Kluwer Arbitration Blog

The Effects of Bankruptcy on Arbitration: An Unresolved Issue of Characterization and Applicable Law

Patricia Živkovi? (University of Aberdeen) · Monday, September 14th, 2015

The effects of bankruptcy on arbitration remain unclear and they differ from jurisdiction to jurisdiction. Although being oft-discussed in doctrine as well in court and arbitral practice, there is still no uniform answer to the question of which law governs such effects. We saw this question again in the Svea Court of Appeal's ["Svea Court"] decision rendered on March 20, 2015 between Advadis S.A. ["Advadis"] and Royal Unibrew A/S ["Royal Unibrew"][Case No. T 8043-13].

Royal Unibrew's subsidiary, Royal Unibrew S.p.z.o.o. ("RU"), concluded a transfer agreement with Advadis and its majority shareholder Mr. AB. The acquisition was completed in 2005. The agreement provided for all the disputes to be "submitted for resolution to the Arbitration Institute of the Stockholm Chamber of Commerce in accordance with its rules."

In 2006, based on the application of the Polish bank Kredyt Bank, the control over one of the RU's bank accounts was seized and a certain amount was paid to the bank. Royal Unibrew considered that this amount and costs incurred due to this seizure should be compensated by Advadis pursuant to warranties which were provided in connection with the acquisition. The arbitration was commenced by Royal Unibrew in 2011, and on May 29, 2013, the final award was rendered which ordered Advadis and Mr. AB to jointly and severally compensate Royal Unibrew. Advadis and Mr. AB filed a motion to the Svea Court to set the award aside. This blog post is analysing one of the grounds for such a motion – invalidity of the arbitration agreement due to Advadis's bankruptcy.

Parties' submissions

Advadis, a company incorporated in Poland, was declared bankrupt in 2012. In the setting aside proceedings, Advadis claimed that Polish law should be applicable to the effects of the bankruptcy on the arbitration. Advadis claimed the invalidity of the arbitration agreement based on the provision of the Polish law which states that any arbitration clause loses its legal effect at the date of bankruptcy and pending arbitrations should be discontinued. Royal Unibrew, on the other hand, submitted that Swedish law should be applicable, and that under this law the arbitration agreement remained valid. It also invoked Article 15 of the Council Regulation 1346/2000 of 9 May 2000 ["Insolvency Regulation"] which provides that

> "The effects of insolvency proceedings on a lawsuit pending […] shall be governed solely by the law of the Member State in which that lawsuit is pending."

Advadis followed by a request for a preliminary ruling from the European Court of Justice [“ECJ”] to determine whether the Article 15 of the Insolvency Regulation can be waived by a transfer agreement.

The Svea Court’s decision

Although it would be interesting to see what the ECJ’s opinion would be in this regard, the Svea Court decided not to ask for the preliminary ruling from the ECJ on waiver of Article 15 because it preceded this issue by a review of applicable law. The issue of which law governs the arbitration agreement was exhaustively analysed in the English court’s decision in Sulamerica case [*Sulamerica CIA Nacional de Seguros SA and others v Enesa Engenharia SA and others* [2012] EWCA Civ 638]. Although without as detailed reasoning as in the English court’s decision, in which the court did not find an express choice of the substantive law to be sufficient evidence of the governing law of the arbitration agreement, the Svea Court similarly stated that the agreement provides “that the substantive laws of Poland shall govern the parties’ agreement”, but that it “does not explicitly provide that the parties’ arbitration agreement shall be governed by Polish law”.

Furthermore, it concluded that choice of Stockholm as the place of arbitration indicated Swedish law as to be applicable to the arbitration agreement. Consequently, the Svea Court did not find any provision under which the arbitration agreement should cease to exist in given circumstances, and it found it to be valid.

Comparison with the “Elektrim saga”: The issue of characterization and applicable law

The Svea Court’s decision was not the first one which tackled the issue of which law governs the effects of bankruptcy on arbitration in relation to the controversial and quite unique provision of Polish law. This issue was widely discussed a few years ago in a scholarly work when it was brought before two different arbitral tribunals, and, consequently, before two different national courts – the English courts [Syska v. Vivendi Universal SA(2008) EWHC 2155 (Comm) (Clarke J); Syska v. Vivendi Universal SA (2009) EWCA Civ 677 (CA [Civ Div])] and the Swiss court [Swiss Federal Supreme Court, Mar 31, 2009, docket no. 4A_428/2008], and these courts came to different conclusions due to different characterization of the issue and different applicable laws.

In both cases, one of the parties, a Polish company Elektrim, went bankrupt in the course of arbitration. Without going to further details, it can be stated that the English court(s) posed the question as an issue of law applicable to the effects of bankruptcy on the lawsuit pending under Article 15 of the Insolvency Regulation, and found English law to be applicable being “the law of the Member State in which that lawsuit is pending”. Since the applicable law contained no legal provisions which would require discontinuance of the arbitration, the English court did not set aside the arbitral award.

On the other hand, the Swiss Federal Supreme Court for obvious reasons did not apply the Insolvency Regulation. It qualified the issue of a bankrupt Polish party as to be an issue of the standing to participate in the proceedings which depended on the preliminary issue of the party’s legal capacity. Since party’s legal capacity under the Swiss Private International Law was to be governed by the law of the place of the party’s incorporation, the Swiss court applied Polish law. Consequently, it found that the Polish party lost its legal capacity and standing in the arbitration once it went bankrupt due to the above mentioned provision of the Polish law. The issue was revisited again by the Swiss Federal Supreme Court under a similar provision of the Portuguese

law in 2012 [DFC 138 (2012) III714], but although the final decision was different, characterization of the issue was still the same – (non)existence of legal capacity.

Interestingly, the Svea Court's approach falls somewhere in between these two decisions. Although being a national court of the EU Member State, it does not follow the English court's approach, since it circumvented the application of the Insolvency Regulation by characterizing the issue as to be an issue of validity of the arbitration agreement. In this regard it simply stated that "[s]ince the arbitration was Swedish, [the issue of existence of the arbitration agreement] shall be settled under Swedish law, unless the parties have agreed otherwise."

At the same time, the Svea Court also disregarded the Swiss approach, and it qualified this issue to be an issue of validity of the arbitration agreement, rather than the one of legal capacity of the Polish party. So, was the Svea Court right in doing so?

It is difficult to say which approach is the correct one. However, this decision raises a question whether the purpose of Article 15 of the Insolvency Regulation was violated by such non-application? Can a simple re-characterization of an issue circumvent the application of Article 15, which subjects the effects of bankruptcy on pending arbitration to the law of the place where such arbitration is pending? It is important to mention that the Article 142 (and 147) of the Polish Law on Bankruptcy and Reorganization go beyond the effect of bankruptcy on validity of the arbitration agreement by stating that

> "Any arbitration clause concluded by the bankrupt shall lose its legal effect as at the date bankruptcy is declared and any pending arbitration proceedings shall be discontinued."

In other words, these articles govern not only validity of the arbitration clause, but further effects of bankruptcy on pending arbitration as well. Both the loss of legal effect and discontinuation of pending arbitration proceedings are effects of bankruptcy on arbitration, and as such should fall under Article 15 of the Insolvency Regulation when the applicable law is to be determined.

The second question that stems from the Svea Court's decision is: does a choice of law applicable to arbitration agreement supersede the application of the Insolvency Regulation? The answer should probably be "no". However, this answer might change if the parties choose the law applicable specifically to the effects of bankruptcy, which would open an interesting discussion regarding the application of Article 15 and the possibility to waive it.

Conclusion

There are two important aspects of this decision. Firstly, it impliedly confirmed that the unique Polish regulation of the matter is not a preferred solution. This provision will hopefully not be an issue any more since new laws regulating bankruptcy will enter into force on January 1, 2016, when it will be substantially changed and bankruptcy of one of the parties will not result in the discontinuation of the arbitration proceedings.

Secondly, it provides a new perspective on the issue of effects of bankruptcy on arbitration. In the case at hand, the application of Article 15 would make little difference since it would lead to application of Swedish law as well. However, if in the next case the place of arbitration will differ

from the law which governs the arbitration agreement, the issue is whether the court can and should avoid the application of Article 15 by mere re-characterization of an issue as an issue of validity, rather than as a broader issue of effects of bankruptcy on arbitration.

This entry was posted on Monday, September 14th, 2015 at 6:00 am and is filed under Applicable Law, Arbitration Agreements, Arbitration Proceedings, Bankruptcy and arbitration, Sweden
You can follow any responses to this entry through the Comments (RSS) feed. You can skip to the end and leave a response. Pinging is currently not allowed.