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Can You Enforce an International Arbitration Award That's Been Set Aside?

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On July 8, the Second Circuit affirmed a refusal to enforce a $1.8 billion arbitration award (now worth approximately $2.7 billion with interest) annulled by a Nigerian court in *Esso v. Nigerian National Petroleum Company*. In its opinion, the appellate court confirmed that it will respect and uphold annulments of international arbitration awards by national courts in the interest of "comity" where the annulment and court decision otherwise comports with public policy. This unanimous decision further develops Second Circuit law regarding that part of the New York Convention that allows — but does not require — courts to decline to enforce an award set aside by a court in the jurisdiction in which the award was issued.

At bottom, the Second Circuit's decision in *Esso* maintains the (what some practitioners might call frustrating) status quo first introduced by *Hilton v. Guyot* some 140 years ago: Where public policy allows, U.S. courts will uphold foreign court rulings in the name of comity. In the case of arbitration, *Esso* confirms that U.S. courts will enforce these foreign court judgments even where national courts contradict one of the fundamental principles of international arbitration by allowing parties the much-protested second bite at the proverbial apple. Here, however (in perhaps an uplifting turn) the Second Circuit has provided a longer leash from which courts may occasionally reject this comity owed to international set-asides.

Relevant Background

In *Esso Expl. & Prod. Nigeria Ltd. v. Nigerian Nat'l Petro. Corp.*, the Second Circuit generally upheld a lower court's refusal to enforce part of a $1.8 billion arbitral award, plus interest, issued in favor of subsidiaries of ExxonMobil Corp. and Royal Dutch Shell PLC in Nigeria.

The underlying dispute arose between Esso Exploration (in conjunction with Production Nigeria Limited) and the Nigerian National Petroleum Corporation (NNPC), an organization wholly owned by the Nigerian government. In 1993, Esso and NNPC entered an agreement regarding oil production at the Nigerian-governed Erha oil field on the Gulf of Guinea. The agreement permitted Esso to develop Erha for profit with the understanding that NNPC was contractually entitled to "lift" stipulated amounts of extracted oil to satisfy taxes and royalties that Esso owed to the Nigerian government. The remaining oil would represent NNPC's own profit from the development. Esso began to successfully pull oil from Erha in 2007, and by 2009, NNPC began lifting more oil than Esso believed it was entitled to extract under their agreement. Esso then accused NNPC of breaching the parties' contract.

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The parties' contract provided for arbitration convened in Nigeria. In 2011, Esso arbitrated the dispute under the rules of the Nigerian Arbitration and Conciliation Act and won. The contractually created tribunal found that NNPC had lifted more oil than allowed under contract and entered an award of $1.8 billion award (plus interest) in Esso's favor.

NNPC then challenged the award in Nigerian courts. Ultimately, the Nigerian Court of Appeals found portions of the contract relating to tax payments were inarbitrable under the 1990 Nigerian Petroleum Profits Tax Act (PPT) and must be decided by a Nigerian tax tribunal. The Nigerian courts nullified the award a year later.

While various appeals remained pending in the Nigerian courts, Esso petitioned the U.S. District Court for the Southern District of New York to enforce its award under Article V(1)(e) of the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).[1] The New York Convention obligates signatory states to enforce an award made by an arbitral panel in another signatory state, referred to as the "primary jurisdiction." Article V of the convention (as codified by FAA Section 201) establishes an exception to the enforcement obligation, however, for awards that a court in the primary jurisdiction has set aside:

"1. Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that: … (e) The award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

2. Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that: … (b) The recognition or enforcement of the award would be contrary to the public policy of that country."

A court considering a petition for enforcement "may — but is not required to — enforce the award."[2] Furthermore, U.S. courts have recognized this public policy exception, set out in Article V, applies to only the most dire of circumstances:

"The public policy exception does not swallow the rule: "The standard is high, and infrequently met"; "a judgment that 'tends clearly' to undermine the public interest, the public confidence in the administration of the law, or security for individual rights of personal liberty or of private property is against public policy.""[3]

However, prior to *Pemex*, precedent for enforcing this public interest exception was sparse.[4]

The Pemex Legacy

In deciding whether to enforce the *Esso* award, the District Court looked to the Second Circuit's guidance in the *Pemex* opinion. The 2016 decision allowed district courts to exercise their discretion to enforce a previously annulled award where the primary jurisdiction's annulment decision was "repugnant to fundamental notions of what is decent and just."[5] This standard, the Second Circuit has cautioned, is "high, and infrequently met."[6]

Pemex involved a U.S. construction company that obtained an award in a Mexican arbitration, which a Mexican court later annulled. The construction company argued that the Mexican court's annulment stood in stark contrast

to U.S. public policy and rule of law, and the award should still be enforced. To the surprise of many, the District Court agreed. According to the Second Circuit, the Mexican court's retroactive application of a law, coupled with its refusal to recognize the tribunal's jurisdiction over an instrumentality of the sovereign or provide an alternative method of adjudication on the merits, rendered the national court's decision "offensive to the notions of justice." The court held the award should be enforced in the U.S., regardless of the Mexican court's annulment.

Working from the presumption that "a final judgement obtained through sound procedures in a foreign country is generally conclusive," the court balanced four main factors to determine whether the circumstances surrounding the award surmounted the "high hurdle of the public policy exception."[7] These factors included (1) the vindication of contractual undertakings and the waiver of sovereign immunity; (2) the repugnancy of retroactive legislation that disrupts contractual expectations; (3) the need to ensure legal claims find a forum; and (4) the prohibition against government expropriation without compensation.[8]

The Second Circuit first turned to the issue of contractual waiver of sovereignty. In reviewing the contract at issue, it found that the Mexican court's invocation of sovereign immunity, after the state had previously released this status in not one, but two contracts, shattered the petitioner's expectation in contracting, "thereby impairing one of the core aims of contract law."[9]

The court next weighed the effect of retroactive application of law. In the process of adjudicating the *Pemex* dispute, the Mexican court retroactively applied new laws to the parties' contract. The Second Circuit highlighted that this practice was also repugnant to U.S. law.[10]

The court then looked at the availability of alternative forums. It found that if SDNY would have accepted the Mexican court's nullification, petitioner could find no sure forum in which to bring its contract claims. Holding that "the imperative of having cases heard — somewhere — is firmly embedded in legal doctrine … ," the court also marked this factor against nullification.[11]

Finally, the court turned to the issue of government expropriation without compensation. Here, the government subsidiary rescinded petitioner's contracts and forcibly removed them from project sites before frustrating any possible relief with new legislation. The court ruled that this amounted to an unconstitutional taking, an inherent wrong they could not enforce.[12]

Weighing these factors, the SDNY found the annulment met the high standard required to activate the New York Convention's public policy exception. On appeal, the Second Circuit held that:

"… the Southern District exercised discretion, as allowed by treaty, to assess whether the nullification of the award offends basic standards of justice in the United States … the Southern District did not abuse its discretion by confirming the arbitral award at issue because to do otherwise would undermine public confidence in laws and diminish rights of personal liberty and property … . Taken together, these circumstances validate the exercise of discretion and justify affirmance."[13]

Courts in the Second Circuit and throughout the United States have applied these *Pemex* factors since.

The District Court's Application and Pemex

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In considering whether to enforce the nullified award in *Esso*, Judge William H. Pauley III of the Southern District of New York naturally looked to *Pemex*. The parties did not dispute that the award was previously set aside, so outside of procedural determinations, the remaining questions required analyzing the *Pemex* factors to determine whether to uphold the annulment.

In weighing the first factor, the District Court found that though the parties agreed to an arbitration contract, NNPC had continuously argued that the tax dispute itself was nonarbitrable under Nigerian tax law. The parties therefore did not clearly agree to arbitrate this dispute. This separated *Esso* from *Pemex* in which the parties did not object to arbitration from the outset.

The second factor considered whether retroactive legislation cancelled existing contract rights. In *Esso*, no such retroactive legislation existed. Although the Nigerian courts applied a new interpretation to the PPT, the New York District Court held that "new interpretations of constitutional provisions and amendments are commonplace in American jurisprudence."[14]

The third factor favored NNPC, as Esso already had multiple appeals pending in Nigeria and was immediately put on notice that NPCC objected to arbitration. The existence of these appeals in Nigerian courts, one of which resulted in the remand of the case to a lower court for resolution, pointed to the existence of a viable alternative forum in which Esso could bring their claims. Esso did not argue the fourth factor.

Ultimately, "although it was a 'close call' because the Nigerian court's rulings [on tax law and the contract] were 'seemingly anomalous,' the four *Pemex* considerations overall favored extending comity to the Nigerian judgments partially setting aside the Award."[15] The court then refused Esso's petition in full.

Pemex Revisited and the *Esso* Gloss

Though the Second Circuit generally agreed with the District Court's decision to uphold the annulment, it held that Judge Pauley "hewed more closely than [he] should have" in applying the *Pemex* factors. The Second Circuit held these factors are not rules — they are guidelines. *Pemex* did not reduce this analysis to a four-factor formula that courts "must — or necessarily even should — apply in every case involving set-aside arbitral awards."[16]

Instead, district courts "may, and should, consider other factors relevant to the circumstances of a particular case … ."[17] Put alternatively, the factors that led to *Pemex*, while sometimes helpful, are not necessarily relevant to other petitions seeking to enforce set-aside awards. There is room for the court's discretion.

The court also took time to admonish a *laissez-faire* approach to the New York Convention's "set-aside" exception:

[A]lthough important — [the exception] should not be understood as an invitation to a relaxed exercise of impressionistic discretion. Rather, the comity that U.S. courts owe to foreign judgments remains a vital prudential concern.[18]

This standard for denying comity, the court mused, should not be easily met.

The Second Circuit found that the lower court was overzealous in its application of the annulment as well. The Nigerian courts, after all, had reinstated portions of the award not related to tax law, whereas the District Court nullified the entire award. The court therefore remanded the case to the District Court, so it could delineate between these sections.[19]

Moving Forward

Perhaps the biggest takeaway for U.S. parties seeking to enforce set-aside international arbitration awards is to beware of the court's newly confirmed wide discretion. The *Pemex* factors were never meant to be exclusive, but rather serve as an example of what courts should consider. Though the Second Circuit upheld the lower court decision in *Esso*, this ruling may ultimately provide U.S. courts more agency in determining whether to uphold set-asides.

Following *Esso*, courts must still decide whether an award set-aside is "repugnant to fundamental notions of what is decent and just," but how they reach this conclusion is, for better or worse, entirely within their discretion, and the analysis may change based on the facts of each individual case. Though some practitioners may argue that the U.S. application of the New York Convention applies comity to the *wrong* international decision (perhaps emphasis should be placed on the arbitral award, and not the enforcement of an often self-interested seat), the Second Circuit has made it clear the status quo still remains:

"To carefully balance "the goals of comity and res judicata" with "fairness to litigants," courts being asked to enforce a set-aside arbitral award must evaluate whether the judgment that set aside the award "tends clearly to undermine the public interest, the public confidence in the administration of the law, or security for individual rights of personal liberty or of private property."[20] *In the absence of a clear adverse effect on these fundamental public policy concerns, comity stands firmly as our guiding value.*" (emphasis added).[21]

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[1] *See* 9 U.S.C. § 207.

[2] *Esso Expl. & Prod. Nigeria Ltd. v. Nigerian Nat'l Petro. Corp.*, No. 19-3159 (2d Cir. 2022), at *5.

[3] *Corporación Mexicana de Mantenimiento Integral, S. de R.L. de C.V. v. Pemex-Exploración y Producción*, 832 F.3d 92, 106 (2d Cir. 2016) (Pemex) (citing *Ackermann v. Levine*, 788 F.2d 830, 837 (2d Cir. 1986)).

[4] *Pemex*, 832 F.3d at 106.

[5] *Pemex* (internal quotation marks omitted). As the *Esso* court noted, *Pemex* and others arise in the context of a later-enacted treaty known as the Panama Convention. 9 U.S.C. §§ 301-307. The Panama Convention is substantively identical to the New York Convention, and the authority interpreting one is often applied to the other. *Pemex*, 832 F.3d at 105.

[6] *Id.*

[7] *Id.* at 106.

[8] *Id.*

[9] *Id.* at 107.

[10] *Id.*

[11] *Id.* at 109.

[12] *Id.* at 110.

[13] *Id.* at 110.

[14] *Esso Expl. & Prod. Nig. v. Nigerian Nat'l Petroleum Corp.,* 397 F. Supp. 3d 323, 353 (S.D.N.Y. 2019).

[15] *Id.* at 354. *Esso Expl. & Prod. Nigeria Ltd. v. Nigerian Nat'l Petro. Corp.*, Nos. 19-3159 (L), 19-3361, 2022 U.S. App. LEXIS 18837, at *19-20 (2d Cir. July 8, 2022).

[16] *Esso Expl. & Prod. Nigeria Ltd. v. Nigerian Nat'l Petro. Corp.*, Nos. 19-3159 (L), 19-3361, 2022 U.S. App. LEXIS 18837, at *31-35 (2d Cir. July 8, 2022).

[17] *Esso*, 2022 U.S. App. LEXIS 18837, at *31-35.

[18] *Esso*, 2022 U.S. App. LEXIS 18837, at *31-35 (2d Cir. July 8, 2022).

[19] *Id.* at *33.

[20] *Id.* (quoting Ackermann, 788 F.2d at 841-42).

[21] *Id.* at 36-37.

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