Domestic Insolvency and International Commercial Arbitration

A Portuguese Perspective

MASTER IN LAWS DISSERTATION

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TABLE OF CONTENTS

INTRODUCTION

Much has been written on the impact of the insolvency declaration of a party on international arbitration. Thus, the purpose of this dissertation is to assess the impact of an international arbitration and the ensuing award on the pending insolvency proceedings of a party to such international commercial arbitration.

The main concern is the case of a non-secured creditor's claim based on a contractual right, where parties have entered into an arbitration agreement, facing insolvency of its counterparty before or after commencing an international arbitration. Does insolvency have an impact on the jurisdiction of the arbitral tribunal or the award can be rendered anyway? Should the award be deemed to affect the other creditors of the insolvent? Should it be treated as any other foreign decision or does it have features that may entitle it to supersede domestic law, even when confronted with a procedure mainly set upon mandatory rules, such as insolvency? Is the nature and purpose of the insolvency procedure relevant? How should such impact be perceived by the international commercial legal order?

Due to international arbitration nature and derivation, arbitrators may be deemed to have a significant power to influence insolvency proceedings, as they may be granting an advantage to a creditor towards all the others, notably when the arbitral decision entails set-off and netting. However, such advantage must be balanced by the insolvency court, under the principle of equality of treatment of non-secured creditors in insolvency.

Portuguese perspective seems to be particularly interesting for such confrontation, considering the lack of case law regarding this matter, under the current Insolvency Code, in force for the last nine years, and the influence that a decision recently held by the Swiss Federal Supreme Court on a pending arbitration may have in the course of future insolvency cases.

I. Insolvency vs. International Arbitration: differences in nature and goals

Insolvency[1] and arbitration tend to clash with each other as they have diverse perspectives, aiming to solve different problems and conflicting underlying policies[2]. This requires a careful interaction whenever a particular situation poses problems concerning these two points of view, in an international background.

Arbitration is deemed to be the elected technique of alternative dispute resolution whenever international commerce is considered. International trade often opposes parties of different jurisdictions, therefore from different legal environments, who do not easily submit a potential dispute to a particular judicial system of the country of one of the contracting parties or even to a third and neutral country. This choice has much to do with the well-known rigidity of national procedural laws and the difficulty to reach a swift and final decision before domestic courts. Celerity and cost-reduction are cherished values by those who look for a solution in arbitration, trusting that a final judgement is to be held by whom is familiar with the subject-matter of the argument and acquainted with the practices and customs of international commerce.

Hence, **international commercial arbitration** emerges as the most efficient way of settling a dispute regarding issues at the free disposal of the parties, between international trade players. However, it is now submitted to go beyond a simple party autonomy mechanism and to be part of what has been called the *transnational order*, an autonomous body of principles and rules of international

[1] The term *insolvency* shall be used broadly as a synonym of *bankruptcy*, *liquidation*, *administration* and *reorganization proceedings*.

[2] V LAZIC, 'Arbitration and Insolvency Proceedings: Claims of Ordinary Bankruptcy Creditors', in *Electronic Journal of Comparative Law*, 1999, pp. 3ff, available at http://www.ejcl.org/33/abs33-2.html

commerce, detached from any particular national legal system or any specific State law and much based in customary law and fundamental principles.[3]

International arbitration, rooted in such transnational order, is denationalized and delocalised. The arbitration clause actually places international arbitration in the transnational legal order, from which it derives its recognition and power. As a consequence, also arbitrators' authority and the award itself derive from such order. Transnational law features like the *severability of the arbitration agreement* and *Kompetenz-kompetenz* confirm such position.[4] According to the *doctrine of severability or segregation of the arbitration agreement*, even though the contract may be invalid, the arbitration agreement therein inserted stands alone for its validity and effectiveness. In turn, under *kompetenz-kompetenz* principle the arbitral tribunal is to decide on its own jurisdiction, assuming first that it has standing to make such assessment, thus entailing the idea that the jurisdiction of arbitral tribunal is decided by the arbitrators themselves.[5]

International arbitration is therefore structured upon three pillars: *(i)* the l*ex arbitri* – the law that governs the arbitration, which in a rather traditionalist perspective tends to be the national law of the seat of arbitration, *(ii)* the *lex contractus*, the governing or substantive law, which does not necessarily have to be a particular national system of law, but may refer to public international law or to a blend of

[3] J DALHUISEN, *Dalhuisen on Transnational Comparative Commercial, Financial and Trade Law*, Vol. 1, Hart Pub., 2010, p. 42ff; L LIMA PINHEIRO, in *Arbitragem Transnacional. A Determinação do Estatuto de Arbitragem*, Almedina, Coimbra, 2005, pp. 375ff.

[4] DALHUISEN, *Dalhuisen on Transnational Comparative Commercial, Financial and Trade Law*, pp. 45ff, and *id.*,'The Sources of the Modern Transnational *Lex Mercatoria*', 'The Modern *Lex Mercatoria* and its Dynamism' and 'The Modern *Lex Mercatoria* and International Arbitration' available at http://opiniojuris.org/

[5] N BLACKABY/C PARTASIDES/A REDFERN/M HUNTER, *Redfern and Hunter on International Arbitration*, Oxford, 5th Ed, 2009, pp. 344ff.

both or to rules known as 'international trade law', 'transnational law' or 'the modern law merchant' – the so-called *modern lex mercatoria*[6], and *(iii)* the system of recognition an enforcement of international arbitral awards, backed up by the *1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, the 'New York Convention', which we shall address later on.

On the other hand, **insolvency** is set upon a completely different scenario. Insolvency is in essence territorial, shaped by the sovereignty aspect of the relevant State. Its main legal regime is found in local regulatory law, guided by its vocation to a universal summoning of the insolvent's creditors and aimed to set forth the ranking of creditors and distribution among them. The underlying rationale of its legal regime is based on its public interest function – pay to the insolvent creditors and either reorganize or eliminate the insolvent entity from the market. This public policy quest for market efficiency translates into the main engine of the proceedings, ultimately guided by the creditors' best interests, the protection of the debtor or the preservation of employment, depending on the prevailing domestic policy purpose.[7]

Insolvency legal regimes usually provide for a certain limitation of rights of the debtor and its creditors in order to pursue its purpose. Exclusive jurisdiction of state courts, mandatory provisions (both substantive and procedural) affecting the insolvent party's assets and ruling the status and conduct of the insolvent party, of the creditors and of the trustee, a high degree of state control, dispossession procedures, mandatory stay of pending proceedings and centralisation of credits are some of the typical characteristics of insolvency laws.[8]

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[6] DALHUISEN, *Dalhuisen on Transnational Comparative Commercial, Financial and Trade Law*; LIMA PINHEIRO, *op. cit.*, pp. 383ff.

[7] LAZIC, *op. cit.*, p. 3

[8] D BAIZEAU, 'Arbitration and Insolvency: Issues of Applicable Law', in *New Developments in International Commercial Arbitration*, Müller/Rigozzi Eds., Schultess, 2009, p. 98; G YANG,

Insolvency proceedings are therefore generally ruled by mandatory provisions, leaving less room to party autonomy, which nonetheless may be called upon in a recovery or reorganization scenario, where in some circumstances creditors are allowed to dictate the restructure of the bankrupted company, as well as the terms and conditions of payment plans to creditors.

In this vein, values like the equality of unsecured creditors and protection against individual enforcement become fundamental insolvency principles, which in some jurisdictions may even rise up to public policy order elements, as we shall see later on.

II. Comparative Law overview

a. Universality *v.* Territoriality

The interplay between insolvency and international arbitration leads to different solutions enacted by each national law.

In order to understand how these two fields of law cope with each other, we should bear in mind whether and to what extent a given national legal order recognizes an insolvency declared in a different jurisdiction. In this regard, one

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Insolvency Proceedings and Their Effect on International Commercial Arbitration, LL.M. Thesis, University of Ghent, p. 2, available at http://lib.ugent.be/fulltxt/RUG01/001/892/212/RUG01-001892212_2012_0001_AC.pdf; M ROBERTSON, *Cross-Border Insolvency and International Commercial Arbitration, Characterisation and choice of law issues in light of Elektrim S.A. (in bankruptcy) v Vivendi SA*, 2009, Bucerius Law School MLB Thesis, p. 2ff, available at http://www.robertsonarbitration.com/uploads/1/2/0/0/12008821/markrobertson_masterthesis_crossborderinsolvencyica.pdf

could distinguish between *universal* and *territorial* in what concerns the approach taken by each legal order *vis-à-vis* a foreign insolvency.

Under the *principle of universality*, the *lex concursus* considers itself to have extraterritorial effects and demands recognition in any other jurisdiction, thus a third country would generally recognize such foreign insolvency. Ideally this would mean that in nowadays globalized reality, an insolvency declaration would have its effects accepted and recognized throughout the world and distribution amongst creditors would be equally made in *a single* procedure, either through liquidation or reorganization.

Given the difficulties to achieve such a uniform method, by virtue of national laws obstacles, a notion of *modified universalism* has achieved considerable support, the main idea being to favour a choice of law according to which the applicable law is the law of the *lex concursus*.[9]

This is the case in the EU, due to the European Insolvency Regulation[10], which purpose is to deal with diversity of insolvency laws amongst Member States. Thus, whenever insolvency is declared in a particular Member State, such declaration and its effects are expected to be acknowledged by all other EU jurisdictions, particularly in what concerns the assets of the insolvent.

Chapter 15 of the US Bankruptcy Code also seems to follow this path. It is intended *to provide effective mechanisms for dealing with cases of cross-border*

[9] J L WESTBROOK, 'International Arbitration and Multinational Insolvency', in *29 Penn State International Law Review* 635, 2011, p. 643, available at http://www.iiiglobal.org/component/jdownloads/finish/649/5794.html

[10] Council Regulation (EC) N. 1346/2000 of 29 May 2000 on insolvency proceedings, in *Official Journal* L 160, 30/06/2000, in force since May 31, 2002.

insolvency and therefore provides the legal framework by which US Courts are available to companies involved in insolvency proceedings outside the US.[11]

On the other hand, under a *territorial* approach, insolvency declared abroad and its effects will not be automatically acknowledged. They will entirely depend on the policy of the country where recognition is sought. Chinese[12] and Swiss[13] law could be pointed out as examples of this approach.

Although different approaches may be taken by national statutory laws, insolvency is essentially territorial and any related extraterritorial effects ultimately depend on the recognizing court, rather than on a universality concept, which, in practice, may prove to be not very helpful. Thus, as we shall see, even under the European Insolvency Regulation, different interpretations of the many important exceptions[14] it comprises, intended to cope with regulatory matters within its conflict of law rules model, may actually circumvent such *universalist* purpose.

b. Effects of insolvency in the arbitration: key-issues under discussion

It is commonly acknowledged that times of global economic and financial crisis usually bring about an increasing number of companies declared to be in an insolvency status, either submitted to liquidation or reorganization proceedings.

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[11] G H GLINE/J GEISENHEIMER, 'Constraints on Stay Relief Afforded to Chapter 15 Debtors', *ABI Committee News*, International Committee vol. 7, n. 6, 2010, available at http://www.abiworld.org/committees/newsletters/international/vol7num6/constraints.html

[12] P K WAGNER, 'When International Insolvency Law meets International Arbitration', in *Dispute Resolution International*, vol. 3, n. 1, 2009, p. 66, available at http://www.weitnauer.net/uploads/downloads/aufsaetze/Wagner_article.pdf

[13] BAIZEAU, *op. cit.*, p. 104

[14] Notably arts. 4, 5-15, 17-18 and 27-28; WESTBROOK, *op. cit.*

Paying attention to that phenomenon, legal writings, often driven by case law, show a growing concern and interest for the impact that such insolvency declaration may have where pertaining to a party to an international arbitration.

The discussion has focused on some **key-issues**, such as the application of overriding imperative rules by the arbitral tribunal, the relevance of the seat of arbitration and of the country where insolvency was declared; the conduct of the arbitral proceedings and the guarantee of due process; the effect of the insolvency on the arbitration agreement and the jurisdiction of the arbitral tribunal; the capacity or standing of the insolvent to be a party to the arbitration; the contents of the arbitral award and the importance of the place of enforcement. Some of these topics shall be now briefly discussed.

i. Overriding mandatory rules or lois d'application immediate

At the heart of the debate is the understanding that some principles and rules of a given national law (including core insolvency provisions) may be considered overriding mandatory or even regulatory rules, sometimes qualified in its own country as part of its domestic and international public policy – *lois de police* or *lois d'application immediate*.[15] Being so, in their own perspective and although other countries may not accept them as such and therefore deny its application, such rules would be provided with an extraterritorial effect, impinging on the ruling of the contract irrespective of its governing law.

If such rules are ignored by the arbitral tribunal, when deciding the dispute, recognition/enforcement of the ensuing award may be refused if sought in a country where such rules are deemed to be of immediate application, with

[15] BAIZEAU, *op. cit.*, p.100

grounds on the violation of the country's public policy, although it could still be recognized and enforced elsewhere, *e.g.*, where the debtor has assets.

Thus, public order issues should be taken into account by the arbitral tribunal when judging the cause. In fact, 'it is generally accepted that the public policy and mandatory provisions of the *lex causae* should be applied by arbitral tribunals'.[16] Arbitrators should keep to the facts and claim presented by the parties, unless overriding principles and rules or interventionist norms which are not part of the *lex contractus* need to be brought in and contemplated to decide the dispute. These overriding notions of *negative* public policy, which work as a correction factor, may refer to ethics, fraud, corruption, competition law or regulatory law, for instance. In this vein, 'arbitrators may take into account any other mandatory law having a close connection with the subject matter of the dispute, particularly where a disregard of such law would lead to a result contrary to international public policy'.[17] Furthermore, placing international arbitration within a transnational legal order, as discussed above, may by virtue of the progressive concept of a truly *transnational legal order* entail limits to the result to which the applicable law would lead to, when such result contradicts fundamental rules and principles of public international law, deriving from several international sources and common to many national States and 'civilized nations'.[18]

International arbitrators still tied up to the moorings of the seat of arbitration, seem to be quite aware of the particular risk of having the award annulled whenever insolvency matters are at stake, especially when the seat is in the

[16] BAIZEAU, *op. cit.*, p. 99.

[17] J POUDRET/S BESSON, *Comparative Law of International Arbitration*, Sweet & Maxwell, London, 2007, p. 610.

[18] LIMA PINHEIRO, *op. cit.*, pp. 265ff, 472ff; F TREZZINI, 'The Challenge of Arbitral Awards for Breach of Public Policy according to Art. 190, para. 2 lit. e) of the Swiss Private International Law', in *Three Essays on International Commercial Arbitration*, ADV, Lugano, 2003, pp. 130ff.

country where insolvency was primarily ordered. Again, bearing in mind international arbitration position in the transnational legal order, it is clear that arbitrators do not have nationalities and should not know boundaries. They should have no seat of their own. Yet it is arbitrators' duty to produce a final and enforceable award. It is thus desirable that particular attention is paid to the international public policy of the country where insolvency proceedings were lodged or to which the subject-matter of the dispute has a close connection, for instance where the defendant has assets[19]– not because it may happen to be the country of the seat, but because it is highly probable that such turns out to be the first, if not only, place of the enforcement of the award.

International arbitrators should not pay deference to the law of the seat, except for the support-role the jurisdiction of the seat may have to the arbitration or if an issue of international public policy of the country of the seat becomes pertinent.[20] Such deference should thus go to a *minimum* international standard of public policy.[21] As for the application of national rules, '*d'application immediate*' or insolvency law, it is up to arbitrators to decide insofar should they be relevant or even if they qualify as regulatory rules that must be observed to decide the matter.

ii. Due process and stay of the arbitral proceedings

The guarantee of **due process** is also an issue thoroughly discussed whenever arbitration faces insolvency of one of the parties. One of the most common procedural consequences of the declaration of insolvency of a party to a pending arbitration proceeding is to have the insolvent substituted in such proceedings by

[19] POUDRET/BESSON, *op. cit.*, p. 610.

[20] DALHUISEN, 'The Modern *Lex Mercatoria* and International Arbitration'.

[21] LIMA PINHEIRO, *op. cit.*, pp. 469ff

the new representative appointed within the insolvency – the *Liquidator*, *Trustee*, *Official Receiver* or *Insolvency Administrator*.

On the other hand, should the arbitration commence *after* the declaration of insolvency it seems clear that the *Notice* or *Request for Arbitration* must be addressed to the appointed Administrator,[22] as the insolvent representative.[23]

National legislation frequently provides that the Administrator has the power to decide whether he or she will participate in the arbitration proceedings. Yet whether the Administrator actually participates or not has no influence on the jurisdiction of the arbitral tribunal. In some circumstances, even if the Administrator refuses such participation, the counterparty may still be able to enforce the arbitration award against the insolvent, at least in third countries. Consequently, a potential claimant could initiate arbitral proceedings against a respondent in administration or a respondent may file a counter-claim against the insolvent claimant, even without the Administrator's consent. Such arbitration would constitute default proceedings – where one of the parties fails to participate – and would be more vulnerable to sanction based on the violation of due process, which usually qualifies as an infringement of international public policy.[24]

Together with such legal provision, many insolvency statutes establish **a stay of ordinary pending proceedings**, in order to assure that the Administrator is provided with an opportunity to participate, becomes acquainted with the terms of the process and eventually files or reviews its defence. It has been accepted that such effect should also apply to arbitration. Failure to fulfil these requirements may become very important to demonstrate that both parties did not had equal

[22] The term 'Administrator' shall be used hereinafter as a synonym of the referred expressions.

[23] S WALKER/A GARCIA, 'Insolvency in international arbitration: a growing concern', available at www.twobirds.com/English/News/Articles/Pages/Insolvency_international_arbitration.Aspx

[24] *ibid*.

opportunities to be heard by the arbitral tribunal and that in general due process was not followed, which may sustain an annulment claim of the award before the courts of the seat of the arbitration or ultimately qualify as a ground for the refusal of the recognition of the award, when sought before the enforcement courts, pursuant to article V(b) of the New York Convention.

Despite the different solutions adopted throughout national legal orders, the stay of the arbitral proceedings seems to collect the majority of the answers to the problem emerging from a declaration of insolvency when arbitration has already been launched[25], even when there are no specific legal provisions referring to arbitration.[26] Generally, actions aimed for the collection of debts are prevented from continuation or commencement as of the date of the insolvency liquidation opening. Any claim of an unsecured creditor for payment against the estate, including enforcement claims, may only be pursued by filing in insolvency.[27]

In England and Wales, rules governing the stay of court proceedings are deemed to be applicable to arbitration.[28] The *principle of the preclusion of individual action* by creditors is inserted in the 1986 English Insolvency Act with respect to corporate liquidation or winding-up by the courts, as well as in the case of administration proceedings.[29]

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[25] BAIZEAU, *op. cit.*, p.101

[26] V LAZIC, 'Cross-border Insolvency and Arbitration. Which consequences of Insolvency proceedings should be given effect in Arbitration?', in *Liber Amicorum Eric Bergsten, International Arbitration and International Commercial Law: Synergy, Convergence and Evolution*, Kröll/Mistelis/Perales/Viscasillas /Rogers Eds., Kluwer Law International, 2011, p. 352

[27] *ibid.*, p. 340

[28] POUDRET/BESSON, *op. cit.*, p. 505

[29] LAZIC, 'Cross-border Insolvency and Arbitration', p. 351

In Germany, the arbitral tribunal must allow the Administrator, as the successor of the insolvent, sufficient time to prepare its defence, which may in practice lead to a stay of the proceedings.[30] The opening of proceedings establishes a prohibition of individual compulsory enforcement, meaning that the insolvency creditors cannot, for the duration of the proceedings, enforce either upon the insolvency assets or upon the debtor's available assets. The insolvency creditors shall only be permitted to enforce their claims under the provisions governing the insolvency proceedings.[31]

In Switzerland, authors are divided regarding a mandatory stay of the arbitral proceedings upon a party's insolvency. The relevant provision of Swiss law is article 207 of the Debt Collection and Insolvency Act, under which civil court proceedings to which the debtor is a party are stayed (*ex lege*) when one party is declared insolvent. The question is to consider if said provision should be applied to international arbitral proceedings as well. The majority of commentators, though, is against a mandatory stay of the arbitral proceedings and considers that such provision is not part of public policy. Furthermore it is submitted that the rule's purpose is fulfilled if the insolvency administrator is provided with the opportunity to be acquainted with the case and to assess the overall situation in order to be able to make the necessary decisions. [32]

[30] POUDRET/BESSON, *op. cit.*, p. 505

[31] Section 87 *Insolvenzordnung*, available at http://www.gesetze-im-internet.de/inso/index.html.

[32] POUDRET/BESSON, *op. cit.*, p. 505; G NATER-BASS/O MOSIMANN, 'Effects of Foreign Bankruptcy on International Arbitration', p. 176, available at http://www.homburger.ch/fileadmin/publications/BANKRUPT.pdf

French Code of Civil Procedure contains an express provision on the interruption of arbitral domestic proceedings[33], when reorganisation or bankruptcy liquidation has been opened.[34] Also, under French law all individual claims enforced against real estate and movable assets of the debtor, as well as all legal actions aiming for payment against the debtor are suspended.[35] This provision is deemed to be a part of national and international public policy (*ordre public*).[36]

In the Netherlands, after the declaration of insolvency, any claim against the debtor for payment out of the estate can only be asserted in the verification procedure. Pending domestic arbitral proceedings shall be suspended with the opening of the insolvency. Although not univocally, since there are dissident opinions in legal writings and case law, this provision has been deemed not to exclude or prevent the continuation of pending arbitrations under Dutch law, i.e., such proceedings may be resumed if the claim is disputed in the verification procedure, either by the trustee or by another creditor, as it occurs with court proceedings.[37]

Similar provisions can be found in other legal European orders as in Austria, Belgium and Italy.[38]

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[33] Art. 1471 which remits to arts. 369 to 362 of *Code de Procédure Civile*, available at http://www.legifrance.gouv.fr/affichCode.do;jsessionid=CF341466BA543976AF3255D6E45FEB34.tpdjo13v_2?cidTexte=LEGITEXT000006070716&dateTexte=20130604

[34] LAZIC, 'Cross-border Insolvency and Arbitration', p. 352.

[35] As per art. L622-21 § 2 *Code de Commerce*, cf. LAZIC 'Cross-border Insolvency and Arbitration', p.350 ft. 30.

[36] LAZIC, *ibid.*; NATER-BASS/MOSIMANN, *op. cit*, p. 177.

[37] Pursuant to arts. 26 and 29 of Dutch Insolvency Act (*Faillissementswet*); cf. LAZIC, *ibid.*, p. 351 ft. 35, and 'Arbitration and Insolvency Proceedings', p. 15, ft. 84.

[38] LAZIC, 'Cross-border Insolvency and Arbitration', p. 351.

As for the United States, the *Bankruptcy Code* provides for a broad stay of all lawsuits and arbitrations, at least temporarily, unless the court allows them to proceed.[39] Unlike the relevant provisions of the insolvency statutes in France and in the Netherlands, the US automatic stay can, in theory, cease by the decision of the court having jurisdiction in bankruptcy or upon a certain period of time.[40] All claims against the insolvent are to be filed before the insolvency court. The filing of a petition under the Code, 'operates as a stay, applicable to all entities' for actions taken against the insolvent, including commencing or continuing a legal or administrative proceeding, attempts to enforce judgments against a debtor or its property or attempts to collect or recover a claim against the debtor. After filing such a petition for relief, almost all claims against the insolvent are prevented from being executed and prosecuted.[41] The stay comes into effect immediately upon filing a petition, without further application for relief.[42] *The automatic stay is one of the fundamental protections given to a debtor and the estate by the bankruptcy laws. It operates as protection for creditors as well, providing for their equal treatment in an orderly manner*.[43]

iii. Locus standi or legal capacity?

The procedural matter concerning the representation of the insolvent, usually referred as ***locus standi***, and its ability to participate in arbitration has been many times misunderstood and framed as a question of (lack of) **capacity of the insolvent** to be a party to the arbitration.

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[39] Section §362(a); WESTBROOK, *op. cit.*, p. 639, ft. 14

[40] Section §362(e); LAZIC, 'Arbitration and Insolvency Proceedings', p. 15.

[41] The only exceptions are those actions expressly exempted under Section §362(b).

[42] GLINE/GEISENHEIMER, *op. cit.*

[43] LAZIC, 'Cross-border Insolvency and Arbitration', p. 350.

In fact, one of the most important consequences of entering into insolvency proceedings is that the insolvent loses its ability to freely dispose of its estate. The extent of such limitation of the right to manage and dispose of its assets may vary according to the applicable insolvency law, but usually includes the possibility to proceed with or defend legal actions brought against it. However, as previously mentioned, such limitations provided by national law have territorial effect only. The powers of the insolvent over assets of its estate located in other countries will depend on the law of such third jurisdictions. Until insolvency is recognized and its effects accepted, the insolvent retains full capacity regarding such assets.

Disposal powers are usually transferred to the Administrator, who is the appointed entity to govern the estate and represent the insolvent thereon. For instance, Chinese insolvency law expressly provides that the Administrator is the one who should participate in legal actions, arbitrations or any other legal procedures on behalf of the insolvent.[44] Under US insolvency law, upon insolvency order, the *trustee* becomes the representative of the estate and has capacity to sue and be sued.[45]

Some disposal powers may however be subject to a prior approval from the creditors' assembly or committee or from the Court. Under Portuguese insolvency law, for example, the *insolvency administrator* acts as the legal representative of the insolvent, but cannot sell specific assets of the estate without a previous approval from the creditors committee.[46] Also, under English insolvency law, subject to prior permission of the creditors' committee or the court, the trustee may carry on any business of the bankrupt so far as may be necessary for winding it up, bring, institute or defend any legal action or legal proceedings relating to the

[44] YANG, *op. cit.*

[45] Section 323 US Code.

[46] Arts. 55, 81, 82 and 161 of the Portuguese Insolvency Code.

property comprised in the bankrupt's estate. In a company winding-up proceeding, the *liquidator* is entitled to bring or defend any legal action on behalf of or against the estate, without sanction of the court or the liquidation committee in voluntary winding-up, whereas in compulsory winding-up by the court, with such sanction.[47]

The discussion around the **legal capacity of the insolvent** to be a party to the arbitration was thoroughly debated in light of the *Vivendi vs. Elektrim* cases, which became paramount examples of the importance of the choice of applicable law in international arbitration.

The *Vivendi* cases[48] emerged from a dispute between *Vivendi Universal S.A.* and *Vivendi Telecom S.A.*, both French companies ('*Vivendi'*), and *Elektrim*, a Polish company, regarding the purchase of shares of a Polish mobile telephone company (*Polska Telephoia Cyfrowa*) by the former. The agreement under discussion – *Third Investment Agreement* – was entered into in 2001 and contained an arbitration clause providing for arbitration in London, according to the Arbitration Rules of the London Court of International Arbitration (LCIA).

By filing a claim for breach of the agreement in an amount of € 1.9 billion, *Vivendi* commenced arbitration in London, in 2003.

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[47] Section 314(1)(a) and Part I Sched.5 (1 and 2), Section 314(1)(b) and Part II Sched. 5(9A) and Sections 165 and 167 and Parts I and II of Sched. 4 of the Insolvency Act 1986.

[48] See, among others, BAIZEAU, *op. cit.*, p.113, and 'Compétence de l´Arbrite et Faillite à la Lumiére des Arrêts Anglais et Suisse dans l'Affaire Vivendi c/ Elektrim', *Les Cahiers de l'Arbitrage* 2009/3, available at http://www.chaffetzlindsey.com/wp-content/uploads/2009/12/00013089.PDF; NATER-BASS/ MOSIMANN, *op. cit.*; LAZIC, 'Cross-border Insolvency and Arbitration', p. 338ff; ROBERTSON, *op. cit.*; WESTBROOK, *op. cit.*.

In March 2006, *Vivendi* and *Elektrim*, among others, entered into a *settlement agreement*, which included an arbitral agreement referring any disputes to a tribunal to be constituted under the rules of the International Chamber of Commerce ('ICC'), with seat in Geneva, Switzerland.

Vivendi alleged a breach of the *settlement agreement* and commenced the Swiss arbitration proceedings in April 2006. *Elektrim* filed its defence claiming that it had been declared insolvent by the Warsaw District Court in August 2007 and that, as a consequence, pursuant to article 142 of the Polish insolvency law, it had lost its legal capacity to be a party to the arbitration, either by itself or through the appointed Administrator, Mr. Josef Syska.

According to the translation agreed upon between the parties, article 142 of the Polish insolvency law states that '*any arbitration clause concluded by the bankrupt shall lose its legal effect as at the date insolvency is declared and any pending arbitration proceedings shall be discontinued*.'

1. The Swiss *Vivendi* case

The arbitral tribunal considered that Polish law governed the effect of the insolvency in *Elektrim*'s capacity to be a party in the arbitration and concluded that, pursuant to the referred legal provision, it had no jurisdiction to decide the matter. *Vivendi* sought for the annulment of the arbitral tribunal's interim award on jurisdiction before the Swiss courts, but in March 2009 the Swiss Federal Supreme Court confirmed the arbitral tribunal's decision declining jurisdiction with respect to *Elektrim*[49].

[49] Case n. 4A_428/2008, available at the website of the Swiss Federal Supreme Court (www.bger.ch).

In summary, the Swiss Federal Supreme Court held that the Swiss Federal Act on Private International Law[50] (SPILA) contains a specific provision on the capacity to be a party to an arbitration (*capacité d'être partie a un arbitrage*), but only applicable to State entities, which provides that they may not invoke its own law to contest the arbitrability of a dispute or their capacity to be subject to an arbitration.[51] Thus, when considering a private entity, such capacity depends on the law applicable according to the relevant conflict of law rules, which in what regards a company refers to the law of the State under which it is organized.[52] Since *Elektrim* was a Polish company, its capacity to be a party to the arbitration should be governed by Polish law. According to the Swiss Federal Supreme Court, the application of Polish law led to the application of article 142 of Polish insolvency law which was deemed to deprive a Polish insolvent party of its capacity to continue with a pending arbitration. Consequently, according to the Swiss Federal Supreme Court, *Elektrim* had lost its capacity to be a party to arbitral proceedings.

2. Revisiting Vivendi's reasoning

In a recent case, however, the Swiss Federal Supreme Court had the chance to revisit this theme and shed light on the rather criticized reasoning held in *Vivendi*.[53]

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[50] Available at http://www.admin.ch/opc/fr/classified-compilation/19870312/index.html#a154

[51] Art. 177(2) SPILA.

[52] Art. 154 (1) and 155 (c) SPILA.

[53] F SPOORENBERG/D FRANCHINI, 'Bankruptcy No Restriction to Arbitration Unless It Exclude's Bankrupt's Legal Capacity', ILO, 2012; N VOSER/A GEORGE, ' Insolvency and arbitration: Swiss Supreme Court revisits its Vivendi vs. Elektrim decision', Kluwer Arbitration Blog, 2012, available at http://kluwerarbitrationblog.com/blog/2012/12/05/insolvency-and-arbitration-swiss-supreme-court-revisits-its-vivendi-vs-elektrim-decision/; N VOSER/J MENZ/E FISCHER/S WITTMER, 'Switzerland: arbitration round-up 2012', PLC, 2013, available at http://arbitration.practicallaw.com/8-523-8286?source=relatedcontent;

In August 2010, a Chinese company started arbitration proceedings in Geneva, under ICC rules, against a Portuguese company that had been declared insolvent a year before. The Portuguese Administrator argued that the arbitral tribunal lacked jurisdiction to settle the dispute, since the respondent had been declared insolvent in August 2009.

In its defence, the Portuguese insolvent company invoked a particular provision, article 87[54] of the Portuguese Insolvency and Recuperation of Companies Code ('PIC'), which allegedly would have caused the suspension of the efficacy of the arbitration agreement to which the insolvent was a party. In an interim award rendered in November 2011, the arbitral tribunal held that it had jurisdiction to decide the dispute at hand.

The respondent challenged the award before the Swiss Federal Supreme Court, which, in a decision rendered in October 2012[55], upheld the arbitral tribunal's finding that the referred legal provision did not apply to the subject of the dispute.

In fact, the Swiss Federal Supreme Court considered that a Portuguese insolvency estate remains a holder of rights and obligations, i.e., enjoys legal personality, until its full liquidation. Consequently, it also has legal capacity to participate in an arbitration under Chapter 12 of SPILA[56]. Even if some kind of "lack of capacity to intervene in arbitrations" could be derived from article 87(1) PIC for future (Portuguese) arbitrations, this would be irrelevant to the capacity to be a

[54] See Section IV below.

[55] Case n. 4A_50/2012, available at www.bger.ch; a translation into English is available at http://www.josemigueljudice-arbitration.com/xms/files/02_TEXTOS_ARBITRAGEM/06_decisoes_judiciais_sobre_arbitragem/suica_arb_e_insolvencia_16_octobre_2012_4A_50_2012.pdf

[56] Which refers to International Arbitration.

party according to the Swiss *lex arbitri*, provided that the insolvent has legal personality, which was undisputed in the case (§3.4.2). Therefore, according to the Swiss *lex arbitri*, article 87(1) PIC regulates one aspect of the substantive validity of the arbitration agreement that must be assessed in light of article 178(2) SPILA, which states that an arbitration agreement is valid if it complies with the law chosen by the parties, the law governing the dispute or with Swiss law. In any case, under Swiss law, insolvency does not affect the validity of an arbitration agreement, which is why article 87(1) PIC does not deprive the arbitration clause of its efficacy (§3.6).

Responding to the appellant's argument, according to which the *Vivendi* case reasoning should be mirrored in the case under discussion, the Court enlightened that the *Vivendi* judgment should be assessed in the specific context of Polish law and of the doctrine developed thereunder, which was expressed in the legal opinions of the Polish law professors. It could neither be generalized, nor the conclusions withdrawn therein, as to Polish law, extended to other legal orders. In particular, it cannot be inferred from the fact that article 142 of the Polish insolvency law contains no explicit reference to the legal capacity or to the capacity to be a party, that Portuguese article 87 PIC should be interpreted in the same way, despite any resemblances in the wording of both provisions, particularly when such an interpretation does not result from Portuguese case law or legal writings, as the arbitral tribunal considered proved (§3.5.3).

The underlying reasoning of the Swiss chapter in *Vivendi* has become now much clearer after the quoted 2012 decision. The arbitral tribunal and the Swiss court's judgements were determined by the framing that the parties gave to the issue – thus, the importance of the parties' allegation. In fact, pleading that the respondent lacked legal capacity to participate in the arbitration triggered the path for arbitrators and judges, who felt compelled to apply the law of the place of incorporation in what concerns an insolvent company legal capacity, mixing a

pure matter of insolvency law with a corporate law issue. When recently reviewing its own judgement, the Swiss Federal Supreme Court led us to conclude that the only reason why the decision in *Vivendi* resulted in the confirmation that *Elektrim* had lost its capacity to be a party in the arbitration was that, according to Polish scholars, this *was deemed to be* the correct interpretation to be drawn out of article 142 of the Polish insolvency law, despite the fact that its wording does not specifically refer to *legal capacity*. Moreover, by deciding as it did, the Court actually acknowledged the Polish insolvency law provision with an *extraterritorial effect* that it did not had, considering that *Elektrim*'s insolvency had not been recognised in Switzerland and therefore the effects of such insolvency could only be argued in Poland and in third countries that would have accepted it under their own law.

On the other hand, confronted with a similar Portuguese legal provision, the same Court was convinced that the legal capacity of the insolvent company was left untouched and that no legal Portuguese provision, case law or doctrine pointed to a different conclusion. The Swiss Federal Supreme Court confirmed that *subjective arbitrability* in an international arbitration proceeding with a seat in Switzerland should be decided pursuant to the conflict rules of Swiss law, the *lex arbitri*. Under such provisions, corporations are governed by the law of the State in which they are incorporated. As a result, the Court ruled that where a foreign entity has legal personality under its constitutive law, it has the capacity to act in an international arbitral proceedings with seat in Switzerland. Furthermore, the Court confirmed that even if article 87 PIC would prevent a Portuguese insolvency estate to act as a party in a Portuguese arbitral proceedings, this would be without influence on an international arbitral proceedings in Switzerland. According to the Court, in Switzerland, it is only important that national law affords legal personality to the insolvent and thus that it may have rights and liabilities. The Court found that there are several provisions in Portuguese law from which it is possible to conclude that the Portuguese insolvency estate has

rights and liabilities (thus, legal personality) until its liquidation is completed, therefore also being legally capable of participating in arbitration, under chapter 12 SPILA. In particular the Court noted that it results from article 87(2) PIC, pursuant to which arbitral proceedings which are pending at the moment of the declaration of insolvency shall proceed, that an insolvency estate's capacity to act is itself not affected by Portuguese law in an already pending arbitral proceedings (§3.4.2). As a result, the Court correctly concluded that the declaration of insolvency did not prevent the insolvent from participating in an arbitration in Switzerland.

3. The English Vivendi case

In the English *Vivendi* case, *Elektrim* did not raise the issue of its alleged lack of capacity and rather challenged the jurisdiction of the arbitral tribunal, again based on article 142 of the Polish insolvency law. Because of that, the choice of the applicable law was different and the ultimate result was the opposite.[57]

In March 2008, the English arbitral tribunal considering that both the arbitration and the insolvency proceedings were pending in two different EU Member States applied the European Insolvency Regulation ('Regulation'), which deals with proceedings being conducted in one EU Member State, while insolvency proceedings involving one of the parties to the arbitration agreement has been opened in another Member State. The arbitral tribunal further considered that, pursuant to the Regulation, English law was to be applied and overruled *Elektrim*'s insolvency administrator application, considering that it had jurisdiction to settle the dispute. The High Court confirmed the award's

[57] BAIZEAU, *op. cit.*, p. 115

conclusions in October 2008, which were upheld by the Court of Appeal, in July 2009[58].

In determining the law that should govern the consequences of the insolvency declared in one Member State, insofar as they affect the arbitration pending in another Member State, the Court of Appeal particularly contemplated the provisions contained in articles 4 and 15 of the Regulation. In what matters for the case at hand, the referred provisions provide that *the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened*, notably on *current contracts to which the debtor is party* and on *proceedings brought by individual creditors, with the exception of lawsuits pending.*[59]

The *effects of insolvency proceedings on lawsuits pending* are addressed in article 15:

> '*The effects of insolvency proceedings on a lawsuit pending concerning an asset or 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.'*

The Court of Appeal interpreted this rules' intersection in light of the Regulation's purpose and concluded that '*if litigation or arbitration has begun before insolvency occurs the natural expectation of businesses would be that it should be that law* [of that Member State where the legal action has begun or the reference to arbitration is taking place] *that should determine whether the proceedings should continue or come to a shuddering halt.'*

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[58] *Syska & Anor v Vivendi Universal S.A. & Or*, 2009, EWCA Civ 677, available at http://www.bailii.org/ew/cases/EWCA/Civ/2009/677.html

[59] Arts. 4(1) and 4(2)(e) and (f)

As a result, the Court of Appeal confirmed that the expression *lawsuit pending* in article 15 comprises pending arbitral proceedings. Also, although an arbitration agreement may be considered a *current contract*, as far as it relates to future, non-pending arbitral proceedings, and to that extent governed by the *lex concursus*, in relation to existing, pending arbitral proceedings, the particular rule of pending lawsuits applies and, pursuant to article 4(2)(f) and article 15, the law of the State where such proceedings are pending shall govern.[60]

Consequently, in the case under analysis, English and not Polish law applied. Pursuant to English law the arbitral tribunal had jurisdiction to hear the case and the insolvency did not affect the course of arbitration. In conclusion, the Court of Appeal considered that the arbitrators came to the correct conclusion and the High Court was correct to decline to set aside their award.

This case has revealed the importance of the Regulation whenever arbitration comes across insolvency within the EU territory. When *Vivendi* decided to enforce the final arbitral decision against *Elektrim*'s estate in Poland, the Polish Court refused to enforce the damages awarded at first. However, the decision was overturned by the Warsaw Court of Appeal, granting recognition and enforcement to the LCIA award. In sum, the Court considered that the scope of article 15 of the Regulation was broad enough to cover arbitration proceedings and that no violation of public policy would be committed with the recognition of an award rendered against a Polish insolvent company in a country where the law allows for continuation of arbitration.[61]

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[60] BAIZEAU, *op. cit.*, p.110

[61] NATER-BASS/MOSIMANN, *op. cit.*, p. 168; LAZIC, 'Cross-border Insolvency and Arbitration', p. 360; A FARREN/S NADEAU-SEGUIN, 'Enforcement of the LCIA Award in *Elektrim v Vivendi*', available at http://arbitration.practicallaw.com/9-501-0419#.

In conclusion, from an international arbitration perspective, insolvency does not trigger a problem of incapacity of the party, especially when the insolvency order was not recognized at the country of the seat. It rather poses a challenge to observe due process guarantee, as in most of the cases it may entail the substitution of the insolvent by its Administrator, who will ultimately decide to participate or not, without affecting the jurisdiction of the tribunal or the continuation of the proceedings.

iv. Validity of the arbitration agreement

Another topic of discussion is the effect that the declaration of insolvency may have on the validity of the arbitration agreement.

As previously mentioned, the principle of the segregation or severability of the arbitration clause entails the idea that even though the agreement is deemed to be invalid, such clause is autonomous, stands alone and survives. This conception also triggers the discussion on the governing law of the arbitral agreement. In fact, if for instance, according to the choice of the parties, the governing law of the contract is English law and the arbitration clause is separated from the rest of the contract one may ask what the governing law of the arbitration agreement should be: English law also or another one, like the law of the seat, for example?

In this regard, it is generally understood that, although severable, the arbitration clause is still part of the agreement and as a consequence, the governing law of the arbitration agreement should be the same, especially when chosen by the parties, as the parties' autonomy should prevail. In fact, *predictability can in our view be best achieved if the validity of the arbitration agreement is to be determined according to the law chosen by the parties or, absent such a selection, pursuant to*

the lex arbitri.[62] However, in accordance with the concept previously discussed that places the arbitration agreement in *transnational order*, such agreement should be governed by private transnational law fundamental principles, mandatory customs and practices and treaty law and only complementarily by party autonomy's choice of law.

Thus, when confronted with insolvency effects, the arbitration agreement could be deemed unharmed insofar as it remains valid in light of its own governing law (be it transnational law, *lex mercatoria* or under 'common principles' of national systems of law), validity which is to be assessed freely by arbitrators themselves.[63]

The application of the *lex concursus* to the arbitration agreement pursuant to the declaration of insolvency of one of the parties' may reveal to be disastrous to international arbitration – as we already had the chance to see in the Swiss *Vivendi* case.[64] Such a solution is capable of completely frustrating the expectations of the

[62] NATER-BASS/MOSIMANN, *op. cit.*, p. 179, also referring other authors: G NAEGELI, 'Bankruptcy and Arbitration – What should prevail?', in *Austrian Yearbook on International Arbitration 2012*, Klausegger et al. eds., 2010, p. 202, and L MARKET, 'Arbitrating in the Financial Crisis: Insolvency and Public Policy versus Arbitration and Party Autonomy – Which Law Governs?', in *Contemporary Asia Arbitration Journal*, Vol. 2 (2), 2009, p. 240.

[63] LIMA PINHEIRO, *op. cit.*, pp. 211ff

[64] In fact, a minority of the Swiss Federal Supreme Court has dissented, considering that the arbitration agreement remained valid despite the invoked provision of the Polish law, arguing that the effects of a party's insolvency on the validity of an arbitration agreement are to be governed by the law applicable to its substantive validity. In the case under discussion, Swiss law was the *lex arbitri* which provides for a *favor validitatis* rule (art 178(2) SPILA) considering that an arbitration agreement is valid if it complies with the law chosen by the parties, the law governing the dispute or Swiss law. As under Swiss law a party's declaration of insolvency does not void an arbitration agreement, the arbitration agreement should have been deemed valid and binding upon the parties. Cf. NATER-BASS/ MOSIMANN, *op. cit.*, p. 169.

parties, who have chosen to settle any dispute arising from the agreement away from either national courts and have now to face the effects of an unknown rather rigid legal regime on such agreement. Furthermore, it may inclusively motivate a party willing to escape from a current or imminent arbitration to file for insolvency as a maneuver to plea the invalidity of the arbitration agreement or even the loss of capacity to participate in arbitration and consequently the lack of jurisdiction of the arbitral tribunal to hear the case. And one has to bear in mind that, since the arbitration agreement may be deemed a *current contract* regarding to non-pending arbitrations, for the purpose of article 4(2)(e) of the Regulation, this is actually the solution put in place in the EU whenever insolvency is declared in one of its Member States and should have its effects recognized by any (annulment or enforcement) court in other Member State.

Thus, in light of a *favor arbitratis* approach, the law governing the insolvency proceedings should only be applicable to very limited procedural issues, such as the representation of the insolvent by the insolvency administrator and the extent of its powers, for instance to settle the dispute, and only to the extent that such insolvency is recognized. No impact however should be drawn out of such insolvency order by arbitrators regarding the validity of the arbitration agreement and therefore the jurisdiction of the arbitral tribunal.[65]

III. Recognition and enforcement of the arbitral award

The legal framework of recognition and enforcement of an arbitral award in a given country is one of the most important indicators of its involvement in international commerce.

[65] According to NATER-BASS/MOSIMANN, *if at all, such law may only be taken into account if it qualifies as a loi d'application immédiate in view of international public policy at the seat of the arbitration – op. cit.*, pp. 175.

There are basically three systems of recognition and enforcement of such awards based on its legal source. The most important is the one set forth in the abovementioned New York Convention, which, as of June 2013, has 149 parties and 24 signatories.[66] Secondly, we find the regime established in other bilateral or multilateral international treaties. In the countries that did not sign said Convention and are not bound by any other public international law instrument, such cases are ruled by their own law regarding recognition and enforcement of foreign decisions.[67]

Apart from this general legal framework, we may still point out the regime provided by the 1965 *Washington Convention* on the settlement of investment disputes between States and nationals of other States, which provides for a mandatory recognition of the awards rendered under ICSID[68] arbitration and compels to the enforcement of the pecuniary obligations imposed therein *as if it were a final judgment of a court in that State*.[69]

Under the **New York Convention**, any arbitral award, arising out of differences between natural or legal persons, rendered in a State different than the one where recognition and enforcement are sought shall be recognized and enforced by the courts and public authorities of a signatory State.

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[66] See United Nations Treaty Collection website at http://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg_no=XXII-1&chapter=22&lang=en

[67] M FRANÇA GOUVEIA, 'O Reconhecimento de Sentenças Arbitrais Estrangeiras nos Países Lusófonos', in *III Congresso do Centro de Arbitragem da Câmara de Comércio e Indústria Portuguesa – Intervenções*, Almedina, 2010, p. 96.

[68] International Centre for Settlement Disputes (https://icsid.worldbank.org/ICSID/FrontServlet)

[69] Art. 54(1) *Washington Convention*.

Exceptions to this broad rule may however apply if the enforcement State adopted the so called *reciprocity reservation*, according to which recognition and enforcement may be refused to awards not rendered in the territory of *other* contracting State, or if the enforcement State has restricted the substantive scope of the convention by declaring it to be only applicable to awards referring to "commercial relationships", qualified as such by its own domestic law – the *commercial reservation*.[70] Moreover, such recognition and enforcement obligation shall also apply regarding any written agreement entered into between the parties according to which the dispute is to be settled by resort to arbitration.[71]

Hence, the courts of any contracting State, if confronted with a dispute which the parties have previously and validly referred to arbitration or with an international arbitral award, must redirect the parties to the arbitration upon request of one of them or recognize and enforce the award, unless some of the exceptions provided in article V of the New York Convention apply.

Article V expressly states that the court *may* refuse to recognize and enforce the award if any of the exceptions set forth therein apply. Thus, it should be noted that even if one of the following circumstances occurs, it is not mandatory for the Court to refuse recognition and enforcement. Such decision depends only on the Court's discretion. Furthermore, the burden of proof that the exception applies is on the party against whom the recognition and enforcement of the award is sought. However, no revision on the merits shall be allowed. Therefore, any claim based on errors of judgement, whether of fact or law, cannot qualify as grounds for such refusal. Also, it is worth noting that this list of exceptions is absolutely exhaustive, meaning that it does not allow any extensive interpretation or

[70] Art. I.

[71] Art. II

analogical reasoning, which could qualify as an abusive review on the merits by a national court.[72]

In view of the discussion held so far, the exceptions more commonly argued in cases where one of the parties has been declared insolvent shall now be briefly reviewed.

First of all, under the provision set forth in **article V(1)(a)**, the court may refuse recognition and enforcement of the award if it finds that the parties to the arbitration agreement were *under some incapacity* in light of their own law. What matters here is whether a certain party had the requisite capacity at the time of execution of the arbitration agreement, on the moment of the conclusion of the agreement, and not at the time of the commencement of the arbitration, on the date of the award or as of the respective enforcement. It refers to the capacity *to enter* such an agreement. Such understanding results from the wording of the provision under analysis which uses the past tense: *"parties to the agreement [...] were [...] under some incapacity"*.[73]

Thus, even if one would consider that the insolvency of one of the parties to the arbitration would trigger its incapacity – discussed previously – such incapacity would be irrelevant for the scope of this exception, since it would have occurred *after* the execution of the arbitration agreement.

The court may also refuse recognition and enforcement if it considers that the arbitration agreement is not valid. Such assessment must be made in light of the relevant governing law: *under the law to which the parties have subjected it* (the

[72] C BORRIS/R HENNECKE, in *New York Convention – Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1958 – Commentary*, hereinafter '*NYC Commentary*', Wolff Ed., CH Beck Hart Nomos (Co-publishers), 2012, pp. 244, 252.

[73] S WILSKE/T FOX, *ibid.*, p. 272

law governing the arbitration agreement) *or, failing any indication thereon, under the law of the country where the award was made* (the law of the seat). As discussed above, insolvency declaration does not by itself generally encumber the arbitration agreement's validity, which remains effective insofar its governing law determines so.

Violation of due process may also qualify as a ground for refusal of recognition and enforcement of the award, pursuant to **article V(1)(b)**. As previously discussed, this guarantee assures that both parties participated in a properly conducted arbitral proceeding, in which equality of arms and opportunities were granted to each one to plead its case before the tribunal and have a fair hearing. Thus, lack of proper notice of the appointment of the arbitrator(s) or of the arbitration proceedings may fulfil such ground for refusal. Also, any form of constraints abusively imposed on a party deemed to have concurred to endanger the presentation of its case may also qualify. This notably covers the right to submit evidence, to make legal or factual submissions to the tribunal and comment on evidence and submissions in the case file before any decision is granted.

Naturally, the part invoking such violation will have to demonstrate how such violation has determined the decision held by the arbitral tribunal; that such abuse has proved to be detrimental in the final award for the party resisting recognition and enforcement. This means that a *material* infringement of due process guarantee (not simply skipping a *formality*) has to be verified so that refusal should be granted. [74]

Furthermore, the party willing to use such argument must also be able to produce evidence that it had already raised such issue during the arbitral proceedings

[74] M SCHERER, *ibid.*, pp. 279 and 280

although without success. In fact, the silence of the party before a particular violation of due process, when it had the chance to raise such objection, may be interpreted as a waiver on its right and should be considered abusive when used as an (unheard of) argument to sustain the envisaged refusal.[75]

Once again, issues concerning the governing law should be considered when assessing the alleged violation of due process. In fact, due process requirements are not the same in every jurisdiction and can be quite different whether applying the law of the seat of arbitration or the law of the enforcement court, for instance. However, courts practice has chosen a balanced solution. In applying article V(1)(b) national judges tend to consider that the law of the *forum* is the one applicable, but it should be mitigated by the international character of the arbitration. Therefore, courts have found that compliance with 'minimal standards of fairness' should work as a minimum pattern for due process, irrespectively of what the purely national requirements of domestic law would impose.[76]

Another argument related to excess of competence or jurisdiction of the arbitral tribunal is stated in **article V(1)(c)**, where jurisdiction concerns to matters the arbitral tribunal has authority to consider and competence is meant to refer to the contents of the decision *vis-à-vis* the terms of the submission to arbitration. It generally refers to situations where, although valid, the decision held in the award falls outside the scope of the arbitration agreement or the issues submitted by the parties to arbitration. The arbitration agreement is *not only the source of the tribunal jurisdiction but also the limit to the tribunal's authority.*[77] But arbitrators are generally not allowed to decide *ultra petita*, i.e., beyond the relief sought by the parties, unless mandatory rules of the governing law on the merits apply.

[75] *ibid.*, p. 288.

[76] *ibid.*, p. 284 – where reference to French, German, Italian, Spanish, Swiss and US case law is made in detail.

[77] C BORRIS/R HENNECKE, *ibid.*, p. 309.

Again failure to raise objection to the arbitral decision based on lack of jurisdiction or competence may trigger the preclusion of the right to invoke it later on before the enforcement court.[78]

Upon insolvency of one of the parties, the recognition/enforcement of the award may be objected with this ground, if it is considered that the tribunal has rendered a decision on issues that are beyond its authority. The question may rise for instance when recognition is sought in the country of insolvency[79] and the award impacts on assets of the estate located in that territory. Local courts may deem arbitrators to have trespassed their powers, although a different perspective may be adopted in third countries.[80]

Another ground to oppose to recognition and enforcement of a foreign award is the improper composition of the arbitral tribunal or flawed arbitral proceedings to which **article V(1)(d)** refers to. Both the composition of the tribunal and the conduct of the arbitral proceedings must be in accordance with the parties' agreement, which may specifically refer such procedural issues to a body of law or to an arbitral regulation. If no express indication is made, the law applicable to the arbitration agreement should apply. As previously mentioned, if the parties remained silent in regard of such choice of law, the law governing the contract (*lex contractus*) should apply. And only in case where parties' autonomy has given no indication at all, the law of the seat of the arbitration (*the law of the country where the arbitration took place*) should be called upon to rule such matters.

[78] *ibid.*, pp. 311, 320, 328.

[79] Where either primary or secondary proceedings are pending.

[80] J DALHUISEN, 'Arbitration in International Finance', in *Estudos em Homenagem a Miguel Galvão Teles*, Vol. II, Almedina, 2012, p. 107f.

In light of **article V(1)(e)**, recognition and enforcement may also be barred when the award *(i)* has not yet become binding on the parties, *(ii)* has been set aside or *(iii)* suspended by a competent authority of the country in which, or under the law of which, that award was made.

The concept of *binding* award[81] is crucial but no clue is given on what is the governing law under which it should be qualified as such. Most courts take the approach of asserting whether the arbitral award meets all the requirements to be binding in light of the applicable arbitration law – which could either point to the law of the country of the seat or to the rules of the arbitral institution that rendered the award. The award should not be considered binding if it fails to comply with some formal requirements established in *lex arbitri*, unless they amount to a double *exequatur*, or if the party opposing to recognition and enforcement is able to prove that a legal remedy with suspensive effect is pending.[82]

One of the main goals of the drafters of this provision was to overcome the requirement of *double exequatur*, as it was established in the Geneva Convention of 1927, according to which the award had to collect two *exequaturs*, both in the country of the seat of arbitration (assuring its *finality*) and in the enforcement country. Thus, according to article V(1)(e) *a contrario*, it suffices to achieve only the *exequatur* at the place of the enforcement.[83]

[81] In the New York Convention predecessor, Geneva Convention of 1927, the word 'final' was used instead, cf. N BLACKABY/C PARTASIDES/A REDFERN/M HUNTER, in *Redfern and Hunter on International Arbitration*, Oxford, 5th Ed, 2009, p.649.

[82] C LIEBSCHER, in *NYC Commentary*, pp. 359, 362.

[83] *ibid.*, p. 356f.

The New York Convention favours here the *delocalisation theory*,[84] which detaches an international commercial arbitration award from control under the law of the place in which it is held and submits it only to the place of enforcement.[85]

The French *Cour de Cassation* has expressly adopted this position in 2007, by enforcing an arbitral award that had been set aside by the English High Court, stating that *an international arbitral award, which does not belong to any state legal system, is an international decision of justice and its validity must be examined according to the applicable rules of the country where its recognition and enforcement are sought*.[86] For French jurisprudence this is actually the rule to be followed. French international arbitration law excludes the setting aside of the award as a ground to refuse the enforcement, as the award is not an expression of a particular judicial system, but it is rather independent of the legal order of the country of its origin.[87]

Hence, the courts of the seat may still annul the award on the basis of local criteria, but annulment becomes irrelevant, because even if annulled the award may still be enforced in other jurisdictions besides the country of the seat. Annulment is relevant only for the country of the seat, within its territory. In practical terms, the ultimate power of recognition and enforcement is where there are assets to respond for the decision. By adopting the language *'may'* and not *'must' refuse*, the New York Convention actually supports this perspective. If granting full power of recognition and enforcement to the Courts of the seat

[84] *ibid.*, p. 367ff.

[85] BLACKABY/PARTASIDES/REDFERN/HUNTER, *op. cit.*, pp.189, 650.

[86] *Soc PT Putrabali Adyamulia v Soc Rena Holding et al* (2007), *Revue de l'Arbitrage* 507, cited by BLACKABY/PARTASIDES/REDFERN/HUNTER, *op. cit.*, p. 189, also quoted by C LIEBSCHER, *op. cit.*, p. 370 ft. 893, among other Dutch and US court decisions which also enforced awards that had been set aside in the country where they were rendered.

[87] C LIEBSCHER, *op. cit.*, p. 370.

would have been a purpose, it would have imposed mandatory refusal to enforcement courts when the award had been set aside at the seat of the arbitration. Instead, it brought recognition and enforcement to where it matters most.[88] Notwithstanding, the majority of the enforcement courts still show deference to the annulment decision and tend to decline enforcement of such award.[89]

Recognition and enforcement of the award can still be refused based on two other grounds, as foreseen in **article V(2)**. However, unlike the grounds reviewed so far, refusal may be granted in such circumstances by the court's own motion and without any request from the party resisting recognition and enforcement.

Exceptions set forth in said provision work as a 'safety-valve' and serve the purpose of allowing the Convention contracting states to protect their own public interests.[90]

The first of this second set of grounds is the non-arbitrability of the dispute – **article V(2)(a)**. Whenever the court considers that the issues dealt with in the award could not have been submitted to arbitration, because they are not at the free disposal of the parties, it may refuse to recognise and enforce it.

Thoroughly debated in academia, the arbitrability issue has evolved in the last years. Many national legal statutes have broadened the range of subject-matters that parties may refer to an arbitral tribunal using their autonomy.[91] For instance, the recent Portuguese Arbitration Act, inspired by the UNCITRAL Model Law

[88] C LIEBSCHER, *op. cit.*, p. 367-368.

[89] BLACKABY/PARTASIDES/REDFERN/HUNTER, *op. cit.*, p 653; C LIEBSCHER, *op. cit.* , p. 370-371.

[90] D QUINKE, in *NYC Commentary*, p. 381-382.

[91] *ibid.*, p. 381

and in line with the most modern statutes and arbitral institutions, has widened the concept of arbitrability,[92] by making it grow from 'any dispute that does not concern non-disposable rights'[93] to 'any dispute regarding claims of property nature' or even 'regarding non-pecuniary claims, provided that the parties to the dispute are entitled to conclude a settlement regarding the subject matter of the dispute'[94]. In what regards international arbitration, the *New Arbitration Act* adopts a clear *favor validitatis* approach considering that the arbitration agreement shall be valid (thus the dispute deemed arbitrable) if it complies with the respective requirements of the law chosen by the parties to govern the arbitration agreement, of the law governing the merits of the dispute or of Portuguese law. [95]

In the New York Convention wording, the concept of a *difference* that is *not capable of settlement by arbitration* is the same used in article II(1) and refers to the legal incapability imposed by a given law which restricts arbitrability to a certain type of claims or disputes.[96] According to article V(2)(a), the court assesses the arbitrability of the subject matter dealt with in the award pursuant to its own law – the law of the country in which recognition and enforcement are sought. Naturally this depends first and foremost on the enforcement State own concept of what disputes should be reserved for the courts of law and the ones that

[92] Highly influenced by Swiss and German laws, according to A RIBEIRO MENDES, 'A Nova Lei de Arbitragem Voluntária Evolução ou Continuidade?' pp. 10-11, available at http://www.trp.pt/ficheiros/estudos/novalav_armindoribeiromendes.pdf; the relevant provision wording has been inspired notably in art. 177(1) of SPILA and art. 1030(1) of German Code of Civil Procedure.

[93] Art. 1(1) of the former Portuguese Arbitration Act – *Lei 31/86*.

[94] Provided that such disputes are not legally subject to State courts jurisdiction or to mandatory arbitration – art. 1(1) and (2) *Lei 63/2011*, the 'New Arbitration Act'.

[95] Art. 51(1) *Lei 63/2011*, clearly inspired by art. 178(2) of SPILA and art. 9(2) of 2003 Spanish Arbitration Act – cf. RIBEIRO MENDES, *op. cit.*, pp. 6ff.

[96] D QUINKE, *op. cit.*, p. 383.

may be submitted to arbitration,[97] but according to that State's *international notion of arbitrability*.[98]

Typical non-arbitrable subject matters are usually illustrated by issues concerning employment law, competition law, regulatory law and insolvency law, among others. Nevertheless, in what concerns insolvency law, it is fairly common to see a clear distinction between 'core' issues of insolvency, which encompass the opening and closing of the insolvency proceedings, appointment of the administrator and inventory of claims and assets[99], and matters regarding *claims against or by the insolvent party*, *verification of credits* and *severability of assets of the insolvent estate*, which have been increasingly considered to be capable of being subject to arbitration.

However, in many contracting states, the effects of insolvency in the arbitration agreement do not fall under the discussion of arbitrability, in the sense that claims remain indisputably arbitrable. Instead, the arbitration agreement may be deemed to be *null and void*, *inoperative* or *incapable of being performed*, for the purpose of article II(3). If that is the case, then recognition and enforcement of the award would not be refused for non-arbitrability of the subject matter, but, if argued, for 'invalidity' (here used in its broadest sense) of the arbitration agreement under its governing law, based on article V(1)(a).[100]

Finally, the award may be refused recognition/enforcement if the court finds it to be contrary to public policy – **article V(2)(b)**. It is one of the most invoked

[97] BLACKABY/PARTASIDES/REDFERN/HUNTER, *op. cit.*, p. 655.

[98] D QUINKE, *op. cit.*, p. 388ff.

[99] D QUINKE, *ibid.*, p. 398 ff; J DALHUISEN, 'Arbitration in International Finance', p. 103.

[100] D QUINKE, *ibid.*, p. 399.

grounds in the attempt to bar recognition and enforcement but it is rarely granted.[101]

The vagueness of the concept is much due to the freedom that States have to determine their own public policy and it is consistent with the purpose of excluding an award that is deemed to violate the State core sense of justice. However, the ambiguity of the notion of public policy may also serve to hinder recognition and enforcement of foreign arbitral awards and may be abusively used as an emergency escape to circumvent the New York Convention pro-enforcement approach.[102]

In light of the provision set forth in article V(2)(b), public policy according to which the award's recognition and enforcement has to be in line with is the one of the country where it is sought – the *lex fori*. Such defence must be construed narrowly as it should only be employed 'where enforcement would violate the forum state's most basic notions of morality and justice'[103]. It has been submitted however that a purely national concept of public policy does not fulfil the spirit and purpose of the Convention and its favourable treatment of foreign awards. The approach that is reputed to be the most compatible with such purpose is the one that adopts *an international and not a domestic dimension, a national standard specifically for international awards which is more generous than for domestic awards*.[104]

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[101] R WOLFF, in *NYC Commentary*, p. 405.

[102] *ibid.*, p. 406.

[103] *Par. Whittem. Overseas Co Inc v Soc. Gén. de l'Industrie du Papier (RAKTA) 508 F2d969, 2nd Cir 1974*, as quoted by BLACKABY/PARTASIDES/REDFERN/HUNTER, *op. cit.*, p. 658

[104] BLACKABY/PARTASIDES/REDFERN/HUNTER, *op. cit.*, p. 658; WOLFF, *op. cit.*, p. 408 ff.

In some countries, a few principles and provisions of insolvency law are deemed to be part of the State national and international public policy. Hence, when insolvency of one of the parties to the arbitration is declared, such notion may obstruct to the recognition and enforcement of the award based on public policy ground, if sought before the courts of those countries.

In France, for instance, *principle of the preclusion of individual actions*, provisions on the *dispossession of the debtor*, *interruption of proceedings* and *principle of equality among creditors* are considered to form part of the French *ordre public*. Therefore, as a principle, a foreign arbitral award rendered against an insolvent party should only have the chance to be recognised and enforced before a French court if it is confined to determine the amount of the credit and declare it against the estate pursuant to the applicable provisions of insolvency law.[105] In 2009, the *Cour de Cassation* confirmed this route when refusing to enforce an award based on its violation of French international public policy. The *Cour de Cassation* found that the arbitral tribunal had violated public policy by ordering an insolvent party to pay damages, instead of limiting itself to validate and quantify those damages. Pursuant to French insolvency law, and as a matter of public policy, legal proceedings (including arbitration) should be limited to the validation and the quantification of claims, resuming only upon the stay of such proceedings and the filing of the respective claim with the Administrator.[106]

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[105] LAZIC, *Cross-border Insolvency and Arbitration*, p. 353.

[106] *Cour de Cassation*, *Chambre Civile 1*, 6 Mai 2009, 08-10.281, available at http://legifrance.gouv.fr/affichJuriJudi.do?oldAction=rechJuriJudi&idTexte=JURITEXT000020594892&fastReqId=276128787&fastPos=1; C VON KRAUSE, 'International Arbitration and French Insolvency Proceedings: French Supreme Court Reiterates Importance of Public Policy', Kluwer Arbitration Blog, 2009, available at http://kluwerarbitrationblog.com/blog/2009/10/28/international-arbitration-and-french-insolvency-proceedings-french-supreme-court-reiterates-importance-of-public-policy/

Yet, 'the German Supreme Court was less stringent and accepted a condemnatory award as proof of claim in insolvency proceedings. It held that the award was to be interpreted as merely determining the existence of the claim and its amount for the purposes of insolvency proceedings. However, it should be emphasised that the creditor did file its claim in the insolvency procedure and that it was clear to all the parties that the award was to be used for the purposes of insolvency proceedings'.[107] Therefore, also according to German courts practice, an insolvency creditor may only ask the arbitral tribunal to declare its claim valid, since an arbitral award ordering the Administrator to fulfil an insolvency creditor's claim would not be enforceable under German law.[108]

In this connection, as discussed above, arbitrators may be compelled to take insolvency domestic regulatory and public order requirements into account in their decision.

IV. The Portuguese Insolvency law solution

Under Portuguese law, the intersection between insolvency and arbitration is dealt with in article 87 of the Portuguese Insolvency and Recuperation of Companies Code (PIC), enacted in 2004. This is an innovative provision which was missing in the former Bankruptcy Code.[109]

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[107] LAZIC, *Cross-border Insolvency and Arbitration*, p. 360, making reference to BGB Beschl. 29.1.2009 – III ZB 88/07, 24 *Neue Juristische Wohenschrift*, *NJW*, 2009, 1747.

[108] J KRAAYVANGER/M C HILGARD, 'The Impact of German Insolvency Proceedings on International Arbitration', 2010, Mayer Brown Pub., available at http://www.mayerbrown.com/publications/the-impact-of-german-insolvency-proceedings-on-international-arbitration-07-19-2010/

[109] Código dos Processos Especiais de Recuperação de Empresa e de Falência, enacted by *Decreto-Lei 132/93*.

Article 87 PIC was inspired by the former wording of article 52[110] of the Spanish Insolvency Law (*Ley Concursal*).[111] In fact, the wording of this provision in the Code's Preliminary Draft was a mere translation of said article 52(1), declaring *the suspension of the efficacy of the arbitration agreements to which the insolvent is a party, without prejudice to the applicable international treaties.*[112] However, the final wording of said article 87 actually became more sophisticated,[113] as follows:[114]

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[110] *Artículo 52. Procedimientos arbitrales. 1. Los convenios arbitrales en que sea parte el deudor quedarán sin valor ni efecto durante la tramitación del concurso, sin perjuicio de lo dispuesto en los tratados internacionales. 2. Los procedimientos arbitrales en tramitación al momento de la declaración del concurso se continuarán hasta la firmeza del laudo.* See *Ley 22/2003, de 10 de julio, Concursal, Boletín Oficial del Estado, 10 julio 2003*, available at http://www.boe.es/boe/dias/2003/07/10/pdfs/A26905-26965.pdf.

The wording of article 52(1) has been amended by *Ley* 11/2011 and currently states that the declaration of insolvency by itself has no effect on the mediation and arbitration agreements to which the insolvent is a party, unless the court deems them detrimental to the insolvency proceedings in which case the former may be suspended, but always without prejudice to the provisions of applicable international treaties. See *Boletín Oficial del Estado, 21 mayo 2011*, available at http://www.boe.es/boe/dias/2011/05/21/pdfs/BOE-A-2011-8847.pdf.

[111] L MENEZES LEITÃO, in *Código da Insolvência e da Recuperação de Empresas Anotado*, Almedina, Coimbra, 2009, p. 128ff.

[112] As per art. 80 of *Anteprojecto do Código*, in *Código da Insolvência e da Recuperação de Empresas*, Ministério da Justiça, Coimbra Editora, 2004.

[113] L CARVALHO FERNANDES/J LABAREDA, in *Código da Insolvência e da Recuperação de Empresas Anotado*, Quid Juris, Lisboa, 2009, p. 360.

[114] Under the caption *Convenções Arbitrais* (Arbitration Agreements), the original text reads as follows:

1. Fica suspensa a eficácia das convenções arbitrais em que o insolvente seja parte, respeitantes a litígios cujo resultado possa influenciar o valor da massa, sem prejuízo do disposto em tratados internacionais aplicáveis.

2. Os processos pendentes à data da declaração de insolvência prosseguirão porém os seus termos, sem prejuízo, se for o caso, do disposto no n.º 3 do artigo 85.º e no n.º 3 do artigo 128.

1. *Without prejudice to the applicable international treaties, the efficacy of arbitration agreements to which the insolvent is party, relating to disputes which result may affect the value of the insolvency estate, shall be suspended.*
2. *Proceedings pending as of the date of the declaration of insolvency shall continue, without prejudice to the provisions set forth in article 85(3) and of article 128(3), where applicable.*

First of all, it must be underlined that article 87(1) makes an explicit reservation in favour of international treaties.

Although there is still no Portuguese case law on the scope of said provision, considering that it follows the path laid down by Spanish law, it is worth to note that, in 2009, the Court of Appeal of Barcelona, deciding a matter under the former wording of *Ley Concursal*, found that, due to the explicit reservation in favour of international treaties, such legal provision should be construed as excluding international arbitration.[115]

It is possible to have the same interpretation in face of the Portuguese provision, as it also excludes international treaties application. Following to such reasoning, this legal provision would only apply to domestic arbitration. Cases where an international arbitration award is under discussion would be dealt with under the New York Convention, of which Portugal is a signatory State.

According to this understanding, a creditor of the insolvency relying the proof of its credit (duly claimed in the insolvency proceedings) on an international arbitral

[115] *Audiencia Provincial de Barcelona, Sección 15ª, Auto de 29 Abr 2009, Rec. 708/2008,* in *La Ley*, 213720/2009

award, would necessarily have its credit recognized and enforced within the insolvency proceedings, namely for purposes of verification and respective payment. Meaning that the insolvency court would grant the *exequatur*, but would be prevented from reviewing the merits of the arbitral decision and would *automatically*, i.e., without further discussion of the grounds invoked, admit the claimed credit to the verified list of creditors, in which it would be ranked, and afterwards proceed to payment, according to creditors' precedence rules provided by the national insolvency law.

This would undoubtedly be the friendliest construction of the Portuguese legal provision towards international arbitration, as this would mean that foreign awards would be *insolvency-proof* in what regards Portuguese debtors.

However, one of the fundamental features of insolvency proceedings is that every credit claimed against the insolvent must be open to dispute by any other creditor. This obviously brings accrued difficulties when a claim emerges from a dispute which the parties to the relevant agreement have referred to arbitration, since other creditors of the insolvency are not bound by the arbitral agreement entered into between such parties.

Thus, a further interpretation of article 87 is required to identify its precise scope of application.

Despite the general caption of 'Arbitration Agreements', article 87(1) refers to the *efficacy of the arbitration agreement*, whereas article 87(2) refers to *pending arbitration proceedings*. This distinction leads us to conclude that §2 limits the scope of §1. Indeed, in what regards arbitration proceedings already in course, article 87(2) confirms the efficacy of the arbitration agreement, in which the jurisdiction of the arbitral tribunal is grounded, despite the declaration of insolvency of one of the parties to the arbitration. Moreover, it expressly states the

effects that insolvency has in such pending proceedings by validating its continuance, but pointing out the replacement of the insolvent for the Administrator in the arbitration[116] and the filing of the creditor's claim within the insolvency proceedings[117].

Thus, under article 87(2), the insolvency of a Portuguese party to an arbitration does not have any other impact on the pending arbitration proceedings except for the participation of the insolvency administrator in the arbitration from then on, as its representative, and the imposition to the creditor to file its claim in the insolvency proceedings as the only mean to achieve payment.

Naturally that, resuming here the discussion on the requirements of due process, although not imposed by law, a stay of the arbitration seems to be advisable, so that the insolvency administrator may become familiar with the subject matter under discussion and duly proceed with the representation of the insolvent or reach a settlement with the creditor.

Following the line of reasoning that has been argued, also under Portuguese law, insolvency does not trigger any kind of incapacity to the insolvent, causes no form of invalidity to the arbitration agreement and has no impact on the jurisdiction of the arbitral tribunal.

[116] Pursuant to art. 85(3) PIC, which states that the insolvency administrator represents the insolvent in any pending proceedings, irrespective of whether the latter are attached to the insolvency proceedings or not.

[117] According to art. 128(3) PIC, which states that verification encompasses all credits against the insolvency, regardless of its nature and grounds, and that even the creditor who has its credit recognized by a final judgment is not exempted from claiming its credit in the insolvency proceedings in order to attain payment.

On the other hand, when no arbitration has yet been launched, the impact of insolvency occurs on the arbitration agreement to which the insolvent is a party – article 87(1).

However, article 87(1) does not generally apply to every single arbitration agreement. In fact, the wording of said provision limits its scope to *disputes which result may influence the value of the insolvent estate*. Thus, in order to properly assess the rule's extent, one has to identify which disputes may potentially have a result capable of affecting such value.

Article 46(1) PIC defines *insolvent estate* by saying that it is intended to satisfy the insolvency creditors, upon payment of its own debts, and that, save for otherwise provided, it encompasses all of the debtor's patrimony as of the date of the insolvency declaration, as well as all the assets and rights acquired by the debtor while the proceedings are pending.

Therefore, *only* the disputes referred to arbitration which outcome may potentially affect the assets or rights included in the insolvent patrimony shall be affected by the impact of the insolvency declaration.[118] The disputes envisaged by the rule are exclusively the ones that address specific assets or rights (*e.g.* receivables) encompassed in the insolvent estate.

As a consequence, a potential right of credit over the insolvency does not form part of the insolvent estate. In case it is recognized, it conveys an asset of a third party over the insolvent estate, which corresponds to a liability of the insolvency estate. Yet such liability has no effect on the value of said estate, since said value corresponds to the sum of the rights and assets therein. Naturally, the estate shall eventually provide for payment of the acknowledged credits, but indeed the

[118] CARVALHO FERNANDES/LABAREDA, *op. cit.*

amount of the credits claimed and recognized is absolutely independent of its value. As a result, pursuant to article 87(1), a claim where recognition and quantification of a credit is sought is not prevented from being submitted to arbitration, as the arbitration agreement to which both creditor and debtor are parties remain valid and effective.[119]

This means that Portuguese insolvency law acknowledges the validity and efficacy of an arbitration agreement entered into by the insolvent party irrespective of the insolvency declaration. Consequently, an arbitral decision settling a dispute with no influence on the value of the insolvent estate should be recognized within the insolvency proceedings.

Therefore, a foreign award recognizing the existence of and quantifying a credit over the insolvency estate ought to be recognized and enforced by the insolvency court. That is to say that, pursuant to article 87(1) and the aforementioned provisions of the New York Convention, the relevant credit must be admitted to the list of creditors and deemed to be automatically verified without further discussion on the merits.

However, this automatic recognition of a credit based on an international arbitration award must still be in line with the *principle of equality of unsecured creditors* and with the concept of *collective enforcement of credits* of the insolvency proceedings. These are indeed core values of insolvency which may inclusively be deemed to be part of public policy, according to the understanding of French and German courts already mentioned above.

[119] L MENEZES LEITÃO, in unpublished legal opinion obtained with kind permission of the author.

This means that in order to receive payment, all creditors – including the ones that are party to an arbitration agreement and therefore are entitled to submit the dispute to an international arbitral tribunal – must claim their credits in the insolvency proceedings, which is the only source of payment. Insolvency proceedings are thus conceived as a magnet centre where every single creditor must come to be paid, the aim being to eliminate any chance of enforcement of credits outside such proceedings.

This solution puts Portuguese insolvency law in line with the principle of preclusion of individual actions as it is adopted by the majority of legislations. *Any claim by an unsecured bankruptcy creditor for payment against the estate may only be pursued by filing in bankruptcy. (…) The purpose is to prevent the depletion of the debtor's assets and to ensure orderly payment to creditors. All ordinary unsecured, non-preferred creditors are paid pro rata, in accordance with the principle of the equal treatment of creditors* – par conditio creditorum *or* paritas creditorum.[120]

On the other hand, in light of the distinction set forth in said provision, should a claim pertaining to a specific asset or right held by the insolvent be prevented from being submitted to an arbitral tribunal, pursuant to the arbitration agreement entered into between the parties? In view of the legal definition set forth in article 46 PIC, it seems unquestionable that the result of such dispute would influence the value of the insolvent estate. Apparently, as per article 87(2), already pending arbitrations do not raise this problem, irrespective of the influence they might have on the value of the estate, which can be regarded as an incongruence of the regime.

[120] LAZIC, *Cross-border Insolvency and Arbitration*, p. 349ff.

Under Portuguese insolvency law, anyone who claims to have a proprietary right over an asset that has been wrongfully seized by the Administrator and included in the insolvent estate may file its claim within the insolvency proceedings, pursuant to the special procedure of *restitution and separation of property*, foreseen in articles 141 to 145 PIC. This is deemed to be the only way of reaction available to the owner, in face of an abusive apprehension of an asset that did not belong to the insolvent. It follows a procedural path very similar to the one established for the claim and verification of credits, with few differences, but also providing for a trial upon the submissions of the parties and a final judgement deciding on the property issue. However, the legal regime also allows for the judge to simply order the separation of the asset under discussion, at the request of the insolvency administrator, supported by a favourable opinion of the creditors committee if appointed.[121]

In view of the above, if the efficacy of the arbitration agreements relating to disputes which may affect the value of the insolvency estate, to which the insolvent is a party, is suspended upon declaration of insolvency, article 87(1) PIC would prevent any creditor, claiming a proprietary right over the assets encompassed in the estate, to resort to arbitration to settle the dispute. In fact, the suspension of the efficacy of the arbitration agreement entails that none of the parties may invoke it to commence arbitration against the other. The arbitration agreement is deemed to be temporarily ineffective (*ex lege*). As a consequence, upon declaration of insolvency of one of the parties to the arbitration agreement, no arbitration could be launched to settle a dispute regarding a right or an asset comprised in the insolvent estate.

Nevertheless, as discussed previously, the validity of the arbitration agreement can only be affected by its governing law and not by the *lex concursus*. Thus such

[121] Art. 141(3) PIC.

effect would only verify if Portuguese law was the ruling one. Moreover, taking into consideration the explicit reservation provided in article 87(1) regarding the provisions set forth in the applicable international treaties and the *favor arbitratis* spirit purported in the New York Convention, it is conceivable that such limitation should not hinder an international arbitration agreement efficacy and the scope of the rule might be only limited to domestic arbitration agreements. In fact, the phrase *without prejudice to the applicable international treaties* refers to the deference national law pays to the primacy of international rule of law, as provided for in article 8 of the Portuguese Constitution.

As a consequence, an award rendered in an international arbitration, commenced *after* the insolvency order, settling a dispute pertaining to an asset or right included in the insolvent estate – and therefore affecting its value – could also be recognized and enforced by the insolvency court within the insolvency proceedings, under the New York Convention which directly rules the case, unless some of the exceptions of article V applied. The creditor's claim based on such award would thus be admitted in the insolvency proceedings without further discussion on the merits, including when the award refers to a proprietary right of the claimant on an asset of the estate, in which case the award would be recognized and enforced for the purposes of the *restitution and separation of property* mechanism provided in articles 141 to 145 PIC. Actually, article 87(2) does not halt an arbitration already pending at the date of insolvency though pertaining to such a claim and it seems that there is no reason to discriminate between the two awards.

This construction seems to actually comply with the spirit of the New York Convention *vis-à-vis* the applicable provisions of Portuguese law and better meets the terms of an international arbitration, which does not emerge from *a foreign* legal order but from a truly transnational legal order as discussed above.

However, as in any proprietary matter, such decision would affect third parties, outsiders to the arbitration agreement, notably other creditors of the insolvent, who could be overcome in the overall ranking.

In fact, due to the nature and purpose of arbitration itself, international arbitrators may not be granted with powers to directly affect persons who are not parties to the arbitration agreement.[122] However, this is a matter that may be raised when the arbitral tribunal is called upon to assess proprietary issues, for instance. This brings into discussion the important and yet unsettled problem of *erga omnes* effects in international arbitration. An international award deciding on a specific asset or right held by the insolvent would have an impact on other creditors, on the ranking and on the value of the estate, thus affecting or pre-empting the insolvency regime. In such context, international arbitration would affect third parties and, in that sense, would have *erga omnes* effect in insolvency ranking and distribution. That poses difficult problems, as it is not absolutely established that an international arbitration award may be granted with such effect, especially within an insolvency proceeding.[123]

Related to this topic, it has also been discussed whether a foreign arbitration award should only have a declaratory effect regarding the insolvent party – acknowledging and quantifying the credit or recognizing a proprietary right of the claimant or even denying the existence of a credit of the insolvent estate against an alleged debtor – or if it may go beyond that and actually condemn the insolvent to respectively pay the debt, restitute the asset or restrain from seeking payment of a credit.

[122] BLACKABY/PARTASIDES/REDFERN/HUNTER, *op. cit.*, p. 368.

[123] J DALHUISEN, 'Arbitration in International Finance', pp. 100, 107, 110f, 112.

An award actually condemning the insolvent party to *act* according to the tribunal's findings may be deemed to infringe the abovementioned fundamental values of insolvency law and therefore in breach of international public policy of the state where proceedings were opened.[124] Such construction enhances a rather formal perspective of violation of public policy. Provided that the claimant files its claim and seeks remedy within the insolvency proceedings and that rules governing precedence of creditors are observed, although relying on an award with such *extensive* ruling, no material breach of such core values seems to occur and hence there seems to be no reason to consider that a public policy infringement verifies. Thus an international arbitral award ordering payment, for instance, should be generally accepted provided that the principle of equality of creditors is respected – meaning that creditor will not be paid elsewhere nor before other creditors whose claims are ranked higher in the insolvency proceedings.

However, an award where the arbitral tribunal provides for a set-off and netting of mutual credits of the parties is actually granting a (at least, partial) payment to the creditor of the insolvency. And payment outside the insolvency proceedings should be considered contempt for the principles of equality and of preclusion of individual actions, as well as for domestic insolvency set-off rules, which are known to be particularly tight. Besides, it also affects other creditors and, as mentioned, it remains unclear in how far international arbitrators may decide with such range.[125]

Notwithstanding, regard for international rule of law, particularly in the case at hand, for the New York Convention, leads to conclude that such award could even so be acknowledged, unless public interests would be at stake. In light of the

[124] In this vein, the decisions held by French and German courts referred above.

[125] J DALHUISEN, 'Arbitration in International Finance', p. 100, 102, 108, 110f.

notion of Portuguese international public policy, the declaration of a credit's extinction can hardly be considered to infringe the set of *fundamental principles that structure the presence of the Country in the concert of nations*.[126] Such decision does not in its essence seem to violate the essential notions of morality and justice as they are envisioned and upheld in Portuguese legal order.[127]

In this sense, international arbitrators may actually have the chance to grant an advantage to a creditor of the insolvency estate, backed-up by an award which, under the New York Convention, must be recognized and enforced without being submitted to further challenge of other creditors and without revision on the merits of the cause.

[126] In decision held by the Portuguese Supreme Court of Justice on June 2, 2006, available at http://www.dgsi.pt/jstj.nsf/954f0ce6ad9dd8b980256b5f003fa814/c70f89b50d8a287c8025712a00305768?OpenDocument

[127] Some queries in this respect may however arise when, for instance, considering a credit for punitive damages (BORRIS/HENNECKE, *op.cit.*, p. 325), traditionally deemed to be unacceptable in light of Portuguese law, but already purported by some authors (cf. P MEIRA LOURENÇO, 'A Indemnização Punitiva e Os Critérios Para a Sua Determinação', 2008, available at http://www.stj.pt/ficheiros/coloquios/responsabilidadecivil_paulameiralourenco.pdf)

CONCLUSION

Insolvency law and international arbitration have fundamental differences in nature and purposes. Thus when coming across in a particular situation, they may be tempted to ignore each other. However, it is generally accepted that insolvency, eminently territorial and regulatory, should be deemed to have a very limited impact on international arbitration. Notably it is accepted to have no influence on the jurisdiction of the arbitral tribunal. In turn, an international award, making part of a transnational legal order and being backed up by the New York Convention, should be automatically recognized and enforced by the insolvency court, unless some of the few exceptions foreseen therein apply.

Although in a rather ambiguous wording, it seems to result from Portuguese insolvency law provisions that the declaration of insolvency of one of the parties to an arbitration agreement does not prevent arbitration proceedings from commencing nor continuing. Such declaration does not affect the insolvent's capacity to be a party to the arbitration. The validity and efficacy of an international arbitration agreement remains intact according to its own governing law and so is the arbitrators' jurisdiction.

Thus, from a Portuguese perspective, it seems possible to argue that when an international arbitration award is to be submitted to insolvency proceedings there is, as a rule, no reason for refusal of recognition and enforcement, save for situations where the limited exceptions provided for in the New York Convention apply, but which, as discussed, do not seem to be directly triggered in any aspect by the insolvency order.

Such a construction is thought to be in line with the essential values of international arbitration which, emerging from a transnational order, should not know constraints regarding national legal requirements. Due to its transnational

source of legitimacy, international arbitration may be deemed to occasionally prevail over domestic insolvency provisions. However, domestic judges may bar such result in particular cases where international public policy values are deemed to be in risk of infringement or where arbitrability and jurisdiction issues arise. Hence, the ultimate impact of an award in insolvency proceedings is reserved to be unfolded by the insolvency courts – yet bound by the spirit and purpose of the New York Convention.

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