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Swiss Supreme Court Clarifies Arbitrability of Claims in Insolvency Context

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The economic havoc wreaked by the Covid-19 pandemic has resulted in a 10-year high of corporate bankruptcies in the United States in 2020. While bankruptcy levels across Europe have fallen amid the pandemic, a sharp spike in corporate bankruptcies is expected as economic support programs phase out in the coming months.

This will increase the relevance of the thorny relationship between bankruptcy and arbitration, which regularly gives rise to questions such as the capacity to act. This issue was the subject of a 2009 decision of the Swiss Supreme Court, in which it was held that an insolvent Polish entity no longer possessed the capacity to participate in arbitral proceedings. However, the court came to a different conclusion in a subsequent decision in 2012. Taking a slightly different approach analysing the issue of legal capacity, the court held that an insolvent Portuguese entity was capable of being a party to arbitral proceedings. Both of these decisions were discussed in an earlier blog post. In a recent decision (5A_910/2019), the Swiss Supreme Court has contributed further guidance on these thorny issues, having ruled on the enforceability of an award that was issued against a party against whom bankruptcy proceedings were initiated while the arbitration was ongoing.

Background to the Dispute

The 2019 decision concerned the recognition and enforcement of an arbitral award rendered under the auspices of the London Court of International Arbitration (LCIA). During the LCIA proceedings, the Respondent went bankrupt. With the consent of the creditors, the bankruptcy administrator assigned the Respondent's rights in the LCIA proceedings to A, one of its former directors and creditors. A lost and was ordered to pay the costs of LCIA proceedings.

In the subsequent enforcement proceedings, the cantonal courts of Zurich incidentally recognized the costs award and declared it enforceable. A appealed the decision to the Swiss Supreme Court arguing that the recognition and enforcement of the award should be refused since the subject matter of the dispute is not arbitrable under Art. V(2)(a) of the New York Convention.

Reasoning of the Swiss Supreme Court

The Swiss Supreme Court rejected A's appeal. The Court found that under Swiss law, claims against a Swiss party to a foreign arbitration do not *per se* lose their arbitrability if that party goes into bankruptcy after the initiation of the arbitration proceedings.

1. *Claims Filed after the Initiation of Insolvency Proceedings are not Arbitrable*

At the outset, the Swiss Supreme Court clarified that a claim against an insolvent Swiss party is not arbitrable under Swiss law. Thus, an arbitral award obtained against a Swiss party that was already subject to bankruptcy proceedings when arbitration was initiated is not enforceable in Switzerland.

Following the initiation of insolvency proceedings, claims against the bankrupt party must be asserted through the means of recourse available against the schedule of claims in Swiss courts. The schedule of claims is initially drawn up by the insolvency administrator. It collects the claims of all creditors and orders them according to priority. Thus, asserting an additional claim against the bankrupt party requires a challenge to the schedule of claims. Due to the exclusive jurisdiction of state courts in these proceedings, claims against bankrupt Swiss parties are not arbitrable.

Insolvency claims therefore constitute an exception to the rule that any dispute involving an economic interest (*cause de nature patrimoniale*) is arbitrable (para. 3.6 of the judgment).

2. Claims Filed Before the Initiation of Insolvency Proceedings Remain Arbitrable

Importantly, however, this reasoning is limited to arbitrations initiated after the start of the bankruptcy proceedings. According to the Swiss Supreme Court, it does not necessarily apply to claims which are already pending before an arbitral tribunal when the party goes bankrupt. The Swiss Supreme Court compared this situation with the one when a party falls into bankruptcy during ordinary state court proceedings.

If a party goes bankrupt while a case is pending before Swiss courts, the litigation is suspended and the creditors decide whether the proceedings should be pursued further (para. 3.10 of the judgment). If the creditors decide to continue the litigation, the court judgment is binding on the bankruptcy mass.

This applies in principle also to foreign court proceedings in which a Swiss party falls into bankruptcy while the litigation is ongoing. The judgment of a foreign court against the insolvent Swiss party is binding on the Swiss bankruptcy proceedings if the foreign court stays the proceedings and the creditors subsequently decide to continue the foreign litigation (para. 3.12 of the judgment).

Against this background, the Swiss Supreme Court found that there is no reason why the subject matter of arbitral proceedings should *per se* lose its arbitrability if arbitration was already pending at the opening of the bankruptcy proceedings. Thus, an arbitral award resulting from these proceedings would be enforceable with binding effect on the Swiss bankruptcy procedure (para. 3.13 of the judgment).

Key Takeaways

The Swiss Supreme Court decision clarifies an important point, namely that claims remain generally arbitrable even if insolvency proceedings are initiated against a respondent in an ongoing arbitration. This is consistent with the principle that arbitral awards are afforded the same treatment as domestic and foreign court judgments.

However, it is not entirely clear whether this applies if the arbitral tribunal failed to stay the proceedings to allow the creditors to decide on their continuation. The Supreme Court's reference to domestic and foreign state court proceedings suggests that the suspension is a necessary precondition. To stay on the safe side, a claimant in arbitration against a Swiss debtor who falls into bankruptcy during the proceedings should motion the tribunal for a stay.

Initiating arbitration proceedings against a Swiss party after the opening of the bankruptcy procedure is likely futile as the claim is non-arbitrable. The Swiss Supreme Court's approach regarding the arbitrability of claims against insolvent debtors differentiates between arbitration proceedings that are already pending and arbitration proceedings that commence after the opening of bankruptcy proceedings. As was noted in the recently published IBA Toolkit on Insolvency and Arbitration of March 2021, which is aimed at providing "guidance […] in situations where a party to arbitration proceedings is also subject to insolvency proceedings in one or more jurisdictions", this distinction is not a unique Swiss feature, but is also followed in many other jurisdictions.

It is certainly coincidence that both the Swiss Supreme Court Decision and the IBA Toolkit on Insolvency and Arbitration have been published in the same month. However, this does show that the topic is of growing relevance. The many unresolved questions on the relationship between arbitration and bankruptcy are sure to keep arbitral tribunals and courts occupied in the foreseeable future. In this regard, the Swiss Supreme Court has rendered a timely decision on an important issue.

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