International Insolvency and International Arbitration - A Preliminary Perspective

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INTERNATIONAL INSOLVENCY LAW & INTERNATIONAL ARBITRATION – A PRELIMINARY PERSPECTIVE

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International insolvency law and international arbitration law have historically existed in separate worlds that have rarely intersected. However, the time has come to give more serious consideration to whether, and to what extent, international arbitration can provide useful assistance in international insolvency cases. This paper contains some preliminary observations that may be useful in developing this topic.

I. Introduction

The principal attraction for using international arbitration in the context of international insolvency cases arises from the fact that international arbitral decisions are enforceable in more than 150 countries, including virtually all of the nations engaged in international trade and commerce. This results from the adoption of the New York Convention in more than 150 countries. Thus an arbitral decision issued in an insolvency case can be enforced essentially worldwide.

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4 The exact number of countries that have adopted the New York Convention is apparently difficult to determine, perhaps in part because of uncertainty as to whether certain entities that have adopted the convention qualify as countries.

5 If two conditions were realized (or come to be realized, the consideration of international arbitration in the international insolvency context would be must less important: (1) the adoption of an international insolvency regime to an extent parallel to the reach of the New York Convention, and (2) enforcement mechanism in the international insolvency regime that approximates that of the New York Convention. Such developments may be considered highly unlikely. However, twenty years ago, the development of the regime that we have today was comparably unlikely. So one can be optimistic.
Enforceability in another country of an insolvency decision, in contrast, is more limited. Full enforceability is generally available in the European Union under the E.U. Insolvency Regulation (except Denmark).

Outside the European Union, the principal legal authority for recognition of insolvency orders and judgments is the UNCITRAL Model Law on Cross-Border Insolvency (“the Model Law”), which has been adopted in some 40 countries. There are additional countries that are generally willing to enforce foreign insolvency judgments pursuant to the concept of comity, but are likely to make exceptions in an unpredictable or unknown fashion. In addition, many countries that are important players in international commerce are not subject to any international insolvency legal regime.

The first step in addressing this issue is to understand the nature and extent of the differences between arbitration and insolvency law, especially at the international level.

II. Differences Between Arbitration Law and Insolvency Law

International arbitration law and international trade law are essentially two different worlds. The basic principles of arbitration law and insolvency law are fundamentally different. Arbitration law is based on the principles of party autonomy and consent of the parties, while insolvency law is based on a statutory system providing for judicial supervision and direct judicial involvement in the case. This part briefly describes these differences.

A. International Arbitration Law

The most important feature of international arbitration is the substantial role of the New York Convention in providing for the international enforcement of an arbitral award. Essentially any party that obtains an award in its favor can enforce the award in another country. See the UNCITRAL website for a list of countries that have adopted the Model Law. However, the UNCITRAL list does not include the OHADA countries in Africa: OHADA has adopted the Model Law, which makes it automatically the law for all 17 member countries. See Traité Relatif à L’Harmonisation en Afrique du Droit des Affaires, art. 10, available at http://www.ohada.com/traite/10/2/titre-2-les-actes-uniformes.html (providing, “The uniform acts [of OHADA] are directly applicable and obligatory in the State Parties, notwithstanding any contrary provision of internal law, previously or subsequently enacted.”)
every country where the losing party has assets, because every important trading

country is party to the New York Convention.

1. Arbitration is for Two-Party Disputes

A fundamental feature of arbitration is that in principle it involves only two-party
disputes. While there may be more than two parties in an arbitration, typically there are
only two. If there are more than two parties, they usually align so that there are only two
sides to the dispute.

2. Agreement in Writing

An agreement to arbitrate must be in writing.\textsuperscript{7} The arbitration agreement may be
part of a contract between the parties, or may be a separate arbitration agreement. The
writing may also be contained in an exchange of letters or telegrams.\textsuperscript{8} Such an
agreement is not limited to differences that arise out of a contract: any legal relationship
between two parties may give rise to a dispute that the parties may agree to arbitrate, so
long as it concerns a subject matter that is capable of settlement by arbitration.\textsuperscript{9}

3. Party Autonomy

Typically, the parties have written their own law to govern the transaction by
drafting a contract that specifies in many respects the legal rights and obligations of the
parties. In addition, if a dispute arises between the parties, they are free to determine
the procedure for resolving their dispute, and to choose who should help them in the
resolution process.

\textsuperscript{7} See, e.g., New York Convention, art. II (1) (providing that the New York Convention applies only

\textsuperscript{8} Presumably an exchange of emails or other written communications may also form a valid
agreement to arbitrate.

\textsuperscript{9} For example, the major creditors in the Nortel cases (which involved at least three countries)
agreed to binding international arbitration with respect to any dispute that might arise with respect
to the liquidation of the Nortel assets. If they had agreed to such arbitration on the distribution of
the assets as well, there would not be some $7.5 billion sitting in escrow for a lengthy period of
time awaiting resolution of the distribution rights.
Arbitration preserves a substantial measure of party autonomy. In a typical arbitration with three arbitrators, each party chooses an arbitrator, and the arbitrators then choose a third to participate in the arbitration panel. The parties may also choose the location of the arbitration, the applicable law, the rules under which the arbitration will be conducted, and the language that will be used. The parties also generally choose to conduct the arbitration in private, and to keep the results of their arbitration confidential. Overall, the law governing the rights and obligations of the parties is based on private law, the law governing private relations between parties where no substantial State interest is involved.

4. State Involvement in the Arbitration Process

The State has a limited involvement in the arbitration process, which chiefly may come at one of two points. First, at the outset of the dispute a party may commence a court proceeding on a matter subject to an arbitration agreement. If a party requests that the matter be referred to arbitration pursuant to the agreement, the court is required to refer the matter if it is capable of settlement by arbitration, unless the court finds that one of the following exceptions applies: the agreement is null and void, it is inoperative, or it is incapable of being performed.

The second point of possible State involvement in the arbitration process comes after an award is granted. Such an award is binding and enforceable with respect to the parties in any State that is a party to the New York Convention on Arbitration. Apart from these two points, it is highly unusual for a court to become involved in an arbitration process.

5. Domestic Arbitration

International arbitration differs little in substance from domestic arbitration in these fundamental respects. The parties to an international agreement may choose the governing law for their transaction, which may have little connection to the home States of the parties. The parties have a choice of venues for the conduct of the arbitration, and there is little need that the State chosen as the seat of the arbitration have any connection to the parties or the dispute at issue. In addition, the language chosen for
the arbitration will likely be a language of international commerce (such as English or French), unless the parties share a different common language.

B. Insolvency Law

Insolvency law is different from arbitration law in almost every possible respect. Because of the debtor’s insolvency (or financial difficulties), different rules are applicable in the insolvency process. Insolvency law typically involves many parties – the debtor, all the creditors, and the State. In more complex insolvency case, there may be thousands (or tens of thousands) of creditors. Secured creditors are generally entitled to realize on their collateral (although such realization may be delayed). Certain unsecured creditors are entitled to priority or privilege in repayment, depending on local law. The costs of the procedure must be paid. General unsecured creditors share pro rata (par condicio creditorum) in the remaining assets of the debtor, and equity holders receive nothing unless there is surplus value left over for them. Alternatively, a plan of restructuring is proposed that must receive general creditor approval.

Given these important differences, there are substantial challenges in trying to make use of the international arbitration regime in international insolvency cases. How to bridge this gap depends on how international arbitration is to be used in a particular case (or group of cases).

1. Collective Procedure

The most important difference between arbitration and insolvency is that insolvency law is a collective proceeding involving all creditors of a particular debtor. Insolvency law is designed to solve the problem of a debtor that has insufficient assets to pay all creditors in full. Given the insufficiency of assets, insolvency law determines which creditors receive how much of what is owing to them. At the same time, insolvency law is designed to reduce substantially the total transaction costs that the parties would individually incur in attempting to recover their credits.

Typically there are many claimants in an insolvency case. In consequence, they must all be involved in the distribution process. Typically, a resolution process is utilized to determine how much is owing to each claimant, which is used to determine the claimant’s pro rata share of the distribution. No claims resolution is needed for claimants
who will not receive a distribution in the process (typically because their claims rank lower than those who receive all of the assets). In contrast, in arbitration all of the relevant parties (typically only two) are involved in the proceeding, and they do not need to consider third party rights that may affect their outcome.

2. State Involvement

A second important difference between the insolvency process and arbitration is the State involvement in the insolvency process. The insolvency process is supervised by a court (or, exceptionally, a governmental administrative agency), and a government agent takes over the administration of the assets (or at least supervises their administration where the debtor is authorized to proceed as a debtor in possession). The proceedings in the case are conducted in public.\textsuperscript{10} Creditors must prove their entitlement to share in the assets to the satisfaction of the court. Every court decision in an insolvency case is fully reviewable in the court appellate structure\textsuperscript{11} (unless it has become moot).

Unlike arbitration law, insolvency law is through and through a matter of public law (with limited exceptions), where the State is actively involved in protecting the rights of the parties (which are specified in advance by applicable statute), and the State administers the process through the insolvency courts and through State oversight of individual cases.\textsuperscript{12}

\begin{itemize}
\item\textsuperscript{10} Exceptionally, a few countries (such as France) do not make their insolvency proceedings open to the public.
\item\textsuperscript{11} Countries vary in the extent that appellate review of an insolvency court decision is available. In some countries, an appeal can be taken of any decision, and the proceedings are suspended until the appeal is resolved. In other countries, most appeals must await the conclusion of the case, at which time many of the court decisions may no longer be subject to appeal.
\item\textsuperscript{12} In the United States, for example, State oversight is provided both through the U.S. Trustee system and through the appointment of a trustee to administer each case (except in debtor in possession cases).
\end{itemize}
3. International Insolvency Law

Unlike international arbitration law, which adds relatively minor considerations to domestic arbitration law, international insolvency law involves a substantial new body of law that is quite different from its domestic counterparts in many respects.

The legal regime for international insolvency is based principally upon two international documents. The E.U. Regulation on Insolvency applies to 27 of the 28 E.U. member States, and provides for full international enforcement throughout the European Union of judgments and orders issued in an insolvency case in a member State.

For the remainder of the world, the principal source of law is the UNCITRAL Model Law on Cross-Border Insolvency (“the Model Law”), which requires domestic adoption to become effective in a particular country. The Model Law has been adopted in nearly 40 countries, including several E.U. countries. Under the Model Law, an order for recognition of a foreign insolvency proceeding is required as a prerequisite to enforcing an order issued in the foreign insolvency proceeding. Even after recognition of the foreign proceeding, the court granting recognition (and any other court in that country) has discretion (based on comity) to grant domestic enforcement of a foreign insolvency court order or judgment.

Adoption of the Model Law is progressing. However, it will take a number of years for the recognition of foreign insolvency judgments to become the general rule worldwide. In contrast, an international arbitration order is enforceable essentially worldwide, in all of the countries that have adopted the New York Convention.

13 Pursuant to its E.U. accession agreement, Denmark has opted not to be subject to the E.U. Regulation on Insolvency.

14 There are several EU member countries that have also adopted the Model Law, including Greece, Montenegro, Poland, Romania, Serbia, Slovenia, Spain and United Kingdom. In addition, the EU Regulation is currently in the process of revision, and there has been an effort the include the Model Law in the EU Regulation to cover those circumstances where the EU Regulation is not applicable (i.e., international cases which involve proceedings in non-EU countries). See Draft Amended Version of Council Regulation (EC) No 1346/2000 on Insolvency Proceedings as Amended by Council Regulations of 12 April 2005, 27 April 2006, 20 November 2006, 13 June 2007, 24 July 2008 and 25 February 2010 as Provided by INSOL Europe. However, it appears that this effort will not be successful in this round of revisions to the EU Regulation. The EU Regulation is scheduled for further evaluation and possible revision every five years hereafter, and such an adoption of the Model Law could occur in a future revision.
Parties have few choices with respect to an insolvency cases, even where it is international in character. As between countries, only the country where the debtor’s center of main interests (“COMI”) is located is a proper location for its main proceeding. Absent exceptional circumstances, the parties usually have little choice in the judge who is assigned to an insolvency case at the first instance level.\footnote{There frequently are more choices as to venue available in the United States between the districts where a case may be commenced, even though the individual judge serves by appointment of the court (usually through a random selection process). For a corporation or other business entity, an insolvency case may be commenced either in the state where the debtor is incorporated (its registered office) or the state where its “principal place of business” is located (if different). See 28 U.S.C. § 1408(1) (2012). In addition, if an affiliate or general partner has already commenced a case, that district is an available district for the case. See id., § 1408(b).} The court typically assigns the judge to the case without consulting the parties in interest.\footnote{The parties typically have little opportunity to challenge the assignment of a particular judge to a case, except where the judge has a conflict of interest. See, e.g., Code of Judicial Conduct for United States Judges, Canon 3(C) (prohibiting a judge from serving on a case where the judge has a conflict of interest such as having practiced with a firm when the firm represented a party in the case, or having a financial interest in a party).} The law applicable to the case is the law of the State where the case is commenced (the \textit{lex fora}), which to a certain extent includes its choice of law rules, but the parties have no choice on this subject in an insolvency case. The proceeding is public (except for countries such as France where insolvency cases are assigned to courts that are not open to the public), and the results are available to the public.

III. Legal Basis for Using Arbitration in International Insolvency Cases

The legal basis for using arbitration in international insolvency cases rests principally in the Model Law and the E.U. insolvency Regulation. In addition, it is possible that, apart from these legal structures, the laws of the relevant countries in a particular case may provide for arbitration in a manner that would permit the use of arbitration in the insolvency context.

Arguably the Model Law already provides for the use of international arbitration in support of an international insolvency case. Article 27 provides that the cooperation between courts and administrators referred to in articles 25 and 26 may include, “approval or implementation by courts of agreements concerning the coordination of proceedings.” While this language is more likely to related to the use of protocols for
coordination purposes, an international arbitration agreement may be considered an “agreement concerning the coordination of proceedings.”

A much clearer provision would be an addition to Article 27 that specifically provides that cooperation between courts and administrators may also include the reference of a matter to international arbitration for decision. Such a provision could also authorize an insolvency court to designate the parties to choose the international arbitrators to carry out arbitration authorized by the court. This kind of language would make it clear that international arbitration is a mode of cooperation that is consistent with the Model Law and that is specifically authorized under it.

a. EU Regulation

Under the EU Regulation on Insolvency, both the opening of an insolvency case and any subsequent court order in the case receives automatic recognition in every EU member country (except Denmark, which has opted out of the application of the EU Regulation) with no further formalities. Such recognition is required by the EU Regulation. The Regulation came into force in 2002, and each country that has received EU membership thereafter has been bound by all EU regulations, including the insolvency regulation.

b. UNCITRAL Model Law

In a Model Law country, the enforceability of a foreign decision in an insolvency case is based on comity, not full faith and credit, which must be determined by the domestic court on a case by case basis. In addition, such enforcement is available only after a court in the country where enforcement is sought has recognized the foreign proceeding as a foreign main or non-main proceeding.

The structure of the Model Law, however, does not limit the recognition of insolvency decisions to those in other countries that have adopted the Model Law. The

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17 It is unlikely that an insolvency court would itself designate an arbitrator (or arbitrators), because arbitration is designed to be undertaken by private parties, not at a court’s direction.

18 If the foreign proceeding is denied recognition as a main or a non-main proceeding, enforcement is denied. See, e.g., In re Bear Sterns High-Grade Structured Credit Strategies Master Fund, Ltd., 374 B.R. 122 (Bankr. S.D.N.Y. 2008).
Model Law has no reciprocity provision. In consequence (apart from the limited number of countries that have imposed such a requirement), a court in a Model Law country, after recognizing a foreign insolvency proceeding in any other country (whether or not it has adopted the Model Law), can decide to enforce any decision in that foreign insolvency case.

IV. Ways that International Insolvency and International Arbitration May Interact

There are three scenarios where an international arbitration case and international insolvency case may interact. The arbitration case may be pending when the insolvency case is commenced, or the insolvency case may be pending when the arbitration case is commenced. In a third scenario, an arbitration may be under way when a party to the arbitration commences an insolvency case, which gives rise to a right to assume or reject the contract that gives rise to the arbitration.

A. Arbitration Pending when Insolvency Case is Commenced

We take first the situation were an international arbitration case is pending when the insolvency case is commenced. This raises at least three issues: what law governs the insolvency proceeding; what law determines whether the arbitration may continue while the insolvency case is pending; and what law governs the enforcement of the arbitral award after the arbitration has concluded.

1. Law Governing the Insolvency Proceeding

The issue of the law governing the insolvency proceeding is well recognized. The general rule is that the insolvency proceeding is governed by the lex fori, the law of the forum where the insolvency case is commenced. The European Regulation on Insolvency provides a number of exceptions to this rule. Many of these exceptions are tacitly recognized in the laws of other countries.

19 Romania, South Africa and Mexico have adopted a reciprocity requirement in connection with the Model Law.
A far larger issue is whether a moratorium or automatic stay applicable after the commencement of an insolvency case would suspend an arbitration proceeding. The requirement to suspend and arbitration would largely depend on the law of the forum where the insolvency case is commenced.

Several factors in the insolvency law of the forum are particularly important in this regard. First, if there is a moratorium that comes into place after the commencement of the case (there is in most countries), the moratorium may prohibit the continuance of the arbitration proceeding without obtaining permission from the court. On the other hand, the moratorium may specifically exclude arbitrations from the scope of the moratorium, or there may be an exclusion that covers the particular moratorium at issue. For example, under U.S. law, an arbitration would not be stayed if the debtor is trying to recover money from the other party to the arbitration, but it would cover the arbitration if the other party is seeking money from the debtor.

2. Continuance of the Arbitration after the Commencement of the Insolvency Case

If the arbitration is taking place in the same country as the insolvency case, there is a substantial likelihood that the insolvency moratorium would require the suspension of the arbitration case. This turns on three issues: whether there is a moratorium in the case, and what time period it covers, and whether the moratorium covers the arbitration proceeding.

However, if the arbitration is in a different country, the issue of whether an arbitration is covered by a moratorium also depends on whether the country of the insolvency case applies its insolvency law universally or territorially. A universalist insolvency law is one that applies worldwide, while a territorial insolvency law applies only within the country where it is commenced. The modern trend is to adopt the universalist approach, but a number of countries (particularly those with old insolvency laws) take the territorial approach. Under a universalist system, if a moratorium applies in the insolvency case, it applies to the arbitration where the debtor is a party, wherever the arbitration may be located. If the insolvency law is territorial, an arbitration in another country is not affected by the insolvency moratorium. Whether a country’s insolvency

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20 In some countries, such as Hungary, a moratorium applies only if it is adopted in the meeting of creditors.
law is territorist or universalist is not generally stated in the insolvency law itself – one must consult other authorities to determine this issue.

The commencement of a secondary (or nonmain) insolvency proceeding would change the calculus as to the moratorium. If a secondary or nonmain insolvency proceeding is commenced in a country, that country’s moratorium applies. Thus, for an arbitration that is taking place in that country, that country’s moratorium (and not the moratorium of the country where the main proceeding is commenced) would determine whether the arbitration may proceed. This result is the same in a Model Law country, an E.U. country, and a country where neither is applicable.

Frequently, where the commencement of the insolvency case suspends the arbitration, the insolvency court will authorize the arbitration to continue. There are many circumstances where the continuance of the arbitration is in the best interests of the parties, because it liquidates a debt owing by the insolvency debtor or liquidates a claim owing to a creditor.

**B. Insolvency Case Commenced Before Arbitration Cause**

If an insolvency case has been commenced in the country that has also been designation for an arbitration, the insolvency law governs whether the arbitration can proceed. If the insolvency case is commenced in another country, whether the insolvency case impacts the commencement of the arbitration turns on whether (a) the insolvency law in that country is universal or territorial, and (b) whether that insolvency law permits the arbitration to proceed (or whether court permission is granted, if it is required).

**C. Rejection of a Contract Containing an Arbitration Clause**

The rejection of a contract with an arbitration clause can be particularly disruptive if it occurs while an arbitration procedure is under way. Typically this happens only where the insolvency case is commenced after the commencement of the arbitration. To understand this problem, we start with a general description of the assumption and rejection of contracts in an insolvency case.

Insolvency laws generally provide a possibility for the rejection of a contract in the insolvency case. Alternatively, the administrator may decide to assume or continue
the contract, in which case the administrator (or the debtor in possession) and the counterparty will continue to be bound by the contract. Generally, the administrator will assume a contract if the benefits to the contract outweigh the costs. Alternatively, if the costs to the administrator exceed the benefits to be received, the administrator will generally reject the contract. Generally the decision to assume or to reject a contract lies in the discretion of the administrator, and the counterparty has little or no influence in this decision. The assumption or rejection of a contract in an insolvency case may require a court order, depending on the law of the particular country.

If the relevant arbitration agreement is part of such a contract, the survival of the agreement to arbitrate turns on the treatment of the contract in the insolvency case. If the contract is assumed, the general principal is that it is assumed *cum onere* (with all its obligations). The consequence of such assumption is that the arbitration agreement continues to bind the parties, including the administrator.

In contrast, if the contract is rejected, typically the counterparty to the contract is entitled to a claim in the insolvency case. Such a claim is usually an unsecured claim, but it is a secured claim if the contract provided for security for the counterparty.\(^{21}\)

Outside of the insolvency context, the breach of a contract with an arbitration clause gives a right to the counterparty to invoke the arbitration agreement. However, an insolvency case is an exception to this principle, unless the contract is assumed. Even if the contract is assumed, permission from the court may be required to proceed to arbitration in the case of a post-assumption breach.

An agreement that a contract will be assumed in the event of the commencement of an insolvency case is not enforceable because, under insolvency law, such an agreement would not be capable of arbitration because the power to reject a contract is provided by public law and cannot be bargained away.

As noted, the rejection of a contract containing an arbitration clause while an arbitration procedure is under way is particularly disruptive. Insolvency laws typically permit this to take place – the insolvency case takes primacy over the arbitration. After the commencement of the insolvency proceeding, the administrator (who is newly appointed) must decide whether it is advantageous to the insolvency estate to continue the arbitration proceedings, or to terminate them. The general discretion of an administrator to decide this issue one way or the other applies in this situation, also,

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\(^{21}\) Financing contracts and contracts relating to real estate are frequently secured in this manner. The security may be real estate, or it may be movable property.
V. Possible Uses of Arbitration in International Insolvency Cases

There are a number of kinds of issues that could be amenable to international arbitration in the international insolvency system. A sample of such issues includes the resolution of certain core insolvency issues such as the liquidation of claims, the determination of an avoidance action (preferential, fraudulent or undervalued transaction), the resolution of conflicts among insolvency cases for related entities in different countries, and the negotiation of a restructuring plan. In addition, international arbitration may be useful for the determination of the location of a debtor’s center of main interests (COMI), and the location of an enterprise group’s entity center of main interests (ECOMI) (after an international insolvency regime is adopted for enterprise groups).

A. Core Bankruptcy Issues

The least controversial use of arbitration law in insolvency cases is to resolve contentious issues in a case that lie at the core of insolvency law. Such uses may include the resolution of disputed claims, the prosecution of avoidance actions, and the formulation of a restructuring plan. Issues of this kind may arise in a particular case, which would implicate mainly domestic law, or in related cases in different countries.

The resolution of claims among international related debtors, such as in the Nortel case, is an ideal use of international arbitration. Such arbitration has not been used in that case because the parties have not agreed to submit this matter to arbitration (despite the urging of more than one court).

The use of arbitration to resolve such issues would require the written consent of the parties to resolve such an issue by arbitration, and the approval of the court to send such an issue to arbitration. In addition, the court would have to craft the order approving arbitration in such a way as to protect the rights of third parties in the insolvency case. The court may also have to review the arbitral award after it is issued to assure that no such third party rights are compromised. In consequence, the arbitral

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22 See In re Nortel Networks, Inc., 737 F.3d 265 (3d Cir. 2013).
award may be less final and binding as where there is no overarching insolvency case in which it must fit.

There may be advantages to using arbitration in such a context. One possible advantage arises from the fact that judicial resources are usually limited, and the submission of a complex issue to arbitration could save court time for other matters in the same case, or for other cases assigned to the judge. A second possible advantage where the parties to the arbitration are from different countries (and are creditors in the same case), is that an international arbitral award, with the power of the New York Convention attaching to it, may augment the enforceability of a judicial order based on the award in the insolvency case.

The situation becomes more complex when there are national cases for related entities pending in more than one country. However, here there seems to be no doubt that international arbitration can be useful, and the power of the respective courts to enforce an arbitral award in these circumstances seems to be clear.

**B. Lack of National Court Jurisdiction**

A second possible use of international arbitration is to provide a dispute resolution mechanism where national court jurisdiction is insufficient to resolve the issue adequately. Such a use could be invoked where there is simply no such jurisdiction under the existing international insolvency regime, or where the existing regime of national court jurisdiction needs supplementation.

In the Nor tel case, for example, some $7.5 billion sits in escrow accounts awaiting a resolution of how the funds should be distributed in three related cases in the United States, the United Kingdom and Canada. The parties did agree to international arbitration to resolve any disputes relating to the liquidation of the assets of the various businesses in the countries where insolvency cases were commenced, but this agreement did not encompass the distribution of the proceeds. The principal hinderance to sending the distribution issues to arbitration is that the existing arbitration agreement between the parties does not encompass the arbitration of this phase of the dispute. The decision of the Third Circuit court in the United States makes it clear, at least in the

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23 Courts are virtually always understaffed and overworked.

24 See *In re Nortel*. 
U.S. view, that this dispute could be arbitrated if the parties would agree on international arbitration.25

C. Enterprise Groups

An international insolvency regime for international enterprise groups remains to be elaborated. The existing international insolvency regime (which is less than twenty years old) is limited to the international dimensions of a single legal entity. While both the European Union and UNCITRAL are actively considering the international enterprise group context, much work in developing an international regime for enterprise groups remains to be done.

In the context of enterprise groups with legal entities in different countries, arbitration may be useful. It may be especially useful in contexts where there is no court to resolve disputes between insolvency cases in different States. It may also be especially useful in negotiating a restructuring plan involving entities from more than one State (whether or not such entities have separate insolvency proceedings pending in their various COMI states).

Judge Allan Gropper has identified two additional areas international insolvency cases may benefit from the use of international arbitration: the resolution of disputes between enterprise group affiliates with insolvency cases in different countries, and debt restructurings of business enterprises.26 These issues may be sent to international arbitration in appropriate cases.

In addition to these two areas, it appears that several other issues in international insolvency cases are suitable for international arbitration. These include the use of international arbitration to determine the State where a debtor’s COMI is located. In addition, when the international insolvency regime develops a system for enterprise groups, it will likely be important to determine the location of the enterprise group’s ECOMI, and international arbitration could also provide assistance in making this determination. The mechanics of using arbitration in these contexts remain to be developed.

25 See id.

Judge Gropper identifies three particular issues that need analysis in the international insolvency and international arbitration area: who are the proper parties for such an arbitration agreement, the choice of applicable law, and the enforceability of such an arbitration agreement.\textsuperscript{27} These issues remain to be elaborated.

A much more ambitious use of international arbitration would be to resolve disputes between sovereign entities with financial difficulties. Such disputes could include international disputes between public entities such as sovereign wealth funds or national banks, as well as disputes between sovereigns themselves that are undergoing financial difficulties.

Use of the New York Convention in this context poses two distinct problems under the treaty that would have to be resolved. First, the New York Convention provides that recognition and enforcement of an arbitral award may be refused in a particular country if the subject matter of the dispute is not capable of settlement by arbitration. Second, if enforcement of the award is contrary to public policy. Each of these issues raises problems that remain to be addressed.

\textbf{VI. Limitations of International Arbitration}

The international arbitration system has limitations, which may be important for the purposes of international insolvency law. Some of these limitations can be controlled by the relevant courts that refer matters to arbitration, while others are inextricably tied to arbitration and likely cannot be avoided. Some of these limitations are imposed by the New York Convention, and are inherent in the international arbitration system. Other limitations arise from differences between insolvency law and international arbitration.

The limitations arising from Article V of the New York Convention limit the enforcement of an international arbitral award after its has been rendered. They come into plan only after the completion of the arbitration. They do not prevent a dispute from going to international arbitration in the first instance.

This part addresses those limitations of international arbitration that inhere in the international insolvency system, and those that are a function of the differences in

\textsuperscript{27} See id.
character between insolvency law and international arbitration. Issues of arbitrability and public policy are left to Part VII.  

A. Limitations Imposed by the New York Convention

Article V.1 of the New York Convention provides five procedural grounds on which recognition and enforcement of an arbitration award can be denied: (a) the arbitration agreement is invalid under applicable law or one of the parties is under an incapacity; (b) a party was not given proper notice of the procedure or the appointment of an arbitrator or was otherwise unable to present his or her case; (c) the dispute is not within the terms of the arbitration agreement or was not contemplated by it; (d) the composition of the arbitral body or the arbitral procedure was not in accordance with the agreement of the parties (or the law of the country where the arbitration took place); or (e) the award has not become binding or has been set aside or suspended by a competent authority of the country in which (or under the law of which) the award was made.

The procedural grounds specified in the New York Convention for refusal to recognize and enforce an arbitration agreement are essentially within the control of the insolvency court, once an insolvency case is commenced concerning one of the parties to arbitration (whether the arbitration is under way when the insolvency case is commenced, or the arbitration commences with permission of the court). The insolvency court is available to determine the validity of the arbitration and the capacity of the participants, the sufficiency of notice to the parties to the arbitration, whether the dispute falls within the terms of the arbitration agreement, the legitimacy of the composition of the arbitral body, and the finality of the arbitration award.

In addition, because an insolvency case collects the debtor and all of the creditors in a single forum, that court can make a determination that resolves each of these procedural issues. In addition, the insolvency court is the likely venue for enforcing the arbitral award, so that its resolution of these issues is likely to be definitive as between the parties to the arbitration.

\[28\] See text infra at notes 29-51.
B. Arbitration Limitations Based on Relationship Between Arbitration and Insolvency Processes

The nature of an insolvency process raises certain issues with respect to the use of international arbitration related to an insolvency case. Some of these features are controllable by the insolvency court, and some are features of international arbitration that must be accepted as part of the arbitration system.

1. Controllable Features

International arbitration has three characteristic features that are inherent in the arbitration process, but are eminently controllable by the courts if the arbitration results from a court reference. Such international arbitrations are notorious for being too slow, too expensive, and secret. These features typically arise in part because such arbitrations are not subject to judicial control. However, when the arbitration results from referral by a court, the court can impose controls that eliminate these problems.

1. Speed

Some insolvency matters need to be decided quickly. “First day orders” are typical in a U.S. chapter 11 case (which are typically issued within a few days of the commencement of the case (but often not on the first day), without which a restructuring may be impossible. While such issues are usually not good candidates for arbitration, there are some matters that could usefully be sent to arbitration (e.g., a dispute on the location of a debtor’s COMI) where a decision within a few days or weeks is essential to the success of a restructuring.

A court order sending the parties to arbitrate such an issue could include a time frame (e.g., two weeks or a month) in which the decision must be returned to the court. This can be accomplished by a court order that imposes specific limitations on the arbitration. For instance, the order authorizing the arbitration could specify a deadline for completing the arbitration. The order should further provide that, if the arbitration is not completed before the deadline, the order referring the matter to arbitration expires. In appropriate circumstances, this deadline could be delayed for cause shown.
Presumably, the international arbitration community could adopt processes to make a
decision in the required time frame.

2. Cost

International arbitrations are known to be expensive. However, the order for
arbitration could impose a budget on an arbitration. Such a budget would govern the
costs for the arbitrators, the attorneys to be paid by the estate, and any other
professionals who may be entitled to seek compensation from the estate (e.g., expert
witnesses) with respect to the arbitration. If lawyers and other professionals acting for a
creditor are entitled to compensation from the estate (whether by contract or otherwise),
the court could provide a budget for them as well.

3. Secrecy

International arbitration is typically conducted in private, outside the public eye.
This contrasts sharply with the treatment of insolvency cases, which are conducted in
open court and any member of the public may attend and observe.

Arbitration typically does not take place in a courtroom, where there is space for
members of the public, or even interested parties, to attend and observe. It is possible,
however, for the court referring the matter to arbitration to specify that certain persons be
permitted to attend, and that the parties choose a location for the arbitration that can
accommodate these individuals. In addition to counsel for the administrator, such
individuals may include counsel for the debtor, counsel for a committee of creditors, and
counsel for a major secured creditor.

Some arbitral awards are reported in publications of the arbitration industry. The
court may require the publication of such an award in an appropriate case. In addition,
the court may require that a transcript of the arbitration proceedings be made available
to interested persons (who may be specified by the court).

C. Features of Arbitration that Cannot Be Avoided

In contrast to the foregoing controllable features, which can be alleviated in the
arbitration order issued by an insolvency court, there are three features of international
arbitration that are endemic to the arbitration system and cannot be avoided, where the arbitration is related to an insolvency case. For the most part, these features must be accepted in matters where an arbitration is related to an insolvency case.

1. Errors of Fact and Law

A first such feature is that, if the arbitrator makes an error of fact or law, the error is generally not reviewable by a court. As to errors of law, in sharp contrast, a judicial error is fully reviewable by a higher court. An error of fact by a court is typically also reviewable on appeal, but in a more limited fashion: the review is limited to findings of fact that are clearly erroneous or that are not supported by substantial evidence in the record.

2. Creation of Caselaw

A second limitation of arbitration arises from the fact that arbitration does not create caselaw. Insolvency laws are complex and subtle, and give rise to many issues of interpretation. One of the functions of insolvency courts is to resolve ambiguities in the interpretation of a statute, which promotes consistency in its interpretation.

Especially in a common law system, the effects of such caselaw extend far beyond the cases in which the decisions are issued. Parties use caselaw to structure their transactions and to settle disputes out of court. While caselaw is not always definitive (because it often does not come from a court with binding authority), it often is persuasive in other courts. In consequence, parties are likely to follow it even when it could be challenged, because such a challenge is both expensive and risky. This principle applies to a substantial extent in civil law countries, also, even though caselaw may not be a typical source of law.

In contrast, arbitral decisions are often not made public, and thus create no source of statutory interpretation at all. Even those arbitral decisions that are made public are rarely treated even as persuasive authority.
3. Arbitrator Bias

A third limitation of arbitration is that arbitrators may be biased. Especially where a party is a repeat player in the arbitration system at issue, arbitrators have a financial incentive to favor the repeat player at the expense of parties who do not regularly engage in arbitration. This feature results from the fact that arbitrators are appointed by the parties for the specific arbitration. Arbitrators tend to want repeat engagements, and tend to favor the repeat players that can hire them repeatedly. In contrast, judges are appointed by governmental agencies (or elected by popular vote, in some countries), and their compensation comes from the government, not the parties.

VII. Arbitrability and Public Policy

Apart from the foregoing procedural matters, Article V of the New York Convention provides that recognition and enforcement of an arbitral award can be denied if the competent authority in the country where recognition and enforcement is sought finds: “(a) the subject matter of the difference is not capable of settlement by arbitration under the law of that country; or (b) the recognition or enforcement of the arbitral decision is contrary to the public policy of that country.”

Like the procedural matters based on Article V.1, these issues arise after the completion of the international arbitration and the granting of an arbitral award, at the time that enforcement of the award is sought in a forum of a particular country.

A. Arbitrability of Matters Relating to Insolvency Cases

Enforcement of an international arbitral award may be denied by a domestic authority if, under the laws of that country, the subject matter of the arbitration is not capable of settlement by arbitration.

29 New York Convention, art. V.2.

30 While, formally, these issues do not arise until the stage of enforcement of an arbitral award by a competent authority, it is wise to plan for them at an earlier stage of the controversy, so that the efforts and costs of arbitration are not fully incurred before addressing the appropriate manner to deal with these issues.
The analysis may take a jurisdictional form: jurisdiction over insolvency matters is given to the relevant insolvency courts, and not to arbitral tribunals. This argument is frequently based on the statutory grant of jurisdiction to the insolvency courts.

Under this analysis, it is the insolvency court that has jurisdiction to resolve disputes in an insolvency case, and arbitration plays no role in this process. Alternatively, it may be only a matter of long-standing custom that all insolvency matters go to the insolvency court, and that any provision for the arbitration of any such matters no longer applies after the commencement of an insolvency case.

1. Private Law vs. Public Law

Especially in civil law legal systems, there is an important distinction between private law and public law: private law governs matters strictly between private actors, such as the parties to a typical contract, while public law governs matters involving an organ of the government or matters in which the government has an interest. In such a taxonomy, the home of arbitration is found in private law, where the non-state parties may agree between themselves to submit any dispute to arbitration pursuant to an arbitration system chosen by the parties.

Insolvency law, in contrast, is through and through a public law system that involves the government and the public interest. It is supervised by a court. The administrator is a quasi-public official appointed by the court. The debtor is mandated to turn over its assets to the administrator for liquidation pursuant to a public procedure mandated by law. The liquidated estate is divided among the creditors according to their legislatively determined priorities. A restructuring plan must be approved by the court.

31 “Insolvency court,” in this context, means any court that exercises jurisdiction over an insolvency case. A relatively few States have specialized insolvency courts to handle all insolvency cases. A substantial number of countries have commercial courts, whose jurisdiction includes insolvency cases. In other countries, insolvency cases may go to courts of general jurisdiction (or to a specific general jurisdiction court (frequently the highest such court), if there is more than one court level with general jurisdiction).

32 Even in the United States, with a quintessential common law legal system, bankruptcy law is public law, rather than private law. In Granfinanciera, for instance, the U.S. Supreme Court held that there is no right to a jury trial in most bankruptcy matters because they are governed by public law. However, the court found that fraudulent transfer matters, even though included in the U.S. bankruptcy code, have historically been considered matters of private law, and thus the U.S. Constitutional guaranty of a right to trial by jury applies. See Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 55-64 (1989).
and is imposed on the parties by a court order. Those not paid in full share pari passu pursuant to law. Finally, any discharge of debt is strictly governed by applicable statute.

Under this analysis, contract law and international arbitration (as well as domestic arbitration) belong to the private law domain. Indeed, arbitration is a species of private contractual ordering of the dispute resolution process for contractual disputes. In contrast, insolvency law belongs to the public law domain, where dispute resolution is inherently the adjustment of public rights in which the government always has an important role.

Issues of public law have traditionally been viewed as not arbitrable. Under this view, Article V.2 may properly be invoked to deny the enforcement of an arbitration decision on an issue of public law. Because insolvency law is public law, insolvency law disputes would be a species of public law disputes that are not arbitrable.

It would follow that arbitration does not have a role in insolvency (except to the extent that insolvency law has swept private law matters into its orbit). Resolution of disputes by privately chosen methods, such as arbitration, cannot be applied to issues of public law. International arbitration has traditionally dealt with disputes over the rights of the parties under private law (typically contract law).

This is an issue that is taken up country by country, when the enforcement of an arbitral award is sought. Thus, the enforcement authority in each country decides separately whether an arbitral award involving insolvency law is “capable of settlement by arbitration.”

It is no longer a generally accepted rule that issues of public law are not capable of settlement by arbitration. As a general principle, some public law issues are in fact arbitrated, and arbitral awards on these issues are in fact enforced. The law is fluid on this matter at the present time, and it is uncommon for authorities who are requested to enforce arbitral awards to base a denial on the lack of arbitrability, even where public law issues are involved. Indeed, it was recently claimed that, “[m]ost public law claims are now capable of being arbitrated.”

There is rather little public discussion today on the arbitrability of claims, separate from the discussion of public policy. Presumptively, this is because the enforcement

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authorities rarely consider this a basis for denying recognition and enforcement, except within the context of public policy. Accordingly, we turn to issue of public policy.

B. Public Policy

The much more common ground for the determination of whether to enforce an arbitral award is the second branch of Article V.2, which permits the denial of enforcement if the recognition or enforcement of the arbitral award would be contrary to the public policy\textsuperscript{34} of the country where enforcement is sought.\textsuperscript{35}

The issue for this paper is whether a national authority may properly use public policy as a ground for denying the recognition or enforcement of an international arbitral award involving an insolvency issue, \textit{solely because it is an arbitral award involving an insolvency law issue}. The denial of recognition or enforcement on some other public policy grounds is another matter, and is not within the scope of this discussion.\textsuperscript{36}

For the purposes of this discussion, it is the public policy clause in the New York Convention that is at issue here, and not the public policy clause in the Model Law.\textsuperscript{37}

\textsuperscript{34}Public policy has been defined as manifesting the common sense and common conscience of the citizens as a whole that extends throughout the State and is applied to matters of public health, safety and welfare. \textit{See, e.g.}, \textsc{West’s Encyclopedia of American Law} 173 (2d ed. 2005).

\textsuperscript{35}Arbitrability is often viewed as an issue of public policy. Thus, in the discussion of these issues, they tend to blend together. However, the New York Convention treats them as formally separate issues.

\textsuperscript{36}There may be particular instances where an international arbitral award involving an insolvency law issue should not be recognized or enforced in a particular country. Such a decision should be based on international public policy, as determined by the authority that is requested to recognize and to enforce the decision.

\textsuperscript{37}The Model Law provides that a court may refuse to take an action governed by a nation’s version of the Model Law if it would be “manifestly contrary” to that nation’s public policy. \textit{See} Model Law, art. 6. While the Final Report addresses the impact of this language, it is not applicable here, because this paper concerns only the public policy provision of the New York Convention Convention, which does not contain the word “manifestly.” However, the Final Report makes it clear that its interpretation of the public policy provision in the New York Convention is entirely consistent with implying that this term is included in the Convention provision.
1. Public Policy Construed Narrowly

Perhaps the most important consideration with respect to the application of the New York Convention’s provision on public policy is that it is applied very narrowly.38 This issue is taken up in the Final Report of the Committee on International Arbitration of the International Law Association’s New Delhi Conference39 (“the Final Report), an authoritative report on the meaning of "public policy" in the New York Convention. As the Final Report states, “[t]he application of international public policy, narrowly defined, should mean that public policy is rarely a ground for refusing enforcement of international arbitral award.”40 A reviewing court should have “a pro-enforcement bias.”41

In addition, the Final Report makes it clear that there should be a procedural component to the concept of public policy in the New York Convention. If a party has not raised the public policy issue in the arbitration itself, that party should be precluded from raising it in the recognition and enforcement hearing before a national authority.42

There are many rules in a particular country that are “mandatory” in the sense that they are not subject to being set aside by an agreement of the parties. The Final Report specifies that such a mandatory rule does not thereby become eligible for application under the public policy provision of the New York Convention.43 Such a mandatory rule may support application of the public policy exception only if the recognition and enforcement of the arbitral award “would manifestly disrupt the essential political social or economic interests protected by the rule.”44

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38 International public policy typically has a narrower scope than domestic public policy. See Final Report, ¶ 11.


40 See id., ¶ 16. In fact, the Final Report notes that attempts to resist the enforcement of an international arbitral award on the grounds of public policy “have rarely been successful . . ..” See id., ¶ 23.

41 See Gibson, supra note 33, at 1228-29.

42 See Final Report, ¶ 45.

43 See id., ¶ 48.

44 See id., Recommendation 3(b).
At the same time, the body of principles and rules constituting the applicable public policy should be those of the enforcing country. Thus, they do not come from the country whose law is applicable to the arbitration, or from a separate body of international law as such. However, because of the narrow scope rule for the application of the public policy provision, the Final Report notes that there is, “a notable consistency in decisions amongst courts of different countries and legal traditions” on the interpretation and application of public policy under the New York Convention.

As viewed in the Final Report, international public policy that can support the denial of recognition and enforcement of an international arbitral award may include abuse of rights, violations of good faith, the prohibition against uncompensated expropriation, and the prohibition against discrimination. Public policy also may include the prohibition of activities that are against good morals, such as “piracy, terrorism, genocide, slavery, smuggling, drug trafficking and pedophilia.” Public policy also incorporates such procedural rules as the requirement that a tribunal be impartial, and the making of an award induced or affected by fraud or corruption.

Because international arbitral awards rarely involve such problems as these examples suggest, the Final Report states that public policy should rarely be invoked to deny recognition and enforcement of such an award.

2. Insolvency Issues not Barred by Public Policy

There is clearly no public policy in almost all countries against the enforcement of an international arbitral award as such. By ratification of the New York Convention, virtually all nations have consented to such enforcement.

45 See id., ¶ 20. As the Final Report notes, the New York Convention specifies that it is the public policy of “that country” (i.e., the enforcing State) that is applicable. See id., ¶ 20. Thus, this public policy may vary from country to country. See id., ¶ 21.

46 See id., ¶ 22.

47 See id., ¶ 28. The Final Report also identifies as an example of public policy under the New York Convention the principle of pacta sunt servanda. See id. This principle should not be applied as a public policy in the insolvency context, because, through and through, insolvency law sets aside this principle.

48 See id.

49 See id., ¶ 29.
Equally, there is nothing in international insolvency law, as such, that makes an international arbitral award relating to insolvency law not amenable to recognition and enforcement. The rejection of this principle is fundamental to the Model Law, and its adoption by some forty nations.\textsuperscript{50} One of the most important features of the Model Law is its provision for the recognition of foreign insolvency proceedings and the enforcement of particular foreign court decisions in their insolvency cases.\textsuperscript{51}

Thus, the fact that the international arbitral award involves an insolvency law matter (whether international or domestic) should not be an appropriate ground, as such, for denying recognition and enforcement of an international arbitral award.

**VIII. Conclusion**

It is clear that there is a role for international arbitration in the international insolvency process. Parties and their counsel on both the arbitration and the insolvency side need to develop an understanding of the applicable law in both areas to use them effectively. In addition, there are many issues that need further exploration and elaboration to make the use of arbitration in the insolvency context successful. Much work can profitably be done in this area of inquiry.

\textsuperscript{50} For a discussion of the countries that have adopted the Model Law, see text *supra* at note 7.

\textsuperscript{51} See, generally, Model Law, arts. 15-23 (providing for the recognition for foreign insolvency proceedings, and for the enforcement of their judgments and orders as appropriate in a particular case).