International Arbitration and Multinational Insolvency
Jay Lawrence Westbrook

The collision between an increasing number of multinational insolvencies and an increasing number of multinational arbitrations constitutes the irresistible force meeting the immoveable object. In many countries, an insolvency proceeding overrides most other laws and sweeps into its embrace virtually all legal matters relating to the debtor. Yet international arbitration as embodied in the “New York” Convention has achieved a highly favored state of enforcement around the world. This paper considers the choice-of-law issues that arise from their collision.

Electrim was a Polish company that became involved in a staggering morass of litigation and arbitration throughout the first decade of the new century. Vivendi, a venture partner of Electrim, launched an arbitration proceeding against the Polish concern in London. Shortly before the first hearing in the arbitration, an insolvency proceeding for Electrim was opened in Poland. The administrator of the insolvency took the position that Polish insolvency law abrogated the arbitration clause in the contract between the parties, leaving the matter to be resolved in court. Vivendi claimed the status of the arbitration was governed by English law, which would not halt the arbitration. The arbitration tribunal rejected Electrim’s request for dismissal of the arbitration and went forward to hold hearings and issue an award. The United Kingdom courts upheld the tribunal, ruling that the European Regulation on Insolvency Proceedings (the “EU Regulation”) allocated the decision about the arbitration to the law of the country where the arbitration was pending. Under UK law the arbitration was permitted to go forward, even though the court recognized that the Polish proceeding was the “main” proceeding under the EU Regulation and that Polish law would hold the arbitration clause extinguished by the insolvency.

Electrim was involved in a second arbitration, in Switzerland. The Swiss arbitral tribunal ruled that Polish law controlled and dismissed Electrim from the multiparty arbitration.

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2 For a discussion of the morass, see Law Debenture Trust Corp Plc v Electrim SA, [2009] EWHC 1801 (Ch).
The Swiss Supreme Court agreed. While the Polish insolvency rules did not operate directly in Switzerland, under Swiss conflicts principles the law of the insolvency jurisdiction should control and thus the arbitration should be halted as against the insolvent debtor.

Needless to say, it is not for me to opine about the proper interpretation of English law, Polish law, Swiss law, or the EU Regulation.\(^5\) The results just described may or may not be have been correct under the relevant laws. My concern is to take the Electrim cases as hypothetical examples to explore the choice-of-law rules explicitly or implicitly adopted in these cases and to consider which of them would make the best sense from a policy point of view if we were free to amend all applicable laws to produce the best results.

**Background**

There were two types of issues in these cases. One was choice of the proper law to govern the choice between arbitration and the claims process in the insolvency court. The second was the substance of the underlying choice itself. Although this paper is about the choice-of-law question, there are two areas of substantive legal doctrine that serve as important background: the theory of recognition and cooperation in multinational insolvency cases and the domestic-law rules concerning the enforceability of arbitration clauses in insolvency proceedings.

**Territorialism and Universalism**

In brief, territorialism and universalism are the terms used to described the two approaches to multinational insolvency matters. Territorialism is the traditional “grab rule,” wherein each national court seizes what property it can and distributes its proceeds under local law. Universalism is based on the idea that an effective insolvency law, operating in rem as to hundreds or even thousands of claimants, must have a legal reach coextensive with the market. Therefore, in a globalizing world we would ideally have one proceeding for a multinational company that would realize upon its assets and distribute the resulting value globally, whether by way of liquidation or reorganization.\(^6\) Given the difficulties of achieving the ideal in a world of nation states, a notion of modified universalism has achieved considerable support.\(^7\) It is understood as a pragmatic doctrine that seeks to achieve practical results that approach so far as possible those that would obtain in a pure universalist system. The logic of modified

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\(^5\) The wisdom of modesty in this regard is illustrated by the fact that the Warsaw Court of Appeals has apparently overruled a lower court decision that the Electrim arbitration award was not enforceable in the Polish bankruptcy. See Special Case, supra note 4, at n. 41. I do not attempt in this paper to probe further Polish law in that regard.


universalism tends in general to favor choice-of-law rules that apply the law of the “main” insolvency proceeding in many circumstances. The EU Regulation adopts that approach, although with many important exceptions.8

Arbitration and the Insolvency Claims Process

Although this paper is about choice of law, that analysis requires some review of the existing domestic rules for adjudicating insolvency claims that would normally be subject to arbitration, whether the arbitration is local or international. Thus it is necessary to understand the considerations that courts weigh domestically and the policies to be served in order to determine whether local law or the law of the insolvency court should govern in deciding whether to arbitrate the claims or send them through the insolvency claims process. To do that, we must see the factors that give rise to varying domestic rules. As we have seen, in Electrim the UK law required that the claims be resolved in arbitration, while the Polish law, applied in Switzerland, sent the parties to the claims process in the insolvency court. As to international arbitration, it is difficult to separate the domestic rule from the choice-of-law rule and to distinguish the overlapping factors relevant to each. In Electrim, for example, the UK court was required first to decide if it would apply the Polish insolvency rule or the English rule. Having decided to apply the English rule, it had to decide whether that rule gave the trumping card to arbitration law or insolvency law in the case of an international arbitration and a multinational insolvency. The choice-of-law decision was that English law applied and the domestic decision was that arbitration law prevailed over deference to a foreign insolvency.9

Most national insolvency laws halt domestic lawsuits (and probably arbitrations as well) when an insolvency proceeding is brought. However, there are some countries—for example, Mexico—where lawsuits are not halted, but are permitted to continue10 and to produce results binding in the insolvency court on the merits of claims. Conversely, even more unusual is the Polish rule flatly canceling any arbitration clause in insolvency.11

Although few countries have a statutory rule about permitting arbitration to resolve claims in insolvency cases, some common law countries have begun to generate case law approaches. In the United States, for example, a rule is emerging that usually enforces arbitration clauses against the debtor’s bankrupt estate (and therefore against its creditors),12 but creates certain categories of legal issues where the court may not enforce arbitration.13 As to

8 E.g., European Regulation, articles 4, 17-18, 27.
9 It appears that the English version of the Model Law was not applicable to the case.
11 Electrim at 356.
12 However, the United States Bankruptcy Code provides for a broad stay of all lawsuits and arbitrations, at least temporarily, unless the court decides to permit them to go forward. Bankruptcy Code §362(a).
these categories (usually “core” cases involving claims peculiar to insolvency), some cases have held that the judicial claims process should be used, rather than the arbitration process, while others have said the court has discretion to choose one or the other, depending on the circumstances. The US cases have shown a disinclination to distinguish between domestic and international arbitration in applying these rules.

Powerful policies favor enforcement of arbitration agreements and awards, whether local or international. These policies are especially important in the international arena. The most important benefit of international arbitration is neutrality of forum. That advantage is lost if the counterparty is forced in the case of insolvency 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.

Another pillar of the policy supporting international arbitration is the predictability it provides for commercial transactions. The parties to an arbitration clause know it will be given effect almost always. However, a decision to enforce arbitration will affect hundreds or even thousands of parties—the other creditors of the debtor—who will rarely know what choices the debtor has made concerning arbitration. By contrast, the claims process in insolvency court is easily predictable. In the case of an international contract, the counterparty to the arbitration contract has a fairly strong chance of predicting the “center of main interests” (or “COMI”) of the debtor, which is the place where a main insolvency proceeding would be opened. The COMI of a company is usually easy to predict, so use of that concept provides a greater likelihood that all creditors will be able to predict the claims process that will apply to claims of all creditors. That is, the counterparty that enters into a contract with a corporation headquartered in Country A will be able to have its lawyers ascertain the rules concerning enforceability of arbitration clauses in the insolvency laws of Country A. Following this approach, in the example under discussion where the other contract party is a Polish company, the counterparty would know that its arbitration rights will not be enforced if the Polish concern enters an insolvency proceeding.

International arbitration policy is embodied in the New York Convention, perhaps the most successful commercial convention of modern times. Some may doubt that the Convention will permit courts to refuse enforcement of arbitration agreements and awards in insolvency

14 The concept of COMI and the debate about its definition and usefulness has filed the insolvency literature. See, e.g., Edward J. Janger, Virtual Territoriality, xx COLUM. J. TRANSNAT’L L. xx (forthcoming 2010); Jay Lawrence Westbrook, A Response to Professor Janger, xx COLUM. J. TRANSNAT’L L. xx (forthcoming 2010).

cases. Yet the Convention offers a ready answer in its defense of “incapacity.” To quote a prior work:\textsuperscript{16}

Article V(1)(a) authorizes nonenforcement if “[t]he parties to the agreement ... were, under the law applicable to them, under some incapacity ••••”\textsuperscript{17} Although this exception, on its face, seems to refer to the parties' capacity at the time the arbitration agreement was made, rather than to their capacity at the time of the arbitration proceedings, the background of the provision suggests that the drafters were concerned with ensuring that both parties be properly represented during the arbitration proceeding; therefore, the provision refers to the parties' capacity at the time of arbitration.\textsuperscript{18}

The Swiss Supreme Court relied upon just this sort of capacity analysis in holding that, Electrim lost its capacity to arbitrate under Polish law once its insolvency proceeding had been opened.\textsuperscript{19}

But the fact that the Convention can be understood to permit a defense to arbitration does not determine which result is the best policy. Certain important virtues of insolvency procedures


\textsuperscript{17} U.N. Convention, supra note 15, art. V, para. 1(a). See also U.N. Doc. E/CONF.26/SR.17, 24, \textit{International Commercial Arbitration-New York Convention pt. III}, at C (G. Gaja ed. 1979) [hereinafter cited as ICA-Convention]. A provision regarding incapacity of a party as a defense had been part of the earlier Geneva Convention on the Execution of Foreign Arbitral Awards, 92 L.N.T.S. 301 (Sept. 26, 1927). This provision was carried forward in the preliminary drafts submitted to the Conference by the International Chamber of Commerce and by the 1955 Ad Hoc Committee. U.N. Doc. E/2704 and Con. 1 (1958), ICA-Convention, supra, at A1.4, Annex A1.7. It was omitted, however, from the working draft submitted to the Conference. U.N. Doc. E/CONF. 26/L.43 (1958), ICA-Convention, supra, at B.5.1. Its omission may have arisen from a belief that an incapacity defense would rarely arise, especially in a commercial context. See U.N. Doc. E/CONF. 26/SR.17 (1958), ICA-Convention, supra, at C.143. After several discussions of the issue, the final language concerning incapacity was inserted at the last meeting of the Conference. U.N. Doc. E/CONF.26/5a24 (1958), ICA-Convention, supra, at C.220, 221, 223.\textsuperscript{18} See Contini, \textit{International Commercial Arbitration}, 8 AM. J. Comp. L. 283, 300-01 (1959). The context in which the incapacity defense is found admittedly suggests that it may refer to the parties' capacity when the arbitration agreement arose, since article V(1) (a) deals with the validity of the agreement underlying the award and the incapacity clause refers back to article II which applies to recognition of the agreement prior to an award. The earlier drafts containing the incapacity defense had not set it forth in the same provision containing the agreement invalidity defense, but instead had expressly linked incapacity to lack of proper representation. U.N. Doc. E/2704 and Con. 1 (1955), ICA-Convention, supra note 72, at A1.1, Annex .7 (1955 Ad Hoc Committee draft); U.N. Doc. E/CONF. 26/L.17 (1958), ICA-Convention, supra note 72, at B.1.12 (Netherlands Amendments May 26, 1958). Of course, the change in the location of the provision could be argued to demonstrate that the conference intended to make it refer to capacity at the time the agreement arose. However, the Netherlands delegate who offered the incapacity language which was adopted specifically referred to incapacity in relation to the award, not to the agreement, suggesting that the focus remained upon incapacity during arbitration. U.N. Doc. E/CONF. 26/SR.24 (1958), ICA-Convention, supra, at C.220. [Remainder of footnote omitted].

\textsuperscript{19} It is important to note that the court applied Polish law because Poland was the jurisdiction of incorporation, rather than because the main insolvency proceeding was pending there. However, in most cases the debtor will be incorporated in the same jurisdiction as its COMI.
must be balanced against the benefits of arbitration. These virtues are closely related to the purposes of insolvency law. The claims procedures are often “summary” in nature. That is, they are designed in the interests of economy to resolve contentious claims more quickly and inexpensively than would the normal processes of litigation or arbitration. While that means the result may be “rough justice” as compared with more elaborate procedures, a less robust but less expensive procedure often makes sense when there is not enough value available to satisfy most claims in full and a relatively quick result is important to permit distributions to creditors at the earliest time. In addition, certain claims are unique to insolvency law. The Paulian actions are the most obvious example. These sorts of claims are often intertwined with contract claims in disputes over commercial transactions.

Expense and delay have a further impact on the desirability of enforcing arbitration. On the one hand, international commercial arbitration is very expensive and often very slow. Whatever the virtues of domestic arbitrations in saving litigation costs, international arbitration are notoriously expensive, perhaps even more expensive than court procedures, and they often drag on for years. Thus in the international context, the argument for preferring court procedures on grounds of reduced expense and delay are enhanced.

On the other hand, either arbitration or local litigation cases may have proceeded close to resolution by the time the insolvency proceeding is opened, although that was apparently not the case in Electrim. Where that is true, the expense of redoing a claims process almost completed may be greater than permitting the pending arbitration to be finished and an award entered.

These variables may provide some support for a discretionary rule like that emerging in some of the United States, because such a rule enables a court to choose one process or the other as suits the particular case. It also provides a mechanism whereby the party seeking arbitration and the tribunal itself might usefully influence the result by offering to finish the arbitration by a certain date at a fixed expense. Of course, such a rule also requires giving substantial discretion to the court, which some will find undesirable or inconsistent with existing legal regimes.

**The Choice-of-Law Issues**

In principle, there are no less than three choice-of-law questions that arise from the facts in the two Electrim cases: the applicable insolvency law, the law applicable to halting the arbitration, and the law governing ultimately enforceability of the arbitration agreement or award in the insolvency court. The second and third questions are those relating specifically to

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the claims process. The second question—halting the arbitration—itself has two distinct parts, as explained below.

The first question seems easy enough in the Electrim case. On the facts, the Polish proceeding seemed clearly to be the “main” proceeding as that term would be used under the European Regulation or the Model Law on Cross-Border Insolvency (“Model Law”). In any event, there was no insolvency proceeding pending in the UK, so there was no other insolvency law to be applied. Thus the court found that the applicable insolvency law was the Polish one and that the Polish statute clearly abrogated the arbitration clause. If the Polish insolvency statute controlled, then the arbitration must cease and would have no effect. Thus the first question is answered easily: Poland provides the applicable insolvency law. That leaves the two questions related to the claims process.

The remaining two claims-process questions are equally easy in the pure forms of universalism or territorialism. In a fully universalist system of the management of multinational insolvencies, the clause would be abrogated by the single applicable insolvency law and the effect would be as if a Polish insolvency moratorium (or stay) was applied to halt the arbitration and to require litigation of the claim in the insolvency court. Conversely, in a fully traditional, territorialist jurisdiction, the answers to the claims-process questions would be equally easy. The Polish insolvency case would have no effect locally and the arbitration agreement and any resulting award would be enforceable in the local court at the place of arbitration and perhaps elsewhere, but not in the insolvency court.

However, in the world of modified universalism as reflected in both the European Regulation and the Model Law, the local court has an important role to play in answering the two claims-process questions. First, it must decide whether to halt the arbitration in light of the insolvency. Is that decision governed by local law or the law of the insolvency court? That is the first claims-process issue. In the UK case, the court found that the European Regulation allocated that issue to the local law and therefore applied English law to determine if the arbitration should be halted, even temporarily.

21 See supra note 7 and accompanying text.
22 Depending on the state of the arbitration proceeding and the circumstances of the insolvency proceeding, it will often be proper to apply to the arbitral tribunal in the first instance to request a stay or dismissal of the arbitration. That was done in both the Electrim cases. For ease of expression, I will refer instead to the local court at the place of arbitration, which is where the insolvency administrator must turn if the tribunal refuses the request.
23 There is also an important choice-of-forum issue here. Should the choice-of-law questions and the underlying merits of the claims-process issues be decided by the local court or should it defer to the insolvency court? This paper does not address that problem. This area is one of many in multinational insolvency law where choice of law and choice of forum are intertwined.
24 Interestingly, it appears that an arbitration would be stayed in England upon the filing of a winding up or an administration proceeding. Insolvency Act 1986, s. 130(2); para 43(6) of Schedule B1. The UK court did not look to its insolvency rule for this purpose.
The second claims-process issue is whether the arbitration should be halted permanently or should be permitted to go forward and yield an award that would be binding on the merits in the insolvency court. The judgment of Longmore, L.J., in the UK case stated that the arbitration would go forward and would resolve the merits of the case for the purposes of the insolvency proceeding. His judgment stated that the result in arbitration would allow the arbitration creditor, Vivendi, “to join the body of creditors [in the Polish court] with an established claim.” That is, English law governed the claims-process issue and it would make the arbitration decision conclusive on the merits of the creditor’s claim. His judgment thus held that article 15 of the European Regulation applied English law both to exempt the arbitration from the insolvency stay and to make any award dispositive in the Polish insolvency court on the merits of the claim. There is obviously logic in linking those results, because it would seem bootless to permit an arbitration to go forward only to require the claimant to relitigate the merits in the insolvency court as a condition of obtaining a dividend from the debtor’s assets. But on that basis, the decision to let the arbitration go forward, with or without a temporary delay, has the effect of making the award enforceable and ousts the claims procedure normally employed in the insolvency court for the claims resolved by the arbitration.  

Properly understood, whether to halt the arbitration is a question with two distinct parts. The first raises the possibility of a temporary delay in the arbitration, a matter of timing. The second possibility is a permanent halt, leaving the arbitration claimant to resort to the ordinary claims process in the insolvency court. That second question obviously collapses into the third issue, will arbitration or the insolvency court be the forum for the claim? We will consider the issue of a temporary halt first and then turn to the ultimate question.

The approach of the European Regulation to address halting the arbitration as a choice-of-law problem implicitly ignores the question of a temporary stay. That question is a matter of case management—aiming for maximization of value and accuracy of result. If a lawsuit or arbitration continues after an insolvency proceeding is brought, there is a serious risk it will not be well defended (or prosecuted), especially if a trustee or administrator has just been appointed, which is still the procedure in most kinds of insolvency proceedings in most countries. Indeed, experience in insolvency matters shows that the prior conduct of a lawsuit or arbitration may have been neglected by a corporate leadership caught in the turmoil of financial crisis. Thus the debtor’s case may be weakened already when control of the debtor is assumed by an administrator unfamiliar with the matter and distracted by a host of other pressing concerns.

The consequence of an arbitration thus neglected is that deadlines may be missed, defaults may be entered, and some important arguments on the merits may not be made or may

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25 This statement assumes the UK court was correct in so interpreting the European Regulation. Note that the Swiss court was not construing or applying the European Regulation.
be made badly. Lawyers may be unpaid and uninstructed, circumstances notoriously inconsistent with legal success. Preparation for a key hearing may be hasty and incomplete. If the result is that a claim is honored that would have been rejected in the normal contentious process or if the claim is awarded at an amount far higher than merited, then the other creditors of the debtor have suffered unjustified injury. The Vivendi-Electrim arbitration award may have been quite correct, but it was for certain quite large—almost €2 billion. An award so large might just elbow out all the other creditors by its sheer size. If it were twice as large as it should have been if properly defended, then the other creditors are likely to have been severely prejudiced. Of course, I have no view whether the Electrim award was accurate or not nor do I know if the case was well defended. The defense may have been excellent in fact. The point is merely that if the case were not well-defended because of the factors mentioned above, the result would be seriously unjust to a large number of innocent creditors of the debtor.

The risk of flawed adjudication is sufficiently substantial by itself as to justify some control over pending proceedings to avoid these results. That control might be exercised by the local court of the place of arbitration in direct response to notice of the opening of the insolvency proceeding or in response to a request from the foreign insolvency court for assistance in the form of a temporary stay of the arbitration. In appropriate circumstances, the insolvency court should telephone, fax, or mail the local court,27 so that the local court can feel confident in the justice of the request. Given the mutual trust required by the legal structure of the EU,28 the local court would presumably grant such a request almost always. Such a procedure granting a temporary, provisional delay of the arbitration would deal with the first part of the stay question as the case-management problem it really is.

Once the arbitration has been delayed and the insolvency administrator has had a reasonable opportunity to become familiar with the case and to consult with arbitration counsel, the issue that would remain would be whether the restraint of the arbitration proceeding should be lifted and the merits of the claim should be resolved there or in the insolvency court. The proper choice of applicable law determining that point is the third question presented above.

The central point is that a jurisdiction’s choice-of-law decision about arbitration should be closely linked to its policy on recognition and cooperation in insolvency matters. If a country takes a largely territorialist view, with little deference to a foreign insolvency proceeding pending in the debtor’s home country, then its policy of supporting arbitration should probably prevail unless a local insolvency proceeding is filed. On the other hand, if a jurisdiction is

26 See Westbrook, supra note 16.
27 Again, I mean to include first resort to the arbitration tribunal when appropriate. Direct communication between courts and administrators has gone from being unknown to an increasing acceptance as a crucial part of the management of multinational insolvencies. See Principles, supra note 6; Model Law, supra note 6 articles 1525-26; Jay L. Westbrook, *International Judicial Negotiation*, 38 TEX. INT. L.J. 567 (2003).
committed to some significant degree to modified universalism or at least close international cooperation in multinational insolvencies, then the logic of that commitment requires a global approach to claims resolution to the maximum extent possible. If a local court permits arbitration to go forward to an award and enforces that award against local assets, then it has moved away from an international system back to the traditional territorial regime. If it refuses to enforce against local assets and sends the arbitration award claimant to the insolvency court and that court refuses to accept the award as conclusive, the arbitration will have cost everyone concerned much time and money for nothing.

So a court with a commitment to modified universalism in insolvency matters should apply the law of the insolvency court with regard to the proper process for resolving claims or should defer that decision to the insolvency court itself. If a company based in New York enters insolvency, the local court should in most cases adopt the American rule of usually permitting arbitration to go forward (although after a temporary delay as noted above), while in the case of a Warsaw-based company, the local court should halt the arbitration and refer the claimant to the insolvency court.

This conclusion is reinforced by the fact that the debtor prior to insolvency may have entered into more than one arbitration contract calling for arbitration in different jurisdictions, as in the case of Electrim. If local law is applied to resolve the enforceability of the arbitration clause, Electrim demonstrates there will often be disparate results unrelated to the merits of the claims. Only by applying the procedural law of the insolvency court can it be assured that the same process with be applied to similarly situated contract counterparties. Closely related is the fact that parties can choose the place of arbitration and therefore attempt to manipulate the procedural rules governing claims, especially if the debtor company seems financially shaky at the time the contract is written. It is much harder for a counterparty to influence the location of the main insolvency proceeding and therefore the enforceability of the arbitration clause. Finally, and not least important, modern reorganization procedures, which are crucial to preserving value for all creditors in large global insolvencies, require a central oversight and control of insolvency cases. The attempt to rescue a multinational often will not survive a multiplication of procedures across a number of national jurisdictions.

For all these reasons, it seems to me the best rules are that temporary stays of arbitration should routinely be granted upon the insolvency of one party and that the ultimate method of claims resolution should be determined under the law of the insolvency court. Modified universalism has come to be viewed as the most desirable (or the least undesirable) of the possible approaches to multinational insolvencies. The logic of that approach—and the globalization that underlies its appeal—lead almost always to the conclusion that the law of the
main insolvency proceeding should be chosen to govern the various issues that may arise.$^{29}$ Thus it is not surprising that a close analysis leads to the same result here.