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The Recognition of International Arbitration Awards That Have Been Vacated At The Arbitral Seat: The US Approach

Elvis Costello has engaged in various collaborations in his almost 40-year career. Among them was one 20 years ago with Burt Bacharach, the musical legend famous for the pop songs he wrote with Hal David in the 1960s, which include such gems as *Walk On By*, *Alfie*, and *Do You Know The Way To San Jose?* In one of the songs from the album Costello released with Bacharach in 1998, they pose this question: "Does the extinguished candle care about the darkness?"[1] Like most metaphysical questions, pondering too hard about it simply gives one a headache. But in the field of international arbitration a similar metaphysical question abounds: Does an extinguished award exist? And trying to think about it too hard likewise can be migraine-inducing.

The answer to this metaphysical question, of course, has practical implications: can a court recognize and enforce an arbitration award that has been vacated by a court at the seat of the arbitration? In a country with more than its fair share of renowned philosophers, from Descartes to Sartre to Derrida, the French approach to this question does indeed have a metaphysical dimension: an arbitration award, of its nature, exists independently of any legal order, with the result that French courts have no difficulty confirming awards that have been vacated at the seat.[2] By contrast, in Germany, which has also produced numerous prominent philosophers (from Kant to Hegel to Schopenhauer), no court has so far recognized an award that has been vacated at the seat.[3]

I want to discuss the United States approach to this question. In a country whose distinctive philosophical tradition is pragmatism (as expounded by James, Dewey and Pierce), it is perhaps no surprise that US courts have eschewed metaphysics in favor of a practical approach.

Before turning to the details of the US approach to the question of whether a court should recognize and enforce an arbitration award that has been vacated by a court at the seat, it is worth explaining the difference between, on the one hand, the "vacatur" or "set aside" of an award and, on the other, the recognition and enforcement of an award.

This article discusses those differences by focusing upon awards that fall under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention") and the Inter-American Convention on International Commercial Arbitration ("Panama Convention"). There is no substantive difference between the two from the standpoint of the enforcement of arbitral awards and, for the sake of simplicity, the term "Convention" refers to both.[4]

One difference between, on the one hand, the recognition and enforcement of an award and, on the other, its vacatur is straightforward, and relates to the effect of each. When a court *recognizes* an arbitration award it "makes what is already a final arbitration award a judgment of the court." *Florasynth, Inc. v. Pickholz*, 750 F.2d 171, 176 (2d Cir. 1984). In New York, for example, once an award is recognized and enforced, the prevailing party can use all the post-judgment remedies available to execute upon that award that would be available to a party that had secured a court judgment on the merits. *Prudential Blake Realty Inc. v. Schenectady Indus. Development Agency Inc.*, 255 A.D.2d 622 (N.Y.A.D. 3 Dept. 1998). By contrast, when a court *vacates* an arbitration award, it holds, in essence, that that award has no further force and effect. *Cf. United States, v. Williams*, 904 F.2d 7 (7th Cir. 1990) ("a vacated judgment is of no further force and effect").

A second difference relates to which courts have the authority to recognize or vacate an award. Simplifying things slightly, any court in a Convention country can entertain an application to recognize and enforce an award rendered in another Convention country; if an arbitration award is rendered in London or Singapore or Sao Paolo, it can, in principle, be recognized and enforced by a court in Zurich or Tokyo or Paris. By contrast, only the court at the seat of the arbitration (which in most cases is the place of arbitration designated in the arbitration clause) can set aside an award.

A third difference relates to the standards used by the courts to decide whether to recognize or vacate an award. While Article V of the Convention contains uniform standards that courts of all member states are required to use in deciding whether to *recognize and enforce* awards, it contains no standards governing their *vacatur*. Those latter standards are governed by the domestic law at the arbitral seat. Thus, when it comes to the confirmation of awards by US courts, section 207 of the Federal Arbitration Act ("FAA") explicitly incorporates the standards of Article V of the New York Convention. (Section 302 of the FAA does the same for Panama Convention.) By contrast, Section 10 of the FAA contains the unique standards used by US courts for the set aside of purely domestic awards or Convention awards rendered in the US.

As noted above, while the vacatur of an award entails that it has "no further force or effect," that is categorically true only at the place of vacatur. For example, an award that has been vacated at the arbitral seat in, say, Mexico, has no further force and effect in Mexico, and so cannot subsequently be confirmed by the courts there. However, it is an independent and further question whether vacatur at the arbitral seat in Mexico

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1 *This House Is Empty Now*, from Painted From Memory, Elvis Costello and Burt Bacharach.

2 See, e.g., Cour de Cassation, 29 June 2007, Société PT Putrabali Adyamulia v Société Rena Holding et Société Moguntia Est Epices, Rev. de l'Arb. 515 (2007).

3 See, e.g., German Supreme Court, 23 April 2013 – III ZB 59/12, XXXIX YBCA 394 (2014) (referring to Art. IX of the 1961 European Convention on International Commercial Arbitration).

4 Almost 160 countries are party to the New York Convention, including virtually every country engaged in any significant international commerce. The Panama Convention includes virtually all the countries in the Americas, such as the United States, Mexico, and Colombia to name a few. All the Panama Convention countries are a party to the New York Convention. In the United States, the Panama Conventions takes precedence over the New York Convention when the majority of the parties to the arbitration agreement are from Panama Convention countries. 9 USC §305(1). The case of Corporación Mexicana De Mantenimiento Integral, S. De R.L. De C.V. v. Pemex-Exploración Y Producción, 2016 WL 4087215 (August 2, 2d Cir.), which I spend some time discussing in this article involved parties from Mexico and the United States, and thus fell under the Panama Convention, which is the reason I mention that Convention.

entails that that award has no further force and effect in another country, say the United States or France. That depends on what effect a US or French court gives to the Mexican court's decision to vacate the award. A French court, as noted, would give no categorical effect to the Mexican court's vacatur decision because an arbitration award has an existence independent of any legal order. What's the position in the US?

The question of whether or not an award vacated at the seat should be recognized in the US has reached the US courts several times, and the decisions have been mixed. Some courts have recognized vacated awards. *See, e.g., In re Chromalloy Aeroservices,* 939 F. Supp. 907 (D.D.C. 1996) (recognizing award notwithstanding its vacatur at Egyptian arbitral seat); *Corporación Mexicana De Mantenimiento Integral, S. De R.L. De C.V. v. Pemex-Exploración Y Producción,* 2016 WL 4087215 (August 2, 2d Cir.) ("*Pemex*") (recognizing award notwithstanding its vacatur at Mexican seat). Other courts have declined to do so. *See, e.g., Baker Marine (Nig.) Ltd. v. Chevron (Nig.) Ltd.,* 191 F.3d 194 (2d Cir. 1999) (declining to recognize award on ground that it had been vacated at Nigerian seat); *TermioRio S.A., Esp. v. Electranta S.P.,* 487 F.3d 928 (D.C. Cir. 2007) (declining to recognize award on ground that it had been vacated at Colombian seat).

But it is important to note that this difference in outcome does not reflect an incoherence in the US approach to the question of the recognition of vacated awards. Rather, it reflects the application of what is becoming the prevailing test for determining whether a US court should recognize a vacate award. That test has led to different outcomes depending on the facts of the case. I want to explain this test by examining the *Pemex* case.

In *Pemex*, the Court of Appeals for the Second Circuit affirmed a judgment of the District Court for the Southern District of New York ("SDNY") recognizing and enforcing an international arbitration award rendered in Mexico, even though that award had been vacated by a Mexican court. In doing so, the Second Circuit articulated an analytical framework for courts addressing the question of whether to recognize awards that have been vacated at the arbitral seat.

Pemex arose out of a 1997 contract (superseded by a 2003 contract) between Corporación Mexicana De Mantenimiento Integral, S. De R.L. De C.V. ("COMMISA") with Pemex-Exploracíon Y Produccíon ("Pemex") (a state-owned company) to build oil platforms in the Gulf of Mexico. The contract had a clause requiring that disputes be resolved by arbitration in Mexico City. A dispute arose following which Pemex rescinded the contract and seized the oil platforms, which were 94% complete. COMMISA responded by commencing arbitration proceedings in Mexico City. In 2009, the arbitration tribunal issued an approximately $300 million award in COMMISA's favor. COMMISA then successfully petitioned to confirm that award in the SDNY. Pemex appealed the SDNY's decision to the Second Circuit and, at the same time, moved to vacate the award in Mexico.

While the appeal was pending, the Mexico court vacated the award on the ground that Pemex could not be required to arbitrate. And relying on that vacatur, Pemex persuaded the Second Circuit to vacate the SDNY judgment and remand the case so that that the SDNY could consider the effect of the Mexican court's decision.

After hearing expert evidence on Mexican law, the SDNY confirmed the award notwithstanding its vacatur in Mexico. It did so on the ground that the Mexican court's vacatur was based on the retroactive application of Mexican law. Specifically, the SDNY found that the vacatur was based on a 2007 change in the Mexican law made after the underlying contract was executed, the effect of which was to (i) grant exclusive jurisdiction for disputes related to public contracts (as in *Pemex*) in the Tax and Administrative Court and so override any arbitration agreement; and (ii) establish a 45 day limitation period for suits in that Court. The SDNY found that the vacatur judgment "violated basic notions of justice in that it applied a law that was not in existence at the time the parties' contract was formed and left COMMISA without an apparent ability to litigate its claim." Pemex, again, appealed to the Second Circuit. The central question for the court was whether a district court can confirm an award that has been vacated at the seat, and, if so, in what circumstances.

On appeal, the Second Circuit began its analysis by focusing on the text of the Convention, noting that Article V states only that a petition to confirm an award "*may*" be refused when an award has been vacated at the seat. The Second Circuit stated that "the plain text of the [Convention] seems to contemplate the unfettered discretion of a district court to enforce an arbitral award annulled in the awarding jurisdiction." Of course, noting that the question is a matter of discretion provides little guidance about how that discretion should be exercised.

The Second Circuit went on to provide that guidance by framing the issue as one of a clash between two competing obligations of US courts: on the one hand, the obligation of a district court to confirm an arbitration award pursuant to the Convention and, on the other, its obligation, based on international comity, to respect the judgment of a foreign court.

Thus, the central question for the Second Circuit in deciding whether to confirm an award that had been vacated by a judgment of the court at the seat is this: should a US court recognize the judgment of a court at the seat vacating an arbitral award? If it chooses to do so, the effect is to treat the arbitral award as extinguished. If, by contrast, it declines to recognize the judgment, the award remains effective and, barring other defenses to enforcement, should be recognize.

US courts have traditionally recognized foreign judgments based on the doctrine of comity. Comity "is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation. . ." *Hilton v. Guyot*, 159 US 113 (1895). However, as the Second Circuit noted in *Pemex*, the doctrine of comity is not without limits. "[A] final judgment obtained through sound procedures in a foreign country is generally conclusive … unless … enforcement of the judgment would offend the public policy of the state in which enforcement is sought." And a judgment offends public policy when it is "repugnant to fundamental notions of what is decent and just in the State where enforcement is sought." The Second Circuit noted that this standard "is high and infrequently met."

In *Pemex*, the Second Circuit found that the high standard was met as a result of "four powerful considerations: (1) the vindication of contractual undertakings and the waiver of sovereign immunity; (2) the repugnancy of retroactive legislation that disrupts contractual expectations; (3) the need to ensure legal claims find a forum; and (4) the prohibition against government expropriate without compensation."

The Second Circuit's approach in *Pemex*, which echoes its approach in *Baker Marine* and the DC Circuit's approach in *TermioRio,* is a practical, middle ground taking into account competing considerations. On the one hand, if US courts

were to cavalierly ignore judgments of foreign courts vacating awards, there is a risk that foreign courts would disregard US court judgments doing the same. On the other hand, one of the main reasons parties choose international arbitration is neutrality; they want to arbitrate the merits of a dispute before a neutral arbitration panel, rather than take the risk that a national court may favor the local party. It is important, therefore, that there be some standard for reviewing foreign judgments vacating awards to ensure that any bias that was avoided through arbitration at the merits stage does not creep in at the enforcement stage as a result of a parochial approach to vacatur taken by a national court at the arbitral seat.

It is submitted that US courts have struck a reasonable balance between these competing considerations. US courts take an approach standard that would generally require US courts to respect the vacatur judgments of the courts at the seat of the arbitration. But it gives US courts the authority to disregard those judgments in those rare cases where there is clear evidence that the court at the seat engaged in "hometown justice."

Having said all this, I'm still no closer to a solution to Costello's and Bacharach's quandry about the extinguished candle.

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M&A under President Trump

On January 20, 2017, President Trump was sworn into office. A large set of new ideas and strategies came with him to Washington – some of which will have a profound impact on M&A, particularly international M&A. Obviously, the general principles and structures as well as the reasons for M&A transactions remain unchanged. Nevertheless, some of the laws initiated by President Trump as well as the changed and invigorated implementation and application of existing programs have the potential to change the M&A world.

It is still early in president Trump's tenure, and it would be unfair to draw a conclusion one way or the other at this stage. A number of cases and situations were inherited from the previous administration and needed to be completed or wound down. Also, one case or procedure, even if handled quite differently from the previous administration, cannot be used as a prediction for the future. Nevertheless, we can in some areas already discern what can be expected over the next few years.

I. Tax Reform

The Tax Cuts and Jobs Act became law on Dec. 21, 2017 (the "TCJA"), and, for legal entities, brought major changes. Most commentators agree that the TCJA will have a significant impact on the overall environment, the deal structures, and the contract negotiations of the M&A transactions.

The TCJA is a massive legislation and makes changes to many sections of the tax code. To address all of them adequately in this article is impossible. Moreover, many changes are quite complex with a dizzying array of details that need to be complied with. Listing them is neither possible nor helpful to understand the general principles that will affect M&A transactions; accordingly, we refrain from exhaustive explanations. Having said this, it is, however, worth considering the following aspects which directly affect M&A.

(1) M&A Funding: More funds available for M&A

The TCJA was designed to reduce the tax burden of businesses. The objective of the TCJA was to allocate cash to the private sector rather than the government in the hopes that companies would use it for the creation of jobs and for other investments which will stimulate the economy. A portion of that cash, it is estimated, will be spent on M&A. This goal was implemented through a number of changes to the Internal Revenue Code (the "Code"), the most pertinent are the following: First, the tax rate for corporations was reduced by 40%, from 35% to 21%,[1] incentivizing corporations to move operations to, and generate more income in, the United States. There was rare consent in Congress that the U.S. corporate tax rate of 35% was too high in comparison with virtually every country in the Western World and, thus, that U.S. companies were handicapped. (There was less consent on what to do about it.) Second, a special tax rate of presently 10.5% (until 2025, thereafter 13.125%) is applicable to income derived by foreign subsidiaries from intellectual property (the "*global intangible low-tax income*" or so called GILTI tax). Finally, the United States moved closer to a territorial system for businesses and, thus, corporations may now "*bring home*" overseas profits from their subsidiaries (for more detail see (4) below) without additional U.S. taxes (before, repatriating profits taxed abroad resulted in these profits becoming subject to the 35% tax rate in the United States minus any tax paid abroad). While it is still too early to draw final conclusions, the first reports seem to confirm that the law's goals will be achieved. It was reported that after-tax earnings (25.3%) of all companies in the S&P 500 index during Q I/ 2018 rose twice as much as pretax-earnings (12.1%),[2] a direct result of the lower tax rate. These funds, apparently, drove M&A activity. Mergermarket reported that 3,774 deals worth $890.6BB (ca. 40% of which were in the United States) were announced worldwide in Q1/2018 which represents an 18% increase in deal value when compared to Q1/2017.

(2) M&A structures: Inversions and tax efficient structures on the way out

The lower Federal corporate income tax rate of 21% (instead of previously 35%) will also have a major impact on two areas of M&A practice which garnered much attention in the past.

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1 In addition to Federal income taxation, U.S. businesses are also subject to state and, potentially, municipal/ city income taxes.

2 Thomson Reuters, Wall Street Journal (May 4, 2018).