The National Law Journal (Online)

May 31, 2010 Monday

LENGTH: 1489 words

HEADLINE: The risks of arbitrating with foreign governments;
Granting the sovereign its preferred 'home court' advantage has perils that should be avoided but at a minimum understood.;
INTERNATIONAL ARBITRATION

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BODY:

U.S. companies searching for business opportunities abroad may be considering contracting with foreign governments. Such companies must approach foreign commercial contracts aware of the special challenges of dispute resolution with foreign sovereigns because disagreements are as much a part of international business as the agreements. By knowing about the challenges, they can address potential problems at the start of negotiations with the foreign government and accurately calibrate the risk/reward calculus of the opportunity.

Dispute-resolution agreements should provide for international arbitration using one of the major international arbitration institutions to provide a neutral forum, less time-consuming proceedings, flexibility, decision-makers with expertise and an internationally enforceable award. Parties must turn to courts and rely on international agreements for enforcement of an arbitral award, particularly the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards - commonly known as the "New York Convention" - although regional treaties do exist. There is no international law on enforcement of arbitral awards; enforcement is an issue for local law and comity. Companies should be wary of contracting with a foreign state that is not a signatory to the New York Convention or other such convention.

Foreign sovereigns offering substantial contracts may expect companies to accede to their preference for the dispute-resolution provision. Granting the sovereign its preferred "home court" advantage has risks that should be avoided but at minimum understood.

Foreign states understandably would prefer to have arbitrators of their nationality preside in the arbitration. Most international arbitral institutions, however, require a sole arbitrator or chairman to be of a neutral nationality unless expressly waived by parties. See, e.g., Article 9(5), International Chamber of Commerce (ICC) Rules; Article 6(1), London Court of International Arbitration (LCIA) Rules. Companies should not waive this requirement. A foreign sovereign may be able to influence the arbitrator of its nationality or intimidate an arbitrator from making an award adverse to the sovereign.

Foreign states also would prefer their language as the language of the arbitration. U.S. companies should push hard to have English selected, given its status as lingua franca. Arbitration in the sovereign's foreign language is costly and provides the opposing party a strategic advantage.

Choice of law and the situs of the arbitration are critical. A company needs to familiarize itself with the options for applicable law to confirm that it understands the relevant principles of contract law and other relevant law such as the law on arbitration. For example, in TermoRio v. Electranta, 487 F.3d 928 (D.C. Cir. 2007), a publicly owned Colombian utility was able to prevail in getting an adverse ICC arbitration award annulled in a Colombian court on the ground that Colombian law did not expressly permit the use of ICC procedural rules in arbitration as of the date of the arbitration agreement. The U.S. Court of Appeals for the D.C. Circuit then refused to enforce the annulled award.

A company also needs to understand the standards for annulling an arbitral award. If possible, a company should negotiate a choice-of-law provision designating the situs and law applicable to be of a neutral country. Permitting a foreign state to prevail in insisting on its own law and/or in-country situs is dangerous because it would be notably easier for the sovereign to annul an adverse arbitral award. Under the New York Convention, an arbitral award may be annulled only in a court of primary jurisdiction, i.e., local courts of the situs or whose substantive law applies to the dispute. Thus, a sovereign would be able to move in its own domestic courts to overturn an adverse award. A company would be at a significant disadvantage defending its award in local courts especially if there is no independent judiciary.

If the sovereign succeeds in having the adverse arbitral award annulled, then a company will have a difficult time attempting to enforce the annulled award in the United States, especially given recent case law. The New York Convention provides that a court "may" refuse to enforce an arbitral award if it has been annulled in a court of primary jurisdiction. Article V(1)(e). The Federal Arbitration Act (FAA), which implements the New York Convention, expressly requires U.S. courts to enforce awards from signatory countries unless narrow grounds for refusal or deferral apply under articles V and VI of the Convention. Four Seasons Hotels and Resorts B.V. v. Consorcio Barr S.A., 533 F.3d 1349, 1351 (11th Cir. 2008), citing 9 U.S.C. 207.

The first U.S. case concerning enforcement of an annulled award, Chromalloy Gas Turbine Corp. v. Arab Republic of Egypt, 939 F. Supp. 907 (D.D.C. 1996), enforced an arbitral award that the Egyptian Air Force had succeeded in annulling in an Egyptian court for not properly applying Egyptian law. The court relying, inter alia, on an express provision in the contract that "[t]he decision...shall be final and binding and cannot be made subject to any appeal or other recourse," exercised its discretion and enforced the annulled award. Id. at 912. Companies should insist on such a provision in their arbitration agreement.

More recently, in TermoRio v. Electranta, the D.C. Circuit refused to enforce a Colombian contractor's arbitral award against a Colombian government public utility after a Colombian court annulled it. The D.C. Circuit found the case to be "plainly distinguishable" from Chromalloy because there was no provision making the arbitral award final and not subject to other recourse. The court also recognized that an annulled award may be enforced if the annulment decision of the forum state court is repugnant to the public policy of the forum state because there is evidence of bad faith, foul play or bias. This is a high standard to meet. An example of such bias likely would have been found concerning the arbitration in Telcordia Tech Inc. v. Telkom SA Ltd., 458 F.3d 172 (3d Cir. 2006). In Telcordia, a South African court annulled an arbitral award against a former state company. This decision was heavily criticized and overturned by the Supreme Court of Appeal of South Africa. Parties should be wary of contracting with a state party that is unwilling to have an arbitration agreement designating a neutral situs and law.

Finally, foreign states are uniquely positioned to slow down arbitrations. Companies should attempt to negotiate an arbitration agreement with a provision barring a stay of arbitral proceedings in favor of other proceedings. Without such a clause, a sovereign wishing to slow proceedings could be tempted to initiate a government investigation or domestic proceeding and move to stay until domestic proceedings are completed. The decision on a stay would be left to the discretion of the tribunal without such a clause.

U.S. companies need to soberly approach drafting of contract-performance provisions and temper the optimism present at contract award. Contract requirements must be made as clear as practicable to avoid disputes. Effort should be exerted to negotiate clear specifications and standards that can be objectively tested. For contract performance that cannot be defined appropriately during contract negotiation, a clear negotiation process and schedule must be established to define this performance in the future. Even then, companies need to be cognizant of how risk is allocated between the parties if future negotiations do not lead to clear standards.

Large contracts with foreign states often involve government-furnished inputs on which the contractor's performance depends. These government-furnished inputs can include one or more of the following: access to equipment, facilities or property; sharing of information; or participation by qualified personnel. To minimize delays in performance and disputes, these inputs by the foreign government must be clearly defined, deadlines established and tracked. In addition, the consequences of government delays or nonperformance must be specified.

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LOAD-DATE: April 9, 2014