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Insolvency and International Arbitration: An Alternate Perspective

Ishaan Madaan · Monday, June 15th, 2020

The COVID-19 pandemic and the ensuing lockdowns have the legal community debating and exploring force majeure. That, however, does not rule out the imminent likelihood of international arbitration locking horns with domestic insolvency law. Arbitration agreements and subsequent awards may possibly be left redundant and award-holders remediless where insolvency proceedings are commenced in respect of a party. This post argues that the legitimacy of an arbitration agreement or an award-holder's right to seek enforcement of such an award should remain unaffected despite any pending domestic insolvency proceedings.

Introduction

Whether or not non-performance of a contract triggers its force majeure clause is for the fact finder to decide. However, for purposes of this post, it is possible that the party claiming impairment may also be tackling insolvency.

Insolvency legislations are designed with domestic economic objectives, aiming to support a state's economic, social and political goals. Whether insolvency results in reorganization of the debtor or liquidation of his assets, all claims and enforcements against the debtor are extinguished. In case of liquidation, the debtor ceases to have a corporate existence and in the alternative, reorganization cannot take place until all pending claim proceedings against the debtor are buried. In any event, insolvency law is centralized and formalistic. Arbitration, on the other hand, is decentralized, contractual and party autonomy based. The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 (the 'Convention') lays down the crucial tests for the success of arbitration, and supports the idea of arbitration.

The Intersection

In case of a conflict, most international arbitration award holders would not find enforcing awards against an insolvent debtor worth their candle. It takes years of efforts and resources to conclude an arbitration, which is a result of parties' consent and investment of mind by both parties and the tribunal constituted pursuant to their consent. The conflict of laws approach mostly focusses on the issues of procedural and substantive laws applicable to an arbitration. The concept of arbitrability

is wider in the international context than in a national context.

There are conflicting views and decisions. Some courts have refused the continuation of arbitration proceedings during the pendency of insolvency proceedings in respect of the insolvent party. Whether it be the institution or continuation of arbitral proceedings, or the enforcement of arbitral awards, the probable conflicts could only be seen in light of the Convention, either owing to the capacity of the insolvent party or the public policy of the state which would hinder the arbitral process.

The aspect of incapacity of an insolvent party to an arbitration proceeding can be fairly understood from the Swiss perspective as emanated in the *Elektrim/Vivendi* decision followed by the Swiss Supreme Court's revisit of the decision. The Court held that the capacity of the party in an arbitration is to be determined on the preliminary substantive question of legal capacity and held that the same is to be determined by the law of the state where such party is registered as an entity. The Court went on to conclude that since insolvent entities still have rights and duties during the subsistence of insolvency proceedings, they have the legal capacity to be parties to arbitration in Switzerland. The incapacity must, therefore, exist at the time of entering into the agreement and not during arbitration proceedings and /or enforcement of the award.

No party can make any headway without the assistance of national courts. Arbitral tribunals may be delocalized, but national courts are bound by the laws which create them. 'Public policy' is a wide term. Article V(2)(b) of the Convention empowers national courts to refuse enforcement of foreign awards in case of contravention or conflicts with the public policy of that state. Insolvency law is seen as one of the backbones of states' economic and legal framework, creating certainty in the market and promoting economic stability and growth (*see* UNCITRAL Guide on Insolvency Law, p. 10). Insolvency law may, therefore, be held to be a part of a nation's public policy. They are clear in as much as they prohibit continuation of all proceedings against the insolvent entity and its estate, and violation of the automatic stay may entail severe punishment as it may be deemed to be against the public policy of that nation. Enforcement proceedings are essentially domestic proceedings where courts are likely to refuse enforcement of arbitral awards against an insolvent party.

An Indian court in *Cruz City 1 Mauritius Holdings v. Unitech* in 2017 held that enforcement of a foreign award can be only refused if such an enforcement is found to be contrary to the fundamental policy of Indian law, interest of India and justice or morality and that 'Fundamental Policy of Indian Law' does not mean provisions of the statute but substratal principles on which Indian law is founded. The US Supreme Court in Scherk v. Alberto-Culver Co., while discussing the refusal to enforce international arbitration agreements, held that it "would surely damage the fabric of international commerce and trade, and imperil the willingness and ability of businessmen to enter into international agreements…To refuse to enforce an arbitration clause in the context of an international transaction 'would reflect a parochial concept that all disputes must be resolved under our laws and in our courts… ***We cannot have trade and commerce in world markets … exclusively on our terms, governed by our laws, and resolved in our courts***".

Be that as it may, there exists a conflict between arbitration and insolvency in the international context. National public policy exists for the national subjects, but international public policy holds constitutional validity in national laws in as much as treaties and conventions bind the domestic structures, then should primacy be given to statutes that govern domestic structures and parties?

What Prevails?

The principle of insolvency is to give back to the creditors who exist in a domestic realm where, constitutionally speaking, citizens have a say in the evolution of the law; are aware of it, structure themselves according to it, and are bound by it, but are aliens bound the same way?

Yes, arbitration is regulated, and it should be, but why frustrate an agreement – and everything that led to the agreement and its performance – on the actions of someone completely unrelated to it. If one has to choose between the international arbitration and domestic insolvency, there has to be a definitive clarity which trumps any ambiguity. The journey would fail if the destination is compromised. If delocalization of arbitration is conceptually recognized, it ought to be treated holistically and uniformly. Arbitration came about out of respect for party autonomy, and freedom of trade, and there is no reason to not uphold the principle of *pacta sunt servanda*.

The domestic creditors should take the entity as they found it, with a bundle of rights and obligations that include the duty to arbitrate.[1)] To denounce continuation or enforcement on grounds of public policy becomes a domestic matter. Another US Court in *Parsons & Whittemore* held that "public policy is not the same as governmental policy; the latter cannot stand in the way of the duty to observe international treaty obligations. The award was enforced. The judgment included what may be the most-often quoted expression of the relevant standard: 'enforcement must violate the forum state's most basic notion of morality and fairness.'"

Recommendation 3(a) of the International Law Association's Committee on International Commercial Arbitration's Final Report (2002) on Public Policy as a Bar to Enforcement of International Arbitral Awards says, "An award's violation of a mere 'mandatory rule' (i.e. a rule that is mandatory but does not form part of the State's international public policy so as to compel its application in the case under consideration) should not bar its recognition or enforcement, even when said rule forms part of the law of the forum, the law governing the contract, the law of the place of performance of the contract or the law of the seat of the arbitration."

Unless the substantive validity of an arbitration agreement is in question, it is both illogical and unlawful to stall arbitration proceedings against an insolvent entity. Rules of procedure under substantive insolvency ought to be kept separate from the rules of procedure facilitating enforcement of judgements; only the latter facilitating enforcement of foreign awards.

The Convention in the present form did not address insolvency; which ought to be construed as not being a hurdle. Therefore, the very idea of brushing under the carpet a valid arbitration agreement or an otherwise valid award in the face of domestic insolvency is an in-principle disregard of Articles II and III of the Convention, which casts a duty on all contracting states to recognize and enforce "agreement in writing" and "arbitral awards". These articles are a fine mixture of respecting party autonomy and sovereignty, the same sovereignty with which the contracting states assented to the Convention while mutually respecting the concept party autonomy worldwide. This autonomy goes deep; deep enough to render the judgement of a party appointed sole arbitrator to have greater international force than nine unanimous justices of the U.S. Supreme Court (*ICSID Review – Foreign Investment Law Journal*, Volume 25, Issue 2, Fall 2010, Page 340).

Conclusion

Insolvency laws at best form part of governmental policies, but not international public policy. In the case of a party going insolvent before or during international arbitration proceedings, courts in reliance of domestic insolvency laws should not prevent the institution or continuation of such proceedings. Moreover, it curtails the growth of international arbitration or enforcement of an award passed against an insolvent, at least for the signatories to the Convention, for the signatory states have by definition adhered to a policy of enforcement of foreign awards. Refusing to recognize and enforcing agreements and awards on grounds of insolvency is fundamentally denigrative of the Convention. Invoking public policy to reject a foreign arbitral award is to be done only after much hesitation lest the system of the Convention be undermined (The Idea of Arbitration – Jan Paulsson).

References

?1 The Idea of Arbitration – Jan Paulsson, at p. 118.

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