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Arbitration for Insolvency: Streamlining the Scope of Arbitrability

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The increased globalization of business and the rising popularity of arbitration as a standard method of alternative dispute resolution ("**ADR**") has fostered an intersection of arbitration and insolvency. Arbitration is increasingly used to resolve various matters related to insolvency, such as cross-border debt recovery and disputes between creditors and debtors in insolvency proceedings.

In the past two decades, the intersection of arbitration and insolvency has increased several times over, with Nortel Networks Inc., Lehman Brothers and MF Global as just a few significant examples where ADR mechanisms were used to resolve cross-border disputes related to insolvent debtors. Moreover, States like Brazil, Chile, Peru and Singapore, among others, have introduced statutory provisions, legislations and draft legislative proposals supporting arbitration as means of settling insolvency disputes.

This post proposes a proposal to determine the arbitrability of insolvency disputes that could provide a win-win outcome by enabling a consistent global approach to segregate arbitrable and non-arbitrable insolvency issues.

Arbitration and Insolvency: Why Is Compromise Between the Two Beneficial?

Traditional insolvency regimes lack arbitration's flexibility and efficiency. To address the rising number of insolvency-related disputes, arbitration provides a possible means of dispute settlement.

Arbitration allows parties to tailor their proceedings to their dispute and offers 'fast-track proceedings', which can relieve the burden on national court systems struggling to cope with inflexible statutory procedures that make it impossible for even simple insolvency-related disputes to be resolved quickly and inexpensively. Instead, specific pressure points within the insolvency process can be efficiently addressed through arbitration, such as resolving creditor claims, resolving disputes between affiliates, valuing and distributing assets, approving restructuring plans, and providing a more streamlined and expeditious resolution mechanism for insolvency-related disputes.

Cross-border insolvency disputes raise several concerns for businesses, including time, language barriers, inconsistent national laws and the lack of a universally accepted framework, although multiple initiatives have been taken, such as the 1997 UNCITRAL Model Law on Cross-Border

Insolvency. For example, when the assets of an enterprise are located in different jurisdictions, a workout arrangement between the debtor and the creditors is the only way ahead for restructuring. However, it is difficult for the creditors to find common ground when assets are located in different jurisdictions since creditors negotiate against the backdrop of what they would otherwise receive under the local insolvency law governing the estate from which their rights are derived. These rights can differ as different insolvency laws provide different allocations of assets to various creditor groups. Failure to arrive at an agreement can result in the liquidation of an otherwise viable business.

In contrast, arbitration could be a way forward if the parties are deadlocked and unable to agree on a single proposal. Arbitration allows the parties to choose a restructuring-friendly law to be applied to the substance of the dispute, resulting in more certainty and a sense of fairness which may even convince the hold-out creditors to participate in restructuring. Arbitration also provides the benefit of a legally enforceable award, through existing international agreements. The New York Convention provides for the recognition and enforcement of arbitral awards in the 172 States which have ratified the Convention.

Last but not least, cross-border insolvency can be very expensive since insolvency proceedings in different national courts can involve huge expenses, whereas, from a logistical standpoint, an arbitration proceeding in one forum would be less expensive.

Compatibility Averse to Viability – Fact Check

To a great extent, the rules of arbitration are consistent among jurisdictions; however, most jurisdictions lack any rules concerning the intersection of arbitration and insolvency. Relevant rules in this regard are generally found in national insolvency laws, which set different limitations on the arbitrability of insolvency disputes and, thus, inconsistent criteria for the arbitrability of insolvency disputes persist among jurisdictions.

Efforts to standardize arbitrable insolvency-related issues can be seen in different case examples and scholarly sources. Both have endeavoured to delineate the insolvency-related issues which are and are not arbitrable. The most common distinction is between ‘core’ and ‘non-core’ issues in an insolvency proceeding, which is a test devised by U.S. courts.

Core issues are generally understood as issues pertaining to rights accruing exclusively within the insolvency proceedings or which arise post-application of the insolvency statute. These issues are fundamental to the insolvency proceedings and would not otherwise survive outside of such proceedings. In contrast, non-core issues arise in an insolvency proceeding but are merely related to it and have no direct connection with the insolvency statute per se. Such issues, if arising independently of a bankruptcy proceeding, would lie in a civil forum for adjudication.

No universal and uniform definition of ‘core’ insolvency issues exists, as each jurisdiction has its own criteria for determining what constitutes ‘core’. Switzerland, as an example, adopts ‘core/non-core’ categorisation, nonetheless more issues are held to be of ‘mixed’ nature. France and Italy also have embraced a similar idea, however with different nomenclature, i.e., ‘pure’ instead of ‘core”. Core insolvency issues are generally considered non-arbitrable, while non-core issues are considered arbitrable.

Insolvency-Related Issues Categorization: Comparing Prevailing Methods with Ideal Methods

The prevailing way of categorizing insolvency-related issues for the purposes of arbitrability is to categorize them into ‘core’ and ‘non-core’; however, the effectiveness of this method is debatable. In particular, the effectiveness of these categories is undermined by subsequent U.S. court cases, including US Lines Inc. v. ASOMPIA and In re Gurga, holding that merely determining an issue to be ‘core’ would not *ipso facto* render it non-arbitrable and similarly, on receipt of a party’s consent, even a ‘non-core’ issue can be heard by the bankruptcy court. Further to that, it appears from the rulings that the distinction was created to determine the cause of action and not arbitrability.

In fact, this categorization completely ignores other relevant factors for arbitrability, such as the pecuniary or non-pecuniary nature of the subject matter of a dispute or exclusive functions of designated authorities. Furthermore, whether or not the arbitration is commenced before the debtor turns insolvent and whether third-party rights remain unaffected are also important considerations.

These flaws raise two main questions: (a) why is it necessary to categorize insolvency-related issues for determining arbitrability; and (b) if such a categorization is needed, what are the ideal criteria and how should the categorization be conducted?

Admittedly, answering the first question is open to debate and beyond the scope of this post. As to the second question, assuming such categorization be conducted, two possible mechanisms can be adopted: (i) exhaustive list, or (ii) guideline.

An exhaustive list of all potentially non-arbitrable issues related to insolvency may be developed through the collective efforts of expert delegates from all stakeholder countries under the umbrella of an intergovernmental organization, such as the UNCITRAL. With the universal acceptance of such a model list, uncertainty regarding the issues forming part thereof would be alleviated.

Nevertheless, the flaw in this mechanism is two-fold. Firstly, obtaining global acceptance for such a list would be challenging. Secondly, even if we consider that the participation of national delegates in the list-framing process contributes to achieving wide acceptance, as time progresses, non-arbitral issues in the list may later be held to be arbitrable or new legal issues may arise that give rise to questions regarding their arbitrability and create for the possibility of inconsistent interpretations.

Alternatively, a more feasible mechanism may be development of a widely recognized guideline, with a universalist approach and a pro-arbitration attitude. The guideline would focus merely on parameters for distinguishing between insolvency-related issues that may not be arbitrable from the entire pool of insolvency-related issues. As such, the parameters can ideally consider limiting factors such as conflict with international public policy, non-adversarial issues, exclusive functions of the designated authority, etc., while preserving a reasonable presumption that all other insolvency-related issues are arbitrable.

Such a guideline can be developed by an intergovernmental organization such as UNCITRAL after detailed deliberations with subject-matter experts. There is a reasonable concern that the proposed guideline may be interpreted inconsistently by different legal systems. Nevertheless, the authors believe that a straightforward guideline would significantly discourage such interpretations. Moreover, such a guideline would leave a sense of autonomy among States and encourage them to follow the universalist approach, while as a matter of caution and exception, States would still be able to limit the scope of arbitration on issues that in their beliefs fundamentally conflict with their national standards and public policies.

Conclusion

Despite the practical reasons that arbitration may be used as a forum to resolve insolvency-related disputes, the legal framework under which such issues may be resolved remains underdeveloped. The arbitrability of insolvency-related disputes is one of these areas.

The preceding discussion has presented a novel approach to determine the arbitrability of insolvency disputes, aiming to establish a win-win scenario by promoting a methodology for segregating non-arbitrable issues within the realm of insolvency. This proposal is designed to strike a delicate balance, encompassing a perspective that seeks to minimize inconsistency while preserving a sense of autonomy.

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