Kluwer Arbitration Blog

A Dialogue on International Arbitration and Insolvency

Ishaan Madaan and Chauhan Prakhar (Jindal Global Law School) · Sunday, September 6th, 2020

The intersection of arbitration and insolvency, ever since the onset of the pandemic, is becoming a topical area of focus. The Centre for International Legal Studies (an Austria based non-profit society) and Arbinsol (a platform dedicated to the research on arbitration and insolvency) have responded by organizing an ongoing series of "post-pandemic" webinars. The most recent, 'A Dialogue on International Arbitration and Insolvency,' featured Professor Loukas Mistelis and Professor Patricia Shaughnessy, who shared their views on adjudicating claims where the intersection is involved. Ishaan Madaan and Professor Prakhar Chauhan moderated the program while Christian Campbell contributed with a few closing remarks. This post provides a recap of the webinar and additional comments on the topic.

The dialogue centered around the role of an arbitral tribunal adjudicating a dispute where either contesting party is simultaneously undergoing insolvency proceedings elsewhere. It emphasized the complex questions faced by tribunals in two different scenarios: where party (undergoing insolvency proceedings) is in parallel arbitration proceedings, and where the tribunal is seated in a country other than the insolvent's home jurisdiction.

The stage at which a tribunal is informed of a party's insolvency was considered to be of utmost importance. Another pertinent issue taken up during the discussion was the relationship between the arbitrators and the insolvency trustee/administrator, who is the custodian of the liquidation estate. The dialogue also covered the speakers' opinions with respect to sham arbitrations. A discussion on sham arbitrations is imminent as parties often resort to arm-twisting mechanisms to frustrate the entire adjudicatory process by misusing the gaps in the legislative schemes of different countries.

Insolvency v. International Arbitration: A 'nuclear threat'?

Initiating the discussion, Professor Mistelis compared the situation with a 'nuclear threat'; as the arbitrator is expected to render an enforceable award, and an award against an insolvent party may never be enforced. A claim of insolvency jeopardizes the efficiency of an arbitration, as parties may be required to advance costs, which may further culminate into the inability of the party to participate in the entire process. While a party's liquidity to meet an award is not the tribunal's concern, the same does have a bearing when it comes to a party's ability to participate in the proceedings. Joining in, Professor Shaughnessy detailed the risks which arbitrators face in *ad hoc* arbitrations when compared to institutional arbitration. She emphasized on the convenience that the

more sophisticated institutional arbitration may offer, as opposed to *ad hoc* arbitration where the tribunal itself may be required to push the parties towards securing the costs of the arbitration. Faced with the risk of rendering an unenforceable award, a tribunal may likely require the party advocating to proceed with the arbitration to make out a convincing case, unless concerns of inarbitrability, public policy, applicable law etc. are facially apparent. The characterization of issues and fact-finding by the tribunal into the allegations by the parties was unanimously agreed upon as a key role which the arbitrators play. A key aspect which surfaced was the categorization of enforceability as 'enforceability in law' and 'enforceability in fact' (only the former fell within the domain of the tribunal to achieve).

With regard to categorization, the perspective of the tribunal is of immense importance, e.g. whether the validity of the arbitration agreement itself is in question, whether insolvency is seen as a procedural issue, the effect of domestic insolvency proceedings on ongoing international arbitration, etc. The *Elektrim/Vivendi* saga provides a perfect example of how differently tribunals can approach pendency of a party's insolvency proceedings in contradicting ways. Although a Swiss tribunal refused to continue with arbitration proceedings against Elektrim (then undergoing insolvency proceedings in Poland), an LCIA tribunal proceeded in arbitration against Elektrim at the same time. Both awards were also, incidentally, upheld. The Swiss Supreme Court, which had upheld the Swiss tribunal's award, however, later revisited its views in another case. Article II of the New York Convention (the Convention) touches upon capacity of the parties, but that usually comes into play to determine whether the party had the capacity to enter into an arbitration agreement. It may be argued that an insolvent party may enter into such an agreement, however, in most instances, a party would have entered into an arbitration agreement prior to triggers of insolvency, i.e. when capacity was not really in question. Arbitrators would usually be guided by the Convention, especially Article II (3), which entails that matters should not be referred to arbitration when the agreement is either null and void, inoperative or incapable of being performed.

Temporal primacy of the proceedings

The issue of temporal primacy of the proceedings (whether insolvency pre-dated arbitration or *vice-versa*) becomes relevant when addressing the above questions. The source of the tribunal's power lies in the arbitration agreement. A tribunal would have to be mindful of public policy concerns if an insolvency proceeding has already begun in respect of a party to an international arbitration proceeding. In domestic arbitrations, such situations would likely not arise as typically all proceedings come to a standstill upon the initiation of insolvency proceedings. When arbitration precedes insolvency, the tribunal may have a broader scope of adjudicating the claim before it. In such cases, the role and the interdependence of the tribunal and the insolvency trustee becomes important. Questions of whether the trustee should mandatorily be permitted representation in the arbitral process or whether an application for security costs can be allowed on disclosure of insolvency are worth researching, when the issue of primacy is addressed.

Professor Shaughnessy emphasized the division of core and non-core issues to determine arbitrability. The powers, which the trustee draws, emanate from a legislation governing the insolvency process, whereas, the contractual origins of arbitration limit the scope of the tribunal's powers (for instance, the liquidation estate cannot be identified in an arbitration, the appointment of the trustee cannot be the subject matter of arbitration, etc.). Although insolvency is a collective process (i.e., involving resolution of claims by multiple creditors), it is different from classical

arbitration. They both have different DNAs, with the former having a domestic pull and with a single jurisdiction.

Insolvency trustee's relationship with the tribunal

The relationship between the trustee and the arbitrators was then taken up by the panelists. Professor Shaughnessy indicated that a tribunal lacks jurisdiction to decide on amounts to be disbursed from the insolvency estate once the trustee has been appointed. The domestic rules need to be considered in order to conclusively decide the fate of the intersection, especially when it comes to payments of costs. The trustee or the municipal courts, as prescribed under the legislation, are better equipped to deal with such a situation. Drawing from his experience, Professor Mistelis pointed out that the tribunal should be convinced that the trustee has the capacity to represent the party undergoing insolvency proceedings. A trustee, in his capacity as a party representative, should be treated equally with the opposite party. Citing instances from investment and commercial arbitrations, Professor Mistelis emphasized how security for costs may become a major issue for maintaining the sanctity of the entire process, especially when one of the parties is facing insolvency proceedings. A pertinent question, which Professor Shaughnessy raised in the context of simultaneous representation of the insolvent party by the trustee and by the management of the party in the same arbitration, was the location of the seat (whether the same as or different than the jurisdiction of the insolvency proceedings). The discussion steered to ask whether we are more concerned with the seat of the bankruptcy or with the seat of arbitration. If concerned with former, the court will decide who has a better right. But if latter, then the tribunal may proceed and issue the award. It is hard to find an applicable law on this issue.

Allegations of insolvency and Sham Arbitrations

The discussion further progressed to elaborate on the extent to which an arbitrator should investigate the veracity of the claim of insolvency. In Professor Mistelis' opinion, an allegation of insolvency should be evidenced before the tribunal. The tribunal also has a duty to verify both the allegations and the implications of such insolvency proceedings under domestic law. Professor Shaughnessy stated that court insolvency proceedings provide ample proof of the existence of such a situation, and allegations of impecunity have to be demonstrated, too. In the context of sham arbitrations, an instance was discussed where a creditor forced receivership on a company. The receiver then appointed an arbitrator in one jurisdiction, to gain control over the assets of the company. The company had to approach the local courts arguing that a court in another jurisdiction had already decided the appointment of an arbitrator to be incorrect. 'Aggressive creditors' usually tinker with possible recourses and compel multiple proceedings to recover dues. It was also observed that sham arbitrations are more likely to take place in an *ad hoc* rather than in institutional arbitration.

Concluding remarks

The commonalities emerging from this free-flowing exchange of views indicate that the interplay between arbitration and insolvency is largely addressed on a case-by-case basis, whilst there

appears a need for addressing it at a legislative level or by resorting to more uniform international instruments. The dialogue, in most part, called out the elephant(s) in the room when it comes to this interplay. Because of the enormity of the conflicts that this interplay raises, it calls for sound and experienced professionals, on either side of the proceedings, to tend to, and to influence the outcomes in a way that results in viable solutions. The myriad of issues that these conflicts raise would otherwise lead to more chaos and less resolution in the post-pandemic times. The dialogue also raised one pertinent point (discussed in detail here) and one that should be advocated for without disregard to insolvency issues. International arbitration should generally be allowed to go forward and its integrity should be maintained subject to the circumstances. It is otherwise easy to derail and disrupt arbitral processes by threatening insolvency. The pandemic would anyway lead to countless reasons for 'restructuring' and insolvency triggers would arise in huge numbers.

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