

# Client Alert

International Arbitration Practice Group

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## Second Circuit Clarifies Law on Enforcement of Foreign Arbitral Awards under the New York Convention

### Introduction

On January 18, 2017, the United States Court of Appeals for the Second Circuit (Second Circuit) issued its decision in *CBF Indústria de Gusa S/A v. AMCI Holdings, Inc.*,<sup>1</sup> a case considering important questions on the application of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) and the doctrine of issue preclusion in the context of an action to enforce an arbitral award against non-signatories to the underlying arbitration agreement.

The Second Circuit reversed the decision of the United States District Court for the Southern District of New York, which had held that (i) the New York Convention and its implementing legislation in the Federal Arbitration Act (“FAA”),<sup>2</sup> require award creditors to seek confirmation of a foreign arbitral award before the award may be enforced by a district court, and (ii) the award creditor’s causes of action for fraud against non-signatories as alter-egos of the award debtor should be dismissed prior to discovery on the ground of issue preclusion due to the arbitral tribunal’s having found that no fraud had occurred. The Second Circuit’s decision clarified that “recognition and enforcement” under the New York Convention and the FAA occur in a single proceeding, that an award creditor may seek to bind a non-signatory to a foreign arbitral award through an enforcement proceeding brought under the Convention, and that the equitable doctrine of issue preclusion does not mandate dismissal of fraud allegations where there is a plausible showing of the other party’s “unclean hands.”

### Background on the New York Convention

The New York Convention, which is implemented in the United States through Chapter 2 of the FAA, applies to the “recognition and enforcement of arbitral awards made in the territory of a State other than the State where the recognition and enforcement of such awards are sought [*i.e.*, “foreign arbitration awards”]” and to “arbitral awards not considered as domestic awards in the State where their recognition and enforcement are sought [*i.e.*, “nondomestic awards”].”<sup>3</sup> An award is considered to be “made” in the country in which the arbitration is seated, and the courts of that country

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are generally accorded unique status under the Convention. Specifically, the Convention creates a framework by which courts in the country in which an award is “made” have “*primary* jurisdiction over the arbitration award” and have jurisdiction “to set aside or modify an award in accordance with [their] domestic arbitral law and its full panoply of express and implied grounds for relief,”<sup>4</sup> while courts in a country other than the primary jurisdiction in which enforcement is sought sit in *secondary* jurisdiction with respect to the award and may either enforce or refuse to enforce a foreign or nondomestic arbitration award if they find that one of the exclusive grounds for non-recognition explicitly set forth in Article V of the New York Convention applies.<sup>5</sup> Courts of secondary jurisdiction do not, however, have authority under the Convention to set aside or modify an award.

## ***CBF Indústria de Gusa S/A v. AMCI Holdings, Inc.***<sup>6</sup>

CBF Indústria, a group of Brazilian companies that produce and supply pig iron, entered into a series of contracts with Steel Base Trade, AG (SBT), a Swiss company, for the sale and purchase of pig iron (the Contracts). All Contracts contained an identical dispute resolution clause calling for arbitration under the rules of Conciliation and Arbitration of the International Chamber of Commerce, Paris (ICC). CBF Indústria and SBT were the only signatories to the Contracts.

On November 16, 2009, CBF Indústria commenced ICC arbitration proceedings in Paris, France against SBT, alleging that SBT breached its obligations under the Contracts (the ICC Arbitration). While the arbitration was pending, SBT gradually transferred its assets and business operations to a Swiss entity named Prime Carbon GmbH (Prime Carbon), which had substantial overlap with SBT in ownership and control. CBF Indústria brought this to the attention of the ICC tribunal and requested that the tribunal “[r]ecognize the existence of fraudulent acts’ as a basis upon which appellants might reach the assets of related third parties, ‘recognize as illegal the fraud perpetrated by [SBT], which shall then be held liable, permitting [appellants] to pursue [their] credits against [SBT’s] shareholders and managers, by application of the disregard doctrine[.]’”<sup>7</sup> CBF Indústria also asserted they were entitled to pierce the corporate veil and make SBT’s shareholders, directors, and affiliated companies liable for CBF Indústria’s losses. Before the conclusion of the ICC Arbitration, SBT had filed for bankruptcy. SBT’s bankruptcy administrator informed the ICC that SBT did not have sufficient funds to participate in the arbitration and admitted the claims against SBT. On November 9, 2011, the tribunal rendered an award in favor of CBF Indústria (the ICC Award). It did not grant CBF Indústria’s requested relief to reach Prime Carbon or any other third party, holding that CBF Indústria “did not introduce sufficient evidence in the present proceedings to demonstrate the existence of fraud in the bankruptcy proceedings.”<sup>8</sup> Because SBT had transferred essentially all of its assets to Prime Carbon, CBF Indústria were unable to enforce their award against SBT.

## **Proceedings in the District Court for the Southern District of New York**

On April 18, 2013, CBF Indústria filed an action in the district court for the Southern District of New York, seeking to enforce the ICC Award under the New York Convention against various corporate affiliates and two individuals (Appellees), whom CBF Indústria alleged were “alter egos” and “successors-in-interest” of SBT, and to recover on five state law fraud claims (the Enforcement Action). Appellees filed a motion to dismiss on the grounds of *forum non conveniens*, and argued that the action was an improper effort to modify the award and that CBF Indústria were precluded from asserting the state law claims because their fraud claims had been denied by the arbitral tribunal. The district court granted Appellees’ motion to dismiss, in part on grounds that “courts generally must avoid complex factual determinations regarding alter-ego or successor-in-interest theories in confirmation actions.”<sup>9</sup> Its conclusion largely rested upon the Second Circuit’s holding in *Orion Shipping v. Eastern States Petroleum Corp.*,<sup>10</sup> in which the Court of Appeals noted, in the context of an action to confirm a nondomestic arbitral award, the following:

This [confirmation] action is one where the judge's powers are narrowly circumscribed and best exercised with expedition. It would unduly complicate and protract the proceeding were the court to be confronted with a potentially voluminous record setting out details of the corporate relationship between a party bound by an arbitration award and its purported 'alter ego'.<sup>11</sup>

Although *Orion Shipping* involved an award issued in the United States (but falling under the Convention and Chapter Two of the FAA because it involved foreign parties), the district court nonetheless found its holding applicable, noting that "the difference in the scope between 9 U.S.C. § 9 and 9 U.S.C. § 207 is minimal."<sup>12</sup> The district court construed *Orion Shipping* as essentially requiring a two-step process by which an award creditor could seek to enforce its arbitral award against a third party: the award creditor must first confirm the award, then it may seek to impute liability to a third party through an alter-ego finding sought during the post-judgment enforcement process.

The district court noted subsequent Second Circuit precedent finding an exception to the rule set forth in *Orion Shipping* that applies when the factual issue of whether a third party may be held liable for an arbitral award will not "require the court to engage in extensive fact-finding."<sup>13</sup> Specifically, the district court took sight of *Productos Mercantiles v. Faberge USA*,<sup>14</sup> in which the Second Circuit found that the district court should have made a determination concerning whether the subject arbitral award could be enforced against a third party alleged to be a corporate successor to the award debtor, as "the necessary documents" that would establish that relationship "should be readily available."<sup>15</sup> However, the district court distinguished *Productos Mercantiles* and noted that "[m]aking an alter ego or successor-in-interest determination will not be a factually straightforward issue in this case," and that "successor liability in this case is factually complex, and significant evidentiary exploration will be needed in order to determine Plaintiffs' claims."<sup>16</sup>

The district court rejected CBF Indústria's attempt to "sidestep the *Orion* problem by only seeking enforcement of the Award, claiming that the SBT bankruptcy proceeding confirmed the Award."<sup>17</sup> The district court noted first that the Swiss Bankruptcy court's inventory of CBF Indústria's claims against SBT "is not the same thing as recognizing and confirming an arbitral award."<sup>18</sup> Second, the district court explained that "*Orion* does contemplate separate actions for the confirmation of an arbitral award and an enforcement action against an award debtor's alter egos,"<sup>19</sup> and that "[i]f Plaintiffs were allowed to bring an enforcement action based on alter-ego theory without the confirmation of the Award in any court it would effectively act as a bypass on the recognition and enforcement scheme contemplated by the Second Circuit in *Orion*."<sup>20</sup> The court noted its view that "[CBF Indústria's] enforcement action may be permissible if the Award was confirmed in Switzerland or other court of competent jurisdiction,"<sup>21</sup> but found that the award had not been so confirmed, and ultimately dismissed the claim for enforcement of the unconfirmed award against the Appellees.

The district court also dismissed appellants' state law fraud claims on the basis that they were precluded by the tribunal's prior ruling on appellants' fraud allegations presented in the arbitration.<sup>22</sup>

In response to the district court's dismissal of the Enforcement Action, CBF Indústria initiated an action to confirm the arbitral award against SBT in the same district court (the "Confirmation Action"). However, during the pendency of the Enforcement Action, unbeknownst to CBF Indústria, SBT was deleted from the Swiss Commercial Register. The district court dismissed the action, holding that, under Rule 17(b) of the Federal Rules of Civil Procedure, SBT lacked capacity to be sued because it was no longer a corporate entity according to Swiss law and was therefore, effectively, a nullity.<sup>23</sup> Having found that "[CBF Indústria] cannot seek to enforce the Award against

SBT's purported alter egos prior to confirming the Award against SBT," the district court held that because "SBT lacks capacity to be sued under Rule 17," "the Award cannot, therefore, be confirmed against it in this Court."<sup>24</sup>

## The Second Circuit Reverses

CBF Indústria appealed the district court's decisions in the Enforcement Action and the Confirmation Action, and the Second Circuit considered its consolidated appeals. The Second Circuit held that the district court erred in finding that (i) the New York Convention and the FAA required appellants to confirm the foreign arbitral award as a prerequisite to enforcement; and (ii) because issues of fraud were presented to the arbitral tribunal, the equitable doctrine of issue preclusion mandated dismissal of appellants' fraud claims before discovery.<sup>25</sup>

The Second Circuit began its consideration of the first issue with an analysis of the terms "recognition," "enforcement," and "confirmation." In this context, the Court noted that "recognition and enforcement" jointly refer to the process of reducing a foreign arbitral award to a judgment pursuant to the court's secondary jurisdiction:<sup>26</sup> "Recognition" is the determination that the award is entitled to preclusive effect, while "enforcement" is the reduction of the award to a judgment. It noted also that "[t]he process by which a nondomestic arbitral award is reduced to a judgment of the court by a federal court under its *primary* jurisdiction is called 'confirmation.'"<sup>27</sup> The Court found the confusion of these terms "understandable" because Section 207 of the FAA uses term "confirm" instead of "recognition and enforcement,"<sup>28</sup> but reasoned that, read in context with the New York Convention, and in light of the Convention's goal of facilitating enforcement, "it is evident that the term 'confirm' as used in Section 207 [of the FAA] is the equivalent of 'recognition and enforcement' as used in the New York Convention for the purposes of foreign arbitral awards."<sup>29</sup> The Second Circuit concluded that the "New York Convention and Chapter 2 of the FAA require only that the award-creditor of a foreign arbitral award file one action in a federal district court to enforce the foreign arbitral award against the award-debtor."<sup>30</sup> Furthermore, the Second Circuit clarified that its holding in *Orion Shipping*, a pre-Convention case decided under Chapter One of the FAA, must be limited to domestic awards over which the court exercises primary jurisdiction, and was inapposite in cases, like this one, involving foreign awards.<sup>31</sup> There was thus no basis on which to dismiss CBF Indústria's Enforcement Action for failure to confirm the ICC Award first.

Next, the Second Circuit found that "the question of whether a non-signatory may have a foreign arbitral judgment enforced against it by a federal district court sitting in secondary jurisdiction" was simply a question of whether "the subject matter of the difference is not capable of settlement by arbitration under the law of the country in which enforcement is sought" pursuant to Article V(1)(a) of the Convention.<sup>32</sup> The Second Circuit held that "there are three questions involved in determining this issue: (1) whether the federal district court or the arbitrator is to decide question (2); (2) whether 'the merits of the dispute' are to be arbitrated or decided by the court—the 'question of arbitrability'; and (3) the merits of the dispute." The Court found that, if the court found that the parties clearly and unmistakably agreed that a court, and not an arbitrator, should decide whether an arbitral award could be enforced against a third party, the court should then proceed to the merits of the question, to be guided by the general principle that a non-signatory party may be bound to an arbitration agreement by "(1) incorporation by reference; (2) assumption; (3) agency; (4) veil-piercing/alter-ego; [or] (5) estoppel."<sup>33</sup> The Second Circuit ultimately remanded to the district court for further legal and factual determinations in this regard.

Regarding the district court's finding on issue preclusion, the Second Circuit held that the district court erred in dismissing CBF Indústria's five causes of action for fraud on that basis. The Second Circuit restated the "settled law" that "the doctrine of issue preclusion is applicable to issues resolved by an earlier arbitration[.]" but highlighted that "the mere fact [] that an issue appears to have been resolved by an earlier arbitration does not necessarily mean that issue preclusion applies."<sup>34</sup> The doctrine will apply only if (i) the identical issue was raised in

the arbitration, (ii) the issue was actually litigated and decided in that proceeding, (iii) the party had a full and fair opportunity to litigate it, (iv) resolution of the issue was necessary to support a valid final judgment on the merits, and (v) application of this equitable doctrine is fair. The Second Circuit took note of CBF *Indústria's* position that they were denied a full and fair opportunity to litigate the merits of their fraud claims due to Appellees' fraud and misconduct before the ICC tribunal during the course of the Arbitration. Moreover, the Court noted that the application of the issue preclusion doctrine will not be "fair" if the party asserting the doctrine – here, the appellees accused of fraud – has unclean hands. The Second Circuit concluded that the district court erred in dismissing CBF *Indústria's* fraud claims before discovery on the basis of issue preclusion and remanded the case with the instruction that CBF *Indústria* should be allowed to conduct discovery regarding the fraud claims,<sup>35</sup> while holding that appellees would have the opportunity to re-raise the issue preclusion argument after discovery, at the district court's discretion.<sup>36</sup>

## Conclusion

The Second Circuit's holding that "enforcement and recognition" are a single proceeding brings clarity to any confusion that may have been caused by the use of different terminology in the New York Convention and Chapter Two of the FAA. It is now settled in the Second Circuit that "confirmation" under the FAA, Section 207, has the same meaning as "recognition and enforcement" under the New York Convention, and that a single proceeding achieves both aims and comports with the objectives of speedy enforcement under the New York Convention.

Despite its attempt to clarify the concepts of the terms "recognition" and "enforcement" under the Convention and Chapter Two of the FAA, the Second Circuit's decision left murky the status of *Orion Shipping*, which cautioned courts against unduly complicating summary proceedings with complex factual findings concerning whether that award may be enforced against alleged alter-egos or successors. The Second Circuit found *Orion Shipping* on the ground that the award in that case was made in the United States, but failed to take sight of the fact that it was nonetheless decided under the New York Convention, and offered no explanation for why the reasoning underpinning its decision in *Orion Shipping* would be less applicable in the context of proceedings to recognize and enforce a foreign, rather than a domestic, arbitral award.

The decision could thus simply be viewed as a further erosion of the *Orion Shipping* rule, which the Second Circuit appeared to acknowledge as outdated and/or irrelevant, and which had already been previously curtailed by the Court's 1994 decision in *Productos Mercantiles*, which created an exception to the rule against enforcing an arbitral award against non-signatories at the confirmation stage in cases where the issue of non-party liability was "clear and straightforward." Notably, in this case, the alter-ego and successor liability issues appeared to be far from clear-cut: there were no contractual guarantees or covenants binding the Appellees as successors-in-interest or assigns, so CBF *Indústria* would have been required to make the substantial factual showings necessary to prove the alter-ego or third-party beneficiary status of the Appellees, and the court's determination of these issues would likely have significantly prolonged the proceedings, thereby producing the very result that the *Orion Shipping* rule was intended to prevent. Although the Second Circuit's decision was not expressly confined to the facts of the case, those facts likely compelled the Court's departure from the procedural limitation set forth in *Orion Shipping*. Notably, the procedural mechanism chosen by the plaintiffs in this case rendered the application of the *Orion Shipping* rule particularly inapposite, as "enforcement" of the award was sought by complaint, rather than through the summary procedures provided by Chapters One and Two of the FAA, which provide for actions to be commenced by petition/motion.<sup>37</sup> Indeed, by commencing the enforcement action by complaint rather than by petition, the plaintiffs may have intentionally relinquished their right to summary enforcement of the award, with the understanding that a factually-intensive alter-ego inquiry was unavoidable by virtue of SBT's insolvency. However, the Second Circuit's decision does not cite this as a determinative factor in its decision, and gave no

indication as to whether a different result would be appropriate in a case where “recognition and enforcement” is sought through a summary proceeding rather than by plenary action.

In sum, although the Second Circuit’s decision was arguably effective in addressing (and likely intended to address) the unusual circumstances of the case before it, it is unclear how the decision will affect future cases involving substantially different facts. However, at minimum, it appears that Second Circuit law does permit award-creditors seeking enforcement of a foreign arbitral award to seek to bind non-signatories to the award in the context of proceedings to “recognize and enforce” that award pursuant to the New York Convention and Chapter Two of the FAA.

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<sup>1</sup> *CBF Indústria de Gusa S/A v. AMCI Holdings, Inc.*, No. 15-1133-CV(L), 2017 WL 191944 (2d Cir. Jan. 18, 2017).

<sup>2</sup> 9 U.S.C. § 201 *et seq.*

<sup>3</sup> *CBF Indústria*, 2017 WL 191944 at \* 9 (internal citations omitted).

<sup>4</sup> *Id.* at \* 9 (citing *Yusuf Ahmed Alghanim & Sons v. Toys “R” Us, Inc.*, 126 F.3d 15, 23 (2d Cir. 1997)) (internal quotation marks omitted).

<sup>5</sup> New York Convention, art. V:

1. Recognition and enforcement of the award may be refused ... only if ...: (a) The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or (b) The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or (c) The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or (d) The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or (e) The award has not yet become binding, on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

2. Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that: (a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or (b) The recognition or enforcement of the award would be contrary to the public policy of that country.

<sup>6</sup> In an appeal from a decision on a motion to dismiss, the Court of Appeals accepts the facts, as pleaded, as true for the purposes of the appeal. *CBF Indústria*, 2017 WL 191944 at \*2 (internal citations omitted). The facts as described herein reflect the Second Circuit’s posture.

<sup>7</sup> *Id.* at \* 5 (internal citations omitted).

<sup>8</sup> *Id.* at \* 6 (internal citations omitted).

<sup>9</sup> *CBF Industria de Gusa S/A/ v. AMCI Holdings, Inc.*, 14 F. Supp. 3d 463, 476 (S.D.N.Y. 2014) (citing *Orion Shipping & Trading Co. v. Eastern States Petroleum Corp.*, 312 F.2d 299, 301 (2d Cir. 1963)).

<sup>10</sup> 312 F.2d 299.

<sup>11</sup> *Id.* at 301.

<sup>12</sup> *Id.* at 476.

<sup>13</sup> *Productos Mercantiles E Industriales, S.A. v. Faberge USA, Inc.*, 23 F.3d 41, 47 (2d Cir. 1994).

<sup>14</sup> 23 F.3d 41.

<sup>15</sup> *Id.* at 47.

<sup>16</sup> *CBF Industria de Gusa S/A v. AMCI Holdings, Inc.*, 14 F. Supp. 3d 463, 477 (S.D.N.Y. 2014).

<sup>17</sup> *Id.* at 478.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 479.

<sup>21</sup> *Id.* at 479.

<sup>22</sup> *Id.* at \* 7.

<sup>23</sup> *CBF Indústria*, 2017 WL 191944 at \* 8.

<sup>24</sup> *CBF Industria de Gusa v. AMCI Holdings, Inc.*, No. 13 CIV. 2581 LRWS, 2015 WL 1190137, at \*9 (S.D.N.Y. Mar. 16, 2015), *vacated and remanded sub nom. CBF Indústria de Gusa S/A v. AMCI Holdings, Inc.*, No. 15-1133-CV(L), 2017 WL 191944 (2d Cir. Jan. 18, 2017).

<sup>25</sup> *Id.* at \* 8. The Second Circuit also considered appellants' arguments on the district court's application of the doctrines of estoppel, *forum non conveniens*, and international comity, but declined to decide these questions. For this reason, their discussion is omitted herein.

<sup>26</sup> *Id.* at \* 10 (citing N.Y. Convention, arts. III, IV, V.).

<sup>27</sup> *Id.* at \*11.

<sup>28</sup> *Id.* at \* 12 (internal citations omitted).

<sup>29</sup> *Id.* at \* 10 (internal citations omitted).

<sup>30</sup> *Id.* at \* 12 (internal citations omitted).

<sup>31</sup> *Id.*

<sup>32</sup> *Id.* at \*14 (citing *VRG Linhas Aereas S.A. v. MatlinPatterson Glob. Opportunities Partners II L.P.*, 717 F.3d 322, 325 (2d Cir. 2013)).

<sup>33</sup> *Id.* at \*15 (citing *Smith/Enron Cogeneration Ltd. P'ship, Inc. v. Smith Cogeneration Int'l, Inc.*, 198 F.3d 88, 97 (2d Cir. 1999)).

<sup>34</sup> *Id.* at \* 15 (internal quotation marks and citation omitted).

<sup>35</sup> Notably, SBT refused to comply with an ICC order requiring disclosure of its assets, receivables and rights that may have been sold, donated or transferred to third parties since the commencement of the arbitration. *Id.* at \*5.

<sup>36</sup> *Id.*

<sup>37</sup> 9 U.S.C. § 6; 9 U.S.C. § 208.