Arbitration and Insolvency Friends or Foes

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Business matters are very dynamic and require a high level of flexibility. For this very reason, arbitration procedures have been developed to provide a quick way for business people to settle disputes. This improves the business process and thus increases the profitability of any undertaking, which is the ultimate goal of any business.

However, there is also another side of business life: the failure of the undertaking, which leads to insolvency or even bankruptcy.

Relations between insolvency and arbitration

In the past years, the question of the compatibility of insolvency and arbitration has been increasingly raised. Whereas in an insolvency, greater attention is paid to costs; arbitration primarily pursues the goal of bringing about a rapid resolution of disputes so that not too many resources are devoted to that disagreement. Of course, a speedy solution is a basic goal in both proceedings, but the priorities differ.

A closer analysis shows that there are many arguments against the coexistence of insolvency and arbitration proceedings at the same time. The most important aspects in which the two procedures contradict each other are described below.

Consent, participation and impact on the parties

Arbitration can only take place if all parties involved agree to this procedure. It follows that only those parties who have given their consent are involved. Ultimately, the proceedings only have an effect on the parties; the arbitral award is only pronounced for and against the parties involved.

Insolvency, on the other hand, is a process that involves as many parties as possible - regardless of whether they agree or not. The fact that a business is in financial difficulties usually causes a domino reaction; all parties interested in the business strive to achieve the highest possible performance with limited resources so that claims are covered as far as possible. This requires, in principle, equality among creditors, which is why all creditors should be included in the insolvency proceedings. However, the debtor can also be forced to take measures for which consent is not required (e.g. the liquidation of assets).

Moreover, the rights and obligations of the parties to the insolvency proceedings are provided for by law, so that deviation from them is usually prohibited.

It is true that insolvency is not a direct obstacle to arbitration proceedings aimed at collecting claims of the insolvent company. In principle, the creditors and the debtor could come to an agreement, so that such arbitration proceedings would also take place during the insolvency. In such a situation, the effects of the arbitration are available to all parties involved in the insolvency: what is awarded against or for the debtor's assets benefits, respectively is borne by all.

However, it must be mentioned that insolvency proceedings prevent any other proceedings for the collection of claims of individual creditors against the insolvent. The opening of insolvency proceedings leads, by operation of law, to the suspension of such proceedings and thus also of arbitration proceedings for the assertion of claims against the insolvency debtor.

Confidentiality of the arbitration proceedings vs. publicity of the insolvency

Since the time of the *bancus ruptus* in the Roman insolvency proceedings, the publicity of the insolvency proceedings has been one of the most important principles. The necessity of any interested person to know the circumstances in which the debtor finds itself enjoys the highest importance. In this sense, participants in the insolvency proceedings must be kept constantly informed, e.g. through reports from the insolvency administrator.

In contrast, arbitration is mostly a private matter that usually only takes place between the parties. Parties are basically allowed to coordinate a high variety of matters among themselves, which may run parallel or even contrary to legal regulations (of course, mandatory restrictions such as public order must be upheld).

Therefore, the two procedures are fundamentally incompatible, at least as far as the participants in the insolvency proceedings are concerned.

Conclusions

Even if, at first glance, many common objectives of the two procedures can be identified, there is an incompatibility that precludes the parallel or combined management of both procedures. Each of the procedures should be used for the purpose and within the legal framework for which it is suitable or intended.

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