COURT OF APPEAL ADDRESSES PRECLUSIVE EFFECT OF COLLUSIVE FOREIGN COURT JUDGMENT AND PROCESS FOR DETERMINING ARBITRABILITY OF DISPUTE

By: Roland C. Goss

It is not unusual for there to be parallel or serial disputes regarding a reinsurance contract or program. In *Telenor Mobile Communications AS v. Altimo Holdings & Investments Limited*, - F.3d -, 2009 WL 3200685 (2d Cir. Oct. 8, 2009), a non-insurance case, the Court addressed two significant issues relating to arbitration procedures:

1. Whether a district court acted in manifest disregard of law by confirming an arbitration award that failed to give preclusive effect to a judgment of a foreign court relating to an issue before the arbitration panel; and

2. Whether the district court erred in not holding a trial to determine whether a dispute before it was arbitrable.

FACTS

The facts here demonstrate a particularly complicated and intertwined procedural history. Kyivstar G.S.M. ("Kyivstar"), a Ukrainian mobile telecommunications company, had five owners, including Telenor Mobile Communications AS ("Telenor"), a Norwegian company, and Storm LLC ("Storm"), a Ukrainian company. Telenor and Storm bought out the other shareholders, and signed a Shareholder Agreement providing for the ownership and governance of Kyivstar. The Shareholder Agreement contains an arbitration provision. As a result of Storm's alleged breach of the Shareholder Agreement, Telenor initiated arbitration against Storm in the United States.

A. Ukrainian Litigation - Phase 1

On April 14, 2006, the day of the first conference of the arbitration panel, Storm's two owners, Altimo Holdings & Investment Limited ("Altimo") and Alpren Limited ("Alpren"), sued Storm in a Ukrainian court, seeking a declaration that the Shareholder Agreement was invalid because the person who signed it on behalf of Storm, Mr. Nilov, lacked the authority to sign the agreement. The purpose of this action was to void the contract and the accompanying arbitration agreement to subvert the arbitration. Telenor was not named as a party, nor was it or the arbitration panel notified of the filing of the lawsuit.

Storm retained no counsel for the Ukrainian lawsuit, and did not submit a written defense. Instead, in a remarkable conflict of interest, an officer of Altimo (one of Storm's owners and an opposing party in the lawsuit), who is not an attorney, appeared at a hearing purportedly on behalf of Storm and registered an "oral opposition" to the lawsuit on the ground that the arbitration panel had jurisdiction over his own company's claim against Storm. This proceeding lasted 20 minutes. On April 25, 2006, eleven days after the lawsuit was filed, the Ukrainian court rendered a decision adjudicating the merits of the suit, holding that Nilov lacked the authority to sign the Shareholder Agreement on behalf of Storm, declaring the agreement to be "null and void in full, including the arbitration clause, from the time of execution." 2009 WL 3200685 at *3. Storm "appealed," and the Ukrainian appeals court affirmed one month later, on May 25, 2006. The Ukrainian lawsuit therefore went from initial filing to final judgment and the disposition of an appeal in a mere 41 days.

B. The Arbitrators Don't Buy It

Predictably, Storm then filed a defense in the arbitration, moving to dismiss the arbitration on the basis that the claims were not arbitrable in light of the final judgment of the Ukrainian court. The arbitration panel denied the motion to dismiss and on October 22, 2006 entered a partial final award. The panel found that: (1) it had jurisdiction to determine the arbitrability of the claims before it; (2) Storm and Telenor "had a clear intent to have their disputes resolved through arbitration;" and (3) the arbitration provision was severable and hence not subject to the Ukrainian judgment. *Id.*

C. Ukrainian Litigation - Continuation

With the arbitrators prepared to ignore the Ukrainian judgment and proceed to the merits of the arbitration claim, Storm returned to the Ukrainian court of appeals, which quickly concluded that the arbitration proceeding was invalid and that any arbitration pursuant to that agreement was in violation of its prior order.

D. U.S. Litigation - Phase 1

The saga then moved to Untied States courts, with Storm filing an action in New York state court seeking an injunction terminating the arbitration and vacating the partial arbitral award in light of the decisions of the Ukrainian courts. Telenor removed the case to the U.S. District Court for the Southern District of New York ("the U.S. action"). A request by Storm for a preliminary injunction was denied on two independent bases: (1) that the panel's partial award was interlocutory, and therefore not subject to appeal; and (2) that Storm was unlikely to prevail on the merits.

E. Ukrainian Litigation - Phase 2

Alpren, one of Storm's owners and a plaintiff in the original Ukrainian lawsuit, then filed another lawsuit in the Ukraine, and quickly obtained an injunction, which purported to enjoin Telenor and Storm from participating in the arbitration. Telenor was not named as a party to this

new lawsuit, nor was it even advised of its filing. The arbitration panel denied two requests from Storm to stop the arbitration pursuant to the Ukrainian court's injunction.

F. U.S. Litigation - Continuation

Telenor then sought, and was granted, an anti-suit injunction in the U.S. action against Storm and its related entities which enjoined their proceeding with the Ukrainian litigation. The U.S. District Court found that "there is no doubt that [the Ukrainian] litigation has been designed to, and has had the effect of, interfering in the arbitration process" and that it had been "conducted in the most vexatious way possible." *Id.* at *4. The district court also expressed its opinion that Nilov had at least apparent authority to sign the Shareholder Agreement on behalf of Storm under either New York or federal law. *Id.*

The arbitration continued, and Storm refused to participate. The arbitration panel issued a final award, which in part affirmed the earlier partial award. The panel held that Nilov had both actual and apparent authority under New York law to sign the Shareholder Agreement on behalf of Storm and that Storm had breached the Shareholder Agreement. Telenor was granted an injunction but no damages. *Id.*

The district court granted Telenor's request to confirm the final arbitral award and denied Storm's motion to vacate the award. The court held that the panel had not manifestly disregarded the law by failing to give preclusive effect to the Ukrainian judgments as to the validity of the Shareholder Agreement, and hence the arbitrability of the claims. The Ukrainian judgments and orders were disregarded because they were the product of a collusive lawsuit. With respect to the arbitrability issue, the district court held that Storm had proffered insufficient evidence to warrant a trial, and that, to the contrary,

> Storm provided every conceivable assurance to Telenor that its signatory officers were empowered to bind it to [the Shareholder Agreement]. When Storm breached the agreement, it was provided with precisely the fair and impartial hearing it had bargained for … despite making repeated efforts to renege on its agreement and to torpedo the proceeding by collusive and vexatious litigation.

Id. at *5.

Predictably, Storm appealed.

ANALYSIS

The Court of Appeals ("the Court") affirmed the district court's decision. The Court began its analysis with the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("the New York Convention"), which applied to this award, noting the very limited judicial review of arbitral awards and the rule that awards must be confirmed unless the party opposing confirmation proves that one of the "defenses" to confirmation specified in the New York Convention are found to be present. The Court then noted "two important

presumptions" in analyzing arbitrability issues: (1) that doubts concerning the scope of arbitral issues be resolved in favor of arbitrability due to the strong public policy in favor of arbitration; and (2) that arbitrability questions are to be decided by the courts rather than by the arbitrators. *Id.* at *6. Finally, the Court laid the groundwork for its manifest disregard of law analysis in three respects: (1) describing the very limited scope of the doctrine; (2) stating that the award must be enforced "if there is a *barely colorable justification* for the outcome reached" *Id.* at *7, *quoting Wallace v. Buttar*, 378 F.3d 182, 190 (2d Cir. 2004) (emphasis in original); and (3) noting that there is a "strong presumption that an arbitration tribunal has not manifest[ly] disregarded the law …." *Id.* at *9, *quoting Westerbeke Corp. v. Daihatsu Motor Co.*, 304 F.3d 200, 212 n. 8 (2d Cir. 2002).

A. The Preclusive Effect of Prior Determinations

Finding that the failure to give the Ukrainian decisions effect in the arbitration was not a manifest disregard of law, the Court stated that the general analysis for determining the impact of the Ukrainian decisions on the arbitration was governed by the principles set forth in *Ackermann v. Levine*, 788 F.2d 830 (2d Cir. 1986).

> [A] final judgment obtained through sound procedures in a foreign country is generally conclusive as to its merits unless (1) the foreign court lacked jurisdiction …; (2) the judgment was fraudulently obtained; or (3) enforcement of the judgment would offend the public policy of the state in which enforcement is sought.

2009 WL 3200685 at *8, q*uoting* 788 F.2d at 837 (2d Cir. 1986) (emphasis in original).

The Court essentially found that lawsuits which are collusive, or which violate "the rule against 'friendly litigation'" (*Lord v. Veazie*, 49 U.S. (8 How.) 251, 256 (1850)), have "unsound procedures" within the meaning of *Ackerman*. 2009 WL 3200685 at *8. There did not seem to be serious contest in the record for the conclusion that the Ukrainian procedures were collusive. The result was that the Ukrainian lawsuits were "not binding on the arbitration panel."

The Court of Appeals stated that Storm "does not seriously dispute that the Alpren litigation was a cooperative venture among allied interests … [and] offers no good reason why we should not affirm on the district court's finding of collusion." 2009 WL 3200685 at *9 n. 9. Noting that Telenor was never made a party to or even provided notice of the existence of any of the Ukrainian litigation, the Court stated that the failure of the Ukrainian court "to afford Telenor what we would regard as rudimentary due process [citation omitted], provides an independent colorable justification for the panel's conclusion that the Ukrainian proceedings were unsound for *Ackerman* preclusion purposes." *Id.* at *9.

Finally, the Court rejected Storm's contention that the arbitral award should be vacated pursuant to Article V(2)(b) of the New York Convention because it would be contrary to New York public policy to force a party (Storm) to comply with an arbitral award that will cause it to violate a foreign judgment. The Court stated that "it is Storm's improper collateral litigation, not

the arbitral award, that is contrary to public policy," and that Storm's situation "is entirely of its own making." *Id.* at *10.

B. The Procedure for Determining Arbitrability

After affirming that Storm did not have a short-cut way to avoid the consideration of the merits of the arbitrability decision through the Ukrainian court decisions, the Court proceeded to review the district court's *de novo* consideration of whether Nilov had authority to sign the Shareholder Agreement on behalf of Storm. The analysis centered upon *Sphere Drake Ins. Ltd. v. Clarendon Nat'l Ins. Co.*, 263 F.3d 26 (2d Cir. 2001), in which the Court previously held that a district court must hold a trial to determine whether a claim is arbitrable.

The Court held that in order to be entitled to a trial on the issue of arbitrability, the party opposing arbitration must present "some evidence" of a dispute as to arbitrability. The issue was whether Nilov had apparent authority to sign the Shareholder Agreement on behalf of Storm. The Court noted that under New York law, whether a person has apparent authority to do an act is susceptible to judgment as a matter of law against the principal. "Here, there is no genuine issue of fact, let alone a material one, as to Nilov's apparent authority: There is substantial evidence that Telenor received multiple notices from Storm that Nilov had the authority to execute the [Shareholder] Agreement and there is no evidence, at least that has been brought to our attention, that Telenor should have thought otherwise." *Id.* at *10.

After discussing specific representations of Nilov's authority made by Storm to Telenor, the Court stated that "Storm does not challenge the validity of these representations to Telenor of Nilov's apparent authority to execute the agreement. … [T]he record evidence shows that everyone at the relevant time, including Storm, thought that Nilov had the authority to execute the agreement. That is sufficient ground on which to conclude that Storm has failed to proffer sufficient evidence from which a rational juror could conclude that Nilov lacked apparent authority to execute the [Shareholder] Agreement and that no trial was required to find out if the agreement was, or was not, arbitrable." *Id.* at *11.

In many cases, it may be difficult to sustain a finding that the party opposing arbitration did not proffer "some evidence" to support the proposition that the claims were not arbitrable. However, the arbitrability issue here was relatively simple: whether Nilov had authority to sign the Shareholder Agreement on behalf of Storm. The issue was also one as to which controlling law held that summary adjudication, as a matter of law, was appropriate if supported by the factual record. While what constitutes "some evidence" was not delineated clearly by the Court, the opinions of both the district court and the Court of Appeals demonstrate that the factual record of this case was so overwhelming that "no rational juror" could have concluded that Nilov lacked apparent authority to execute the Shareholder Agreement on behalf of Storm. *Id.* This record would seem to fail Storm's burden under any conceptualization of the "some evidence" test.

CONCLUSION

This opinion is significant in that it articulates a "collusive litigation" exception to the *Ackerman* doctrine, and places a burden upon a party opposing arbitration to proffer "some evidence" to support its position in order to be entitled to a trial on the issue of arbitrability.

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Roland Goss is a partner with Jorden Burt, LLP, resident in the firm's Washington, D.C. office. He is the chair of the firm's reinsurance practice and blogmaster for its reinsurance and arbitration blog, www.ReinsuranceFocus.com. For further information please contact Roland Goss (rcg@jordenusa.com or (202) 965-8148).