

The Validity of Arbitration Clauses in Bankruptcy Proceedings

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[Background](#)

[Validity of Arbitration Clauses](#)

[Supreme Court Decision](#)

[Comment](#)

Background

Under Swedish law the property of a debtor which has been declared bankrupt is vested in the bankruptcy estate. Accordingly, following a declaration of bankruptcy the debtor ceases to be in control of its property. If litigation is pending between the debtor and some other person, the bankruptcy estate may take over the debtor's action.

The Bankruptcy Act provides a procedure to resolve disputes regarding claims which a creditor has lodged with the bankruptcy estate. The court's decision in such proceedings will have effect only on the scope of the bankruptcy.

Validity of Arbitration Clauses

As the Bankruptcy Act provides a mechanism for resolving disputed claims in bankruptcy proceedings, the extent to which a creditor may rely on an arbitration clause to refer such disputes to arbitration has long been debated in legal writing.

In a 1913 decision the Supreme Court stated that a creditor is entitled to invoke the arbitration clause and thus refer disputes to arbitration, even if the debtor has been declared bankrupt and bankruptcy proceedings are pending. However, the ruling was not unanimous. Two out of five Supreme Court justices were of the view that the procedure prescribed by the Bankruptcy Act for disputed claims should take precedence over the arbitration clause. The dissenting judges particularly noted that the other creditors in the bankruptcy were unable to influence the composition of the arbitration tribunal or safeguard their interests in the bankruptcy in any other manner.

Over the years the view of the dissenting judges in that case has gained support and the state of the law became unclear. This uncertainty has been settled to some extent by the Supreme Court's decision of January 2 2003.

Supreme Court Decision

In this case a dispute arose with regard to a claim lodged against the bankruptcy of an insurance company. The dispute was referred to arbitration by the creditor under an arbitration agreement contained in the contract between the debtor and the creditor. The bankruptcy estate objected and argued that the claim should be decided before the bankruptcy court in accordance with proceedings for disputed claims stipulated by the Bankruptcy Act.

However, the bankruptcy estate's arguments found no favour with the Supreme Court, which confirmed its 1913 decision. The court compared the situation to that where a judgment is rendered in proceedings that take place before a debtor is declared bankrupt. In such case the judgment is binding on all the creditors, even though they were not given any opportunity to influence the litigation.

The Supreme Court also took into account the fact that other creditors are able to intervene in an action against the debtor with respect to a claim in the bankruptcy. According to the Supreme Court other creditors might also be given such a right to intervene in arbitration proceedings. If a creditor is not allowed to intervene in the arbitration proceedings by the other creditor/party to the arbitration agreement, the arbitral award may be denied any binding effect in the bankruptcy. However, the Supreme Court did not need to decide on the creditors' right of intervention in this case.

Comment

It is clear from the Supreme Court's decision that an arbitration clause may generally be successfully invoked within the procedure for resolving disputed claims in bankruptcy proceedings. Importantly, the Supreme Court has opened the door to allowing other creditors to intervene in arbitration proceedings between a creditor and a debtor in bankruptcy regarding a bankruptcy claim.


However, several questions regarding the effects of an arbitral award in bankruptcy proceedings remain unanswered. For instance, it is unclear whether a debtor, despite the receivership, has an independent right to nominate an arbitrator and whether awards, where the debtor has nominated an arbitrator, will be given effect against other creditors in the bankruptcy proceedings.

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