Journal of Civil & Legal Sciences

ISSN: 2169-0170

Review Article Open Access

The Impact of Insolvency on the Arbitrability of a Dispute (With the Emphasize on Russian Realities)

Daria Efimova*

Department of the Dispute Resolution, LLM Student, Legal Expert at the Arbitration Centre, Former Vis Mootie, London, England, UK

Abstract

The author examines the problematic issues in regard to the impact insolvency proceedings can have on the resolution of the dispute in arbitration. The case practice shows that there are two possible scenarios. Either the arbitration proceedings shall be stayed until the insolvency procedures are terminated, or arbitration proceedings can continue despite the introduction of insolvency procedures against one of the parties. The reasons and consequences of both decisions are described in the article. For the sake of complicity, the author also examines insolvency legislation of England and France, as two major arbitration jurisdictions, to provide an answer to the question how this problem is decided in other countries.

Keywords: International commercial arbitration; Insolvency proceedings; Arbitrability; Enforcement of an award; Public policy; Registry of creditors

Introduction

Where a party to international commercial arbitration is also a subject to parallel insolvency proceedings, an arbitrator faces additional difficulties and additional questions of fact and law [1]. These two processes are very different in nature. In arbitration the overwhelming principle is the principle of parties' autonomy, while in insolvency - a duty of equal treatment of creditors. One of the main features of arbitration is predictability of outcome, at the same time, collective proceedings are common for insolvency cases. In addition, arbitration is known as a delocalized institute, while insolvency proceedings are based on a territorial principle.

Thus, a number of questions arise. Namely, can arbitration proceedings continue despite one party becoming insolvent. There is no unequivocal answer to this question. Case practice is still developing.

For instance, in case No. A56-27823/2018 an arbitral award for recovery of debt from a company declared bankrupt was executed outside the bankruptcy proceedings because claims were qualified as pending. Such way of court analysis could be described as positive. Courts have held a similar position until in 2019.

In 2019 the Russian Court of Appeal came to the conclusion that in such cases the arbitration agreement shall be deemed unenforceable under the public policy in Russia given that the outcome of the arbitral tribunal's consideration on a claim for recovery of debt may affect the formation of the debtor's estate. At the same time, the judicial administrator can neither affect the outcome of the arbitral tribunal's consideration of the claim, nor appeal against the award [2].

Let us consider this legal relationship in terms of Russian insolvency law. Article 29 of the Resolution of the Plenum of the Supreme Arbitration Court of the Russian Federation of June 22, 2012 No. 35 "About some procedural questions connected with hearing of cases about bankruptcy" states that the existence of unsuspended and uninterrupted proceedings against a creditor in insolvency case gives grounds for the court considering the insolvency case to dismiss the claim. This paragraph of the Resolution can be interpreted in several ways. The first concept is to extend the scope of this provision to arbitration. It leads to the conclusion that the effect of introducing insolvency procedures shall be the same on the proceedings in a state court and in arbitration. However, in practice it turns out that the application of this Resolution becomes impossible due to the fact that de lege lata it can be said that it refers to the "proceedings" in question, which indirectly gives an indication of the proceedings in state courts and not in arbitration.

In case practice, the question of interpretation arises at the stage of enforcement of arbitral awards [3]. After all, it is an execution order and not the award itself on the basis of which a state court activates the state enforcement mechanism. Thus, if the rules of the Resolution do not apply by analogy to arbitration on matters not related to the issue of an execution order, then the consideration of the case in arbitration without suspending or terminating it shall not affect the consideration of an application for inclusion of creditors' claims to the registry. Therefore, the court in insolvency proceedings shall not leave without consideration an application for inclusion of creditors' claims in the registry, even if it establishes that the creditor has also filed a claim to arbitration, and shall dismiss the claim if the creditor has filed an application for the enforcement of an arbitral award, which he/she does not want to suspend or terminate.

Despite above-mentioned arguments, courts more often refer to paragraph 1 of Article 63 of the Federal Law "On Insolvency (bankruptcy)", according to which from the date of introducing first insolvency stage (an observation), any claims against the debtor may only be made in insolvency proceedings. This interpretation finds its reflection in doctrine [4]. Courts interpreted this provision as making the dispute non-arbitrable from the date observation procedures has been introduced [5]. The rulings of lower courts were further reversed by the Supreme Arbitration Court of the Russian Federation; however, judges of the Supreme Arbitration Court did not examine the issue of arbitrability, only the timeline. In situations like this, it would be reasonable to stay arbitration proceedings (by analogy with state courts) until the end of the observation procedure or in any other way "exit" from the proceeding with minimum costs and without

***Corresponding author:** Daria Efimova, Department of the Dispute Resolution, LLM Student, Legal Expert at the Arbitration Centre, Former Vis Mootie, London, England, UK, Tel: +998916330770; E-mail: richmond0770@gmail.com.

Received November 05, 2021; **Accepted** November 19, 2021; **Published** November 26, 2021

Citation: Efimova D (2021) The Impact of Insolvency on the Arbitrability of a Dispute (With the Emphasize on Russian Realities). J Civil Legal Sci 10: 295.

negative procedural consequences of further impossibility of resuming proceedings in case of termination of insolvency proceedings after the completion of observation.

The rules of existing arbitration institutions do not fully address issues relating to the imposition of observation procedure. Article 43 of the Russian Arbitration Centre at Russian Institute of Modern Arbitration Rules provides the possibility of suspending the arbitration at the request of a party or tribunal itself, if such suspension is necessary to render a just and fair award. If after the imposition of observation, the arbitral tribunal upon the claimant's request suspends the arbitration, and at the end of the observation (when the observation ends with the termination of insolvency procedures), it will be possible to include claimant's claims to the registry of creditors.

The Rules of the ICAC at the Chamber of Commerce and Industry of the Russian Federation in paragraph 2 (c) §45, in turn, states that an order for the termination of proceedings shall be issued when the arbitral tribunal finds that the continuation of proceedings has become unnecessary or impossible for any reason, in particular in the absence of the prerequisites necessary for the consideration and resolution of the case on the merits, including if due to the inaction of the claimant the case remains without movement for more than six months. Thus, it is a claimant who bears the risk of substantial financial loss as a result of the introduction of observation procedure against the respondent, since the registration fee is not refundable and arbitration fee can be only subject to a reduction. In Arbitration Centre at the Russian Union of Industrialists and Entrepreneurs reduction in such cases is 30% [6]. While in courts, if the debtor is declared bankrupt, and the court, on its own initiative or at the request of any person involved in the case, resumes the proceedings and leaves the statement of claim without consideration, the state fee shall be returned [7].

All these issues make arbitration less competitive in comparison with state courts. If there is a possibility that insolvency proceedings will be initiated against the respondent, it is worth considering all pros and cons before starting arbitration and paying arbitration fee. If this possibility is visible at the stage of the conclusion of the contract - whether to include an arbitration clause. For further development of the issue, it seems reasonable to look at how other jurisdictions deal with parallel insolvency proceedings.

In France, if insolvency proceedings are initiated against a party involved in arbitration, this could lead to conflicts between the applicable arbitration rules and the insolvency law [8]. In the case of Liquidateurs of Sté Jean Lion v. Sté International Company for Commercial Exchange Income, the highest court in France confirmed the general principle that an arbitral tribunal can only issue awards determining the amounts owed by an insolvent party. Under French insolvency law, the tribunal cannot order either party to pay any amount [9]. Failure to do so may result in a refusal to enforce the arbitral award. Therefore, remedies directly related to the insolvency (such as actions for the recovery of damages) are not subject to arbitration.

When a party to an arbitration agreement goes bankrupt, the English insolvency law prevails over the rules of arbitration. In Syska (Elektrim SA) v Vivendi Universal SA and Ors case, the court confirmed that despite the fact that a legal entity was subject to insolvency in Poland, the law of England must apply as a legal entity was involved in arbitration in London [10].

Conclusion

The English law was to determine the impact of insolvency proceedings on the arbitrability of the dispute. The court ruled that there were no restrictions in English domestic law that would prevent the continuation of the arbitration despite the Polish insolvency proceedings. On the basis of the foregoing, it may be concluded that the rules of the existing arbitral institutions need to be considered and finalized in view of possible introduction of insolvency proceedings against a respondent. The more elaborate rules are - the more competitive arbitration against litigation become.

References

1. Mantilla-Serrano F (1995). International Arbitration and Insolvency Proceedings. Arb Int EU 11 1: 51–74
2. https://education.law-books.ru/wp-content/uploads/2021/08/%D0%9E%D0%B8%D0%9F-5-2021.indd.pdf
3. https://www.refworld.org/docid/595f3a934.html
4. https://civpro.org/article/the-origins-of-the-principles-of-good-faith-and-the-presumption-of-innocence-in-civil-matters/
5. http://www.cisarbitration.com/2014/10/09/overview-of-essential-russian-cases-related-to-arbitration-may-september-2014/
6. https://arbitration-rspp.ru/en/arbitration-clause/
7. https://globalarbitrationnews.com/wp-content/uploads/2017/06/Russia.pdf
8. Khayat D (2010). Coexistence Between Bankruptcy and Arbitration Laws in France. Mayor Brown US:1-1.
9. Živković P (2010) Liquidateurs of Sté Jean Lion v. Sté International Company for Commercial Exchange Income. Mayor Brown US:1-1.
10. https://www.casemine.com/judgement/uk/5a8ff70060d03e7f57ea580a