

Arbitration - Switzerland

The Uneasy Relationship between Arbitration and Bankruptcy

July 30 2009

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Facts

A recent dispute referred to arbitration pertained to a settlement agreement executed on March 29 2006 between Vivendi SA and other telecommunications entities in Switzerland and Poland on one side, and Deutsche Telekom AG, T-Mobile, Elektrim SA and other telecom entities in Switzerland, Poland and Germany on the other.⁽¹⁾ The settlement agreement provided for arbitration pursuant to the International Chamber of Commerce Rules of Arbitration, with the seat of arbitration in Geneva. The Supreme Court's summary report does not specify which law governed the merits of the case.

At an early stage of the arbitration, bankruptcy proceedings were initiated in Poland against Elektrim SA, one of the co-defendants in the arbitration. The proceedings resulted in a bankruptcy ruling being issued in Poland on August 21 2007. Elektrim SA notified the arbitration tribunal of the ruling on September 5 2007 and requested the termination of the proceedings against it. In doing so, it relied on Article 142 of the Polish Bankruptcy Law which provides that:

"any arbitration clause concluded by a bankrupt shall lose its legal effect as at the date bankruptcy is declared and any pending arbitration proceedings shall be discontinued."

The arbitration tribunal upheld Elektrim SA's jurisdictional objection and terminated the arbitration proceedings against it with an interim award on July 21 2008. In summary, relying on various local authorities on the issue, the arbitration tribunal found that Article 142 applies to all pending arbitration proceedings involving a company incorporated in Poland, whether such proceedings are conducted in Poland or abroad. While denying that Polish law could terminate or even suspend an arbitration proceeding conducted in Switzerland under the application of Swiss arbitration law, the tribunal, relying on the general conflict of law provisions applicable in Swiss law (ie, Article 154 *et seq* of the Private International Law Act), held that the incidence of Polish bankruptcy proceedings on a Polish company should be governed by Polish law. In particular, it would be for Polish law to determine the incidence of such proceedings on the existence of a Polish company and its continued capacity to be party to an arbitration proceeding.

Decision

The Supreme Court dismissed an annulment proceeding filed against the interim award and considered that the arbitral finding was not based on an erroneous interpretation of Polish law.

Apart from an express provision regarding state entities, Swiss arbitration law is silent on the parties' subjective capacity to arbitrate. On the one hand, the court acknowledged that such capacity pertained to the preliminary substantive question of the legal capacity of the parties which, it held, should be governed in an international arbitration proceeding by the law designated by the general conflict of law provisions pertaining to these matters (ie, Articles 154 and 155c of the Private International Law Act governing the legal capacity of corporate entities). Numerous scholarly writings were cited in support of this finding. On the other hand, the court considered that the conflict of law provision which addresses the issue of the validity of an arbitration agreement (ie, Article 178(2) of the act) does not deal with the capacity of the parties to enter or remain in an arbitration agreement.

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The court then confirmed that legal capacity – and hence the continued capacity to be party to an arbitration proceeding – should be determined in application of the law of the place of incorporation of a legal entity, following Articles 154 and 155c of the act. Thus, Polish law was to be applied to the exclusion of any other law. Furthermore, the court upheld the arbitration tribunal's reasoning and finding based on Article 142 of the Polish Bankruptcy Law.

Comment

The court's decision (like that of the arbitration tribunal) is sound and unsurprising in its reliance on the law of incorporation to determine the legal capacity of parties either to initiate or take part in an arbitration proceeding. This is a matter of common sense, not least because in most instances the final award will be enforced (and must be recognized) in the state of incorporation of the losing party – that party's lack of capacity to arbitrate under the law of that state would be a serious obstacle to such recognition and enforcement. Although not the prime and direct responsibility of international arbitrators, recognition and enforcement issues remain a fundamental concern of all players in the arbitration process, since they constitute a key element in the efficiency of the process in an international context.

The scope of Article 142 of the Polish Bankruptcy Law is problematic in that its first part seems to deal with the termination of the arbitration agreement. From a Swiss law perspective, one could argue that such termination should be ruled exclusively by the arbitration law governing the proceeding. However, this argument was not pursued by the parties and so the Supreme Court focused only on the capacity to pursue arbitration.

Also surprising is the clear-cut reasoning of the court – traditionally rather cautious in its approach – to two controversial issues.

First, the court – and the tribunal – determined the law governing the party's capacity to arbitrate based exclusively on the Swiss conflict of law provisions (ie, Private International Law Act, Articles 154 and 155c). The automatic and unreserved application of Swiss law is disputable. It is generally agreed that the Arbitration Act (ie, Chapter 12 of the Private International Law Act) must be dissociated from the other chapters of the act, with the (disputed) exception of a few milestone provisions (eg, Article 19 on public policy). In particular, it is generally considered that the parties' choice of arbitration in Switzerland (and hence the application of Swiss arbitration law) does not in itself imply reference to the other provisions of the Private International Law Act. Thus, an international arbitration tribunal seated in Switzerland should determine the relevant applicable law on the merits on the basis of the relevant provisions contained in the Arbitration Act only (ie, Article 187 of the Private International Law Act) and not on the basis of the general Swiss conflict of law provisions. The court did not suggest any convincing justification for its referring to provisions outside the Arbitration Act. The scholarly writings cited by the court in support for its reliance on Articles 154 and 155c of the Private International Law Act are not all as explicit as the unreserved reference of the court might imply. Thus, for the sake of coherence, the court should either have based its decision only on the Swiss Arbitration Act (ie, Chapter 12 of the Private International Law Act) or explained in more detail its reasons for finding that reliance on other provisions was necessary in this case.

A second issue that deserved further explanation is the court's unreserved endorsement of the effects of foreign bankruptcy proceedings (and bankruptcy laws) on the international arbitration proceeding conducted in Switzerland. Admittedly, the arbitration tribunal and the court made clear that Polish law could not by any means directly put an end to an international arbitration proceeding conducted abroad. Nevertheless, considering the importance of the issue at stake (ie, the definitive loss of the capacity to arbitrate), and considering the lack of either unanimous or converging arbitral practice and scholarly writing on the issue, a more thoroughly motivated decision examining the various trends and solutions would have been highly appreciated in such a critical economic period.

The effect of this decision should not be underestimated, considering the peculiarities of the case and, more particularly, the unusually radical content of Article 142 of the Polish Bankruptcy Law regarding arbitration clauses and arbitration proceedings. The court did not consider this decision worthy of publication in its official reports. However, the decision will revive – more than it will resolve – the longstanding debate on the uneasy relationship between arbitration and bankruptcy.

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Endnotes

(1) Decision 4A_428/2008 of the Swiss Supreme Court in *Vivendi SA*. The full text of the decision, which will not be published in the official reports of the Supreme Court's decisions, is available in German at www.bger.ch/fr/index/jurisdiction/jurisdiction-inherit-template/jurisdiction-recht/jurisdiction-recht-urteile2000.htm.

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