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Aims & Scope
Switzerland is generally regarded as one of the World’s leading place for arbitration proceedings. The membership of the Swiss Arbitration Association (ASA) is graced by many of the world’s best-known arbitration practitioners. The Statistical Report of the International Chamber of Commerce (ICC) has repeatedly ranked Switzerland first for place of arbitration, origin of arbitrators and applicable law.

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The Capacity of a Bankrupt Party to Be or Remain a Party to International Arbitral Proceedings

A Landmark Decision of the Swiss Federal Supreme Court

GEORG NAEGELI

In a landmark decision, the Swiss Federal Supreme Court recently clarified a hotly debated issue on the capacity of a bankrupt party to be or remain party to an international arbitration. In so doing, the Court corrected a decision taken only three and a half years earlier, also known as the “Vivendi” decision, that was the subject of a great deal of criticism.

1. The “Vivendi” Decision of 2009

In its judgment of March 31, 2009 (Vivendi SA et al. vs. Deutsche Telekom AG et al. and Elektrim SA et al., 4A_428/2008)\(^1\), the Swiss Federal Supreme Court upheld an interim award issued by an ICC tribunal seated in Switzerland. In the relevant award, the arbitral tribunal had discontinued the arbitration proceedings against the Polish entity Elektrim SA, which had been declared bankrupt after the initiation of the arbitration, due to a lack of jurisdiction.

The facts were the following: The arbitration was initiated in April 2006 based on an arbitration agreement that provided for arbitration under the ICC Rules with the place of arbitration in Geneva. In August 2007, Elektrim SA was declared bankrupt. Elektrim SA notified the ICC tribunal accordingly and requested the termination of the proceedings, invoking article 142 of the Polish Bankruptcy and Restructuring Law (LBR), which at the time read as follows:

“Any arbitration clause conducted by the bankrupt shall lose its legal effect as at the date bankruptcy is declared and any pending arbitration proceedings shall be discontinued.”

The ICC tribunal, relying on expertise submitted by Deutsche Telekom AG, concluded that the purpose of article 142 LBR was to deprive arbitral tribunals of jurisdiction over bankrupt Polish parties. While the tribunal agreed that Polish law cannot provide for the termination of proceedings before an arbitral tribunal with its seat in Switzerland, it held that it is for Polish bankruptcy law to determine the effects of bankruptcy on insolvent Polish entities. The tribunal held that the capacity to act in a Swiss arbitration is governed by the general conflict of law rules of the Swiss Private International Law Act (PILA). The “continued capacity” of Elektrim SA to appear as a party in arbitral proceedings, therefore, had to be determined under Polish law. Pursuant to article 142 LBR, a bankrupt Polish party loses its subjective capacity to be a party to arbitration proceedings. For these reasons, the arbitral tribunal declined jurisdiction over Elektrim SA.

Seized with an appeal of the interim award, the Swiss Federal Supreme Court noted that the PILA is silent on the subjective capacity of non-state parties to arbitrate. The capacity to be party to proceedings depends on legal capacity, which is an issue of substantive law and determined by the law governing the personal statute of legal entities. As Elektrim SA is a Polish corporation, its legal capacity and its capacity to be a party in international arbitral proceedings are governed by Polish law. Relying on the interim award and the opinions of Polish legal experts cited therein, the court concluded that pursuant to article 142 LBR, which rules on a specific aspect of the capacity to be a party to proceedings, a Polish bankrupt entity is deprived of its subjective capacity to arbitrate in a pending arbitral proceeding. Elektrim SA had thus lost its capacity to take part in the ICC arbitration. Based on these grounds, the Swiss Federal Supreme Court upheld the interim award.

It is noteworthy that the “Vivendi” decision was not unanimous. The deliberations, which were held in public, revealed that a minority voted in favor of annulling the interim award on the grounds that Elektrim SA had not lost its capacity to be a party to proceedings. The minority reasoned that the effects of a bankruptcy on an international arbitration in Switzerland should be governed by the law applicable to the substantive validity of the arbitration agreement. According to article 178 of the PILA, this is the law chosen by the parties, the law governing the dispute, or Swiss law – whichever is most favorable.²

² See the summary of the minority opinion provided by GEORG NAEGELI, Bankruptcy and Arbitration – What should prevail?, Austrian Yearbook on International Arbitration 2010, 193, 200 et seq.
The “Vivendi” decision was not published in the official bulletin of the Federal Supreme Court’s leading cases.

2. Controversial Comments on the “Vivendi” Decision

The comments on the decision of the Swiss Federal Supreme Court were controversial. While some authors considered the court’s decision to apply the *lex concursus* to be a

“*matter of common sense, not least because in most instances the final award will be enforced (and must be recognized) in the state of incorporation of the losing part*”

others invoked the legitimate expectations of the parties of an arbitration agreement:

“*The parties have contracted for arbitration. They ought to have it. Moreover, where international arbitration proceedings are already afoot, the creditor claimant may have staked much time and effort, and incurred much expenses, in asserting its rights.*”

It was also emphasized that

“*Any remedy against a bankrupt issuing from an arbitration or which might confer a preference over other creditors can usually be dealt with adequately at the enforcement stage, under the public policy exception to enforcement*.”

The author shared the view of those who looked sceptically upon the Federal Supreme Court decision. The conclusion that Polish bankruptcy law affected the bankrupt’s legal capacity did not appear convincing. Further – as aptly stated by Longmore LJ in a parallel case between

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5 LANDOLT (fn. 4).

6 NAEGELI (fn. 2), 206.

7 NAEGELI (fn. 2), 201 et seq.
Vivendi SA and Elektrim SA before an LCIA tribunal and, on appeal, the English High Court and the Court of Appeal\(^8\) – it would seem to be “natural and understandable” that the law of the seat of the arbitration should determine whether the arbitration should continue. Alternatively, the fact that the bankruptcy entity continues to be able to act through the bankruptcy administrator speaks in favor of treating the issue as one of legal succession, which relates to the subjective scope of the arbitration agreement and is again governed by the law of the seat of the arbitration.\(^9\) Therefore, article 142 LBR would not have applied to the arbitral proceeding against Elektrim – not even as a *loi d’application immédiate*, as the provision did not qualify as a rule of international public policy requiring mandatory application.\(^10\)


In the “Vivendi” case, the Federal Supreme Court was divided over the case and took its decision by 3 votes to 2. It drafted an extremely succinct opinion, which was not published in the official bulletin of the court’s leading cases. Some critics expressed their expectation that the Federal Supreme Court may have wanted to reconsider the issue.\(^11\)

Indeed, on October 16, 2012, the Federal Supreme Court rendered a carefully reasoned decision in a case where the impact of bankruptcy on the capacity to be a party to arbitral proceedings arose again.\(^12\) This time, the court delivered an unambiguous answer which is clearly distinct from the opinion in the “Vivendi” decision: it stated that a foreign bankrupt entity that has legal capacity pursuant to the law governing its registration or incorporation has capacity to be a party of an international arbitral proceeding with seat in Switzerland. Restrictions imposed by such law with regard to arbitration proceedings are irrelevant if they do not

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\(^8\) Josef Syska and Elektrim SA v. Vivendi Universal SA et al. (2009) EWCA Civ 677 at fn. 16. See excerpts of Lord Justice Longmore’s opinion reported by NAEGELI (fn. 2), 197 et seq.; see also *op. cit.*, 202.


\(^10\) NAEGELI (fn. 2), 204.

\(^11\) See, *e.g.*, NAEGELI (fn. 2), 206.

\(^12\) Federal Supreme Court decision of October 16, 2012, docket no. 4A_50/2012, ASA Bull. 2/2013, p. 354.
impact the entity’s legal capacity as such.\textsuperscript{13} The decision was published in the official bulletin of the court’s leading cases.\textsuperscript{14}

\textbf{a) The Facts}

The relevant facts of this new case are similar to those underlying the “Vivendi” decision. The appellant is a Portuguese company that was declared insolvent. After the declaration of insolvency the opponent filed a request for arbitration, based on an arbitration agreement that (again) provided for arbitration in Geneva under the ICC Rules. The appellant argued that – like Elektrim in the “Vivendi” case – the arbitral tribunal lacked jurisdiction because the appellant lacked the capacity to be a party to the arbitral proceedings. The appellant relied on article 87(1) of the Portuguese Insolvency Law (p-IL), which states as follows:

\textit{“Without prejudice to provisions contained in applicable international treaties, the efficacy of arbitral agreements relating to disputes that may potentially affect the value of the insolvency estate and to which the insolvent is party shall be suspended.”}

The arbitral tribunal dismissed the appellant’s line of argument and rendered an interim award in which it confirmed jurisdiction over the appellant.

\textbf{b) The Arbitral Tribunal’s Opinion}

The arbitral tribunal’s opinion is summarized in cons. 3.1 of the Federal Supreme Court decision. The arbitral tribunal concluded that pursuant to Swiss law, the arbitration agreement survives the declaration of bankruptcy and binds the bankruptcy administrator. The disputed issue of capacity was one of Portuguese law as the law under which the appellant was incorporated. The arbitral tribunal noted the appellant’s position that article 87 p-IL, pursuant to which “\textit{the efficacy of arbitral agreements relating to disputes that may potentially affect the value of the insolvency estate and to which the insolvent is party shall be suspended}”, has to be interpreted as invalidating or terminating the validity of the arbitration agreement. The arbitral tribunal, however, did not find any conclusive answer in Portuguese legal writing or case law as to whether article 87 p-IL does – or does not – impact the capacity of the insolvency estate or deprive

\begin{flushright}
\textsuperscript{13} Federal Supreme Court decision of October 16, 2012, docket no. 4A_50/2012, cons. 3.3.4.
\textsuperscript{14} Decision of the Federal Supreme Court (DFC) 138 (2012) III 714.
\end{flushright}
the bankrupt entity of its capacity to be a party to arbitral proceedings. The tribunal concluded that article 87 p-IL relates to the validity of the arbitration agreement against a bankrupt entity rather than to the capacity of the insolvency estate.

c) The Law Governing the Capacity to be a Party to Arbitral Proceedings

In cons. 3.3 of its decision, the Federal Supreme Court turned to the determination of the law that governs the issue of the capacity to be a party to arbitral proceedings. It noted that the 12th Chapter of the PILA on international arbitration does not contain a specific provision dealing with the capacity of non-state parties to participate in arbitral proceedings. Such capacity, therefore, depends on the preliminary issue of legal capacity.

The court referred to its case law pursuant to which the legal capacity of a party to an international arbitral proceeding with its seat in Switzerland is governed by the law governing the personal status of natural persons (Personalsstatut) or, respectively, the law under which a legal entity is incorporated or registered (Gesellschaftsstatut), i.e. by the law determined by articles 33 et seq. or articles 155 and 155(c) PILA, respectively. The court noted that it is disputed in legal writing whether conflict of law provisions outside of the 12th Chapter of the PILA can be applied in international arbitrations in Switzerland; indeed, a significant number of authors emphasize that the law governing the capacity of a party should be determined in accordance with article 187(1) PILA, which provides that the arbitral tribunal shall decide the dispute in accordance with the law chosen by the parties or, in the absence of such choice, the law having the closest connection to the dispute. The Federal Supreme Court, however, held that article 187(1) PILA only deals with the law applying to the merits of the dispute and gives precedence to party autonomy. Article 187(1) PILA thus

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does not determine the law governing the capacity of the parties to the arbitration (cons. 3.3.2).16

The court, therefore, turned to article 154(1) PILA (cons. 3.3.2 i.f.) pursuant to which legal entities are governed by the laws of the state under the provisions of which they are registered or, in the absence of such provisions, under the laws of which they organized themselves (cons. 3.3.3). For the appellant, this was Portuguese law.

d) Conclusions Drawn from the Notion and Scope of Legal Capacity

In cons. 3.3.4, the Federal Supreme Court dealt with the notion of legal capacity. Although succinct, this consideration is crucial to the outcome of the case and, more generally, to the Federal Supreme Court’s position on the relationship between bankruptcy and international arbitral proceedings.

The court recalled that legal capacity is the capacity to be the subject of rights and duties. If a party’s legal capacity is governed by a foreign law, then one must analyze whether such foreign law attributes rights and duties to the entity organized pursuant to its provisions. A foreign entity that has the status of a legal entity pursuant to the law under which it is registered or organized enjoys legal capacity in Switzerland and, therefore, capacity to be a party to proceedings. The same applies with respect to the capacity to be a party in arbitral proceedings under the 12th Chapter of the PILA.

On the basis of these considerations, the Federal Supreme Court drew conclusions that the author submits defines the future position of the court with regard to the interrelation between bankruptcy and international arbitral proceedings. The court held that if the foreign entity has legal capacity pursuant to the law governing its registration or incorporation, it has capacity to be a party to an international arbitral proceeding with seat in Switzerland. If the law under which the entity is registered or incorporated imposes restrictions with regard to arbitration proceedings that do not impact the entity’s legal capacity as such, such restrictions are irrelevant to the capacity of the entity to be a party to arbitration proceedings with their seat in Switzerland. The original German wording reads as follows:

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The court reconfirmed this statement in the subsequent consideration 3.4, in which it dealt with the appellant’s argument that Portuguese entities have no legal capacity for acts that Portuguese law prohibits. The appellant argued that it has lost its capacity to be a party to arbitral proceedings because article 87 p-IL deprives it of such capacity. The Federal Supreme Court disagreed. Even if article 87 p-IL prevents a Portuguese insolvency estate from participating as a party in a Portuguese arbitration, this is without relevance for the entity’s capacity to be a party to international arbitral proceedings with their seat in Switzerland. For the appellant to be a party to such proceedings in Switzerland only requires that the appellant has legal capacity pursuant to Portuguese law. It was not disputed that this was the case.

e) Careful Dissociation from the “Vivendi” Decision

The appellant supported its appeal, inter alia, by reference to the “Vivendi” decision. The Federal Supreme Court noted that the "Vivendi" decision had been amply criticized in both Swiss and international legal writing and referred to a long list of commentators. 17 It refused, however, to

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enter into the merits of the criticisms and stated that the “Vivendi” decision did not set any precedent of relevance to the case under review. The court denied that the “Vivendi” decision confirmed as a matter of principle that an insolvent party loses its capacity to be a party to an arbitration procedure if foreign law provides for the invalidation of the arbitration agreement in the event of insolvency. Rather, the “Vivendi” decision has to be seen in the specific context of Polish law and doctrine. The “Vivendi” decision cannot be generalized, and its considerations on Polish law cannot be transferred to other jurisdictions.

f) Article 87(1) PIL is not a Loi d’Application Immédiate

Finally, the Federal Supreme Court dealt with the appellant’s argument that article 87(1) p-IL should have been applied as a loi d’application immédiate. The court left open whether an arbitral tribunal has to take into consideration mandatory provisions of foreign jurisdictions. It held that in any event, article 87(1) p-IL does not qualify as a mandatory provision. For provisions to qualify as mandatory provisions, the legislator must intend the provision to be imperatively applied in international settings and strictly mandatory. However, article 87(1) p-IL reserves deviating provisions of international treaties and, thus, demonstrates that it was not the legislator’s intention for the provision to be applied imperatively. Furthermore, the provisions of Portuguese insolvency law can be derogated in composition proceedings, which demonstrates that article 87(1) p-IL is not a mandatory provision.

4. Comments

The “Vivendi” decision created the unfortunate impression that a jurisdiction can prevent bankrupt legal entities subject to its laws from being involved in international arbitrations with seat abroad by providing that after the declaration of bankruptcy (i) all arbitration agreements concluded by the bankrupt entity are invalid, and (ii) all pending arbitral proceedings are terminated.18 The “Vivendi” decision came to such conclusions because it qualified the issue as one of legal capacity, namely the subjective capacity to arbitrate in a pending arbitral proceeding. It is common ground that issues of

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18 See also NATALIE VOSER & ANYA GEORGE, Insolvency and arbitration: Swiss Supreme Court revisits its Vivendi vs. Elektrim decision, published December 5, 2012 http://kluwerarbitrationblog.com/blog/2012/12/05/insolvency-and-arbitration-swiss-supreme-court-revisits-its-vivendi-vs-elektrim-decision/
legal capacity are governed by the law at the place of registration of the legal entity, which as a rule is also the place where the entity is declared bankrupt. Accordingly, the continued existence of an international arbitration with its seat in Switzerland would inevitably depend on the *lex concursus* if one of the parties of the arbitration were declared bankrupt.

In the author’s opinion, this decision was rightfully criticized. Indeed, it is difficult to see that legal capacity could be separable in that a legal entity’s legal capacity could not extend to the capacity to be a party to arbitration proceedings. The decision under review now corrects the opinion underlying the “Vivendi” decision and clarifies that for the purposes of the subjective capacity to be a party to arbitration with seat in Switzerland, the test is exclusively whether the relevant entity has legal capacity. The Federal Supreme Court refuses to accept that certain areas of life can be excluded from the legal capacity of an entity. Restrictions regarding the participation in arbitral proceedings that the *lex concursus* imposes on a bankrupt entity with surviving legal capacity do not reduce the bankrupt entity’s subjective capacity to be a party to arbitral proceedings and, therefore, are irrelevant in arbitrations in Switzerland.

Less convincing are the Federal Supreme Court’s attempts to defend the “Vivendi” decision although its opinion of October 16, 2012 clearly contradicts the former. It may be true that the “Vivendi” decision did not mean to set any precedent of relevance with regard to the issue under consideration. But in “Vivendi”, the Federal Supreme Court indeed denied the continued subjective capacity of the bankrupt Elektrim SA to remain a party to arbitral proceedings although it was common ground that Elektrim SA had not lost its legal capacity as such. The court held that article 142 LBR rules on a specific aspect of the capacity to be a party to proceedings and deprives a Polish bankrupt entity of its subjective capacity to arbitrate in a pending arbitral proceeding. Elektrim SA had thus lost its capacity to take part in the ICC arbitration. The conclusions of the court in its decision of October 16, 2012 are irreconcilable with the “Vivendi” opinion.19

An interesting side aspect of the decision of October 16, 2012 is its opinion on the determination of the law that governs the issue of the capacity to be a party to arbitral proceedings. The Federal Supreme Court notes that a significant number of authors assert with emphasis that such law should not

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19 See also MARCO STACHER, Rechtsprechung des Bundesgerichts in Schiedssachen, AJP 2013, 102 et seqq., 103 fn. 14; undetermined NATALIE VOSER & ANYA GEORGE (fn. 18); NATALIE VOSER & ANYA GEORGE, Landmark decision of the Swiss Supreme Court on the effect of a foreign insolvency on arbitration proceedings in Switzerland, published December 6, 2012, http://arbitration.practicallaw.com/3-522-9661.
be determined in accordance with provisions of the PILA outside of its 12th Chapter on international arbitration. 20 Indeed, the 12th Chapter is self-standing and the PILA’s provisions are not binding on international arbitral tribunals seated in Switzerland. 21 This has been confirmed by the Federal Supreme Court in a decision rendered in December 1999, 22 which, however, the Federal Supreme Court does not refer to in its decision under review. In this recent decision, the court notes that article 187(1) PILA only deals with the law applying to the merits of the dispute and gives preference to party autonomy. Thus, article 187(1) PILA is not tailored to resolve the preliminary issue of the legal capacity of the parties. For this reason, the court turned to articles 155 and 155(c) PILA (cons. 3.3.2). 23

There are good reasons to argue that the preliminary issue of legal capacity should not be governed by the law chosen by the parties, which pursuant article 187(1) PILA is the first law that the arbitral tribunal has to turn to for the merits of the case. This does not mean, though, that arbitral tribunals should directly apply conflict of laws provisions of the 1st – 11th Chapter of the PILA instead. However, it is arguable that they can apply such provisions by analogy. 24 Either way, it will hardly be in dispute that legal capacity of a legal entity should be governed by the law under which such entity is registered or incorporated.

20 See fn. 15 above.
21 Gabriele Kaufmann-Kohler, Laurent Lévy & Sabina Sacco (fn. 15), 377.
23 In the case underlying Federal Supreme Court decision docket no. 4A_414/2012 of December 11, 2012 (ASA Bull. 2/2013, p. 344), the issue of capacity was also in dispute. The arbitral tribunal whose award was challenged applied articles 154(1) and 155(c) PILA when determining the law governing the legal capacity of the respondent (section C of the statement of facts). The Federal Supreme Court did not have to review the matter in detail but merely noted that the claimant did for good cause not contest that the arbitral tribunal applied the correct law on the issue of capacity (cons. 2.3.1.1).
24 Gabriele Kaufmann-Kohler, Laurent Lévy & Sabina Sacco (fn. 15), 377.
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