THE EUROPEAN AND MIDDLE EASTERN ARBITRATION REVIEW 2010

Published by Global Arbitration Review
in association with
Hogan & Hartson LLP

gar
The international journal of commercial and treaty arbitration

www.GlobalArbitrationReview.com

Swiss Federal Tribunal Renders Noteworthy Decision on Impact of Foreign Bankruptcy on International Arbitration

Michael Stepek and Matthew Bate
Hogan & Hartson LLP

The global economic crisis has ushered in a new era of insolvency in international business. The past year has seen several large corporations with integrated operations around the world go bankrupt. In this environment, the impact of a party's bankruptcy on the conduct of an international arbitration is likely to be faced with increasingly regularity by courts around the world. In its decision of 31 March 2009 (4A_428/2008), the Swiss Federal Tribunal confronted that very situation, and rendered a judgment that could have significant implications for international arbitrations seated in Switzerland. In its decision, the Federal Tribunal gave effect to a provision of Polish bankruptcy law that deprived a bankrupt party of its legal capacity to arbitrate, thereby divesting the arbitral tribunal of jurisdiction over that party. In reaching this result, the Federal Tribunal held that the issue of a bankrupt party's legal capacity to sue or be sued in an international arbitration should be governed by the law of the place of incorporation (the lex concursus), rather than the law of the seat of the arbitration (the lex loci arbitri). The decision is particularly noteworthy as it reached a result exactly opposite to the one reached by the English Commercial Court in *Syska & Elektrim SA (in Bankruptcy) v Vivendi Universal SA & Others* [2008], and which is widely considered to be a leading authority on the relationship between arbitration and bankruptcy proceedings in the European Union.

This article is organised as follows. We begin by briefly summarising the factual background of the case and the reasoning behind the Federal Tribunal's decision. We then turn to identifying the most salient aspects of the decision. Finally, the article concludes with some general remarks on the potential impact of the decision on international arbitration in Switzerland.

Factual background

The case before the Federal Tribunal stemmed from an arbitration arising out of an alleged agreement to settle a longstanding and highly publicised dispute among Vivendi Universal SA and its affiliates (Vivendi), Deutsche Telekom AG and its affiliates (DT), a Polish conglomerate called Elektrim SA (Elektrim), and others, over ownership and control of one of Poland's leading telecommunications companies known as PTC. This alleged settlement agreement, which existed only in draft form and was never agreed, negotiated or signed, provided for ICC arbitration in Geneva, in English, before a panel of three arbitrators. In April of 2006, Vivendi commenced ICC arbitration against DT, Elektrim and the other parties, seeking recognition and enforcement of the alleged settlement agreement.

In September of 2007, with arbitral proceedings underway, Elektrim informed the ICC tribunal that it had been declared bankrupt by a decision of the Warsaw Bankruptcy Court dated 21 August 2007. Elektrim then requested that the ICC tribunal dismiss it from the arbitration on the grounds that article 142 of the Polish Bankruptcy and Reorganisation Act (PBRA) divested the tribunal of its jurisdiction over Elektrim. Article 142 of the PBRA provided as follows:

> *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.*

In its interim award dated 21 July 2008, the ICC tribunal upheld Elektrim's request, and dismissed it from the arbitration. Applying Swiss conflict of law rules, the tribunal held that a party's legal capacity to arbitrate is governed by the law of that party's place of incorporation – in this case, Poland. The tribunal then looked to article 142 of the PBRA and reasoned that the purpose of this Polish bankruptcy provision was to exclude any and all recourse to arbitration against a bankrupt party in Poland, whether that arbitration was seated in Poland or outside Poland. Accordingly, the tribunal concluded that article 142 of the PBRA operated to deprive it of its jurisdiction over Elektrim.

The Federal Tribunal's decision

On 15 September 2008, Vivendi challenged the ICC interim award before the Federal Tribunal in Lausanne. Vivendi based its challenge on article 190(2)(b) of Switzerland's Private International Law Act (PIL), which provides that an award rendered in Switzerland 'may be set aside [...] if the arbitral tribunal wrongfully accepted or declined jurisdiction'. Vivendi argued that the ICC tribunal wrongly gave effect to the provisions of Polish bankruptcy law, as it was the lex loci arbitri – namely, Swiss law – which was the proper law governing Elektrim's ability to remain a party to the arbitration. As such, according to Vivendi, there was no legal basis for the ICC tribunal to dismiss Elektrim from the arbitration.

In its 31 March 2009 decision, the Federal Tribunal rejected Vivendi's challenge to the ICC interim award, and upheld the ICC tribunal's application of the Swiss conflict of law principles contained in the PIL. The Federal Tribunal held that Elektrim's procedural ability to remain a party to an international arbitration (*parteifaehigkeit*) turned on the more fundamental issue of its legal capacity to sue or be sued (*rechtsfaehigkeit*). As such, the Federal Tribunal reasoned, any objection to a company's legal capacity to sue or be sued must be determined by reference to the law of its place of incorporation, as per article 154 of the PIL:

> *Companies shall be subject to the law of the state the law of which governs their organisation, provided they fulfill the publicity or registration provisions of such law or, in the absence of such provisions, provided they are organised in accordance with the law of that state.*

Accordingly, the Federal Tribunal concluded that Elektrim's legal capacity to remain a party to the arbitration pursuant to its bankruptcy in Poland was to be decided by reference to Polish law, and not Swiss law as the law of the arbitral situs.

The Federal Tribunal also took note of article 178(2) of the PIL, which provides that 'the arbitration agreement shall be valid if it conforms to the law chosen by the parties, to the law governing the dispute, in particular the principal contract, or to Swiss law.' The Federal Tribunal nevertheless found that this particular

Swiss conflict of law provision 'played no role' in the present case, as in its view the matter to be decided was whether Elektrim had the legal capacity to remain a party to the arbitration pursuant to its bankruptcy in Poland, and not whether an agreement to arbitrate had been validly entered into in the first place. Finally, the Federal Tribunal upheld the ICC tribunal's reading of article 142 of the PBRA as divesting all arbitral tribunals worldwide of jurisdiction over a company which had been declared bankrupt in Poland, not just arbitral tribunals sitting in Poland. This reading of the PBRA, it added, was fully supported by numerous respected Polish law experts.

Noteworthy aspects of the decision

The Federal Tribunal's decision is noteworthy in a number of respects.

First, the Federal Tribunal reached the exact opposite result from the English Commercial Court in *Syska & Elektrim v Vivendi*. In *Syska*, Elektrim – which had been sued by Vivendi in a parallel LCIA arbitration in London in connection with the same dispute – sought to challenge the LCIA tribunal's jurisdiction on the basis of article 142 of the PBRA. Unlike the courts in Switzerland, English courts are subject to Council Regulation (EC) No. 1346/2000 (Insolvency Regulation), which forms part of the law in all EU member states. The Insolvency Regulation was designed to promote the proper functioning of the European internal market by ensuring the efficient administration of cross-border bankruptcies, and discourage forum-shopping by opportunistic debtors and creditors. Consistent with this purpose, the Insolvency Regulation contains a series of specific and mandatory choice-of-law rules governing the effect of a bankruptcy across all EU member states. Article 4.2 of the Insolvency Regulation provides that the law of the member state where the company files for bankruptcy determines 'the effect of the insolvency on proceedings brought by individual creditors' but creates an express exception for 'lawsuits pending'. As for 'lawsuits pending', article 15 of the Insolvency Regulation provides that:

> *[t]he 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.*

Christopher Clarke J held that 'lawsuits pending' must be read to include international arbitration as well as state court litigation. In response to Elektrim's argument that 'lawsuits pending' was meant only to refer to state court litigation, the learned judge said:

> *The expectation of those who agree to have their disputes resolved by arbitration that the dispute will be resolved by the arbitral tribunal to which they have agreed under the supervision of the relevant court is no less legitimate than that of those who expect their disputes to be resolved in and by a court […]. Arbitration is not to be regarded as the poor relation for which no saving provision need be made, whereas the court, because it exercises the judicial power of the state, should enjoy a privileged position.*

As a result, the effect of Elektrim's bankruptcy in Poland on the LCIA arbitration was governed by English law as the lex loci arbitri, not Polish law as the lex concursus. As English law contained no bankruptcy provision akin to article 142 of the PBRA, the Commercial Court dismissed Elektrim's challenge to the LCIA's jurisdiction. The Swiss Federal Tribunal's decision thus stands in stark contrast with the approach taken in *Syska*, which is likely to be highly persuasive for other courts within the European Union. Unlike these other European jurisdictions, Switzerland will look to the place of the bankrupt party's incorporation, and not the law of the arbitral seat, to determine the effect of a bankruptcy filing on the party's capacity to arbitrate.

Second, the Federal Tribunal's decision highlighted a noteworthy feature of Switzerland's legislation on international arbitration. Article 177 of the PIL expressly prohibits a state, state-owned or state-controlled enterprise from invoking its own law 'to contest its capacity to be a party in the arbitration or to contest the arbitrability of a dispute which is the subject of an arbitration agreement'. As a result, Elektrim's bankruptcy in Poland would not have divested the ICC tribunal of jurisdiction had it been a state enterprise. French law also accords different treatment to state enterprises on this issue, while in England the matter has yet to be decided.

***

The motivations behind the Federal Tribunal's decision are readily discernible. The Federal Tribunal often applies a deferential standard of review to the decisions of international arbitral tribunals sitting in Switzerland, an approach which generally tends to promote the finality and efficiency of international arbitration as a dispute resolution mechanism. Moreover, any final arbitral award against a foreign bankrupt party would still very likely need to be enforced outside Switzerland in that party's home jurisdiction, where the party is likely to have the majority of its assets. It

HOGAN & HARTSON

3, rue François Bellot
1206 Geneva
Switzerland
Tel: +41 22 787 4000
Fax: +41 22 787 4010

Michael Stepek
mstepek@hhlaw.com

Matthew Bate
mcbate@hhlaw.com

www.hhlaw.com

From the beginnings in 1904 as a single lawyer operation to the status as one of the top international law firms, Hogan & Hartson carries on a tradition of excellence established by founder, Frank J Hogan. With more than 1,100 lawyers practicing in 27 offices worldwide, the firm works seamlessly across multiple practices and offices to provide clients with exceptional service and creative advice.

The Geneva office, more specifically, serves as the headquarters for the firm's prominent international litigation and arbitration practice for Europe, Asia, Africa, and the Middle East. Lawyers at Hogan & Hartson, Geneva, have extensive experience in the prosecution and defence of major claims brought in international arbitrations governed by the rules of the International Chamber of Commerce (ICC), the International Centre for the Settlement of Investment Disputes (ICSID), the London Court of International Arbitration (LCIA), the Swiss Rules of International Arbitration, various chambers of commerce, and other international arbitral fora. The lawyers also handle international civil litigation matters before US, Swiss, and international courts and institutions.

was thus entirely correct that the Federal Tribunal considered the impact of a party's domestic bankruptcy law on its legal ability to participate in an international arbitration in Switzerland.

At the same time, the decision has created some degree of concern about the extent to which domestic bankruptcy laws may interfere with the orderly administration of the international arbitration process in Switzerland. It is far from clear, however, whether such a concern is well-founded. Firstly, it is hard to see how a reference to the law of a company's state of incorporation injects uncertainty into the process. Such laws are readily ascertained and thus their impact or lack thereof on a party's ability to arbitrate is knowable in advance. Indeed, it is, or at least it should be, standard practice for counsel to review the law of its contractual counterparty's state of incorporation to determine its capacity to sue or be sued in arbitration. In this particular case, the threat of Elektrim's bankruptcy had existed for some time, and thus the claimants could hardly claim to have been surprised by the fact that Elektrim was ultimately declared bankrupt. This of course does not address the legislative risk, ie, that the law of the state of incorporation is changed after the arbitration agreement has been entered into, in such a manner that a corporate party no longer has the legal capacity to participate in the arbitration as it had agreed. Such a risk, however, would appear to be rather remote. There appear to be few instances where a change in a party's legal capacity has deprived an arbitral tribunal of its jurisdiction. Moreover, the same type of risk could be seen to be inherent in the approach taken by the court in *Syska*, which looked to the law of the seat of arbitration. After all, the laws of the arbitral seat are no less subject to change after the arbitration agreement is concluded and the seat of the arbitration has been selected. As with the approach taken by the Federal Tribunal under Swiss law, this 'risk' appears to be largely hypothetical and has failed to materialise as a practical matter. Under either approach, one must be cognisant of whose law applies to these issues when entering into the arbitration context.

Michael Stepek

Hogan & Hartson LLP

Michael Stepek practices primarily in international arbitration and litigation, with a particular focus on complex, high-value disputes involving major infrastructure construction projects, joint ventures, insurance coverage, manufacturing, telecommunications and transportation. He has more than 20 years of experience in international law, practising in the United States before establishing residence in Geneva in 1996. Michael represents multinational companies in the litigation and arbitration of complex international commercial, trade, and investment disputes before numerous international fora, including the International Chamber of Commerce, the International Centre for the Settlement of Investment Disputes, the London Court of International Arbitration, the American Arbitration Association, and various chambers of commerce in Switzerland.

Matthew Bate

Hogan & Hartson LLP

Matthew Bate practises primarily in the area of international arbitration and litigation, with a particular focus on complex, high-value disputes involving cross-border investments and commercial matters. Matthew has extensive experience representing multinational clients in arbitrations conducted under the rules of the International Chamber of Commerce (ICC), the London Court of International Arbitration (LCIA), the American Arbitration Association (AAA), and the United Nations Commission on International Trade Law (UNCITRAL), as well as in international litigations before US courts. He has represented clients across a wide variety of sectors, including oil and gas, construction, engineering, telecommunications, biotechnology, professional services, shipping, and aerospace. Over the years, a substantial part of his practice has been dedicated to resolving disputes involving sovereign states, including disputes arising under bilateral investment treaties. Prior to joining Hogan & Hartson, Matthew practised with leading international law firms in Paris and New York. He is a member of the New York Bar, and received his JD from Harvard Law School in 2001. He is a native English speaker and is fluent in French and German.