Proskauer

Second Circuit Declines to Give Preclusive Effect to "Collusive" Foreign Judgments

January 4, 2010

The United States Court of Appeals for the Second Circuit rendered a decision in *Telenor Mobile Communications AS v. Storm LLC*, on October 8, 2009, reinforcing the notion that the strong public policies in favor of arbitration and against improper collateral and unilateral litigation outweigh any concern that a party might have that complying with an arbitral award might cause it to violate a foreign judgment.[1] Foreign judgments procured in the absence of the important protections afforded by fundamental due process and fair play cannot be used to circumvent otherwise enforceable arbitral awards. Indeed, the *Telenor* decision should cause parties to arbitration agreements to think twice before staging "friendly litigation" in an effort to avoid their contractual obligations.

Background: The Dispute, Arbitral Award and Ukrainian Court Proceedings

In January 2004, Telenor Mobile Communications AS ("Telenor"), a Norwegian company, and Storm LLC ("Storm"), a Ukrainian company, entered into a shareholders' agreement outlining the terms of their shared ownership of Kyivstar G.S.M. ("Kyivstar"), a Ukrainian mobile telecommunications company. Telenor and Storm entered into the 2004 shareholders' agreement, which contained an arbitration clause, following Storm's purchase of the outstanding Kyivstar shares held by Omega JSC ("Omega").

An earlier voting agreement between Telenor and Storm contained a promise to enter into a new shareholders' agreement once either the prior shareholders' agreement was terminated or Storm bought Omega's shares. The voting agreement had been signed by Storm's General Director, Valeriy Nilov, and, prior to its execution, Storm had sent Telenor a unanimous resolution by Storm's shareholders authorizing Nilov to do so. Storm later sent Telenor a document, signed by Nilov, entitled "Certificate of Senior Officer of Purchaser," which included a copy of the Storm shareholder resolution authorizing Nilov to execute the voting agreement, as well as minutes of a meeting confirming the resolutions adopted by written polling.

Prior to the execution of the 2004 shareholders' agreement, Storm sent Telenor an email, indicating that it had reviewed the proposed agreement's draft language and that Storm agreed to it and was ready to sign it. The next day, Nilov, on behalf of Storm, and Telenor, signed the 2004 agreement. Although Storm sent Telenor two documents titled "Certificates of Incumbency and Authority of Storm," neither document attached or incorporated by reference any documentation of shareholder authorization.

In February 2006, Telenor brought an arbitration against Storm under the 2004 shareholders' agreement. On April 14, 2006 – the same day that the arbitration panel held its first conference – Alpren Limited ("Alpren"), a Cyprus-based subsidiary of Altimo Holdings & Investment Limited ("Altimo"), filed suit in a Ukrainian court against Storm, seeking a declaration that the 2004 shareholders' agreement was invalid because Nilov lacked the authority to execute it on Storm's behalf. Alpren and Altimo owned Storm, and all three belonged to the same Russian corporate group, Alfa Group Consortium ("Alfa"). In the Ukrainian litigation, Storm retained no counsel and submitted no written defense. On April 25, 2006, the Ukrainian court concluded the Nilov lacked the authority to execute the 2004 shareholders' agreement on behalf of Storm and, only one month later, the Ukrainian appeals court affirmed the lower court's declaration, ostensibly rendering the agreement, in its entirety, "null and void."

Only five days later, Storm filed a statement of defense in the arbitration, arguing, among other things, that, as a result of the Ukrainian court's judgment, Telenor's claims were not arbitrable. Despite that judgment, however, the arbitration panel concluded that it had jurisdiction to determine the 2004 shareholders' agreement's arbitrability and concluded that the dispute was arbitrable because Storm and Telenor "had a clear intent to have their disputes resolved through arbitration," and because the arbitration provision was severable and thus not subject to the Ukrainian judgment.[2]

Storm thereafter sought further clarification from the Ukrainian court. The court concluded – as the Second Circuit noted, "by now unsurprisingly" – that the arbitration agreement was invalid and that any arbitration pursuant to it was in violation of the court's prior order.[3] Only five days after the Ukrainian court issued its clarification, Storm applied in New York state court for an injunction terminating the arbitration and vacating the partial final award rendered by the panel. Telenor removed the lawsuit to federal court, and Storm applied for a preliminary injunction. The district court denied that application, explaining that the panel's order was interlocutory (and thus not ordinarily subject to appeal) and that Storm was not likely to succeed on the merits.

In a new Ukrainian litigation, Alpren then sought – and obtained – an injunction from the Ukrainian court preventing Telenor, Storm and an Altimo officer from participating in the arbitration. Telenor was not a party to this new lawsuit, nor did it receive notice of the injunction. With the Ukrainian injunction in hand, Storm twice applied to the arbitration panel to stop the arbitration. Each time, Storm's application was denied. Telenor applied to the New York federal district court for – and was granted – an anti-suit injunction against Storm and its related entities. Following an evidentiary hearing, the district court wrote 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 "Nilov . . . had at least apparent authority" to sign the 2004 shareholders' agreement under either New York or federal law.[4]

On July 2, 2007, the arbitration panel issued its final award, ruling, in relevant part, that Nilov had both actual and apparent authority under New York law to execute the 2004 shareholders' agreement on Storm's behalf and that Storm was in breach of the agreement in several respects. As a result, Telenor was granted injunctive relief, but no damages.

Shortly thereafter, Telenor petitioned the district court for confirmation of the final award, and Storm cross-moved for vacatur. The court granted Telenor's application and denied Storm's cross-motion. In a written opinion, which the Second Circuit described as "appear[ing] to reflect decreasing patience with Storm's tactics," the district court rejected Storm's arguments that the arbitration panel had manifestly disregarded the law by failing to give determinative effect to the Ukrainian judgments that the 2004 shareholders' agreement was never executed by Storm and thus not arbitrable.[5] The district court concluded that Storm had proffered insufficient evidence to warrant a trial on the issue of the arbitrability of Telenor's claims.

The Second Circuit's Enforcement of the Arbitral Award and Refusal to Recognize the Ukrainian Court Judgments

After briefly discussing the three types of limited review implicated by Storm's arguments on appeal – namely, the seven grounds for denial of confirmation enumerated in the New York Convention, 9 U.S.C. § 207, the question of arbitrability and the question of whether an award was in "manifest disregard" of the law – the Second Circuit explained that it reviews a district court's decision to confirm an arbitration award *de novo* to the extent it turns on legal questions.

The Court then addressed Storm's arguments that: (i) the arbitration panel manifestly disregarded the law when it (a) failed to give preclusive effect to the Ukrainian court's judgments, (b) failed to arrange for a trial on the arbitrability of the 2004 shareholders' agreement, and (c) made its own determination, *de novo*, that Storm executed the 2004 shareholders' agreement; and (ii) contrary to public policy, Storm's compliance with the arbitral award would require it to take actions that would place it in contempt of the Ukrainian courts.

First, explaining that "[e]xamples of manifest disregard . . . tend to be extreme," the Second Circuit reviewed the factual records before both the arbitration panel and the district court establishing that the Ukrainian proceedings were collusive. The Court then observed that "in light of the strong presumption that an arbitration tribunal has not manifestly disregarded the law, the panel's multiple references to the Alfa-internal and *ex parte* nature of the Alpren litigation supply a sufficiently 'colorable' justification for its refusal to give the Ukrainian judgments controlling weight."[6]

After explaining that the arbitration panel was not obliged to interpret as material or meaningful the facts that Storm "had no contact" with its adversary during the Ukrainian litgations and that it presented a defense in those proceedings, the Second Circuit added that "the force of" the Ukrainian proceedings was undermined by the fact that Telenor was not a party to the *Alpren* litigation and "was continually denied notice of the proceedings."[7] Ultimately, therefore, it was the failure of the Ukrainian court to ensure the operation of "rudimentary due process" that "provides an independent colorable justification for the panel's conclusion that the Ukrainian proceedings were unsound for . . . preclusion purposes."[8]

Second, and perhaps most notable, the Second Circuit addressed Storm's argument that, in order to comply with the arbitral award, Storm would necessarily need to take actions violative of the Ukrainian court judgment, and that such a result is contrary to New York public policy. Observing that "[t]wo factfinders . . . concluded that Storm brought the Ukrainian judgments upon itself through use of highly questionable litigation tactics," the Court analogized Storm's situation to "the apocryphal parricide seeking mercy because he had been orphaned."[9] Accordingly, the Second Circuit held that Storm's "improper collateral litigation," and not the arbitral award, was contrary to public policy; namely, the well-established federal public policy in favor of arbitration. As the Court explained:

> Collateral and unilateral litigation of arbitrability – or any other issue pertinent to an arbitration, for that matter – undertaken in a foreign forum by a party to that arbitration in an attempt to protect itself from an adverse award would, if indulged, tend seriously to undermine the underlying scheme of the FAA and the New York Convention.[10]

Finally, the Second Circuit rejected Storm's argument that the district court should have had a separate trial on the issue of the arbitrability of the 2004 shareholders' agreement. Because the record reflected that "Storm [had] sent Telenor a variety of signals that Nilov had the authority to executed the 2004 Agreement," there was no genuine material issue of fact with respect to Nilov's apparent authority. As a result, the Second Circuit held that no trial was required because Storm had failed to proffer sufficient evidence from which a rational juror could conclude that Nilov lacked apparent authority to execute the 2004 shareholders' agreement.

Comment: Concerns for Fundamental Due Process and the Enforcement of Arbitral Awards Remain Paramount

The Second Circuit's ruling in *Telenor Mobile Communications AS v. Storm LLC* comports with the long-standing and substantial body of case law reinforcing the paramount importance of the federal public policy in favor of arbitration.[11] The ruling is also in line with generally accepted principles of comity, recognizing the preclusive effect of foreign court judgments resulting from proceedings that respect certain rudimentary notions of due process and overall fairness. Where, however, it can be shown that a foreign litigant has procured a foreign court judgment in a veiled attempt to side-step a contractual obligation to arbitrate a dispute, the federal courts in the Second Circuit will critically question whether the foreign judgment should have a preclusive effect on any attempt to enforce an arbitral award.

[1] 584 F.3d 396, 2009 WL 3200685 (2d Cir.).

[2] *Id*. at *3.

[3] *Id*. at *4.

[4] *Id*.

[5] *Id*.

[6] *Id*. at *9.

[7] *Id*.

[8] *Id*.

[9] *Id*. at *10.

[10] *Id*.

[11] *See, e.g., Shaw Group Inc. v. Tiplefine Int'l Corp.*, 322 F.3d 115 (2d Cir. 2003), *quoting Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983).

Related Professionals

- **Peter J.W. Sherwin**
  Partner
- **Ana Vermal**
  Partner