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Recent Swedish Ruling on Arbitrability

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On 7 October 2011 the Svea Court of Appeal ruled on whether an arbitral award should be declared invalid or annulled because the dispute – as alleged by the plaintiff – was not arbitrable under the Swedish Arbitration Act.[1)] In finding that the dispute was arbitrable, the Svea Court considered several interesting issues analyzed below.

The background is as follows:

To build a golf course in Moscow, a Russian company (the "Russian Borrower") had borrowed 22 million Swedish Crowns from a Swedish bank (the "Swedish Bank") under a loan agreement entered into on 24 January 1990 (the "Loan Agreement"). The Loan Agreement included an arbitration clause providing for arbitration under the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce ("SCC").

On 19 December 2008 the Swedish bank requested arbitration against the Russian Borrower seeking repayment of a certain capital amount under the Loan Agreement. The Russian Borrower rejected the claim and argued, *inter alia*, that the Loan Agreement violated then mandatory currency regulations in the former Soviet Union and that the dispute was therefore not arbitrable.

The SCC decided that the seat of the arbitration proceedings should be Stockholm.

The sole arbitrator held in the award, *inter alia*, that the Russian Borrower had not proved that the Loan Agreement violated then mandatory currency regulations in the former Soviet Union or in Russia and the Russian Borrower was ordered to pay a certain capital amount with interest thereon and compensation for costs.

The Russian Borrower turned to the Svea Court of Appeal and requested, *inter alia*, a declaration that the award was invalid on the basis that the award included the review of an issue which is regulated in mandatory currency regulations. Hence, the Russian Borrower argued that the issue was not arbitrable and the award should therefore be declared invalid. In the alternative the Russian Borrower requested annulment of the award on the basis that the arbitration agreement was not valid and binding as it violated mandatory currency regulations.

The Russian Borrower argued as follows: Rigorous currency regulations were in force

in the beginning of the 1990s, both in Sweden and in the Soviet Union. Import or export of currency without authorization from the proper authorities was not allowed. Nor was the reduction of a loan amount or granting a respite for payment. In Sweden this followed from the Exchange Control Act (*Sw: valutalagen (1939:350)*) and the Exchange Control Regulation (*Sw: valutaförordningen (1959:264)*). The provisions were sanctioned by penalty and any currency could be forfeited. Since the Loan Agreement violated these provisions the Loan Agreement was invalid.

Further, the parties could not before or after a dispute had arisen "heal" the invalidity of the Loan Agreement. It was not amenable to settlement. Hence, issues arising out of the Loan Agreement were not arbitrable and no dispute under the arbitration clause could be referred to arbitration. This in turn meant that the arbitration agreement was invalid. The relevant point in time for assessing whether an issue is arbitrable is when the arbitration agreement is entered into.

The Swedish Bank disputed that the award was invalid or that it should be annulled. The issue tried in the award – whether the Russian Borrower had a payment liability under the Loan Agreement – is arbitrable. Further, the question whether an arbitration agreement is valid and binding has to be tried separately. The arbitration agreement is valid and binding under Swedish law which is the governing law of the arbitration agreement. Even though the main agreement may be invalid (which the Swedish Bank disputed) this does not mean that the arbitration agreement is invalid. The currency regulations are of no relevance for the validity of the arbitration agreement.

The Svea Court of Appeal held as follows:

Since the arbitration proceedings had been held in Stockholm it was clear that the arbitration agreement was governed by Swedish law. The question whether the dispute was arbitrable was therefore to be tried under Swedish law and under the Arbitration Act only disputes in respect of which the parties may reach a settlement may be referred to arbitration.

An arbitral award is invalid if it includes the determination of an issue which, in accordance with Swedish law, may not be decided by arbitrators (lack of arbitrability). However, the fact that there is mandatory legislation in a certain area of the law does not automatically mean that disputes in this area are not arbitrable. With respect to international disputes which involve foreign legislation it has to be decided on a case-by-case basis whether the foreign law is such that a voluntary settlement of the dispute before a Swedish court would not be accepted. With regard to economical-political regulations in a foreign state there is often no reason why the mandatory provisions should affect the possibility to settle in Sweden and, hence, the arbitrability under Swedish law. This view is in accordance with an international trend to accept that an international dispute may be settled by arbitration although a corresponding national dispute would not be arbitrable.

The relevant point in time for assessing whether the dispute in question is arbitrable is when the Loan Agreement was entered into, i.e. on 24 January 1990. At that time the parties should be able to foresee the consequences of any lack of arbitrability.

When the Loan Agreement was entered into, Sweden as well as the Soviet Union had mandatory currency regulations. The Swedish Exchange Control Act and Exchange Control Regulation included restrictions on the import and export of foreign currency and securities. The same applied to the purchase and sale of foreign currency and foreign claims. However, there were no restrictions for a Swedish legal entity to enter into a loan agreement whereby a foreign legal entity became indebted. The currency regulations were not aimed at disallowing a creditor-debtor relation as such; but concerned the making of payments cross the borders.

The parties' claim and debt under the Loan Agreement could not be deemed subject to mandatory legislation in such way that this undertaking was not amenable to settlement. Hence, the parties could reach a settlement regarding this. The issue tried in the award was the debt undertaking; not how any payment should be made. The dispute was thus arbitrable.

Since the mandatory currency regulations did not mean that a non-arbitrable issue was tried in the award the arbitration agreement was valid and binding. This is regardless of whether said currency regulations may entail that parts of the Loan Agreement were invalid.

The ruling of the Svea Court of Appeal seems quite arbitration friendly and is in line with the international trend to maximize the scope of application of an arbitration agreement. The restrictions in the previous currency control regulations in Sweden were narrowly interpreted and the doctrine of separability was firmly adhered to. The currency regulations in the former Soviet Union were not analyzed at all by the Court of Appeal. However, the Court of Appeal seemed convinced that the issue in dispute – whether there is a payment liability under a loan agreement – was not subject to any mandatory currency regulations. Further, the Court of Appeal did not expressly address whether the Swedish law test for arbitrability – that the dispute must be amenable to settlement – should be determined under Swedish substantive law or the *lex causae*. It has been suggested in Swedish legal doctrine that the question whether the parties are capable of settling the dispute should normally be assessed under the law governing the main contract. If the governing law is foreign law the outcome of that test under foreign law is decisive for the question of arbitrability. In this case it is unclear whether *lex causae* was Swedish law or any foreign law. The reason why this was not dealt with by the Court of Appeal might be that it had no relevance here as the previous currency regulations, both in Sweden and Russia, did not prohibit debt undertakings *per se*.

Leave to appeal was granted by the Court of Appeal[2)] and the Russian Borrower has appealed the judgment to the Supreme Court.

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References

↑**1** Case no. T 6798-10.

↑**2** The Court of Appeal may grant leave to appeal where it is of importance as a matter of precedent that the appeal be considered by the Supreme Court.

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