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Second Circuit Affirmed Enforcement of ICC Arbitral Award Annulled Abroad

Decision confirming an arbitral award annulled in Mexico, underscores US courts' pro-enforcement position and highlights different approaches undertaken by courts around the world.

On August 2, 2016, the United States Court of Appeals for the Second Circuit affirmed a 2013 decision by the US district court in the Southern District of New York, which recognized and enforced an arbitral award — now in excess of US$465 million — for a Mexican subsidiary of the US-based company KBR against a Mexican state oil and gas company, although the award had been set aside at the arbitral seat in Mexico in 2011.[1] (A discussion of that earlier decision and the implications is available in our previous *Client Alert* "Arbitral Award Enforced in the United States Although Annulled Abroad.")

The Second Circuit's Decision in *COMMISA*

The award was rendered in an International Chamber of Commerce (ICC) arbitration arising out of a contract to build oil platforms in the Gulf of Mexico between Corporacion Mexicana De Mantenimiento Integral, S. De R.L. De C.V. (COMMISA), a subsidiary of the US company KBR, and Pemex-Exploracion Y Produccion (PEP), a subsidiary of PEMEX, a Mexican state oil and gas company. The US district court in the Southern District of New York confirmed the award in 2010.

PEP resisted enforcement, while commencing parallel annulment proceedings in Mexico. PEP sought annulment on the grounds that, among other reasons, the ICC tribunal had exceeded its jurisdiction by hearing the parties' dispute relating to PEP's attempted administrative rescission of the contract. Under a Mexican law enacted in 2009 — while the arbitration was pending — administrative rescission of contracts are no longer subject to arbitration proceedings.[2]

PEP eventually succeeded in setting aside the award in Mexico. The Mexican court judgment in 2011 was based in large part on the new Mexican law precluding the arbitration of administrative rescissions. Following the annulment, the Second Circuit granted PEP's motion to vacate and remand to the district court to consider the implication of the annulment in the arbitral seat, Mexico.[3]

The 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention),[4] which principally governs the enforcement of international arbitral awards, requires contracting parties to recognize and enforce such awards, except as provided under the New York Convention.[5]

Under Article V(i)(e) of the New York Convention, courts may refuse recognition and enforcement if the award "has been set aside or suspended by a competent authority in the country in which ... that award

was made." In *COMMISA*, the parties invoked the 1975 Inter-American Convention on International Commercial Arbitration (the Panama Convention),[6] a regional version of the New York Convention, which contains the identical exception to enforcement as Article V(i)(e) of the New York Convention.[7]

On remand, the Southern District declined to defer to the Mexican annulment and again confirmed the award, finding that the annulment "violated basic notions of justice," where a retroactive application of the Mexican law rendered administrative rescissions non-arbitrable and left COMMISA without any forum to litigate its contractual claims.[8]

Concluding that the district court properly exercised its discretion in confirming the award, the Second Circuit held that giving effect to the nullification in Mexico "would run counter to United States public policy" and would "be repugnant to fundamental notions of what is decent and just in this country."[9] The Second Circuit observed the "truly unusual procedural history of this case," which calls for reconciliation of "two settled principles that militate in favor of opposite results: a district court's discretion to confirm an arbitral award, and the comity owed to a foreign court's ruling on the validity of an arbitral award rendered in that country."[10]

In an analysis of Article V of the Panama Convention, the Second Circuit held that a district court may exercise discretion to enforce an arbitral award annulled at the arbitral seat, consistent with the Convention's "pro-enforcement aim."[11] However, the exercise of such discretion "is constrained by the prudential concern of international comity" and is appropriate only to "vindicate fundamental notions of what is decent and just in the United States."[12]

In this case, the Second Circuit found that the "high hurdle" was surmounted by "four powerful considerations:"

- PEP's waiver of sovereign immunity by agreeing to the arbitral forum entitles COMMISA to the protection of its contractual expectations, "one of the core aims of contract law"
- Mexico's retroactive legislation deprives COMMISA of its contractual rights and is repugnant to "elementary considerations of fairness" as well as U.S. law
- The absence of any forum for COMMISA to litigate its contractual claim magnifies the injustice
- The rescission of contract and subsequent frustration of relief by PEP, an instrumentality of the Mexican government, amounts to unconstitutional government expropriation without compensation[13]

Accordingly, although a court should "act with trepidation and reluctance" in enforcing an arbitral award that was annulled by courts at the arbitral seat, in the rare circumstances of this case, the Second Circuit found that the district court properly exercised its discretion to confirm the award.[14] The nullification of the award by the Mexican court "offends basic standards of justice in the United States," such that deference to the Mexican decision "would undermine public confidence in laws and diminish rights of personal liberty and property."[15]

In addition, the Second Circuit dismissed two threshold objections PEP raised on appeal, concluding that the court has personal jurisdiction over PEP, and the venue properly lies in the Southern District of New York.[16]

Finally, the Second Circuit held that the district court did not exceed its "confirmation authority" in including in its judgment US$106 million in performance bonds, which was not referenced in the damages

section of the arbitral award.[17] COMMISA has posted the performance bonds pursuant to the contract and PEP collected them after the Mexican court had annulled the arbitral award.[18] The Second Circuit reasoned that the performance bonds were "part of the final arbitration award," as the ICC tribunal had issued a preliminary order enjoining PEP from collecting on the performance bonds and PEP had no subsequent right to collection.[19]

As a result of the decision, COMMISA now finds itself with an award which is no longer valid in Mexico, but is valid and enforceable in New York. Thus, as a practical matter, while COMMISA cannot enforce the award in Mexico, it can collect against assets that PEP holds in New York. Whether COMMISA can enforce the award in other jurisdictions depends on the approach those jurisdictions may take in enforcing foreign arbitral awards that have been set aside at the seat of arbitration, as discussed in more detail below.

Enforcement of Arbitral Awards That Have Been Set Aside at the Seat of Arbitration

The Second Circuit's affirmation of the district court decision in *COMMISA* join an ever-growing body of jurisprudence from courts around the world grappling with the issue of whether a national court of a signatory state to the New York Convention should recognize and enforce a foreign arbitral award that has been set aside at the seat of arbitration. Nevertheless, currently only a handful of jurisdictions have developed clear case law indicating the approach their courts would take when facing this issue.[20]

Jurisdictions Likely to Enforce Awards That Have Been Set Aside

United States: The *COMMISA* decision affirms recent US court rulings under which the exercise of discretion to enforce arbitral awards annulled at the arbitral seat is limited to achieve "fundamental notions of what is decent and just" in the United States. In an earlier case *Chromalloy Aeroservices v. Arab Republic of Egypt*, which the 2013 district court opinion discussed, the US Court of Appeals for the D.C. Circuit enforced an arbitral award that had been set aside at the seat of arbitration, finding that launching an appeal against the award in Egypt violated the final and binding nature of the award and that failing to recognize the award would violate US pro-arbitration public policy.[21] However, subsequent US court decisions have deviated from the broad ruling in *Chromalloy*, and refused to confirm awards that had been annulled at the seat of arbitration.[22]

Nevertheless, this later case law left open the possibility that a US court would decline to recognize a foreign court's annulment for public policy reasons. In *TermoRio S.A. E.S.P. v. Electranta S.P.*, the US Court of Appeals for the DC Circuit framed the relevant inquiry as whether the foreign court's annulment of the award "violated basic notions of justice."[23] Consistent the *TermoRio* standard, the Second Circuit found that *COMMISA* implicated issues of fundamental fairness and thus upheld the district court's exercise of discretion to confirm the award.[24] Thus, while *COMMISA* revived the *Chromalloy* principle permitting a US court to recognize an award that has been set aside at the seat of arbitration, *COMMISA* also affirmed the *TermoRio* approach of only affording courts the narrow discretion to do so if deferring to the foreign court's judgment would be fundamentally unfair.

France: With the *COMMISA* decision, the US affirms its position alongside France as a prominent and traditionally arbitration-friendly jurisdiction, inclined to enforce arbitration awards that have been set aside at the seat of arbitration. However, unlike the US courts, which require a showing of a fundamental unfairness to confirm an annulled award, the French courts tend to follow a bright-line rule, by which arbitral awards are recognized and enforced regardless of the annulment, without inquiring into the fairness of the foreign court's annulment proceedings.

In 2005, in the seminal case of *Société Hilmarton Ltd v Société OTV*,[25] the French Court of Cassation confirmed an award which had been annulled at the seat of arbitration, ruling that arbitral awards were divorced from any national legal order, including that of the seat, and thus the award continued to exist despite the annulment.[26] This principle was again reaffirmed in May 2012 by the Paris Court de Grande Instance in *Maximov v. NLMK*,[27] which recognized an arbitral award rendered in Russia and subsequently set aside by a Russian court on the grounds that the dispute was not arbitrable. Without inquiring into the annulment proceedings themselves, the Court de Grande Instance concluded that the Russian court's annulment was not sufficient to refuse recognition of the award in France.

The Netherlands: Dutch courts have taken an approach similar to that of US courts, demonstrating an inclination to inquire into the fairness of the annulment of an arbitral award at the seat of arbitration before deciding whether to recognize the award or defer to the foreign court's decision. In 2009, in *Yukos Capital S.A.R.L. v. OAO Rosneft*,[28] the Amsterdam Court of Appeal upheld an award rendered in Russia as enforceable in the Netherlands, despite a Russian court's annulment of the award, finding that the annulment of the award was not the result of an impartial and independent judicial process. In September 2012, the Amsterdam Court of Appeal applied a similar approach in *Nikolai Vikorovich Maximov v. OJSC Novolipetski Metallurgichesky Kombinat*,[29] which also involved an arbitral award rendered in Russia and subsequently set aside by the Russian courts. The Dutch court held that the Russian judgment annulling the award should be respected absent specific indications that the judgment was the result of an unfair trial. Additionally, the Dutch court ordered further hearings to determine the fairness of the annulment proceedings in Russia.

Other Jurisdictions: According to the 2012 ICC Guide to National Procedures for Recognition and Enforcement of Awards under the New York Convention, recognition and enforcement of awards that have been set aside at the seat of arbitration is also likely available in Austria, Brunei, Croatia, Denmark, Ireland, Lebanon, Luxembourg, Mexico, Panama, Poland, Spain and Turkey, although the courts of these states have yet to consider the issue.[30]

Jurisdictions Likely to Refuse to Enforce Awards That Have Been Set Aside

Courts in other contracting parties to the New York Convention take the view that an arbitral award that has been set aside at the seat of arbitration cannot be recognized and enforced. England and Germany follow this approach. Hungary, India, Italy, Japan, Korea and Switzerland also likely follow this approach, although the courts of these states have yet to consider the issue.[31]

Australia, while seeking to become a pro-arbitration jurisdiction, has recently deferred to an English court's decision to confirm an arbitral award rendered in London, but the approach the Australian court would take regarding an award that had been set aside abroad remains unclear.[32] Similarly, Hong Kong has also taken a deferential approach to an arbitral award confirmed at the arbitral seat, China, despite the challenging party's allegation of bias of the tribunal,[33] but the jurisdiction has yet to address the specific issue of an award set aside at the arbitral seat.

Key Take-Aways

- The *COMMISA* decision reaffirmed the US approach articulated in *Baker Marine* and *TermoRio*, which permits courts the narrow discretion to recognize and enforce an arbitral award annulled at the arbitral seat only if deferring to the foreign court's annulment would be fundamentally unfair and offend public policy.

- The Dutch courts follow a similar approach, deferring to the foreign court's annulment absent specific evidence that the annulment had resulted from unfair proceedings.

- French courts demonstrate the most liberal approach to enforcement of foreign arbitral awards and are likely to recognize and enforce an award that has been set aside at the arbitral seat, without inquiring into the annulment proceedings at all.

- English and German courts, on the other hand, are likely to refuse to recognize and enforce an award that has been set aside at the seat of arbitration.

- In most other jurisdictions, courts have yet to provide guidance on how they would approach the specific issue.

Strategic Considerations

- The annulment proceedings in Mexico in the *COMMISA* case underscore the importance of carefully selecting the seat of arbitration and opting for a jurisdiction whose local law and judiciary are likely to respect the finality of an arbitral award.

- US courts will likely confirm arbitral awards that have been set aside at the seat of arbitration only if deferring to the foreign court's annulment decision would result in fundamental unfairness. Thus, a party seeking to set aside an arbitral award at the arbitral seat is well-advised to do so because the US courts are likely to defer to the annulment decision absent a showing of fundamental unfairness and violation of public policy.

- A party wishing to enforce an award that has been set aside at the seat of arbitration should consider enforcing against its counterparty's assets in a jurisdiction likely to recognize the award despite the annulment, such as France, the Netherlands or the US.

Despite criticisms that the decision creates uncertainty and potential for forum-shopping, *COMMISA* is likely to signal a broader trend in international arbitration in which claimants pursue enforcement proceedings, notwithstanding an annulment decision at the arbitral seat. Further jurisprudence on this issue is thus likely to emerge in the near term in the US and around the globe.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Claudia T. Salomon
claudia.salomon@lw.com
+1.212.906.1230
New York

Lilia B. Vazova
lilia.vazova@lw.com
+1.212.906.1881
New York

Iris H. Xie
iris.xie@lw.com
+1.212.906.4530
New York

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Endnotes

1 *Corporacion Mexicana De Mantenimiento Integral, S. De R.L. De C.V. v. Pemex-Exploracion Y Produccion*, Docket No. 13-4022, 2016 WL 4087215 (2d Cir. Aug. 2, 2016) (hereinafter COMMISA).

2 COMMISA at *3.

3 See id.

4 330 UNTS 38; 21 UST 2517; 7 ILM 1046 (1968).

5 New York Convention, Art. II.

6 1438 U.N.T.S. 245. The Panama Convention, to which Mexico is a signatory, applies to members of the Organization of American States.

[7] Because of the similarities between the Panama Convention and the New York Convention, the New York district court relied on precedent under the New York Convention in deciding the matter. See *Corporacion Mexicana De Mantenimiento Integral, S. De R.L. De C.V. v. Pemex-Exploracion Y Produccion*, 962 F. Supp. 2d 642, 653-54 (S.D.N.Y. 2013).

[8] 962 F. Supp. 2d at 644.

[9] COMMISA at *13-14.

[10] Id. at *1.

[11] Id. at *9.

[12] Id.

[13] Id. at *9-13.

[14] Id. at *13.

[15] Id.

[16] Id. at *4-7.

[17] Id. at *13-14.

[18] Id.

[19] Id.

[20] ICC International Court of Arbitration Bulletin 733: ICC Guide to National Procedures for Recognition and Enforcement of Awards under the New York Convention, v. 23/Special Supplement 2012 (hereinafter ICC Guide).

[21] 939 F. Supp. 907, 912-13 (D.D.C. 1996).

[22] See, e.g., *Baker Marine (Nig.) Ltd, v. Chevron (Nig.) Ltd*, 191 F2d 194 (2d Cir. 1999); *Spier v. Calzaturificio Tecnica. S.pA*, 71 F. Supp. 2d 279, 288 (S.D.N.Y. 1999); *TermoRio S.A. E.S.P. v. Electranta S.P.*, 487 F.3d 928, 938 (D.C. Cir. 2007).

[23] 487 F.3d at 939.

[24] 962 F. Supp. 2d at 656-57.

[25] Cour de cassation, 23 March 1994, YB Comm Arb, Vol XX (1995) 663.

[26] Hilmarton at 665.

[27] *Maximov v. NLMK* (Tribunal de Grande Instance, Paris, 16 May 2012).

[28] Case No. 200.005.269/01, Amsterdam Court of Appeal, April 28, 2009.

[29] Case No. 200.100.508/01, Amsterdam Court of Appeal, September 18, 2012.

[30] ICC Guide at 20.

[31] Id.

[32] *Coeclerici Asia (Pte.) Ltd. v. Gujarat NRE Coke Ltd.*, [2013] F.C.A. 1395 (30 Aug. 2013); *Gujarat NRE Coke Ltd. v. Coeclerici Asia (Pte.) Ltd.*, (2013) 304 A.L.R. 468. See also Matthew Barry, The Role of the Seat in International Arbitration: Theory, Practice, and Implications for Australian Courts, J. *Int'l Arb.* 289 (2015).

[33] *Gao Haiyan v. Keeneye Holdings Ltd.*, [2012] 1 H.K.L.R.D. 627. See Barry, supra note 32, at 311.