Fault Lines in International Commercial Arbitration

- By Charles H. Brower II, The University of Mississippi School of Law,
  for ITA

On March 23, in Washington, DC, the Institute for Transnational Arbitration and the American Society of International Law will co-host a conference on "Fault Lines in International Commercial Arbitration."

Building on the American Law Institute's draft Restatement of the U.S. Law on International Commercial Arbitration, Gary Born, Jan Paulsson, J. William Rowley, QC, Linda Silberman, and Judge Diane P. Wood will discuss controversial themes that have emerged in the course of the drafting process. These include: (1) How National Is *International* Arbitration?; and (2) The Limits of Party Autonomy.

Although the themes for the conference may have an abstract tone, they encompass a host of issues relevant to anyone practicing in the field. Take the first theme, which one could easily reframe as "How International Is *National* Arbitration?"

Assuming that one drafts a national Restatement on an international topic, should the process aim to record the existing specificities of national practice, or to facilitate their subordination to international norms? To the extent that one aims to bridge gaps between national and international norms, should one focus on elimination of the most unusual local practices, which the draft Restatement does by rejecting (1) the application of forum non conveniens to enforcement proceedings, and (2) the use of "manifest disregard of the law" as a judicially created ground for vacating awards under § 10 of the Federal Arbitration Act (FAA)? *See* RESTATEMENT (THIRD) OF THE U.S. LAW OF INTERNATIONAL COMMERCIAL ARBITRATION § 5-21(a) (Council Draft No. 2, 2010) ("An action to enforce a Convention award is not subject to . . . dismissal on forum non conveniens grounds."); RESTATEMENT (THIRD) OF THE U.S. LAW OF INTERNATIONAL COMMERCIAL ARBITRATION § 4-11E, ALTERNATIVE C (Preliminary Draft No. 4, 2010) ("A court may not vacate a U.S. Convention award for manifest disregard of the law.").

Alternatively, instead of just pruning the outliers, should one aim for virtual congruence between national and international standards? If so, should the Restatement promote greater harmony between those formally distinct sources of law, or should it abolish the formal distinctions through direct incorporation of international norms into domestic law?

As a concrete example of the questions just posed, one may cite the draft Restatement's treatment of the grounds for vacatur of New York Convention awards rendered in the United States (U.S. Convention awards). In its current form, the draft Restatement proposes (but will have to choose between) two alternatives: (1) vacatur in accordance with the grounds set forth in § 10 of the FAA (which generally governs

the vacatur of domestic awards), or (2) vacatur in accordance with the grounds for refusal to enforce awards under Article V of the New York Convention. *See* RESTATEMENT (THIRD) OF THE U.S. LAW OF INTERNATIONAL COMMERCIAL ARBITRATION § 4-7, ALTERNATIVES A & B (Preliminary Draft No. 4, 2010).

In one sense, the choice of vacatur grounds for U.S. Convention awards is not simple. As a purely textual matter, one can defend either of the alternatives mentioned above. For example, § 10 of the FAA might be the appropriate vehicle because (1) the Convention does not regulate the standards for vacatur of awards at the place of arbitration, but contemplates that the curial courts will continue to apply national standards in vacating awards (Article V(1)(e)); (2) in implementing the Convention by statute (9 U.S.C. § 208), Congress provided for the continued application of the FAA's domestic provisions to the extent that they do not conflict with the Convention or any part of its implementing legislation; and (3) in implementing the Convention by statute (9 U.S.C. § 207), Congress also required confirmation of awards unless a court finds any of the grounds for refusal "specified" in the Convention. Because those grounds include vacatur by a court applying national standards at the place of arbitration (Art. V(1)(e)), recourse to § 10 of the FAA does not conflict with the Convention or its implementing legislation. *See* RESTATEMENT (THIRD) OF THE U.S. LAW OF INTERNATIONAL COMMERCIAL ARBITRATION § 4-7 reporters' note b (Preliminary Draft No. 4, 2010). On the other hand, one could take the position that the same provisions permit vacatur only for the grounds "specified" in the New York Convention itself because the application of any other standard would "conflict" with § 207, which requires U.S. courts to confirm awards absent one of grounds "specified" in the Convention.*Id*.

Although selection of the proper grounds for vacatur may not be easy as a textual matter, the stakes are surprisingly low because the draft Restatement considers § 10 of the FAA to be "largely congruent" with Article V of the New York Convention. RESTATEMENT (THIRD) OF THE U.S. LAW OF INTERNATIONAL COMMERCIAL ARBITRATION § 4-7 reporters' note a (Preliminary Draft No. 4, 2010). As a result, selection of either source "presumably would not have any importance as a matter of substance." *Id*. Both approaches should, thus, generally yield the same outcomes on petitions to vacate Convention awards.

If both options remain defensible and produce identical outcomes, why agonize over the method that the Restatement adopts for striking a balance between national and international norms? *See id*. ("An initial question is whether a choice among the alternatives even matters."). As in so many cases, the question is not "what" one chooses, but "how" one chooses—an issue that may have cascading effects for the entire Restatement.

If the Restatement were to let courts decide through the accumulation of judicial precedent, it would favor the application of § 10 of the FAA by a three-to-one margin among United States Courts of Appeal. RESTATEMENT (THIRD) OF THE U.S. LAW OF INTERNATIONAL COMMERCIAL ARBITRATION § 4-7 reporters' note c (Preliminary Draft No. 4, 2010). However, the reporters have rejected this approach on the grounds that the Restatement is not a popularity contest.

If the Restatement were to let its advisors and members of its consultative group decide through the accumulation of comments, it would overwhelmingly favor the application of Article V grounds. However, one wonders if that represents a different kind of popularity contest involving practitioners driven to promote New York as a venue for international arbitration, and academics eager to bring the FAA into line with the UNCITRAL Model Law, which offers a "pleasing symmetry" between (1) the grounds for refusing enforcement, and (2) the grounds for vacating awards. *See* RESTATEMENT (THIRD) OF THE U.S. LAW OF INTERNATIONAL COMMERCIAL ARBITRATION § 4-7 reporters' note d (Preliminary Draft No. 4, 2010) (examining the policy considerations, and emphasizing that the unification of grounds for non-enforcement and for vacatur may "enhance the attractiveness of the U.S. as an arbitral forum").*See also* United Nations Commission on International Trade Law Model Law on International Commercial Arbitration, arts. 34, 36, 40 U.N. GAOR Supp. (No. 17) at 89, U.N. Doc. A/40/17 (1985) (adopting the substance of New York Convention Article V as the grounds both for refusing enforcement and for setting aside awards); NIGEL BLACKABY ET AL., REDFERN AND HUNTER ON INTERNATIONAL ARBITRATION 595 (5th ed. 2009) (emphasizing the "pleasing symmetry" between the grounds for non-enforcement and for setting awards aside under the UNCITRAL Model Law).

If the Restatement were to follow the intent of Congress, the question becomes whether to focus on (1) what Congress would do if presented with the options today, or (2) what Congress probably had in mind when adopting the Convention's implementing legislation in 1970. *See* RESTATEMENT (THIRD) OF THE U.S. LAW OF INTERNATIONAL COMMERCIAL ARBITRATION § 4-7 reporters' note d (Preliminary Draft No. 4, 2010) ("The issue . . . is what Congress intended in enacting Section 207.").

If approached as a forward-looking judgment about policy, it makes sense to limit the grounds for vacatur of U.S. Convention awards to the grounds actually specified in Article V of the Convention. As explained above, that would not change the substantive outcome of actions to vacate awards, but it would send a clear signal that United States adheres to universally accepted standards for vacating awards, thereby increasing New York's appeal as a venue for international arbitration. *Id.*

If approached as a backwards-looking inquiry into the likely intent of Congress during 1970, the picture changes dramatically. As a matter of historical record, the United States did not sign the New York Convention in 1958 because the U.S. delegation concluded that "certain provisions were in conflict with some of our domestic laws." H.R. Rep. 91-1181, at 1, *reprinted in* 1970 U.S.C.C.A.N. 3601, 3601-02. *See also Certain Underwriters at Lloyd's London v. Argonaut Ins. Co.*, 500 F.3d 571, 576 (7th Cir. 2007).

In addition, some contemporaneous observers expressed concerns about the use of multilateral treaties to regulate a topic for which the 50 states had at least a degree of concurrent jurisdiction. *See*Martin Domke, *The United Nations Conference on International Commercial Arbitration*, 53 AM. J. INT'L L. 414, 417 & n.27, 419 & n.41 (1959).

Still concerned about unintended changes to U.S. law in 1970, the State Department proposed to implement the New York Convention not by general amendments to the FAA's existing provisions, but through a separate chapter that would "deal *exclusively* with *recognition and enforcement* of awards falling under the Convention." H.R. Rep. 91-1181, at 2, *reprinted in* 1970 U.S.C.C.A.N. 3601, 3603 (emphasis added). In doing so, the State Department assured Congress that "[t]his approach would leave *unchanged* the largely settled interpretation of the Federal Arbitration Act." *Id.* (emphasis added).

Given the history of concern about unintended changes to domestic law, one might regard it as perilous to assume that the Convention's implementing legislation reflects enthusiasm for abolishing the use of national standards for vacatur of U.S. Convention awards. To the contrary, the historical context arguably reflects a sense of caution aimed at preservation of a national character for arbitration.

Perhaps the same sense of caution should militate against the consideration of foreign standards as a dimension of public policy for purposes of refusal to enforce awards under Article V(2)(b) of the Convention. *See* RESTATEMENT (THIRD) OF THE U.S. LAW OF INTERNATIONAL COMMERCIAL ARBITRATION § 5-14 cmt. e (Council Draft No. 2, 2010) (indicating that "a court may take into account public policies recognized at the arbitral seat or in other jurisdictions having a connection to the dispute"). But that remains a topic for discussion on March 23.

For more information about the conference, please visit the ITA's website (http://www.cailaw.org/ita/ASIL_11.html).

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December Surprise: New Second Circuit Ruling on Forum Non Conveniens in Enforcement Proceedings

- By Charles H. Brower II, The University of Mississippi School of Law,
for ITA

On December 14, the Second Circuit rendered its decision in*Figueiredo Ferraz e Engenharia de Projecto Ltda. v. Republic of Peru*, 2001 WL 6188497 (2d Cir. Dec. 14, 2011), which represents a significant development in the court's jurisprudence on forum non conveniens dismissals of actions to enforce foreign arbitral awards. As explained below, the decision also reveals anomalies in the New York Convention and the Federal Arbitration Act (FAA), which take the instruments beyond the scope of international commercial arbitration and, thus, may encourage forum non conveniens dismissals in certain cases.

As previously discussed in this blog, the Second Circuit drew criticism in 2002 by applying the forum non conveniens doctrine to dismiss an action brought by the Russian state gas company's insurer to enforce an award not only against the Ukrainian state gas company named in the award, but also against the Ukrainian government. *See Monegasque de Reassurances S.A.M. (Monde Re) v. Nak Naftogaz of Ukraine*, 311 F.3d 488 (2d Cir. 2002); Charles H. Brower II, Reflection on Forum Non Conveniens: Monde Re Was Right?!?.

Contrary to general opinion in the field, this author supported the Second Circuit's decision in *Monde Re* because the plaintiff did not only seek summary enforcement of the award against its counterparty to the arbitration, but also sought relief against a third-party government based on veil-piercing theories that would have raised difficult questions of foreign law, required the collection of evidence from government sources in foreign capitals, and drawn U.S. courts into a politically charged dispute about energy security in Europe. See Brower, *supra*.

At a high level of generality, the alignment of parties and the procedural history in *Figueiredo* called forth memories of *Monde Re*: the claimant brought an arbitration and received an award against a state-controlled program in Peru ("Water for All"), then sought enforcement in New York not only against the named counterparty, but also against the Republic of Peru based on veil-piercing arguments. *Figueiredo Ferraz e Engenharia de Projecto Ltda. v. Republic of Peru*, 655 F. Supp. 2d 361, 367 (S.D.N.Y. 2009). However, the similarity stops there. Contrary to the situation in*Monde Re*, the district court held that the veil-piercing arguments could be resolved without further collection of evidence because the Peruvian Ministry of Housing, Construction and Sanitation had *itself*: (1) made partial payments of sums due under the award; (2) asserted, in intra-governmental correspondence, that the Ministry of Economy and Finance had an obligation to satisfy the award; and (3) initiated proceedings to set aside the award in Peruvian courts. *Id.* at 371.

Also contrary to the situation in *Monde Re*, the case did not raise questions that would have drawn U.S. courts into explosive political controversies involving two or more foreign states. Given the simplicity of the issues and the absence of political baggage, the district court exercised its discretion not to dismiss the enforcement action on forum non conveniens grounds. *Id.* at 374-77.

In a final contrast to *Monde Re*, the Second Circuit *reversed* the district court's denial of forum non conveniens dismissal, based almost exclusively on Peru's interest in applying a domestic statute that prohibits state agencies from paying more than three percent of their annual operating budgets to satisfy any particular judgment.*Figueiredo*, 2011 WL 6188497, at *4-*5. Many observers read the Second Circuit's decision as an unwelcome December surprise that (1) lowers the threshold for forum non conveniens dismissals in enforcement proceedings, and (2) increases opportunities for second-guessing of district courts inclined to retain jurisdiction over enforcement proceedings.

As in *Monde Re*, however, observers seem to have lost sight of critical facts underlying the Second Circuit's decision in *Figueiredo*. These include the facts that:

(1) *Peru* represented the legal seat of arbitration; (2) the arbitral tribunal rendered its decsion "ex aequo et bono" and awarded the claimant more than $21 million; (3) the Ministry requested a Peruvian court to set aside the award on the grounds that Peruvian law limits recovery to the amount of the contract for *international arbitrations* involving a non-domestic party; (4) the Peruvian court denied set-aside because the claimant "had designated itself a *Peruvian* domiciliary in the agreement and the arbitration," with the result that "the arbitration was a '*national*arbitration' involving only *domestic* parties"; (5) when seeking enforcement of the award in New York, the claimant described itself as a *Brazilian* corporation; and (6) Peru's appellate brief stridently argued that the claimant should be deemed a *Peruvian* national, given the position it had taken in the agreement, the arbitration and the set-aside proceedings. *Id.* at *1 (emphasis added); Brief of Peru at 57-59; Reply Brief of Peru at 29. In short, one might describe the claimant's tactics as vexatious, cloaking itself in a Peruvian flag to secure the higher measure of damages available in "national" arbitrations, then cloaking itself in a Brazilian flag to avoid the three-percent payment cap for national arbitrations.

As one reads the appellate briefs of the parties on the topic of nationality, the claimant distinguishes between corporate domicile and nationality, whereas Peru seems to equate the two—an outcome that seems consistent both with the Peruvian court's conclusions in the set-aside proceedings and with U.S. definitions of corporate citizenship for purposes of diversity jurisdiction. *Compare* Brief of Figueiredo Ferraz e Engenharia de Projecto Ltda. at 70-72, *with* Brief of Peru at 57-59, *and* Reply Brief of Peru at 29. *See also Figueiredo*, 2011 WL 6188497, at *1; 28 U.S.C. § 1332(c)(1)

(assigning citizenship to corporations based on place of incorporation *and* principal place of business).

While the district court's analysis accepted the claimant's distinction between domicile and nationality, the Second Circuit (1) emphasized the Peruvian court's description of the arbitration as a "'national arbitration' involving only domestic parties," and (2) seemed exceedingly reluctant to allow an ostensibly *Peruvian* entity to use enforcement proceedings to avoid the application of Peru's statutory cap on payments when dealing with the *Peruvian* government in a contract both executed and performed in *Peru*. *Compare Figueiredo*, 655 F. Supp. 2d at 372, with *id.*, 2011 WL 6188497, at *1, *5.

Whatever the proper legal designation of the claimant's nationality, the case reveals anomalies in the New York Convention and the Federal Arbitration Act. If one assumes that the claimant donned Peruvian nationality as a matter of law, the case clearly escapes the scope of *international* arbitration, inasmuch as it represents a legal relationship solely between *Peruvian* entities, with contractual performance solely in *Peru*, and conduct of the arbitration proceedings solely in *Peru*. Viewed from that perspective, the case represents a *national* arbitration that falls squarely outside the scope of most instruments on international commercial arbitration.

Going back to the early history of international instruments on the topic, the 1923 Geneva Protocol on Arbitration Clauses applies only to agreements "between parties[] subject respectively to the jurisdiction of different contracting parties." Geneva Protocol on Arbitration Clauses, art. 1, Sept. 24, 1923, 27 L.N.T.S. 157. The 1927 Geneva Convention on the Execution of Foreign Arbitral Awards applied only to awards "made in pursuance of an agreement . . . covered by the [1923 Geneva Protocol]," meaning an agreement between parties having diverse nationalities. Geneva Convention on the Execution of Foreign Arbitral Awards, art. 1, Sept. 26, 1927, 92 L.N.T.S. 302.

Similarly, the 1961 European Convention on International Commercial Arbitration applies only to agreements and awards "arising from international trade between physical or legal persons having . . . their habitual place of residence or their seat in different Contracting States." European Convention on International Commercial Arbitration, art. I(1)(a), Apr. 21, 1961, 484 U.N.T.S. 364.

Likewise, in the preamble to the 1975 Inter-American (Panama) Convention on *International* Commercial Arbitration, states parties express their desire to "conclud[e] a convention on international commercial arbitration." Inter-American Convention on International Commercial Arbitration, pmbl., 1438 U.N.T.S 248. While none of the operative articles expressly limits that instrument's coverage to

international commercial disputes, the limitation finds confirmation in Article 3, which provides: “In the absence of an express agreement between the parties, the arbitration shall be conducted in accordance with the rules of procedure of the Inter-American Commercial Arbitration Commission [(IACAC Rules)].” It seems unlikely that states parties, such as the United States, contemplated application of the IACAC Rules to purely domestic arbitrations in which the disputing parties failed to identify a set of arbitration rules. See H.R. Rep 101-501, *reprinted in* 1990 U.S.C.C.A.N. 675, 676-77 (emphasizing the Panama Convention’s role in facilitating “international commerce,” “trade,” and “foreign investment”). Cf. John P. Bowman, *The Panama Convention and Its Implementation Under the Federal Arbitration Act*, 11 Am. Rev. Int’l Arb. 1, 37 (2000) (“Application of the Panama Convention to international commercial arbitration permeates the Convention from beginning to end.”).

Finally, and most recently, the UNCITRAL Model Law on International Commercial Arbitration applies only to “international commercial arbitration,” defined to encompass situations where: (1) the parties have their places of business in different states; (2) the arbitration is seated outside the state in which the parties have their places of business; (3) a substantial place of contractual performance lies outside the state in which the parties have their places of business; or (4) the parties have expressly agreed that the subject matter of the dispute relates to more than one country. UNCITRAL Model Law on International Commercial Arbitration, art. 1(1), (3), U.N. Doc. A/40/17/Annex I (June 21, 1985).

In other words, on one view, *Figueiredo* involved relationships so squarely grounded in Peru that the resulting arbitration could not possibly have qualified for coverage by almost any of the leading instruments on international commercial arbitration—except, of course, the New York Convention.

True to its official name, the Convention on the Recognition and Enforcement of *Foreign* Arbitral Awards, applies to any award rendered on the territory of a foreign state (or, if the state of enforcement has adopted the reciprocity reservation, the Convention applies to any award rendered on the territory of a foreign state party). Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Art. I(1), (3), June 10, 1958, 330 U.N.T.S. 38.

Unlike almost every other leading instrument, the New York Convention does not require the disputing parties to have diverse nationalities or to engage in transactions that cross national borders. While the New York Convention aims primarily “to facilitate arbitration in international commerce,” and while an early ICC prototype had referred to “international awards,” concerns about a-national awards and the difficulties of defining international commerce prompted delegates to the New York Convention’s 1958 drafting conference to reorient that instrument’s coverage towards

foreign awards. Albert Jan van den Berg, The New York Arbitration Convention of 1958, at 17 (1981). As a result, the New York Convention technically applies to foreign awards grounded in a single jurisdiction. Thus, for purposes of enforcement in the United States, an award falls under the Convention even if rendered in Paris between two French wine merchants under a contact for the sale of French wine. *Id*.

In his seminal work on the New York Convention, Albert Jan van den Berg described this phenomenon as a "harmless 'side-effect'" that "scarcely occurs in practice" and had "not occurred in any of the reported cases." *Id*. at 18. In addition, he opined that the New York Convention's uniquely broad scope might prove useful in cases where the losing parties to domestic arbitrations possess substantial bank accounts in foreign jurisdictions. *Id*. While van den Berg's assessment holds true as a general matter, one wonders if the "side-effect" remains so "harmless" when private parties exploit it to reach the assets of their own governments, thus draining the national treasury in violation of otherwise applicable national laws.

Confirming the potential for mischief in the circumstances just outlined, one need not search long for precedent rejecting the efforts of disgruntled national corporations to circumvent the limits of domestic redress against their own governments by invoking the machinery of international dispute settlement. *Cf. Loewen Group, Inc. v. United States*, ICSID Case No. ARB(AF)/98/3, Award ¶ 223 (June 26, 2003) (finding it "inconceivable" that states would negotiate treaties to provide their own citizens with international avenues for redress of regulatory disputes). This holds true even in the context of the New York Convention, where the only court to address the issue outside the Second Circuit invoked the forum non conveniens doctrine to dismiss an enforcement action brought by a foreign entity against its own government with respect to an arbitration involving public utilities and seated in the state of the disputing parties' nationality. *Termorio S.A. E.S.P. v. Electrificiadora del Atlantico S.A. E.S.P.*, 421 F. Supp. 2d 87, 103-04 (D.D.C. 2006).

Of course, the New York Convention's unusually broad scope should not apply to cases that, like *Figueiredo*, arise under the Panama Convention. As mentioned above and recognized by some courts, the Panama Convention does not cover foreign awards involving parties, transactions, and arbitral proceedings grounded in a single foreign jurisdiction. See *Energy Transport Ltd. v. M.V. San Sebastian*, 348 F. Supp. 2d 186, 199 (S.D.N.Y. 2004) ("For example, if parties sought enforcement in the United States of an award rendered in Panama, involving only Panamanian citizens conducting a domestic transaction, the New York Convention would likely apply but the Inter-American Convention would not because of the award's purely domestic character."); Bowman, *supra*, at 39 ("Under the Panama Convention, . . . a foreign award rendered . . . in Uruguay, involving only Uruguayan citizens engaged in a domestic transaction, may not be enforceable.").

However, this clear understanding of the Panama Convention's scope reveals an anomaly in the FAA. Despite the obvious differences between the respective scopes of the Panama and New York Conventions, the United States inexplicably implemented the Panama Convention through a statutory provision that incorporates by reference most of the New York Convention's implementing legislation. See 9 U.S.C. § 302. As a result, while the Panama Convention applies only to international commercial arbitration, the United States has extended its coverage by statute to awards grounded in a single foreign jurisdiction. Bowman, *supra*, at 39 n.104, 75. While "harmless" in most cases, this little-known "side-effect" could prove both unexpected and aggravating to foreign governments dealing with their own citizens in domestic transactions, on matters of public importance.

Given the United States' relative lack of interest in localized disputes between foreign governments and their own nationals on matters of local importance, it seems wise for U.S. courts to preserve forum non conveniens dismissals as a possible antidote for the rare situations in which the New York Convention's and the FAA's unusually broad scope threatens to produce surprising results. Far from provoking allegations of treaty violations, such dismissals seem more likely to draw appreciation from states parties dealing with their own citizens on matters of the public interest.

For the reasons stated above, the Second Circuit's decision in *Figueiredo* deserves more sympathetic consideration than accorded by most observers. Likewise, the forum non conveniens doctrine deserves slightly better treatment than the categorical rejection adopted by the draft Restatement on the U.S. Law of International Commercial Arbitration. By failing to leave any opening for forum non conveniens dismissals, the Restatement's drafters run the risk that their final product will draw the same respect expressed by the majority in *Figueiredo*, which damned the ALI's work by failing to mention it at all.

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