

Lack of funds does not enable parties to escape arbitration



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Arbitration does not provide for legal aid or an exemption from paying costs. Some regard this as a disadvantage of alternative dispute resolution. One party's lack of funds to pay for its share of arbitration costs can indeed deprive it of its day in arbitration court. This issue recently came before the Warsaw Court of Appeals, which decided that a party's lack of funds to launch arbitration does not render the arbitration agreement defective.**(1)**

Facts

The parties entered into a shareholder and investment agreement. The agreement included an arbitration clause providing for the arbitration of all disputes arising out of or relating to the agreement before a Polish arbitration court.

A dispute arose between the parties and one of them initiated state court proceedings. It claimed that it did not have the funds to start arbitration and that this should cause the arbitration agreement to lose its legal effect. The defendant invoked the arbitration agreement and argued that the claimant's position was erroneous. The Warsaw Regional Court rejected the statement of claim, referring the parties to arbitration after finding that the arbitration agreement was valid and effective. The court pointed out that by agreeing to arbitration, the parties had limited their right to access the courts (ie, the state court) granted by the Constitution.

The claimant appealed the decision, invoking, among other things, the right to access the courts granted by the Constitution and Article 6(1) of the European Convention on Human Rights 1950. It argued that if a party does not have the funds to start arbitration and the given arbitration rules do not allow for exemption from the courts, this would infringe such party's right to a fair trial. Thus, such an arbitration agreement should lose its legal effect and a state court cannot reject such a case. It also argued that the defendant's reliance on the arbitration agreement was an abuse of its procedural right and that the court should therefore disregard it.

Decision

The Warsaw Court of Appeals dismissed the appeal. However, it decided that the claimant should not pay for

the defendant's costs given its financial situation.

The claimant relied on Article 1168(2) of the Code of Civil Procedure. Under this provision, unless the parties agree otherwise, an arbitration agreement will lose its legal effect if the arbitral tribunal specified in the clause does not accept the case or if it is impossible for the tribunal to hear the case for other reasons.

The court found that the inability to execute an arbitration agreement specified in Article 1168 may be caused by the pathological nature of the agreement, which can be primary or result from subsequent events. The court disagreed that a lack of funds to launch arbitration is such a subsequent event. The court, invoking Polish case law, clarified that the dissolution of a permanent arbitration court or an inability to complete the arbitral panel are among the reasons why an arbitration agreement may lose its legal effect. The common factor of these examples is that they refer to arbitrators or arbitration courts and not to the parties. These examples are also objective and permanent. In turn, a lack of funds to launch arbitration is a subjective factor which can change over time.

The court went on to explain that by deciding on arbitration, the parties had accepted this means of dispute resolution with its pros and cons. One benefit of arbitration over litigation is the expeditiousness of the proceedings. However, at the same time, the parties to arbitration agree on the limitation of the procedural guarantees which exist in state court litigation.

The court also underlined that the claimant could not invoke a single Polish case in which the court had decided to continue litigation despite the existence of an arbitration agreement for reasons relating to the claimant's financial situation. The court noted the claimant's reference to the decision of the Krakow Court of Appeals.⁽²⁾ However, it contended that this decision pertained to whether a party can apply to a state court for an exemption from paying arbitration costs and did not shed any more light on the issue in question.

The court also invoked changes in Polish insolvency law, according to which a party's bankruptcy does not entail the automatic loss of an arbitration agreement's legal effect (for further details please see "*Elektrim* case era comes to an end"). The bankruptcy administrator can terminate this agreement if there are no funds for arbitration. If the law prescribes termination (ie, links such an effect with an action of one party), it confirms that the agreement does not automatically lose its effect because of a party's financial problems.

The court disagreed with the claimant's argument that a lack of funds for arbitration triggers the inoperativeness of an arbitration agreement. It pointed out that this occurs if the agreement is valid and effective but it is impossible to conduct arbitration (eg, due to the unclear wording of the agreement).

The court noted that some commentators agree that a lack of funds can render an arbitration agreement inoperative; however, it disagreed with this argument. This view omits the possibility that a party may unfairly diminish its financial situation to prevent arbitration.

The court also emphasised that even if it should consider the financial situation of a party when deciding whether to refer parties to arbitration, this situation must be objective and permanent and prevent the party from initiating arbitration. The claimant's exemption from paying costs in state court proceedings does not in itself signify that its financial situation would prevent it from paying arbitration fees.

The court clarified that the defendant's invoking of the arbitration agreement before the state court to refer the parties to arbitration was not an abuse of process. In doing so, the defendant had acted according to the law and in an attempt to refer the parties to the proper forum which they had agreed would hear their disputes. A defendant, especially when it has had to pay to start arbitration, should be able to expect the other party to act accordingly and even make an effort to raise the funds required for the arbitration.

Comment

The issue of access to justice in arbitration is gaining attention both in Poland and globally. The Warsaw Court of Appeals' decision is an example of rather a formal and strict approach to parties' arguments that costly arbitration can impair their access to justice. It lies on the other side of the spectrum from the Krakow's Court of Appeals 2013 decision, which was more lenient and favourable to parties to arbitration agreements which suffer financial difficulties. The Krakow court did not exclude the fact that a party invoking a lack of funds for arbitration should prevail in some factual scenarios. The issue is interesting and the Supreme Court may even present its view on the matter. Until then, parties that consider arbitration must reflect on both the advantages and disadvantages, including the fact that there is little to no possibility of being exempted from paying arbitration costs.

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Endnotes

- (1) Warsaw Court of Appeals, 27 April 2020, VII AGz 35/20.
- (2) Krakow Court of Appeals, I ACz 1251/13, available here in Polish.

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