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Federal Courts Strengthen Protection of International Arbitration Awards

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OVERVIEW

On January 7, 2008, the United States Court of Appeals for the Fifth Circuit issued a ruling in *Gulf Petro Trading Co., Inc. v. Nigerian Nat'l Petrol. Corp.* ("**Gulf Petro**"),¹ a long-running dispute between Petrec International, Inc. ("**Petrec**"), a wholly owned subsidiary of Gulf Petro, and the Nigerian National Petroleum Corporation ("**NNPC**"). The ruling demonstrates the Fifth Circuit's determination to protect international arbitration awards from collateral litigation challenges, and represents a natural extension of federal appellate decisions such as *Karaha Bodas Co., L.L.C. v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara* ("**Karaha Bodas v. Pertamina**"),² a cornerstone of the federal jurisprudence under the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "**New York Convention**" or "**Convention**").

The New York Convention governs the enforcement of international arbitration awards. Embodying a robust pro-arbitration policy, the Convention directs the courts of contracting states to confirm a foreign arbitral award³ unless one of seven specified grounds for non-recognition is present, and it strictly limits the circumstances in which a party can seek to vacate, modify or otherwise avoid an award by appealing to the courts of a "secondary jurisdiction" (i.e., a court of a signatory country other than the one in which the arbitration took place). Though the Convention strictly limits parties' ability to directly attack international arbitral awards through annulment proceedings in secondary jurisdictions, unsuccessful parties frequently attempt to circumvent these limitations by initiating post-arbitral litigation that, while not sounding in

"annulment," seeks to avoid the enforcement or effectuation of an unfavorable award through more conventional causes of action. Such cases are often styled as "independent actions," purportedly unrelated to the merits of the underlying arbitration and therefore arguably permissible. In two recent decisions, U.S. federal courts have demonstrated an increasing hostility to such litigation; more importantly, they have shown a willingness to look behind the four corners of parties' claims to ensure that creative pleading is not used to circumvent the Convention's limitations on post-arbitral attacks.

GULF PETRO

In *Gulf Petro*, the Fifth Circuit affirmed a decision of the United States District Court for the Eastern District of Texas dismissing, for lack of subject matter jurisdiction, a complaint alleging, among other things, RICO violations, fraud and conspiracy against the prevailing party in a prior arbitration between the parties. The Fifth Circuit both articulated the analytical framework for determining whether such actions constitute impermissible "collateral attacks" and found, as a matter of first impression, that the Convention precludes U.S. courts from exercising subject matter jurisdiction over any case that constitutes, in substance, a collateral attack on an international arbitral award.

The underlying arbitration that gave rise to the *Gulf Petro* case was filed in Switzerland in 1998 by Petrec against the NNPC as a result of a failed oil joint venture. Petrec alleged that NNPC failed to contribute its share of capital to the joint venture and refused to provide adequate access for Petrec to perform its operations. Though the arbitral tribunal issued a partial award that was largely favorable to Petrec, it ultimately decided in

its final award that Petrec did not have standing to maintain its claims against NNPC, and dismissed the claim.

Petrec challenged the Final Award in the “primary jurisdiction” (Switzerland) on the grounds that it violated Swiss arbitration law and public policy, but the Swiss courts upheld the decision of the tribunal. Petrec then filed suit in the Northern District of Texas, seeking, *inter alia*, confirmation of the Partial Award and damages. The District Court dismissed the action on the ground that, by seeking to enforce the Partial Award, Petrec was effectively attempting to nullify the Final Award in violation of the Convention. In an unpublished opinion,⁴ the Fifth Circuit affirmed the District Court’s decision dismissing the action.

In 2005, Petrec changed tack and filed a claim before the Eastern District of Texas seeking damages on the grounds that the Final Award was procured through fraud, corruption and bribery. In its complaint, Petrec sought relief under the federal RICO statutes, the Texas Deceptive Trade Practices Act, Texas common law fraud, and the Texas common law tort of civil conspiracy. Specifically, Petrec claimed that the arbitrators failed to disclose various conflicts and accepted a \$25 million bribe in exchange for a favorable award for NNPC. Again, however, the complaint was dismissed for lack of subject matter jurisdiction.

On appeal, Petrec urged that an independent basis existed for its damages claim and the claim was not merely a collateral attack on the Final Award. The Fifth Circuit was unconvinced. Adopting the reasoning set forth previously by the Sixth Circuit in two domestic arbitration cases, *Corey v. New York Stock Exchange* and *Decker v. Merrill Lynch, Pierce, Fenner & Smith*,⁵ the Fifth Circuit held that, under the circumstances, a claim for damages must stem directly from the purported wrong, and not from any effect such a wrong may have had on the arbitral award. Finding that Petrec’s action did not meet this threshold test, the Fifth Circuit stated:

The harm in this case did not result when the arbitrators failed to disclose business dealings, engaged in ex-parte communications with NNPC, or were bribed. Rather, it resulted from the impact that these acts had on the Final Award.⁶

In bringing the 2005 suit, Petrec sought damages in the amount of the award it believed it should have received in the Swiss arbitration, as well as costs, expenses, and consequential damages stemming from the unfavorable award it did receive. The court found that such a claim for relief “show[ed] that its true objective in [the] suit [was] to rectify the harm it suffered in receiving the unfavorable Final Award” and, as such, it “amount[ed] to no more than a collateral attack on the Final Award itself.”⁷ The Fifth Circuit further found that once a court determines that a claim constitutes a collateral attack under this analytical framework, “[t]he Convention dictates that a United States court, sitting in secondary jurisdiction, lacks jurisdiction to consider such an action” and dismissal is required.⁸

KAHARA BODAS

As noted above, Gulf Petro represents a natural extension of federal appellate decisions that have underscored the need to enforce arbitral awards and protect them from collateral challenges. Specifically, the Fifth Circuit’s decision in *Gulf Petro* represented the domestic application of a principle that the Second Circuit recently applied to enjoin a party from collaterally attacking a Swiss arbitral award in a Cayman Islands court. In *Karaha Bodas v. Pertamina*,⁹ the Second Circuit recently affirmed a district court’s injunction preventing a party from prosecuting a claim to recover, through a Cayman Islands lawsuit claiming “fraud,” the amount that it lost in a Swiss arbitral proceeding that had been concluded several years earlier and confirmed by a Texas federal court, as well as by courts in Hong Kong and Canada.¹⁰ Unlike in *Gulf Petro* (where the Fifth Circuit ruled upon its own jurisdiction), the Second Circuit clarified the rule that applies to a federal court’s ability to enjoin a party from prosecuting a **foreign** lawsuit resulting from arbitration. It held that the test set forth in *China Trade and Dev. Corp. v. M.V. Choong Yong* (“*China Trade*”),¹¹ which sets forth the Second Circuit’s general rule governing foreign anti-suit injunctions, applies to all such determinations. Notably, one of the threshold requirements of the *China Trade* test is that “resolution of the case before the enjoining court is dispositive of the action to be enjoined.”¹² In other words, no injunction will be granted unless the matters at issue are so similar that a decision in one case would be determinative of the outcome of the other.

Much like in *Gulf Petro*, the most vigorously contested point upon appeal in *Karaha Bodas* was the characterization of the “independent” action for fraud as a collateral attack. Pertamina argued that the “case before the enjoining court” could not be dispositive of the Cayman Islands “fraud” action for the following reasons: 1) the “case” originally before the New York court was limited to a determination of whether certain funds located in New York could be used to satisfy the arbitral award, the determination of which could not be dispositive in an action for “fraud”; 2) the Cayman Islands suit is “a proceeding separate and independent of the arbitration proceedings and award”;¹³ and 3) that federal courts ruling on foreign arbitration awards are courts of secondary jurisdiction under the New York Convention and are therefore “not entitled to protect judgments related to a foreign arbitral award from foreign interference.”¹⁴

The Court rejected each of these arguments and held that the New York judgment was dispositive of the issues raised in the Cayman Islands suit despite the fact that it was pleaded as an action sounding in fraud. First, the Court found that, by registering the Texas court’s confirmation of the arbitration award in New York, the New York court was thereby empowered to protect that judgment as though it had rendered it.¹⁵ Second, and similar to the findings in *Gulf Petro*, the Court found that the very nature of the relief sought in the Cayman Islands suit (i.e., recovery of an amount equal to the amount turned over to *Karaha Bodas* as a result of the arbitration award) belied any claim by Pertamina that it was not attacking the properly confirmed and enforced arbitral award. And finally, the Court found that though the district court was a court of secondary jurisdiction under the Convention (such that it cannot dictate how other “secondary” jurisdictions can rule in an enforcement proceeding), “federal courts do have inherent power to protect their own judgments from being undermined or vitiated by vexatious litigation in other jurisdictions.”¹⁶

While the Second Circuit’s decision in *Karaha Bodas* reconfirmed the multi-factor analysis first developed in *China Trade* to determine whether a foreign anti-suit injunction may be issued, the decision is analogous to *Gulf Petro* in that it demonstrates a determination to protect foreign arbitral awards (particularly those that have been confirmed by U.S. courts) from collateral litigation attacks brought *outside* the U.S. where the substance of the foreign lawsuit seeks to undermine the effect of the award.

CONCLUSION

Though the procedural postures and applicable standards in *Gulf Petro* and *Karaha Bodas v. Pertamina* differ, both cases represent efforts by the federal courts to rigorously protect international arbitral awards as contemplated by the Convention. The Fifth Circuit articulated an express jurisdictional bar prohibiting U.S. courts from hearing cases that represent, in substance, a “mere collateral attack” on a foreign arbitral award. Even though the Second Circuit ruled that a more stringent test is appropriate when determining whether to permit a party to prosecute collateral litigation in a *foreign* jurisdiction, it nevertheless exhibited a clear preference for upholding and enforcing arbitral awards. As the Second Circuit’s ruling notes, in order to “protect the regime established by the Convention for enforcement of international awards,” it is sometimes necessary for federal courts to “[enjoin] parties from engaging in foreign litigation that would undermine it.”¹⁷ Indeed, as articulated by the district court in *Karaha Bodas v. Pertamina*, a federal court has “the *duty* to deal with abusive litigation tactics used by a party before it.”¹⁸ In sum, both cases show that where a party is merely seeking to vitiate or nullify an arbitral award in contravention of the policies of expedience and finality inherent in the Convention – whether at home or abroad – federal courts will not permit it.





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¹ 512 F.3d 742, (5th Cir. 2008).

² 500 F.3d 111 (2d Cir. 2007), petition for cert. filed, ___ U.S.L.W. ___ (U.S. Nov. 8, 2007) (No. 07-619).

³ The Convention defines a "foreign arbitral award" as an arbitral award made in the territory of a country other than the country where the recognition and enforcement of such award is sought.

⁴ *Gulf Petro Trading Co., Inc. v. Nigerian Nat. Petroleum Corp.*, 115 Fed. Appx. 201 (5th Cir. 2004).

⁵ See *Corey v. New York Stock Exchange*, 691 F.2d 1205 (6th Cir. 1982) and *Decker v. Merrill Lynch, Pierce, Fenner & Smith*, 205 F.3d 906 (6th Cir. 2000).

⁶ *Gulf Petro*, 512 F. 3d at 750.

⁷ *Id.*

⁸ *Id.* at 753

⁹ 500 F.3d 111 (2d Cir. 2007), petition for cert. filed, ___ U.S.L.W. ___ (U.S. Nov. 8, 2007) (No. 07-619).

¹⁰ *Karaha Bodas Co., L.L.C. v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara*, 190 F. Supp. 2d 936 (S.D. Tex. 2001), aff'd, 364 F.3d 274 (5th Cir.), cert denied, 543 U.S. 917 (2004).

¹¹ 837 F.2d 33 (2d Cir. 1987).

¹² *China Trade*, 837 F.2d at 35.

¹³ *Karaha Bodas*, 500 F.3d at 122.

¹⁴ *Id.* at 123.

¹⁵ *Id.* at 121 (citing 28 U.S.C. § 1963).

¹⁶ *Id.* at 124 (citing *Ibeto Petrochemical Indus. Ltd. v. M/T Beffen*, 475 F.3d 56, 64 (2d Cir. 2007)).

¹⁷ *Id.* at 125.

¹⁸ *Id.* at 118 (citing *Karaha Bodas v. Pertamina*, 465 F. Supp. 2d 283, 300 (S.D.N.Y. 2006) (emphasis added)).