Will the new wave of insolvencies affect arbitrations?

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The COVID-19 pandemic is upending economies globally, causing a wave of unexpected insolvencies. The businesses that remain standing may face the question: will my insolvency or that of my counter-party prevent me from resolving disputes by arbitration?

The short answer is no. However, depending on the jurisdiction, there will be some limitations on what can be decided by arbitration. We have therefore briefly summarized some of the issues and challenges that a party may face under US law in the context of an arbitration arising from its own or an opposing party's insolvency.

What happens to existing arbitration agreements?

In the US, as well as in other jurisdictions, arbitration agreements concluded prior to insolvency generally remain valid and binding on the insolvent party. The general exception in the US is when the claim being arbitrated qualifies under US law as a "core proceeding". In other words, US courts will generally enforce arbitration agreements unless they include claims arising out of the insolvency proceeding or claims that are central to resolving a bankruptcy case, such as matters concerning the administration and the distribution of assets of the estate's assets.[i]

What happens to pending arbitrations?

There are certain legal and practical consequences to bear in mind if a party becomes insolvent while an arbitration is pending. In the US, if the company files for bankruptcy under Chapter 11 of the Bankruptcy Code (seeking a reorganization), it remains in control of the business and can continue to act in the arbitration proceedings. But if the company files under Chapter 7 of the Bankruptcy Code (seeking a liquidation), a trustee will be appointed to control the company and the trustee will represent it in any arbitration proceedings. [Ii]

Another consideration is that the filing of an insolvency proceeding in the US triggers an "automatic stay" of most claims against the insolvent party. This means that most part of pending proceedings – including arbitrations [iii] – (around the world) must be stayed until the bankruptcy court allows them to be resumed (at the request of a party) or until the bankruptcy proceeding is concluded or dismissed. [iv] Therefore, if an award is rendered while an automatic stay is in effect, it is unlikely that the award will be recognized and enforced by US courts. [v]

Can an award against an insolvent party be individually enforced?

Generally speaking, the answer is no. In the US, the prevailing party can only enforce the award against an insolvent party by making a claim in the insolvency proceedings. [vi] And given that insolvency laws are often considered part of countries' public policy, disregarding them may result in a foreign court refusing to enforce the award pursuant to Article V(2)(b) of the New York Convention or principles of international comity. [vii]

Can an insolvent party enforce an award against a solvent party?

Yes. If the insolvent party prevails in an arbitration against a solvent party, it can enforce the award as usual.

What are the benefits of arbitrating to resolve insolvency-related disputes?

There are several reasons to choose arbitration over litigation for pre- and post-insolvency disputes. For example, awards are easier to enforce internationally, which can be a real advantage for a prevailing creditor enforcing against an insolvent debtor (especially when the assets are located in different jurisdictions). Furthermore, arbitration can be especially useful to a debtor in financial distress, allowing them to obtain and enforce a favorable award more quickly by using expedited proceedings. Finally, arbitration proceedings are confidential and there is greater flexibility in how the procedure is conducted.

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Notes:

i. Whether a claim involves a "core" or "non-core" proceeding can be hard to predict. Under the U.S. insolvency rules and caselaw, core proceedings are generally understood to include claims that are central to resolving the bankruptcy case, such as the ones listed in Section 157 of Title 28 of the United States Code. Generally, the court will have discretion not to enforce arbitration agreements with respect to core claims if the arbitration would undermine the objectives of the Bankruptcy Code. In the U.S., for example, *see B.D. Cooke & Partners Ltd. v Certain Underwriters at Lloyd's, London*, 606 F. Supp. 2d 420, 424–425 (S.D.N.Y. 2009) (rejecting the argument that the insolvency of a party renders the arbitration agreements "incapable of being performed"); *see also Hagerstown Fiber Ltd. P'ship v Carl C. Landegger*, 277 B.R. 181 (Bankr. S.D.N.Y. 2002) (granting a motion to compel the arbitration of fraud claims, but not fraudulent transfer claims brought pursuant to section 544(b) of the Bankruptcy Code).

i *See* 11 USC s 1104 and 11 USC s 701. Yet in this case the trustee will have to respect the procedural steps already taken by the company and continue with the arbitration as the insolvent party would have done (for example, the trustee will not be able to alter the composition of an arbitral tribunal already constituted). *See Hays and Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149, 1155–57 (3d Cir. 1989) (holding that "in actions brought by the trustee as successor to the debtor's interest under section 541, the "trustee stands in the shoes of the debtor and can only assert those causes of action possessed by the debtor. [Conversely,] [t]he trustee is, of course, subject to the same defenses as could have been asserted by the defendant had the action been instituted by the debtor."" citing Collier on Bankruptcy, para 323.02.).

iii. If the insolvent party is the claimant in the arbitration, the existence of counter-claims may well cause a stay of the whole proceeding.

iv. 11 USC s 362(d).

v. The Third Circuit Court of Appeals held: that "the automatic stay provision of the Bankruptcy Code promotes a public policy sufficient to preclude enforcement of an award that violates its terms or interferes with its purposes". *ACandS, Inc. vs Travelers Cas. & Sur. Co.*, 435 F.3d 252, 258 (3d Cir. 2006). *See also In re Johnson*, 548 BR 770, 798 (Bankr. S.D. Ohio 2016) (holding that an arbitral award resulting from an arbitration that had proceeded in violation of the automatic stay is void).

vi. The filing of a bankruptcy petition in the US immediately triggers the automatic stay provision, suspending nearly all civil actions or proceedings against the debtor, including the enforcement of arbitral awards, pursuant to the Bankruptcy Code (11 USC s 362(a)(1). A creditor willing to enforce a US arbitral award against the insolvent debtor shall file a proof of claim with the Bankruptcy Court, according to Section 501 of the Bankruptcy Code and Rules 3001-3002 of the Federal Rules of the Bankruptcy Procedure.

vii. Article V(2): Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that: […] (b) The recognition or enforcement of the award would be contrary to the public policy of that country.

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