

CHAPTER 11

Recent Finnish Supreme Court Case Law in the Arbitration Landscape

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§11.01 INTRODUCTION

This chapter is intended to provide the international readership of the Stockholm Arbitration Yearbook insight into the recent Finnish Supreme Court judgments related to arbitration. The three judgments discussed below have clarified what constitutes sufficient grounds for setting arbitral awards aside under Finnish law. The judgments address due process (the *Due Process* case, KKO 2018:48), the binding effect of arbitration agreements vis-à-vis third parties as guarantors (the *Guarantor* case, KKO 2019:111) as well as the relationship between arbitration, bankruptcy and property law (the *Bankruptcy Estate* case, KKO 2019:64). As the judgments involve issues that are likely to arise in many jurisdictions, the authors hope that even non-Finnish readers will benefit from the observations below. Lastly, the chapter also provides a brief update on the possible revision of the Finnish Arbitration Act (1992/967, the ‘FAA’).

§11.02 FINDING A BALANCE BETWEEN A PARTY’S RIGHT TO PRESENT ITS CASE AND ARBITRATOR’S CONDUCT OF PROCEEDINGS: THE DUE PROCESS CASE (KKO 2018:48)

[A] Introduction

The first of the Finnish Supreme Court’s judgments to be discussed was rendered on 26 June 2018¹ and provides useful guidance on finding the balance between parties’ right

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1. *The Due Process Case*, decision No. KKO:2018:48, Case No. S2017/54 (KKO 26 June 2018).

to present their cases and arbitrators' right to conduct the proceedings. The question was whether the respondent was provided sufficient opportunity to present his case² when the arbitrator had ignored his observations on the amount of damages because they were not made until the closing statement. An insufficient opportunity to present one's case constitutes a ground for setting the award aside under section 41 of the FAA. The Supreme Court found that the arbitrator's procedural decision not to observe the respondent's arguments made in the closing statement had not violated the respondent's right to be heard or his right to sufficiently present his case. Consequently, the action for setting the award aside was rejected.

[B] Background and the Lower Court Judgments

A had worked as the CEO of a Finnish and an Estonian company. Pursuant to A's executive employment contract, disputes arising out of the contract were to be resolved in arbitration in accordance with the arbitration rules of the Arbitration Institute of the Finland Chamber of Commerce (the FAI). The Finnish and Estonian companies had transferred all their claims to their principal owner E Group Plc (hereinafter, 'E') with the result that E and A became the parties to the arbitration clause.

In the arbitration E claimed damages from A arguing that A as CEO had made unlawful decisions regarding travel expenses, additional benefits and their processing in the accounts of the Finnish company, due to which the company had been ordered to pay tax increases, additional taxes and late payment penalties. During the arbitration, A opposed the claim in his written reply without submitting any specific grounds concerning the amount of the claim. However, later in his written closing statement, submitted after the hearing, A argued that the amount of the claim included payments for which he was not liable while at the same time accepting liability for the bulk of the monetary amount of the claim. In making the final award, the arbitral tribunal did not observe A's arguments presented in his closing statement concerning the amount of the damages because it was presented only after the hearing. The arbitral tribunal ordered A to pay the entire amount claimed by E.

A initiated setting aside proceedings in the Helsinki District Court on the ground that he had not been given a sufficient opportunity to present his case since the arbitral tribunal had not considered his submission concerning the amount of the claimed damages presented to the tribunal only after the hearing in a post-hearing brief (written closing statement). The District Court, however, found that A had had a sufficient opportunity to present his views on both the grounds and amount of the damages during the proceedings, but he had not availed himself of this opportunity before his closing statement. Furthermore, the District Court noted that the parties had effectively

2. Article V(1)(b) of the New York Convention provides that recognition and enforcement of the award may be refused if 'a party was otherwise unable to present its case'. The wording in s. 24.1 of the Swedish Arbitration Act (SFS 1999:116) provides that 'The arbitrators shall afford the parties, to the extent necessary, an opportunity to present their respective cases in writing or orally.' Similarly, the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce (2017, the 'SCC Rules'), Art. 23.2.

agreed on preclusion preventing new arguments being made in the written closing statements. If A's arguments concerning the alleged amount of damages made in his written closing statement had been admitted by the arbitral tribunal, E would have also had to have been reserved an opportunity to present counter-arguments and possible evidence which would have led to a delay from the originally agreed procedural plan.

The Court of Appeal likewise dismissed A's claim by stating that a clear procedural timetable had been established to secure the expediency of the proceedings. While (contrary to the District Court) the Court of Appeal considered that the arbitrator had not issued a completely unambiguous preclusion order, it also concluded that it ought to have been clear to the parties on the basis of the procedural timetable that the claims and their grounds were to be presented before the set date and that they would risk not being considered by the tribunal should they be presented after the set date without a weighty reason. Since A had not put forward any acceptable reason for not objecting to the amount of the damages before his closing statement, the Court of Appeal held that A had been given a sufficient opportunity to present its case.

[C] The Judgment of the Supreme Court

The Supreme Court dismissed A's claims and confirmed the conclusion of the Court of Appeal. While section 41 of the FAA provides that an arbitral award may be set aside if the arbitral tribunal fails to give a party a sufficient opportunity to present its case, the Supreme Court noted that the preparatory legislative works state that it is sufficient that a party is *given* an opportunity to be heard – if that opportunity is not used, the arbitrators are not prevented from deciding on the matter. Furthermore, by referring to precedent KKO 2008:77,³ the Supreme Court noted that the applicability of arbitration for the settlement of commercial disputes depends to a large extent on the binding nature and enforceability of the arbitration award. For that reason, the grounds on which the validity of awards can be disputed have both in domestic and in international regulation been sought to be restricted so that only clear formal errors and relatively gross procedural errors may result in the nullity or the setting aside of an award.

The Supreme Court also stated that according to section 25(2) of the FAA, either party may amend or supplement its claims and their grounds during the arbitral proceedings unless the proceedings would thereby be unduly delayed, but that this provision only applies if the parties have not agreed otherwise. As arbitration is largely based on party autonomy, and the procedural provisions of the FAA are mostly non-mandatory, if the parties have not agreed otherwise, the authority to decide is left to the arbitrators on the basis of section 23 of the FAA.⁴ According to section 23 of the

3. *Polar Electro v. Werfen Australia*, Decision No. KKO:2008:77, Case No. S2006/716 (KKO 2 July 2008).

4. In this regard, s. 23 of the FAA essentially corresponds with Art. 19 of the Model Law.

FAA, when deciding on the procedure, the arbitrators need to observe the other provisions of the FAA and take into account the requirements of equal treatment of the parties and the expediency of the procedure. This means finding a balance between those provisions and the mandatory section 22 of the FAA, i.e., the requirement of providing the parties with a sufficient opportunity to present their cases – a general procedural principle of due process that cannot be dispensed with. If compromised, the violation of the principle forms grounds for setting the award aside pursuant to section 41 of the FAA.

In this particular case, the Supreme Court noted (similar to the Court of Appeal) that the procedural timetable that the parties had agreed on did not constitute such a preclusion order that would have expressly restricted the parties' right to present new arguments after the set date. According to the Supreme Court, such restriction would have required a clear preclusion order issued by the arbitrator and accepted by the parties. In the absence of a clear preclusion order, it is for the arbitral tribunal to evaluate on a case-by-case basis whether deciding on the matter would be unduly delayed should a party's procedural motion be accepted – such as A supplementing his grounds for the dismissal of part of the claims. According to the Supreme Court, the arbitrators have wide discretion in this regard, with the principles of equal treatment of the parties, the parties' right to present their case and procedural expediency defining the outlines of such discretion. Importantly, the Supreme Court noted that it is not a sufficient ground to set aside an award if the court hearing the case had evaluated the excessiveness of the delay differently from the arbitral tribunal. Instead, the bar for setting aside an arbitral award must be set to a level where the party's right to be heard has been infringed so that, as a consequence, the party has been denied a sufficient opportunity to present its case.

Continuing on the merits of this particular case, the Supreme Court found that A had not altered its claims during the arbitration, but he had, however, supplemented his grounds for dismissal in his closing statement. Since E had already in its statement of claim presented the claim to which A's observations related, the Supreme Court reasoned that A could have made the allegations about the amount of the claim already in the written phase before the hearing. Since A had not availed himself of this opportunity before his closing statement or presented any reason for such conduct, and since the established process timetable sought to structure the procedure so that the disputed issues would be identified already in the written phase, the Supreme Court concluded that A was able to anticipate that any submissions made at a later stage would risk not being considered. For the above reasons, the Supreme Court held that the arbitral tribunal's procedural decision was not to be considered unpredictable or surprising and that A's opportunity to present his case had not been undermined in a way to constitute a reason for setting the award aside under the FAA.

[D] Analysis: Confirmation of Arbitrators' Margin of Discretion in Making Procedural Decisions

The Supreme Court's judgment in *Due Process* provides useful guidance to arbitrators in cases where the seat leads to the application of the FAA on the procedural issues.⁵ It establishes that arbitrators indeed have wide discretion in balancing procedural decisions between the right to be heard, expediency of the proceedings and equal treatment of the parties – it is insufficient that as a result of an *ex post* assessment of the arbitral tribunal's procedural decision the competent court would view the delay to the proceedings differently from the tribunal, as long as the court finds that in making the procedural decision the party's opportunity to present its case was not denied. Therefore, the Supreme Court confirmed that it is up to the arbitrators to determine the excessiveness of the delay that would be caused if the action was allowed,⁶ thus also allowing room for a procedural judgment rule, i.e., 'a court will not second-guess an arbitrator's exercise of his procedural judgment, if his decision is based on a bona fide assessment of the case and is reasonable under the circumstances'.⁷

The Supreme Court's reluctance to revisit the arbitral tribunal's procedural decision and the Court's recognition of the tribunal's discretion in making such decisions set a relatively high threshold for finding that a party was not given sufficient opportunity to present its case. The said approach can be seen to follow the position taken by the Supreme Court already previously in its landmark judgment KKO 2008:77, where the foothold of arbitrators' wide margin of discretion was confirmed. In that judgment, the Supreme Court found that the party's right to sufficiently present its case was not violated although the arbitral tribunal had based its decision on section 36 of the Finnish Contracts Act (the equivalent being section 36 of the Swedish Contracts Act) without specifically providing the parties with an opportunity to argue on the applicability of section 36 of the Contracts Act.⁸ Together these judgments can be viewed to provide the arbitrators with a rather spacious safe harbour for making procedural decisions.

5. Better knowledge of the actual impact of robust case management decisions on the enforceability of arbitral awards in the particular judicial system(s) where the arbitration is either seated or the award is likely to be sought to be enforced has been introduced as one solution to fighting due process paranoia. See Remy Gerbay, *Due Process Paranoia* (Kluwer Arbitration Blog, 6 June 2016).

6. This is also a prerequisite for rightfully limiting the parties' right to amend or supplement their claims under s. 25(2) of the FAA.

7. See Klaus Peter Berger & J. Ole Jensen, *Due Process Paranoia and the Procedural Judgment Rule: A Safe Harbor for Procedural Management Decisions by International Arbitrators*, XIV(54) Rev. Bras. Arb. 73, 76 (2017).

8. Case KKO 2008:77 would in itself merit a full-length article and, indeed, it has spurred several commentaries. See, e.g., Jan Waselius & Tanja Jussila, *Does the Adversarial Principle Prevail in Arbitration? – An Analysis of Case KKO 2008:77* (Juridiska Föreningens Tidskrift, 2011/4–5 p. 712). In this article, however, suffice it to say that together the two judgments have been seen to express a pro-arbitration attitude. See Mika Hemmo: *Tarpeellinen asianajotilaisuus, preklusio ja oikeus suulliseen käsittelyyn – välimiesten harkintavallasta uuden kotimaisen oikeuskäytännön valossa* (Liikejuridiikka 2018/3 p. 42).

However, the users of arbitration need not to worry that the safe harbour would lead to their right to be heard being trodden on. In light of the factual background of the case, the procedural decision reached by the arbitrator perhaps cannot be described – at least from a Finnish and a Swedish perspective – as a particularly gutsy or surprising one but rather as a necessary means to prevent the proceedings from unnecessarily stretching and wadding. After all, A had been provided the right to present his case throughout the proceedings and decided not to present certain specific arguments before his closing statement without an acceptable reason.⁹ While ‘an instinct to protect the parties’ due process rights is a vital part of any successful arbitrator’s DNA’,¹⁰ the restriction of not allowing the respondent’s arguments is likely to have been based on the arbitrator’s comfort of knowing that the opportunity to present those arguments had been available to the respondent ever since he had received the statement of claim. Therefore, the judgment also confirms a certain requirement of active advocacy for the parties as well, meaning that they will need to actively and effectively make use of the means available to them to present their case.

The flipside of the Supreme Court’s judgment is of course that it does not establish when the delay to the proceedings would have been acceptable, and the respondent’s submission should have been accepted. (This of course was also not the issue to be resolved in the case.) This is particularly so since the Supreme Court did not base its decision on the (ambiguous) preclusion order having shaped the parties’ reasonable expectations, as did the District Court and the Court of Appeal, but on the arbitrator’s margin of discretion to assess whether excess delay to the proceedings would be caused by allowing A’s late arguments and to balance such delay against A’s right to be heard. In other words, the Supreme Court did not confront the issue regarding the existence of a valid preclusion order but instead considered the case as an issue of a party’s right to present its case. Under such reasoning, the procedural timetable had only an indirect impact on the arbitrator’s mandate to conduct the proceedings (and also meant that the arbitral tribunal’s procedural decision not to observe A’s arguments presented in his closing statement could not have been regarded as surprising by A).¹¹

9. While the Swedish Supreme Court’s recent judgment in *Belgor (Joint Stock Company Belgorkhim-prom v. Koca Insaat Sanayi Ihracat Anonim Sirketi)*, NJA 2019 p. 171, Case No. T- 5437-17 (NJA 20 March 2019), para. 41) did not concern a preclusion order or the right to submit supplementary rebuttal arguments in the closing statement but a respondent’s right to submit an expert report to the arbitral tribunal, the requirement of an acceptable reason by the respondent having not availed itself of the right in accordance with the procedural timetable was also mentioned by the Swedish Supreme Court in its reasoning as to why the denial of the respondent’s right did not constitute a denial of the party’s right to present its case. Similarly, *CicloMulsion AG v. NeuroVive Pharmaceutical AB*, NJA 2019 p. 382, Case No. T796-18 (NJA 30 April 2019), para. 12.

10. Klaus Peter Berger & J. Ole Jensen, *Due Process Paranoia and the Procedural Judgment Rule: A Safe Harbor for Procedural Management Decisions by International Arbitrators*, XIV(54) Rev. Bras. Arb. 73, 76 (2017).

11. Certain case commentaries have pointed out that the Supreme Court should have specifically commented upon preclusion. Under Finnish law, party autonomy of course extends to preclusion, thus allowing the parties to freely agree on any kind of preclusion rules. The FAI Arbitration Rules (not applicable to the case at the time) also include a specific mandate to arbitrators to order preclusion (Art. 35 of the FAI Arbitration Rules in force as of 1 January 2020 and Art. 33.3 of the FAI Arbitration Rules in force as of 1 June 2013). However, the approach

However, as is well known, due process paranoia rests on a belief that domestic courts will have a stricter understanding of due process than arbitrators.¹² While the apprehensions regarding the possible unenforceability of the award belong to normal risk-awareness and guarantee a fair and one-time procedure for the parties, an unfounded and ill-suited extension of the parties' procedural rights is no longer based on the arbitrators' pursuit for a just outcome but rather on their fear of rendering an unenforceable award. The Supreme Court's judgment is therefore a necessary confirmation that under Finnish law only a denial of the party's opportunity to present its case will amount to such an infringement that the award is to be set aside.¹³ The Supreme Court therefore expressed support for arbitrators' margin of discretion in reaching procedural management decisions.

§11.03 AN ARBITRATION AGREEMENT IN A PRINCIPAL LOAN AGREEMENT AND ITS BINDING EFFECT VIS-À-VIS GUARANTORS: THE *GUARANTOR* CASE (KKO 2019:111)

[A] Introduction

In *Guarantor*¹⁴ from 19 December 2019, the Supreme Court found that an arbitration clause included in a loan agreement bound not only the debtor but also the company that had guaranteed the debtor's loan.¹⁵ The action for setting the award aside on the basis of the arbitral tribunal having exceeded its mandate by resolving a question concerning the rights of a guarantor, i.e., a third party to the loan agreement was dismissed by the Supreme Court.

chosen by the Supreme Court nonetheless touches upon the same elements as the tribunal would have had to consider even if an ambiguous preclusion order had been in place: the requirements of equal treatment of the parties, the expediency of the procedure and the parties' opportunity to present their case.

12. Michael Polkinghorne & Benjamin Ainsley Gill, *Due Process Paranoia: Need We Be Cruel to Be Kind?* 34(6) J. Int'l Arb. 935, 938 (2017). In the 2015 survey by Queen Mary University of London and White & Case due process paranoia was defined as 'a perceived reluctance by tribunals to act decisively in certain situations for fear of the award being challenged on the basis of a party not having had the chance to present its case fully'. See Queen Mary University of London & White & Case: *2015 International Arbitration Survey: Improvements and Innovations in International Arbitration*, 2.

13. See the *Due Process Case*, para. 19.

14. Decision No. KKO:2019:111, Case No. S2018/745 (KKO 19 December 2019).

15. On a general level, the basic principle in Finland is that arbitration agreement is binding on the civil law universal successors of the parties to the arbitration agreement. Also in singular succession situations usually the one who acquires the right under the main agreement will be bound by the arbitration clause. However, the prerequisite is that the successor was aware or should have known about the arbitration agreement at the time of the succession. Möller Gustaf, *Välimiesmenettelyn perusteet* (Helsinki: Lakimiesliiton Kustannus, 1997), 21–22.

[B] Background

As a legal background to the international reader, there is no specific provision under Finnish law as to the binding effect of an arbitration agreement other than towards a private guarantor, i.e., a natural person giving a guarantee.¹⁶ Regarding private guarantors, section 37 of the Act on Guarantees and Third-Party Pledges (361/1999) explicitly provides that a private guarantor shall not be bound by an agreement, concluded before the dispute, to the extent that disputes concerning the guarantee are to be submitted to arbitration.¹⁷

As for the factual background of the case, company A had provided funding to companies active in developing countries. B was an Indian company that manufactured concrete elements for the construction industry and C an Indian real estate company. B and C belonged to the same group of companies owned by the Y family. XY acted as the CEO of both B and C.

A and B had signed a loan agreement in 2009 which contained an arbitration clause to the effect that disputes arising out of and relating to the loan agreement were to be finally settled in arbitration in accordance with the FAI Arbitration Rules by a sole arbitrator. The loan agreement was subsequently amended three times by separate amendment agreements in 2009 and 2012. All of the amendment agreements contained a dispute resolution clause that referred to the arbitration clause in the loan agreement.

Later in 2009, after the loan agreement had been executed, C became a guarantor for payment (as for its own debt) for B's debt to A. The dispute resolution clause in the guarantee undertaking provided that A was entitled to bring disputes arising out of the guarantee undertaking before Helsinki District Court as the first instance. However, in the third amendment agreement between A and B, C agreed that it would accept the amendment agreement and the amended amount of the loan under that agreement.

The CEO XY signed the loan agreement on behalf of B, and the guarantee undertaking and the third amendment agreement on behalf of C. All these three engagements determined Finnish law as the applicable law however specifically excluding the application of the Act on Guarantees and Third-Party Pledges to the guarantee undertaking.

A initiated arbitration proceedings against B and C jointly for the repayment of the loan under the loan agreement and the amendment agreements. C contested the arbitral tribunal's jurisdiction among others on the ground that no arbitration agreement had been entered into between C and A, and that any claims based on the

16. Pursuant to the Act on Guarantees and Third-Party Pledges (361/1999), the definition of private guarantor does not, however, cover a person who at the time of giving the is the managing director, a member of the board, the supervisory board or another comparable body, a general partner or a founder in the debtor corporation or foundation, or a parent corporation, nor a person who holds, directly or indirectly, at least one third of the shares or votes of a company, or has a comparable holding or control in another corporation.

17. Pursuant to the preparatory works of the Act (Government Bill 189/1998 vp, 72–73), neither does an arbitration clause concluded in the main agreement bind the private guarantor even if he has known about the clause and the guarantee has for example been included in the main agreement.

guarantee undertaking should be settled in the Helsinki District Court as provided in the guarantee undertaking.

The arbitral tribunal found that it had jurisdiction to resolve the matter by stating that C had become bound by the arbitration agreement because it was aware of the arbitration clause in the loan agreement when it undertook to guarantee the loan. In the final award rendered in 2015, the tribunal obliged B and C jointly to pay A the capital amount of the amended loan agreement with claimed interest.

C initiated court proceedings to set aside the award pursuant to section 41(1) of the FAA by arguing that the arbitral tribunal had exceeded its authority. Both the District Court and the Court of Appeal rejected C's action.

[C] The Judgment of the Supreme Court

The question before the Supreme Court was whether the arbitral tribunal had exceeded its authority when it had decided the matter also in respect of guarantor C on the basis of the arbitration clause included in the loan agreement.

Previous Finnish case law establishes that a guarantor can invoke an arbitration agreement against the creditor concluded between the debtor and the creditor and, on the other hand, that an arbitration agreement in the principal loan agreement does not prevent claims being pursued against the guarantor in general courts where the guarantee does not include an arbitration agreement.¹⁸ Also among Finnish legal scholars unanimity prevails as to the guarantor's ability to invoke an arbitration clause in the principal loan agreement at least when the guarantor knew or should have known about the arbitration clause when agreeing to guarantee the loan.¹⁹ However, the question of whether a creditor can invoke an arbitration agreement in the principal loan agreement against the guarantor has not been the subject of previous case law. In this respect the views among Finnish legal scholars also vary. Some commentators are of the opinion that the guarantor should specifically accept to be bound by the arbitration agreement whereas some have argued that the creditor could invoke the arbitration agreement also where the guarantor knew or should have known about the arbitration agreement before agreeing to the guarantee.²⁰ Overall, however, the question of the binding effect of arbitration agreements in principal loan agreements in respect of non-private guarantors is unresolved in Finland.

The Supreme Court stated that the rule concerning private guarantors cannot be taken as a starting point for non-private guarantors because their need for protection may essentially deviate from that of private guarantors.²¹ As for non-private guarantors, the general rule to be extracted from the Supreme Court judgment is however rather brief. According to the Court, the circumstances under which companies can

18. KKO 1930 II 555; KKO 1939 II 424; KKO 1953 II 103; KKO 1933 I 58; KKO 1936 II 507.

19. Möller, *supra* n. 15, 24–25.

20. No unanimity on this question can, however, be said to prevail. Möller, *supra* n. 15, 25.

21. The preparatory works for the Act on Guarantees and Third-Party Pledges (HE 189/1998 vp, 72) provide that private guarantors are in need of protection as they cannot be assumed to be familiar with arbitration and related costs.

undertake to guarantee other companies' loans can vary significantly. Therefore, the Supreme Court concluded that the assessment of the binding effect of an arbitration agreement in the principal loan agreement vis-à-vis the guarantor must be made case by case. Elements to be taken into account in such assessments include guidance available from previous case law,²² the specific characteristics of arbitration, practical needs as well as the protection of the guarantor.

In this particular case, the Supreme Court stated that C was not a party to the loan agreement containing the arbitration clause, and the arbitration clause had not been expressly referred to in the guarantee undertaking. Further, according to the Supreme Court, the wording of the guarantee or the fact that C had agreed to the amended amount of the loan in the third amendment agreement did not as such mean that C had expressly agreed to be bound by the arbitration agreement. In addition, the guarantee had a specific dispute resolution clause. Therefore, according to the court, no far-reaching conclusions could be made regarding C's intention to be bound by the arbitration clause.

Regardless of the above, the Supreme Court then went on to summarise the particular circumstances of the case that led the Court to consider that C nonetheless was bound by the arbitration agreement. Those included the following: (i) the guarantee undertaking was issued in such a way that it concerned solely the amended loan agreement; (ii) the loan agreement, the amendment agreements and the guarantee undertaking were parts of the overall arrangement between the companies concerning the principal loan; (iii) no particular arguments to protect C in its capacity as the guarantor had been made; and (iv) the interpretation according to which C should be bound by the arbitration agreement could be supported by the practical need to concentrate the resolution of commercial disputes concerning the same overall arrangement to one dispute resolution method. On the above grounds the Supreme Court found that since A's claim concerned the repayment of debt under the principal loan agreement and the amended loan agreements, which C had agreed to guarantee as if it were its own debt, and since the dispute between A and B was to be finally settled in arbitration, the arbitrator had not exceeded its authority when it had found to have jurisdiction also in respect of C.

[D] Analysis: The Need for Case-Specific Assessment Remains

The most obvious takeaway of the judgment is that although in this case the guarantor was found to be bound by the arbitration agreement, the judgment does not provide overarching generally applicable rules as to the binding effect of arbitration agreements in loan agreements extending to guarantors. The case-by-case assessment rule therefore provides little clarification to standard practice in Finland.

22. The Supreme Court's judgment in the *Guarantor Case* includes a summary of precedents KKO 1990:106, KKO 1992:155, KKO 2007:18 and KKO 2013:84 that may be relevant as guidance when considering whether the creditor is entitled to invoke an arbitration agreement in the principal loan agreement against the guarantor. It is not possible, however, to summarise those cases within the confines of this article.

In this particular case, there were specific circumstances that justified the conclusion in respect of C: the loan agreement and the guarantee undertaking were signed by the same person XY and, therefore, the guarantor C had become aware of the arbitration clause in the loan agreement. Furthermore, the guarantee undertaking specifically excluded the application of the Act on Guarantees and Third-Party Pledges, and although it included a specific dispute resolution clause, it was not an exclusive one. The dispute resolution clause in the guarantee undertaking also indicated that C had accepted the possibility of litigation in Finland and, therefore, according to the Supreme Court, the binding effect of the arbitration agreement could not be regarded as surprising for C.²³

There are, however, certain statements in the judgment that extend beyond the circumstances of the particular case. First of all, the Supreme Court stated that the provisions in the Act on Guarantees and Third-Party Pledges concerning private guarantors do not as such serve as the basis of assessment in respect of non-private guarantors and, thus, recognising the different level of protection required by these two types of guarantors, the possibility to extend arbitration agreements to non-private third-party guarantors was unlocked. Moreover, the lack of certainty regarding the guarantor's intent to be bound by the arbitration agreement did not prevent the Supreme Court from reaching a conclusion that, given the overall circumstances of the case, C was indeed regarded to be bound by the arbitration agreement.

In addition, the Supreme Court attached particular weight to the need for arbitration to produce final and binding awards (which in turn requires that the grounds for setting aside awards are restricted), as well as to the practical need of concentrating all disputes relating to the same commercial arrangement to be resolved within one dispute resolution method. To this end, the Supreme Court repeated familiar wording from its previous case law by stating that only clear formal errors specified in the FAA and relatively gross procedural errors may cause the nullity or the setting aside of an award. As to claims concerning excess of mandate, the Supreme Court stated that the arbitral tribunal can be seen to have exceeded its authority for example when it has settled a dispute which is not governed by a valid arbitration agreement between the parties.²⁴

What unfortunately still remains unresolved, however, is under which circumstances a non-private guarantor is not bound by an arbitration clause in the loan agreement. Is there a requirement that the guarantor was aware or should have known about the arbitration agreement before issuing the guarantee? In addition, rules regarding bankruptcy or third-party protection under property law may of course

23. In this regard, the reasoning of the Supreme Court is perhaps not the most ideal one. After all, for an Indian company with little understanding of the Finnish legal system, agreeing to litigate in Finland does not automatically mean that the company had perceived that the guarantee could also be settled in arbitration in Finland but it could have also consciously selected different dispute resolution mechanisms in the loan agreement and the guarantee undertaking. However, taking into account the overall specific circumstances of the case, the interpretation of the Supreme Court is very sensible.

24. *Polar Electro v. Werfren Australia*, Decision No. KKO:2008:77, Case No. S2006/716 (KKO 2 July 2008).

further cause the inapplicability of the arbitration agreement. Some more light is shed on the question of the binding subjective scope of arbitral agreements in the field of bankruptcy and property law in the Supreme Court judgment detailed below.

§11.04 ARBITRATION, BANKRUPTCY, PLEDGE AGREEMENTS AND THIRD PARTY PROTECTION: THE *BANKRUPTCY ESTATE* CASE (KKO 2019:64)

[A] Introduction

The Finnish Supreme Court's judgment in *Bankruptcy Estate*²⁵ rendered on 18 July 2019 concerns an arbitration agreement contained in a pledge agreement and its binding effect vis-à-vis the pledgor's creditors. The Supreme Court was presented with the question of whether, in view of the fundamental premise that an arbitration agreement is only binding on the parties to the arbitration agreement, the arbitral tribunal had exceeded its authority by resolving a question concerning the rights of third parties.²⁶

[B] Legal Framework

Bankruptcy Estate concerns questions pertaining to the perfection of pledge as well as the binding effect of a pledge agreement in bankruptcy. To this end, before introducing the facts of the case, some background information on Finnish law may be helpful to the international reader.

Compared to the other Nordic jurisdictions, the Finnish Bankruptcy Act (120/2004), comprehensively reformed in 2004, can be characterised by the high level of autonomy provided to creditors and the strength of the position of secured creditors.²⁷ Insolvency laws in Finland are largely mandatory and, therefore, the debtor cannot effectively agree, for example, to weaken the legal position of creditors or limit the right of succession of the bankruptcy estate to enter into contractual relationships instead of the debtor.²⁸ As a rule, agreements not concerning receivables subject to bankruptcy remain valid even after the bankruptcy. Thus, an arbitration agreement

25. Decision No. KKO:2019:64, Case No. S2017/675 (KKO 18 July 2019).

26. In addition, a subsequent question raised before the Court was whether a decision on the costs of arbitration can be set aside on the grounds of partially setting aside the award. While the question in itself is an interesting one, may it suffice to state within the confines of this article that the Supreme Court found that as the tribunal's award on costs did not specify the allocation of costs as to the claims decided by the tribunal and, therefore, it was not possible to determine the costs relating to the claims regarding which the tribunal was found to have exceeded its mandate, the tribunal's decision on costs was also to be set aside in its entirety.

27. Risto Koulu, *Konkurssioikeus*, in Risto Koulu, Heidi Lindfors & Johanna Niemi (eds), *Insolvenssioikeus* (Helsinki: WSOYpro 2004, Sanoma Pro, Alma Talent Oy 2017), 17.

28. Risto Koulu, *Johdatus insolvenssioikeuteen*, in Risto Koulu, Heidi Lindfors & Johanna Niemi (eds), *Insolvenssioikeus* (Helsinki: Alma Talent Oy 2017), 128–129; *The Social Insurance Institution of Finland v. Bankruptcy Estate of A*, Decision No. KKO:2016:100, Case No. S2015/236 (KKO 18 December 2016).

made before the bankruptcy binds the bankruptcy estate in disputes initiated after the bankruptcy and falling within the ambit of the arbitration agreement.²⁹ However, principles protecting third parties may restrict the validity of agreements in bankruptcy. If the dispute concerns a question that the debtor could not have agreed on with binding effect on its creditors before the bankruptcy, arbitration agreements concerning such questions are also not binding on the bankruptcy estate.³⁰

As for pledge law, the principle of publicity is one of the overriding principles in Finland. A pledge agreement has legal effects only *inter partes* until perfection requirements are duly fulfilled.³¹ The effectiveness of a pledge and the priority of the creditor created by the pledge in bankruptcy require, as a rule, that the pledge has been duly perfected. A pledge of receivables is created by a pledge agreement that must be perfected by a notice to the debtor.³² A pledge agreement has no specific formal requirements, but in the notice the debtor must explicitly be required to make payments to the pledgee.³³ Since there are no formal requirements for pledge agreements, pursuant to section 2 of the FAA which states that any dispute in a civil or commercial matter which can be settled by agreement between the parties may be referred to arbitration, disputes regarding or arising out of pledge agreements can in principle be referred to arbitration. However, as above, mandatory provisions can restrict the binding scope of such agreements.

[C] The Judgment of the Supreme Court

[1] Background and the Arbitral Process

Finnish entities A Ltd and B Ltd had entered into a pledge agreement over certain receivables in 2011. The pledge agreement contained an arbitration clause submitting all disputes arising out of the agreement to arbitration, the applicable law being Finnish law. The pledgor A was declared bankrupt in 2012. In 2013, B initiated arbitration against the bankruptcy estate of A relying on the arbitration clause in the pledge agreement.

B requested the arbitral tribunal to confirm, among other things, that the pledge had been duly perfected in accordance with Finnish law (claim 1.2) and that the pledge agreement and the pledge were in force and bound the bankruptcy estate (claim 1.7). The bankruptcy estate in turn requested the arbitral tribunal to dismiss the claim due to the tribunal's lack of jurisdiction. It contended that B's claims were preliminary questions to recovery to the bankruptcy estate, belonging to the exclusive jurisdiction of general courts.

29. KKO 1952 I 1; The preparatory works for the reform of the bankruptcy legislation (HE 26/2003 vp), 50, 130.

30. Möller, *supra* n. 15, 23.

31. Janne Kaisto, *Puhdas esinevastuu ja panttioikeuden yleiset opit (Die reine dringliche Haftung und die allgemeinen Lehren des Pfandrechts)*, Defensor Legis 5/2005 1005, 1009 (2005).

32. See, e.g., Jarmo Tuomisto, *Saatavan panttaus* (Helsinki: Talentum, 2015), 53.

33. See, e.g., *Cooperative Bank Y v. Bankruptcy Estate of A*, Decision No. KKO 2005:131, Case No. S2003/335 (KKO 13 December 2005).

In a voting decision, the arbitral tribunal granted B's claims. The arbitral tribunal found that the bankruptcy estate was bound by the arbitration agreement.³⁴ It considered that as far as the matter did not concern actual recovery to the bankruptcy estate, which pertained to the exclusive jurisdiction of general courts, the tribunal had the jurisdiction to resolve the validity, force and binding effect of the pledge agreement, as well as to review the evidence and legal facts concerning the interpretation of the pledge and the pledge agreement. However, the tribunal noted that it did not have jurisdiction to determine whether the pledge had been duly perfected (claim 1.2). Further, the tribunal noted that it did not have jurisdiction to determine whether the pledge was binding if the action was to be reversed in cases of recovery to the bankruptcy estate (claim 1.7), nor had this been requested by B.³⁵ In 2014, the tribunal rendered the final award where it confirmed B's claims and obliged the bankruptcy estate to cover B's legal costs and the costs of the arbitration.

[2] *The Lower Court Judgments*

The bankruptcy estate sought to set aside the award in the Helsinki District Court on the basis that the tribunal had exceeded its authority (section 41(1)(1) of the FAA) when deciding on B's claims 1.2 and 1.7.

The Helsinki District Court found that it followed from the mandatory provisions of the Bankruptcy Act that an arbitration agreement concluded before bankruptcy did not bind the bankruptcy estate to the extent the dispute concerned the perfection of the pledge, which the debtor could not have agreed upon with a binding effect towards its creditors. By confirming that the pledge had been duly perfected, the arbitral tribunal had simultaneously also confirmed the binding effect of the pledge vis-à-vis bankruptcy creditors. Thus, the District Court set aside the arbitral award in respect of claims 1.2 and 1.7.

The Helsinki Court of Appeal upheld the District Court's judgment by reasoning that the perfection of the pledge and its binding effect towards third parties were questions that A did not have the authority to agree on in a manner binding the bankruptcy estate and A's creditors. Therefore, the arbitration agreement was also not binding on A's bankruptcy estate in these respects and the tribunal had in the same respects also exceeded its authority.

34. The decision was made by a majority vote. One of the three arbitrators voted in dissent and held that the bankruptcy estate was not bound by the arbitration agreement in relation to a dispute concerning the perfection of the pledge.

35. The dissenting arbitrator considered that claims 1.2 and 1.7 concerned the rights of third parties i.e., the rights of other bankruptcy creditors. The perfection of the pledge was a condition for the pledge to be binding towards third parties. As the bankruptcy estate had not accepted the arbitration agreement concluded by A or itself entered into a new arbitration agreement, the arbitration agreement did not bind the bankruptcy estate in relation to a dispute concerning the perfection of the pledge. Thus, it was a question of the scope of the arbitration agreement, but not of the exclusive jurisdiction of a general court over disputes involving perfection of a pledge.

[3] *The Judgment of the Supreme Court*

The question before the Supreme Court was whether the arbitration agreement was binding on the bankruptcy estate in relation to B's claims 1.2 and 1.7 and whether the arbitrators had exceeded their authority in resolving these claims.

The Supreme Court stated that, as in Sweden, it is established in Finland that a bankruptcy estate is not bound by an arbitration agreement made by the debtor in cases of recovery to a bankruptcy estate when the matter concerns the creditors' legal remedy to reverse an action regarding the debtor's property.³⁶

Furthermore, the court stated that it has been established that principles protecting third parties mean that agreements cannot be made to the detriment of third parties regarding their rights in rem. Therefore, as the debtor cannot determine the in rem protection of a right based on an agreement, correspondingly, a bankruptcy estate cannot be bound by an arbitration clause regarding such protection.

Consequently, the Supreme Court noted that the tribunal had confirmed that the pledge had been duly perfected before the company was declared bankrupt (claim 1.2) and thereby the tribunal had not only confirmed the contractual obligations of the parties but gone beyond that, in essence confirming a direct effect on A's bankruptcy creditors who were not parties to the pledge agreement or the arbitration agreement.

In addition, according to the Supreme Court, also the confirmation by the tribunal of the validity of the pledge and the pledge agreement vis-à-vis the bankruptcy estate (claim 1.7) meant that the award had confirmed the pledge had been duly perfected. Therefore, the effects of the award were not restricted to resolving questions regarding the pledge agreement *inter partes*.

The Supreme Court therefore concluded that because A could not have agreed with B on the binding effect of the pledge vis-à-vis A's future bankruptcy creditors or on the fulfilment of the prerequisites for the pledge to obtain in rem protection in bankruptcy, there was no valid arbitration agreement in this respect and the bankruptcy estate was therefore not bound by the arbitration agreement concerning B's claims 1.2 and 1.7. Consequently, the arbitral tribunal had exceeded its authority and, as stipulated in section 41(1)(1) of the FAA, the award was to be set aside respectively.

[D] *Analysis: Binding Scope of Arbitration Agreements*

The Supreme Court's judgment addresses the question of the mandate of an arbitral tribunal: the Supreme Court found that the arbitrators had exceeded their jurisdiction within the meaning of section 41(1) of the FAA when they had resolved questions that were not matters capable of being agreed on by the debtor with a binding effect on the bankruptcy estate and, thereby, resolved questions in respect of which there was no valid arbitration agreement. As stated above, it is also noteworthy that the Supreme

36. *Five Seasons Fritidsaktiebolags konkursbo (bankruptcy estate) v. Five Seasons Försäljningsaktiebolag*, NJA 1993 p. 641, Case No. Ö240-92 (NJA 26 November 1993); *Svenska Kredit*, NJA 2003 p. 3, Case No. Ö3504-01 (NJA 2 January 2003); Lars Welamson & Mikael Mellqvist, *Konkurs: och annan insolvensrätt* (Stockholm: Wolters Kluwer, 2017), 163.

Court's judgment does not concern arbitrability. In fact, the arbitrability provision (section 2) of the FAA is not even mentioned in the judgment.³⁷

As freedom of contract is a fundamental rule in the Finnish judicial system, also disputes that may be settled by agreement may, as a rule, be validly resolved through arbitration.³⁸ Thus, also insolvency and property law related disputes, such as the validity of a pledge agreement and other *inter partes* aspects, are in principle *arbitrable*, i.e., capable for settlement by arbitration. However, arbitrability is a separate question of the binding subjective scope of the arbitration agreement. Therefore, the dispute could as such be arbitrable but, to the extent that the dispute involves the determination of a third-party right, e.g., when it concerns perfection of a pledge, the parties to the arbitration agreement are not capable of agreeing on the binding effect of the pledge *ultra partes*, rendering the matter beyond the scope of the arbitration agreement and therefore also beyond the jurisdiction of the tribunal.³⁹

Whether an arbitration agreement shall remain valid vis-à-vis the bankruptcy estate is ultimately defined by the nature of the disputed issue itself. Indeed, as the Supreme Court confirmed, if the matter does not touch solely on the obligations *inter partes* but instead concerns an issue that the debtor could not have agreed on before the bankruptcy with a binding effect towards the bankruptcy estate, the bankruptcy estate is not bound by the arbitration agreement.⁴⁰ It was specifically confirmed in the judgment that third-party rights' protection in rem, i.e., the validity of the right in rem (such as a pledge) in relation to third parties to their detriment, is an issue of this kind. Therefore, the Supreme Court's decision preserved the protected position of bankruptcy creditors.

A similar approach has been taken in Sweden. As is well known, in the Swedish system a bankruptcy estate is bound by an arbitration agreement entered into by the debtor company with respect to contractual rights succeeded to by the bankruptcy estate.⁴¹ On the other hand, a bankruptcy estate is not bound by an arbitration agreement where the dispute concerns an issue over which the debtor company could not have had a right of disposition, such as whether a particular claim enjoys protection in rem in a future bankruptcy of the debtor company.⁴²

37. Section 2 of the FAA provides that any dispute in a civil or commercial matter which can be settled by agreement between the parties may be referred for final decision to be made by one or more arbitrators. In cases where an arbitral tribunal would have resolved a non-arbitrable question, the award would be invalid under s. 40(1) of the FAA.

38. In Sweden see, e.g., *Five Seasons Fritidsaktiebolags konkursbo (bankruptcy estate) v. Five Seasons Försäljningsaktiebolag*, NJA 1993 p. 641, Case No. Ö240-92 (NJA 26 November 1993).

39. Tuomas Hupli, *Välímiesmenettely konkurssissa ja yrityssaneerauksessa*, Defensor Legis 3/2015, pp. 437 and 444.

40. The position is similar to that taken in Sweden. See, e.g., Torgny Håstad, *Något om skiljedomsavtals verkan mot tredje man, Process och exekution: vänbok till Robert Boman* (Uppsala: Iustus Förlag, 1990), 180.

41. See, e.g., Lars Heuman, *Skiljemannarätt* (Stockholm: Norstedts Juridik AB 1999), 102; Stefan Lindskog, *Skiljeförfarande – En kommentar* (Stockholm: Norstedts juridik, 2012), 224–225; Anders Relden & Ola Nilsson, *Chapter 3 The Arbitration Agreement*, in Ulf Franke, Annette Magnusson, et al. (eds), *International Arbitration in Sweden: A Practitioner's Guide* (Alphen aan den Rijn: Kluwer Law International, 2013), 75.

42. In *Five Seasons Fritidsaktiebolags konkursbo (bankruptcy estate) v. Five Seasons Försäljningsaktiebolag*, NJA 1993 p. 641, Case No. Ö240-92 (NJA 26 November 1993), the Swedish Supreme

§11.05 CONCLUDING REMARKS

Finland is in a strong position to serve as a place for international arbitration especially due to its political neutrality, geographical location, respect for the rule of law, freedom from corruption, and well-functioning regulatory and operational setting. As for the regulatory setting, the FAA was enacted in 1992 (and there have been five minor amendments since). Although the almost 30-year-old Act has worked well in practice, there have been initiatives for revision particularly in order to align the Finnish arbitration regulation with the UNCITRAL Model Law. In 2019, the Finnish Ministry of Justice launched a reform project, at the initiative of the Finland Chamber of Commerce, in order to determine the needs for revision under the current Act. The reform project is, however, still in the early stages.

One of the most notable distinctive features of the FAA that has generated calls for revision is the possibility to challenge an arbitral award on two separate legal grounds: (i) that the arbitral award is invalid (section 40) and (ii) that the arbitral award should be set aside (section 41). Section 40 of the Act provides that the court may declare an arbitral award invalid if, among others, the matter resolved by arbitration is non-arbitrable or if the award is in conflict with *ordre public*. Section 40 does not include any time limit for filing the action for annulment. Pursuant to section 41, a court may set aside an arbitral award upon the request of a party within three months of the date on which the party received a copy of the award, when certain conditions are met. These include, among others: (i) arbitrators exceeding their mandate, (ii) challenges on the arbitrators' impartiality and independence and (iii) the arbitrators' failure to give a party a sufficient opportunity to present its case.

Both sections 40 and 41 have remained unrevised since the enactment of the FAA in 1992, and the elimination of the invalidity provision (section 40) has been the focus of the revision discussion, in particular because the contents of the section have been criticised for being inconsistent with both the UNCITRAL Model Law and the general idea of effective business dispute resolution. Especially the absence of a time limit for filing an action for annulment of the arbitral award is seen as undermining the finality of arbitral awards.⁴³ However, this internationally rare distinction between the invalidity and annulment of an arbitral award is similar to the Swedish legislation, where the division was upheld as a result of the recent 2019 revision of the Swedish Act. In this context it should also be noted that under the UNCITRAL Model Law the grounds for setting aside an award can be invoked as grounds for refusal of recognition and enforcement of an arbitral award even after the time limit for filing an action for setting aside the award has expired. Thus, as far as the grounds for invalidity are concerned, the difference between Finnish law and the Model Law is more apparent than real.

Court confirmed that a bankruptcy estate was not bound by an arbitration agreement where the dispute concerned unlawful distribution of assets since the parties to the arbitration agreement, i.e., the debtor and its contracting party, could not have entered into an agreement regarding distribution of assets with binding effect towards the bankruptcy estate and its creditors.

43. Heidi Merikalla-Teir, *Finland Takes Important Steps to Increase Its Attractiveness as a Venue for International Arbitration: Launch of the Revision Process of the Finnish Arbitration Act Announced* (Kluwer Arbitration Blog, 17 May 2019).

With regard to parties from foreign countries, it would probably be appropriate to provide that the current grounds for invalidity would instead form such grounds for refusal of recognition and enforcement. Those grounds can be validly invoked even when the time limit for filing an action for setting aside the award has expired.

During 2014–2019, twelve applications for annulling an award were brought before the Finnish Courts of Appeal or the Supreme Court.⁴⁴ In two cases, the award was annulled in full, and in one case the award was annulled in part. The roughly estimated average length of the annulment proceedings in which the judgment was rendered during 2014–2019 was two years nine months from the date the proceedings were initiated in a district court until the date of the final judgment. As is also portrayed by the recent judgments, the Finnish courts recognise the integrity of arbitration by avoiding unnecessary interference in decisions rendered by arbitral tribunals, and can thus be said to be generally arbitration friendly.

While there are no official statistics on the number of arbitral awards challenged in Finland, following the international trend, the number could also be on the rise in Finland. In order for arbitration to maintain its reputation as an effective and final method of solving disputes, the finality of an arbitral award must be able to be determined by the court without undue delay which, as stated above, is also one of the key priorities in the discussions about the reform of the FAA.⁴⁵ Indeed, in the discussion concerning the Finnish legal reform, it has been deemed desirable to simplify and shorten the setting aside proceedings of an arbitral award by centralising the actions in one court, changing over to a discretionary appeal model and reducing the time limit for raising the claim from three months to two months. Eventually, in particular, the speed and the costs of the arbitration proceedings depend on the finality of the arbitral award. The other proposed changes to the Act include derogating from the written form requirement for arbitration agreements and adding provisions on granting interim measures by the arbitral tribunal.

As is apparent from the above, the number of challenges to arbitral awards in Finland does not as such merit the revision of the FAA. However, improvements such as reducing the time limit for setting the award aside from three to two months, as in the recent Swedish Arbitration Act reform, would also be a welcome change in Finland. Furthermore, the causality requirement introduced in Sweden in respect of setting aside an arbitral award, i.e., the requirement that the arbitrators not only exceeded their mandate, but that they did so *‘in a manner that probably influenced the outcome’* of the case, could also be a thinkable reform in Finland. After all, the ‘relatively gross procedural errors’ requirement expressed in the Supreme Court’s judgments commented on above implies the same requirement of causality.

44. The first instance for hearing annulment cases is the District Court level. There is no publicly available database on the number of annulment cases overall, and the above number of cases is based on queries made to the courts. Out of the twelve cases, nine cases were decided finally by the Courts of Appeal and three cases by the Supreme Court.

45. See Merikalla-Teir, *supra* n. 43.

A revision of the FAA is anticipated and would support the development of arbitration in Finland. In the meantime, the recent Supreme Court judgments demonstrate that the Finnish courts understand and support the values and principles of arbitration.

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