Insolvency Proceedings and Their Effect on International Commercial Arbitration

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Introduction

The relationship between arbitration and other fields of law has frequently been the subject of legal writings. As to the interaction between international arbitration and insolvency, it is well observed that they do not coexist easily. The conflict of the two procedures may result from their different objectives and underlying policies.

Arbitration is a private means of dispute settlement based on the will of the parties. The right to arbitrate and the jurisdiction of the arbitral tribunal arise by agreement between the parties and the process is largely shaped by that agreement. V. Lazic considers party autonomy as an underlying policy and the neutrality of the arbitral forum is the most important feature of the commercial arbitration. As the US Supreme Court has recognised, arbitration is a ‘trad[e of] the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition’ which arbitration allows. In contrast, insolvency is a procedure which values the equality of creditors, centralisation of claims, rescue of the insolvent party, a high degree of state control, a transparent and accountable process, a co-ordinated distribution of assets and authority derived from statute. Also, mechanisms like dispossession of the debtor and protection of the debtor against individual enforcement make insolvency law reflect both public and private nature of insolvency law. Typically, insolvency law provides exclusive jurisdiction of state courts and the mandatory stay or even preclusion of all other proceedings, which will certainly conflict with arbitration proceedings. Thus, the essential advantage of international arbitration—neutral forum—is lost if the counterparty is forced in the case of insolvency of the other party to give up its right to neutral arbitration. On the other hand, it is the essence of insolvency that each creditor sacrifices many rights for the collective benefit of the creditor body, especially in a reorganization case.

Virtually any contractual relationship can become the subject of a dispute in

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3 Lazic, op. cit., p.3.
5 3 No. 1 Disp. Resol. Int'l 56
6 Lazic, op. cit., p. 11.
bankruptcy, and because almost any contract can include an arbitration clause, the variety of cases in which arbitration and bankruptcy can collide is nearly limitless.7 Impacts insolvency may have on arbitration are complicated. They include but are not limited to the following aspects. Commencement of insolvency proceedings leads to the dispossession of the debtor and influences his rights to conclude an arbitration agreement and to be a party to arbitration proceedings. Whether and under what condition should the trustee participate in arbitration proceedings, whether new or pending? The jurisdiction of the competent national court dealing with all bankruptcy disputes certainly raises the question of arbitrability of a claim related to insolvency. Whether the relevant provisions of insolvency laws may have the effects of justifying the refusal of the courts to enforce an arbitration agreement previously concluded by the debtor? Furthermore, what is the effect on arbitration proceedings already pending at the time of commencement of the insolvency proceeding, should it be terminated or stayed? Finally, how could the fact that one party is in insolvency proceeding affect the making and the recognition and enforcement of the arbitration award. However, in a cross-border context, things become even more complicated for the reason that before approaching into the aforesaid aspects of conflicts between insolvency and arbitration, the applicable law shall be determined first.

As bankruptcy regimes are created and interpreted based on various social, political and economic contexts of different countries, it is all the more difficult to rely on a general approach to answer the abovementioned questions. Thus not all the interaction points between insolvency and arbitration will be included in this research. This thesis will try to address some important issues thereof through comparative study and judicial analysis. The legal consequences of the opening of insolvency proceedings will be examined in the context of both relevant provisions of insolvency laws and arbitration laws as well as court practice mainly in some European countries and the United States.

The thesis consists of four chapters. Chapter I of this work discusses the issue of arbitrability of insolvency related matters. Attention is going to be made on the relevant factors normally taken into consideration of arbitral tribunals and national courts when determining the arbitrability of an insolvency related matter. Part II

addresses the impact that insolvency proceedings of a party may have on the effectiveness of the arbitration agreements concluded previously and the enforcement of the arbitration agreements in bankruptcy by the courts. The general principle of the issue will be addressed and detailed analysis of the special and abundant judicial practice will be given in the United States. Impacts on the ongoing arbitral proceedings are illustrated in chapter III, including the considerations raised by one party's insolvency for the enforcement of arbitral awards. Part IV sets forth recognition and conflict law issues in a cross-border setting when the international commercial arbitration is or to be seated in one country while the insolvency proceedings of one party is initiated in another.

Finally, for the purposes of this thesis, the terms ‘insolvency’ and ‘bankruptcy’ are synonymously used to cover both the liquidation and the reorganization proceedings. Furthermore, the term ‘trustee’ is used as a generic term for the person appointed by the bankruptcy court to manage the debtor’s estate and to wind up the business on the commencement of insolvency proceedings and which in some jurisdictions may be referred to as ‘administrator’.

Chapter I Arbitrability of Matters in Insolvency Proceedings

Although the right to arbitrate has been widely recognized in national laws and international treaties, the parties and arbitrators do not operate in a ‘legal vacuum’. Apparently, arbitrability is a limitation states give to party autonomy. According to art. II. 1 of the New York Convention on the recognition and enforcement of foreign arbitral awards and art. 2(a) of the UNCITRAL Model Law on International commercial Arbitration the parties can submit to arbitration all or any difference which may arise between them ‘concerning a subject matter capable of settlement by arbitration’. Therefore, before elaborating the conflicts which arbitrators can face when insolvency proceedings were commenced against one of the parties, it is necessary to analyze the arbitrability of insolvency related matters.

As Redfern and Hunter pointed out, the concept of arbitrability is a public policy limitation to arbitration, where the policy favouring arbitration in the international context is balanced against the competing policy underlying the subject-matter concerned.\(^9\) Thus the problem of arbitrability of insolvency related matters is actually the result of balancing the underlying policies of the two special legal disciplines--arbitration and insolvency. It has to be mentioned here that this thesis makes a distinction between arbitrability and enforceability of arbitration agreements. Arbitration agreements may not be enforced out of reasons other than non-arbitrability, such as exclusive jurisdiction of the national court or the automatic invalidity of the agreements provided by national legislation triggered by the insolvency proceedings. All these elements which may affect the enforcement of arbitration agreements other than arbitrability will be illustrated in Chapter II.

1. Principle rule

When issue of arbitrability arises, it is necessary to make recourse to the laws of different states, which include the law of the parties involved, the law governing the arbitration agreement, law of the seat of the arbitration, law of the place of potential enforcement of the award.\(^10\) Different legal systems may have different understandings of the concept of arbitrability, likewise, there is no universal criteria to be applied for determining this issue. However, traditionally accepted is that disputes which have a direct link with insolvency related issues are usually excluded from the domain of arbitration.\(^11\) That is, only pure or core insolvency issues will fall outside the scope of arbitration.

This principle is well supported not only by many national laws and courts’ jurisprudence but also international commercial arbitration institutes like ICC.

The ICC Award 6697 illustrates this principle clearly. The case concerned dispute arising out of a contract between a company incorporated in Québec and a company incorporated in Luxembourg. The latter filed arbitration proceedings, but had in the meantime been declared bankrupt in Luxembourg. The respondent

\(^9\) Ibid, p.137.
requested the tribunal to order the claimant to provide a guarantee to cover the costs of arbitration. The tribunal refused to grant the measure, stating that the order would constitute a violation of the principle of equal treatment of creditors. With regard to the alleged lack of arbitrability of the dispute, the tribunal noted:

‘The mere fact that a party is subject to insolvency proceedings is not in itself sufficient to render a dispute non-arbitrable per se. [ ... ] The only disputes which are excluded are those which have a direct link with the bankruptcy proceedings, namely those disputes arising from the application of rules specific to those proceedings.’

A recent case of ICC also backs this principle. A US company initiated arbitration against a French company which later became subject to insolvency proceedings as the arbitration was pending. The tribunal issued a partial award confirming the claimant's claim for unpaid sums with interest. The respondent argued that this award violated French insolvency law, according to which the arbitration had become void. The tribunal dismissed this challenge to its jurisdiction in its final award, finding that the issue did not impact on the insolvency proceedings as such:

‘[ ... ] we consider that the commencement of liquidation proceedings in relation to Respondent cannot deprive us, the Arbitral Tribunal, of jurisdiction over the disputes submitted to us since such disputes concern the performance and interpretation of the Distributorship Agreement between Claimant and Respondent and do not impact on the insolvency proceedings as such.’

Since the rule that pure bankruptcy issues are not arbitrable is almost undisputed in the literature, the real problem would be how to determine the exact list or actual scope of ‘pure’ issues.

2. Nature of Claims

2.1 Core and noncore issues

13 Final Award in ICC Case No 11876, ICC International Court of Arbitration Bulletin Vol 20 No 1 (2009), at 86.
14 F. Mantilla-Serrano, ‘International Arbitration and Insolvency Proceedings’, Arbitration International(1995), p.69. However, it may not be appropriate to say so because some pure insolvency issues could be arbitrable if the competent court adjudicates so. This could happen in USA and the detailed situation will be addressed in Chapter II.
There are issues which are so obviously ‘pure’ matters of bankruptcy law that no explanation even seems to be needed. The examples can be the issues such as the nomination of the trustee, the commencement of insolvency proceedings or determination of the amount to be paid out of the debtor’s estate, as well as of course the verification, inventarization, collection and distribution of assets and reorganization of business. In fact, in terms of these issues, arbitration and insolvency proceedings might not even ‘overlap’. What are really problematic are the following claims which may be brought to both insolvency and arbitration proceedings:

- Challenge of creditors’ claims on behalf of the estate initiated by the trustee in insolvency proceedings and disputed concerning the acknowledgement of contested claims;
- Secured claims and preferred claims;
- Unsecured claims, including claims regarding the cost of the insolvency proceedings, administrative expenses or the estate (which include the administration and maintenance of the estate); taxes, social insurance contributions and employees’ claims (dismissal pay, vocation compensation);
- Asset claims arising through the bankruptcy proceedings itself;
- Claims resulting from behaviour in violation of duty by the trustees, the administrators, the board of creditors or the experts;
- Claims resulting from the rescission or termination of a contract due to special statutory rights of the trustee and
- Claims not regarding the estate (e.g., matrimony and parentage claims).

While, theoretically, each claim should be dealt with separately regarding its arbitrability, considering the complexity of different legal systems and in most cases lack of legislation on this matter, what appears to be possible is to indicate some significant factors and illustrate typical examples when answering the question.

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15 Lazic, op., cit., p.154
The United States is a rare example where the distinction of core and noncore bankruptcy issues is provided in its legislation. In general, core proceedings are those that are directly related to a bankruptcy court's central functions, for example, an objection to a creditor's proof of claim filed in the bankruptcy case, a motion to terminate the automatic stay against creditor collection activities, a motion to reject an executory contract, or an adversary proceeding to determine the dischargeability of a particular debt. A non-exclusive list of core proceedings may be found in section 157(b)(2). Whether a proceeding is core or non-core will be determined by the bankruptcy court, either on its own motion or on the timely motion of a party. Matters that do not raise bankruptcy issues, such as breach of contract or fraud actions brought on behalf of the debtor by a Trustee against a third-party, are considered noncore proceedings. However, such a distinction in the United States, is for the consideration of the jurisdiction structure: if a proceeding is core, the bankruptcy judge may determine the matter by entering an appropriate order or judgment, while district court or competent state courts may determine noncore proceedings. As to whether the jurisdiction of either core or noncore bankruptcy issues will deprive the jurisdiction of arbitral tribunal on these matters, there is abundant case law some of which will be discussed in the context of enforcement of previously concluded arbitration agreements in Chapter II.

2.2 Individual Actions of Ordinary Bankruptcy Creditors

It is quite understandable that some of those listed matters, especially disputes arising from a contractual relationship between the parties, are usually capable of being subject of arbitral proceedings. They might become non-arbitrable only because the commencement of insolvency proceedings under certain laws, so

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18 See Fred Neufeld, Enforcement of Contractual Arbitration Agreements Under The Bankruptcy Code, 65 AM. BANKR. L.J. 525, 528 (1991) ( "[Section 157] distinguishes between civil proceedings arising under the Bankruptcy Code, which are deemed 'core' matters, and civil proceedings related to the Bankruptcy Code which are deemed 'non-core' matters. A core proceeding ... invo[lv]es a right created by federal bankruptcy law and which would only arise in bankruptcy.").
called the ‘variable dans le temps’\textsuperscript{22} of arbitrability. Monetary claims of ordinary creditors against the debtor seem to be the most typical one of such claims. Insolvency laws require that ordinary creditors obtain payment pro rata for the purpose of equal, collective procedure. Such claim lies in the very essence of the insolvency proceedings and is typical in bankruptcy which is worthwhile for a special analysis.

Bankruptcy law is designed to serve two primary purposes. The first one is to give an overburdened debtor a ‘fresh start’\textsuperscript{23} by relieving debtors of unmanageable obligations, and allowing debtors to resume or continue productive activity in society. Second, bankruptcy ensures an equitable distribution of the debtor's non-exempt assets in the interest of creditors. Bankruptcy creates a process in which creditors as a group can receive the highest possible return, while ensuring that no creditor benefits unfairly at the expense of others. Naturally, the claim of ordinary, non-secured creditors against the debtor’s assets should be accounted as a pure insolvency matter. Thus many jurisdictions have provisions in insolvency laws preventing the this kind of individual actions. In French law, one of the consequences of the declaration of the commencement insolvency is that creditors are suspended or prohibited from taking any legal action regarding debts arising prior to the opening decree. If a creditor fails to do so within that time limit, his claims are deemed extinguished.\textsuperscript{24} Also, under German law, after the order commencing the bankruptcy proceedings, claims for satisfaction out of the bankruptcy estate can be pursued only in accordance with the provisions relating to bankruptcy proceedings.\textsuperscript{25} The same preclusion can be found in Dutch bankruptcy law.\textsuperscript{26}

3. Jurisdiction of Bankruptcy courts

\textsuperscript{23} See 2 COLLIER ON BANKRUPTCY, ¶ 105.01[2], at 105-8 (Alan N. Resnick et al. eds., 15th ed. rev. 2009) (stating affording "fresh start to debtors" is part of bankruptcy courts' mandate).  
\textsuperscript{24} Arts. 47, 48 of the loi du 25 janvier 1985.  
\textsuperscript{25} Art. 12 of the German Insolvency Code (Insolvenzordnung).  
\textsuperscript{26} Chapter II of the Bankruptcy Act of the Netherlands, English version available at: http://www.dutchcivillaw.com/legislation/bankruptcyact011.htm
The reservation of competence for national courts to adjudicate certain matters can sometimes be an indication of non-arbitrability of those issues. Although the criteria have not been mentioned expressly in any of the arbitration laws examined in this thesis, it is illustrated in the literature and jurisprudence. Vesna lazic holds the view that “the scope of jurisdiction of bankruptcy courts seems to play a significant role in determining the arbitrable matters”\(^{27}\). It seems true in China, according to art. 21 of the bankruptcy law, after the people's court accepts an application for bankruptcy, the relevant debtor’s civil action shall be requested with the said people's court that is handling the bankruptcy proceeding. In this way, if insolvency happens before the arbitration is initiated, then the arbitration agreement will not be enforced by the court, which actually turned the otherwise arbitrable issue non-arbitrable anymore. Also in France, it has occasionally been suggested that general rules on arbitrability are supplemented by provisions on exclusive jurisdiction, \(^{28}\) while the prevailing approach is that not all matters falling within the exclusive jurisdiction should be considered as non-arbitrable, but only those which are part of public policy. \(^{29}\) However, the point taken by this thesis is that the exclusive jurisdiction is not a separate criteria but rather a means which can help to determine whether the subject matter is arbitrable. Besides, the extent of the jurisdiction of the courts in bankruptcy is not of the same importance in each country.

Some insolvency laws confer a very broad jurisdiction on bankruptcy courts such as France and the United States. In United States, basically, bankruptcy judges may hear and determine all bankruptcy cases and proceedings arising under or in a bankruptcy case with only small exceptions. But the detail is not discussed here since there will be a specific illustration of the United States jurisdiction scheme in bankruptcy proceedings under Chapter III. As to the situation in France, article 2060 of French Civil Code provides that:

“one may not enter into arbitration agreements in matters of status and capacity of the persons, in those relating to divorce and judicial separation or on controversies concerning public bodies and institutions and more generally in all matters in which public policy is concerned.”

\(^{27}\) P.159  
\(^{28}\) P. Herzog, Civil Procedure in France (1967),  
Those matters remain reserved for adjudication in state courts. ’

Art. 174 of the Décret No.85-1388 du 27 décembre 1985 provides that insolvency courts has jurisdiction to hear and determine everything that concerns reorganization and liquidation, personal bankruptcy or any other sanction provided by relevant law. Despite the broad expression in legislation, the case law in France has developed a restricted interpretation of this provision, limiting jurisdiction of the commercial courts only to issues arising in insolvency proceedings, or having its source in their application or where the insolvency law had an influence on the resolution of the dispute.

Unlike France and the United States, Germany and Netherland are the examples of granting only restrictive jurisdiction to the courts competent in insolvency proceedings. In Germany, the courts competent to adjudicate the bankruptcy cases are competent to decide only on some minor, closely related disputes, whereas the usual rules on jurisdiction should be applied regarding a large amount of other insolvency issues, including proprietary and verification disputes and avoidance of fraudulent transactions. Thus logically the provisions of jurisdiction of bankruptcy courts in Germany seem to be of less importance. Actually the prevailing opinion in German literature is that all disputes related to bankruptcy proceedings are arbitrable. Dutch law is similar to German law in the extent of jurisdiction of bankruptcy courts. The provision of Art.126(13) of the Netherlands Code of Civil Procedure is generally narrowly interpreted so as to limit the jurisdiction of the courts in bankruptcy to matters directly connected with bankruptcy cases, but the verification disputes do fall within their competence. However, contrary to the view in Germany, the Netherland, the exclusive jurisdiction of national courts seems to be a supplementary criterion for determining subject-matter arbitrability.

Chapter II  Enforcement of Existing Arbitration Agreements

32 Arts. 102, 158, 163, 190, 202 of German Bankruptcy Code.
33 Dalhuisen, International Insolvency and Bankruptcy, 1986, 1.02[4][i], Part 2, p.35.
34 Jestaedt, op. cit., p. 58.
35 Dalhuisen, International Insolvency and Bankruptcy, 2.04[4], p.3-256.
The meaning of an arbitration agreement being enforceable contains at least two layers: firstly, the arbitration agreement must be effective; secondly, it follows that referral to arbitration is mandatory for a national court.\textsuperscript{37} Therefore, basically two questions are to be illustrated under this chapter, the first one is whether and how the insolvency of a party may influence the validity of the arbitration agreements; and the second one is what are the standards applied by national courts or arbitral tribunal when determining the enforceability of existing arbitration agreements.

National legislation rarely contains express provisions with respect to the enforceability of arbitration agreements.\textsuperscript{38} Thus, to illustrate the effects of insolvency proceedings on the enforcement of arbitration agreements previously concluded by the debtor, analysis needs to be made of the provisions of both national arbitration laws and insolvency laws especially the correlation between them. Vesna Lazic studied this subject with a comparative view to Germany, Netherland, French, England and United States,\textsuperscript{39} and concluded that the commencement of bankruptcy proceedings does not influence the validity of the arbitration agreement and that ‘the prevailing view in Dutch, French and German literature is that the trustee is generally considered to be bound by arbitration agreements concluded by the debtor \textit{in bonis}'.\textsuperscript{40}

However, there may still be possible exceptions to and limitations on the effectiveness of arbitration agreements due to the trustee’s special power typically conferred by insolvency laws to reject executory contracts and impeach certain transactions. Moreover, the fact that a particular kind of claim is considered to be arbitrable and the fact that insolvency proceedings \textit{per se} do not render the previously concluded arbitration agreement void, does not imply that the agreement will be enforced by the national court or arbitral tribunal. Therefore it is not enough to have a theoretically reached general conclusion regarding the validity of the arbitration agreements, the legal practice of national courts and arbitral tribunals when determining the enforceability of existing arbitration agreements must as well be analyzed in this chapter. For the purpose of a

\textsuperscript{37} Mandatory referral is an obligation provided in most national laws and international treaties, e.g. art.8 of the UNCITRAL Model Law.
\textsuperscript{38} P179. An exception would be Poland,
\textsuperscript{39} Vesna Lazic, Insolvency Proceedings and Commercial Arbitration, pp. 181-183.
\textsuperscript{40} \textit{Ibid}, p.231
detailed illustration of this issue, the relevant laws and legal practice of United Kingdom and the United States will be examined here. In particular, the abundance of the case law in the United States and the controversy on this issue seems to demand more detailed examination.

1. Enforcement of Arbitration Agreements in Bankruptcy Proceedings in United Kingdom

In principle an otherwise valid arbitration agreement remains binding on, and effective between, the contracting parties regardless of an event of insolvency. But there is an exception on the winding-up of a company, in this situation an arbitration agreement previously made by it becomes invalid since the corporate person no longer exists. 41 There are circumstances where a liquidator of a company, before the liquidation has been completed, may bring or defend proceedings (including in arbitration) and these are considered in more detail in Chapter III below. The situation relating to arbitration agreements made with natural persons is different, since they continue to exist after they have been declared bankrupt. Again, in principle, the agreements remain effective.

However, trustee's special power in insolvency proceedings seems to cause limitations to the general non-influence of validity rule. According to section 315 of the Insolvency Act 1986, the trustee in bankruptcy appointed to take control of the bankrupt's estate has the right to disclaim unprofitable contracts. Besides, a specific procedure is inserted into the Insolvency Act 1986 by the Arbitration Act 1996 42 by which the trustee is actually empowered to adopt or reject an arbitration agreement previously made by the bankrupt. That is exactly section 349A of the Insolvency Act 1986 and it provides as follows:

349A Arbitration agreements to which bankrupt is party.

(1) This section applies where a bankrupt had become party to a contract containing an arbitration agreement before the commencement of his bankruptcy.

(2) If the trustee in bankruptcy adopts the contract, the arbitration agreement is


42 Arbitration Act 1996, s.107(1) Sch. 3 para. 46.
enforceable by or against the trustee in relation to matters arising from or connected with the contract.

(3) If the trustee in bankruptcy does not adopt the contract and a matter to which the arbitration agreement applies requires to be determined in connection with or for the purposes of the bankruptcy proceedings—

(a) the trustee with the consent of the creditors’ committee, or

(b) any other party to the agreement,

may apply to the court which may, if it thinks fit in all the circumstances of the case, order that the matter be referred to arbitration in accordance with the arbitration agreement.

(4) In this section—

“arbitration agreement” has the same meaning as in Part I of the Arbitration Act 1996; and

“the court” means the court which has jurisdiction in the bankruptcy proceedings.

The principle of separability of an arbitration agreement seems to be compromised under English law. According to 349A para.1 of the section Insolvency Act 1986, the trustee would be bound by an arbitration agreement if he accepts the underlying contract of which the arbitral clauses forms part. However, if the trustee rejects the contract the decision on enforcement of arbitration agreements would be at the discretion of the court. According to section 349A para.3 of Insolvency Act 1986, an application to the English High Court must first be made in order to obtain the Court’s permission. Such an application must be made with the consent of either the creditors’ committee or the bankrupt's counterparty to the arbitration agreement. It is then open to the Court to consider the circumstances of the case and decide whether the dispute in question ought to be referred to arbitration. If the Court gives its permission for disputes involving the estate to be referred to arbitration, the trustee is bound to observe the earlier arbitration agreement. In the case of Re Atlantic Computer Systems Plc43 the court set out in detail the principles which apply in deciding whether to grant permission:

- The person seeking permission must make a case;
- If granting permission to an owner of land or goods to exercise proprietary

rights, it is unlikely to impede the achievement of the purpose of the administration, permission should normally be granted;

- In other cases the court will carry out a balancing exercise, weighing the legitimate interest of the applicant against those of the companies or creditors;
- In carrying out the balancing exercise, weight should be given to those applying to enforce proprietary rights since an administration should not be conducted for the benefit of unsecured creditors at the expense of those with proprietary interests;
- If permission is not granted, the court may apply conditions such as giving directions to the administrator;
- The court on a permission application will generally not seek to adjudicate upon the dispute over the existence, validity or nature of a security unless the issues raises a short point of law which can be determined conveniently.44

2. Enforcement of Arbitration Agreements in Bankruptcy Proceedings in the United States

In the United States, the question of enforceability of an arbitration agreement in Bankruptcy Proceedings has been considered as ‘an inevitable clash’ between Federal Arbitration Act (FAA) and bankruptcy statutory scheme45 or more precisely a problem of ‘conflicting policies between arbitration and bankruptcy’46. The Arbitration Act, which was enacted in 1925, provides that arbitration clauses contained in written agreements ‘shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.’47 The Supreme Court has noted that ‘[b]y its terms, the [Arbitration] Act leaves no place for the exercise of discretion by a district court, but instead mandates that district courts shall direct the parties to proceed to arbitration on issues as to which an arbitration agreement has been signed.’48 However, Congress under the

statutory scheme in title 28 confers upon the bankruptcy courts centralized jurisdiction over disputes regarding a debtor's assets and legal obligations and litigation 'arising under' or 'arising in' the Bankruptcy Code, or 'related to' a case under the Bankruptcy Code.49

2.1. Centralized jurisdiction of Bankruptcy courts

It is within the context of the bankruptcy jurisdictional scheme under the Judicial Code that courts have been asked to decide whether a bankruptcy court's jurisdiction over a core or non-core proceeding must give way to a contractually binding arbitration agreement. To be precise, Section 1334(c)(1) of title 28 of the United States Judicial Code contains the framework that a bankruptcy court utilizes when deciding whether to abstain from exercising this jurisdiction. Thus, before analyzing judicial practice regarding the enforceability of arbitration agreements in bankruptcy, a brief introduction on the jurisdictional authority of the bankruptcy courts is necessary. In turn, this abstention analysis must guide a bankruptcy court in determining whether an arbitration agreement is in fact enforceable after bankruptcy ensues.

The basic jurisdictional grant for bankruptcy courts under the 1978 Bankruptcy Reform Act was contained in former section 1471 of title 28.50 Section 1471 vested in the new bankruptcy court jurisdiction of all civil proceedings 'arising under' title 11 or 'arising in' or 'related to' cases under title 11. Subsection (b) of [section 1471] is a significant change. It grants the bankruptcy court original (trial), but not exclusive, jurisdiction of all civil proceedings arising under Title 11 or arising under or related to cases under Title 11. This is the broadest grant of jurisdiction to dispose of proceedings that arise in bankruptcy cases or under the bankruptcy code. Actions that formerly had to be tried in State court or in Federal district court, at great cost and delay to the estate, may now be tried in the

\[\text{that reviews of district court decisions should not promote particular substantive results and finding leeway granted arbitrators "does not mean that appellate courts should give extraleeway to district courts that uphold arbitrators".} \]

49 See 28 U.S.C. § 1334(b) (2006) (“District courts should have original but not exclusive jurisdiction of all civil proceedings arising under title 11.”); 28 U.S.C. § 157(b)(1) (2006) (“Bankruptcy judges may hear and determine all cases under title 11 ...”); see also 28 U.S.C. § 1334(e) (2006) (vesting district court in which bankruptcy proceeding is commenced or is pending with "exclusive jurisdiction of all of property, wherever located, of the debtor as of the commencement of such case").

bankruptcy courts. The idea of possession or consent as the sole basis for jurisdiction is eliminated. The bankruptcy court is given *in personam* jurisdiction as well as *in rem* jurisdiction to handle everything that arises in a bankruptcy case.51 Congress sought to shore up its ‘exclusive and pervasive’ 52 jurisdictional grant under section 1471 by allowing the venue of ‘various proceedings, disputes, actions, arising under or related to [the bankruptcy cases]’ to be directly with the bankruptcy courts53 and by allowing the removal of pending civil proceedings from the state courts to the bankruptcy courts.54 Indeed section 1452(a)—the removal provision—was enacted to promote federal court jurisdiction over specified bankruptcy-related claims.55 In short, so long as a bankruptcy court has jurisdiction over an action ‘[t]he efficiency and reorganization goals of the Bankruptcy Code require interpreting Section 1452 in favor of federal jurisdiction and removal except in the limited cases it expressly excepts.’ 56 To further effectuate the new jurisdictional provisions, Congress also gave bankruptcy courts the power to issue any order, process, or judgment necessary or appropriate to carry out the provisions of the Bankruptcy Code with the statutes.57

By combining jurisdiction over all bankruptcy-related proceedings into a single court, the 1978 Bankruptcy Reform Act was designed to expedite the administration of bankruptcy proceedings and reduce the cost for litigants and the system.58 ‘In reducing these adjudicative costs, Congress sought to enhance

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52 See *Auburn Med. Realty v. Bonardi* (*In re Auburn Med. Realty*), 19 B.R. 113, 115 (B.A.P. 1st Cir. 1982) (discussing subsection (b) as “significant change” from prior law by granting bankruptcy court trial jurisdiction for actions formerly designated to state and federal district courts) (citation omitted); *In re Hartley*, 16 B.R. 777, 778 (Bankr. N.D. Ohio 1982) (stating, according to section 1471, district court “shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11”) (citation omitted).
53 1 Collier on Bankruptcy 1.06[4], at 1-100, Alan N. Resnick et al. eds., 15th ed. rev. 2008. (“In keeping with all versions of legislation wherein exclusive and pervasive jurisdiction was given the bankruptcy courts....”).
54 *Ibid.* See Zimmerman, 712 F.2d at 58 (noting “all matters and proceedings that arose in connection with bankruptcy cases’ may now be tried in one action before the bankruptcy court”) (citation omitted); see also 28 U.S.C. §§ 1472-1475(1978), invalidated by Marathon, 458 U.S. 50 (outlining various venues and proceedings that are under jurisdiction of bankruptcy courts).
55 See 28 U.S.C. § 1478 (1978), invalidated by Marathon, 458 U.S. 50 (allowing removal of any claim to bankruptcy court where bankruptcy court has jurisdiction); see also Zimmerman, 712 F.2d at 58 (discussing congressional grant for removal under section 1478).
57 *In re WorldCom*, 293 B.R. at 329.
58 See 11 U.S.C. § 105(a) (2006); NLRB v. Superior Forwarding, Inc., 762 F.2d 695, 698 (8th Cir. 1985)(holding bankruptcy court can “enjoin federal regulatory proceedings” because section 105(a) allows bankruptcy court to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title”)
Currently, in United States, the jurisdiction of bankruptcy cases and proceedings are governed by Sect. 1334 as the Bankruptcy Reform Act 1978 has been amended by the Bankruptcy Amendments and Federal Judgeship Act of 1984. In accordance with this provision the district courts are conferred original and exclusive jurisdiction over all civil proceedings arising under, in or related to bankruptcy cases. The district court in which a bankruptcy case is pending or has been commenced has the exclusive jurisdiction over all the property of the debtor and over the estate, whatever located. The Amendments Act provided, however, for two kinds of abstention of the courts having jurisdiction over a bankruptcy case: discretionary and mandatory abstention. Thus, the district court may abstain from hearing a particular proceeding arising under, in or related to a bankruptcy case, when it is 'in the interest of justice, or in the interest of comity with State Courts or respect for State law.' However, Sect. 1334(c)(2) limited the competence of the district court. Pursuant to this provision, the district court is required to abstain from hearing a state law claim or cause of action with respect to ‘non-core’ matters related to a bankruptcy case, provided that certain conditions are fulfilled. In this context, as to an enforcement of arbitration clause, the question might be whether it falls under the mandatory or under the discretionary abstention. Only a cumulation of all requirements listed in Sect. 1334(c)(2) triggers the obligation of the court to abstain. Therefore, the existence of a pending state action is one of the requirements necessary to be met in order to apply the mandatory abstention provision.

The new provisions reconstituted bankruptcy courts as ‘units’ of the district court, and gives to each district court the authority to refer to bankruptcy judges ‘any or all cases under title 11 and any or all proceedings arising under title 11 or arising

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64 28 U.S.C.A. Sect. 1334(c)(1).
65 The four conditions are: 1) the timely motion of a party, 2) the proceeding is related only to a bankruptcy case (thus not just arising under or arising in a bankruptcy case), 3) if this is a proceeding ‘with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section’, and 4) if ‘an action is commenced, and can be timely adjudicated’, this should be done ‘in a stated forum of appropriate jurisdiction’ (28 U.S.C.A. Sect. 1334(c)(2)).
in or related to a case under title 11.' This is routinely accomplished by a general order of the district court that automatically refers all cases and proceedings within its bankruptcy jurisdiction to the bankruptcy court for its judicial district. However, Sect. 157(b) and (c) differentiate between core matters from noncore matters and restrict the jurisdiction of the bankruptcy courts to adjudicate the non-core proceedings. Namely, bankruptcy judges may hear and determine all bankruptcy cases and core proceedings arising under or in a bankruptcy case. In that respect they may enter appropriate orders and judgments, which are subject to review (i.e. an appeal under Sect. 158). As to non-core matters the bankruptcy court has only limited jurisdictions and they are not authorized to enter final orders and judgments unless the district court with the consent of all parties refers a related proceedings to be adjudicated by the bankruptcy judge.

2.2 Pre-McMahon phase

In early cases decided shortly after the enactment of the 1978 Act, but before the Supreme Court's decision in *McMahon*, several courts had held that bankruptcy courts were not strictly bound by the Arbitration Act. Most notably, the Court of Appeals for the Third Circuit in *In re Zimmerman*, held that the 'purposes of the Bankruptcy Reform Act impliedly modify the Arbitration Act.' Such early decisions focused simply on whether one statutory scheme trumped another. In *Zimmerman*, a trustee in bankruptcy commenced an adversary proceeding against a defendant for breach of contract and the court of appeals upheld the bankruptcy court's denial of the defendant's application to compel binding arbitration based on a contractual arbitration provision. Additionally, even where courts did not explicitly determine that the policies underlying the Bankruptcy Code are superior to those championed by the Arbitration Act, greater reliance was placed on bankruptcy policy and the broad pre-*McMahon* competence of

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67 28 U.S.C. § 157(a) (2000) (granting district courts authority to refer bankruptcy cases to bankruptcy courts); see Standing Order of Referral of Cases to Bankruptcy Judges (July 10, 1984, Ward, Acting Chief Judge) (“Pursuant to Section 157(a) of the Bankruptcy Amendments and Federal Judgeship Act of 1984, any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 are referred to the bankruptcy judges for this district.”); Alec P. Ostrow, Constitutionality Of Core Jurisdiction, 68 AM. BANKR. L.J. 91, 92 n.7 (1994) (“All districts have adopted a general order of reference of bankruptcy cases to the bankruptcy judges.”).
69 28 U.S.C.A. Sect. 1334 (c)(2)
70 Zimmerman v. Cont'l Airlines, Inc., 712 F.2d 55, 56 (3d Cir. 1983)
71 Zimmerman, 712 F.2d at 55 (rejecting defendant's request to stay bankruptcy proceeding and to enforce contract's arbitration clause).
jurisdiction given to bankruptcy courts by Congress. 72 These early cases relied upon the broadening of the jurisdictional grant afforded to bankruptcy courts by the Bankruptcy Reform Act of 1978, noting that bankruptcy courts were no longer bound by distinctions between plenary and summary jurisdiction, and were given the powers of courts of equity, law, and admiralty.73

2.3 Supreme Court’s Guidance—McMahon

In 1987, the Supreme Court rendered a landmark decision in Shearson/American Express, Inc. v. McMahon.74 So far it is the only guidance from the Supreme Court which provided a framework for determining when the Arbitration Act will give way to a conflicting federal statute.

In McMahon, the Supreme Court determined that arbitration clauses must be enforced when claims under section 10(b) of the Securities Exchange Act and claims under the Racketeer Influenced Corrupt Organizations Act were brought against a securities broker by a customer.75 To reach such a conclusion, the Supreme Court articulated the standard for courts to use when evaluating whether Congress intended that a countervailing federal statute would override the Arbitration Act with respect to disputes involving a certain subject matter. The Court noted that:

‘The burden is on the party opposing arbitration ... to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue. If Congress did intend to limit or prohibit waiver of a judicial forum for a particular claim, such an intent “will be deducible from [the statute’s] text or legislative history,” or from an inherent conflict between arbitration and the statute's


73 See In re Cross Elec. Co., 9 B.R. at 410 (noting under former Bankruptcy Act, bankruptcy courts were constrained by ability to dispose of matters before them based on summary jurisdiction, and therefore had little choice but to enforce arbitration clauses) (citing Schilling v. Canadian Foreign S.S. Co., 190 F. Supp. 462, 463 (D.C.N.Y. 1961) (stating limits of summary jurisdictional powers of bankruptcy court prior to enactment of Bankruptcy Reform Act of 1978)).

74 482 U.S. 220, 220 (1987) (establishing strong federal policy favoring arbitration although it may be overridden by contrary congressional command).

75 Ibid. at 233.
underlying purposes....To defeat application of the Arbitration Act ... the [party opposing arbitration] must demonstrate that Congress intended to make an exception to the Arbitration Act for claims arising under [the statute], an intention discernible from the text, history, or purposes of the statute.’ 76

In McMahon, the Court held that to overcome enforcement of an arbitration agreement because of another federal statute, the party must establish congressional intent to create an exception to the Arbitration Act's mandate. 77

Most importantly, the Court wrote that congressional intent to override the Arbitration Act can be discerned in any one of three ways: (i) the other statute's text; (ii) the other statute's legislative history; and (iii) an inherent conflict between arbitration and the other statute's underlying purposes. 78 However, as one commentator has noted, in applying the McMahon standards, courts have found little guidance either in the text or the legislative history of the Judicial Code provisions relating to bankruptcy jurisdiction; applying this Supreme Court approach to decide the enforcement of arbitration agreements in bankruptcy proceedings, ‘the inquiry, therefore, has been framed as whether arbitrating the dispute in question would pose an irreconcilable conflict with the Code.’ 79

Since McMahon, various courts in America seem to have developed their own approaches in determining whether an inherent conflict exists. The analysis has been made on a case-by-case basis, examining the facts and circumstances of the particular dispute. The result of such judicial practice is a wide body of law consisting of divergent decisions issued by various appellate courts.

2.4 Post-McMahon phase

2.4.1 Hays—enforceability of arbitration clauses in non-core proceedings

76 Ibid., at 227
77 McMahon, 482 U.S. at 223.
78 Ibid., at 227.
In *Hays*, a chapter 11 trustee commenced an action against a securities broker for claims under various state and federal securities laws, as well as fraudulent conveyance and constructive trust claims under the trustee’s powers under section 544(b) of the Bankruptcy Code. The defendant securities broker moved to compel arbitration based on the arbitration provision in the customer agreement signed by the broker and the debtor before the commencement of the bankruptcy case. The district court denied the motion, stating that under the *Zimmerman* decision, it had broad discretion to nullify a mandatory arbitration clause. It also stated that since neither the trustee nor the creditors it had represented signed the agreement, they should not be bound by its arbitration provision. The court of appeals reversed, holding that “the trustee-plaintiff stands in the shoes of the debtor for purposes of the arbitration clause.” The court, giving no weight to its decision in *Zimmerman* because it had predated the Supreme Court’s decision in *McMahon* and the 1984 amendments to title 28, also distinguished between litigation in which the trustee seeks to enforce a debtor-derivative pre-petition contract claim, which is a non-core matter, and actions created by the Bankruptcy Code for the benefit of creditors, which are core matters.

The court of appeals in *Hays* found no indication in the text or legislative history of the 1984 amendments to the Judicial Code governing bankruptcy jurisdiction that Congress intended to bar arbitration in the non-core context. It also found no irreconcilable conflict between the statutes governing bankruptcy jurisdiction and the Arbitration Act in non-core proceedings, noting that the consolidation impulse—which is very clear in the context of core claims—is not prevalent in the context of non-core claims. Therefore, the court of appeals held that arbitration of the non-core dispute was mandatory and the court had no discretion to nullify it.

2.4.2 *National Gypsum*—enforceability of arbitration clauses in core proceedings

While *Hays* appears to have addressed the enforceability of arbitration clauses in non-core proceedings, the Court of Appeals for the Fifth Circuit in *In re National*
Gypsum addressed the enforceability of an arbitration clause in core proceedings. 87 Relying on Hays, the court noted that arbitration of derivative, non-core matters does not conflict with the Bankruptcy Code (and in fact “makes eminent sense” in light of the 1984 amendments to the Bankruptcy Code), however the Fifth Circuit commented that Hays did not address specifically whether a bankruptcy court has discretion to enforce an applicable arbitration clause where core bankruptcy issues are involved. 88 The Fifth Circuit expressly rejected a per se rule that the bankruptcy court has discretion to deny enforcement of an agreement to arbitrate in all core proceedings, and instead adopted a standard that questioned whether arbitrating a particular core matter would conflict with the Bankruptcy Code. 89

National Gypsum bifurcated core claims into two categories: claims involving bankruptcy rights, which should remain within the bankruptcy court, and claims involving state law rights, whose arbitration does not inherently conflict with the Code. 90 The court concluded that only core claims arising from the federal rights conferred by the Bankruptcy Code present the type of conflict with the purpose and provisions of the Bankruptcy Code alluded to in McMahon to permit bankruptcy courts to use their discretion in deciding whether to allow arbitration. 91

We think that, at least where the cause of action at issue is not derivative of the pre-petition legal or equitable rights possessed by a debtor but rather is derived entirely from the federal rights conferred by the Bankruptcy Code, a bankruptcy court retains significant discretion to assess whether arbitration would be consistent with the purpose of the Code, including the goal of centralized resolution of purely bankruptcy issues, the need to protect creditors and reorganizing debtors from piecemeal litigation, and the undisputed power of a bankruptcy court to enforce its own orders. 92

87 Ibid. at 1153. The court of appeals also wrote, reasoning a trustee's claims under section 544(b) of the Bankruptcy Code are asserted on behalf of creditors, that “there is no justification for binding creditors to an arbitration clause with respect to claims that are not derivative from one who was a party to it.” Id. At 1155.
88 Id. at 1066.
89 Id. at 1067 (“[N]on-enforcement of an otherwise applicable arbitration provision turns on the underlying nature of the proceeding i.e., whether the proceeding derives exclusively from the provisions of the Bankruptcy Code and, if so, whether arbitration of the proceeding would conflict with the purposes of the code.”).
90 Id. at 1066-67.
91 In re Nat'l Gypsum Co., 118 F.3d at 1069.
92 Id. at 1069.
Applying this standard to the facts in National Gypsum, the court of appeals upheld the bankruptcy court's discretion to deny a motion to compel arbitration.\(^93\) The motion was brought in the context of an adversary proceeding brought by successors of a chapter 11 debtor to determine whether an insurance company's collection efforts were barred by the discharge injunction set forth in section 524(a) of the Bankruptcy Code or by the confirmation of the plan of reorganization in National Gypsum's chapter 11 case.\(^94\) The court of appeals was convinced that arbitration of this core proceeding, which was a non-debtor derivative action to enforce asserted rights created by the Bankruptcy Code completely divorced from National Gypsum's rights under pre-bankruptcy contracts, would be inconsistent with the Bankruptcy Code.\(^95\)

*Hays* and *National Gypsum* formed the groundwork for the analysis done by other courts on the enforceability of arbitration clauses in bankruptcy. Following *Hays* and *National Gypsum*, other circuit courts—most notably the Second Circuit and the Fourth Circuit—addressed this issue. However, while each court took note of the analysis in *Hays* and *National Gypsum*, each court modified the standard, creating yet another means for determining the level of the bankruptcy court's discretion to deny enforcement of an arbitration clause.\(^96\)

2.4.3 Does the bankruptcy court have discretion to nullify arbitration clauses in all core proceedings?

The answer of the Second Circuit court seems to be negative. In *In re United States Lines*, the court of appeals rejected the notion that the bankruptcy court has discretion to nullify arbitration clauses in all core proceedings. Besides, in contrast to the Fifth Circuit's approach in National Gypsum, which divided core claims into two categories based on whether the claim involved state law rights or bankruptcy law rights, the Second Circuit did not make such distinction and reasoned that the bankruptcy court must 'carefully determine whether any underlying purpose of the Bankruptcy Code would be adversely affected by

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\(^{93}\) Id. at 1071 (finding arbitration would irreconcilably conflict with Code).

\(^{94}\) Id. at 1071.

\(^{95}\) Id. at 1071.

enforcing an arbitration clause.\textsuperscript{97} The court of appeals then recognized that there will be occasions where a dispute involving both the Bankruptcy Code and the Arbitration Act “presents a conflict of near polar extremes: bankruptcy policy exerts an inexorable pull towards centralization while arbitration policy advocates a decentralized approach towards dispute resolution.”\textsuperscript{98} Therefore, as to core claims, the court held that a bankruptcy court has discretion to determine arbitrability ‘governed by an assessment of competing policies’.\textsuperscript{99} Thus as long as the subject matter is arbitrable, this case did not give the bankruptcy court unfettered discretion to deny a motion to compel arbitration under an arbitration clause merely because it found that the proceeding was core.

Consistent with that position, in \textit{MBNA America Bank v. Hill},\textsuperscript{100} the Second Circuit held that, based on the unique facts of that case, a bankruptcy judge had no discretion in the core proceeding to deny enforcement of an arbitration clause contained in a consumer loan agreement.\textsuperscript{101} After filing a chapter 7 liquidation petition and receiving a discharge of her debts, the debtor filed an adversary proceeding against the lender as a putative class action on behalf of herself and others similarly situated alleging willful violation of the automatic stay and seeking damages under section 362(h) of the Bankruptcy Code. The bankruptcy court denied the lender’s motion to compel arbitration, concluding that the bankruptcy court was the most appropriate forum, and the district court affirmed, finding that compelling arbitration would “seriously jeopardize the objectives of the Bankruptcy Code.”\textsuperscript{102} Citing \textit{United States Lines}, the court of appeals recognized that:

Bankruptcy courts are more likely to have discretion to refuse to compel arbitration of core bankruptcy matters. However, even as to core proceedings, the bankruptcy court will not have discretion to override an arbitration agreement unless it finds that the proceedings are based on provisions of the Bankruptcy Code that “inherently conflict” with the Arbitration Act or that arbitration of the claim would “necessarily jeopardize” the objectives of the Bankruptcy Code.\textsuperscript{103}

\textsuperscript{97} In re U.S. Lines Inc., 197 F.3d (quoting Hays and Co. v. Merrill Lynch, 885 F.2d 1149, 1161 (3d Cir. 1999)).
\textsuperscript{98} Ibid. (quoting Societe Nationale Algerienne v. Distrigas Corp., 80 B.R. 606, 610 (Bankr. D. Mass. 1987)).
\textsuperscript{99} In re U.S. Lines Inc., 197 F.3d, at 2303.
\textsuperscript{100} 436 F.3d 104 (2d Cir. 2006).
\textsuperscript{101} Ibid. at 109.
\textsuperscript{102} Ibid. at 107.
\textsuperscript{103} Ibid. at 108 (quoting \textit{In re U.S. Lines, Inc.}, 197 F.3d at 640).
The court of appeals then reversed the lower court decisions and held that the bankruptcy court lacked discretion to deny enforcement of the arbitration clause. Although we reach the same conclusion as the lower courts that Hill's section 362(h) claim is a core proceeding, we hold that arbitration of her claim would not seriously jeopardize the objectives of the Bankruptcy Code because (1) Hill's estate has now been fully administered and her debts have been discharged, so she no longer requires protection of the automatic stay and resolution of the claim would have no effect on her bankruptcy estate; (2) as a purported class action, Hill's claims lack the direct connection to her own bankruptcy case that would weigh in favor of refusing to compel arbitration; and (3) a stay is not so closely related to an injunction that the bankruptcy court is uniquely able to interpret and enforce its provisions.\(^{104}\)

However, the Court of Appeals for the Fourth Circuit holds a different opinion. In *White Mountain*, the Fourth Circuit upheld the lower court's refusal to submit a core proceeding to arbitration, the court also took the chance to express its willingness to accept a bright-line distinction that would render all core proceedings subject to the bankruptcy judge's discretion to nullify arbitration clauses. Noting that the Second Circuit, in *United States Lines*, wrote that a determination that a proceeding is core does not automatically give the bankruptcy court discretion to nullify an arbitration clause, the Fourth Circuit commented that:

'\[t\]here is the counter-argument, however, that the statutory text giving bankruptcy courts core-issue jurisdiction reveals a congressional intent to choose those courts in exclusive preference to all other adjudicative bodies, including boards of arbitration, to decide core claims.'\(^{105}\)

In any event, the Fourth Circuit then wrote that 'we need not decide today whether the statutory text itself demonstrates congressional intent to override arbitration for core claims because this case may be decided under *McMahon*'s third line of analysis ....\(^{106}\) This statement clearly reveals that the Fourth Circuit, unlike the Second Circuit, would be willing to consider that the bankruptcy court has discretion to nullify arbitration clauses in all core proceedings, and even sets forth an argument for adopting that principle.


\(^{105}\) *In re* White Mountain Mining Co., 403 F.3d 164, 169 (4th Cir. 2005).

\(^{106}\) *Ibid.*
2.4.5 Reversing the core and noncore dichotomy

It is not hard to find from the aforementioned cases that determining whether a particular proceeding is core or non-core always seems to be the first step in the reasoning of the court when the enforcement of a mandatory arbitration clause is at issue. Until recently, a common thread running through virtually all appellate decisions on the enforcement of arbitration clauses in bankruptcy is that different standards apply depending on whether the proceeding is core or non-core. As discussed above, despite the fact that courts have different opinions on what those standards are, they do have agreed generally that a determination of whether the proceeding is core or non-core has at least some relevance to the question of whether an arbitration clause must be enforced. However, in a recent and surprising decision of the Court of Appeals for the Third Circuit in *In re Mintze*, in which the court revisited the enforceability of arbitration clauses in bankruptcy, it expressly rejected the notion that there are different standards to be applied depending on whether the proceeding is core or non-core. The core/non-core distinction does not affect whether a bankruptcy court has the discretion to deny enforcement of an arbitration agreement. Apparently, therefore, in the Third Circuit the core/non-core distinction is irrelevant in determining whether a bankruptcy court has discretion to nullify an arbitration clause.

The *Mintze* case was between a home equity lender and the debtor. The debtor commenced an adversary proceeding alleging that the lender induced her into entering into an illegal and abusive home equity loan that resulted in the lender

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107 Interestingly, the bankruptcy court in *In re Sacred Heart*, 181 B.R. 195 (Bankr. E.D. Pa. 1995), noted that it “need not decide whether [the] proceeding is core ....” Id. at 197. The court then stayed an adversary proceeding and sent the case to an arbitral panel, yet retained the matter for periodic status reports as to the progress of the arbitration. Id. at 205. There is a minority view that bankruptcy courts do have discretion to determine whether non-core matters should be sent to arbitration, but when it comes to core matters, bankruptcy courts have no discretion and are required to retain jurisdiction, as the Bankruptcy Code impliedly modifies that Arbitration Act. See *In re Guild Music Corp.*, 100 B.R. 624 (Bankr. D.R.I. 1989), where the court stated the following: Where issues to be arbitrated are not exclusively bankruptcy matters, but are otherwise related to the bankruptcy case, such issues may be referred to arbitration, in the sound discretion of the bankruptcy judge. However, where the issues in dispute involve “core” bankruptcy matters, which are the exclusive subject matter of the bankruptcy court, such issues may not be referred to arbitration. Id. at 628; see *In re Hagerstown Fiber Ltd. P'ship*, 277 B.R. 181, 203 (Bankr. S.D.N.Y. 2002)(differentiating between issues that are “procedurally core” or “substantively core”). But see *U.S. Lines, Inc. v. American Steamship Owners Mutual Prot. & Indem. Ass'n, Inc.* (In re *U.S. Lines, Inc.*) 197 F.3d 631, 640 (N.Y. 1999) (“Even a determination that a proceeding is core will not automatically give the bankruptcy court discretion to stay arbitration.”).


109 Id. at 229.
holding a mortgage lien against her home. She had sought to enforce a pre-bankruptcy rescission of the mortgage that she had asserted under the Federal Truth in Lending Act, as well as asserting several other claims under state and federal consumer protection laws. The lender moved to compel arbitration based on an arbitration clause in the loan agreement. The bankruptcy court held that the proceeding should be treated as core based on a stipulation of the parties and decided that it should be heard by the bankruptcy court because the outcome of the rescission claim would affect her chapter 13 plan and the distribution of her money to her other creditors. But the court of appeals disagreed with the bankruptcy court's conclusion that the effect of a resolution of the adversary proceeding on the order of priority of claims and on the amount of distributions to other creditors was sufficient to create an inherent conflict between the Bankruptcy Code's underlying purposes and the Arbitration Act required by the Supreme Court's decision in McMahon. The court of appeals noted that the statutory claims raised by the debtor in the adversary proceeding are all based on state or federal consumer protection laws, including the Truth in Lending Act, and not on any statutory claims raised under the Bankruptcy Code. 'With no bankruptcy issue to be decided by the Bankruptcy Court, we cannot find an inherent conflict between arbitration of Mintze's federal and state consumer protection issues and the underlying purposes of the Bankruptcy Code.' The court of appeals also took the opportunity in Mintze to interpret its earlier decision in Hays so as not to be limited to non-core proceedings. The court in Mintze rejected normal interpretation, but saying that the Hays decision 'did not seek to distinguish between core and non-core proceedings; rather, it sought to distinguish between causes of action derived from the debtor and bankruptcy actions that the Bankruptcy Code created for the benefit of the creditors of the estate.' Thus, actually, it has switched its own position when rendering the decision in Hays more than sixteen years before.

The Third Circuit in Mintze stated that before determining whether the bankruptcy court abused its discretion in denying enforcement of an arbitration clause, the court of appeals must determine whether the bankruptcy court even had any

111 In re Mintz, 434 F.3d at 226, 227.
112 Id.
113 Id. at 231-32
114 Id.
115 In re Mintze, 434 F.3d at 230.
discretion to exercise.\textsuperscript{116} In explaining its ruling in \textit{Hays}, the Third Circuit clarified that it held in that case that ‘whether the McMahon standard is met determines whether the court has discretion to deny enforcement of an otherwise applicable arbitration clause.’\textsuperscript{117} That is, the starting point is \textit{McMahon} and whether the claim at issue is core or non-core is not part of the analysis. Ultimately, the question of whether the bankruptcy court has any discretion at all to deny enforcement of an arbitration clause turns on whether the party opposing arbitration can establish Congressional intent to preclude waiver of judicial remedies for the statutory rights at issue. The position now adopted by the Third Circuit appears to be the most pro-arbitration position of any circuit.

It seems ultimately the long judicial analysis circle towards the enforcement of arbitration agreements in bankruptcy just rounded back to the original but vague standard as to ‘Congress’s intention’. Lack of uniformity of approaches when deciding whether to enforce an arbitration agreement has caused uncertainty in this issue.

Chapter III Effects on Conduct of Arbitration Proceedings and Awards

1. Capacity to participate in arbitration --\textit{Locus Standi}

As mentioned before, the opening of insolvency proceedings implies significant limitations on the debtor’s rights regarding management and disposal of the estate. The extent of this limitation may vary in different kinds of insolvency proceedings, but in general, it influences the right to institute or defend legal actions relating to the estate. In respect to arbitration, it implies that the debtor may not be a proper party against whom an earlier concluded arbitration agreement may be invoked and the debtor’s may not have the right any more to effectively continue arbitral proceedings pending at the time of the opening of the insolvency proceedings.

Since the lack of the right to sue and to be sued is a consequence of debtor’s dispossession in bankruptcy liquidation, it is common that most legal systems pass the right of legal standing concerning the estate to the trustee. For example,

\textsuperscript{116} Id., 229.
\textsuperscript{117} Id., 230.
Chinese bankruptcy law expressly provides that it is the trustee who should participating actions, arbitrations or any other legal procedures on behalf of the debtor.\(^{118}\) Also in the United States, the estate becomes subject to bankruptcy law as soon as the bankruptcy order has been made\(^{119}\) and the trustee becomes the representative of the estate and a successor to the debtor's interest\(^{120}\).

However the trustee is not always entirely independent when deciding whether particular proceedings are to be continued or commenced, sometimes the permission of the creditor’s committee and/or the court is required. According to English bankruptcy law, the trustee is entitled, with permission of the creditor’s committee or the court, to bring, institute or defend any legal action or legal proceedings relating to the property comprised in the bankrupt’s estate.\(^{121}\) The trustee has ‘power to refer to arbitration, or compromise on such terms as may be agreed on, any debts, claims or liabilities subsisting or supposed to subsist between the bankrupt and any person who may have incurred any liability to the bankrupt’ with the sanction of the court.\(^{122}\) And in Corporate winding-up, the liquidator is entitled to bring or defend any legal action on behalf of or against the estate, which right is exercisable involuntary winding-up without the sanction of the court, whereas in compulsory winding-up he will need court approval.\(^{123}\)

### 2. Suspension and Continuation of Pending Arbitration Proceedings

#### 2.1 Stay of the Pending Proceeding

It is widely accepted principle in arbitration that parties are free to determine the manner in which arbitral proceedings are to be conducted and if they fail to do so, most arbitration laws provide for the discretion and freedom of the arbitrators to determine the procedure. However this freedom seems to be limited since insolvency laws normally contain provisions on suspension of pending litigation and on the manner in which pending law suits are to be continued after the commencement of insolvency.

\(^{118}\) P.R.C. Bankruptcy Law, Art.25(7).
\(^{119}\) U.S.C.A. Sect. 323(a).
\(^{120}\) U.S.C.A. Sect. 541.
\(^{121}\) The Insolvency Act of 1986, Sect. 314.
\(^{122}\) The Insolvency Act of 1986, Sect. 314 and Sched. 5, Part. I(6).
Some of those provisions particularly mentioned arbitral proceedings. For instance, in China, article 20 of the Enterprise Bankruptcy Law of People's Republic of China expressly states that after the people's court accepts an application for bankruptcy, any civil action or arbitration involving the relevant debtor that is in the process of trial shall be suspended. The action or arbitration can be resumed after a bankruptcy administrator takes over the debtor's assets.

There are also provisions not referring expressly to arbitration but contain broad notions which can be interpreted as to include arbitration undisputedly, such as the United States and the United Kingdom. Pursuant to Sect. 362 of the US Bankruptcy Code, after filing a petition for relief in bankruptcy proceedings, almost all claims against a debtor or the estate are prevented from execution and prosecution. It provides for an automatic stay of, inter alia, the commencement or continuation of any action or proceedings against the debtor and the estate that was or could have been commenced before filing a petition for relief. Subsection(a) defines the scope of the automatic stay, by listing acts stayed by the commencement of bankruptcy proceedings. The scope of para.(1) is very broad, providing for stay of a 'judicial, administrative or other proceeding against the debtor', thus also pending arbitrations. In England, the bankruptcy order does not automatically stay pending proceedings against the debtor. The court may, however, order stay of 'any action, execution or other legal process' at any time during the bankruptcy proceedings. However, after the bankruptcy order has been issued, no creditor may commence any legal proceedings in respect of any debt provable in bankruptcy unless with the leave of the court.

As to provisions referring only to court proceedings, must they also be considered in arbitral proceedings? In France, although the relevant provisions of the French law do not refer particularly to arbitration proceedings, it is well held by case law that the same applies to pending arbitrations.

2.2 Suggestions on Application/non-application of Suspension

The foregoing conclusion seems to be that national courts have found that the definition of those suspension provisions does include arbitral proceedings and, as a consequence, insolvency may result in a stay of an ongoing arbitration. This should be obeyed by a domestic arbitration but not always so in an international commercial arbitration, since the later recognition and enforcement of the award may be sought in another country. Staying arbitration may hinder the independence of arbitral tribunals from national courts, encumber the flexibility sought by the parties and delay the resolution of the dispute. The practice of arbitral tribunal indeed presents different attitudes on this issue. Some of the arbitral tribunals apply the provisions on suspension of pending law suits while others tend to ignore the parallel insolvency proceedings. The American Arbitration Association is an example which strictly follows the rule of automatic stay in United States and even extended the statutory scope of that stay to cases involving a debtor who was a claimant in the arbitration proceedings. In Coar v. Brown, it stated that ‘the American Arbitration Association informed the parties that due to the filing of a bankruptcy petition...arbitration proceedings were stayed’.  

It cannot be denied that the continuance of an existing international arbitration does not depend solely on the determination of the national courts where the insolvency proceedings take place. In some cases, a tribunal may continue with an arbitration even if the national court dealing with the respondent’s insolvency has ordered a stay of the proceedings. As has been proposed by Mantilla-Serrano that even in the cases when suspension of the proceedings seems mandatory, but one of the parties still requests the tribunal to proceed, the arbitrators should proceed because ‘no one knows best what suits the party’s interest than the party itself’.  

However, this proposal seems to be too absolute and the view taken by the thesis is that this issue should be decided on case by case basis.

First, while not strictly necessary, it may sometimes be a good idea to advise a claimant to appear before the insolvency court in question and try to avoid a stay or obtain leave to proceed with the arbitration. Given the public nature of insolvency proceedings, insolvency courts generally permit claimants to appear

and make representations. Besides, there are practical issues which should be taken into account when deciding whether to initiate or continue arbitration when dealing with an insolvent respondent. No doubt that the availability of assets is the key consideration. Furthermore, special attention should be paid to service and communication because it may raise an issue of due process. An example can be illustrated through a case between a Portuguese Company and a German Company which became subject to bankruptcy proceedings during the process of arbitration. The arbitration went on and an award against the German company was rendered. The enforcement was refused by the German court on the basis of the respondent’s argument that there was no valid representation in the arbitration and that the due process had been violated because the German company was not informed of the arguments of the other party. The court, instead of considering the opening of bankruptcy proceedings in itself was to have any influence on the pending arbitration, held that the German insolvent company had no opportunity to present the case: ‘The mere possibility to submit documents on a disputed contract or to give its view without knowing the arguments of the opponent, is not sufficient for due process (possibly to present its claims and defenses)’. Therefore, inspired by this case, if the arbitration goes ahead, then the following practical issues should be considered.

- Service and communication Usually arbitral rules will provide that each party shall submit sufficient copies of his communication e.g. art. 3 of the ICC arbitration rules, parties may not follow the rule in practice. Then arbitrators need to ensure all documents are communicated to every party. This is especially so when the respondent is a reluctant insolvent party and the claimant has the burden to provide the respondent’s address for service of the request for arbitration and relevant notifications. The absence of proper service or notification of the proceedings constitutes, in most jurisdictions, a ground to set aside an award and resist its enforcement. Claimants must therefore take particular care to ensure that proper service has been carried out on an insolvent respondent, especially since there may have been changes in representation as a result of the insolvency (see “Representation” below). In practice, documents should be served to both the respondent and any administrator involved in the insolvency proceedings. Additionally,

128 V Lazic, p.301
129 XII YCA(1987), FR Germany no. 28, pp.486-487.
insolvent parties often do not participate in an arbitral proceeding. Faced with a defaulting respondent, the tribunal should require the claimant to explain in detail all the measures taken to contact the respondent. And finally, in its award, a tribunal is likely to set out at length any actions taken by the claimant and the tribunal to contact a defaulting party.

- Representation Once informed of the existence of insolvency proceedings, the tribunal should check if there has been any change (by virtue of the operation of law) in the representation of a respondent. It is also well advised to confirm the authority of the respondent's counsel to act on behalf of the insolvent party in the arbitral proceedings.

If necessary, a claimant should request the production of relevant court orders, directions and/or powers of attorney to clarify such issues. Some civil law jurisdictions are particularly strict in this respect and might consider that a party was never put on notice of the proceedings if mistakes were made, opening the way for challenges to enforcement.

All these being said, it is true arbitrators are not necessarily bound by the order of a court, particularly when the arbitral proceedings have their seat outside the jurisdiction where insolvency takes place, so they could just move forward without need for leave or an order somewhere else. However the risk should be borne in mind that progressing arbitration in the context of parallel insolvency proceedings will create issues of due process and potential problems in enforcement may also arise.

3. Influence of Insolvency Proceedings on Arbitral Awards

3.1 Declaratory Effect Only—French case study

Apart from annulment and enforcement issues, a special character may be imposed on the arbitral awards rendered in an arbitration where one party is subject to insolvency proceedings the national laws. An special example is France where the arbitral awards rendered after the commencement of insolvency only have a declaratory effect. The course of action in the French jurisdiction is determined by Art. 47 and 48 of the Loi du 25 janvier 1885. Art.47 contains the
principle that individual actions by creditors are precluded and forms part of French public policy.\textsuperscript{130} All pending proceedings will be suspended until the claim is declared in verification proceedings, after which the proceedings will continue against the trustee upon notification of the parties.\textsuperscript{131} The award will have only declaratory effect, such that the existence of a claim and its amount will be determined, but the award could not condemn the debtor to pay.\textsuperscript{132} The reason for this is that the principle of preclusion of individual actions by creditors, i.e. French public policy would prohibit enforcement of the award.\textsuperscript{133} Again due to the fact that the hindering factor is that of public policy, this is only the case as far as French public policy is applicable.\textsuperscript{134}

In a recent case \textit{Jean X.} decided on May, 2009, the French Supreme Court rendered a decision relating to the consequences of insolvency proceedings commenced in France against a party to pending international arbitration proceedings\textsuperscript{135} A French company had signed three contracts for the sale of crystallized sugar with an Egyptian company. Pursuant to the contracts, the parties were to refer any disputes thereunder to arbitration. The Egyptian company initiated arbitration proceedings on October 5, 2001 to settle a dispute in connection with the performance of the contracts. On May 20, 2003, while arbitration proceedings were ongoing, a French court issued a bankruptcy ruling against the French company and, on July 1, 2003, ordered the French company’s assets to be liquidated. On February 9, 2004, the arbitral tribunal rendered its award, ruling in favor of the Egyptian company and ordering the French company to pay damages. The Egyptian company obtained an order of enforcement (ordonnance d’exequatur) of the award from a French court. The liquidator appealed against such order on, inter alia, the ground that the arbitral tribunal had violated public policy in ordering an insolvent party to pay a sum of money.

On November 8, 2007, the Paris Court of Appeal rejected the appeal and held – reiterating its famous reasoning in the Thales decision\textsuperscript{136} that ‘the recognition or

\textsuperscript{132} Lazic, V., \textit{Arbitration and Insolvency Proceedings}, 4.1.1.
\textsuperscript{133} Lazic, V., \textit{Arbitration and Insolvency Proceedings}, 4.3.2.1.
\textsuperscript{134} Société Thinet v Labrely és-qualités, Rev. Arb. (1989), at pp. 473 et seq.
\textsuperscript{135} Case no. 08-10281, Jean X. v. International Company For Commercial Exchanges (Income), May 6, 2009.
enforcement of an arbitral award can only be considered contrary to public policy if the violation is flagrant, actual and concrete.’ 137 However, in this case, the Egyptian company had, in the course of the appeal proceedings, waived its right to enforce the award and, in any event, the French company was not able to pay damages given that it had been liquidated. Therefore, the arbitral award could not produce any effects in practice. The Court of Appeal decided that the violation was purely ‘formal’ and, thus, upheld the award.138

The liquidator brought the matter before the French Supreme Court (Cour de cassation), which overruled the Court of Appeal’s reasoning on public policy. The Supreme Court held that the arbitral tribunal had violated public policy because it had ordered an insolvent party to pay damages, instead of limiting itself to validating and quantifying these damages. The Supreme Court held, in substance, that, pursuant to French bankruptcy law, and as a matter of public policy, legal proceedings (including arbitration) against an insolvent party in bankruptcy proceeding should be stayed until the claimant has filed a declaration of its claim with the liquidator and, thereafter, legal proceedings should be limited to the validation and the quantification of claims.

3.2 Public Policy and the Enforcement of the Award

3.2.1 Duty to Render an Enforceable Award

It is generally agreed in the arbitral world that the arbitrators have a duty to make best efforts to render an award that is enforceable. Such words can be seen in the rules of famous arbitral institutions, for example, art. 41 of the 2010 ICC Arbitration Rules provides that ‘in all matters not expressly provided for in the Rules, the Court and the arbitral tribunal shall act in the spirit of the Rules and shall make every effort to make sure that the award is enforceable’. For an award to survive either a motion to vacate or an opposition to enforcement, it must meet general requirements and to be against public policy.

137 Ibid.
138 Jean-Philippe Sorba, France: Ruling on the impact of insolvency on enforcing arbitral awards, 
3.2.2 Public Policy—a Ground to Challenge the Award

There is a risk of the non-recognition or non-enforceability of the award in the country where the insolvency proceedings were commenced, pursuant to art.V of the New York Convention. If an arbitral tribunal ignores an insolvency provision that is a mandatory law or international public policy of the seat of arbitration, there is a risk of the annulment of the award.

Under the New York Convention, the enforcement courts have complete discretion; they ‘may’ refuse recognition and enforcement, but will not necessarily do so, in particular where the courts are inclined to promote and support international arbitration. While arbitral tribunals strive to render enforceable awards, it is generally accepted that they are not bound to apply the mandatory provisions of the possible, or even likely, place(s) of enforcement. The prime duty of the arbitral tribunal is to render an award that the courts of the seat of the arbitration will not annul. Nonetheless, in practice, arbitral tribunals endeavour to render enforceable awards and often take into account the law of the likely place of enforcement when the parties specifically address the matter.

Although an extensive academic debate surrounds the question of whether bankruptcy law should be considered a system of mandatory rules or of default rules,\(^{139}\) it has been held in judicial practice that at least some rules in bankruptcy such as the automatic stay is mandatory. Besides, as mentioned above, the purposes of insolvency definitely reflects public interests. Noting from the above French case, bankruptcy order is clearly treated as public policy in France which the court used as a ground to set aside the arbitral award. However, this recent case seems not so in accordance with its previous decisions. Before Jean X., French Courts generally showed reluctance to choose a law not upholding the arbitration agreement.\(^{140}\) The Paris Cour d'appel has decided that the arbitral tribunal can decide on the validity of a foreign bankruptcy declaration on the

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\(^{140}\) Ibid.
grounds of international public policy.\textsuperscript{141} If the foreign insolvency is thus recognised, the law applicable to the insolvency proceeding has to be determined. In French law this is done not through the usage of conflict of law rules, but by the principle of \textit{voie directe}.\textsuperscript{142} French Courts will apply independent rules of law within the boundaries of binding French law and international public policy without the need for a specific conflict of law regulation.\textsuperscript{143}

In the \textit{SNF v. Cytec} case the Cour d’Appel ruled that on an application to annul an award on public policy grounds, the court’s review ‘could only be extrinsic since only the recognition or the enforcement [of the award] is examined with respect to compatibility with international public policy’\textsuperscript{144}, thereby confirming the principles set forth in its previous decision. Subsequently, the Cour de Cassation held much more clearly:

‘Concerning the violation of \textit{international public policy}, only the recognition or the enforcement of the arbitral award has to be examined by the judge [hearing the application to set the award aside] with respect to its compatibility with public policy, with control being limited to the flagrant, effective and concrete character of the alleged violation.’[emphasis added]

The Cour de Cassation concluded that, having exercised its control ‘within the limits of its power of control, that is without an examination of the substance of the arbitral award’\textsuperscript{145}, that the recognition and enforcement of the award was appropriate.

Thus, Although French Supreme Court confirmed that the EC competition laws do form part of French international public policy, the review of arbitral awards in annulment or challenge proceedings is strictly limited. In other words, the Court will decline to review the effect of the contract and will only set aside the award if the award contains a flagrant, effective and concrete violation of EC competition law. However, in \textit{Jean X.}, when dealing with conflict between the international

\textsuperscript{141}Republique de Cote d'Ivoire v Norbert Bey-rard, Rev. Arb. 1994, at p.685.
\textsuperscript{143}Ibid.
\textsuperscript{144}CA Paris, Ch. 1 Sec. C, March 23, 2006, p. 6
\textsuperscript{145}Cour de Cassation, 1ère chambre civile, June 4, 2008, Pourvoi No. 06-15320, p. 2
arbitral award and French bankruptcy policy, the court simply violated this previous approach and annulled the award. Why did the court treat the two cases differently? Does that mean that when bankruptcy policy as one kind of public policy works as a ground, the extent of court’s review on arbitral award can exceed the usual scope and reach to the substance of the case? Some scholar in the United States bankruptcy is different from ordinary civil litigation, in that a complex statutory scheme overlays the entire process and establishes a set of public policies that must be honoured. It thus provides a basis for more extensive review of awards than would be permitted in the ordinary case. In particular, the public policies promoted by the Bankruptcy Code provide solid footing for more probing review of awards on public policy grounds.\footnote{Paul F. Kirgis, Arbitration, Bankruptcy and Public Policy: A Contractarian Analysis, ABI Law Review, Vol.17, p.503.}

Chapter IV Special considerations in cross-border context

With all the elaborations of the interaction between insolvency proceedings and arbitration proceedings in the foregoing Chapters, the effects of domestic insolvency proceedings on domestically seated international commercial arbitration can be worked out, though may not be so clear as confusions do exist in some aspects, relying on certain legal mechanism and persuasive case law of that particular county. However, in a cross-border setting when the international commercial arbitration is or to be seated in one country while the insolvency proceedings of one party is initiated in another, the substantive effects analyzed above cannot be applied directly but only after conflict law issues are solved. The new challenges rose in court and before the arbitral tribunal are: firstly, whether the court or the arbitral tribunal should recognize the cross-border insolvency of a party; and secondly, if the answer is to be answered in the positive, which law governs the effects of the commencement of the insolvency proceeding on arbitration.

1. Recognition of Cross-Border Insolvencies

The aspect of recognition of cross-border insolvencies is observed to be still somewhat underestimated or even neglected in the present discussion. It deals
with the question of whether the insolvency of a party to an arbitration agreement that is commenced in one country must be taken into consideration at all at the place of arbitration or any other jurisdiction that may be involved (e.g. because assets of the debtor are located there). 147

1.1 Territoriality vs. Universalism

The analysis of multi-state insolvency issues within insolvency law scholarship has traditionally been undertaken using the two theoretical extremes of universalism and territoriality. 148 They are used to define the multi-state effects of the insolvency proceedings, thus in order to answer the first question it seems indispensable to briefly address relevant parts of these two different law theories first.

Territoriality addressed choice of forum by permitting a court to exercise jurisdiction over any debtor that satisfies local insolvency law requirements. Territoriality derives from the doctrine of state sovereignty—the notion that the authority of one state, including its insolvency laws and proceedings, should be confined to the territory of that state. 149 The strictly territorial approach claims no extraterritorial reach to a local insolvency order. Thus territorial approach also permits no local recognition of foreign orders or claims. Consequently, a foreign insolvency proceeding will not be recognized in a jurisdiction which has adopted the principle of territoriality.

Universalism means that an insolvency proceeding opened in the insolvent debtor’s domicile, place of incorporation or seat claims to comprise all the assets of the debtor, including those located in other states. Accordingly, this requires each state that adopted universalism given full local effect to an insolvency proceeding opened abroad in the insolvent debtor’s domicile, place of incorporation or seat. It is viewed as a ‘passive’ aspect of universalism. 150

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147 Philipp Wagner, Insolvency and Arbitration: A Pleading for International Insolvency Law, 5 No. 2 DISPINTL 189, p.4.
Both theories have problems. Territoriality is promoted because of the simplicity, effectiveness and certainty in having separate local proceedings\textsuperscript{151}, but is criticized for the its plurality, inefficiency and costs\textsuperscript{152}. Furthermore, it is argued that it may cause unfair or uneven treatment of creditors\textsuperscript{153}, thus the prevailing opinion holds that territoriality is in consistent with the general trend towards facilitating multi-state transactions.\textsuperscript{154} Universalism requires a state to abandon its right to control local assets and to promote ‘worldwide equity’\textsuperscript{155} at the potential expense of its own creditors. Difficulty also lies in its depending upon foreign cooperation for the effectiveness of extraterritorial application of the forum's insolvency law.\textsuperscript{156} Therefore, scholars have proposed various modified models of these extreme theories, including \textit{modified universalism}, \textit{cooperative territoriality} and \textit{secondary bankruptcy}.\textsuperscript{157} In general, these modified models all require recognition of a foreign bankruptcy order but with different degrees of respect to its effects. The European Insolvency Regulation and UNCITRAL Model Law on Cross-Border Insolvency are examples of secondary bankruptcy and will be elaborated below.

\subsection*{1.2 The EU Insolvency Regulation}

The European Union has adopted a set of common rules regarding cross border insolvency within the Union, that is Regulation 1346/2000 on insolvency proceedings (hereinafter referred to as ‘the Regulation’), which has been in force since 31 May 2002. The Regulation regulates cross border insolvency issues between European Union Member States (excluding Denmark) only. The Regulation neither regulates the effects of proceedings opened in third states, nor the effects of Community proceedings with regard to non-member states.\textsuperscript{158}

\begin{thebibliography}{99}
\bibitem{152} Glosband, op., cit., p.481.
\bibitem{153} Ibid.
\bibitem{156} Ibid, p.291.
\bibitem{158} Recital 14 of the Regulation states that the “Regulation applies only to proceedings where the centre of the debtor's centre of main interests is located in the community” and arts 16 and 17 provide “Any judgment opening insolvency proceedings handed down by a court of a Member State which has jurisdiction pursuant to Article 3 shall be recognised in all the other Member States from the time that it becomes effective in the State of opening of proceedings” and “The judgment opening the proceedings referred to in Article 3(1) shall, with no further

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Article 16 of the Regulation provides that in the event that insolvency proceedings are initiated in an EU Member State, such proceedings are to be recognized in all other Member States. Recognition may be denied only if such recognition would result in a violation of public policy. Moreover, the lack of jurisdiction of the bankruptcy court which commences the insolvency proceeding is not sufficient for a denial of recognition under the Regulation.\textsuperscript{159}

1.3 UNCITRAL Model Law on Cross-Border Insolvencies

The purpose of UNCITRAL Model Law on cross-border insolvencies embodies ‘determining when a foreign insolvency proceeding should be accorded “recognition” and what the consequences of recognition may be’\textsuperscript{160}. It sets rules governing the co-operation of courts, the provision of assistance to insolvency administrators, the coordination of two or more proceedings in different countries and the opening of insolvency proceedings. Unlike the Regulation, which has automatic effect throughout the European Community, states are free to enter into the Model Law if they wish and to adapt the law to their own country's particular circumstances. So far Legislation based on the UNCITRAL Model Law on Cross-Border Insolvency has been adopted in 18 countries including the United States.\textsuperscript{161} UNCITRAL Model Law sets up the ‘recognition’ principle\textsuperscript{162} to avoid lengthy and time consuming processes by providing prompt resolution of applications for recognition. Under the UNCITRAL Model Law application has to be made in order to seek recognition of the foreign proceeding. Article 15 of the Model Law establishes the requirements to be met by that application which are just formal requirements and can hardly cause any the obstacle to recognition. The Model Law makes no provision for the receiving court to embark on a consideration of whether the foreign proceeding was correctly commenced under applicable law.\textsuperscript{163} Thus, generally, foreign insolvency proceedings are recognised in jurisdictions adopting UNCITRAL Model Law. However, it is not excluded that

\textsuperscript{159} Philipp K Wagner, When International Insolvency Law Meets International Arbitration, 3 No. 1 Disp. Resol. Int'l 56; Duursma-Kepplinger and Chalupsky, in Duursma-Kepplinger, Duursma and Chalupsky, Europäische Insolvenzverordnung (hereafter Eu-InsVO) (2002), Art 16, para 5


\textsuperscript{161} http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html

\textsuperscript{162} Chapter III.

\textsuperscript{163} 2011 UNCITRAL Model Law on Cross-Border Insolvency: The Judicial Perspective , P.14
the jurisdiction concerned may provide for additional requirements for recognition.

1.4 Arbitral Practice

While the above study shows that most states are now turning to universalism or at least to modified terms of territoriality which means their courts are bound to recognize the foreign insolvency order, arbitral practice reflected both trends.

Arbitrators sometimes still base their refusal to apply national bankruptcy laws on the territorial scope of the laws in question. For instance, an ICC tribunal seating in Paris refused to stay the arbitration on the basis of US insolvency law where the US insolvency order had not been recognised in France and insolvency proceedings had not been opened in France. Likewise, in another case a arbitral tribunal sitting in Japan found that its jurisdiction was not affected by the bankruptcy of the Korean party to the dispute on the ground that Korean bankruptcy law did ‘not purport to apply to litigation or arbitration occurring outside Korea’. In other instances, tribunals have emphasised the absence of a convention on the recognition of national insolvency proceedings between the countries concerned and expressly fell back on the territoriality principle.

However, the opposite trend in favour of a ‘universal’ approach was also reflected in a recent arbitral award. The tribunal sitting in London and applying English law was confronted with a bankruptcy order issued by an Egyptian court. The respondent objected that the Egyptian order could not have any effect on assets located outside of Egypt. The tribunal found that the Egyptian bankruptcy order extended to all of the claimant's assets, and that no distinction was to be made on the basis of their location.

To conclude, the recognition question is mainly solved because strict territoriality is no longer the golden rule in insolvency law and principles of comity and

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universalism plays an increasingly important role in both international and national insolvency legislation. This is especially settled in EU where the recognition procedure according to art. 16 of the Regulation occurs incidentally and automatically. Yet uncertainty still exists in areas where no relevant convention can be applied and the UNCITRAL Model Law is not adopted. Moreover, arbitral practice in arbitral tribunal shows a free pattern when deciding whether to recognize foreign insolvency proceedings against one party in the arbitration.

2. Choice of law applicable to insolvency effects

Although unity has been achieved to a large degree in recognising foreign insolvency orders, the choice of law issue remains quite complicated depending on the jurisdictions involved. Even for the jurisdictions that have adopted the UNCITRAL Model Law, they may recognise foreign insolvency proceedings but they have their own systems of determining the applicable law to the impacts of those proceedings since UNCITRAL Model Law does not provide uniform choice of law rules. Due to the fact that uniform choice of law rules are provided in the Regulation, distinctions can be made between situations in which different jurisdiction are involved and situations involving only similar jurisdiction i.e. situations within the European Union. It will be too wild and almost impossible to examine all the conflict of law rules and practices in different countries. In order to best illustrate the issue, this chapter may only provide an overview of the subject from international perspective while the emphasis is on the situation within the European Union and discuss some key problems by examining the practice of applying the Regulation to specific cases by Member States.

2.1 General principles from international perspective

While the Model Law provides authorization for cross-border cooperation and communication between courts, it does not specify how that cooperation and communication might be achieved, but rather leaves that up to each jurisdiction to determine by application of its own domestic laws or practices. The Model Law does, however, suggest various ways in which cooperation might be implemented. The only exception is art.20, which provides that, where foreign insolvency proceedings have been recognised, the ‘commencement or continuation of individual actions or individual proceedings concerning the

\[168\] UNCITRAL Model Law, art. 27; see also the UNCITRAL Practice Guide, chap. II.
debtor’s assets, rights, obligations or liabilities is stayed’. The *Guide to the Model Law* clarifies that the generic reference to “individual actions” is intended to cover actions before an arbitral tribunal.\(^{169}\) From the perspective of private international law, the provision can be viewed as one example of uniform substantive law which directly regulating one respect of the impact that insolvency may have on pending international arbitration proceedings.

In systems other than the European Union that generally recognise a foreign insolvency proceeding including the International Model Law jurisdictions, the applicable law to the effects of the foreign insolvency proceeding may mostly be domestic law. As a consequence, it is the law of the jurisdiction that is confronted with the recognition of a foreign insolvency proceeding which will provide the mechanism to finding the applicable law to the foreign insolvency’s effects.\(^{170}\) We cannot illustrate the specific rules here but what can be indicated is the possible perspective usually be made by the arbitral tribunal. From an international insolvency law perspective, the question of which law should apply to the effects of the insolvency on arbitration is not as much an issue of finding the applicable law but more an issue of finding the proper recognition perspective for the arbitral tribunal.

A multitude of choices have been made and seem to be followed in practice as regards finding the appropriate law governing the effects of the insolvency on arbitration. These choices include:

- applying the rules provided for by the *lex concursus*;
- applying the law of the arbitration law governing at the place of arbitration (*lex arbitri*);
- applying the law chosen by the parties or otherwise applicable to the substance of the dispute (*lex causae*);
- applying the law of those jurisdictions in which an arbitral award is likely to be enforced;\(^{171}\) and
- applying the law governing the arbitration agreement.\(^{172}\)

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\(^{170}\) Philipp Wagner, Insolvency and Arbitration: A Pleading for International Insolvency Law, 5 No. 2 DISPINTL 189, p.4.


2.2 Clash under the Regulation

The Regulation not only contains immediate recognition rules as addressed above, but also provides choice of law rules regarding the effect of cross border insolvency proceedings which replace ‘within their scope of application, national rules of private international law’. Since the Regulation is directly applicable on all national courts and tribunals within the European Union, in cases which fall within the scope of the Regulation, the court and arbitrator must take into account the choice of law rules contained in the Regulation.

The general choice of law rule is set out in art. 4(1) of the Regulation. According to art. 4(1) of the Regulation, the law of the Member State within whose territory insolvency proceedings are opened shall be applicable to the insolvency proceedings themselves and their effects, and art. 4(2) further states that the law of the state of opening shall determine, in particular:

‘(e) the effects of insolvency proceedings on current contracts to which the debtor is party;
(f) the effects of the insolvency proceedings on proceedings brought by individual creditors, with the exception of lawsuits pending.’ [emphasis added]

Moreover, the provisions of art. 4 are expressly stated to be subject to any contrary provision elsewhere in the Regulation, and in this case art. 15 provides as follows: ‘The effects of insolvency proceedings on a lawsuit pending concerning an asset or a right of which the debtor has been divested shall be governed solely by the law of the Member State in which that lawsuit is pending.’ [emphasis added]

Two questions can be raised regarding the application of these provisions. The first one is whether the ‘lawsuits pending’ in art. 4(2)(f) include pending arbitration proceedings. Secondly, whether the ‘current contracts’ in art. 4(2)(e) include arbitration agreements. If the answer is yes to both and it is indeed supported by case law, then a clash exists between art. 4(2)(e) and art. 15 of the Regulation. The logic is as follows: Suppose that an arbitration proceeding is pending in Member State A (lex concursus) and one party becomes insolvent in Member State B. The arbitration agreement, like any other commercial contract, is a

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174 Elektrim [2008] EWHC 2155 (Comm) at [52].
current contract falling within art.4(2)(e) of the Regulation,\textsuperscript{175} thus the law of Member State B should apply. On the other hand, according to art. 15, the law of Member State B should also apply. However, if both art.15 and art.4(2)(e) are applied successively, art.4(2)(e) deprives art.15 of any substance when the application of the law of the \textit{lex concursus} voids the arbitration agreement.\textsuperscript{176}

The recent judicial analysis in J Syska acting as the administrator of Elektrim SA (in bankruptcy) et al v Vivendi Universal SA et al (hereafter ‘Elektrim v Vivendi’)\textsuperscript{177} reflected the English approach of addressing the clash between art. 4(2)(e) and art.15 of the Regulation.

\subsection*{2.2.1Elektrim v Vivendi}

The relevant facts of the case are as follows:

‘In 2001 Elektrim entered into an investment agreement (TIA) with Vivendi which contained an arbitration agreement providing for arbitration in London under LCIA rules. The arbitration agreement was governed by English law, but the rest of the TIA was governed by Polish law. In 2003 Vivendi commenced arbitration pursuant to the agreement and in early 2007 the LCIA Arbitral Tribunal fixed a hearing on liability issues for October of that year. In August 2007 Elektrim was declared bankrupt by a Polish court pursuant to its own petition. Initially the court's order permitted Elektrim to remain under the control of its own management with a court-appointed supervisor, but in February 2008 the court revoked the self-administration and appointed the supervisor to be administrator of the company's assets.’\textsuperscript{178}

Elektrim first wrote to the Tribunal stating that the arbitration agreement had been annulled by reason of the bankruptcy in August 2007. The tribunal rejected Elektrim's objections and proceeded to find it in breach of the terms of the TIA. Elektrim then issued an application under s.67 of the Arbitration Act 1996 seeking

\textsuperscript{175} For reasons discussed by Christopher Clarke J., there is no distinction between “procedural” and “substantive” contracts. \textit{Elektrim} [2008] EWHC 2155 (Comm) at [99].

\textsuperscript{176} It should be noted that the problem is particular when facing insolvency rules such as Poland bankruptcy law.


to have the Tribunal's award set aside on the basis that the arbitration agreement had ceased to have effect as from August 2007.

The key issue of this case is which law should govern the effects of the Polish bankruptcy order in relation to the arbitration agreement and also the pending arbitration itself. Art.4(2)(e) leads to Polish law while art.15 leads to English law. A double application is not possible because the consequences contradict each other. English law will maintain the arbitration proceeding while article 142 of the Polish Insolvency Law provides:

‘Any arbitration clause concluded by the bankrupt shall lose its legal effect as at the date bankruptcy is declared and any pending arbitration proceedings shall be discontinued.’ [emphasis added]

In summary, both the arbitral tribunal and Christopher Clarke J., applying the Regulation, declined to apply the Polish law but instead held that effects of the Polish insolvency of Elektrim on the “lawsuit pending”, which included the arbitration proceedings seated in England, was governed “solely” by English law.179 This decision was upheld by the English Court of Appeal in its judgment dated July 9, 2009.180

2.2.2 Understanding of ‘lawsuits’

In Elektrim v Vivendi, the arbitral tribunal held that the arbitration had advanced to a stage at which it was to be classified as a “lawsuit pending” for the purposes of art.15, and hence that the effect of the opening of Polish insolvency proceedings was a question properly governed by English law, as the law of the arbitration.

In his judgment, Clarke J. carefully explored the text of the Regulation including the Preambles (also known as ‘Recitals) which precede the substantive articles themselves, and the Virgos-Schmit Report181, which has become accepted as a quasi-official aid to interpretation of the Regulation. He even reviewed the differences in drafting between the official language versions in which the Regulation is currently published as well. Drawing on the published commentaries

179 Elektrim [2008] EWHC 2155 (Comm), para.96-104.
to the Regulation (particularly that jointly written by Virgos and Garcimartin), Clarke J. concluded that it had been the intention of the authors of the former convention (now recycled as a Regulation) that for the purposes of art.4(2)(f) together with art.15 the term ‘lawsuits’ should extend to “actions and arbitrations which seek to determine the existence, validity, content or amount of a claim”\textsuperscript{182}. The judge discerned that the purposes of the Regulation include: (a) ensuring the effective and efficient administration of the insolvency and avoiding one creditor gaining an advantage over the others; and (b) protecting the legitimate expectations of parties and the certainty of transactions.\textsuperscript{183} Therefore Clarke J. declined to set aside the ruling by the majority of the Tribunal. By allowing the Arbitration Tribunal to proceed to a ruling, the cost already expended on pursuing the arbitration to the stage of a liability hearing would not be wasted.

Although the reasoning of this English judgment is viewed by some scholar as of the ‘teleological’ kind and reached a ‘analytical-constructionist conclusions’ which is favoured by the European Court of Justice itself when interpreting the law of the European Union,\textsuperscript{184} it is quite reasonable because it would promote the second objective of the Regulation without prejudicing the effective and efficient administration of the insolvency. It therefore followed that the exception under art.15 applied to a pending arbitration in the same way as it applied to pending litigation before a court.

2.2.3 Solving the clash between art. 4(2)(e) and art.15

Clarke J. admitted the existence of an essential conflict between the two neighboring paragraphs (e) and (f) of art.4(2) of the Regulation, thus the argument made by Elektrim that arbitration agreement is ‘current contract’ for the purpose of the Regulation is supported in his judgment.

Then he stated that the conflict could only be resolved by means of an interpretation whereby art.4(2)(f) was not rendered practically redundant, since the Community legislator could not be supposed to have intended such an effect. In this context, the inclusion of the word “solely” in art.15 of the Regulation was

\textsuperscript{182} Elektrim [2008] EWHC 2155 (Comm), paras 33-34.
\textsuperscript{183} Ibid., paras50 et seq.
\textsuperscript{184} Ian Fletcher, Effect on arbitration proceedings of the EU Regulation, Insolv. Int. 2009, 22(4), 60-62.
seen to be especially significant as revealing the legislator's intentions in this matter. This rationalisation was once again reinforced by the teleological argument that:

‘Parties to a commercial arbitration have a legitimate expectation that the reference will not grind to a halt upon an insolvency … if the law of the place where the arbitration is pending would not have that effect.’

The overall conclusion to be drawn was therefore that the exception in art.15 must be applied so as to make it effective rather than illusory. However, art.4(2)(e) would apply to the arbitration agreement insofar as any future (i.e. non-pending) proceedings were concerned. Thus the clash is avoided by differentiating the situations in which they should apply: one for pending proceedings and the other only for situations when no proceeding has started yet.

The solely application of art.15 is not only taken by the English High Court, the Austrian Supreme Court reached the same conclusion when facing the clash problem between art.15 and art.4(2)(c) the two provisions of the Regulation. Although the situation of that case is not identical to Elektrim v Vivendi, the essence of the clash is the same. According to Maderbacher's translation, the Austrian Supreme Court held:

‘…As regards the respective powers of the debtor and the liquidator, these are governed by the lex fori concursus (Article 4(2)(c) Regulation). Effects of insolvency proceedings on pending lawsuits, on the other hand, pursuant to Article 15 Regulation are governed exclusively by the law of the state in which the lawsuit is pending. There shall be no ‘cumulative’ application of the laws of both states, so that it is well possible that the opening of an insolvency proceeding in member state A leads to a stay in a lawsuit pending before the courts of state B, even if the law of state A would not provide for a stay of the proceeding…’

Therefore, it is agreed that lawsuits pending should be governed solely by the law

185 Elektrim [2008] EWHC 2155 (Comm), para 96.
186 Elektrim [2008] EWHC 2155 (Comm), paras. 97, 100, 102.
187 Elektrim [2008] EWHC 2155 (Comm), Para104
188 9 Ob 135/04z, Austrian Supreme Court, February 23, 2005.
189 The case is not about a pending arbitration but a pending litigation before Austrian Court.
of the Member State in which the lawsuit is pending,

2.3 Another Elektrim case: Swiss decision

Dramatically, almost at the same time, the same issue involving the same Polish company was argued before an arbitral tribunal seated in Switzerland. The Regulation does not apply in Switzerland as it is not a Member State of EU. The tribunal's decision was upheld on appeal to the Swiss Supreme Court. The holding is summarized by Maxi Scherer as follows:

‘The arbitral tribunal held that Article 142 PIL dealt with the issue of a party’s “continued capacity” to participate in an arbitration. Applying Swiss conflicts of law rules, the tribunal further held that a company's capacity must be determined on the basis of its law of incorporation pursuant to Article 154 et seq. of the Swiss Private International Law Act (the ‘SPILA’). The tribunal therefore discontinued the proceedings vis-à-vis the insolvent correspondent…

According to the Supreme Court, “Swiss law is silent on the subjective capacity to arbitrate of non-state parties… Therefore, the general procedural principle applies, according to which the capacity to be a party (Parteilfähigkeit) depends on the preliminary substantive law question of legal capacity (Rechtsfähigkeit) …”

The Supreme Court thus applied Articles 154 and 155 SPILA which govern the legal capacity of corpora-tions and held that ‘the assessment of the legal capacity and thus the capacity to be party to international arbitration proceedings [of a Polish incorporated company] is determined … in accordance with Polish law”.

Obviously the Swiss Supreme Court decision contrasts with the ruling of the English High Court. They reached different conclusions for the same issue as result of application of different laws. And that is not because the Regulation applies in England but not in Switzerland, the problem is rather the approaches to characterize the issue. The result in each case differs because the

characterization of art.142 of the Polish law was different. The Swiss decision accepted that art.142 was to be characterised as issue of capacity and applied Swiss choice of law rules applicable to company capacity. In Elektrim v Vivendi, art.142 of the Polish law was not determined to affect the capacity of Elektrim, it was simply determined that art.15 of the Regulation refers all matters for determination by English law.

2.4 Characterisation Questions

It can be seen from the ‘battle’ between the two Elektrim decisions of Switzerland and England that characterization of the choice of law problem is crucial to the outcome of the case. Actually, it is deemed to be the first essential step in the process of selecting the applicable law.193

As to the situation when deciding what law should apply to determine the effects of insolvency on international commercial arbitration proceedings, the issue raised by the insolvency of one party could be characterised as

- an issue that directly affects the capacity of the insolvent party to be bound by the arbitration agreement, or
- a matter that affects the effectiveness or enforceability of the arbitration agreement itself, or
- an issue of succession or assignment of the arbitration agreement or an issue of locus standi of the parties.

How the initial issue that potentially affects the arbitrator's jurisdiction is characterised will affect the choice of law rule applied.

Characterisation is a fundamental problem but no easy to deal with, just as it is described by Dicey & Morris:

‘The problem of characterisation has given rise to a voluminous literature, much of it highly theoretical. The consequence is that there are almost as many theories as writers and the theories are for the most part so abstract that when applied to a given case, they can produce almost any result.’194

193 Macmillan Inc v Bishopsgate Investment Trust Plc (No.3) [1996] 1 W.L.R. 387; [1996] 1 All E.R., p.585. The second step is that the decision maker must decide which choice of law rule to apply in order to select the relevant applicable law and the final step is to apply the chosen choice of law rule to find the substantive law that will determine the relevant issue.

Despite the complexity of characterization, for the purpose of this thesis, the two key questions can be briefly viewed here. The first problem that arises is which country's system of law should be applied to characterise and the further question is what it is exactly that should be characterised?

There are actually few disputes about the first question. Dicey & Morris notes that the great majority of Continental writers subscribe to the view that the process of characterisation should be performed in accordance with the domestic law of the forum.\(^{195}\) English courts, in most cases, look to foreign law only to discover the nature and scope of the foreign rule, not to determine how it (or the general issue) should be characterised.\(^{196}\)

However, unlike the first question, the second one is quite controversial and there are mainly two approaches: is it a rule of law or a legal issue?\(^{197}\) For example, the characterisation of the choice of law question in the two Elektrim cases could be determined by looking to the wording of art.142 of Poland law and proceeding to characterise the rule on that basis. Alternatively, the choice of law question could be characterised by the “issue in the case” or “question in issue”, which in the two Elektrim cases would be ultimately whether or not the agreement to arbitrate remained valid.

The Swiss Elektrim decision is an example of the approach to characterize the rule of foreign law. Swiss Supreme Court first looked to the Polish rule. It then determined that the Polish law affected Elektrim’s capacity. It then applied Swiss conflict of law rules related to capacity to determine the Polish law applied to void the arbitration agreement. The defects of the first approach can be easily perceived in this reasoning. Poland law, as one of the applicable laws that may afterwards be chosen according to conflict of law rules, should be the result of the whole choice of law process, how could it be the starting point of the reasoning? This is ridiculous as ‘putting the cart before the horse’\(^{198}\). As noted in Dicey &

\(^{195}\) Dicey, Morris and Collins on the Conflict of Laws (2006), paras 2-009.
\(^{196}\) Ibid., paras2-028.
\(^{197}\) Ibid., para.2-007.
Morris, it is arguing in a circle to say that the foreign law governs the process of characterisation before the process of characterisation has led to the selection of the appropriate legal system. Therefore the logical approach is surely the latter one and that is the view preferred in England. English courts have noted that the proper approach should not be subject to mechanistic application but should aim to identify the most appropriate law to govern the particular issue, which means that 'one has to look at the substance of the issue rather than the formal clothes in which it may be dressed.' Approach taken by the English Court of Appeal, is expressed by Auld L.J.: 'Subject to what I shall say in a moment, characterisation or classification is governed by the lex fori. But characterisation or classification of what? It follows from what I have said that the proper approach is to look beyond the formulation of the claim, and to identify according to the lex fori the true issue or issues thrown up by the claim and defence. This requires a parallel exercise in classification of the relevant rule of law. However, classification of an issue and rule of law for this purpose, the underlying principle of which is to strive for comity between competing legal systems, should not be constrained by particular notions or distinctions of the domestic law of the lex fori, or that of the competing system of law, which may have no counterpart in the other's system. Nor should the issue be defined too narrowly so that it attracts a particular domestic rule under the lex fori which may not be applicable under the other system.' In fact, in Elektrim v Vivendi, the judgment is actually silent as to the characterization questions. It does not attempt to differentiate between separate choices of law questions. Neither does the judgment characterise the effect of art.142 of the Polish Bankruptcy Law as an issue affecting the capacity of the Polish company to be a party to an arbitration agreement or a party to the arbitration proceedings, nor does it attempt to address the possibilities as to characterise the substantive issue of the effect of one-party-insolvency according to English law. Actually, if it had characterised following the 'issue of the case' approach, then it could be characterised as an issue affecting the substantive validity of the arbitration agreement, as opposed to one of capacity, which, in absence of express

199 Dicey, Morris and Collins on the Conflict of Laws (2006), para.2-010.
agreement of the parties, is frequently governed by the law of the arbitral seat.\textsuperscript{203}

Some would argue the ‘issue of the case’ approach may always lead to a framing of the ‘issue in the case’ as ‘whether the arbitration agreement remains substantively valid’ in all cases where a party is deprived of capacity. But this is not necessarily correct. For example, an issue that often arises upon insolvency is whether the debtor continues to exist as a separate legal entity as a result of divestment of the debtor and transfer of rights and obligations to the bankruptcy estate. The issue faced by the arbitrator in such a case is not ‘whether the arbitration agreement remains substantively valid’. They are questions of ‘does the debtor exist’, ‘who is the proper party to the arbitration agreement and the pending proceedings’ and ‘whether the rights and claims under arbitration agreement have been assigned’. These are separate issues that require selection of different choice of law rules. The former is likely to be categorized as an issue of capacity, with the most appropriate choice of law rule referring to the debtor’s personal law. The validity of the assignment is likely to be determined according to the law applicable to the arbitration agreement.\textsuperscript{204}

In conclusion, the preferred approach is to look to the substance of the issue before the tribunal and to select the choice of law rule applicable to that issue. On this view, characterisation of art.142 and stay provisions affect the substantive validity of the arbitration agreement and not the capacity of the insolvent party. In cases of doubt the validation principle should be applied.

2.5 Before Arbitral Tribunals

It should be mentioned that all the concerns and rules regarding the choice of law issue are analyzed mainly from the perspective of a national court. Contrary to judges who distinguish between domestic and foreign laws, arbitrators have no forum. In their eyes, all laws, either foreign or domestic, should be of equal dignity.\textsuperscript{205} They are not deemed to be bound to use conflict law rules of the place


\textsuperscript{205} Stefan Kröll, ‘Arbitration and Insolvency: Selected Problems’, in Loukas A Mistelis and Julian D M Lew(Eds),
of arbitration. Does that mean the arbitrators remain free to decide which law governs the effects of foreign insolvency and ignore ordinary choice of law rules in international commercial arbitration practice?

The discretion of the arbitral tribunal is subject to certain limits. Such limits result from the reasons based on which an arbitral award may be annulled or declared unenforceable. First reference can be made to Article 5 of the New York Convention which states that an unenforceable or invalid arbitration agreement, a violation of material procedural rights as well as of public policy will lead to non-recognition of the award. Furthermore, under the applicable arbitration rules e.g. art. 36 ICC Rules as well as under each arbitrator's agreement, the arbitral tribunal is under the obligation to ensure as much as possible that an arbitral award will persist at the place of arbitration and will be enforceable. A violation of this obligation may result in a professional liability claim against each arbitrator.

The limits to arbitrators are especially strict regarding situations falling under the scope of the European Insolvency Regulation, since it is argued to be part of the ordre publique communitaire, as it aims at harmonising certain public interests which are at stake when an insolvency proceeding is commenced. In this way, the objective is to be respected regardless of whether the debtor is subject to a proceeding pending in court or before the arbitral tribunal.

The Eco Swiss case may work as a reference. The case was brought before the European Court of Justice (ECJ) in the course of the enforcement of an arbitral award in the Netherlands. The award had been rendered in Switzerland, thus outside the EU, under violation of EU competition law under Art 81 EC. The ECJ held that Art 81 EC constitutes a fundamental provision which is essential for the accomplishment of the tasks entrusted to the Community and, in particular, for the functioning of the internal market and therefore an integral part of the public policy of each EU Member State. It can be inferred by analogy of this ruling that at least the provisions of the European Insolvency Regulation regarding recognition and conflict of laws issues, as they intend to safeguard material public interests,

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206 Abstimmungsfragen zwischen Internationalem Insolvenzrecht und InternationalerSchiedsgerichtsbarkeit (2008), p. 20 et seq.

are also fundamental provisions and therefore equally binding upon courts and arbitral tribunals, provided that either the place of arbitration is located within the EU or that recognition and/or enforcement of the award is sought in an EU Member State. Therefore, an arbitrator must take the choice of law rules provided in the Regulation into consideration as to arbitrations seated within the European Union.

**Conclusion**

Insolvency and arbitration are based on opposing principles. Whereas arbitration is based on the principle of party autonomy, insolvency establishes a system that is aimed at securing an equal protection of the creditors and an orderly liquidation of the debtor's assets. Furthermore, arbitration relies on the decentralization and confidentiality of disputes, whereas bankruptcy focuses on the centralisation and publicity of all matters related to the liquidation of the estate. Present work was focused on the impact of insolvency proceedings on international commercial arbitration. Differences were made as regards the jurisdictions and underlying legal concepts involved not only in view of arbitration law but also with regard to international insolvency law.

As the foregoing discussion has outlined, there is no globally settled approach to dealing with the effects of insolvency proceedings on arbitration. Every jurisdiction has its own legal systems which may lead to different legal consequences. However, some conclusions can be reached by analysis of some national legislation on arbitration and insolvency as well as case law. Concerning the arbitrability of insolvency related matter, it is well accepted that only pure insolvency matters may be considered as non-arbitrable and exclusive jurisdiction sometimes serve as a means which can decide the arbitrability. As regarding the suspension provisions usually contained in national bankruptcy law, the suggestion for an international commercial arbitral tribunal is to apply them on a case by case basis. The decision to continue should be made after careful examination of the individual circumstances of each case to avoid the possible violation of sue process and public policy.
The issue of enforcement is one of the crucial points where domains of insolvency and arbitration collide. While it is a general rule that the trustee should be bound by the pre-concluded arbitration agreement by the debtor and the arbitration agreement cannot be invalidated automatic by commencement of insolvency proceedings, the actual enforcement of arbitration agreements depends largely on judicial discretion of different countries. And the analysis of American case law shows great complexity and uncertainty. Both Core and non-core distinction and whether a party is involved as plaintiff/claimant or defendant/respondent seems to be relevant factors in judicial reasoning.

Much has been said about the recognition of foreign insolvency order and choice of law issues including the two famous Elektrim cases. In the end, however, when looking at the arguments and reasonings that are presented, many questions remain open in a cross-border context, especially as regards the question of which law should govern the effects of the insolvency of a party. This leads to the somewhat unsatisfactory situation that there is no clear indication how to reliably deal with an insolvency situation in an arbitration context and vice versa. Adoption of the Model Law on Insolvency as well as the EU Insolvency Regulation may, on the one hand, help to reach a common approach to some extent, while put more problems for national courts and arbitral tribunals on the other hand due to the intrinsic contradiction of some provisions. The problem may be partly solved by taking a uniform approach to characterisation. Besides, situations vary based on whether the dispute is taken to a national court or before an arbitral tribunal.
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