The Gabriel Moss Memorial Lecture

"EFFECTS OF FOREIGN INSOLVENCY PROCEEDINGS ON PENDING ARBITRAL PROCEEDINGS ACCORDING TO THE EUROPEAN INSOLVENCY REGULATION"

Prof. Jasnica Garašić, Ph.D.
Faculty of Law of the University of Zagreb

I. INTRODUCTION

Article 15 of the European Regulation on Insolvency Proceedings (EIR) of 2000:
"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."

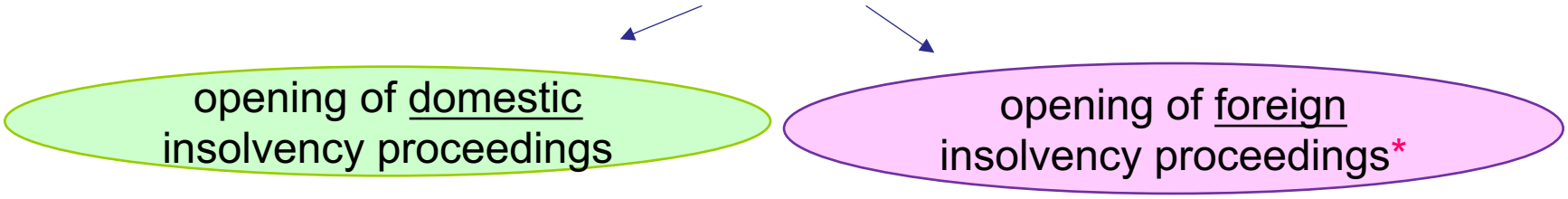
Application only to lawsuits before state courts or also to disputes before arbitral tribunals?

Article 18 of the EIR of 2015 (recast):
"The effects of insolvency proceedings on **a pending lawsuit or pending arbitral proceedings**
concerning an asset or a right which forms part of a debtor's insolvency estate
shall be governed solely
by the law of the Member State in which that lawsuit is pending or
in which the arbitral tribunal has its seat."

There are still some questions and uncertainties in the interpretation of this rule.

Pending arbitral proceedings and arbitral tribunal with its seat in a Member State of the EU

*application of Art. 18 EIR 2015



Foreign insolvency proceedings:

*fall with their characteristics into the scope of the EIR as defined in Art. 1(1-2) EIR

*are listed in Annex A in accordance with Art. 1(1)(sent. 3.) and Art. 2 (no.4) EIR

Foreign **main**, **secondary** or **territorial/particular** insolvency proceedings (Art. 3(1-4) EIR)

Non-recognition of foreign insolvency proceedings because of violation of public policy (Art. 33 EIR)

*no effects of such foreign insolvency proceedings on domestic arbitral proceedings in a Member State

Foreign insolvency proceedings have been **opened in Non-Member State**.
*EIR shall not be applied (Art. 3(1)(1) (sent. 1), Art. 3(2)(sent.1), Art. 19(1)(1), Art. 20(1) EIR
*the law of the Member State in which arbitral tribunal has its seats, including its conflict of laws rules, shall govern the effects of such foreign insolvency proceedings on these arbitral proceedings

**meaning*?

Domestic arbitral proceedings are already pending in a Member State at the moment of the opening of foreign insolvency proceedings in another Member State.

**the time at which the judgment opening insolvency proceedings becomes effective, regardless of whether the judgment is final or not (Art. 2. no. 8 EIR)*

The seat of arbitral tribunal is not located in a Member State, but in a Non-Member State or Denmark.
*Art. 18 EIR is not applicable
*law of such Non-Member State/Denmark is applicable, including its conflicts of laws rules

Domestic arbitral proceedings **concern an asset or a rights which forms part of a debtor's insolvency estate**.

Lex fori concursus determines the assets which form part of the insolvency estate as well as the treatment of assets acquired by or devolving on the debtor after the opening of the insolvency proceedings (Art. 7(2)(sent. 2)(b) EIR.

Irrelevant whether the **debtor** against whom the insolvency proceedings have been opened is the **plaintiff/claimant or the defendant** in arbitral proceedings.

II. APPLICABLE LAW FOR EFFECTS OF FOREIGN INSOLVENCY PROCEEDINGS ON DOMESTIC ARBITRAL PROCEEDINGS

Art. 7(2)(sent. 2)(f) EIR:
"Lex fori concursus shall determine following:
(f) the effects of the insolvency proceedings on proceedings brought by individual creditors, with the exception of pending lawsuits" (and pending arbitral proceedings?)

Article 18 of the EIR of 2015 (recast):
"The effects of insolvency proceedings on a pending lawsuit or
pending arbitral proceedings
concerning an asset or a right which forms part of a debtor's insolvency estate
shall be governed **solely**
by the law of the Member State in which that lawsuit is pending or
in which the arbitral tribunal has its seat."

**no cumulative or alternative application of different national laws is possible;*
**it refers to the internal law of the Member State in which the arbitral tribunal has its seats, excluding its rules of private international law;*
**irrelevant, whether the rules on effects of insolvency proceedings on arbitral proceedings are contained in insolvency law or arbitral law of that Member State*

Does the law of the Member State in which the arbitral tribunal has its seat really govern **all effects of foreign insolvency proceedings on domestic arbitral proceedings?**

Article 18 EIR as an exception from the applicability of the *lex fori concursus* (Art. 7 EIR)

Recital 24 EIR 2000; Recital 67 EIR 2015:

"*to protect legitimate expectations and the certainty of transactions in Member States other than that in which proceedings are opened*"

Virgós-Schmit "Report on the Convention on Insolvency Proceedings" OJ 1996, L6500, mn. 142:

The procedural law of the State where the lawsuit is pending (only) decides "*whether or not the proceedings are to be suspended, how they are to be continued and whether any appropriate procedural modifications are needed to reflect the loss or the restriction of the powers of disposal and administration of the debtor and the intervention of the liquidator in his places.*"

1. Stay/Suspension of Arbitral Proceedings

Article 18 EIR:
the law of the Member State in which the arbitral tribunal has its seats determines
*__whether__ the opening of foreign insolvency proceedings in another Member State and its recognition leads to the __stay or some kind of temporary suspension__ of the domestic pending arbitral proceedings
*the __effects of the stay, suspension__

For many years there has been __tendency between arbitrators to ignore the opening of insolvency proceedings__ against one of the party in arbitral proceedings (no stay, no suspension of arbitral proceedings).

European legislator – Art. 18 EIR – __confirms that insolvency proceedings affect arbitral proceedings__, but it leaves the regulation of these effects to the law of the Member State in which the arbitral tribunal has its seats.

Problem:
**many Member States do not explicitly regulate the effects of the opening of insolvency proceedings on arbitral proceedings neither in their insolvency nor in arbitral law*
**arbitration rules of arbitration institutions usually do not mention this issue.*

Importance of the stay/suspension of arbitral proceedings in the case of the opening of insolvency proceedings against one of the party in arbitral proceedings:

*messy debtor's business records – lack of knowledge of insolvency practitioners on pending arbitral proceedings

*insolvency practitioner as a legal representative of the debtor; violation of the right to be heard

*former management of the insolvent debtor may act in arbitral proceedings in a manner that is detrimental to the insolvency estate

*violation of the interests of insolvency creditors whose claims should be enforced in insolvency proceedings; violation of the principle of equal treatment of insolvency creditors

*violation of the right to be heard – violation of the public policy; arbitral award from such arbitral proceedings can not be recognized and enforced

*insolvency practitioner needs time to study the case of arbitral proceedings to decide how to act in these proceedings

*in some legal systems insolvency practitioner needs the consent of the creditors' committee or creditors' assembly

Necessary balance between:

*interests of a creditor that participates in arbitral proceedings with the insolvent debtor and

*interests of the other debtor's creditors:

UNCITRAL Model Law on Cross-Border Insolvency (1997)

Article 20. Effects of recognition of a foreign main proceeding

1. Upon recognition of a foreign proceeding that is a foreign main proceeding:

(a) Commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities is stayed.

It also includes arbitral proceedings.

(Para 180. *Guide to Enactment and Interpretations of the Model Law on Cross-Border Insolvency Proceedings*)

***automatic stay**

The scope, and the modification or termination, of the stay and suspension are subject to the law of the State that enacted this Model Law (Art. 20(2)).

The reasons for the stay of pending lawsuits and pending arbitral proceedings after the opening of insolvency proceedings against one of the party are the same.

2. Effectiveness, Validity of the Arbitration Agreement i.e. the Arbitration Clause

Does the law of the Member State in which the arbitral tribunal has its seat govern the effects of the opening of foreign insolvency proceedings on effectiveness, validity of the arbitration agreement, i.e. arbitration clause in pending arbitral proceedings according to Article 18 EIR 2015 (Article 15 EIR 2000)?

Positive answer:
Case *Elektrim S.A. et al. v. Vivendi Universal S.A. et al.*, **High Court of Justice**, 2.10. 2008, EWHC 2155 M SchiedsVZ 200, 316-321;
Court of Appeal England, 9.10. 2009, EWCA Civ 677, IILR 2010, 39-46.

The rule in Article 18 EIR 2015 (Article 15 EIR 2000) is *lex specialis* with respect to the effects of insolvency proceedings on arbitration agreement in the case of pending arbitral proceedings.

Counterarguments

Any exception to the general rule of applicability of the *lex fori concursus* has to be interpreted narrowly.

Art. 7(2)(sent. 2)(e) EIR:
Lex fori concursus shall determine following:
(e) the effects of the insolvency proceedings on **current contracts** to which the debtor is party;

**meaning? – only executory contracts?*
**no distinction between substantive contracts and procedural contracts (agreements)*

Is there really a need to have one applicable law regarding the effects of opening of insolvency proceedings on arbitral agreements
when arbitral proceedings are pending
and another applicable law when arbitral proceedings are not pending?

The applicability of the ***lex fori concursus*** to the effects of the opening of insolvency proceedings on the arbitration agreements would also follow from Article 7/1) EIR that foresees the general applicability of the *lex fori concursus* to insolvency proceedings and their effects, if it is not otherwise provided in the EIR.

The lex fori concursus as the law of the **closest connection** when it comes to the effects of the opening of insolvency proceedings on arbitration agreements

**It supports the principle of equal treatment of debtor's creditors.*
**It supports the principle of universalism.*

Insolvency law of the States very rarely contains a provision that invalidates arbitration agreements (clauses) in the case of the opening of insolvency proceedings.

See International Bar Association Toolkit on Insolvency and Arbitration,
IBA Arbitration Committee, 2021
https://ibanet.org/LPD/Dispute_Resolution_Section/Arbitration/toolkit-arbitration-insolvency

3. Capacity to be a Party in Arbitral Proceedings

In a rare case where the applicable law foresees the invalidity of the existent arbitration agreements (clauses) with the opening of insolvency proceedings, after the opening of insolvency proceedings no one can be anymore a party in pending arbitral proceedings initiated before the opening of insolvency proceedings based on such arbitration agreement (clause).

**arbitral proceedings have to be terminated*

Compare **Swiss Federal Court** in the *Vivendi Case*, 31.03. 2009 – 4a_428/2008, ZIP 2010, 2530-2532

Most legal systems and Member States of the EU do not invalidate the existent arbitration agreements (clauses) of the insolvent debtor with the opening od of insolvency proceedings against such a debtor.

Which law applies to the capacity of the insolvent debtor to be a party in arbitral proceedings?

Different solutions in the law of the Member States

*__the insolvent debtor does__ not lose its capacity to be a party in arbitral proceedings after the opening of insolvency proceedings, but __loses only the procedural capacity to undertake acts with the procedural legal effects in arbitral proceedings__ (as well as in law-suits before the state courts);
insolvency practitioner as a legal representative of the debtor
(for example ***Croatia***)

*the insolvent debtor __loses not only the procedural capacity, but also the capacity to be a party in lawsuits and arbitral proceedings__; insolvency estate instead of the debtor becomes a party in such proceedings (for example ***Austria***)

*__the insolvency practitioner becomes a party__ instead of the debtor in lawsuits and arbitral proceedings (dominant opinion in ***Germany***)

Article 18 EIR does not regulate this question.

Art. 7(2)(sent. 2)(c) EIR:
Lex fori concursus shall determine following:
(c) the respective powers of the debtor and the insolvency practitioner;

Art. 7(1) EIR: general applicability of the ***lex fori concursus***

4. Procedural Capacity of the Insolvent Debtor in Arbitral Proceedings

This question is also not subject to the rule contained in Article 18 EIR.

Art. 7(2)(sent. 2)(c) EIR:
Lex fori concursus shall determine following:
(c) the respective powers of the debtor and the insolvency practitioner;

Lex fori concursus applies to the issue of the procedural capacity of the insolvent debtor.

Procedural capacity of the insolvent debtor may vary within the legal system of the same Member State depending on the type of the insolvency proceedings that have bee opened.
(*reorganization, restructuring proceedings, debtor in possession; liquidation proceedings*)

6. Power of Attorney of the Insolvent Debtor in Arbitral Proceedings

Effects of the opening of insolvency proceedings on
a contract for representation (representation agreement) before the arbitral tribunal
that a debtor concludes with an attorney before the opening of insolvency proceedings.

They are governed by ***the lex fori concursus*** in accordance with Article 7(1) and Article 7(2)(sent. 2)(e) EIR.

Art. 7(2)(sent. 2)(e) EIR:
Lex fori concursus shall determine following:
(e) the effects of the insolvency proceedings on **current contracts** to which the debtor is party;

Does the *lex fori concursus* also applies to
the effects of the opening of insolvency proceedings on
a power of attorney issued by the debtor before the opening of insolvency proceedings?

No explicit rule in the EIR; different opinions

The question can be answered in the affirmative.
*any exception from the general rule on the applicability of the ***lex fori concursus***
must be interpreted very narrow;
*the power of attorney arises from the contract for representation

6. Authorization to Initiate the Continuation of the Stayed/Suspended Arbitral Proceedings

The law of the Member State in which the arbitral tribunal has its seats, **generally** determines **who may initiate the continuation** of the stayed/suspended arbitral proceedings regardless what was the reason for the stay.

The question of who is authorized, entitled to initiate the continuation of the stayed/suspended arbitral proceedings after the opening of foreign insolvency proceedings should be decided in accordance with Article 7(1) EIR by the ***lex fori concursus***.

Insolvency law of the Member States:
Usually there are special rules on who is entitled to initiate the continuation of the stayed lawsuits i.e., arbitral proceedings
*in the cases when the insolvent debtor has the role of a plaintiff in such proceedings
*in cases when the pending lawsuit i.e. arbitral proceedings concern the claims lodged in insolvency proceedings and the so-called verification procedure must precede.

Protection of the insolvency estate;
closest connection with the insolvency proceedings

7. Modalities and Form of the Continuation of the Stayed Arbitral Proceedings

The modalities, the form, and generally the procedure concerning the initiation of the continuation of the stayed arbitral proceedings are determined by the ***lex loci arbitri*** **i.e., the** ***lex arbitri*** in accordance with Article 18 EIR.

**pure procedural questions that are in direct connection with the conduct of the arbitral proceedings*

III. CONCLUSION

Interpretation of Article 18 EIR:
The law of the Member State in which the arbitral tribunal has its seat
applies in the first line to:

*the question whether pending arbitral proceedings with the opening of insolvency proceedings and their recognitions *shall be continued or stayed/suspended*;

*the question of *effects of such a stay/suspension*;

*the *question of modalities, form and generally of the procedure* concerning the initiation of the stayed/suspended arbitral proceedings.

The European legislator should have explained the term "pending" arbitral proceedings,
at least in one of the Recitals of the Preamble to the EIR 2015.
**legal predictability and legal certainty*

The words **“and pending arbitral proceedings”** should have been added in Article 7(2)(sent.2)(f) EIR 2015 at the end of the sentence.

Would the introduction of the rule of the **automatic stay** of pending arbitral proceedings modeled on Article 20 of UNCITRAL Model Law on Cross-Border Insolvency be better solution for the EIR?

**having in mind the importance of reasons that justify the temporary stay/suspension of pending arbitral proceedings after the opening and recognition of foreign insolvency proceedings*

The lex fori concursus is the applicable law for the following issues:

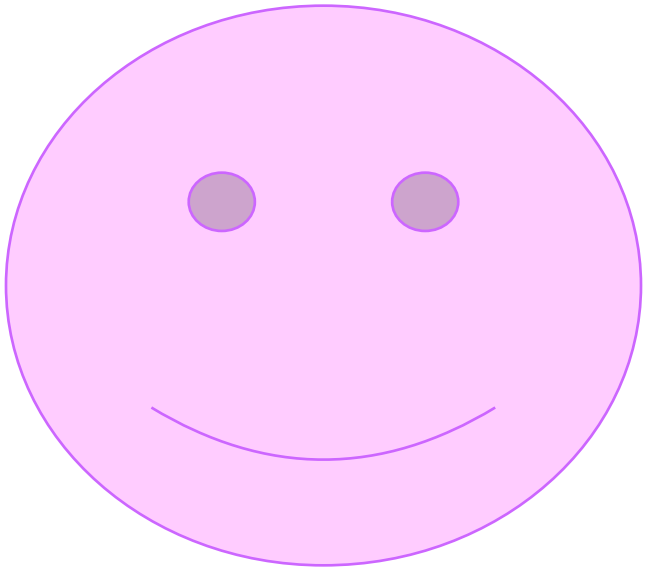
*capacity to be a party in pending arbitral proceedings;

*procedural capacity of the insolvent debtor in pending arbitral proceedings;

*effects on the power of attorney issued by the insolvent debtor before the opening of insolvency proceedings;

*authority/entitlement to initiate the continuation of the stayed/suspended arbitral proceedings

*effects on arbitral agreements (clauses)
(Article 7(1), Article 7(2)(sent.2)(c, e) EIR 2015



THANK YOU VERY MUCH FOR YOUR ATTENTION!