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SHOOK
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Second Circuit Affirms Decision Confirming $300-Million Arbitration Award That Was Annulled by a Mexican Court

On August 2, the United States Court of Appeals for the Second Circuit affirmed a lower court decision confirming a $300 million "arbitral award notwithstanding that the award was nullified by a court in Mexico, where the award was rendered."[1]

This case required the appellate court to "reconcile 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."[2] The Second Circuit chose the former – finding that the district court in New York had discretion to confirm the arbitral award "because giving effect to the subsequent nullification of the award 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."[3]

I. Factual Background and Procedural History

In 1997, a Mexican subsidiary of an American construction company (COMMISA) entered into a contract to build two offshore natural gas platforms in the Gulf of Mexico for a subsidiary of Mexico's state-owned oil and gas company (PEP).[4] In 2003, the parties entered into a substantially similar contract in an attempt to resolve various disputes.[5] Both of the contracts were governed by Mexican law and required that any disputes be "definitively settled through arbitration conducted in Mexico City, D.F., in accordance with the Conciliation and Arbitration Regulations of the International Chamber of Commerce."[6] Mexican law specifically gave PEP the authority to bind itself to arbitration.[7]

The 2003 contract failed to resolve the parties' disputes and "the conflict reached climax in March 2004 when PEP, alleging that COMMISA had failed to meet contractual milestones and had abandoned the project, gave notice of its intent to administratively rescind the contract."[8] At the same time, "PEP seized the platforms, which were 94 percent complete [and] ejected COMMISA from the work sites."[9] By the end of 2004, both

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parties were alleging breach of contract and "COMMISA filed a demand for arbitration."[10]

What followed is 12 years of "protracted litigation" that has "challenged the courts of two countries." [11]

A. Arbitration, Litigation and Legislation

Although the contracts required all disputes to be resolved through binding arbitration, both sides filed actions in the courts of Mexico and the Mexican Congress enacted two laws that threatened the ability of COMMISA to resolve its claims in either arbitration or court.

Before the arbitration proceedings began, "COMMISA filed an *amparo*[12] action in the District Court on Administrative Matters for the Federal District ('Mexican District Court') challenging the constitutionality, appropriateness, and timeliness of PEP's administrative rescission."[13] COMMISA filed this action because "the arbitral panel presumably could not adjudicate" its challenge to PEP's administrative rescission of the contracts.[14] COMMISA lost its *amparo* action.[15]

In May 2005, the arbitration began in Mexico City with both sides participating.[16] The tribunal issued its preliminary award in November 2006 and "enjoin[ed] PEP from attempting to collect on the performance bonds [posted by COMMISA in accordance with the contracts] until the issuance of a final arbitral award."[17]

After the preliminary award, the Mexican Congress enacted two laws that (i) effectively deprived COMMISA of access to Mexican courts; and (ii) prohibited the arbitration of this dispute:

- The Mexican Congress enacted legislation in December 2007 that changed the "available forum for claims that (like COMMISA's) raise issues related to public contracts, and vested exclusive jurisdiction for such disputes in the Tax and Administrative Court."[18] In addition, the statute of limitations was shortened from 10 years to 45 days.[19]
- In May 2009, the Mexican Congress "enacted Section 98 of the Law of Public Works and Related Services ('Section 98'), which ended arbitration for certain claims (such as those by COMMISA)."[20] This law prohibited the arbitration of the administrative rescission and early termination of contracts, *i.e.*, the issues that were being arbitrated.[21]

The new laws had a dramatic impact on PEP's strategy for resolving its dispute with COMMISA, and provided PEP with new avenues outside of the then-pending arbitration to attempt to avoid liability.

B. The Tribunal Issues its Award and PEP Files Suit in Mexico to Nullify the Award While COMMISA Seeks to Confirm the Award in New York

In December 2009, the tribunal issued its Final Award, "finding that PEP breached the contracts and award[ing] COMMISA approximately $300 million in damages."[22] The tribunal also rejected PEP's argument that Mexico's newly-enacted Section 98 prohibited arbitration.[23]

Both sides immediately sought judicial action: (i) "COMMISA raced to confirm the award" in the United States District Court for the Southern District of New York; and (ii) PEP filed "its own *amparo* action which eventually made its way to the Eleventh Collegiate Court, the analog of the United States Court of Appeals for the District of Columbia Circuit."[24] These dueling judicial proceedings are what eventually led to the Second Circuit's decision.

The United States District Court for the Southern District of New York "granted COMMISA's petition to confirm the Award, and judgment was entered on November 2, 2010."[25] PEP appealed this decision to the Second Circuit.[26]

While PEP's appeal was pending, "the Eleventh Collegiate Court held that PEP's rescission was not arbitrable and ordered that the award be annulled."[27] The Mexican court "held that arbitrators are not competent to hear and decide cases brought against the sovereign or an instrumentality of the sovereign," such as PEP.[28] The Eleventh Collegiate Court's "analysis repeatedly referenced the newly-enacted Section 98."[29] The case was then remanded back to a lower Mexican court, which nullified the arbitral award because "it would be 'unacceptable and contrary to the country's legal system' to allow arbitrators 'to resolve a matter of public policy and general interest.'"[30]

Following this decision, "PEP successfully moved . . . for vacatur [in the Second Circuit] and remand so that the Southern District could consider the effect of the Eleventh Collegiate Court's decision."[31] On remand, the district court in New York "received further briefing and conducted a three-day evidentiary hearing chiefly focused on the meaning of appli-

cable Mexican legal provisions."[32] The "parties presented dueling experts who disputed whether the Eleventh Collegiate Court's decision was consistent with the development of Mexican law, and whether the 2007 change in the applicable statute of limitations could apply retroactively to the instant dispute."[33]

In 2013, the Southern District "decline[d] to defer to the Eleventh Collegiate Court's ruling,' and again 'confirm[ed] the Award' on the ground that annulment of the award '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 claims.'"[34]

PEP renewed its appeal to the Second Circuit, arguing (i) that the district court erred by not finding that the arbitral award was an unenforceable nullity; and (ii) that federal courts in New York lacked personal jurisdiction over PEP and that venue was not proper.[35] The Second Circuit heard oral argument on November 20, 2014, and issued its long-awaited decision on August 2, 2016.

II. The Second Circuit Rejects PEP's Arguments and Affirms the District Court's Decision Confirming the Arbitral Award

The Second Circuit began its analysis by explaining that if an order confirming an arbitral award "encompasse[s] its decision to deny comity to a foreign judgment, the standard of review is modified: '[w]e review a district court's decision to extend or deny comity to a foreign proceeding for abuse of discretion.'"[36] The Second Circuit reviewed the district court's conclusions of law *de novo* and its findings of fact for clear error.[37]

A. Preliminary Issues: The Second Circuit Rejects PEP's Personal Jurisdiction and Venue Challenges

Before reaching the merits of PEP's appeal, the Second Circuit rejected PEP's arguments that the district court lacked jurisdiction and that venue was improper.[38]

After acknowledging that "PEP fully briefed its jurisdiction and venue arguments" before the case was remanded, the Second Circuit found that PEP's "due process objections evidently disappeared when its prospects of success were buoyed by the Eleventh Collegiate Court's decision."[39] The court criticized PEP for not continuing to "pursue the First Appeal on

grounds (*inter alia*) of personal jurisdiction and venue" and concluded that PEP "effectively abandoned those arguments and pressed for a remand to consider intervening precedent on which PEP thought it could win."[40] The Second Circuit held that this "abandonment constitutes forfeiture" and that because PEP "affirmatively and successfully sought relief from this Court remanding for a new merits determination in the Southern District, it forfeited its argument that personal jurisdiction is lacking."[41]

The court also explained that "PEP's due process argument fails because PEP is a corporation owned by a foreign sovereign."[42] Under American law, "the jurisdictional protections of the Due Process Clause do not apply to 'foreign states and their instrumentalities.'"[43] The court noted that although it can sometimes be difficult to determine whether a commercial entity is owned by a foreign sovereign, "[t]his is one of the easy cases because PEP affirmatively claims that it is functionally the Mexican government—which it advances as the reason it cannot be forced to arbitrate."[44]

The Second Circuit also rejected PEP's argument that venue was improper in New York and explained that "for essentially the same reasons that PEP forfeited its challenge to personal jurisdiction, it has *a fortiori* forfeited its challenge to venue, because venue is 'a limitation designed for the convenience of litigants, and, as such, may be waived by them.'"[45] Reprising its forfeiture analysis, the court explained that "PEP cannot now reject this forum as extraordinarily inconvenient when it affirmatively sought relief from this Court and from the Southern District of New York."[46]

In his concurring opinion, Judge Winter agreed that the district court had personal jurisdiction over PEP and that venue was proper, but he disagreed with the decision to find "a forfeiture with regard to personal jurisdiction and venue."[47] Judge Winter noted that "PEP timely litigated that issue and the issue of proper venue in the district court" and "extensively argued" in its initial appeal that the district court erred by finding that it had personal jurisdiction over PEP.[48] He also explained that when he was a member of panel that agreed to remand the case, he did not believe that remand would (i) limit the issues that could be litigated when the case returned to the Second Circuit; or (ii) result in PEP forfeiting any of its potential appellate arguments.[49]

B. The Second Circuit Affirms the Lower Court's Decision to Confirm the Judgment and Rejects PEP's Arguments

After rejecting PEP's personal jurisdiction and venue challenges, the Second Circuit turned to the merits of PEP's appeal—did the district court err by confirming the arbitral award notwithstanding the ruling by a Mexican court nullifying this award?

The Second Circuit began by explaining that the "domestic enforcement of foreign arbitral awards is governed by two international Conventions" —the Panama Convention and the New York Convention, which are substantively the same.[50] Article V of the Panama Convention "sets out—and limits—the discretion of courts in enforcing foreign arbitral awards."[51] Pursuant to Article V, there are seven defenses upon which a court may refuse to recognize and execute an arbitral award, including that "t[he] award . . . has been [annulled] or suspended by a competent authority of the country in which, or under the law of which, that award was made."[52] The discretion of a court to "enforce an arbitral award annulled in the awarding jurisdiction . . . is constrained by the prudential concern of international comity, which remains vital notwithstanding that it is not expressly codified in the Panama Convention."[53] Thus, "[a]ny court should act with trepidation and reluctance in enforcing an arbitral award that has been declared a nullity by the courts having jurisdiction over the forum in which the award was rendered."[54]

After acknowledging that "[p]recedent is sparse," the court cited three prior decisions—two from the Second Circuit and one from the District of Columbia Circuit—which rejected attempts to confirm arbitral awards that were annulled by the courts of the countries where they were rendered.[55] The court discussed its prior decision in *Ackermann v. Levine*,[56] in which the Second Circuit held that "[a] judgment is unenforceable as against public policy to the extent that it is 'repugnant to fundamental notions of what is decent and just in the State where enforcement is sought.'"[57] But the court cautioned that this "public policy exception does not swallow the rule: '[t]he standard is high, and infrequently met'; 'a judgment that "tends clearly" to undermine the public interest, the public confidence in the administration of the law, or security for individual rights of personal liberty or of private property is against public policy.'"[58] Thus, "the exercise of that discretion is appropriate only to vindicate 'fundamental notions of what is decent and just' in the United States."[59]

Applying this standard, the Second Circuit concluded that the "the Southern District did not abuse its discretion in confirming the arbitral award notwithstanding invalidation of the award in the Mexican courts" for four reasons.[60]

First, PEP had waived any claim of sovereign immunity because Mexican law "specifically authorized PEP to agree to execute arbitration agreements" and both contracts "constrained COMMISA to arbitrate as the sole recourse for challenging any breach."[61] The Second Circuit concluded that PEP's waiver must be enforced because "[g]iving effect to PEP's twelfth-hour invocation of sovereign immunity shatters COMMISA's investment-backed expectation in contracting, thereby impairing one of the core aims of contract law."[62]

Second, "[g]iving effect to the nullification [of the arbitral award] would likewise impair the closely-related concept of avoiding retroactive application of laws."[63] The enactment of Section 98 was an "abrupt departure" from the parties' contracts and Mexican law in effect at the time the contracts were signed, and "allowing Section 98 to nullify COMMISA's arbitral award would deprive COMMISA of its contract rights through a retroactive change in law."[64] The Second Circuit concluded that the application of Section 98 was retroactive under United States law because "it is incontestable that the capacity of PEP to arbitrate was established in prior law; that it was withdrawn with respect to certain disputes that had already arisen; and that it was withdrawn in a way that frustrated contractual expectation, undid an arbitral award, and precluded redress by COMMISA in any forum."[65] Such "[r]etroactive legislation that cancels existing contract rights is repugnant to United States law."[66]

Third, giving effect to the Mexican court's nullification would leave COMMISA with "no sure forum in which to bring its contract claims."[67] The Second Circuit recognized that the "imperative of having cases heard—somewhere—is firmly embedded in legal doctrine."[68] Yet COMMISA would be deprived of a forum in which it could seek relief because while the arbitration was pending, Mexican law was changed to impose a 45 day statute of limitations (instead of 10 years) and a Mexican court had already dismissed a suit by COMMISA as barred by both the statute of limitations and the doctrine of *res judicata*.[69]

Fourth, the actions of PEP constituted government expropriation without compensation because "PEP, acting on behalf of the Mexican govern-

ment, rescinded the contracts and forcibly removed COMMISA from the project sites."[70] Mexico then enacted legislation to nullify the relief that COMMISA obtained in arbitration and to prevent it from seeking relief in the courts of Mexico.[71] The Second Circuit concluded that "the enforcement of such Mexican law amounted to a taking of private property without compensation for the benefit of the government."[72]

For these reasons, the Second Circuit concluded that the district court properly "exercised discretion, as allowed by treaty, to assess whether the nullification of the award offends basic standards of justice in the United States."[73] Applying this standard, the district court "did not abuse its discretion by confirming the arbitral award at issue because to do otherwise would undermine public confidence in laws and diminish rights of personal liberty and property."[74]

C. The District Court Did Not Err by Including $106 Million in Performance Bonds in the Judgment

The Second Circuit also affirmed the district court's decision to include in the judgment the $106 million in performance bonds that COMMISA posted pursuant to the contracts.[75] Although the arbitrators precluded PEP from collecting on these bonds in their Preliminary Award, "[a]fter entry of the Final Award in favor of COMMISA, PEP collected on the bonds."[76]

On appeal, PEP argued that "inclusion of that amount in the judgment exceeded the bounds of the Southern District's confirmation authority."[77] After recognizing that the confirmation of an arbitral award is merely a "summary proceeding," the Second Circuit concluded that the Final Award incorporated the portion of the tribunal's Preliminary Award "enjoining PEP from collecting on the performance bonds."[78] The court rejected PEP's argument that the failure of the tribunal to specifically reference the performance bonds in its Final Award precluded the district court from awarding the $106 million to COMMISA, because "PEP relied on the Eleventh Collegiate Court decision as a judgment authorizing it to collect on the performance bonds. But that ruling was issued in October 2011—*after* the Final Award had already issued."[79] Thus, it was within the discretion of the district court to interpret the contents of the Final Award and "the $106 million was properly included in the judgment."[80]

III. Conclusion

The Second Circuit's decision provides an important lesson for those seeking to enforce international arbitration awards in the United States or entering into contracts with states or state-owned entities. The selection of the seat of arbitration is a critical decision that must be made after carefully studying the *lex arbitri* (the arbitration law of the seat of arbitration that will govern the arbitration with respect to interim measures, challenge of arbitrators, setting aside of awards, and issues of arbitrability). It is an internationally recognized principle that the arbitration law of the seat will govern the arbitration and subsequent annulment proceedings. Although COMMISA was able to enforce its annulled award in New York, parties should not rely on the possibility that they may be able to confirm an award in the United States (or another country) if the award is declared a nullity in the jurisdiction in which it was rendered because courts will generally refuse to enforce annulled awards on the basis of Article V(1)(e) of the New York or Panama Conventions.

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1 *See Corporación Mexicana De Mantenimiento Integral, S. DE R.L. De C.V. v. Pemex-Exploración Y Producción*, __ F. 3d __, 2016 WL 4087215, No. 13-4022, at *1 (2d Cir. Aug. 2, 2016).

2 *Id.* at *1.

3 *Id.* at *1.

4 *Id.* at *2.

5 *Id.* at *2.

6 *Id.* at *2; *see also id.* at *2 ("The contract, governed by Mexican law, contained the following arbitration clause: **23.3 Arbitration**. Any controversy, claim, difference, or dispute that may arise from or that is related to, or associated with, the present Contract or any instance of breach with the present Contract, shall be definitively settled through arbitration conducted in Mexico City, D.F., in accordance with the Conciliation and Arbitration Regulations of the International Chamber of Commerce that are in effect at that time. The arbitrators shall be three in number, and the language in which the arbitration shall be conducted shall be Spanish.")*.*

7 *Id.* at *2; *see also id.* at *2 ("PEP's (now disputed) authority to bind itself to arbitration was premised on the following provision of the 'PEMEX and Affiliates Organic Law': In the event of international legal acts, Petróleos Mexicanos or its Affiliates may agree upon the application of foreign law, the jurisdiction of foreign courts in trade matters, and execute arbitration agreements whenever deemed appropriate in furtherance of their purpose.").

8 *Id.* at *2.

9 *Id.* at *2.

10 *Id.* at *2.

11 *Id.* at *2.

12 An *amparo* action is a mechanism available to litigants in Mexico challenging the validity or constitutionality of governmental acts; the sole remedy is a declaration that the challenged governmental action is invalid." *Id.* at *2.

13 *Id.* at *2.

14 *Id.* at *12.

15 *Id.* at *12.

16 *Id.* at *2-3.

17 *Id.* at *3.

18 *Id.* at *3.

19 *Id.* at *3.

20 *Id.* at *3.

21 *Id.* at *3; *see id.* at *3 (Pursuant to Section 98, "[a]n arbitration agreement may be executed regarding the disputes arising between the parties related to the construction of contractual clauses or related to issues arising from the performance of the contracts ... The administrative rescission, early termination of the contracts and such cases as the Regulation of this Law may determine may not be subject to arbitration proceedings.").

22 *Id.* at *3.

23 *Id.* at *3.

24 *Id.* at *3.

25 *Corporacion Mexicana de Mantenimiento Integral, S. de R.L. de C.V. v. Pemex-Exploracion y Produccion*, 962 F. Supp. 2d 642, 649 (S.D.N.Y. 2013).

26 *Id.* at 649.

27 *Corporación Mexicana De Mantenimiento Integral, S. DE R.L. De C.V.*, 2016 WL 4087215, at *3.

28 *Corporacion Mexicana de Mantenimiento Integral, S. de R.L. de C.V.*, 962 F. Supp. 2d at 643.

29 *Corporación Mexicana De Mantenimiento Integral, S. DE R.L. De C.V.*, 2016 WL 4087215, at *3.

30 *Corporacion Mexicana de Mantenimiento Integral, S. de R.L. de C.V.*, 962 F. Supp. 2d at 651 (citation omitted).

31 *Corporación Mexicana De Mantenimiento Integral, S. DE R.L. De C.V.*, 2016 WL 4087215, at *3.

32 *Id.* at *4.

33 *Id.* at *4.

34 *Id.* at *4 (alterations in original).

35 *Id.* at *4-13.

36 *Id.* at *4.

37 *Id.* at *4.

38 *Id.* at *5-8.

39 *Id.* at *5.

40 *Id.* at *5.

41 *Id.* at *5.

42 *Id.* at *7.

43 *Id.* at *7 (citation omitted).

44 *Id.* at *7.

45 *Id.* at *7.

46 *Id.* at *7.

47 *Id.* at *14.

48 *Id.* at *14-15.

49 *Id.* at *16 ("I thought we were ordering the reference of any subsequent appeal to this panel in the interests of judicial economy because we had familiarized ourselves with the issues other than arbitrability, i.e. personal jurisdiction and venue. As a panel member voting in favor of the remand as justified in the interests of judicial economy, it never occurred to me that my colleagues viewed the limited remand as limiting the issues to be heard on the subsequent appeal.").

50 *Id.* at *8 (footnote omitted).

51 *Id.* at *8.

52 *Id.* at *8 (citations omitted and alterations in original).

53 *Id.* at *8.

54 *Id.* at *13.

55 *Id.* at *9 (citing *Ackermann v. Levine*, 788 F.2d 830, 841 (2d Cir. 1986) ("A judgment is unenforceable as against public policy to the extent that it is 'repugnant to fundamental notions of what is decent and just in the State where enforcement is sought.'"); *Baker Marine (Nig.) Ltd. v. Chevron (Nig.) Ltd.*, 191 F.3d 194, 197 n.3 (2d Cir. 1999) ("Recognition of the Nigerian [annulment of the arbitral award] in this case does not conflict with United States public policy."); *TermoRio S.A. E.S.P. v. Electranta S.P.*, 487 F.3d 928, 938 (D.C. Cir. 2007) ("*Baker Marine* is consistent with the view that when a competent foreign court has nullified a foreign arbitration award, United States courts should not go behind that decision absent extraordinary circumstances not present in this case . . . . Therefore, it is unsurprising that the courts have

carefully limited the occasions when a foreign judgment is ignored on grounds of public policy. A judgment is unenforceable as against public policy to the extent that it is 'repugnant to fundamental notions of what is decent and just in the State where enforcement is sought.'")).

56 788 F.2d 830, 841 (2d Cir. 1986).

57 *Corporación Mexicana De Mantenimiento Integral, S. DE R.L. De C.V.*, 2016 WL 4087215, at *9 (citation omitted).

58 *Id.* at *9 (citation omitted).

59 *Id.* at *9 (citation omitted).

60 *Id.* at *9.

61 *Id.* at *9.

62 *Id.* at *10.

63 *Id.* at *10.

64 *Id.* at *10.

65 *Id.* at *10; *see also id.* at *10-11 (Although the Second Circuit acknowledged that the Mexican court specifically stated that it was not retroactively applying Section 98, the court concluded that the "sequence of events and the circumstances in which Section 98 was enacted thus resulted in a retroactive application of Section 98 as a matter of *United States* law." (emphasis in original)).

66 *Id.* at *10.

67 *Id.* at *12.

68 *Id.* at *12.

69 *Id.* at *12.

70 *Id.* at *13.

71 *Id.* at *13.

72 *Id.* at *13.

73 *Id.* at *13.

74 *Id.* at *13.

75 *Id.* at *13.

76 *Id.* at *13.

77 *Id.* at *13.

78 *Id.* at *13.

79 *Id.* at *13 (emphasis in original).

80 *Id.* at *13.

ABOUT SHOOK

Shook, Hardy & Bacon has a breadth of experience in all facets of international arbitration, from drafting and negotiating arbitration agreements to representing parties in arbitral proceedings and subsequent domestic annulment and enforcement proceedings under the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. We have also acted as arbitrator or arbitral secretary in both ad hoc and institutional international arbitrations under most institutional rules, including those of the ICC, AAA, ICDR, NAI, LCIA, and UNCITRAL, and governed by a variety of procedural and substantive laws.

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