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The Impact of Cross-border Insolvency on International Arbitration: A Swiss View

By Daniel Eisele and Tamir Livschitz

In cross-border contractual arrangements parties often resort to arbitration as a means to resolve any potential future disputes. The parties then naturally expect any future disputes to be submitted to arbitration regardless of any corporate or other changes which any of the parties may subsequently undergo. Such expectation certainly also applies should one of the parties become insolvent or fall into bankruptcy.

Surprisingly, even though Switzerland is widely perceived as one of the premier places for international arbitration with an arbitration friendly legislation in place, a party's reliance on the choice of arbitration to survive and remain valid in case a party to the agreement falls into bankruptcy was seriously put in jeopardy by case law of the Swiss Federal Supreme Court, until a recent decision by the same body provided further guidance and clarity in the matter.

Jurisdiction of arbitral tribunals in cross-border insolvency situations and the Vivendi case

The question raised by a situation where a party to an arbitration agreement becomes bankrupt relates to such party's legal capacity to arbitrate (often also called subjective arbitrability) and to the validity of the arbitration agreement as such. While Swiss law contains a specific provision preventing state entities from invoking their own law to contest their legal capacity to arbitrate (art. 177 (2) of the Private International Law Act (PILA)), there is no such express provision for private entities.

Lacking such express provision, the Swiss Federal Supreme Court - sitting on appeal - was confronted back in March 2009 with an interim award on jurisdiction rendered by an arbitral tribunal dealing with the impact of cross-border insolvency on its competence to hear the case. In such interim award the arbitral tribunal decided to discontinue arbitration proceedings against a Polish entity, Elektrim SA, which had fallen into bankruptcy subsequent to the initiation of the arbitration proceedings. Since pursuant to Polish law (Art. 142 pKSG), the law of the place of incorporation of Elektrim SA, any arbitration clause concluded by the bankrupt was deemed to lose its legal effect, the arbitral tribunal concluded that the bankruptcy of Elektrim SA revoked its legal capacity to arbitrate and thus the lack of the subjective arbitrability automatically resulted in the lack of jurisdiction of the arbitral tribunal over Elektrim SA.

The Swiss Federal Supreme Court upheld the interim award on appeal (Vivendi SA et al. vs. Deutsche Telekom AG et al. and Elektrim SA et al.; BGer 4A_428/2008 dated 31 March 2009) holding that pursuant to the Swiss conflict of laws rules (art. 154 and 155(c) PILA) the legal capacity of a corporation were governed by the law of such corporation's place of incorporation and, thus, since according to Polish law any arbitration clause lost its legal effect with respect to the bankrupt party, the arbitral tribunal rightfully rejected its jurisdiction over the bankrupt Elektrim SA. The Swiss Federal Supreme Court thereby pointed to the fact that according to the opinions expressed by the Polish law experts who had appeared in the arbitration proceeding a Polish party would lack any legal capacity to conduct an arbitration proceeding.

While the decision triggered a great deal of criticism[1] - the reasons for which would exceed the scope of this article - it resulted in great concern as to whether parties agreeing to arbitration in Switzerland could rely on such agreement also in case one of the parties would subsequently fall into bankruptcy.

Retraction of the *Vivendi* case law

In November 2011, an arbitral tribunal with seat in Geneva issued a jurisdictional award confirming its jurisdiction over a Portuguese entity against which arbitration proceedings had been commenced even though it had prior thereto fallen into bankruptcy. The Portuguese bankruptcy administrator appealed such decision with reference to the Vivendi case, arguing that based on Portuguese insolvency law the Portuguese entity no longer had the capacity to be a party to arbitration. Hence, on appeal the Swiss Federal Supreme Court was asked to again decide on the impact of cross-border insolvency on international arbitration proceedings in Switzerland.

In its holding (BGE 138 III 714; 4A 50/2012 dated 16 October 2012), the Swiss Federal Supreme Court ceased the opportunity to clarify - and in essence (to a certain extent) retract - its previous stance voiced in the Vivendi decision. In a first step, separating the question of the validity of the arbitration clause from the question of legal capacity, the Swiss Federal Supreme Court noted that pursuant to Swiss law an arbitration clause would be valid if it corresponded either to the law chosen by the parties, to the law applicable to the dispute (and to the main contract) or to Swiss law (art. 178 (2) PILA). In application of such rule the arbitration clause was held valid, because under Swiss law an arbitration clause generally survives the opening of a bankruptcy proceeding and remains binding on the bankruptcy administrator.

In a second step the court went on to distinguish the case at hand from the Vivendi case, thereby clarifying its holding in the latter case. The court stated that unlike in the Vivendi case, the pertinent provision in the Portuguese law invoked by the bankruptcy administrator related to the validity of the arbitration clause and not to the question of legal capacity, since it referred to the "efficacy of arbitral agreements" in bankruptcy situations rather than to the legal capacity of a bankrupt party.

The court concluded that if pursuant to the pertinent Swiss conflicts of laws provisions foreign law applied to the question of the legal capacity of an entity - as held in the Vivendi decision - one would need to determine whether under such foreign laws an entity that had entered a bankruptcy proceeding could still hold rights and obligations in general. Should this be the case, such entity would be deemed to have legal capacity for the purposes of an arbitration agreement.

The court further clarified that any possible limitations foreign laws may impose on a bankrupt party that are specific to arbitral proceedings and leave the legal capacity of the foreign entity untouched would be fundamentally irrelevant from the point of view of the capacity to be a party to an arbitration seated in Switzerland. Hence, if the legal capacity of a foreign party could pursuant to its laws of incorporation be affirmed, the validity of the arbitration clause would be decided pursuant to art. 178 (2) PILA, permitting also the application of Swiss law under which a bankrupt party remains bound by an arbitration agreement for as long as it has legal capacity to hold rights and obligations.

Conclusion: No impact of cross-border insolvency on arbitration in Switzerland

With its recent decision the Swiss Federal Supreme Court has in essence retracted from its previous position on the impact of cross-border insolvency on arbitration. It has made clear that a foreign party falling into bankruptcy will not lose standing and will continue to be bound by an arbitration clause, even if the laws of incorporation of such foreign party stipulate limitations on bankrupt entities to arbitrate. In other words, the Swiss Federal Supreme Court has clearly confirmed that as a rule cross-border insolvency will have no impact on an arbitration proceeding in Switzerland.

The contrary will only be the case in the very unlikely situation where based on the laws of incorporation of a foreign bankrupt entity the mere fact of the opening of a bankruptcy proceeding de-

prives such entity from its general ability to hold rights and obligations, which in the vast majority of global jurisdictions will not be the case.

Daniel Eisele is a partner of the law firm Niederer Kraft & Frey AG in Zurich, Switzerland (www.nkf.ch). He specializes in large and complex litigation and arbitration proceedings, commercial contracts and international business transactions in all kind of industries, in particular in connection with trade and commerce, finance and banking, technology and sports. During the last 20 years of professional practice, he has represented clients in more than 200 arbitration, court and other procedures.

Daniel can be contacted by phone on +41 58 800 80 00 or via e-mail at daniel.eisele@nkf.ch

Tamir Livschitz is a Senior Associate with Niederer Kraft & Frey AG in Zurich, Switzerland (www.nkf.ch). He has extensive experience in the field of international arbitration, where he represents clients in complex arbitration proceedings conducted under various institutional rules, in ad hoc proceedings as well as in sports arbitration matters. Tamir is qualified to practice in three different jurisdictions and he regularly acts as a speaker at international arbitration events in Switzerland and abroad.

Tamir can be contacted by phone on +41 58 800 80 00 or via e-mail at tamir.livschitz@nkf.ch

1 - See, in particular: PIERRE A. KARRER, The Swiss Federal Supreme Court got it wrong, wrong, wrong and wrong a fourth time, ASA Bulletin 1/2010 S. 111 f.; AEBI/FREY, Impact of Bankruptcy on International Arbitration Proceedings, ASA Bulletin 1/2010 , S. 120, 123; LARS MARKERT, Arbitrating in the Financial Crisis: Insolvency and Public Policy versus Arbitration and Party Autonomy - Which Law Governs?, Contemporary Asia Arbitration Journal 2/2009 S. 217, 233; SPOORENBERG/FELLRATH, The Uneasy Relationship between Arbitration and Bankruptcy, ILO Newsletter 30 July 2009; BERNHARD BERGER, Die Rechtsprechung des Bundesgerichts zum Zivilprozessrecht im Jahre 2009, 3. Teil: Schiedsgerichtsbarkeit, ZBJV 147/2011 S. 555 ff.; STEFAN KRÖLL, Arbitration and Insolvency - Selected Conflict of Laws Problems, in: Conflict of Laws in International Arbitration, Ferrari/Kröll [Hrsg.], München 2011, S. 232 f.

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