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Insolvency and arbitration: Swiss Supreme Court revisits its Vivendi vs. Elektrim decision

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Few Swiss cases have sparked as much debate in the arbitration community as the Swiss Supreme Court's 2009 decision in *Vivendi vs. Elektrim*. In that decision, the Supreme Court upheld the award of an arbitral tribunal seated in Switzerland which had declined jurisdiction over one of the respondents, Elektrim, after the latter was declared insolvent in Poland.

In a recently published decision dated 16 October 2012 (case reference 4A_50/2012), the Supreme Court was once again faced with the question of the effect that foreign insolvency proceedings have on an arbitration seated in Switzerland. The Supreme Court examined the issue in depth, revisiting its decision in *Vivendi vs. Elektrim* and addressing the widespread criticism that the decision had engendered. Other than in *Vivendi vs. Elektrim*, it came to the conclusion that the insolvency of a party does not affect the arbitral tribunal's jurisdiction.

The facts of the case are relatively straightforward. A Portuguese company (X) was party to a sales and purchase agreement for multi-crystalline silicon wafers with a Chinese company (Y). In 2009, there was some disagreement between the parties regarding performance of the agreement. Shortly thereafter, X filed for bankruptcy in Portugal and the creditors decided to wind up the company. A few months later, Y initiated arbitration proceedings against X under the ICC Rules. The seat of the arbitration was Geneva.

As in *Vivendi vs. Elektrim*, the issue was whether the arbitral tribunal had jurisdiction to decide a dispute involving an insolvent party. In an interim award rendered in 2011, the arbitral tribunal ruled that X's insolvency did not affect its jurisdiction. X petitioned the Swiss Supreme Court to have the interim award set aside.

The objection raised by X went to its capacity to be a party in the arbitration, an aspect of "subjective arbitrability" (*subjektive Schiedsfähigkeit*). The Supreme Court approached the issue as follows:

- Subjective arbitrability is an issue governed by the *lex arbitri.*
- Whilst the Swiss *lex arbitri,* Chapter 12 of the Private International Law Act (PILA), contains a specific provision governing the issue of subjective arbitrability in relation to states and state-controlled entities, there is no such provision for other parties.

- Absent specific provisions, general procedural principles apply: the capacity to be a party (*Parteifähigkeit*) in arbitral proceedings presupposes general "legal capacity" (*Rechtsfähigkeit*), meaning the capacity to have rights and obligations.
- According to the case law of the Supreme Court in *Vivendi vs. Elektrim*, the law governing the issue of legal capacity is determined pursuant to the general conflict-of-laws provisions of the PILA. For a foreign legal entity, legal capacity is governed by the law at the place of incorporation.

Based on the above, the Supreme Court held that if X was still constituted as a "legal person" (*Rechtspersönlichkeit*) under Portuguese law and had the capacity to have rights and obligations, then it also had the capacity be a party in arbitral proceedings in Switzerland.

Up to this point, the Supreme Court's reasoning mirrored that in *Vivendi vs. Elektrim*. However, in *Vivendi vs. Elektrim*, the Supreme Court went on to find that the capacity of insolvent Polish entities to be parties to arbitral proceedings was governed by a specific provision of the Polish Bankruptcy and Reorganisation Act (PBRA), Article 142, which reads as follows:

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

The Supreme Court held that, pursuant to that provision, Elektrim had lost the capacity to be a party to the arbitration seated in Switzerland when it was declared insolvent.

This finding gave rise to strong criticism in the arbitration community, with most commentators arguing that Article 142 PBRA did not affect the capacity of an insolvent Polish entity to be a party in foreign arbitral proceedings. In their view, the provision pertained to the validity of the arbitration agreement, which is an issue governed exclusively by the Swiss *lex arbitri*.

In the case at hand, the Supreme Court held that the *Vivendi vs. Elektrim* decision could not serve as a general precedent. Rather, that decision was "*to be seen in the specific context of Polish law and doctrine*", and its findings in relation to Polish law could not be transferred to other foreign legal systems or jurisdictions. And indeed, despite the many similarities between the cases, the Supreme Court came to directly opposite conclusions.

X argued that under Portuguese law, an entity has no legal capacity for acts which are prohibited by law. It then referred to Article 87(1) of the Portuguese Insolvency Code (PIC), which reads as follows:

> *"Without prejudice to provisions contained in applicable international treaties, the efficacy of arbitral agreements relating to disputes that may potentially affect the value of the insolvency estate and to which the insolvent is party shall be suspended"*.

According to X, Article 87(1) PIC prohibits an insolvent entity from taking part in new arbitration proceedings, and therefore negates its legal capacity in this regard.

While the provision is very similar to Article 142 PBRA, the Supreme Court rejected X's argument. It referred to several further provisions of the PIC which show that an insolvent entity still retains its legal personality. In particular, it pointed to Article 87(2) PIC, which implies that the capacity of an entity to be a party in pending arbitration proceedings is not affected by a declaration of insolvency.

According to the Supreme Court, Article 87(1) PIC pertains only to the validity of the arbitration agreement, an issue which is governed exclusively by the Swiss *lex arbitri.* Given that the principle of *favor validitatis* applies and that under Swiss law at least, the insolvency of a party has no impact on the validity of the arbitration agreement, Article 87(1) PIC cannot render the arbitration clause ineffective. On that basis, the Supreme Court held that, even if Article 87(1) PIC were to mean that an insolvent entity is barred under Portuguese law from taking part in new arbitrations seated in Portugal, this would have no consequence on its capacity to be a party in an arbitration seated in Switzerland, as the only requirement is that the entity still has legal personality and legal capacity. Article 87(1) PIC does not affect the legal personality of an insolvent Portuguese entity and therefore has no impact on the capacity of such an entity to be a party in an arbitration seated in Switzerland.

On a first reading, the implications of this new decision are not entirely clear. We understand the Supreme Court's findings to mean that, as long as an insolvent entity still has legal personality and (at least "residual") legal capacity according to the law at the place of incorporation, then it will be considered capable of being a party in arbitral proceedings in Switzerland according to the Swiss *lex arbitri*. This applies irrespective of any foreign provisions which, according to their wording, limit the capacity of the entity to be a party in pending or future arbitral proceedings or render the arbitration agreement ineffective.

The Supreme Court has therefore, in effect, defined the concept of subjective arbitrability under the Swiss *lex arbitri,* at least in relation to insolvent entities. Any insolvent entity which has legal capacity is considered capable of being a party in arbitral proceedings in Switzerland. To arrive at this result, the Supreme Court followed the same basic line of reasoning as in *Vivendi vs. Elektrim,* apparently confirming its jurisprudence. However, the Supreme Court seems to have taken a slightly different approach when examining the issue of legal capacity under Portuguese law than it did when examining the same issue under Polish law. Whether or not the result of *Vivendi vs. Elektrim* would have been the same, had this more recent approach been applied at the time, is open to speculation.

Irrespective of whether or not one agrees with the somewhat convoluted reasoning of the Supreme Court, the result of this decision should be welcomed. It sends a valuable message that foreign insolvency laws cannot, as a rule, affect an entity's capacity to be a party in an arbitration seated in Switzerland. It is to be hoped that this will resolve the issue for most, if not all, cases in which a foreign party to an arbitration seated in Switzerland is declared insolvent.

On a final note, it will be worth examining whether and how the issues raised in this decision—in particular the lack of a specific provision governing subjective arbitrability for non-state entities—should be dealt with in the upcoming revision of Chapter 12 PILA.

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