International Corporate Rescue

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Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

Annual Subscriptions:
Subscription prices 2010 (6 issues)
Print or electronic access:
EUR 695.00 / USD 845.00 / GBP 495.00
VAT will be charged on online subscriptions.
For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

(1) Jozef Syska (2) Elektrim SA v (1) Vivendi Universal SA (2) Vivendi Teleom International SA (3) Elektrim Telekomunikacja Sp z.o.o. (4) Carcom Warzawa Sp z.o.o. [2009] EWCA Civ 677

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Introduction

Where an arbitration is proceeding in one Member State of the European Union and one of the parties to the arbitration becomes insolvent in another Member State, are the consequences of that insolvency, in so far as they affect the arbitration, to be determined by the law of the Member State where the insolvency proceedings have been instituted or the law of the Member State in which the arbitration is taking place?

The Court of Appeal heard an appeal from a judgment of Christopher Clarke J ([2008] EWHC 2155 (Comm), now reported at [2008] 2 Lloyd's Rep 636). In that decision the judge had held that, where main insolvency proceedings had been opened in Poland, but arbitration proceedings had already been pending in England at the date of insolvency, then the effects of the insolvency on the arbitration agreement were governed by the law of England (the Member State in which the arbitration was pending) rather than the law of Poland (the Member State in which the insolvency proceedings had opened).

Background

Elektrim SA, the second claimant and appellant ('Elektrim') was a Polish company, which at one time owned a substantial shareholding in PTC, a Polish mobile telephone company.

On 3 September 2001 Elektrim entered into an agreement known as the Third Investment Agreement ('TIA') with Vivendi Universal SA and Vivendi Telecom International SA, the first and second respondents (together 'Vivendi'). This was one of a series of agreements whereby Vivendi was intended to acquire an interest in PTC. Article 5.11 (c) of the TIA contained an agreement to arbitrate (the 'Arbitration Agreement') which provided for arbitration in London under LCIA rules. It was common ground between the parties that the arbitration agreement was governed by English law (although the rest of the TIA was governed by Polish law).

On 22 August 2003 Vivendi commenced arbitration pursuant to the Arbitration Agreement. In the arbitration Vivendi advanced claims that Elektrim had breached its obligations under the TIA by interfering with, or failing to secure, the interest that Vivendi was supposed to obtain in PTC. In early 2007, the LCIA arbitral tribunal fixed a hearing on liability issues for 15-19 October 2007. The claims made were in the order of EUR 1.9 billion.

Meanwhile, on 21 August 2007, Elektrim was declared bankrupt by an order of the Warsaw District Court pursuant to its own petition of 9 August 2007. As a result of that order, Elektrim became a 'bankrupt' for the purposes of Polish law. The order of 21 August 2007 of the Warsaw District Court (a) declared that Elektrim was bankrupt, (b) appointed Jozef Syska (the first claimant) as Court Supervisor and (c) provided for Elektrim's own management to retain control of all of Elektrim's assets and to take any actions within the ordinary scope of its business. On 5 February 2008, the Warsaw Court appointed Mr Syska as the administrator over Elektrim's assets.

On 22 August 2007, Elektrim wrote to the Tribunal and Vivendi saying that, as result of the bankruptcy, the Arbitration Agreement had been annulled pursuant to Article 142 of the Polish Bankruptcy and Reorganisation Law. This provides that: 'any arbitration clause concluded by the bankrupt shall lose its legal effect as at the date bankruptcy is declared and any pending arbitration proceedings shall be discontinued'. On 15 October 2007, the scheduled arbitration hearing began in London. At that hearing, the Tribunal heard argument from both parties as to whether the arbitration agreement had been annulled. On 20 March 2008, the Tribunal issued an Interim Partial Award (the 'Award'). The Tribunal by a majority rejected Elektrim's objections to their jurisdiction and declared that Elektrim had breached the terms of the TIA.

On 2 October 2008 Christopher Clarke J handed down his judgment, rejecting the claimants' application under section 67 of the Arbitration Act 1996 to set aside the Award on the ground that in accordance with Polish bankruptcy law the judgment had lost its

legal effect as at the date bankruptcy was declared. Since the judgment, the Tribunal had rendered a final award dated 12 February 2009 by which it awarded (1) damages to the first respondent in the amounts of EUR 1,670,180,000 and EUR 38,971,000 and (2) damages to the second respondent in the amounts of EUR 166,871,000 and EUR 600,000 (the 'Final Award').

Applicable law

The question of whether the consequences of insolvency proceedings in one Member State, in so far as they affect arbitration proceedings in another Member State, are to be determined by the law of the former or the latter fell to be determined with reference to the EC Insolvency Regulation (the 'Insolvency Regulation').

Article 4 (1) of the Insolvency Regulation provides that:

(i) Save as otherwise provided in this Regulation, 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, hereafter referred to as the 'State of the opening of proceedings';

(ii) The law of the State of the opening of proceedings shall determine the conditions for the opening of those proceedings, their conduct and their closure ...

Article 4 (2) then gives a non-exclusive list of the examples of matters which the law of the state of the opening of proceedings is to determine. Two examples are:

(e) the effects of insolvency proceedings on current contracts to which the debtor is party;

(f) the effects of insolvency proceedings on proceedings brought by individual creditors, with the exception of lawsuits pending.

Article 15 further provides that:

> '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 the lawsuit is pending.'

The first instance decision

The judge at first instance had held that there was a conflict between the general provision in Article 4, which declared that the law of the opening of proceedings ('*lex concursus*') was the law applicable to insolvency proceedings, and the 'special' or 'particular' exception that the effects of insolvency proceedings on pending lawsuits or references to arbitration should be governed solely by the law of the Member State in which that lawsuit or reference was pending on the other hand.

There was no provision of English law annulling the Arbitration Agreement. The fact that Article 4 (2)(e) would apply Polish law to 'current contracts' (including the agreement to arbitrate) made no difference because it was only an example of the general provision, and it had to yield to the specific provision

The submissions

On appeal Counsel for the appellants contended that the judge had been wrong to say that Article 4 and Article 15 were in conflict. He made the following submissions:

(a) Article 4 was the primary article both chronologically and as a matter of construction of the Insolvency Regulation.

(b) Article 4 particularly applied to 'current contracts' and that must include current agreements to arbitrate.

(c) The *lex concursus* therefore determined the effects of the insolvency proceedings on the agreement to arbitrate.

(d) The agreement to arbitrate must, therefore, be regarded as annulled or void from the date of the bankruptcy.

(e) The pending reference could not have any independent existence once the agreement to arbitrate ceased to have effect.

(f) The arbitrators therefore had no jurisdiction to proceed.

The judgment

In his leading judgment, Longmore LJ made the following initial observations:

(a) It is not difficult to see why pending lawsuits should be excluded from the general application of the *lex concursus* set out in Article 4. If a legal action has begun or a reference to arbitration has been constituted in a Member State, it is natural that it should be the law of the Member State where the legal action has begun or the reference to arbitration is taking place which should determine whether or not that action or reference be continued or not.

(b) If no claim has begun before insolvency proceedings are opened, it is appropriate that the *lex concursus* should determine how any subsequent litigation or arbitration should proceed. But if

litigation or arbitration has begun before insolvency occurs, the natural expectation of business would be that it should be that law that should determine whether the proceedings should continue or come to a halt.

(c) These considerations are reflected in recitals 23 and 24 of the Insolvency Regulation. The latter provides that: 'automatic recognition of insolvency proceedings to which the law of the opening State normally applies may interfere with the rules under which transactions are carried out in other Member States. To protect legitimate expectations and the certainty of transactions in Member States other than that in which proceedings are opened, provisions should be made for a number of exceptions to the general rule'.

Though his Lordship agreed that Article 4 and Article 15 are not really in conflict, he held that once it is accepted that 'lawsuit pending' includes pending references to arbitration, it must be Article 15 that is the relevant and appropriate Article. For that reason, one cannot say that Article 4 is 'primary' to Article 15: each article has its own sphere of operation, and once it is clear that there is a 'lawsuit pending' the question of whether that lawsuit should be continued by reason of the insolvency is to be determined solely by English law as 'the law of the Member State in which the lawsuit is pending'.

His Lordship referred to paragraph 142 of the Virgos-Schmidt report (which would have been the Official Report of the bankruptcy Convention had one ever been agreed). This paragraph draws a distinction between proceedings by way of execution (governed by the *lex concursus*) and proceedings (lawsuits) to establish liability (governed by the law of the Member State where such proceedings are under way).

For these reasons, Longmore LJ decided that the question whether pending lawsuits should be continued in the light of insolvency is to be determined by the law of the Member State in which those proceedings are pending, and dismissed the appeal.

Comments

It was generally accepted that 'lawsuit pending' (referred to in Article 15) included references to arbitration, and that arbitration fell within Article 15, which acted as an exception to Article 4. Consequently English law applied to the effect of Elektrim's bankruptcy on the arbitration proceedings.

However, if no claim is instituted before the onset of insolvency proceedings, then it is appropriate that the *lex concursus* should determine how any subsequent litigation or arbitration should proceed. The practical effect of this is that, when considering arbitration against a party that is or is about to become insolvent, thought should be given to the likely effect of any such insolvency on the arbitration, and whether arbitration should be instituted *before* the formal opening of main proceedings.

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