather than governmental decision makers who are tasked with deciding the merits of disputes between parties who have agreed to arbitrate and with rendering a binding and enforceable arbitral award. The international arbitration system is designed and intended to enable parties to an arbitration agreement to resolve disputes that arise between them in a fair and efficient manner. It does so by allowing the parties the flexibility to decide upon the procedures that are suitable for a particular type of dispute in a particular legal context and by ensuring, in most cases, that parties are bound by their agreements to arbitrate and that arbitral awards are enforceable.

1.2. Insolvency laws, on the other hand, are designed to address the collective satisfaction of the outstanding claims from assets of the debtor when the debtor cannot meet its financial obligations as they fall due. Opening of insolvency procedures will often affect the capacity of the debtor and its pre-existing rights and obligations with respect to third parties. It will also affect third parties’ rights with respect to the debtor or the debtor’s estate.

1.3. A fundamental and defining feature of international arbitration is that it is consensual in nature and generally applies only to the parties to the agreement. Consequently, the arbitral tribunal derives its jurisdiction to decide and determine issues between the parties from the arbitration agreement. For this reason the

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3 United Nations Convention on Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention), 1958, Article II.
arbitral tribunal only retains its jurisdiction if the agreement to arbitrate is and remains valid, operative and capable of being performed.\(^7\)

1.4. The New York Convention is of particular importance to the International Arbitration system and is given effect in each Contracting State through national arbitration legislation, which in turn, in most Contracting States has resulted in a ‘pro-arbitration legislative frameworks which grant arbitral institutions, arbitrators and the parties broad autonomy to conduct the arbitral process in such a way that will give effect to arbitration agreements and awards.’\(^8\) There is a strong tendency in modern arbitration practice to limit the impact of parochial domestic legislation that affects the validity of arbitration agreements.\(^9\) Most contemporary arbitration legislations tend to limit judicial intervention in arbitral proceedings, with such intervention being reduced to supporting and assisting the arbitral process and ensuring basic procedural principles and matters of (manifest) public policy are upheld.\(^10\) The result is a system that allows many commercial disputes to be resolved privately in a relatively borderless manner,\(^11\) that largely suits the needs of the dispute resolution needs of the international business community and in the majority of cases allows arbitral awards to be successfully enforced.

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\(^7\) Article II(3) United Nations Convention on Recognition and Enforcement of Foreign Arbitral Awards (‘the New York Convention’), 1958; See also, for example, Article 6(4) of the current (1998) ICC Rules provides: “Unless otherwise agreed, the Arbitral Tribunal shall not cease to have jurisdiction by reason of any claim that the contract is null and void or allegation that it is non-existent, provided that the Arbitral Tribunal upholds the validity of the arbitration agreement.”.


\(^9\) Born, Gary B., *International Commercial Arbitration*, Kluwer Law International, The Netherlands, 2009, p 566, 410-411; Ledée v. Ceramiche Ragno, 684 F.2d 184, 187 (1st Cir.) (1982), ‘The parochial interests of the Commonwealth, or of any state, cannot be the measure of how the “null and void” clause is interpreted. Indeed, by acceding to and implementing the treaty, the federal government has insisted that not even the parochial interest of the nation may be the measure of interpretation. Rather, the clause must be interpreted to encompass only those situations such as fraud, mistake, duress and waiver’. See also, Rhone Mediterranee Compagnia Francese Di Assicurazioni E Riassicurazioni v. Achille Lauro, 712 F.2d 50, 53-54 (3d Cir.) (1983). For a contrasting view in the context of insolvency see Canada (Attorney General) v. Reliance Insurance Company, 2007 (2007) 87 O.R. (3d) 42, Ontario Superior Court of Justice.


1.5. On the other hand, insolvency laws have, up until recent times, remained primarily territorial in nature, having effects only within the boundaries of the state of opening of the proceedings, and subject to the parochial interests of individual states.¹²

1.6. Unlike international arbitration, insolvency is a collective action that must strike a balance and choose between many competing interests rather than a private dispute resolution mechanism involving only the parties to an arbitration agreement.¹³ When a company is insolvent a range of parties’ interests need to be taken into consideration. These include the debtor, the owners and management of the debtor, secured and unsecured creditors including tax agencies, employees, guarantors of debt and wider social and political considerations.¹⁴

1.7. Fundamental objectives of insolvency law include preservation of the insolvent estate’s assets, ensuring equal treatment of creditors that are in the same class and efficient collection and distribution of assets.¹⁵ These objectives are achieved through centralised control over the insolvency proceedings and other individual creditors’ actions. As a result, when a corporation enters insolvency, private individual rights are often subjugated to the greater needs of the collective administration of the insolvent estate according to the applicable insolvency law.¹⁶

1.8. Accordingly, the issue of most relevance in pending international arbitrations is the effect that insolvency of one party to an arbitration agreement has on the continued validity and operability of the arbitration agreement and the arbitrator’s jurisdiction and, consequently, on the enforceability of any award rendered by the arbitral tribunal against the assets of the insolvent estate.

2. Current trends in insolvency and global economic downturn

2.1. The World Trade Organisation Quarterly Merchandise Export Developments report indicates that there has been a sharp decrease in the level of global exports in 2008 and the first quarter of 2009. Nearly all gains in world exports since 2005 have been lost in the past 9 months, as is shown in the following graph:  

![Quarterly world merchandise export developments, 2005-09](http://www.wto.org/english/res_e/statis_e/quarterly_world_exp_e.htm)

2.2. In the current economic climate, the number of arbitration agreements and proceedings affected by insolvency issues can be expected to increase as parties are unable to meet their obligations as they fall due. Inevitably the numbers of arbitrations affected by the insolvency of one party to the arbitration agreement is likely to increase as a result of the current economic downturn.

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18 Statistics from the United Kingdom, for the first quarter of 2009 indicate that compulsory liquidations have increased by 56% and voluntary liquidations have increased by 62.5% on the same period in 2008. [http://www.insolvency.gov.uk/otherinformation/statistics/200905/index.htm](http://www.insolvency.gov.uk/otherinformation/statistics/200905/index.htm), last visited 15 June 2009.
PART II – OVERVIEW OF EFFECTS OF INSOLVENCY OF A PARTY ON ARBITRAL PROCEEDINGS

3. General issues that arise when a party to an arbitration proceeding is declared insolvent

3.1. Insolvency of one party to an arbitration agreement can affect the arbitration agreement and arbitral proceedings in a number of ways. The precise effect will vary depending on the applicable law. Often insolvency results in the total or partial divestment of the corporation's assets and court supervised control over the insolvent estate. Insolvency laws may affect the capacity of the insolvent corporation to be party to previously concluded arbitration and other contractual agreements, the capacity of the insolvent corporation to enter into new arbitration agreements, it will determine who has the right of the manage assets in the insolvent estate, the power of the trustee, liquidator or other similarly situated person to avoid or enter into arbitration agreements and other contracts, the capacity or right of the insolvent corporation to remain a party to pending arbitral or court proceedings and whether or not such proceedings are automatically stayed or allowed to continue. Depending on the law applied, these differences can have important implications for enforceability of the arbitration agreement and arbitral award under the New York Convention. In particular, issues arise under Articles II(3), V(1)(a), V(1)(b), V(1)(d) and V(2)(b). To explain how one common feature of insolvency laws may affect arbitrations in different ways a comparative overview of the effects of a mandatory stay on legal proceedings is set out below.

4. Comparative overview of effects of a mandatory stay of legal proceedings on arbitrations seated within jurisdiction of the bankruptcy court

4.1. A mandatory stay on individual creditors ‘enforcement’ actions intended to prevent seizure of assets is a fundamental principle of insolvency law and is common to most, if not all, legal systems. This rule serves the purpose of preventing piecemeal

19 For a comparative overview of international insolvency law amongst the 4 major (English common law, American common law, Napoleonic and Roman/Germanic civil law) and 4 minor legal systems see, Wood, Phillip R, Principles of International Insolvency, 2nd Ed, Sweet & Maxwell, London, 2007.
and premature disbursement of the assets of the estate. On the other hand, a mandatory stay on legal proceedings generally, which has been held in a number of cases in common law jurisdictions to includes arbitration proceedings, is less uniformly prevalent and the effect on arbitration of these statutory stay provisions varies amongst the major legal systems' insolvency laws.

4.2. The distinction between the enforcement actions and legal proceedings generally is summarised by Virgós/Garcimartin as follows:

‘…In the first case, the creditor satisfies his interests directly. In the second case, he obtains a decision on the merits which does no more than allow him to join the body of creditors with an established claim.’

4.3. Professor Wood notes that a general stay on all legal proceedings serves a wider purpose than a stay on individual creditors’ actions and is “intended to ensure that litigation is centralised at the insolvency forum” which is otherwise scattered under contract forum selection clauses. It also minimises the expense of litigation by replacing litigation proceedings with an admission of claims process that provides for equal treatment of creditors in the same class. There is no reason to exempt arbitration proceedings from this rationale.

4.4. In many common law jurisdictions, with the exception of Australia, all proceedings, including arbitration proceedings, are stayed and the stay remains operative until leave of the court is granted to lift the stay or, in some jurisdictions, permission of

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22 Canada: see s 21 Winding Up and Restructuring Act; Hong Kong, see s 181(b) Companies Ordinance; England: see s 130(2) Insolvency Act 1986; Lazić, Vesna, Insolvency Proceedings and Commercial Arbitration, Kluwer Law International, The Hague, 1998, p 251; United States of America: see s 362(a) of the Bankruptcy Code; New Zealand: see s 248(3) Companies Act 1993; India: see s 446 Companies Act 1956; Australia: In Australia current the position is different than other common law jurisdictions as the wording of s 440D and 471B Corporations Act 2001 refers only to a 'court' and not to 'legal proceedings'. 'Court' has been interpreted not to include arbitral proceedings - Auburn City Council v Austin Australia Pty Ltd [2004] NSWSC 141 – whether this case will be followed in future remains to be seen; France: see article 47-48 loi du 25 janvier 1985 Art 1465 NCPC; Germany: Art 12 KO, Art 240 ZPO; Switzerland: see Art 207 I.P.
27 See fn 22 above; Auburn City Council v Austin Australia Pty Ltd [2004] NSWSC 141
the liquidator is obtained to initiate or continue legal proceedings. Wilful violation of the stay may result in contempt of court fines and damages. However, the stay is usually territorial in nature and is not intended to apply to proceedings in foreign courts. Similarly, the stay has no extraterritorial effect on foreign arbitrations until the insolvency proceeding is recognised by the state at the arbitral seat or by the arbitral tribunal. The court has a wide discretion to lift the stay on legal proceedings and will take into account a range of factors which, broadly stated, aim to determine whether any circumstances exist that make it necessary for the legal proceeding to continue, for example, whether the relief requested would result in timely and relatively efficient partial or complete resolution of the issues between the parties and whether the issues can be dealt with more appropriately in arbitration rather than bankruptcy proceedings. Stays will often be lifted in cross-border international arbitrations, particularly if insolvency occurs at a late stage of proceedings, as arbitration is the most appropriate forum to resolve the merits of the dispute between international parties. There is little point re-litigating the merits of the dispute in the bankruptcy court.

4.5. In France legal proceedings are automatically stayed, however, once the creditors’ representative is notified, the proceedings may be continued without further approval. Once insolvency proceedings are opened against one party the arbitration tribunal can only render a declaratory award and cannot order the insolvent estate to pay from its assets. A breach of these rules in France has been held to be a breach of domestic and international public policy providing grounds for setting aside an

28 See fn 22 above; see also for example, CIR v H & P Developments Limited 29/11/06, Associate Judge Gendall, HC Wellington, New Zealand, CIV-2006-485-2222
30 Re Vocalion (Foreign) Ltd [1932] All ER 519.
arbitral award pursuant to Article V(2)(b) of the New York Convention. In Germany, there is some debate as to the applicability a mandatory stay on arbitration proceedings, with the prevailing view that arbitral proceedings are suspended only for a time necessary for the liquidator to review the file and prepare its defence, after which the arbitration may continue. In Switzerland, a similar view has been expressed. In Spain, arbitration agreements to which the debtor is a party will have no value or effect for the duration of the insolvency proceedings, however, arbitrations pending at the date the insolvency is declared will normally be continued until the award becomes final.

4.6. In some jurisdictions the arbitration agreement itself is either void by operation of law or the jurisdiction of the arbitrator is invalid upon the insolvency of one of the parties. For example, in Italy the arbitration is suspended and the dispute must be referred to the bankruptcy court, which excludes the power of the arbitrators. The position in the Netherlands is similar. In Latvia, Civil Procedure Law, Article 478(8) provides that disputes “regarding the rights and obligations of persons that have been declared insolvent before the making of the award by the arbitral tribunal” are not arbitrable.

In Poland, Article 142 of the Polish Bankruptcy and Reorganisation law provides, ‘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.’ Born argues, referring to the wording of the Latvian rule, that ‘Properly analyzed, this type of legislation involves the capacity of the (insolvent) party, with local legislation withdrawing from that party a legal capacity which previously existed.’ This issue is discussed further in Part IV.

Numerous authors have commented on these and other issues in detail from the perspective of particular national legal systems. Each of these commentaries analyses the effects from the perspective of the chosen national insolvency law that is presumed to apply, for example when both the insolvent party is organised and the arbitration is seated within the jurisdiction of the applicable insolvency law, but few authors attempt to assess the cross-border effects of insolvency on a pending arbitration or the appropriate choice of law rules that should be applied by the arbitrator or a national court at the seat of the arbitration when insolvency proceedings are opened against a party to the pending arbitration proceedings in a foreign state. Little attention has been given to the effects that legislation such as the European Insolvency Regulation (1346/2000) and the UNCITRAL Model Law on Cross Border Insolvency have on these issues.

PART III – EFFECT OF INSOLVENCY ON ARBITRATION PROCEEDINGS IN A CROSS BORDER CONTEXT

5. A choice of law problem

5.1. Whether or not an arbitral tribunal must give effect to any of the national laws mentioned in Part II is fundamentally a choice of laws problem. As pointed out by Laurent Levy, the preliminary question for the international arbitrator is not whether national bankruptcy laws should impose a stay of proceedings or invalidate the arbitration agreement. It is whether the arbitrator must observe the insolvency law applicable to the insolvent party and whether arbitrator continues to have jurisdiction to proceed with an international arbitration.

5.2. To put this problem in context: Two separate companies Company 1 and 2 are incorporated in Country A and Country B respectively. They enter into a contract to build a large construction project in Country C. The contract includes an arbitration clause to arbitrate any dispute arising out of or in relation to the contract. The

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arbitration clause stipulates the arbitral seat will be located in country D and the arbitration will be conducted according to a specified set of institutional arbitral rules (say ICC). The substantive law applicable to the contract is the law of Country C due to the construction project being built there. As is common for arbitration agreements, the agreement is silent on the applicable procedural law or the law to be applied to the arbitration agreement itself. Due to problems at the construction site Company 1 and Company 2 fall into dispute. Company 2 invokes the arbitration clause and arbitration is commenced in Country D. Both parties invest heavily in legal representation. Each fights tenaciously for their respective beliefs in the strength of their legal or moral positions. The arbitration continues for over a year, perhaps two or more. Unfortunately, in the interim, the world economy has taken a turn for the worse and Company 1, due to lack of available credit, can no longer met its obligations as they fall due. As a result, Company 1 is declared insolvent by the court in Country A where it has its registered office and centre of main interest. Country A’s laws purportedly terminate or stay all legal proceedings.

5.3. In such a situation the arbitration tribunal sitting in Country D is faced with the following questions: Is the arbitrator required to recognise the effects of Country A’s insolvency laws and can the arbitral proceeding continue? If the arbitral proceeding can continue, how should it proceed so that any award rendered is enforceable?46

5.4. It is widely accepted that under most institution rules the arbitrator has the jurisdiction to determine the effect that such laws may have on the validity of the arbitration agreement and the arbitrator’s jurisdiction to continue with the proceeding.47 Ordinarily jurisdictional decisions will be made at first instance by the arbitrator. In a situation as described above, amongst other things, the arbitrator will be conscious of the time and expense already expended in the arbitration by the parties and will not wish to delay or deny one party of the effect of the arbitration agreement and the benefit of an award because of the insolvency of the other party, particularly if the insolvency was voluntary and occurred at a late stage in the arbitral proceeding.

46 An arbitrator has a duty to make best efforts to render an award that is enforceable. See Article 32.2 LCIA Rules; Article 35 ICC Rules; see also Moses, Margaret L. The principles and practice of international commercial arbitration, Cambridge University Press, Cambridge, 2008, p 79-81.
5.5. It is well accepted in international arbitration that different laws can apply to govern the substance of the underlying contract, to the arbitration agreement itself, to the internal and external procedure of the arbitration and to the choice of law rules applied. The parties are generally, within limits, free to choose which law to apply to each of these aspects but frequently only agree upon the substantive law applicable to the underlying contract and the arbitral seat. In absence of express choice of law by the parties, the arbitrator is faced with a complex problem of deciding which choice of law rules to apply to determine the separate issues raised by the insolvency of one of the parties to the arbitration agreement.

6. Particular relevance of personal law

6.1. An additional, important and separate consideration is the personal law applicable to the parties themselves. The personal law of a party will determine its capacity to enter into arbitration agreements and, consequently, its ability to be a party to arbitration proceedings. It may also affect the operability of the arbitration agreement. Ordinarily, the personal law of the corporation will determine the effects of insolvency on the corporation’s capacity, rights and obligations and also on those of other interested parties such as the tax department, employees, secured and

50 For further detailed discussion of this issue and the multiplicity of choice of law approaches taken to determining this issue see Gary B., International Commercial Arbitration, Kluwer Law International, 2009, p 422
51 National courts, arbitral tribunals and commentators have adopted a wide variety of choice-of-law approaches, ranging from application of the law of the judicial enforcement forum, to application of the law of the arbitral seat, to application of the law governing the underlying contract, to application of a “closest connection” or “most significant relation” standard, to a “cumulative” approach looking to the law of all possibly-relevant states. Other authorities have suggested even more esoteric choice-of-law rules, including the law of the arbitrator’s residence or lex mercatoria.
52 See Born, Gary B., International Commercial Arbitration, Kluwer Law International, The Netherlands, 2009, p 555, fn 669 ‘Award in ICC Case No. 7373, discussed in Grigera Naín, Choice-of-Law Problems in International Commercial Arbitration, 289 Recueil des Cours 9, 98-99 (2001) (“The question of capacity and power of authority to sign a contract is generally governed by the law of the domicile or the national law of the concerned person. This solution is followed in nearly all countries of both the Civil and the Common Law systems.”) Judgment of 5 May 1976, V Y.B. Comm. Arb. 217 (Swiss Federal Tribunal) (1980) (“All problems concerning the legal status of a legal entity are governed by the law of the State in which it has its seat and from which it derives its legal capacity”).
unsecured creditors and shareholders.\textsuperscript{53} It will also dictate the powers and limitations to those powers granted to the administrator of the insolvent estate.

6.2. This is recognised in Swiss law, where the Swiss Federal Supreme Court has noted:

\begin{quote}
\textquote{``The question of jurisdiction of the arbitral tribunal also comprises the question of the subjective scope of the arbitration agreement. Whether all parties to the proceedings are bound to it, is a question of their capacity to be a party to the arbitration proceedings and, thus, a prerequisite for a decision on the merits or the admissibility [of the claims].''}\textsuperscript{54} [emphasis added]
\end{quote}

6.3. The personal law of a corporation is the law of the state of the company's place of incorporation, real seat, domicile or 'Centre of Main Interest' or similar concept\textsuperscript{55}, depending on the choice of law rule applied.\textsuperscript{56} Under both the European Insolvency Regulation 1346/2000 and the UNCITRAL Model Law on Cross Border Insolvency, the Centre of Main Interest of the corporation is a matter of fact that will be determined at a particular point of time but is presumptively the place it has its registered office.\textsuperscript{57} By definition there can only be one 'centre of main interest' at any point of time and therefore only one \textit{lex concursus}.\textsuperscript{58} Although a corporation may choose its own personal law by choosing the way and where it initially organises and structures its affairs and business interests, this will be dictated by the needs of the business and it cannot easily change its personal law at will. A company cannot simply contract out of its personal law.\textsuperscript{59} As a result, the effects that the insolvency of a corporation will have on the enforceability of current contracts against the

\textsuperscript{55} See Regulation 1346/2000, Article 3(1); \textit{Eurofood IFCS Ltd v Enrico Bondi v Bank of America N.A}, C-341/04, OJ C 251, ECJ, 2 May 2004, Para 37; Similarly in the United States see, 11 U.S.C s §1517(b)(1) incorporating terms of the UNCITRAL Model Law on Cross Border Insolvency; See \textit{In re Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd.}, 374 B.R. 122, Bankr, S.D.N.Y. 2007.
\textsuperscript{56} For the purpose of this paper it does not matter which choice of law rule is applied as what is relevant is that the personal law will be determined by the result of that inquiry. As the centre of main interest is used in both the European Union Regulation on Insolvency Proceedings (EIR) and the UNCITRAL Model Law on Cross Border Insolvency adopted in a number of nations outside the European Union-- the centre of main interest will be referred to.
\textsuperscript{57} \textit{Eurofood IFCS Ltd v Enrico Bondi v Bank of America N.A}, C-341/04, OJ C 251, ECJ, 2 May 2004, para 37
\textsuperscript{58} Article 3(1) and 4(1), Regulation 1346/2000; \textit{Re Main Knitting Inc}, Case No 0811127211, Bankruptcy Court, (NDNY 2008), paragraph 16, available at \url{http://chapter15.com/c15_files/20080508/0013OBJHSBCBankToMORecogProceeding.pdf}, last visited 11 June 2009.
insolvent estate, including arbitration agreements, or on a pending arbitral proceeding to which it is a party, are highly related to the personal law of the corporation.

6.4. This is important as the question of capacity also has implications on the enforceability of an arbitral award under article V(1)(a) of the New York Convention, which expressly applies the personal law of the parties to questions of incapacity as distinct from the law applicable to the arbitration agreement.\textsuperscript{60}

6.5. Capacity is also relevant under Article II(3) of the New York Convention. For example, in Canada, the effect of the stay imposed on legal proceedings on the insolvency of one party to an arbitration agreement was held to render the arbitration agreement inoperative, and therefore not enforceable under the Canadian International Commercial Arbitration Act\textsuperscript{61}, because the debtor company lacked capacity. This was because its capacity to be a party to the arbitration agreement and therefore the arbitration proceeding was suspended by the court as a result of the mandatory stay.\textsuperscript{62} The Supreme Court, New York County, similarly held in the context of an insolvent insurer governed by state insurer insolvency laws, that ‘disputes involving the liquidator for an insolvent insurer are not arbitrable, since the insolvent insurer which agreed to arbitrate has become under an incapacity at the time of arbitration’.\textsuperscript{63}

6.6. In light of the above case law, it is worth considering the interpretation of Article II(3) and V(1)(a) of the New York Conventions. Each of the above cases concerned referral of the matters to arbitration under the wording of Article II(3) and not to

\textsuperscript{60} Article V(1)(a) NYC, provides ‘Recognition and enforcement of the award may be refused…[if] (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.’ See further, Born, Gary B., International Commercial Arbitration, Kluwer Law International, The Netherlands, 2009, p 553.

\textsuperscript{61} This Act adopts the UNICITRAL Model Law on International Commercial Arbitration, which includes identical terms to Article II(3) of the New York Convention and requires the court to refer a matter which is the subject of an arbitration agreement to arbitration ‘unless it finds the agreement is null and void, inoperative or incapable of being performed’.

\textsuperscript{62} Canada (Attorney General) v. Reliance Insurance Company, 2007 (2007) 87 O.R. (3d) 42, Ontario Superior Court of Justice, Para 31-32 – citing with approval Casey B, Janet Mills, Arbitration Law of Canada: Practice and Procedure, Juris Publishing Inc, New York, 2005 p 69 ‘If a party is bankrupt or insolvent and under court protection then the arbitration agreement, as any other commercial contract, is affected. It is inoperative.’; See also Luscar Ltd v Smoky River Coal Limited 1999 A.B.Q.B. 202 (CANL II) [Alta. Q.B.], Para 33; Due to practically identical legislation as exists in Canada, the same reasoning could apply to company insolvency in New Zealand, see Article 8, Schedule 1, Arbitration Act 1996 (NZ), s 248(1)(c) Companies Act 1993 (NZ).

pending arbitrations. Article II(3) only applies at the stage of referral and not whilst arbitration is in progress. Once the parties have been referred to arbitration the courts will not be called on to address whether an agreement is ‘null, void, inoperative or incapable of being performed’. The next point of contact with local courts is at the annulment or enforcement stage. Accordingly, once the arbitration is complete a court will look to Article V to determine whether the award should be enforced. However, Born states that the same substantive analysis that applies in the context of the enforcement of arbitration agreements is equally applicable in resolving an application to recognize an arbitral award and that authorities dealing with Article II are also relevant when analysing cases under Article V(1)(a). This is because it does not make sense to apply different criteria when referring a matter to arbitration than when enforcing an award.

6.7. Lazić argues that Article V(1)(a) only refers to incapacity of the party at the time of entering into the arbitration agreement and not at the time of or during the arbitration. The reason Lazić gives is that a distinction must be drawn between the capacity of a party to enter into an arbitration agreement and the proper representation of the party in the arbitral process and ability to present its case, which is dealt with under Article V(1)(b). However, Article V(1)(b) is concerned with issues of natural justice and procedural fairness and not with capacity issues that fundamentally affect the validity or operability of the arbitration agreement itself. These issues are specifically referred to in Article V(1)(a).

6.8. Article V(1)(a) which provides two separate choice of law rules which may affect the ultimate validity of the arbitration agreement. Issues of capacity of a party are distinct from issues that affect the substantive validity of the arbitration agreement. Article V(1)(a) provides different choices of rules for each. These are both separate issues from locus standi and the proper parties to the arbitration. Born acknowledges that law applicable to the insolvent estate may withdraw the insolvent estate’s capacity to be party to legal proceedings or to be party to an arbitration

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agreement.\textsuperscript{68} It is not difficult to envisage situations where a party may lose capacity during a pending proceeding, for example, if a natural person suffered a head injury or stroke, depriving them of capacity. Potential effects of this is to render the arbitration agreed void or inoperable and deprives the arbitrators of their jurisdiction to determine the case or, depending on the timing of the insolvency, may also have the effect of preventing the incapacitated party, or anyone else, from presenting their case. Therefore there seems little justification for limiting the concept of incapacity in Article V(1)(a) in all cases to the time of entering into the arbitration agreement and not extending it situations where legal capacity is lost either before or during arbitral proceedings.

6.9. Born’s view is supported by a recent decision of the Swiss Supreme Court. The court held in its decision dated 31 March 2009\textsuperscript{69} that the arbitral tribunal was correct in discontinuing the proceedings against the insolvent party because the insolvent party lost capacity to be a party to the arbitration proceedings as a result of the application of its personal law by the arbitral tribunal. This correctness of this case is discussed in further detail below in Part IV.

7. Treatment of insolvency of a party to a pending arbitral proceeding in contemporary arbitral practice.

7.1. Several authors have noted that arbitrators have generally refused to stay the arbitral proceedings when faced with the insolvency of one party to an arbitration agreement, at least in cases prior to the enacting of the European Insolvency Regulation and UNCITRAL Model Law on Cross Border Insolvency.\textsuperscript{70} Mantilla-Serrano notes that, ‘With respect to the grounds for denying suspension, the arbitrators seem to rely heavily on the territorial effects of insolvency proceedings.’\textsuperscript{71} Examples given are ICC Case No. 6057 where the tribunal held in circumstances where the French party was declared bankrupt during pending arbitral proceedings in Syria, ‘regardless of French

\textsuperscript{69} 4-A428/2008, Swiss Supreme Court, 31 March 2009.
law, the arbitral tribunal, sitting in Damascus and applying Syrian law considers that its mission...is not to be affected by a Court's decision rendered subsequently in France which, without more, is not intended to produce effects in Syria."  

Similarly, in ICC Case No. 5996, the tribunal held ‘That the [arbitral] tribunal...sitting in Tunis in an international arbitration, is not compelled to grant the trustee's request [for suspension of the arbitration], for the tribunal is not bound by a particular (substantive or procedural) national law and, least of all, by the French law that is completely foreign to the present proceedings.’  

It is apparent from the above that whether foreign insolvency laws are given any effect in the proceeding depends on whether applicable choice of law rules make the foreign insolvency law applicable to the arbitral proceeding.


8. Overview of Part IV

8.1. The European Union Regulation on Insolvency Proceedings 1346/2000 (‘the Regulation’) was enacted to facilitate proper functioning of the EU internal market and to ameliorate some of the problems created by the territorial approach to insolvency proceedings.  

Recent case law, involving the insolvency of Elektrim S.A during pending arbitration proceedings, has highlighted important issues regarding the application of the choice of law rules in the Regulation to pending international arbitration proceedings. The first important issue, of more general application, is how choice of law issues should be characterised in international arbitration, as this fundamentally affects the choice of law rule applied and the outcome of the proceeding. The second issue, of relevance to arbitrations seated in EU Member States, is whether or not the choice of law rules set out in Article 4 of the Regulation are mandatory in a pending arbitration proceeding and override ordinary choice of law rules. Before turning to those issues a brief outline of the Regulation is provided.

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74 Preamble 2 and 3, Regulation 1346/2000.

9.1. Purposes of the Regulation include ensuring the effective and efficient administration of the insolvency proceeding; preserving equality of creditors; and protecting the legitimate expectations of parties and the certainty of transactions.\textsuperscript{75} The Regulation also attempts to prescribe uniform choice of law rules, which replace ‘within their scope of application, national rules of private international law.’\textsuperscript{76}

9.2. The Regulation regulates cross border insolvency issues between European Union Member States (excluding Denmark) only. The Regulation neither regulates the effects of proceedings opened in third states nor the effects of Community proceedings with regard to non-member states.\textsuperscript{77} This means that in arbitration proceedings two corporations with their centres of main interest located in Member States can avoid the application of the Regulation by choosing an arbitral seat that is not within a Member State.

9.3. In cases to which the Regulation applies, it is directly applicable on all national courts and tribunals within the European Union.\textsuperscript{78} In such cases the court and arbitrator must take into account the choice of law rules contained in the Regulation, which, debatably, replace national rules of private international law when a lawsuit is pending.\textsuperscript{79}


\textsuperscript{76} Preamble 23, EC Regulation 1346/2000.

\textsuperscript{77} This proposition is derived from recital 14 which states that the ‘Regulation applies only to proceedings where the centre of the debtor’s centre of main interests is located in the community’ and article 16 and 17 which provide ‘Any judgment opening insolvency proceedings handed down by a court of a Member State which has jurisdiction pursuant to Article 3 shall be recognised in all the other Member States from the time that it becomes effective in the State of opening of proceedings’ and ‘The judgment opening the proceedings referred to in Article 3(1) shall, with no further formalities, produce the same effects in any other Member State as under this law of the State of the opening of proceedings, unless this Regulation provides otherwise…’; Israel, Jona, European cross-border insolvency regulation: a study of regulation 1346/2000 on insolvency proceedings in the light of a paradigm of co-operation and a Comitas Europaea, Intersentia, Antwerpen, 2005, p 252; Virgos, M, Schmit, E, ‘Report on the Convention on Insolvency Proceedings, 3 May 1996, para 11; Wessels, B. Current Topics in International Insolvency Law, Deventer: Kluwer, 2004, p 39.

\textsuperscript{78} Commission of the European Communities v AMI Semiconductor Belgium BV/BA and Others, Case C-294/02, Opinion of Advocate General, Kokott, 23 September 2004.

9.4. The general choice of law rule is set out in Article 4(1) of the Regulation.\textsuperscript{80} The overriding general principle of the Regulation is to apply the law of the country where the debtor has its centre of main interest to determine all effects of the insolvency of the debtor (\textit{the lex concursus}), subject to the express exceptions to this rule set out in the Regulation.\textsuperscript{81}

9.5. Of some importance to issues that follow, Article 4(2) provides, \textit{inter alia}, that ‘the law of the state of the opening of the proceedings shall determine in particular: (c) the respective powers of the debtor and the liquidator; (e) the effects of insolvency proceedings on current contracts to which the debtor is a party; (f) the effects of insolvency proceedings on proceedings brought by individual creditors; with the exception of lawsuits pending.’ ‘Lawsuits pending’ has been held to include pending arbitrations.\textsuperscript{82}

9.6. Specific exceptions to the general choice of law rule applying the \textit{lex concursus} are set out in Articles 5-15. Article 15 is of particular relevance to pending arbitration proceedings and provides, ‘The effects of insolvency proceedings on a lawsuit pending concerning an asset or a right of which the debtor has been divested shall be governed solely by the law of the Member State in which that lawsuit is pending’. Article 15 only applies to lawsuits pending in Member States. In non-member states the national conflict of laws rules will apply.\textsuperscript{83} As a matter of principle of interpretation, such exceptions to the general principle are to be interpreted narrowly and should not give rise to interpretation going beyond the cases expressly envisaged by the convention.\textsuperscript{84}

9.7. Contrary to established rules of party autonomy in international arbitration, the Regulation, arguably, restricts the freedom of the arbitral tribunal to apply the choice of law rules chosen by the parties or that the arbitral tribunal deems are otherwise appropriate and replaces them with the mandatory choice of law rules provided for

\textsuperscript{80} Article 4(1) Regulation 1346/2000 provides ‘Save as otherwise provided in this Regulation, the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened…’.

\textsuperscript{81} Pursuant to Article 3(1), EIR 1346/2000 only ‘the Member State within the territory of which the centre of the debtor’s main interest is situated shall have jurisdiction to open insolvency proceedings’. See also Preamble 23.

\textsuperscript{82} Jozef Syska Acting as the Administrator of Elektrim S.A. (In Bankruptcy) and Elektrim S.A. (In Bankruptcy) v Vivendi Universal S.A. Vivendi Telecom International S.A. Elektrim Telekomunikacja Sp Z O.O, Carcom Warszawa Sp Z O.O. [2008] EWHC 2155 (Comm), High Court, para 52; See also footnote 23 above where arbitrations have been held to be ‘proceedings’ in the context of stays on proceedings in insolvency cases.


\textsuperscript{84} See principles applied in a different context by the ECJ in \textit{Group Josi Reinsurance Company S.A v Universal General Insurance Company}, Case C-412/98, ECJ, 1998, para 49.
in the Regulation. Whether the Regulation displaces the ordinary choice of law rules in a pending arbitration is discussed at paragraph 13.

10. Different Characterisation of same rule of law leads to opposite results

10.1. As alluded to above, recent case law has raised the important issue of how an arbitral tribunal or court should characterise foreign insolvency rules of law in order to select the most appropriate choice of law rules applicable to the issues in the pending arbitration.

10.2. The most recent and detailed judicial analysis of the choice of law provisions in the Regulation was in *Josef Syska and Elektrim SA (in administration) v Vivendi Universal SA* [2008] EWHC 2155 (Comm), Christopher-Clarke J ("Elektrim v Vivendi"). The facts are summarised by Professor Fletcher as follows:

“In 2001 Elektrim [a Polish incorporated company with its centre of main interest in Poland] entered into an investment agreement (TIA) [regarding telecommunications infrastructure in Poland] with Vivendi [a French incorporated company] which contained an arbitration agreement providing for arbitration in London under LCIA rules. The arbitration agreement was governed by English law [because the arbitral seat was in England and the parties conceded that was the case], but the rest of the TIA was governed by Polish law. In 2003 Vivendi commenced an arbitration pursuant to the agreement and in early 2007 the LCIA Arbitral Tribunal fixed a hearing on liability issues for October of that year. In August 2007 Elektrim was declared bankrupt by a Polish court pursuant to its own petition. Initially the court’s order permitted Elektrim to remain under the control of its own management with a court-appointed supervisor, but in February 2008 the court revoked the self-administration and appointed the supervisor to be administrator of the company’s assets."\(^{85}\)

10.3. The main issue in the case arose because Article 142 of the Polish Bankruptcy law unambiguously provides, "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." An issue for the arbitrators and for Christopher-Clarke J was therefore whether to apply Polish law. If Polish law applied, the arbitration agreement would

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have no further effect and the arbitration would terminate. If English law applied the arbitration could continue.86

10.4. In summary, both the arbitral tribunal and Christopher Clarke J, applying the Regulation choice of law rules, declined to apply the Polish law but instead held that effects of the Polish insolvency of Elektrim on the ‘lawsuit pending’, which included the arbitration proceedings seated in England, was governed ‘solely’ by English law.87 This decision was upheld by the English Court of Appeal in its judgment dated 9 July 2009.88

10.5. In Elektrim v Vivendi the judgment is silent as to what English law should apply and does not determine, for example, whether it is the English insolvency law that applies, whether it is the English arbitral procedural law or English law generally. Nor does the judgment attempt to differentiate between separate choices of law questions. For example, the judgment does not attempt to characterise the effect of Article 142 of the Polish Bankruptcy law as an issue affecting the capacity of the Polish company to be a party to an arbitration agreement or a party to the arbitration proceedings, which, as discussed above is in almost all legal systems governed by the personal law of the insolvent company. Alternatively, this issue could be characterised as an issue affecting the substantive validity of the arbitration agreement, as opposed to one of capacity, which, in absence of express agreement of the parties, is frequently governed by the law of the arbitral seat.89 The judgment simply states that English law, applying Article 15, solely determines all the effects of the Polish insolvency proceedings on the pending arbitration proceeding.

10.6. By contrast, the same issue involving the same Polish company was recently argued before an arbitral tribunal seated in Switzerland.90 The tribunal’s decision was upheld on appeal to the Swiss Supreme Court.91 Scherer summarises the holding as follows:

90 The Regulation does not apply in Switzerland as it is not a Member State.
91 4_A428/2008, Swiss Supreme Court, dated 31 March 2009.
“The arbitral tribunal held that Article 142 PIL dealt with the issue of a party’s “continued capacity” to participate in an arbitration. Applying Swiss conflicts of law rules, the tribunal further held that a company’s capacity must be determined on the basis of its law of incorporation pursuant to Article 154 et seq. of the Swiss Private International Law Act (the “SPILA”). The tribunal therefore discontinued the proceedings vis-à-vis the insolvent co-respondent…. According to the Supreme Court, “Swiss law is silent on the subjective capacity to arbitrate of non-state parties…. Therefore, the general procedural principle applies, according to which the capacity to be a party (Parteifähigkeit) depends on the preliminary substantive law question of legal capacity (Rechtsfähigkeit) …. ” The Supreme Court thus applied Articles 154 and 155 SPILA which govern the legal capacity of corporations and held that “the assessment of the legal capacity and thus the capacity to be party to international arbitration proceedings [of a Polish incorporated company] is determined … in accordance with Polish law.””

10.7. The choice of law rule applied will depend on how the problem is characterised at the outset. As reflected in Article V(1)(a) of the New York Convention, if the arbitral tribunal or enforcing court characterises the issue as one of capacity it will be determined by the law applicable to the party. If the arbitrator characterises the issue as one that affects the substantive validity of the arbitration agreement, it will be determined in accordance with the law applicable to the arbitration agreement.

10.8. The result in each case is different because the characterisation of Article 142 of the Polish law was different. The Swiss decision accepted that Article 142 was to be characterised as issue of capacity and applied Swiss choice of law rules applicable to company capacity. In Elektrim v Vivendi, Article 142 of the Polish law was not determined to affect the capacity of Elektrim, it was simply determined that Article 15 refers all matters for determination by English law. Correct characterisation of the choice of law problem is crucial to the outcome of the case. Unfortunately neither case addresses this issue.


11. **Approach to Conflict of Laws and Characterisation questions**

11.1. Analytically the process of selecting the applicable law can be broken down into three essential steps.  

11.2. First, the decision maker must identify and characterise the relevant issue that must be resolved between the parties. For example, the issue raised by the insolvency of one party could be characterised as an issue that directly affects the capacity of the insolvent party to be bound by the arbitration agreement, it could be characterised as a matter that affects the operability of the arbitration agreement itself, or it could be characterised as an issue of succession or assignment of the arbitration agreement or an issue of locus standi of the parties. How the initial issue that potentially affects the arbitrator’s jurisdiction is characterised will affect the choice of law rule applied. For example, Mantilla-Serrano states, ‘Regarding matters concerning the capacity of the insolvent party (or its representatives) to pursue the arbitration, the arbitrators consistently refer such issues to the personal law of the party, which for corporations is generally the law of the place of incorporation.’ He goes on to state ‘With regard to matters relating to the assignment of the claims and of rights under the arbitration clause, it is typical to apply the lex contractus as agreed to between the parties or determined by the arbitrator.’

11.3. Second, the decision maker must decide which choice of law rule to apply in order to select the relevant applicable law. This can be a difficult problem for the arbitrator as, unlike a court that is bound to apply the conflict rules of the forum in which it sits, the arbitrator is not so bound.

11.4. Third and finally, the decision maker must apply the chosen choice of law rule to find the substantive law that will determine the relevant issue.

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11.5. The problem of characterisation has been described as a fundamental problem in the conflict of laws.\textsuperscript{97} The learned authors of Dicey & Morris\textsuperscript{98} note that ‘The problem of characterisation has given rise to a voluminous literature, much of it highly theoretical. The consequence is that there are almost as many theories as writers and the theories are for the most part so abstract that when applied to a given case, they can produce almost any result. They appear to have had almost no influence on the practice of the courts in England.’ Nonetheless, some general principles can be discussed with respect to the Elektrim v Vivendi and Swiss Supreme Court cases referred to at paragraph 10.

11.6. The first problem that arises is which country’s system of law should be applied to characterise the rule of foreign law. In other words should Article 142 of the Polish law be characterised according to English law (\textit{lex fori}) or characterised according to Polish law.\textsuperscript{99} Dicey \& Morris notes that the great majority of Continental writers subscribe to the view that the process of characterisation should be performed in accordance with the domestic law of the forum.\textsuperscript{100} English courts, in most cases, look to foreign law only to discover the nature and scope of the foreign rule, not to determine how it (or the general issue) should be characterised.\textsuperscript{101} The approach taken by the English Court of Appeal, is expressed by Auld LJ:

\begin{quote}
Subject to what I shall say in a moment, characterisation or classification is governed by the \textit{lex fori}. But characterisation or classification of what? It follows from what I have said that the proper approach is to look beyond the formulation of the claim, and to identify according to the \textit{lex fori} the true issue or issues thrown up by the claim and defence. This requires a parallel exercise in classification of the relevant rule of law. However, classification of an issue and rule of law for this purpose, the underlying principle of which is to strive for comity between competing legal systems, should not be constrained by particular notions or distinctions of the domestic law of the \textit{lex fori}, or that of the competing system of law, which may have no counterpart in the other’s system. Nor should the issue be defined too narrowly so that it
\end{quote}

attracts a particular domestic rule under the lex fori which may not be applicable under the other system.\textsuperscript{102}

11.7. Given that Article 15 of the Regulation provides that any lawsuit pending should be governed \textit{solely} by the law of the Member State where the lawsuit is pending, any issue of characterisation should also be determined by the lex fori. In a pending arbitration this would be by the law of the arbitral seat. In the \textit{Elektrim v Vivendi} case this is English law.

11.8. A further question, raised by Auld LJ, is what it is exactly that should be characterised? Is it a legal issue or a rule of law?\textsuperscript{103} For example, the characterisation of the choice of law question in \textit{Elektrim v Vivendi} could be determined by looking to the wording of Article 142 and proceeding to characterise the rule on that basis. Alternatively, the choice of law question could be characterised by the ‘issue in the case’ or ‘question in issue’, which in \textit{Elektrim v Vivendi} was ultimately whether or not the agreement to arbitrate remained valid. The latter view has been preferred in England.\textsuperscript{104} English courts have noted, the proper approach should not be subject to mechanistic application but should aim to identify the most appropriate law to govern the particular issue, which means that ‘one has to look at the substance of the issue rather than the formal clothes in which it may be dressed.’\textsuperscript{105}

11.9. An example of the problem of characterising a rule of law as one of capacity or one of formal validity according to the terms of the rule may be found in \textit{Ogden v Ogden}.\textsuperscript{106} Hayward summarises the facts as follows:

\begin{quote}
\textit{An English domiciled woman married, in England, a French domiciled man aged 19. By French law, a man of that age needed his parents’ consent to marry and, without such consent, the marriage was voidable.}
\end{quote}

The issue for the court was whether the French law requiring parental consent was one of capacity and therefore applicable or whether it was an issue of formal validity,

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\textsuperscript{104} Morris, J.H.C, McClean, D, \textit{The Conflict of Laws}, (5\textsuperscript{th} Edition), Sweet and Maxwell, London, 2000, p 494;
\textsuperscript{106} Ogden \textit{v Ogden} [1908] P 46.
\end{flushright}
in which case it was not.\textsuperscript{107} The English Court of Appeal held that, according to English law, it was a rule of formal validity and therefore not applicable. Clearly the Frenchman was able to get married. He just needed his parents’ consent. By analogy to \textit{Ogden v Ogden}, a stay on proceedings could be characterised similarly as a rule of formal validity and not of capacity. In most cases, a corporation still has the capacity to initiate and defend lawsuits and arbitrations; all that is needed is the Court’s or creditor’s committee’s consent to do so.\textsuperscript{108}

\section{Characterisation of the choice of law problem in Elektrim v Vivendi}

12.1. Article 142 of the Polish insolvency law could be characterised as an issue of capacity, or it could be characterised as an issue of substantive validity of the arbitration agreement itself. More generally, the rule could be characterised as a procedural rule of law or a substantive rule of law. In England, issues of procedure will be governed by the lex fori. Issues of substance will be governed by the lex causae.\textsuperscript{109}

12.2. The first approach, mentioned above, is to identify the legal characteristic of a particular rule by looking to the rule itself.\textsuperscript{110} The wording of Article 142 of the Polish insolvency law provides, ‘\textit{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}’. The subject of the rule is the arbitration clause and the rule plainly addresses the substantive validity of the arbitration clause. It says nothing about Elektrim’s legal capacity. In fact, at the time the tribunal rendered its award in \textit{Elektrim v Vivendi}, the previous management board had full control and management of the estate and had the right under Polish law to initiate or defend lawsuits which came within its ordinary scope of business. Article 142 in substance does not affect Elektrim’s capacity.

\textsuperscript{108} Characterisation of the Latvian law as affecting the arbitration agreement rather than as a capacity issue poses greater difficulty as the wording of the Latvia, Civil Procedure Law, Article 478(8) provides that disputes "regarding the rights and obligations of persons that have been declared insolvent before the making of the award by the arbitral tribunal" are not arbitrable.
12.3. However, applying a similar approach the Swiss Supreme Court came to a different conclusion.\textsuperscript{111} It first looked to the Polish rule. It then determined that the Polish law affected Elektrim’s capacity. It then applied Swiss conflict of law rules related to capacity to determine the Polish law applied to void the arbitration agreement. Unfortunately, this reasoning is putting the cart before the horse. As noted in \textit{Dicey & Morris}, it is arguing in a circle to say that the foreign law governs the process of characterisation before the process of characterisation has led to the selection of the appropriate legal system.\textsuperscript{112}

12.4. The problem with characterising Article 142 of the Polish law, or general stay provisions as issues that affect the capacity of the insolvent party having extraterritorial effect, is that it automatically results in the non-enforceability of arbitration clauses whenever a party is declared insolvent\textsuperscript{113} and means that in almost all cases an arbitration, no matter at what stage, would grind to a halt. This is not the default position in England, even on death of a natural person to an arbitration agreement.\textsuperscript{114}

12.5. The above difficulty in characterisation can be avoided by applying the ‘issue in the case’ approach taken in \textit{Wight and Others v. Eckhardt Marine GmbH} and looking to the most appropriate choice of law rule to apply.\textsuperscript{115} The advantage of this approach is that the wording of the foreign rule in question is not determinative of the characterisation issue and has little relevance until it is deemed to be applicable by the appropriate choice of law rule.

12.6. Ultimately, the issue in each case was whether the arbitration agreement remained substantively valid. The answer to that question is found by applying the \textit{lex causae} selected by the appropriate choice of law rule of the forum that applies to that question and not by first looking at the terms of the foreign rule of law. Subject to whether Article 4 of the Regulation displaces the ordinary English choice of law rules, which will be discussed below, the ordinary and most appropriate English

\textsuperscript{111} See paragraph 10.6 above.
\textsuperscript{114} Section 8(1), Arbitration Act 1996 (UK) provides ‘Unless otherwise agreed by the parties, an arbitration agreement is not discharged by the death of a party and may be enforced by or against the personal representatives of that party.’
choice of law rule is Rule 54 in *Dicey & Morris*, which provides ‘the material validity, scope and interpretation of an arbitration agreement are governed by its applicable law, namely, (a) the law expressly or impliedly chosen by the parties; or, (b) in the absence of such choice, the law which is most closely connected with the arbitration agreement, which will in general be the law of the seat of the arbitration.’ In Switzerland, this approach would have lead to an application of choice of law rule in Article 178(2) of the Swiss Private International Law and an application of Swiss law to resolve that issue. It would not have led to an application of Articles 35-36 and 154-155, which led to an application of Polish law. Accordingly, the pending arbitration proceedings should not have been terminated.

12.7. The problem in the *Elektrim v Vivendi* case is not dissimilar from the problem posed in *Ledee v Ceramiche Ragno*¹¹⁸, where Italian and Puerto Rican parties had agreed to arbitrate in Italy. Puerto Rican law provided that ‘Any stipulation that obligates a dealer to adjust, arbitrate or litigate any controversy that comes up regarding his dealer’s contract outside of Puerto Rico, or under foreign law or rule of law, shall be likewise considered as violating the public policy set forth by this chapter and is therefore null and void’. The US court refused to give effect to Puerto Rican law and was not concerned that an arbitral award rendered in Italy might not be enforceable in Puerto Rico and instead held that giving effect to such a law would be ‘antithetical to the goals of the [New York] Convention’. A similar argument could be made against the parochial Polish or Latvian laws.¹¹⁹ There is however, no discussion regarding the characterisation of the Puerto Rican law as one that affects the capacity of the Puerto Rican party to agree to arbitration or whether the Puerto Rican law should be characterised as affecting the substantive validity of the arbitration agreement.

¹¹⁶ *Dicey, A. V., Morris, J. H. C. & Collins, L., Dicey, Morris and Collins on the Conflict of Laws, 14th edition*, Sweet and Maxwell, London, 2006, Rule 57; Similarly, the Article 178(2) of the Swiss Private International Law provides: ‘As to substance, the arbitration agreement shall be valid if it complies with the requirements of the law chosen by the parties or the law governing the object of the dispute and, in particular, the law applicable to the principal contract, or with Swiss law.’


¹¹⁸ *Ledee v Ceramiche Ragno* 684 F.2d 184 (1st Cir. 1982).

12.8. Applying the ‘issue in the case’ approach to characterisation to Ledee, from the perspective of the arbitrator seized of the proceeding, the issue is again whether the arbitration agreement is valid or not and whether the arbitrator retains jurisdiction. The actual terms of the Puerto Rican law are not determinative of the characterisation issue. Whether or not the arbitrator should give effect to Puerto Rican law is dependent on whether Puerto Rican law applies to the arbitration agreement. Italian choice of law rules are likely to apply the law of the arbitral seat to govern the substantive validity of the arbitration agreement and not Puerto Rican law.

12.9. Further, even if the ‘rule of law’ characterisation approach is applied, the wording of the Puerto Rican law reveals that the Puerto Rican party has the ability to agree to arbitrate but the agreement would not be enforceable by the Puerto Rican courts if the agreement sought to arbitrate outside of Puerto Rico or selected foreign law. This is an issue that affects the validity of the arbitration agreement. It should be determined according to the law applicable to that agreement according to the choice of law rule that deals with substantive validity of arbitration agreements. It is not a question of capacity of the Puerto Rican party.

12.10. However, the above approach may be subject to criticism because it would, arguably always lead to a framing of the ‘issue in the case’ as ‘whether the arbitration agreement remains substantively valid’ in all cases where a party is deprived of capacity. But this is not necessarily correct. For example, an issue that often arises upon insolvency is whether the debtor continues to exist as a separate legal entity as a result of divestment of the debtor and transfer of rights and obligations to the bankruptcy estate. The issue faced by the arbitrator in such a case is not ‘whether the arbitration agreement remains substantively valid’. They are questions of ‘does the debtor exist’, ‘who is the proper party to the arbitration agreement and the pending proceedings’ and ‘whether the rights and claims under arbitration agreement have been assigned.’ These are separate issues that require selection of different choice of law rules. The former is likely to be categorised as an issue of capacity, with the most appropriate choice of law rule referring to the debtor’s personal law. The validity of
the assignment is likely to be determined according to the law applicable to the arbitration agreement.120

12.11. If either of the above approaches are wrong, a third approach is to characterise Article 142 as a rule of procedure and not as a rule of substance. That Article 142 is a rule of procedure was expressed by Patten LJ in upholding Christopher-Clarke J’s judgment in Elektrim v Vivendi on appeal.121 If that view is correct, according to English conflict of law rules, Article 142 of the Polish law is to be disregarded.

12.12. Born, in a comprehensive review of authorities on choice of law rules applied to arbitration agreements, notes that there is a multiplicity (at least 9) approaches to choice of law question relating to the validity of arbitration agreements in international arbitral practice which has often led to complexity and confusion.122 However, more often than not the choice of law result is to apply the law of the arbitral seat, unless that choice of law would invalidate the arbitration agreement. Born argues that there is a trend in contemporary arbitral practice towards application of a validation principle whereby the arbitrator, when faced with different choice of law approaches, is likely to and should select the choice of law approach that leads to the validity of the arbitration agreement as this best gives effect to the parties’ intention to arbitrate.123 He advocates for a similar approach to issues of capacity.124 For example, if two parties both aged 20, one living in France, the other in England, entered into an arbitration agreement, when say French law allows people to enter arbitration agreements at age 21 and English law allows this to occur at age 18, then the rule that validates the agreement should apply.

12.13. In conclusion, the preferred approach is to look to the substance of the issue before the tribunal and to select the choice of law rule applicable to that issue. On this view,
characterisation of Article 142 and stay provisions affect the substantive validity of the arbitration agreement and not the capacity of the insolvent party. In cases of doubt the validation principle should be applied. However, in EU Member States this gives rise to the another question as to whether an arbitrator must apply the choice of law rules in Article 4 of the Regulation or whether the arbitrator remains free to apply ordinary choice of law rules in international arbitral practice.

13. **Whether choice of law rules in Article 4 are mandatory when Article 15 applies**

13.1. In *Elektrim v Vivendi* there is little doubt that the arbitration agreement itself was governed by English law before insolvency occurred. English legal practice, prior to insolvency, would have found that English law applied to the arbitration agreement, when the seat was in London under the LCIA rules. However, Article 4(2)(e) of the Regulation arguably interfered with the ordinary choice of law rules applied to arbitration agreements in international arbitrations and dictated that Polish law applied to the arbitration agreement after Elektrim entered insolvency. The reason for this is that an arbitration agreement, like any other commercial contract, is a current contract falling within Article 4(2)(e) of the Regulation. Article 15 on the other hand deals with selection of the law of the Member State where the lawsuit is pending and not to the arbitration agreement. However, if both Article 15 and article 4(2)(e) are applied successively Article 4(2)(e) deprives Article 15 of any substance when the application of the law of the *lex concursus* voids the arbitration agreement.

13.2. A further problem is that Article 15 gives no guidance as to the meaning to be attributed to the words ‘the law’. Whilst most judgments addressing Article 15 agree that lawsuits pending should be governed solely by the law of the Member State in which the lawsuit is pending, different courts in different jurisdictions have reached different conclusions regarding this issue, with some courts applying, by analogy the provisions of the insolvency law of the forum seized of the proceeding and others applying the procedural law. Two examples are provided below.

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125 For reasons discussed by Christopher-Clarke J, there is no distinction between ‘procedural’ and ‘substantive’ contracts. *Elektrim v Vivendi Universal S.A* [2008] EWHC 2155 (Comm), para 99.
126 *Elektrim v Vivendi Universal S.A* [2008] EWHC 2155 (Comm), paras 76.
127 It should be noted that this result is a particular problem created by insolvency rules such as those in Latvia and Poland and would not necessarily result in the same terminal result in other legal systems as described above at paragraph 4.
13.3. *The Austrian approach*

13.3.1. The Austrian Supreme Court reached the following solution to the problem.\(^{128}\) The facts are summarised by Maderbacher as follows:

“On 6 August 2001, plaintiff, a limited liability company with its registered office in Kaiserslautern [Germany] filed an action against defendant, an Austrian businessman, for default on payment of an amount of DM 350,000 (approximately EUR 180,000) before an Austrian court. But for a small portion of the claim, the action was successful in the first instance. Defendant appealed. Before the hearing on the appeal took place, plaintiff filed for insolvency…"\(^{129}\)

13.3.2. According to Maderbacher’s translation, the Austrian Supreme Court held:

“…As regards the respective powers of the debtor and the liquidator, these are governed by the lex fori concursus (Article 4(2)(c) Regulation). Effects of insolvency proceedings on pending lawsuits, on the other hand, pursuant to Article 15 Regulation are governed exclusively by the law of the state in which the lawsuit is pending. There shall be no “cumulative” application of the laws of both states, so that it is well possible that the opening of an insolvency proceeding in member state A leads to a stay in a lawsuit pending before the courts of state B, even if the law of state A would not provide for a stay of the proceeding…

With regard to Article 15 Duursma-Kepplinger has expressed her view that when a reorganization proceeding of a type listed in Annex A to the Regulation has been opened in member state A, member state B when deciding on its effects on a lawsuit pending before its courts must examine the principles and fundamental features of this reorganization proceeding conducted in state A and consequently apply those national rules which it would apply had a comparable proceeding been opened on its own territory.”

13.3.3. In line with the decision in *Elektrim v Vivendi Universal S.A*, the Austrian Court held that Austrian law exclusively governs the effects of insolvency proceedings on lawsuits pending. Similar to Christopher-Clarke J’s

\(^{128}\) 9 Ob 135/04z, Austrian Supreme Court, 23 February 2005.

statement that English law shall alone determine the effects of the insolvency proceedings on a lawsuit pending in England, the court goes on to say that there can be no cumulative application of the laws of both states. Therefore, according to the Austrian court, it must apply its own rules of law that it would have applied had a comparable insolvency proceeding been opened in Austria. In other words, the Austrian court will apply Austrian insolvency law to determine the effects on the lawsuit pending.

13.3.4. The difficulty with this approach is that insolvency proceedings have not been opened in Austria. If secondary proceedings were opened in Austria pursuant to Article 3(2) of the Regulation then it would make sense to apply Austrian insolvency law provided for by Article 28, as insolvency laws are designed to govern insolvency proceedings whereas the general rules of civil procedure are designed to govern civil proceedings. However, in the absence of the opening of insolvency proceedings in Austria, there is little justification for applying Austrian insolvency law to a pending lawsuit in Austria. Further the solution only functions if the proceedings are comparable, as might be the case between Germany and Austria. This solution may not work as between the UK and Austria due to differences in insolvency laws.

13.4. **The English approach**

13.4.1. The English Courts reached a different conclusion to the Austrian Supreme Court. In *Mazur Media Ltd. v. Mazur Media G.M.B.H*¹³⁰ proceedings between the respective parties were pending before the English courts when *Mazur Media* GmbH was declared insolvent in Germany. German insolvency law provided for an automatic stay of proceedings. Section 130(2) of the English Insolvency Act 1986, similarly applies an automatic stay on pending proceedings when insolvency proceedings are opened in England.¹³¹ In *Mazur Media*, as in *Elektrim v*

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¹³¹ s 130(2) of the Insolvency Act, 1986, ‘When a winding-up order has been made, no action or proceeding shall be proceeded with or commenced against the company or its property, except by leave of the court and subject to such terms as the court may impose.’
Vivendi and the decision of the Austrian Supreme Court, Collins J held that, in accordance with Article 15, it was for the English law to determine the effect that insolvency of the German company had on the lawsuit pending in England. However, unlike the Austrian Supreme Court, Collins J held, in effect, that it was for English procedural law (lex fori) and not English insolvency law that was to determine whether a stay should be granted or not.

13.5. Accordingly, one approach to the interpretation is to limit the meaning of ‘the law’ applicable under 4.2(f) and 15 to selecting the procedural law of the forum that is seized of the pending lawsuit excluding the insolvency law of the forum. On this approach if the matter is pending before a court, this matter will be determined by the rules of civil procedure of the forum court. If it is pending before an arbitral tribunal it will be determined by the procedural law of the arbitration.

13.6. In support of this view the Virgos-Schmit Report provides:

“Effects of the insolvency proceedings on other legal proceedings concerning the assets or rights of the estate are governed (ex Article 15) by the law of the Contracting State where these proceedings are under way. The procedural law of this State shall decide whether or not the proceedings are to be suspended, how they are to be continued and whether any appropriate procedural modifications are needed in order to reflect the loss or the restriction of the powers of disposal and administration of the debtor and the intervention of the liquidator in his place.”

13.7. The above statement contemplates different laws applying to different issues that arise when a party to a pending proceeding is insolvent. The above statement contemplates that the lex concursus will determine the effects on the insolvent party’s capacity. The procedural law of the pending proceedings will then determine how

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132 Mazur Media Ltd. v. Mazur Media G.M.B.H. [2004] EWHC 1566, para 54 “It is clear from its context that s. 130(2) does not apply to foreign insolvency proceedings... Nor is there any basis for any argument that it could apply by analogy. The effect of art. 4(2)(f) and art. 15 of the Insolvency Regulation is to leave the question whether there should be a stay to the English Court in the circumstances in which they apply. In fact the court has an inherent discretion, reinforced by the Supreme Court Act, 1981, s. 49(3), to stay proceedings, whenever it is necessary to prevent injustice....”

133 For further discussion of these two approaches see Moss, Gabriel QC, Fletcher, Professor Ian F, Isaacs, Stuart QC, The EC Regulation on Insolvency Proceedings: A Commentary and Annotated Guide (2nd Edition), Oxford University Press, 2009, paras 8.244-8.249.

the change of capacity of the insolvent party is to be dealt with in the pending proceeding. The procedural law of the forum will not determine how the insolvent party’s capacity or powers are affected.

13.8. Limiting the meaning of ‘the law’ in Article 15 to refer exclusively to the procedural law of the lawsuit pending creates its own problems as the procedural law of the forum may not provide a solution to finding the appropriate law to determine the substantive effect of insolvency. If Article 15 determines that the procedural law is applicable to the lawsuit pending, this will ordinarily result in the arbitral tribunal having discretion to determine the substantive effect of the insolvency on the tribunal’s jurisdiction to continue with the arbitration but it would not assist with the characterisation issue nor with the which choice of law rules the arbitral tribunal should apply in order to determine whether the substantive effect of a foreign insolvency law should be given any effect in the arbitral proceedings.

13.9. An approach to this next stage of the problem, which fits with the scheme of the Regulation, is to apply the other choice of law rules under Article 4 the Regulation rather than the ordinary choice of law rules. In accordance with Article 4(1), in the absence of any express exception provision in the Regulation, the choice of law applied would be the *lex concursus*.

13.10. The problem with this approach applied to the *Elektrim v Vivendi* case is that if the choice of law rules in the Regulation are applied then the inevitable result is that the Regulation selects Polish law to determine the substantive effect on the arbitrator’s jurisdiction. Polish law would determine if the arbitration agreement is invalid whether the issue is framed as one of capacity of Elektrim to be a party to an arbitration agreement or whether it is framed as an issue that affects the validity of the arbitration agreement. For the reasons stated above this approach was rejected by Christopher-Clarke J where he determined that Article 4(2)(f) and Article 15 must override Article 4(2)(e).

13.11. Christopher-Clarke J determined that choice of law rule in Article 4(2)(f) and Article 15, that applies English law to determine the effect of insolvency on ‘lawsuits pending’, must exclude the choice of law rule set out in Article 4(2)(e) that would

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135 For example see Article 33(1) Arbitration Act 1996 (UK); LCIA Rules Article 23.1.
have applied Polish law to determine the effect on the arbitration agreement. The reasons given by his Honour for this conclusion were that Article 15 provides that the law of the Member State in which arbitration is pending shall alone (‘solely’) determine the effect of the insolvency proceedings on that arbitration; commercial certainty is best served if the arbitration proceedings do not terminate and the exception in Article 4.2(f) and 15 must be applied so as to make Article 4.2(f) effective rather than illusory because if Article 4(e) prevailed, then the arbitration would necessarily come to an end. Further, Article 4.2(f) is the ‘more specific’ provision as to the effect of the insolvency proceedings on a ‘lawsuit pending’ than the 'more general' Article 4(e) which relates to current contracts so it must take precedence.\(^{{137}}\) In addition, as noted by Longmore LJ on appeal, if Article 4(2)(e) is applied in such circumstances ‘pending lawsuits and pending arbitrations would be treated differently which cannot be right’\(^{{138}}\) leading to the odd result that a party to a lawsuit could continue with a proceeding whereas a party to an arbitration could not. A similar view in the case was expressed by Patten LJ.\(^{{139}}\)

13.12. Patten LJ also said:

> Where I part company with Mr Moss’s argument is in its assumption that, in a case which otherwise falls within Article 15, the draftsman of the Regulation intended to prescribe a different system of law to govern the effect of the insolvency proceedings on the arbitration agreement from that which governs the proceedings themselves. Once it is accepted that an existing reference to arbitration constitutes a pending lawsuit within the meaning of Article 15 then the choice of national law to determine "the effects of insolvency proceeding on a lawsuit pending" would appear to comprehend any issues about the validity of the arbitration agreement which would affect the continuation of the arbitration itself.\(^{{140}}\)


\(^{{139}}\) Elektrim S.A. (In Bankruptcy) v Vivendi Universal S.A. [2009] EWCA Civ 677, (Court of Appeal), para 33, ‘It seems to me unrealistic to assume that the Regulation was also intended to discriminate in its application of the choice of law rule between the types of lawsuit covered by Article 15 simply according to the jurisdictional basis (contractual as opposed to statutory) of the different types of possible proceeding. The present case is within the express terms of Article 15 and, in my judgment, one need look no further.’

13.13. The effect of the High Court and Court of Appeal’s judgment is that all choice of law questions under Article 4 that lead to a choice of law that is in contradiction with the choice of law provision in Article 15 will be resolved by substantive English law, insofar as they affect the pending lawsuit. Virgos-Garcimartín have stated ‘the use of the term "solely" is aimed at preventing the cumulative application of different national laws.’\textsuperscript{141}, which suggests that the other conflict rules in the Regulation are no longer applicable to resolving these issues and that these matters must be referred ‘solely’ to the substantive national law of the Member State where the lawsuit is pending. In other words, Article 15 by use of the word ‘solely’ displaces all other choice of law questions. This has the effect of reversing, for example, the ordinary conflict of law rule that applies the personal law of the party to questions which are properly characterised as relating to that party’s capacity. It could also result in overriding parties express choices of law in an arbitration agreement.

13.14. This solution raises some practical difficulties, which can be demonstrated if applied to a problem that might arise under Article 4(2)(c) of the Regulation.

13.15. Article 4(2)(c) provides that the law of the State of the opening of the insolvency proceedings shall determine the respective powers of the debtor and the liquidator. This is because the liquidator will be appointed by the court of the opening of the proceedings and will derive his or her powers from the laws of that state. So, for example, if Polish law denied the debtor or liquidator the power to be a party to or continue with any legal proceedings, unless those proceedings were brought before the Polish bankruptcy court\textsuperscript{142}, but English law allowed liquidators to decide whether to continue with legal proceedings, then, according to Virgos’ view that there can be no cumulative application of different national laws, English law would prevail. Effectively this would mean that English law would determine the powers of a foreign debtor or liquidator to act with respect to the pending proceedings. This result does not make sense as the English law has no connection with the position of the liquidator as administrator of the foreign insolvency proceedings. In arbitration proceedings this problem is even more apparent as laws of the place of the arbitral


\textsuperscript{142} This rule seems to apply in the Netherlands: See Lazić, p252, ‘Art. 26 of the Netherlands Faillissementswet clearly states that the claims of ordinary bankruptcy creditors, i.e. claims aiming at payment against the estate, may not be pursued in any other manner than by filing the claim for verification in the bankruptcy. It follows that such claim may not be pursued in arbitration, either.’
seat may have no connection whatsoever with the business affairs, location of assets, or corporate structure of either party or the winding up of insolvent party’s affairs. Notwithstanding what the English court might determine, the Polish appointed liquidator is bound by Polish law and could not lawfully participate further in the proceedings pending in England without being in breach of Polish law.

13.16. This issue is again an issue of characterisation. Liquidator’s powers ought to be characterised as an issue of capacity and should be referred to the law from which the liquidator derives his powers. Article 15 cannot mean that all issues arising in a pending proceeding must be determined according to the substantive law of the Member State where the lawsuit is pending. As discussed above, any award rendered in such circumstances may be unenforceable under Article V(1)(a), V(1)(b) or V(2)(b) of the New York Convention as the insolvent party was, for example, “under the law applicable to them under some incapacity.”

14. **Article 15 includes conflict of laws rules of the Member State when a lawsuit is pending**

14.1. One solution to the above problem is to interpret the words in Article 15 ‘shall be governed solely by the law of the Member State in which the lawsuit is pending’ to include the conflict of laws rules which are part of the law of the Member State where the lawsuit is pending. On this approach the effect of Article 15 is to suspend the operation of the other choice of law rules in Article 4 of the Regulation and refer those matters to the court or arbitral tribunal seized of the proceeding, but this approach faces some opposition.

14.2. Preamble 23 to the regulation states:

“This Regulation should set out, for the matters covered by it, uniform rules on conflict of laws which replace, within their scope of application, national rules of private international law. Unless otherwise stated, the law of the Member State of the opening of the proceedings should be applicable (lex concursus).”

14.3. The Virgos-Schmiti report further provides:

“The Convention sets out, for the matters covered by it, uniform rules on conflict of laws which replace national rules of private international law. When these rules on conflict of
laws talk of the "applicable law", they refer to the internal law of the Contracting State designated by the rule, excluding its rules of private international law.

14.4. Similarly, based on Preamble 23 and the above comment, Professor Fletcher notes, without question, ‘An important general point about he choice of law provisions in the Regulation is that wherever they make reference to ‘the law’, this denotes the substantive, domestic law of the Member State concerned.’

14.5. However, unlike Article 15 of the EC Convention on the Law Applicable to Contractual Obligations (the Rome Convention), neither of the preamble nor the above comments are binding law but are only intended to guide interpretation of the substantive provisions in the Regulation. The inclusion of the words ‘should’ and ‘for the matters covered by it’ and ‘Unless otherwise stated’ allow for exceptions to the application of the uniform conflict of laws rules. Further, Preamble 24 of the Regulation allows for exceptions that protect the legitimate expectations of the parties. Giving effect to express choices of law in an arbitration agreement would be an example of a legitimate expectation.

14.6. The Regulation uses the words ‘solely by the law of the Member State’ in three other provisions. Review of these provisions reveals that, unlike a pending arbitration proceeding which most likely involves a multiplicity of choice of law questions, the provisions deal with very limited and relatively straightforward choice of law problems. Articles 8 applies to contracts related to immoveable property, where the applicable law is the law of the place where the property is situated. This rule conforms with the usual conflict of law rule applied to immovable property and can only lead to the application of one possible system of law. Article 9 applies to the special case of payment systems and financial markets and solely applies the law of applicable to that system or market. Similar to immovable property, the payment and financial system or market is likely to be located and organised under only one legal

145 Preamble 24 provides ‘Automatic recognition of insolvency proceedings to which the law of the opening State normally applies may interfere with the rules under which transactions are carried out in other Member States. To protect legitimate expectations and the certainty of transactions in Member States other than that in which proceedings are opened, provisions should be made for a number of exceptions to the general rule.’.
regime and does not lead to a conflict of laws problem. However, Article 10 differs from the previous two provisions and provides ‘The effects of insolvency proceedings on employment contracts and relationships shall be governed solely by the law of the Member State applicable to the contract of employment.’ It as is not difficult to envisage circumstances in which conflict of laws questions would necessarily arise and must be applied to determine which Member State’s law is applicable to the contract of employment. The Virgos-Schmit report notes that this question will be determined by the Rome Convention.

14.7. Notwithstanding Preamble 23 and comments in the Virgos-Schmit Report, Article 10 contemplates the application of conflict rules different from those provided for elsewhere in the Regulation and that do not necessarily lead to an application of the lex concursus. Accordingly, the words ‘solely by the laws of the Member State in which the lawsuit is pending’ can be taken to include the conflict of laws rules of that Member State. There is no reason why an arbitral tribunal should not apply the choice of law rules of the arbitral seat in order to determine the substantive law rule to apply to determine the effect of the insolvency on the pending arbitration. As noted above, this however requires that the arbitrator to correctly characterise the provision that potentially has effect on the arbitral proceedings in order to apply the correct choice of law rule.

14.8. Applying the approach that Article 15 displaces the other choice of law rules in the Regulation and requires the sole application of the law of the Member State including that Member State’s choice of law rules to the Elektrim v Vivendi case, Article 142 of the Polish law would only have an effect on a lawsuit pending in England, if English choice of law rules called for an application of Polish law. Applying English conflict of laws rules, the result would be that English law and not Polish law would apply to the arbitration agreement. Therefore, Article 142 of the Polish insolvency law would have no effect and the arbitral tribunal would retain jurisdiction.

14.9. This approach has the advantage of preserving existing arbitral practice regarding the effects of insolvency of one party on the proceedings which generally has only given effect to foreign insolvency laws if the foreign insolvency law is deemed to be applicable to the arbitration. It gives maximum freedom to the arbitral tribunal or court seized of the proceeding to apply the law that is most appropriate to determining the effect of the insolvency on the pending lawsuit. In other words, it treats a lawsuit pending as falling outside the scope of the Regulation and leaves all matters for the determination of the forum of the pending lawsuit. It does not however mean that the court or arbitral tribunal must apply only the substantive law of the lex fori or arbitral seat to determine all issues but must decide which law to apply according to the choice of law rules deemed applicable in that forum. For a court this will always be the choice of law rules of the forum but is not necessarily true for arbitration. This approach avoids the difficulty of applying the substantive law of the forum seized of the proceedings to an issue that has little or no relation to the insolvency proceedings or to the parties themselves.

14.10. As arbitration is fundamentally consensual, this approach allows the arbitrator to give effect to the parties express choices of laws, which as stated at paragraph 5.5, may select different laws to apply to different aspects of an arbitration proceeding. Failing an express choice of law, for example, relating to the law applicable to the arbitral agreement, the arbitrator is free to select the law applicable to the arbitration agreement according to established choice of law principles and arbitral practice, for example, Rule 54 in Dicey & Morris.

14.11. In the context of insolvency, this approach discourages parties from attempting to avoid or delay the rendering of an award through voluntarily or opportunistic insolvency and upholds the underlying objectives of the New York Convention and international arbitration process. On the other hand, the choice of law rules in Article 4 of the Regulation are not designed for, nor appropriate to answer all the choice of law questions that can potentially arise in a pending international arbitration proceeding.

14.12. As a final point, the above problems could be avoided if ‘lawsuits pending’ were excluded from the application of the Regulation altogether under Article 1(2).
PART V – ENFORCEABILITY ISSUES

15. Enforceability of the award in Elektrim v Vivendi

15.1. It is interesting to consider whether the arbitral award in *Elektrim v Vivendi* would be enforceable under the New York Convention.

15.2. Levy argues that as the arbitrator is not integrated into any legal system but is rather bound by the parties’ arbitration agreement he will not need to give any priority to the laws of the seat of the arbitration and in particular, the territoriality or universality of a bankruptcy is not an issue in international arbitration. The Regulation and the UNCITRAL Model Law on Cross Border Insolvency arguably modify this position.

15.3. The latter has been recently adopted in many major trading nations outside of the European Union. Importantly, the UNCITRAL Model Law does not depend on any reciprocity requirements and insolvency administrators or other similarly situated persons can avail themselves of the UNCITRAL Model Law in any state where it has been enacted. Because both laws facilitate recognition of foreign insolvency proceedings, both pieces of legislation have implications on the validity and operability of arbitration agreements and the enforceability of arbitral awards in jurisdictions to which the Regulation and UNCITRAL Model Law apply. The universal effect of the insolvency proceedings is therefore an important consideration that the arbitrator must take into account in order to discharge his or her duty to make best efforts to render an enforceable award.

15.4. In most cases the arbitrator is bound by the external arbitral procedural law of the arbitral seat and the orders of the courts made within that jurisdiction. This is important as the effects of insolvency proceedings in one European Union Member state will automatically be recognised in another European Union Member state by

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operation of law.\textsuperscript{152} In other countries, an application for recognition of the insolvency proceeding pending in a Country A may be made to the courts of, say Country D where the pending arbitration is sited. The court will apply its own law including its own choice of law rules to determine whether or not to recognise the insolvency proceeding in Country A and the law to be applied to decide whether or not to order that the arbitral proceedings pending in Country D be stayed or terminated.\textsuperscript{153} In countries that have enacted the UNICTRAL Model Law on Cross Border Insolvency, an effect of recognition of a Foreign Main Proceeding is to either automatically, or at the discretion of the national court, stay all proceedings within the enacting country’s territory.\textsuperscript{154} In some jurisdictions the power of the courts to interfere in the arbitral process once proceedings have commenced is limited.\textsuperscript{155} Nevertheless, if the courts of country D recognise the insolvency proceedings in Country A and order a stay or termination of arbitral proceedings in Country D, it is doubtful that the arbitral tribunal seated in Country D can continue with the arbitration in contempt of a court order terminating or staying the arbitral proceedings in country D, although the arbitral tribunal can ordinarily continue with the arbitration pending the outcome of the court decision.\textsuperscript{156} Under the UNCITRAL Model Law the stay may also be lifted on application to the court.\textsuperscript{157}

15.5. In practice, the first port of call for Vivendi would be to file its claim supported by the award in the Polish bankruptcy proceeding. If the award is accepted by the Polish bankruptcy court then Vivendi will rank amongst other creditors of the same class and will receive its share of any surplus assets on a \textit{pari-passu} basis. However, a serious impediment to enforceability arises if the Polish bankruptcy court declines to accept the validity of the award. For similar reasons as held by the Swiss Supreme Court, the Polish bankruptcy court could do so on the grounds that the bankrupt estate was incapacitated under Article V(1)(a) or on public policy grounds.

\textsuperscript{152} Article 16, 17, Regulation 1346/2000.
\textsuperscript{154} For example, United States of America: States of America: see s 362(a) of the Bankruptcy Code; New Zealand: see Article 20 and 21 of Schedule 1, Insolvency (Cross-border) Act 2006.
\textsuperscript{155} For example see, Article 1(c), 31 and 32 Arbitration Act 1996 (UK); Poudret, Jean-François, Besson Sébastien, Ponti, Annette, \textit{Comparative Law of International Arbitration}, Sweet & Maxwell, 2007, p 502.
\textsuperscript{157} For example: In New Zealand: see Article 20(2) Schedule 1, Insolvency (Cross-border) Act 2006.
under Article V(2)(b). Whether or not an award is contrary to public policy will be left to the determination of the enforcing court but is generally construed narrowly. It should be noted that assembling all claims in a single proceeding to allow the equitable and orderly distribution of assets and equality of creditors is recognised in most, if not all insololvency regimes.

15.6. Whether or not the award is enforceable in a third country will depend on the recognition of effects of the insolvency proceeding in that country. It is likely, however, that the enforcing court in a third country will refer the claim back to the lex concursus and the law of the lex concursus will determine its enforceability. This is particularly so in countries subject to the Regulation that must automatically recognise the foreign insolvency proceedings. This is also likely to be the case in other common law jurisdictions on the basis of comity or recognition under the UNCITRAL Model Law. An example of this approach is found in Victrix S. S. Co. v. Salen Dry Cargo A.B. On the basis of application of comity principles pursuant to the former s 304 of the Bankruptcy Code, the US Court refused to enforce the award in the US in circumstances where an arbitral award was rendered in London against Salen, a Swedish company, after insolvency proceedings had been opened in Sweden. The Court held that as a matter of US public policy the individual creditor’s claims should be referred to the Swedish bankruptcy court and could not be enforced against Salen’s assets in the United States.

15.7. In support of a contrary proposition, Lazić cites Fotochrome, Inc. v. Copal Co., Ltd and states ‘In Fotochrome the Court held that the fact that an arbitral award was rendered contrary to the order of the bankruptcy court disallowing continuation of foreign arbitral proceedings did not render this award non-enforceable in the US bankruptcy proceedings. Such an award was held not to be contrary to public policy.’ However, the court in Fotochrome

161 Victrix S.S. Co. v. Salen Dry Cargo A.B., 825 F.2d 709 (2d Cir. 1987).
162 See also Cunard Steamship Co., Ltd v. Salen Reefer Services A.B. 773 F.2d 452 (2d Cir.1985) for a case to similar effect.
163 Fotochrome, Inc. v. Copal Co., Ltd 517 F.2d 512 (2d Cir. 1975).
was not at all concerned with questions of enforceability or public policy under Article V.\textsuperscript{165}

15.8. In \textit{Fotochrome} the arbitration was between a US company and Japanese company that was neither present nor doing business in the US. The arbitration was seated in Japan. Nearing the completion of the arbitral proceedings the US corporation filed for bankruptcy in the US, invoking an automatic stay under US law on all legal proceedings. Notwithstanding the stay, the arbitral tribunal rendered its award. In those circumstances the US court concluded that ‘a Bankruptcy Court does not have the power in a Chapter XI arrangement to relitigate the merits of a contract dispute which has been resolved by binding arbitration in a foreign forum, commenced before the filing of the Chapter XI petition and concluded thereafter by an arbitral award in the foreign country.’\textsuperscript{166} The reasoning in the judgment makes it clear that the stay order did not have extra-territorial effect on the Japanese arbitral proceedings. In light of that, the court stated that ‘\textit{Copal} must seek a judgment based on the award in a District Court of the United States under 9 U.S.C. § 207.5 \textit{Fotochrome} must, in turn, be given the right to assert the non-enforceability of the award under conditions specified in Article V of the Convention. The determination of the enforcement of the award is a matter not before us on this appeal.’

15.9. Accordingly, the decision in \textit{Fotochrome} is in line with English authority on the extra-territorial effect of the mandatory stay of proceedings\textsuperscript{167} but does not deal with the issue of enforceability in the US of foreign arbitral awards when insolvency proceedings have been opened in a foreign state. It is likely that the decisions in the \textit{Victrix} and \textit{Cunard Steamship Co., Ltd. v. Salen Reefer Services} would be followed in such a case, effectively limiting the enforcement forum to the lex concursus.

\textsuperscript{165} \textit{Fotochrome, Inc. v. Copal Co., Ltd} 517 F.2d 512 (2d Cir. 1975), Para 15-16, ‘As we shall see, this appeal can be decided without the necessity of determining whether the Bankruptcy Act involves a “public policy” which is contrary to enforcement of arbitral awards under the Convention.’ The questions that arise on this appeal are: (1) Is a foreign arbitral award rendered after the filing of a Chapter XI petition in the United States Bankruptcy Court nevertheless a valid determination on the merits? (2) If it is, what is the domestic “competent authority” to consider the limited defenses against its enforcement, the District Court or the Bankruptcy Court?


\textsuperscript{167} \textit{Re Vocalion (Foreign) Ltd} [1932] All ER 519.
CONCLUSION

The differences between the nature of insolvency proceedings and arbitration proceedings have led to a number judges, authors and commentators to state that insolvency and arbitration ‘presents a conflict of near polar extremes’. The legal consequences and territorial scope of the effects of insolvency of one party on its legal capacity and on the legal rights of others are far from uniform. In a cross-border context the effect of insolvency of one party on the validity and operability of an arbitration agreement and the arbitral tribunal’s jurisdiction is dependant on the system of law that is applied to determine that question. The outcome of that inquiry will depend on the choice of law rule applied. It is critically important to properly characterise issues in a case at the outset so that the correct choice of law rule is selected to determine the appropriate substantive law.

Characterisation is governed by the lexi fori. It is the substance of the issue or problem presented in the case that should be characterised and not the specific rule of foreign law. Mandatory stay provisions and provisions such as Article 142 of the Polish law ought to be characterised as raising an issue as to the substantive validity of the arbitration agreement and not as issues affecting the capacity of the insolvent party. In the alternative these rules are procedural in nature and have no application in forum court or arbitral tribunal where a lawsuit is pending. In case of doubt, a validation principle ought to be applied. This approach best preserves the underlying goals and principles of international commercial arbitration, which has developed to avoid the interference of parochial laws that undermine the arbitral process.

In European Union Member States, Article 15 of Regulation 1346/2000 refers all issues in a pending proceeding for determination solely by the law of the Member State where the lawsuit is pending. The remaining choice of law provisions in Article 4 cease to apply when Article 15 applies. This does not however mean that the court or arbitral tribunal must apply only the substantive law of the lex fori or arbitral seat to determine all issues but must decided which law to apply according to the choice of law rules deemed applicable in that forum. This approach leaves any court or arbitral tribunal free to determine the effect that insolvency of a party to a proceeding has on the pending proceedings according to

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whichever law it deems applicable to those proceedings and effectively excludes lawsuits pending from the scope of the Regulation.

Finally, increased ease of recognition of foreign insolvency proceedings facilitated by the Regulation and UNCITRAL Model Law is likely result in courts, where those laws are applicable, refusing to enforce an arbitral award against an insolvent entity and instead refer enforcement actions to the country where the debtor has its centre of main interests, for satisfaction according to that country’s insolvency laws, effectively limiting the only realistic enforcement forum to the country of opening of the insolvency proceedings.

Mark Robertson
Master of Law and Business
Bucerius Law School / WHU Otto Beisheim School of Management
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