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# Sanctity Of Arbitration Awards: English High Court Dismisses Untimely Claim That Tribunal's Substantive Jurisdiction Was Retroactively Destroyed

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**A commentary article reprinted from the March 2018 issue of Mealey's International Arbitration Report**

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# Commentary

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### I. Introduction

The recent English Commercial Court decision in *Exportadora De Sal S.A. de C.V. v Corretaje Maritimo Sud-Americano Inc*[1] is an important reminder of the need to act promptly in jurisdiction challenges and a welcome example of the English courts' support of international arbitration. Mr Justice Andrew Baker made clear that challenges to arbitral awards must be brought in a timely manner, and that English law will not allow a party to fall back on the laws of its local jurisdiction in order to avoid obligations under an otherwise valid and enforceable contract.

Haynes and Boone CDG, LLP represented the successful respondent in the proceedings, Corretaje Maritimo Sud-Americano Inc (**CMSA**)[2].

### II. Background

The proceedings arose out of a shipbuilding contract dated 3 July 2014 (the **SBC**) for the design, construction and sale of a self-unloading salt barge concluded between Exportadora De Sal S.A. De C.V. (**ESSA**) and CMSA. ESSA, a Mexican corporation that is 51% owned by the Mexican Government and 49% by Mitsubishi Corporation, is also one of the world's largest salt mining corporations located in the coastal region of Guerrero Negro, Baja California Sur. Salt produced by ESSA is removed from its production facility at Guerrero Negro via barges to an offshore export terminal at Cedros Island. ESSA however has a fleet of old barges which require tugs to move them. The SBC was intended to be the first step in a project to modernise the fleet.

The SBC was concluded following a public invitation to tender in response to which CMSA had submitted the lowest bid. The contract provided for an overall contract price of US$27,240,000 payable in four instalments. The SBC was subject to English law and disputes were to be referred to arbitration in London under the LMAA terms[3]. While ESSA paid the first instalment under the contract, it failed to pay the second instalment and thereafter CMSA terminated the contract and commenced arbitration proceedings in August 2015 claiming the second instalment.

## III. The arbitration proceedings and events in Mexico

ESSA took no part in the arbitration until late July 2016, by which time a final hearing of the merits had been fixed to commence in September 2016. ESSA sought to put forward a defence that the SBC resulted from the bribery of one of its employees, which was permitted by the arbitration tribunal subject to certain conditions. The tribunal also adjourned the hearing until December 2016.

At the same time as it began to take part in the arbitration, an administrative investigation was commenced in Mexico looking at ESSA's compliance with certain regulatory requirements applicable to it (as a state owned corporation) in relation to the SBC. The investigation was in the form of a regulatory audit inspection by the Ærgano Interno de Control (the **OIC**), which is a body with particular oversight functions under Mexican administrative law. In August 2016 the OIC issued a preliminary observations report indicating that the tender process for the SBC was null, due to certain procedural irregularities (primarily that the tender was allegedly carried out without prior authorisation of the board of directors). This report triggered an intervention by the OIC at the conclusion of which, on 16 November 2016, it issued an official resolution (the **Resolution**) that decreed the tender null. The Resolution also ordered ESSA to "early terminate" the SBC, which ESSA purported to do on 28 November 2016.

Despite these events in Mexico, ESSA made no objection to the tribunal's jurisdiction and continued to play a full role in the rescheduled arbitration hearing in December 2016. Indeed even when the issue of the Mexican proceedings was raised before the tribunal during the hearing, ESSA's position was that those proceedings were a separate matter. However, almost two weeks after the conclusion of the hearing ESSA raised a challenge to the tribunal's jurisdiction founded exclusively upon the Resolution.

Following an exchange of written submissions in relation to the jurisdiction challenge, the tribunal issued its award in April 2017. The tribunal rejected ESSA's bribery claims and concluded that CMSA had validly terminated the contract and was entitled to payment of the second instalment. The tribunal also dismissed the jurisdiction challenge, without considering its merits, on the basis that there had been an unjustified delay in making the challenge.

## IV. ESSA's challenge

Shortly after the issue of the award, ESSA commenced proceedings in the English Commercial Court. ESSA sought declarations that it did not have capacity to enter in to the SBC and the arbitration agreement contained within it; and as such the tribunal lacked substantive jurisdiction and the award should be set aside.

There was no dispute that English law was the governing law for the purposes of the SBC and the arbitration agreement. Consequently the law of the seat of the arbitration, or the *lex curia*, was also English law. ESSA's challenge was therefore founded upon the Arbitration Act 1996 (the **1996 Act**), specifically section 67 thereof which provides that a party may apply to the court challenging any award of a tribunal as to its substantive jurisdiction[4].

ESSA alleged the tribunal had jurisdiction at the start of the arbitration but that this was "destroyed" upon the issue of the Resolution. This was based on the contention that, under principles of Mexican administrative law, the Resolution retrospectively nullified the SBC such that it was treated as if it had never existed. It was said that, as a consequence and as from the date of the issue of the Resolution, ESSA had no legal capacity to enter into the SBC or the arbitration agreement contained within it, thereby depriving the tribunal of its substantive jurisdiction.

This was an unusual argument because it is difficult to see how an issue of capacity could ever arise during arbitration proceedings; either a party had capacity at the time it concluded the related arbitration agreement or it did not. ESSA was, however, bound to take this position. Had it argued that it lacked capacity at the outset, i.e. when the SBC and arbitration agreement were concluded in July 2014, there is no question that the challenge would have been raised far too late for the purposes of the 1996 Act[5]. As it happens, and as explained in more detail below, ESSA's challenge was nonetheless too late despite relying on the Resolution issued in November 2016.

## V. An issue of capacity at all?

There was no real dispute between the parties as to the correct approach, under English conflict of laws

rules, in deciding whether a foreign corporation has the capacity to conclude a contract. *Dicey, Morris & Collins on the Conflict of Law*[6] provides in Rule 175 as follows:

> "*(1) The capacity of a corporation to enter into any legal transaction is governed both by the constitution of the corporation and by the law of the country which governs the transaction in question.*
>
> *(2) All matters concerning the constitution of a corporation are governed by the law of the place of incorporation.*"

The objective of this rule, and conflict of laws rules generally, is to enable a court to identify which system of law is applicable to resolve a legal question when there is a foreign element involved. Thus in the present case, if, under the system (or systems) of law identified according to the rule, ESSA had the necessary capacity, then in concluding the SBC it will have entered in to a valid and enforceable legal transaction. However what separated the parties was their interpretation of the test for capacity. It was CMSA's case that, under English law, capacity is the legal ability to exercise specific rights including, in particular, the ability to enter a valid contract with a third party. This was the test laid down by the Court of Appeal in *Haugesund Kommune and another v Depfa ACS Bank*[7]. The judge agreed with this interpretation.

Understood in this context ESSA's complaints, although expressed in terms of capacity, did not go to capacity at all and were, in essence, mischaracterised. The principles of Mexican law relied upon by ESSA, despite the fact that they appeared to have some form of retrospective effect under Mexican law, in truth went to the performance and discharge of the contract. It made no difference that those principles spoke of 'nullity'; the use of such wording in itself does not mean that the principle is one of capacity when in truth, and properly interpreted, it concerns discharge.

The point was perhaps best made by Baker J, who explained at [39], "*a doctrine that accepts and acknowledges that a valid and binding contract was concluded, including a valid and binding arbitration agreement, but requires by reason of the act of an administrative body over two years later that it thereafter be treated as if it had never been validly concluded is, by nature, not a doctrine concerning capacity to contract.*"

## VI. Too little too late

The 1996 Act bars parties from making late objections to a tribunal's jurisdiction. In particular, under the relevant provisions of the 1996 Act[8], it was incumbent on ESSA to object to the tribunal's jurisdiction as soon as possible unless it did not know, and could not with "*reasonable diligence*" have discovered, the grounds for the objection. The purpose of these provisions is to ensure that parties do not hold back jurisdiction arguments in reserve while they "test the water" with the arbitration tribunal. As Baker J emphasised, the first question a party should ask itself when presented with an arbitration claim (both as a matter of logic and practicality) is whether it accepts the validity of the process.

However, in the present challenge, and despite ESSA's argument that it was the Resolution in November 2016 declaring the tender null that affected its capacity to conclude the SBC, the difficulty faced by ESSA was that it was well aware of the underlying OIC regulatory investigation. Indeed, ESSA knew that the OIC would likely decree the nullity of the tender process by (at the very latest) August 2016. Therefore given that the jurisdiction challenge was not raised until well after the December 2016 hearing, and also well after the issue of the Resolution, it was plainly not made as soon as possible.

In the judge's view, ESSA should have treated the Resolution as a development "*of the highest priority*" and sought "*urgent advice*" as soon as it was received. Had it done so, the objection could have been raised "*within a working day or two*" of receiving the Resolution. Given that it failed to act with the necessary urgency, even if ESSA had had a viable claim of lack of substantive jurisdiction, it was brought too late and was barred by operation the 1996 Act.

## VII. Commentary

Baker J's substantive findings as to the characterisation of ESSA's arguments follow established English jurisprudence. In a case heard almost sixty years ago[9], an argument by a Greek bank that its local laws extinguished liability under an otherwise enforceable English law contract was rejected by the then House of

Lords (now the Supreme Court). In that case it was said that "*. . .liabilities under [English law contracts] cannot be discharged by foreign legislation*1D;[10]. Much in the same way, in the present case a finding under a Mexican administrative law process could not affect an otherwise valid and enforceable English law contract.

Such an approach is also consistent with the view of the international arbitration community that, as a matter of principle, state entities should not be permitted to rely on their own domestic law to argue that they lack capacity to conclude a contract[11]. Indeed, and as Baker J noted in his judgment, that the Mexican administrative process relied on by ESSA did not affect the validity of the arbitration proceedings would be the "*instinctive reaction of any experienced international arbitration practitioner*".

Thus, although not creating any new law, the decision represents a reminder of the English courts' firm support of international arbitration. Arguments made on the wrong footing in an attempt to avoid otherwise enforceable contractual obligations will ultimately unravel. The case is also a stark reminder of the need to make challenges to the jurisdiction of the tribunal at the first opportunity and as a matter of some urgency; a failure to do so will almost certainly see the challenge fail.

## Endnotes

1. [2018] EWHC 224 (Comm).

2. The Haynes and Boone CDG, LLP team were made up of Partner Andreas Dracoulis and Associates Jonathan Morton and Matthew Turner and instructed barristers Huw Davies QC of Essex Court Chambers and James Leabeater of 4 Pump Court.

3. The LMAA terms are a set of arbitral rules published by the London Maritime Arbitrators Association. They are very commonly applied to arbitration agreements incorporated within maritime related contracts including shipbuilding contracts.

4. Note that under English law an application under section 67 will be a re-hearing of the jurisdiction challenge, i.e. any earlier determination by the tribunal is of no weight: see *Dallah Real Estate v Pakistan* [2010] UKSC 46.

5. This is because in such circumstances it would have been incumbent on ESSA to raise its challenge not later than the time it took its first step in the arbitration proceedings to contest the merits, i.e. in July 2016: see section 31(1) of the 1996 Act.

6. 15th Edition, Sweet and Maxwell 2017.

7. [2012] QB 549 per Aikens LJ at paragraph 47.

8. Section 31(2) was found to be the relevant provision for the purposes of the timing of any jurisdiction challenge to be raised before the tribunal; section 73(1) applied as it precludes challenges under section 67 of the 1996 Act that are brought too late.

9. See *Adams v National Bank of Greece* [1961] AC 255 where a Greek statute that had been amended precisely in order to extinguish the bank's obligations under foreign currency bonds. However, the House of Lords held that the amendment to the Greek statute gave rise to an issue that was in fact contractual in nature; thus the amendment could not affect liability under English law bonds however the argument was made out by the bank.

10. Per Lord Denning at page 287.

11. Whether a state controlled entity may hide behind its own legislation in an attempt to deny that it had capacity to conclude an arbitration agreement is not, however, a point that has been answered under English law (although it has been touched upon in *JSC Zestafoni G Nikoladze Ferroalloy Plant v Ronly Holdings Ltd* [2004] EWHC 245 (Comm)). It was not an issue that was addressed in the present case given the other shortcomings in ESSA's arguments. ■

**MEALEY'S: INTERNATIONAL ARBITRATION REPORT**
*edited by Lisa Hickey*
**The Report** is produced monthly by

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Telephone: (215)564-1788 1-800-MEALEYS (1-800-632-5397)
Email: mealeyinfo@lexisnexis.com
Web site: http://www.lexisnexis.com/mealeys
ISSN 1089-2397