# Insolvency and Arbitration Agreements in Spain: Commentary on Decision 266/2019 of 30 September 2019[1]


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The effects of the commencement of insolvency proceedings by a party to an arbitration agreement may vary significantly from one jurisdiction to another. Such effects also vary depending on whether or not arbitration proceedings have already commenced pursuant to an

1 Judgment 266/2019 of 30 September 2019, Commercial Court Number 1 of Santander, Rec. 427/2018 ('**Judgment 266/2019**') (La Ley 137375/2019), which has been appealed to the Appeal Court of Cantabria.

arbitration agreement entered into by the insolvent party.[2]

In Spain, insolvency is governed by Royal Legislative Decree 1/2020 of 5 May, which approves the consolidated text of the Insolvency Act ('RLD 1/2020'), which entered into force on 1 September 2020 and derogated the Spanish Insolvency Act (Law 22/2003 of 9 July).[3] The general rule is that the commencement of insolvency proceedings does not in and of itself affect mediation or arbitration agreements signed by the insolvent party.[4] In turn, mediation and arbitration proceedings already commenced may continue until the termination of the mediation proceedings or until the award becomes final.[5] As an exception to this rule and unless international treaties provide otherwise, when a court finds that an arbitration agreement could be detrimental to the insolvency proceedings, such agreement may be suspended.[6]

Also a specific reference in case there is fraud in the mediation clauses and arbitration agreement and arbitration procedures is included under article 140(4) of RLD 1/2020[7].

2 These differences depend on the applicable law. Some national rules establish that arbitration proceedings already initiated need to be terminated. Others, on the contrary, allow for these proceedings to begin or continue in spite of the commencement of insolvency proceedings. Besides these differences and the complex interplay between arbitration law and insolvency law (see, in this regard, the litigation between the Elektrim and Vivendi groups over the last decade; for example, SYSKA & ELEKTRIM SA v Vivendi Universal SA and Ors [2009] EWCA Civ 677), the cross-border aspects of these two disciplines have not gone unnoticed by academics, international organisations and national legislators. See PENADÉS FONS, Manuel Alejandro, 'Cross-Border Insolvency and International Commercial Arbitration' (Ph.D. Thesis, University of Valencia, 2015), available online at http://dx.doi.org/10.2139/ssrn.3472328.

3 The consolidated text of the Insolvency Law (Law 1/2020 of 5 May) ('**RLD 1/2020'**), available online in Spanish at https://www.boe.es/buscar/act.php?id=BOE-A-2020-4859.

4 Article 140(1) of RLD 1/2020 reads as follows: '*1. The commencement of insolvency proceedings shall not per se affect the validity of the mediation clauses and arbitration agreements signed by the debtor.*' (the original in Spanish reads as follows: '*La declaración de concurso, por sí sola, no afectará a la vigencia de los pactos de mediación ni a los convenios arbitrales suscritos por el deudor.*'). The current wording of Article 140(1) of RLD 1/2020 stems from Article 52(1) of the Insolvency Act (Law 22/2003 of 9 July), which was the result of a 2011 amendment introduced by Law 11/2011 of 20 May to bring it in line with the EU approach to the matter. Prior to this amendment, Article 52(1) of the Insolvency Act determined that arbitration agreements to which the insolvent debtor was a party were automatically left without '*value and effect*' during the insolvency proceedings.

5 Article 140(2) of RLD 1/2020 reads as follows: '*2. Mediation proceedings and arbitration proceedings that are pending on the date when insolvency is declared will continue until the mediation proceedings end or until the arbitration award is final. The insolvent debtor's legal standing in these proceedings shall be governed by the provisions for declarative trials in Chapter I of this Title*' (the original in Spanish reads as follows: '*Los procedimientos de mediación y los procedimientos arbitrales en tramitación a la fecha de la declaración de concurso continuarán hasta la terminación de la mediación o hasta la firmeza del laudo arbitral. La representación y defensa del concursado en estos procedimientos se regirá por lo establecido para los juicios declarativos en el capítulo I de este título*').

6 Article 140(3) of RLD 1/2020 reads as follows: '*3. The judge hearing the insolvency proceedings, ex officio or at the request of the insolvent debtor [...] or the insolvency administrator [...], may grant, before mediation or arbitration proceedings have begun, the suspension of the effects of those clauses or agreements, if the judge considers that they could be detrimental to the insolvency proceedings. Without prejudice to the provisions of international treaties.*' (the original in Spanish reads as follows: '*3. El juez del concurso, de oficio o a solicitud del concursado, en caso de intervención, o de la administración concursal, en caso de suspensión, podrá acordar, antes de que comience el procedimiento de mediación o de que se inicie el procedimiento arbitral, la suspensión de los efectos de esos pactos o de esos convenios, si entendiera que pudieran suponer un perjuicio para la tramitación del concurso. Queda a salvo lo establecido en los tratados internacionales.*')."

7 Article 140(3) of RLD 1/2020 reads as follows: '*4. If there is fraud, the insolvency administrator may challenge before the insolvency judge the mediation clauses and arbitration agreements and arbitration procedures.*'

## When a court finds that an arbitration agreement could be detrimental to the insolvency proceedings, such agreement may be suspended

It is precisely the exception envisaged in Article 140(3) of RLD 1/2020 that Commercial Court Number 1 of Santander (the 'Court') –which has been appealed to the Appeal Court of Cantabria– applied in its judgment of 30 September 2019, where it upheld a request to suspend the effects of an arbitration agreement on the grounds that it could be detrimental to the insolvency proceedings.

### Arbitration Agreement and Relevant Facts

The case before the Court concerned an events promoter —which was ultimately declared insolvent— that signed a contract with the representatives of a singer for a concert in Spain. In addition to the arbitration agreement, the contract included a governing law clause that established as applicable the laws of England and Wales. The arbitration agreement was very short. It simply stipulated that any dispute would be resolved by arbitration with seat in London and that the proceedings would be conducted in English.

The singer did not show up for the concert and returned only part of his fee. The events promoter argued it was entitled to recover the remainder of the fee and compensation for the damage suffered.

Later on, the events promoter filed for insolvency before the Court. In the judgment, the Court indicated that the insolvent party's main (and almost sole) asset was precisely the credit that it held against the singer and most of its creditors were consumers affected by the cancelation of the concert.

Invoking the exception in the second sentence of Article 52(1) of the Insolvency Act –currently, Article 140(3) of RLD 1/2020–, the promoter filed an application for the suspension of the arbitration agreement. It gave two main reasons to support its position that the agreement was detrimental to the insolvency proceedings: first, the wording of the arbitration agreement was too vague (since it did not provide for the appointment of the arbitrator, the institution administering the arbitration or the applicable rules, and it was precisely this vagueness that ultimately rendered the arbitral

agreement ineffective)[8] and as such would significantly delay the arbitration proceedings and consequently generate a great deal of uncertainty in the insolvency proceedings; second, irrespective of the above, the fact that the seat of the arbitration was London would, in any event, force the party that had been declared insolvent to incur '*unbearable costs*.' The singer did not file a response and was declared in default.

**Ruling**

The Court upheld the promoter's application and suspended the effects of the arbitration agreement.

First, the Court concluded that, in accordance with Article 3(1) of the Spanish Arbitration Act[9] and Article 1 of the European Convention on International Commercial Arbitration,[10] any potential arbitration between the parties would be international.[11]

It then analysed the applicable law to establish the effects of the promoter's insolvency on the arbitration agreement.[12] The Court ruled that, since none of the existing international treaties regulates this issue,[13] EU Regulation 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (the 'EU Regulation') would apply.

**Precision in the drafting of arbitration agreements is a key factor to be analysed by the court when assessing if an arbitration agreement could be detrimental to the insolvency proceedings**

Article 7(1) of the EU Regulation provides that the law applicable to insolvency proceedings and their effects is, save as otherwise provided in the EU Regulation, the *lex fori concursus*, which determines, among other matters, '*(e) the effects of insolvency proceedings on current contracts to which the debtor is party*' and '*(f) the effects of the insolvency proceedings on proceedings brought by individual creditors, with the exception of*

8 The judgment notes that, even though this is not the main issue at stake, the events promoter considered the arbitral agreement '*an imposed general condition, without prior notification or information, which was included in an annex to the contract, not highlighted, and which contained many inaccuracies regarding the arbitration procedure and the type of arbitration*.'

9 Act 60/2003, of 23 December, of Arbitration.

10 Article 1 of the European Convention on International Commercial Arbitration reads as follows: '*1. This Convention shall apply: (a) to arbitration agreements concluded for the purpose of settling disputes arising from international trade between physical or legal persons having, when concluding the agreement, their habitual place of residence or their seat in different Contracting States;* [...].'

11 Judgment 266/2019, paras 8-9.

12 Judgment 266/2019, paras 11-23.

13 Neither the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, made in New York on 10 June 1958, nor the European Convention on International Commercial Arbitration, made in Geneva on 21 April 1961, regulates the effects of insolvency on arbitration agreements. Nor does the UNCITRAL Model Law on International Commercial Arbitration (1985, as amended in 2006) or the UNCITRAL Model Law on Cross-Border Insolvency (1997) refer to this issue.

*pending lawsuits*.'[14] Article 18 of the EU Regulation provides that the effects of insolvency proceedings on a pending lawsuit or pending arbitral proceedings concerning an asset or a right which forms part of a debtor's insolvency estate shall be governed solely by the law of the Member State in which that lawsuit is pending or in which the arbitral tribunal has its seat.

Given that in the case at hand there was no ongoing arbitration, the Court determined that the rule applicable to the effects of the insolvency on the agreement was the Insolvency Act, i.e. the law of the Member State where the promoter's insolvency proceedings had been initiated, and, more precisely, its Article 52(1).[15] It considered this rule applicable not only to domestic arbitration proceedings but also to international arbitration proceedings that could be affected by domestic insolvency proceedings.[16]

After confirming its jurisdiction to decide on the promoter's application to suspend the effects of the arbitration agreement, the Court analysed the meaning of the phrase '*detrimental to the insolvency proceedings*' which is the key element for triggering the application of the exception under the second sentence of Article 52(1), allowing for the suspension of the effects of the arbitration agreement.[17] The Court acknowledged the existence of two different schools of thought: one school argues that the substantive element for the suspension of effects would be the existence of '*obstacles of a procedural nature*' to moving forward the insolvency proceedings, while the other considers that any potential detriment to carrying out the insolvency proceedings, including the creditors' interest, would be relevant in the assessment. The Court considered that the detriment required to suspend the effects of an arbitration agreement '*should not be understood in a purely adjective, procedural, abstract sense, but linked to the meaning, purpose, usefulness and effectiveness of the insolvency proceedings.*'[18]

Finally, and precisely as a result of this interpretation, the Court ruled that the arbitration agreement should be suspended. It considered that it would be detrimental to carry out the insolvency proceedings given ***(i)*** the delay that would be caused by the vagueness of the drafting of the arbitration agreement, ***(ii)*** the fact that the insolvent party's main asset was precisely the credit that it held against the singer, linked to the fact that, for the multiple creditors (thousands of consumers) of the promoter to be able

14 Although the issue is beyond the scope of this article, the court considered whether the applicable law should be determined based on sub-section (e) of Article 7.1 of the EU Regulation –if the arbitration agreement is assessed from a contractual perspective– or sub-section (f) –if we consider it from a procedural point of view. It concluded that it should be determined under sub-section (f).

15 Judgment 266/2019, paras 24-27.

16 The Court acknowledged that this conclusion is contrary to the position adopted in 2009 by the Court of Appeal of Barcelona (SAP of Barcelona (Section 15) num. 86/2009 of 29 April 2009 [JUR 2009\472969]), which considered that Article 52(1) of the Insolvency Act (prior to the 2011 legislative amendment) was only applicable to national arbitration proceedings and not to international proceedings.

17 Judgment 266/2019, paras 28-35.

18 Judgment 266/2019, para 30 *in fine*.

to recover their credits in the insolvency proceedings, the promoter would first have to be successful in a breach of contract and damages claim against the artist; and *(iii)* the significant cost of the arbitration proceedings, which the insolvent party would not be able to bear.

**Comment**

Despite the amendment introduced in 2011 to align the Spanish insolvency legal framework with EU law and the general rule that the commencement of insolvency proceedings does not affect an arbitration agreement signed by an insolvent debtor, the Court's judgment applies the exception and orders the suspension of the arbitration agreement.

This decision is certainly grounded on the existence of the very particular circumstances just described. However, the judgment should also serve as a warning that the amended wording of Article 140(3) of RLD 1/2020 does not fully protect arbitration agreements.

The court also underlines that precision in the drafting of arbitration agreements is a key factor to be analysed by the court when assessing if an arbitration agreement could be detrimental to the insolvency proceedings. The reasoning underlying the Court's judgment seems to be that, because the arbitration agreement was too vague, there would be a delay in starting the arbitration proceedings that would inevitably defer, and consequently be detrimental to, the insolvency proceedings.

In addition, the Court stresses the significant financial cost of starting arbitration proceedings in London (which it considers to be 'notorious' without therefore discussing any evidence in this respect) '*as opposed to having recourse to the Spanish courts*' and finds it would be unbearable for the insolvent promoter. The judgment seems to take for granted that it is cheaper to litigate before a Spanish court than to submit the dispute to a foreign arbitral tribunal, and consequently a party would be better off before local courts in insolvency-related cases. In doing so, the Court fails to consider that, leaving aside the vagueness of the specific arbitration agreement analysed by the Court and the subsequent difficulty in '*starting*' the arbitration proceedings, arbitration could often result in a quicker resolution of the dispute.