



## SWITZERLAND: Supreme Court should recalibrate its review following bankruptcy case decision

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A recent Supreme Court decision on bankruptcy and capacity to arbitrate could be the start of a slippery slope, if unaddressed. **Phillip Landolt**, partner at Charles Russell LLP in Geneva explains what he'd like to see.

In a decision of 31 March 2009 (4A\_428/2008) the Swiss Supreme Court agreed with an ICC arbitral tribunal located in Geneva that the Polish bankruptcy of the principal respondent deprived that arbitral tribunal of jurisdiction.

The claimant Vivendi and various associated interests initiated the arbitration based on a global settlement agreement of their dispute with the Polish company Elektrim over the ownership of shares in one of Poland's principal mobile telephone interests.

A little over a year into the arbitration, Elektrim informed the arbitral tribunal that it had just been declared bankrupt in Poland and requested that the arbitral tribunal give effect to article 142 of the Polish Bankruptcy and Reorganisation Act, and decline jurisdiction.

Article 142 of the Polish Bankruptcy and Reorganisation Act provides as follows:

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

Supported by a chorus of opinions from professors of Polish law, the arbitral tribunal accepted that this provision had the effect of depriving the bankrupt of capacity to be a party in an arbitration. The arbitral tribunal applied generally accepted legal principles as exemplified in Switzerland's Private International Law Act (the Swiss PIL Act) to determine that capacity to be a party in arbitration was subject to the law of a legal person's regular incorporation. Since Elektrim was indeed duly incorporated in Poland and in compliance with all the relevant local requirements, it was Polish law that determined this capacity to arbitrate, and therefore the arbitral tribunal in Switzerland had no jurisdiction over it.

The Swiss Supreme Court agreed.

It first remarked that the Swiss arbitration law statute only contains provisions to save arbitrations from foreign legal provisions relating to the incapacity of state parties. According to the Supreme Court, Swiss arbitration law is silent as regards the incapacity of non-state entities.

The Supreme Court then followed the same analytical route as the arbitral tribunal did in denying arbitral jurisdiction, with the difference that it appeared to apply general Swiss conflicts law on its own authority rather than referring to the general principles of private international law exemplified in the Swiss PIL Act. It stated that "there are no apparent grounds to doubt this legal approach".

### Commentary

There is a certain fatalism in the Supreme Court's reasoning. It drives towards the legal result that any interference with a party's legal capacity and in particular its capacity to act as a party to arbitration under the foreign law governing that party will derail a Swiss arbitration. The following way-stations may be discerned en route: capacity to arbitrate is a matter going to jurisdiction; the arbitration-saving provision of Swiss arbitration law (article 178 of the Swiss PIL Act) does not apply in respect to legal capacity; rather, legal capacity is subject either to general conflicts principles or the specific provisions of Swiss private international law.

So treated, Swiss law risks becoming at best a hostage to fortune or, worse, hostage to any dirigiste impulses or anti-arbitration wiles of a foreign legislator.

### *A sensible decision?*

It is worth asking: what values worthy of protection and otherwise unachievable, require the funnelling of all the legal issues surrounding a bankrupt to one particular bankruptcy court? Any remedy against a bankrupt 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. There tends, after all, to be a general incidence between the location of the bankrupt's assets and the place of bankruptcy.

If there is not much to gain then, there is also much to sacrifice. 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 expense, in asserting its rights.

#### *Is Swiss arbitration really bereft of defences?*

It has been suggested that the Supreme Court may in fact have wished to provoke a legislative reaction by declaring that to be the position. This has occurred in the past where one of its decisions, the well-known *Fomento* decision, led parliament to apply a legislative patch ensuring that it is for the Swiss arbitral tribunal seized of a matter that is equally subject to proceedings pending abroad to determine whether or not it has jurisdiction, and indeed generally without regard to the existence of such foreign proceedings.

#### *Other options*

A more effective way out of this difficulty would be for the Supreme Court to treat matters subject to its jurisdictional review as coterminous with those falling within Swiss arbitration law's pro-arbitration provision on the validity of arbitration clauses.

So either the Supreme Court's jurisdictional review under article 190(2)(b) of the Swiss PIL Act must be shortened, or its reading of the pro-arbitration validity provision, article 178 of the Swiss PIL Act, must be lengthened.

Different legal systems reasonably take different views of what matters are jurisdictional. And even if Swiss law treats incapacity as a jurisdictional matter, the Supreme Court's jurisdictional review need not extend to such matters. Certainly the Supreme Court's public policy review, for example, is narrower than the category of mandatory norms applicable by the arbitral tribunal.

As for article 178, it ensures that an arbitration clause is good providing it meets the requirements of either Swiss law, the law of the contract, or the law which the parties have expressly subjected the arbitration clause to.

The application of Swiss law under article 178 is intended to serve a prophylactic function, warding off interference with arbitration that is unjustified from the point of view of Swiss law. In the usual scenario, this entails simply interpreting an arbitration clause under Swiss law. But from time to time, as here, it might be treated as occasioning a review of the application of foreign law on legal capacity to ensure compatibility with the system of Swiss law, and in particular Swiss arbitration law. If foreign law expressly cannot prevent a state entity from being subject to arbitration in Switzerland (article 177(2) of the PIL Act), logically it cannot prevent a non-state entity either. Only reasons for such interference with arbitration recognised as valid under Swiss arbitration law may achieve this result. More broadly, the pro-arbitration character of Swiss arbitration law requires that any interference sponsored by foreign law be in vindication of values worthy of protection from the point of view of Swiss law.

A more limited solution was also available to the Supreme Court in this case. The particular incapacity under the Polish Act could have been characterised as a matter of arbitrability. Indeed, the provision in the Swiss PIL Act saving arbitration from foreign legislation disqualifying state entities is in fact the second paragraph of the article in that act dealing with arbitrability. So at least some forms of non-state entities' capacity must also be matters of arbitrability. Swiss law of course supplies a most admirable pro-arbitration substantive rule – any economic question is in principle arbitrable.

In addition, it bears noting that the Supreme Court's uniform rigour in jurisdictional review would appear to require tempering on at least some matters. If the application of Swiss law under article 178 of the PIL Act is to be treated as a review for compliance with pro-arbitration values in Swiss law, then some degree of deference to the arbitral tribunal's view is necessary if any practicable degree of legal predictability is to be assured.

Secondly, the Supreme Court cannot properly require arbitral tribunals sitting in Switzerland to apply Swiss conflicts law in its jurisdictional analysis, since the scheme of Swiss arbitration law excludes this. From at least 1999 onwards, the Supreme Court has accepted that arbitration tribunals sitting in Switzerland are not subject to any of the PIL Act except for its chapter 12 (the arbitration chapter) with its complete, if brief, code on applicable law.