The Arbitration Review of the Americas

2024

United States: arbitration hubs thriving thanks to robust judicial support

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United States: arbitration hubs thriving thanks to robust judicial support

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Summary

In summary

The Supreme Court's 2022 decision in ***ZF Automotive*** limited the use of section 1782 for obtaining discovery in private international commercial arbitration. ***Alpene*** and ***WeBuild*** indicate challenges in using section 1782 for public international arbitrations. In 2023, the Second Circuit ruled in ***Smarter Tools*** that a district court can remand an unclear arbitration award to allow the arbitrator to clarify the reasoning. Further, the Eleventh Circuit has determined that grounds for vacating arbitration awards in Chapter 1 of the FAA can apply to international arbitration awards. In 2023, the Supreme Court decided that civil liability under RICO may be available against fraudulent domestic efforts to avoid the enforcement of an international arbitration award.

Discussion points

- Section 1782 discovery in international arbitration
- Second Circuit carves out an exception to the ***functus officio*** doctrine
- Eleventh Circuit decides on grounds for vacatur of international arbitration awards
- RICO may be available to a foreign plaintiff to sue a domestic US award-debtor

Referenced in this article

- *In Re Alpene, Ltd*
- *ZF Automotive*
- *In Re WeBuild*
- *Smarter Tools Inc v Chongqing Senci Import & Export Trade Co, Ltd*
- Corporación AIC, SA v Hidroeléctrica Santa Rita SA
- *Yegiazaryan v Smagin*, consolidated with *CMB Monaco v Smagin*

US federal courts continue to grapple with section 1782 discovery in international arbitration

Efforts to obtain discovery for use in international arbitration continue to present issues in US courts. These efforts concern the use of 28 USC section 1782(a) (section 1782), which empowers a US federal district court to order a person within its district to give testimony or provide evidence for use in foreign dispute resolution proceedings. The relevant part of section 1782 provides as follows.

> The district court of the district in which a person resides or is found may order him to give his testimony or statement or to produce a document or other thing for use in a proceeding in a foreign or international tribunal, including criminal investigations conducted before formal accusation.

As discussed in our article in last year's edition, in June 2022 the US Supreme Court held that neither a private, international commercial arbitral tribunal nor an ad hoc United Nations Commission on International Trade Law (UNCITRAL) investor-state arbitral tribunal constitutes a 'proceeding in a foreign or international tribunal' under section 1782. According to the Supreme Court, a '"foreign tribunal" more naturally refers to a tribunal belonging to a foreign nation than to a tribunal that is simply located in a foreign nation. And for a tribunal to belong to a foreign nation, the tribunal must possess sovereign authority conferred by that nation.'

However, the Supreme Court reserved its position on certain ad hoc tribunals because 'sovereigns might imbue an ad hoc arbitration panel with official authority' as governmental and intergovernmental bodies 'may take many forms'. That carve out has allowed parties to continue efforts to use section 1782 in some investor-state arbitrations. Unfortunately for the parties seeking discovery, these efforts, to date, have been rebuffed, at least by the US federal courts for the Southern District and the Eastern District of New York.

In Re Alpene

In ***In Re Alpene, Ltd***, a magistrate judge for the US Federal District Court for the Eastern District of New York held that an International Centre for Settlement of Investment Disputes (ICSID) tribunal convened pursuant to a China–Malta bilateral investment treaty (BIT) was not a 'foreign or international tribunal' under section 1782. Alpene is a Hong Kong corporation and a claimant in an investor-state treaty arbitration against Malta before the World Bank's ICSID. Alpene sought section 1782 discovery (documents and a deposition) from a New York resident for use in the ICSID arbitration.

The ***Alpene*** court looked to the Supreme Court's decision in ***ZF Automotive*** in considering whether the ICSID tribunal qualified as a foreign or international tribunal, noting that '[t]he relevant question is whether the nations intended that the [arbitral] panel exercise governmental authority', and in ***ZF Automotive***, 'all indications [we]re that they did not.' In examining this question, the ***Alpene*** court noted that the BIT between Malta and China provides that a dispute between an investor and one of the contracting parties that is not resolved through negotiations can be submitted at the investor's choice to: (1) a court of appropriate jurisdiction in the country that is a party to the dispute (here, Malta); (2) arbitration under the auspices of the ICSID; or (3) ad hoc arbitration under the Arbitration Rules of the UNCITRAL (like the arbitration panel in ***ZF Automotive***). Inclusion of domestic courts as an option for dispute resolution, the court found, 'undercut[s] the contention that the arbitration panel had governmental authority'. But Alpene noted that the Supreme Court had left open the possibility that sovereigns 'might imbue such an arbitration tribunal with official authority'.

Alpene chose to initiate arbitration under the ICSID, which the court noted is an independent, self-contained system:

> The ICSID operates under the authority of the World Bank, an intergovernmental organization, and is an international arbitration institution established in 1966 for legal dispute resolution and conciliation between states and investors who are nationals of other states. (See About ICSID, ICSID), https://icsid.worldbank.org/About/ICSID (last visited Oct. 6, 2022) . . . [T]he applicable treaty [China–Malta BIT] did not itself create the ICSID panel, which "consists of individuals chosen by the parties and lacking any official affiliation with [the treaty nations.]" [citations omitted]

The Court also noted that the China–Malta BIT was silent as to whether it was the parties' intent 'to imbue [the ICSID] with governmental authority'.

In finding that there was insufficient support for the argument that Malta and China 'intended to imbue the ICSID arbitration panel with governmental authority', the ***Alpene*** court considered the similarities between the ad hoc UNCITRAL panel in ***ZF Automotive*** and the ICSID panel, as well as some significant differences; it also discussed issues of comity and the need to interpret section 1782 in accord with the US Federal Arbitration Act (FAA), which limits discovery. Interestingly, the magistrate in ***Alpene*** made the observation that '[w]hile the Supreme Court did not address ICSID investor-state arbitrations specifically, by reaching out to decide this issue absent a circuit split, it did signal a desire to limit the availability of discovery in U.S. courts for international commercial arbitrations'.

In Re WeBuild

In ***In Re WeBuild***, the US Federal District Court for the Southern District of New York similarly held that an ad hoc ICSID tribunal convened pursuant to a Panama–Italy BIT was not a 'foreign or international tribunal' under section 1782. After discussing the Supreme Court's analysis in ***ZF Automotive***, the federal court noted that its 'central inquiry was whether the treaty parties . . . had indicated an intent "to imbue the body in question with governmental authority"'. In concluding that the ICSID tribunal was not a foreign or international tribunal for section 1782 purposes, the ***WeBuild*** court considered a number of factors.

First, as in ***ZF Automotive***, the ICSID tribunal at issue was not a pre-existing body but one formed for the purpose of adjudicating investor-state disputes; 'ICSID does not have pre-existing panels', but rather panels that are formed following a request for arbitration. Second, the investor treaty at issue did not create the ICSID tribunal; rather, it is the ICSID rules that govern the formation of a tribunal if ICSID is chosen as the forum for dispute resolution. Third, in ***WeBuild***, the ICSID tribunal was independent of and not affiliated with either of the investor states. Fourth, the tribunal did not receive any government funding, but rather the parties to the dispute funded the tribunal. Fifth, the confidentiality of the ***WeBuild*** ICSID arbitration proceedings, according to the federal court, was 'more akin to private commercial arbitration than adjudication by a governmental body'. Last, the fact that the parties to the Panama–Italy BIT had a choice to resolve disputes in a court of competent jurisdiction or via an ad hoc arbitration proceeding militated against a finding that the tribunal was a foreign or international tribunal. The Court stated that the authority of the ICSID tribunal existed because the parties agreed to arbitration, 'not because [Italy] and [Panama] clothed the panel with governmental authority'. These factors may be considered by other courts when determining the applicability of section 1782 in other public international dispute resolution proceedings. Notably, the federal district court's opinion in ***WeBuild*** is currently the subject

of an appeal to the US Court of Appeals for the Second Circuit, and further clarification as to the applicability of section 1782 in public international arbitration, such as ICSID arbitration, may be forthcoming.

Conclusion

With the Supreme Court's decision in 2022 in ***ZF Automotive***, the use of section 1782 to obtain discovery for use in private international commercial arbitration was severely curtailed. And while the Supreme Court did leave open the possibility that some investor-state arbitrations might constitute proceedings in a foreign or international tribunal, that carve-out appears – to date at least – to be given a constricted interpretation as well. The reasonings of the US federal district courts in ***Alpene*** and ***WeBuild***, and the factors cited in support of denying the requested discovery, point to continued challenges in using section 1782 to obtain discovery for use in public international arbitrations, and in particular ICSID arbitrations.

US Court of Appeals for the Second Circuit carves out exception to functus officio doctrine permitting remand to obtain a 'reasoned award'

Is a court required to vacate an arbitration award, under the ***functus officio*** doctrine, where the award is deemed not to satisfy the parties' request for a reasoned award or, alternatively, may a court remand the award to the arbitrator to clarify the award?

On 17 January 2023, in ***Smarter Tools Inc v Chongqing Senci Import & Export Trade Co, Ltd***, the Second Circuit held that a district court may properly remand, rather than vacate, an unclear arbitration award to provide the arbitrator with an opportunity to clarify the reasoning supporting the award. The issues presented to the Second Circuit were:

- whether the district court violated the ***functus officio*** doctrine by remanding, instead of vacating, an arbitration award that was deemed not to be a reasoned award; and
- whether the arbitrator's subsequent final amended award, issued after remand, complied with the parties' request for a reasoned award.

Background of the arbitration and award

The underlying arbitration arose out of purchase orders between Smarter Tools Inc (STI) and Chongqing SENCI Import & Export Trade Co Ltd (SENCI) for the supply of gas-powered generators. SENCI commenced the arbitration after STI failed to pay the purchase price for a number of generators. STI counterclaimed contending, inter alia, that SENCI delivered non-conforming generators that did not comply with certain standards promulgated by the California Air Resources Board (CARB). The purchase orders included an arbitration clause providing for disputes to be resolved under the International Commercial Dispute Resolution Procedure of the American Arbitration Association in the City of New York. During the arbitration proceedings, the parties jointly agreed to the request for a reasoned award.

After the merits hearing, the arbitrator issued a six-page award granting SENCI's claim for payment and denying STI's counterclaims for lost profits and other damages. The award included a brief description of the claims and procedural matters together with a section setting forth the factual background and findings, as well as a final section itemising the relief awarded. As support for the dismissal of STI's counterclaims, the arbitrator provided the following statement in the award:

> [h]aving heard all of the testimony, reviewed all of the documentary proofs and exhibits, I do not find support for STI's claims, nor do I find the testimony of Expert Witness . . . to be credible. Therefore, I find that . . . testimony . . . is not credible, does not constitute proper rebuttal evidence testimony and must be excluded.

STI filed a petition to vacate and SENCI filed a cross-petition to confirm the final award. The New York District Court concluded that the arbitrator failed to issue a reasoned award because the final award did not contain any rationale for rejecting STI's counterclaims. The District Court acknowledged the arbitrator's finding that STI's damages expert was not credible. The District Court considered this credibility finding to be a sufficient rationale for rejecting STI's damage calculation. But the District Court concluded that the credibility of STI's damages expert had no bearing on STI's allegation that SENCI breached the supply agreement, which presented a question of liability – not damage. In assessing whether the award constituted a 'reasoned award', the District Court noted that an arbitrator is not obliged to discuss each piece of evidence presented but must at least provide some rationale for rejecting a parties' claim. In particular, the District Court found that the final award did not include any factual findings as to whether SENCI supplied defective or non-compliant generators.

Thus, the District Court remanded the case to the arbitrator who then issued a nine-page final amended award (the Amended Award) that included a new section with additional findings relating to STI's counterclaims. SENCI moved to confirm this Amended Award, and STI again petitioned to vacate the Amended Award. The District Court confirmed the Amended Award, and STI appealed.

Second Circuit analysis

In the United States, arbitration awards are generally confirmed consistent with the strong public policy to encourage the use of arbitration. Consistent with this principle, the Second Circuit affirmed the District Court's confirmation of the Amended Award.

First, the Second Circuit found that the District Court correctly remanded the final award to obtain a reasoned award. Generally, under the ***functus officio*** doctrine, the Second Circuit observed that after the arbitrator renders a decision regarding the issues submitted in the form of an award, the arbitrator lacks any power to redetermine that decision. But, the Second Circuit explained that the rationale undergirding the ***functus officio*** doctrine is to prevent arbitrators from changing their ruling after issuance due to outside communication and unilateral influence. As an exception to the ***functus officio*** doctrine, the Second Circuit found that this rationale did not apply where an award is remanded to permit the arbitrator to clarify, not alter, the reasoning in the award. Ultimately, in ***Smarter Tools***, the arbitrator issued the Amended Award, which clarified the rationale for rejecting STI's counterclaims.

The Second Circuit found that the District Court's remand for a clarification was consistent with the parties' joint request that the arbitrator issue a reasoned award.

Notably, in its decision remanding the final award to the arbitrator, the District Court stated that the arbitrator 'exceeded his authority' in issuing an award that does not meet the standard of reasoned opinion. The Second Circuit, however, did not directly address this issue because it concluded that the District Court's remand was proper.

The Second Circuit rejected STI's argument that ***vacatur*** was the only option available under the FAA section 10 (***vacatur***) and found that the failure to provide a reasoned award best fits under FAA section 11 (modification). The Second Circuit stated that FAA section 10(a)(4) provides for a strong presumption in favour of enforcing an arbitration award, and focuses on whether an arbitrator had the power to reach a certain issue, not whether the arbitrator correctly decided that issue. Because the parties jointly agreed that the arbitrator was to produce a reasoned award, the failure to provide a reasoned award was a formal error not affecting the merits of the case. Under these circumstances, remanding the award to the arbitrator to produce a reasoned award avoided vacating the original award and forcing the parties to begin anew.

Second, the Second Circuit agreed with the District Court that the new Amended Award was a reasoned award. The Amended Award provided additional rationale for denying STI's claim; namely, that the evidence did not show that STI had ordered CARB-certified generators. In particular, in the Amended Award, the arbitrator explained that STI did not submit credible evidence to support its claim and that the evidence purporting to demonstrate that the parties orally agreed to additional terms that were not in the purchase orders was simply not credible.

As a result, the Second Circuit dismissed STI's petition to vacate the Amended Award holding that remand is a permissible choice where an arbitrator fails to produce an award in the form agreed by the parties. The Second Circuit relied on the parties' joint agreement for a reasoned award and that a clarification of the final award was required to provide an award in the form requested by the parties.

Takeaways for arbitrators in drafting reasoned awards

When the parties request a reasoned award, an arbitrator should take care to articulate at least some support for the conclusions set forth in the award. The Second Circuit reaffirmed that '[a] reasoned award sets forth the basic reasoning of the arbitral panel on the central issue or issues raised before it', but 'need not delve into every argument made by the parties'. But, the broad parameters that a reasoned award may include 'something short of findings and conclusions of law but more than a simple result' does not provide arbitrators with detailed guidance in drafting a reasoned award. The decision in ***Smarter Tools*** suggests that merely adjudicating all issues presented may not be sufficient for a reasoned award.

First, an arbitrator should include as part of a reasoned award some rationale for the adjudication of claims. The District Court remanded the final award in ***Smarter Tools*** even though the arbitrator expressly denied the counterclaim and provided reasoning for rejecting STI's calculation of damages. The District Court held that a reasoned award should have also explained the rationale for the conclusion that there was no oral agreement to modify the

express terms of the purchase order. The ***Smarter Tools*** case is, therefore, distinguishable from an award that does not adjudicate an issue that has been submitted.

Second, an arbitrator does not need to include as part of a reasoned award findings of fact and conclusions of law absent an express agreement by the parties. In ***Smarter Tools***, the District Court cited case law for the proposition that a reasoned award is not required to be as fulsome or elucidated as one party would like. Rather, an award may be deemed to be reasoned where it contains 'the panel's rationale'. If an arbitrator sets forth the relevant facts and the key factual findings supporting its conclusions on the central issues, then the failure to provide a detailed rationale for every facet of the decision is not required for a reasoned award.

Third, an arbitrator's reasoned award may be brief and does not need to be lengthy so long as it 'charts the path to its result with clear and well-reasoned findings'.

Ultimately, ***Smarter Tools*** further confirms the strong presumption in favour of arbitration. An award that provides at least some rationale for its conclusions is more likely to survive a petition seeking to vacate the award on the grounds that it does not qualify as a reasoned award.

The Eleventh Circuit aligns with sister circuits on grounds for vacatur of international arbitration awards

In Corporación AIC, SA v Hidroeléctrica Santa Rita SA[1] the United States Court of Appeals for the Eleventh Circuit aligned with its sister circuits and held that an international arbitration award subject to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the Convention) may be vacated on any of the grounds enumerated under Chapter 1 of the FAA.[2] In doing so, the Court overruled nearly 25 years of precedent within the circuit.

Implementation of the Convention

In 1925, the United States enacted the FAA to provide for judicial enforcement of arbitration agreements and arbitration awards, except in certain types of contracts expressly excluded under the FAA. In addition to setting forth the grounds upon which arbitration awards should be confirmed, the FAA set forth the grounds upon which arbitration awards may be vacated.[3]

Following the United States' ratification of the Convention in 1970, the US Congress enacted Chapter 2 of the FAA[4] to implement the Convention. Like the Convention itself, Chapter 2 of the FAA is silent on ***vacatur***. Notwithstanding this, Chapter 2 of the FAA contains a residual clause providing that 'Chapter 1 applies to actions and proceeding brought under [Chapter 2] to the extent that [Chapter 1] is not in conflict with [Chapter 2] or the Convention.'[5]

Prior precedent on vacatur of international arbitration awards

Prior to Corporación AIC, the Eleventh Circuit held that parties seeking ***vacatur*** of an international arbitration award under the Convention could only rely on the grounds for non-recognition set forth in article V of the Convention.[6] The Eleventh Circuit, however, was at odds with the other circuit courts that had addressed the issue, all of which have held that

an international arbitration award arising under the Convention may be vacated on any of the grounds specified under Chapter 1 of the FAA.[7] This made the Eleventh Circuit an outlier.

Case background and procedural history

The case arose from a dispute between two Guatemalan companies, Corporación AIC, SA and Hidroeléctrica Santa Rita, SA, concerning an agreement to build a hydroelectric power plant in Guatemala.[8] After Hidroeléctrica issued a force majeure notice that forced Corporación AIC to stop work on the project, Hidroeléctrica initiated an arbitration proceeding to recover advance payments it had made.[9] Corporación AIC, in turn, counterclaimed for damages, costs and expenses.[10]

At the conclusion of the arbitration, a divided arbitral tribunal issued an award ordering Corporación AIC to return the advance payments made by Hidroeléctrica, but allowing Corporación AIC to retain the fees it had earned under the contract.[11] Corporación AIC then filed a suit in the United States District Court for the Southern District of Florida seeking ***vacatur*** of the award.[12] Specifically, Corporación AIC argued that the arbitral tribunal exceeded its powers, 'a ground set out in 9 U.S.C. § 10(a)(4), a provision of Chapter 1 of the FAA'.[13]

Because the arbitration was seated in Miami, Florida, and involved international parties, the parties agreed that the award was a non-domestic award governed by the Convention.[14] The District Court denied the petition to vacate under Eleventh Circuit precedent, namely, ***Industrial Risk*** and ***Inversiones***, because those cases held that the exclusive grounds for ***vacatur*** of an award governed under the Convention are those set forth in article V of the Convention.[15]

An Eleventh Circuit panel of three judges affirmed the District Court's ruling, but opined that ***Industrial Risk*** and ***Inversiones*** were wrongly decided and should be overruled by the full court.[16] Subsequently, the Eleventh Circuit vacated the panel opinion and ordered a rehearing ***en banc***.[17]

Eleventh Circuit analysis

The Eleventh Circuit began its analysis by focusing on the language of the Convention and the FAA, respectively. It found that confirmation of an award under the FAA is 'essentially the same' as recognition and enforcement under the Convention, whereas, 'set aside', 'suspend' and 'annul' under the Convention are 'interchangeable' with ***vacatur*** under the FAA.[18] It further noted that the Convention 'allocates different responsibilities to different jurisdictions' with respect to judicial remedies.[19] Specifically, the country that serves as the seat of the arbitration (or whose law governs the conduct of the arbitration) serves as the 'primary jurisdiction' where procedural issues are decided.[20] And, '[a]ll other countries which are signatories to the Convention are considered secondary jurisdictions.'[21]

The Court further explained that 'only courts in the primary jurisdiction can vacate an arbitration award; where courts in secondary jurisdictions 'can only decide whether to recognize and enforce an arbitral award'.[22] And, article V of the Convention sets forth the only grounds upon which recognition and enforcement of an arbitral award may be refused.-[23]

Analysing the text of the Convention further, the Court noted that the Convention 'does not provide grounds for vacatur'.[24] The only reference to ***vacatur*** is found at article V(1)(e), which allows courts exercising secondary jurisdiction to refuse recognition or enforcement of an award if the award has been 'set aside or suspended' in the primary jurisdiction.[25] The Convention, however, 'does not purport to regulate the procedures or set out the grounds for vacatur in the primary jurisdiction'.[26]

Turning to the FAA, the Court explained that Chapter 2 of the FAA implements the Convention and, thus, 'the two texts should be read harmoniously'.[27] Like article V of the Convention, however, Chapter 2 of the FAA focuses only on recognition and enforcement and does not provide grounds for ***vacatur***.[28]

Notwithstanding, the US Supreme Court has previously explained that the Convention 'requires courts to rely on domestic law to fill gaps'.[29] Based on the Supreme Court's discussion in ***Outokumpu*** and the Convention's 'binary framework', the Court held that 'the primary jurisdiction's domestic law acts as a gap filler and provides the vacatur grounds for an arbitral award.'[30]

In the United States, of course, the domestic law is the FAA, which provides the grounds for vacatur of arbitration awards at section 10 of Chapter 1.[31] And, Chapter 2's residual clause (Section 208) provides that Chapter 1 applies to actions and proceedings brought under Chapter 2 to the extent not inconsistent with Chapter 2 or the Convention.[32] Thus, the Court held that because the Convention and Chapter 2 of the FAA are both silent on the grounds for ***vacatur***, section 10 of Chapter 1 of the FAA (which sets forth the grounds for ***vacatur*** of a domestic award) acts as the gap filler and applies to ***vacatur*** proceedings for awards under the Convention where the United States is the primary jurisdiction.[33]

In reaching this conclusion, the Court noted that it was now in alignment with the Second, Third, Fifth and Seventh Circuits, which have interpreted the interplay between the Convention and the FAA in the same manner. As a result, the Eleventh Circuit overruled ***Industrial Risk*** and ***Inversiones***, which it held were 'outliers' that were 'plainly and palpably wrong'. [34] Additionally, the Court remanded the case for the District Court to consider Corporación AIC's request for ***vacatur*** under section 10(a)(4) of Chapter 1 of the FAA.

Conclusion

The Eleventh Circuit has joined its sister circuits, and all of which have addressed the issue have held that, where the United States serves as the primary jurisdiction, the grounds for ***vacatur*** of arbitration awards set forth in Chapter 1 of the FAA apply to international arbitration awards under the Convention.

The Supreme Court makes civil RICO available against fraudulent domestic efforts to avoid the enforcement of an international arbitration award

On 22 June 2023, the Supreme Court, in a 6-3 opinion in ***Yegiazaryan v Smagin***,[35] held that a foreign plaintiff can sue a domestic US award-debtor under the Racketeer Influenced and Corrupt Organizations Act (RICO) for the debtor's fraudulent efforts to avoid collection on

the US judgment confirming the foreign arbitral award, when the circumstances indicate the injury sustained by the creditor arose in the United States.

RICO

RICO is a US federal law that provides a private right of action to '[a]ny person injured in his business or property by reason of a violation of' RICO's substantive provisions (18 USC §1964(c)). 'Racketeering activity' is defined broadly under the statute, and includes a wide range of offences involving fraud, such as mail and wire fraud (18 USC § 1961(1)). A plaintiff that has sustained injuries as a result of a RICO violation may obtain treble damages, costs and attorney's fees (18 USC §1964(c)).

A common question is what being 'injured' means (18 USC §1964(c)). Under ***RJR Nabisco, Inc v European Community***, 579 U.S. 325, 346 (2016), the Supreme Court held that the statute 'requires a civil RICO plaintiff to allege and prove a domestic injury to business or property and does not allow recovery for foreign injuries'.

The issue in ***Yegiazaryan v Smagin*** was whether a foreign plaintiff with no alleged connection to the United States may nevertheless allege a 'domestic' injury under ***RJR Nabisco*** sufficient to maintain a RICO action.

Takeaways for the collection of international arbitration awards in the United States

With this decision, the Supreme Court opened a significant new avenue for creditors of international arbitration awards to enforce their awards in the United States, when the creditor's inability to collect on the award is the result of the debtor's racketeering activity within the meaning of RICO and the injury is sufficiently grounded in the United States.

The analysis will be case specific and will depend on the circumstances of each case. However, award creditors must bear in mind the following:

- Any international arbitration award will need to be confirmed in the United States and converted into a US judgment before this avenue becomes available.
- For the avenue to be available, the debtor must have violated the RICO statute (eg, in avoiding collection on the award), committing racketeering activity within the meaning of RICO.
- The injury the creditor sustained must be domestic under ***Yegiazaryan***. Although it is unclear how the lower courts will interpret the ***Yegiazaryan*** test to determine whether there is domestic injury, US courts have been instructed to look to the 'circumstances surrounding the alleged injury', in particular, to the nature of the alleged injury, the racketeering activity that directly caused it, and the injurious aims and effects of that activity'.
- The threat of treble damages under RICO may be a powerful negotiation tool.
- Third parties, including law firms and banks, must be warned of the consequences that may arise from assisting award debtors from meeting their payment obligations resulting from enforcement proceedings in the United States.

Factual background[36]

In 2014, Vitaly Smagin (Smagin) (a resident in Russia) prevailed in an arbitration seated in London and obtained an award against Ashot Yegiazaryan (Yegiazaryan) (a Russian citizen residing in California) for US$84 million (London Award). Smagin sought the recognition and enforcement of the London Award in California under the New York Convention for the Recognition and Enforcement of Foreign Arbitral Awards. After issuing a temporary protective order, followed by a preliminary injunction freezing Yegiazaryan's assets in California, the District Court for the Central District of California (the District Court) issued judgment against Yegiazaryan for US$92 million, including interest.

Some time after the District Court froze Yegiazaryan's assets, Yegiazaryan was granted an arbitration award issued against Suleymon Kerimov in an unrelated matter (Kerimov Award). Yegiazaryan obtained a US$198 million settlement in satisfaction of the Kerimov Award.

To avoid the District Court's asset freeze, Yegiazaryan accepted the settlement funds for the Kerimov Award through the London office of a US law firm headquartered in Los Angeles, and created a sophisticated net of offshore entities to hide the funds. He deposited the funds in CMB Monaco, and instructed friends and acquaintances to file claims against him around the world to obtain sham judgments that would be paid using the settlement funds, thus preventing Smagin from accessing them.

Yegiazaryan also hid his assets in the United S by transferring them to shell companies owned by members of his family. He disobeyed the District Court's orders instructing him to refrain from continuing to prevent Smagin from collecting on the judgment, and was held liable for contempt of court. To avoid complying with the District Court's orders, Yegiazaryan claimed to be ill, forged a doctor's note (a doctor who is a resident in California) and submitted it to the District Court. Yegiazaryan also threatened the doctor when he received a subpoena to be deposed in connection with the note.

Smagin's RICO claim

Smangin brought a civil claim under RICO against Yegiazaryan, CMB Monaco and 10 other defendants. Smangin claimed that defendants worked under Yegiazaryan's instructions to thwart Smagin's collection efforts on the California judgment. To do so, defendants embarked on a pattern of wire fraud and other RICO offences, including witness tampering and obstruction of justice. Smagin sought actual damages, treble damages and attorneys' fees, as RICO allows him to do.

The District Court dismissed the complaint finding that Smagin failed to allege a domestic injury as required by RJR Nabisco. The District Court emphasised that Smagin is a citizen and resident of Russia, and therefore he sustained the injury derived from his inability to collect the award in Russia, where he resides.

The Ninth Circuit reversed. Instead of following the Seventh Circuit residency-based test for domestic injuries involving intangible property (such as the collection of a judgment), the Ninth Circuit adopted a context-specific approach. Under the residency-based test, Smagin could not show domestic injury because he resides in Russia. However, under the approach adopted by the Ninth Circuit, Smagin had pleaded a domestic injury because the concerted

efforts to prevent Smagin from collecting on the California judgment originated in California and largely took place in California.

The Supreme Court's decision

The Supreme Court affirmed the Ninth Circuit decision and held that Smagin had sustained a domestic injury within the meaning of RICO, despite him being a Russia resident. It also held that the test to determine whether there is domestic injury involving intangible property under ***RJR Nabisco*** is a context-specific inquiry.

Specifically, courts should look to the circumstances surrounding the alleged injury to assess whether it arose in the United States. In this suit, that means looking to the nature of the alleged injury, the racketeering activity that directly caused it and the injurious aims and effects of that activity.

If the circumstances surrounding the injury, that is, the inability to collect a US judgment, 'sufficiently ground the injury' in the United States, then the plaintiff has pleaded a domestic injury under ***RJR Nabisco***, making the private right of action under RICO available to that plaintiff.

In particular, the Court emphasised that most of the racketeering activity that prevented Smagin from collecting the judgment, as well as other facts, made it clear that the injury arose in the United States, inter alia:

- the judgment Smagin was trying to collect was a US judgment (because Smagin had the London Award confirmed in the United States and converted into a US judgment);
- Yegiazaryan created a net of US shell companies to hide his US assets and avoid complying with the asset freeze ordered by a California District Court;
- Yegiazaryan submitted forged evidence to a US district court (the doctor's note); and
- threatened a US-based witness when he received a subpoena to be deposed in connection with the forged evidence.

Even the facts and conduct that occurred abroad were initiated from California, where Yegiazaryan resides and from where he provided instructions to other defendants and co-conspirators. Notably, the effects of the RICO violations were felt in California, the Court found, because the rights provided by the US judgment from which collection was sought and thwarted only exist in California.

In conclusion, the circumstances surrounding the injury were enough for the Supreme Court to conclude that, in this case, the injury arose from the United States and Smagin had met the domestic injury requirement under the statute to bring a civil RICO claim against Yegiazaryan.

Footnotes

[1] ***Corporación AIC, SA v. Hidroeléctrica Santa Rita S.A.***, 66 F.4th 876 (2023).

[2] 9 U.S.C. § 1 et seq.

[3] See 9 U.S.C. §§ 9 (addressing confirmation) and 10 (setting forth grounds for vacatur).

[4] 9 U.S.C. § 201 et seq.

[5] 9 U.S.C. § 208.

[6] See ***Industrial Risk Insurers v. M.A.N. Gutehoffnungshutte GmbH***, 141 F.3d 1434, 1445-46 (11th Cir. 1998); ***Inversiones y Procesadora Tropical INPROTSA, S.A. v. Del Monte International GmbH***, 921 F.3d 1291, 1301-02 (11th Cir. 2019).

[7] Specifically, the Second, Third, Fifth and Seventh Circuits have interpreted the interplay between the Convention and the FAA in this manner. See ***Ario v. Underwriting Members of Syndicate 53 at Lloyds for 1998 Year of Account***, 618 F.3d 277, 292 (3d Cir. 2010); ***Karaha Bodas Co. v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara***, 335 F.3d 357, 368 (5th Cir. 2003); ***Yusuf Ahmed Alghanim & Sons v. Toys "R" Us, Inc***., 126 F.3d 15, 22 (2d Cir. 1997); ***Lander Co. v. MMP Invs., Inc.***, 107 F.3d 476, 478 (7th Cir. 1997).

[8] ***Corporación AIC***, 66 F.4th at 880.

[9] Id. at 880-81.

[10] Id. at 881.

[11] Id.

[12] id.

[13] id.

[14] id.

[15] id.

[16] id.

[17] id.

[18] id. at 882.

[19] id. at 883.

[20] id.

[21] id. (citations omitted).

[22] id. at 883-84.

[23] id. at 884.

[24] id. at 885.

[25] id.

[26] id.

[27] id.

[28] id. at 886.

[29] id. (citing ***GE Energy Power Conversion France SAS, Corp. v. Outokumpu Stainless USA, LLC***, — U.S. —, 140 S. Ct. 1637, 1645 (2020).

[30] id. at 886.

[31] See 9 U.S.C.§ 10.

[32] ***Corporación AIC***, 66 F.4th at 886.

[33] id.

[34] id. at 888-89.

[35] ***Yegiazaryan v. Smagin***, No. 22-381, 2023 WL 4110234 (U.S. June 22, 2023); consolidated with ***CMB Monaco v Smagin***, 214 L. Ed. 2d 382, 143 S. Ct. 646 (2023).

[36] Obtained from the SCOTUS decision.

IN SUMMARY

The Supreme Court's 2022 decision in ***ZF Automotive*** limited the use of section 1782 for obtaining discovery in private international commercial arbitration. ***Alpene*** and ***WeBuild*** indicate challenges in using section 1782 for public international arbitrations. In 2023, the Second Circuit ruled in ***Smarter Tools*** that a district court can remand an unclear arbitration award to allow the arbitrator to clarify the reasoning. Further, the Eleventh Circuit has determined that grounds for vacating arbitration awards in Chapter 1 of the FAA can apply to international arbitration awards. In 2023, the Supreme Court decided that civil liability under RICO may be available against fraudulent domestic efforts to avoid the enforcement of an international arbitration award.

DISCUSSION POINTS

- Section 1782 discovery in international arbitration
- Second Circuit carves out an exception to the ***functus officio*** doctrine
- Eleventh Circuit decides on grounds for vacatur of international arbitration awards
- RICO may be available to a foreign plaintiff to sue a domestic US award-debtor

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REFERENCED IN THIS ARTICLE

- *In Re Alpene, Ltd*
- *ZF Automotive*
- *In Re WeBuild*
- *Smarter Tools Inc v Chongqing Senci Import & Export Trade Co, Ltd*
- Corporación AIC, SA v Hidroeléctrica Santa Rita SA
- *Yegiazaryan v Smagin*, consolidated with *CMB Monaco v Smagin*

US FEDERAL COURTS CONTINUE TO GRAPPLE WITH SECTION 1782 DISCOVERY IN INTERNATIONAL ARBITRATION

Efforts to obtain discovery for use in international arbitration continue to present issues in US courts. These efforts concern the use of 28 USC section 1782(a) (section 1782), which empowers a US federal district court to order a person within its district to give testimony

or provide evidence for use in foreign dispute resolution proceedings. The relevant part of section 1782 provides as follows.

> The district court of the district in which a person resides or is found may order him to give his testimony or statement or to produce a document or other thing for use in a proceeding in a foreign or international tribunal, including criminal investigations conducted before formal accusation.

As discussed in our article in last year's edition, in June 2022 the US Supreme Court held that neither a private, international commercial arbitral tribunal nor an ad hoc United Nations Commission on International Trade Law (UNCITRAL) investor-state arbitral tribunal constitutes a 'proceeding in a foreign or international tribunal' under section 1782. According to the Supreme Court, a '"foreign tribunal" more naturally refers to a tribunal belonging to a foreign nation than to a tribunal that is simply located in a foreign nation. And for a tribunal to belong to a foreign nation, the tribunal must possess sovereign authority conferred by that nation.'

However, the Supreme Court reserved its position on certain ad hoc tribunals because 'sovereigns might imbue an ad hoc arbitration panel with official authority' as governmental and intergovernmental bodies 'may take many forms'. That carve out has allowed parties to continue efforts to use section 1782 in some investor-state arbitrations. Unfortunately for the parties seeking discovery, these efforts, to date, have been rebuffed, at least by the US federal courts for the Southern District and the Eastern District of New York.

In Re Alpene

In ***In Re Alpene, Ltd***, a magistrate judge for the US Federal District Court for the Eastern District of New York held that an International Centre for Settlement of Investment Disputes (ICSID) tribunal convened pursuant to a China–Malta bilateral investment treaty (BIT) was not a 'foreign or international tribunal' under section 1782. Alpene is a Hong Kong corporation and a claimant in an investor-state treaty arbitration against Malta before the World Bank's ICSID. Alpene sought section 1782 discovery (documents and a deposition) from a New York resident for use in the ICSID arbitration.

The ***Alpene*** court looked to the Supreme Court's decision in ***ZF Automotive*** in considering whether the ICSID tribunal qualified as a foreign or international tribunal, noting that '[t]he relevant question is whether the nations intended that the [arbitral] panel exercise governmental authority', and in ***ZF Automotive***, 'all indications [we]re that they did not.' In examining this question, the ***Alpene*** court noted that the BIT between Malta and China provides that a dispute between an investor and one of the contracting parties that is not resolved through negotiations can be submitted at the investor's choice to: (1) a court of appropriate jurisdiction in the country that is a party to the dispute (here, Malta); (2) arbitration under the auspices of the ICSID; or (3) ad hoc arbitration under the Arbitration Rules of the UNCITRAL (like the arbitration panel in ***ZF Automotive***). Inclusion of domestic courts as an option for dispute resolution, the court found, 'undercut[s] the contention that the arbitration panel had governmental authority'. But Alpene noted that the Supreme Court had left open the possibility that sovereigns 'might imbue such an arbitration tribunal with official authority'.

Alpene chose to initiate arbitration under the ICSID, which the court noted is an independent, self-contained system:

> The ICSID operates under the authority of the World Bank, an intergovernmental organization, and is an international arbitration institution established in 1966 for legal dispute resolution and conciliation between states and investors who are nationals of other states. (See About ICSID, ICSID), https://icsid.worldbank.org/About/ICSID (last visited Oct. 6, 2022) . . . [T]he applicable treaty [China–Malta BIT] did not itself create the ICSID panel, which "consists of individuals chosen by the parties and lacking any official affiliation with [the treaty nations.]" [citations omitted]

The Court also noted that the China–Malta BIT was silent as to whether it was the parties' intent 'to imbue [the ICSID] with governmental authority'.

In finding that there was insufficient support for the argument that Malta and China 'intended to imbue the ICSID arbitration panel with governmental authority', the ***Alpene*** court considered the similarities between the ad hoc UNCITRAL panel in ***ZF Automotive*** and the ICSID panel, as well as some significant differences; it also discussed issues of comity and the need to interpret section 1782 in accord with the US Federal Arbitration Act (FAA), which limits discovery. Interestingly, the magistrate in ***Alpene*** made the observation that '[w]hile the Supreme Court did not address ICSID investor-state arbitrations specifically, by reaching out to decide this issue absent a circuit split, it did signal a desire to limit the availability of discovery in U.S. courts for international commercial arbitrations'.

In Re WeBuild

In ***In Re WeBuild***, the US Federal District Court for the Southern District of New York similarly held that an ad hoc ICSID tribunal convened pursuant to a Panama–Italy BIT was not a 'foreign or international tribunal' under section 1782. After discussing the Supreme Court's analysis in ***ZF Automotive***, the federal court noted that its 'central inquiry was whether the treaty parties . . . had indicated an intent "to imbue the body in question with governmental authority"'. In concluding that the ICSID tribunal was not a foreign or international tribunal for section 1782 purposes, the ***WeBuild*** court considered a number of factors.

First, as in ***ZF Automotive***, the ICSID tribunal at issue was not a pre-existing body but one formed for the purpose of adjudicating investor-state disputes; 'ICSID does not have pre-existing panels', but rather panels that are formed following a request for arbitration. Second, the investor treaty at issue did not create the ICSID tribunal; rather, it is the ICSID rules that govern the formation of a tribunal if ICSID is chosen as the forum for dispute resolution. Third, in ***WeBuild***, the ICSID tribunal was independent of and not affiliated with either of the investor states. Fourth, the tribunal did not receive any government funding, but rather the parties to the dispute funded the tribunal. Fifth, the confidentiality of the ***WeBuild*** ICSID arbitration proceedings, according to the federal court, was 'more akin to private commercial arbitration than adjudication by a governmental body'. Last, the fact that the parties to the Panama–Italy BIT had a choice to resolve disputes in a court of competent jurisdiction or via an ad hoc arbitration proceeding militated against a finding that the tribunal was a foreign or international tribunal. The Court stated that the authority of the ICSID tribunal existed because the parties agreed to arbitration, 'not because [Italy] and [Panama] clothed the panel with governmental authority'. These factors may be considered by other courts when determining the applicability of section 1782 in other public international dispute resolution proceedings. Notably, the federal district court's opinion in ***WeBuild*** is currently the subject of an appeal to the US Court of Appeals for the Second Circuit, and further clarification as to

the applicability of section 1782 in public international arbitration, such as ICSID arbitration, may be forthcoming.

Conclusion

With the Supreme Court's decision in 2022 in ***ZF Automotive***, the use of section 1782 to obtain discovery for use in private international commercial arbitration was severely curtailed. And while the Supreme Court did leave open the possibility that some investor-state arbitrations might constitute proceedings in a foreign or international tribunal, that carve-out appears – to date at least – to be given a constricted interpretation as well. The reasonings of the US federal district courts in ***Alpene*** and ***WeBuild***, and the factors cited in support of denying the requested discovery, point to continued challenges in using section 1782 to obtain discovery for use in public international arbitrations, and in particular ICSID arbitrations.

US COURT OF APPEALS FOR THE SECOND CIRCUIT CARVES OUT EXCEPTION TO FUNCTUS OFFICIO DOCTRINE PERMITTING REMAND TO OBTAIN A 'REASONED AWARD'

Is a court required to vacate an arbitration award, under the ***functus officio*** doctrine, where the award is deemed not to satisfy the parties' request for a reasoned award or, alternatively, may a court remand the award to the arbitrator to clarify the award?

On 17 January 2023, in ***Smarter Tools Inc v Chongqing Senci Import & Export Trade Co, Ltd***, the Second Circuit held that a district court may properly remand, rather than vacate, an unclear arbitration award to provide the arbitrator with an opportunity to clarify the reasoning supporting the award. The issues presented to the Second Circuit were:

- whether the district court violated the ***functus officio*** doctrine by remanding, instead of vacating, an arbitration award that was deemed not to be a reasoned award; and
- whether the arbitrator's subsequent final amended award, issued after remand, complied with the parties' request for a reasoned award.

Background Of The Arbitration And Award

The underlying arbitration arose out of purchase orders between Smarter Tools Inc (STI) and Chongqing SENCI Import & Export Trade Co Ltd (SENCI) for the supply of gas-powered generators. SENCI commenced the arbitration after STI failed to pay the purchase price for a number of generators. STI counterclaimed contending, inter alia, that SENCI delivered non-conforming generators that did not comply with certain standards promulgated by the California Air Resources Board (CARB). The purchase orders included an arbitration clause providing for disputes to be resolved under the International Commercial Dispute Resolution Procedure of the American Arbitration Association in the City of New York. During the arbitration proceedings, the parties jointly agreed to the request for a reasoned award.

After the merits hearing, the arbitrator issued a six-page award granting SENCI's claim for payment and denying STI's counterclaims for lost profits and other damages. The award included a brief description of the claims and procedural matters together with a section setting forth the factual background and findings, as well as a final section itemising the relief awarded. As support for the dismissal of STI's counterclaims, the arbitrator provided the following statement in the award:

> [h]aving heard all of the testimony, reviewed all of the documentary proofs and exhibits, I do not find support for STI's claims, nor do I find the testimony of

> Expert Witness . . . to be credible. Therefore, I find that . . . testimony . . . is not credible, does not constitute proper rebuttal evidence testimony and must be excluded.

STI filed a petition to vacate and SENCI filed a cross-petition to confirm the final award. The New York District Court concluded that the arbitrator failed to issue a reasoned award because the final award did not contain any rationale for rejecting STI's counterclaims. The District Court acknowledged the arbitrator's finding that STI's damages expert was not credible. The District Court considered this credibility finding to be a sufficient rationale for rejecting STI's damage calculation. But the District Court concluded that the credibility of STI's damages expert had no bearing on STI's allegation that SENCI breached the supply agreement, which presented a question of liability – not damage. In assessing whether the award constituted a 'reasoned award', the District Court noted that an arbitrator is not obliged to discuss each piece of evidence presented but must at least provide some rationale for rejecting a parties' claim. In particular, the District Court found that the final award did not include any factual findings as to whether SENCI supplied defective or non-compliant generators.

Thus, the District Court remanded the case to the arbitrator who then issued a nine-page final amended award (the Amended Award) that included a new section with additional findings relating to STI's counterclaims. SENCI moved to confirm this Amended Award, and STI again petitioned to vacate the Amended Award. The District Court confirmed the Amended Award, and STI appealed.

Second Circuit Analysis

In the United States, arbitration awards are generally confirmed consistent with the strong public policy to encourage the use of arbitration. Consistent with this principle, the Second Circuit affirmed the District Court's confirmation of the Amended Award.

First, the Second Circuit found that the District Court correctly remanded the final award to obtain a reasoned award. Generally, under the ***functus officio*** doctrine, the Second Circuit observed that after the arbitrator renders a decision regarding the issues submitted in the form of an award, the arbitrator lacks any power to redetermine that decision. But, the Second Circuit explained that the rationale undergirding the ***functus officio*** doctrine is to prevent arbitrators from changing their ruling after issuance due to outside communication and unilateral influence. As an exception to the ***functus officio*** doctrine, the Second Circuit found that this rationale did not apply where an award is remanded to permit the arbitrator to clarify, not alter, the reasoning in the award. Ultimately, in ***Smarter Tools***, the arbitrator issued the Amended Award, which clarified the rationale for rejecting STI's counterclaims. The Second Circuit found that the District Court's remand for a clarification was consistent with the parties' joint request that the arbitrator issue a reasoned award.

Notably, in its decision remanding the final award to the arbitrator, the District Court stated that the arbitrator 'exceeded his authority' in issuing an award that does not meet the standard of reasoned opinion. The Second Circuit, however, did not directly address this issue because it concluded that the District Court's remand was proper.

The Second Circuit rejected STI's argument that ***vacatur*** was the only option available under the FAA section 10 (***vacatur***) and found that the failure to provide a reasoned award best fits under FAA section 11 (modification). The Second Circuit stated that FAA section 10(a)(4)

provides for a strong presumption in favour of enforcing an arbitration award, and focuses on whether an arbitrator had the power to reach a certain issue, not whether the arbitrator correctly decided that issue. Because the parties jointly agreed that the arbitrator was to produce a reasoned award, the failure to provide a reasoned award was a formal error not affecting the merits of the case. Under these circumstances, remanding the award to the arbitrator to produce a reasoned award avoided vacating the original award and forcing the parties to begin anew.

Second, the Second Circuit agreed with the District Court that the new Amended Award was a reasoned award. The Amended Award provided additional rationale for denying STI's claim; namely, that the evidence did not show that STI had ordered CARB-certified generators. In particular, in the Amended Award, the arbitrator explained that STI did not submit credible evidence to support its claim and that the evidence purporting to demonstrate that the parties orally agreed to additional terms that were not in the purchase orders was simply not credible.

As a result, the Second Circuit dismissed STI's petition to vacate the Amended Award holding that remand is a permissible choice where an arbitrator fails to produce an award in the form agreed by the parties. The Second Circuit relied on the parties' joint agreement for a reasoned award and that a clarification of the final award was required to provide an award in the form requested by the parties.

Takeaways For Arbitrators In Drafting Reasoned Awards

When the parties request a reasoned award, an arbitrator should take care to articulate at least some support for the conclusions set forth in the award. The Second Circuit reaffirmed that '[a] reasoned award sets forth the basic reasoning of the arbitral panel on the central issue or issues raised before it', but 'need not delve into every argument made by the parties'. But, the broad parameters that a reasoned award may include 'something short of findings and conclusions of law but more than a simple result' does not provide arbitrators with detailed guidance in drafting a reasoned award. The decision in ***Smarter Tools*** suggests that merely adjudicating all issues presented may not be sufficient for a reasoned award.

First, an arbitrator should include as part of a reasoned award some rationale for the adjudication of claims. The District Court remanded the final award in ***Smarter Tools*** even though the arbitrator expressly denied the counterclaim and provided reasoning for rejecting STI's calculation of damages. The District Court held that a reasoned award should have also explained the rationale for the conclusion that there was no oral agreement to modify the express terms of the purchase order. The ***Smarter Tools*** case is, therefore, distinguishable from an award that does not adjudicate an issue that has been submitted.

Second, an arbitrator does not need to include as part of a reasoned award findings of fact and conclusions of law absent an express agreement by the parties. In ***Smarter Tools***, the District Court cited case law for the proposition that a reasoned award is not required to be as fulsome or elucidated as one party would like. Rather, an award may be deemed to be reasoned where it contains 'the panel's rationale'. If an arbitrator sets forth the relevant facts and the key factual findings supporting its conclusions on the central issues, then the failure to provide a detailed rationale for every facet of the decision is not required for a reasoned award.

Third, an arbitrator's reasoned award may be brief and does not need to be lengthy so long as it 'charts the path to its result with clear and well-reasoned findings'.

Ultimately, ***Smarter Tools*** further confirms the strong presumption in favour of arbitration. An award that provides at least some rationale for its conclusions is more likely to survive a petition seeking to vacate the award on the grounds that it does not qualify as a reasoned award.

THE ELEVENTH CIRCUIT ALIGNS WITH SISTER CIRCUITS ON GROUNDS FOR VACATUR OF INTERNATIONAL ARBITRATION AWARDS

In Corporación AIC, SA v Hidroeléctrica Santa Rita SA[1] the United States Court of Appeals for the Eleventh Circuit aligned with its sister circuits and held that an international arbitration award subject to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the Convention) may be vacated on any of the grounds enumerated under Chapter 1 of the FAA.[2] In doing so, the Court overruled nearly 25 years of precedent within the circuit.

Implementation Of The Convention

In 1925, the United States enacted the FAA to provide for judicial enforcement of arbitration agreements and arbitration awards, except in certain types of contracts expressly excluded under the FAA. In addition to setting forth the grounds upon which arbitration awards should be confirmed, the FAA set forth the grounds upon which arbitration awards may be vacated.[3]

Following the United States' ratification of the Convention in 1970, the US Congress enacted Chapter 2 of the FAA[4] to implement the Convention. Like the Convention itself, Chapter 2 of the FAA is silent on ***vacatur***. Notwithstanding this, Chapter 2 of the FAA contains a residual clause providing that 'Chapter 1 applies to actions and proceeding brought under [Chapter 2] to the extent that [Chapter 1] is not in conflict with [Chapter 2] or the Convention.'[5]

Prior Precedent On Vacatur Of International Arbitration Awards

Prior to Corporación AIC, the Eleventh Circuit held that parties seeking ***vacatur*** of an international arbitration award under the Convention could only rely on the grounds for non-recognition set forth in article V of the Convention.[6] The Eleventh Circuit, however, was at odds with the other circuit courts that had addressed the issue, all of which have held that an international arbitration award arising under the Convention may be vacated on any of the grounds specified under Chapter 1 of the FAA.[7] This made the Eleventh Circuit an outlier.

Case Background And Procedural History

The case arose from a dispute between two Guatemalan companies, Corporación AIC, SA and Hidroeléctrica Santa Rita, SA, concerning an agreement to build a hydroelectric power plant in Guatemala.[8] After Hidroeléctrica issued a force majeure notice that forced Corporación AIC to stop work on the project, Hidroeléctrica initiated an arbitration proceeding to recover advance payments it had made.[9] Corporación AIC, in turn, counterclaimed for damages, costs and expenses.[10]

At the conclusion of the arbitration, a divided arbitral tribunal issued an award ordering Corporación AIC to return the advance payments made by Hidroeléctrica, but allowing Corporación AIC to retain the fees it had earned under the contract.[11] Corporación AIC then filed a suit in the United States District Court for the Southern District of Florida seeking ***vacatur*** of the award.[12] Specifically, Corporación AIC argued that the arbitral tribunal exceeded its powers, 'a ground set out in 9 U.S.C. § 10(a)(4), a provision of Chapter 1 of the FAA'.[13]

Because the arbitration was seated in Miami, Florida, and involved international parties, the parties agreed that the award was a non-domestic award governed by the Convention.[14] The District Court denied the petition to vacate under Eleventh Circuit precedent, namely, ***Industrial Risk*** and ***Inversiones***, because those cases held that the exclusive grounds for ***vacatur*** of an award governed under the Convention are those set forth in article V of the Convention.[15]

An Eleventh Circuit panel of three judges affirmed the District Court's ruling, but opined that ***Industrial Risk*** and ***Inversiones*** were wrongly decided and should be overruled by the full court.[16] Subsequently, the Eleventh Circuit vacated the panel opinion and ordered a rehearing ***en banc***.[17]

Eleventh Circuit Analysis

The Eleventh Circuit began its analysis by focusing on the language of the Convention and the FAA, respectively. It found that confirmation of an award under the FAA is 'essentially the same' as recognition and enforcement under the Convention, whereas, 'set aside', 'suspend' and 'annul' under the Convention are 'interchangeable' with ***vacatur*** under the FAA.[18] It further noted that the Convention 'allocates different responsibilities to different jurisdictions' with respect to judicial remedies.[19] Specifically, the country that serves as the seat of the arbitration (or whose law governs the conduct of the arbitration) serves as the 'primary jurisdiction' where procedural issues are decided.[20] And, '[a]ll other countries which are signatories to the Convention are considered secondary jurisdictions.'[21]

The Court further explained that 'only courts in the primary jurisdiction can vacate an arbitration award; where courts in secondary jurisdictions 'can only decide whether to recognize and enforce an arbitral award'.[22] And, article V of the Convention sets forth the only grounds upon which recognition and enforcement of an arbitral award may be refused.-[23]

Analysing the text of the Convention further, the Court noted that the Convention 'does not provide grounds for vacatur'.[24] The only reference to ***vacatur*** is found at article V(1)(e), which allows courts exercising secondary jurisdiction to refuse recognition or enforcement of an award if the award has been 'set aside or suspended' in the primary jurisdiction.[25] The Convention, however, 'does not purport to regulate the procedures or set out the grounds for vacatur in the primary jurisdiction'.[26]

Turning to the FAA, the Court explained that Chapter 2 of the FAA implements the Convention and, thus, 'the two texts should be read harmoniously'.[27] Like article V of the Convention, however, Chapter 2 of the FAA focuses only on recognition and enforcement and does not provide grounds for ***vacatur***.[28]

Notwithstanding, the US Supreme Court has previously explained that the Convention 'requires courts to rely on domestic law to fill gaps'.[29] Based on the Supreme Court's discussion in ***Outokumpu*** and the Convention's 'binary framework', the Court held that 'the primary jurisdiction's domestic law acts as a gap filler and provides the vacatur grounds for an arbitral award.'[30]

In the United States, of course, the domestic law is the FAA, which provides the grounds for vacatur of arbitration awards at section 10 of Chapter 1.[31] And, Chapter 2's residual clause (Section 208) provides that Chapter 1 applies to actions and proceedings brought under Chapter 2 to the extent not inconsistent with Chapter 2 or the Convention.[32] Thus, the Court

held that because the Convention and Chapter 2 of the FAA are both silent on the grounds for ***vacatur***, section 10 of Chapter 1 of the FAA (which sets forth the grounds for ***vacatur*** of a domestic award) acts as the gap filler and applies to ***vacatur*** proceedings for awards under the Convention where the United States is the primary jurisdiction.[33]

In reaching this conclusion, the Court noted that it was now in alignment with the Second, Third, Fifth and Seventh Circuits, which have interpreted the interplay between the Convention and the FAA in the same manner. As a result, the Eleventh Circuit overruled ***Industrial Risk*** and ***Inversiones***, which it held were 'outliers' that were 'plainly and palpably wrong'. [34] Additionally, the Court remanded the case for the District Court to consider Corporación AIC's request for ***vacatur*** under section 10(a)(4) of Chapter 1 of the FAA.

Conclusion

The Eleventh Circuit has joined its sister circuits, and all of which have addressed the issue have held that, where the United States serves as the primary jurisdiction, the grounds for ***vacatur*** of arbitration awards set forth in Chapter 1 of the FAA apply to international arbitration awards under the Convention.

THE SUPREME COURT MAKES CIVIL RICO AVAILABLE AGAINST FRAUDULENT DOMESTIC EFFORTS TO AVOID THE ENFORCEMENT OF AN INTERNATIONAL ARBITRATION AWARD

On 22 June 2023, the Supreme Court, in a 6-3 opinion in ***Yegiazaryan v Smagin***,[35] held that a foreign plaintiff can sue a domestic US award-debtor under the Racketeer Influenced and Corrupt Organizations Act (RICO) for the debtor's fraudulent efforts to avoid collection on the US judgment confirming the foreign arbitral award, when the circumstances indicate the injury sustained by the creditor arose in the United States.

RICO

RICO is a US federal law that provides a private right of action to '[a]ny person injured in his business or property by reason of a violation of' RICO's substantive provisions (18 USC §1964(c)). 'Racketeering activity' is defined broadly under the statute, and includes a wide range of offences involving fraud, such as mail and wire fraud (18 USC § 1961(1)). A plaintiff that has sustained injuries as a result of a RICO violation may obtain treble damages, costs and attorney's fees (18 USC §1964(c)).

A common question is what being 'injured' means (18 USC §1964(c)). Under ***RJR Nabisco, Inc v European Community***, 579 U.S. 325, 346 (2016), the Supreme Court held that the statute 'requires a civil RICO plaintiff to allege and prove a domestic injury to business or property and does not allow recovery for foreign injuries'.

The issue in ***Yegiazaryan v Smagin*** was whether a foreign plaintiff with no alleged connection to the United States may nevertheless allege a 'domestic' injury under ***RJR Nabisco*** sufficient to maintain a RICO action.

Takeaways For The Collection Of International Arbitration Awards In The United States

With this decision, the Supreme Court opened a significant new avenue for creditors of international arbitration awards to enforce their awards in the United States, when the creditor's inability to collect on the award is the result of the debtor's racketeering activity within the meaning of RICO and the injury is sufficiently grounded in the United States.

The analysis will be case specific and will depend on the circumstances of each case. However, award creditors must bear in mind the following:

- Any international arbitration award will need to be confirmed in the United States and converted into a US judgment before this avenue becomes available.
- For the avenue to be available, the debtor must have violated the RICO statute (eg, in avoiding collection on the award), committing racketeering activity within the meaning of RICO.
- The injury the creditor sustained must be domestic under ***Yegiazaryan***. Although it is unclear how the lower courts will interpret the ***Yegiazaryan*** test to determine whether there is domestic injury, US courts have been instructed to look to the 'circumstances surrounding the alleged injury', in particular, to the nature of the alleged injury, the racketeering activity that directly caused it, and the injurious aims and effects of that activity'.
- The threat of treble damages under RICO may be a powerful negotiation tool.
- Third parties, including law firms and banks, must be warned of the consequences that may arise from assisting award debtors from meeting their payment obligations resulting from enforcement proceedings in the United States.

Factual Background[36]

In 2014, Vitaly Smagin (Smagin) (a resident in Russia) prevailed in an arbitration seated in London and obtained an award against Ashot Yegiazaryan (Yegiazaryan) (a Russian citizen residing in California) for US$84 million (London Award). Smagin sought the recognition and enforcement of the London Award in California under the New York Convention for the Recognition and Enforcement of Foreign Arbitral Awards. After issuing a temporary protective order, followed by a preliminary injunction freezing Yegiazaryan's assets in California, the District Court for the Central District of California (the District Court) issued judgment against Yegiazaryan for US$92 million, including interest.

Some time after the District Court froze Yegiazaryan's assets, Yegiazaryan was granted an arbitration award issued against Suleymon Kerimov in an unrelated matter (Kerimov Award). Yegiazaryan obtained a US$198 million settlement in satisfaction of the Kerimov Award.

To avoid the District Court's asset freeze, Yegiazaryan accepted the settlement funds for the Kerimov Award through the London office of a US law firm headquartered in Los Angeles, and created a sophisticated net of offshore entities to hide the funds. He deposited the funds in CMB Monaco, and instructed friends and acquaintances to file claims against him around the world to obtain sham judgments that would be paid using the settlement funds, thus preventing Smagin from accessing them.

Yegiazaryan also hid his assets in the United S by transferring them to shell companies owned by members of his family. He disobeyed the District Court's orders instructing him to refrain from continuing to prevent Smagin from collecting on the judgment, and was held liable for contempt of court. To avoid complying with the District Court's orders, Yegiazaryan claimed to be ill, forged a doctor's note (a doctor who is a resident in California) and submitted it to the District Court. Yegiazaryan also threatened the doctor when he received a subpoena to be deposed in connection with the note.

Smagin's RICO Claim

Smangin brought a civil claim under RICO against Yegiazaryan, CMB Monaco and 10 other defendants. Smangin claimed that defendants worked under Yegiazaryan's instructions to thwart Smagin's collection efforts on the California judgment. To do so, defendants embarked on a pattern of wire fraud and other RICO offences, including witness tampering and obstruction of justice. Smagin sought actual damages, treble damages and attorneys' fees, as RICO allows him to do.

The District Court dismissed the complaint finding that Smagin failed to allege a domestic injury as required by RJR Nabisco. The District Court emphasised that Smagin is a citizen and resident of Russia, and therefore he sustained the injury derived from his inability to collect the award in Russia, where he resides.

The Ninth Circuit reversed. Instead of following the Seventh Circuit residency-based test for domestic injuries involving intangible property (such as the collection of a judgment), the Ninth Circuit adopted a context-specific approach. Under the residency-based test, Smagin could not show domestic injury because he resides in Russia. However, under the approach adopted by the Ninth Circuit, Smagin had pleaded a domestic injury because the concerted efforts to prevent Smagin from collecting on the California judgment originated in California and largely took place in California.

The Supreme Court's Decision

The Supreme Court affirmed the Ninth Circuit decision and held that Smagin had sustained a domestic injury within the meaning of RICO, despite him being a Russia resident. It also held that the test to determine whether there is domestic injury involving intangible property under ***RJR Nabisco*** is a context-specific inquiry.

Specifically, courts should look to the circumstances surrounding the alleged injury to assess whether it arose in the United States. In this suit, that means looking to the nature of the alleged injury, the racketeering activity that directly caused it and the injurious aims and effects of that activity.

If the circumstances surrounding the injury, that is, the inability to collect a US judgment, 'sufficiently ground the injury' in the United States, then the plaintiff has pleaded a domestic injury under ***RJR Nabisco***, making the private right of action under RICO available to that plaintiff.

In particular, the Court emphasised that most of the racketeering activity that prevented Smagin from collecting the judgment, as well as other facts, made it clear that the injury arose in the United States, inter alia:

- the judgment Smagin was trying to collect was a US judgment (because Smagin had the London Award confirmed in the United States and converted into a US judgment);
- Yegiazaryan created a net of US shell companies to hide his US assets and avoid complying with the asset freeze ordered by a California District Court;
- Yegiazaryan submitted forged evidence to a US district court (the doctor's note); and
- threatened a US-based witness when he received a subpoena to be deposed in connection with the forged evidence.

Even the facts and conduct that occurred abroad were initiated from California, where Yegiazaryan resides and from where he provided instructions to other defendants and

co-conspirators. Notably, the effects of the RICO violations were felt in California, the Court found, because the rights provided by the US judgment from which collection was sought and thwarted only exist in California.

In conclusion, the circumstances surrounding the injury were enough for the Supreme Court to conclude that, in this case, the injury arose from the United States and Smagin had met the domestic injury requirement under the statute to bring a civil RICO claim against Yegiazaryan.

Endnotes

1 *Corporación AIC, SA v. Hidroeléctrica Santa Rita S.A.*, 66 F.4th 876 (2023). ^ Back to section

2 9 U.S.C. § 1 et seq. ^ Back to section

3 See 9 U.S.C. §§ 9 (addressing confirmation) and 10 (setting forth grounds for vacatur).- ^ Back to section

4 9 U.S.C. § 201 et seq. ^ Back to section

5 9 U.S.C. § 208. ^ Back to section

6 See*Industrial Risk Insurers v. M.A.N. Gutehoffnungshutte GmbH*, 141 F.3d 1434, 1445-46 (11th Cir. 1998); ***Inversiones y Procesadora Tropical INPROTSA, S.A. v. Del Monte International GmbH***, 921 F.3d 1291, 1301-02 (11th Cir. 2019). ^ Back to section

7 Specifically, the Second, Third, Fifth and Seventh Circuits have interpreted the interplay between the Convention and the FAA in this manner. See***Ario v. Underwriting Members of Syndicate 53 at Lloyds for 1998 Year of Account***, 618 F.3d 277, 292 (3d Cir. 2010); ***Karaha Bodas Co. v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara***, 335 F.3d 357, 368 (5th Cir. 2003); ***Yusuf Ahmed Alghanim & Sons v. Toys "R" Us, Inc***., 126 F.3d 15, 22 (2d Cir. 1997); ***Lander Co. v. MMP Invs., Inc.***, 107 F.3d 476, 478 (7th Cir. 1997). ^ Back to section

8 *Corporación AIC*, 66 F.4th at 880. ^ Back to section

9 Id. at 880-81. ^ Back to section

10 Id. at 881. ^ Back to section

11 Id. ^ Back to section

12 id. ^ Back to section

13 id. ^ Back to section

14 id. ^ Back to section

15 id. Back to section

16 id. Back to section

17 id. Back to section

18 id. at 882. Back to section

19 id. at 883. Back to section

20 id. Back to section

21 id. (citations omitted). Back to section

22 id. at 883-84. Back to section

23 id. at 884. Back to section

24 id. at 885. Back to section

25 id. Back to section

26 id. Back to section

27 id. Back to section

28 id. at 886. Back to section

29 id. (citing*GE Energy Power Conversion France SAS, Corp. v. Outokumpu Stainless USA, LLC*, — U.S. —, 140 S. Ct. 1637, 1645 (2020). Back to section

30 id. at 886. Back to section

31 See 9 U.S.C.§ 10. Back to section

32 *Corporación AIC*, 66 F.4th at 886. Back to section

33 id. Back to section

34 id. at 888-89. Back to section

35 *Yegiazaryan v. Smagin*, No. 22-381, 2023 WL 4110234 (U.S. June 22, 2023); consolidated with *CMB Monaco v Smagin*, 214 L. Ed. 2d 382, 143 S. Ct. 646 (2023). Back to section

36 Obtained from the SCOTUS decision. Back to section

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