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UPDATE

Grand Court refuses to enforce a foreign arbitral award, holding that there had been no consent to arbitrate

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The recent decision of *VRG Linhas Aereas S.A. v. Matlin Patterson Global Opportunities Partners (Cayman) II L.P. & Ors*[1] is a rare example of the Cayman Court refusing to enforce a foreign arbitral award. The decision provides guidance on some of the issues the Cayman Court may look at when determining if the requisite consent to arbitrate existed between parties, the scope of an arbitration tribunal's jurisdiction and whether an arbitration award breaches the principles of natural justice, such that it would be contrary to Cayman public policy to enforce it.

Introduction

On 1 September 2016, the Plaintiff commenced proceedings in the Grand Court of the Cayman Islands (the Court), *ex parte*, seeking orders for the enforcement of an arbitration award it had obtained against the Defendants in Brazil (the Arbitral Award).

In a ruling dated 26 October 2016 (the Preliminary Ruling), Mangatal J granted the Plaintiff leave to enforce the Arbitral Award as a judgment or order of the Court and entered judgment against the Defendants in the terms of the Arbitral Award. However, the Judge also provided the Defendants with an opportunity to apply to set aside the Preliminary Ruling before the Arbitral Award could be enforced.

The Defendants duly applied to set aside the Preliminary Ruling and the matter came back before Mangatal J, on an *inter partes* basis, in June 2018.

Factual background

The First and Second Defendants (the MP Funds) are private investment funds that specialise in *"distressed investing"*. In 2005, the MP Funds established a Delaware company (DelCo) to serve as an investment vehicle for pursuing an opportunity in the Brazilian aviation industry. DelCo and three Brazilian investors established a Brazilian company (BrazilCo) that was used to acquire Varig Logistica SA (Varilog), which operated a Brazilian cargo airline. BrazilCo and Varilog then used the Plaintiff, also a Brazilian company, as a special purpose vehicle to purchase a passenger airline business.

In March 2007, BrazilCo and Varilog (together the Sellers) sold their shares in the Plaintiff to a Brazilian company called GTI SA (the Purchaser) pursuant to a Share Purchase and Sale Agreement (the PSA). The PSA contained an arbitration clause requiring the parties to submit all disputes between them to arbitration. None of the Defendants were parties to the PSA. The MP Funds did, however, give an undertaking, by way of a letter to the Purchaser (the Non-Compete Letter), that they would not compete with the Plaintiff's business, which was annexed to the PSA.

[1] Unreported, 19 February 2019.

The dispute

A dispute arose between the Purchaser and the Sellers in relation to the operation of a price adjustment mechanism contained in the PSA, which the Purchaser referred to arbitration pursuant to the arbitration clause in the PSA. By this time, the Purchaser had merged with the Plaintiff, and the Plaintiff was therefore the claimant in the arbitration.

Instead of commencing the arbitration proceedings against the Sellers only, however, the Plaintiff also commenced proceedings against DelCo and the MP Funds on the basis that they were the *"alter egos"* of the Sellers and therefore (it was argued) (i) bound by the arbitration clause agreed by the Sellers in the PSA and (ii) jointly and severally liable with the Sellers for the amount of the purchase price adjustment due under the PSA.

The decision of the arbitration Tribunal

The MP Funds argued from the outset that they were not parties to the PSA. Nevertheless, the arbitration Tribunal (the Tribunal) determined that it had jurisdiction over the MP Funds on the basis that they had entered into the Non-Compete Letter.

The Tribunal rejected the Plaintiff's *"alter ego"* claim against the MP Funds. However, the Tribunal held the MP Funds liable for the entire purchase price adjustment amount (approximately R$93 million) on the basis of a tort under Article 148 of the Brazilian Civil Code known as *"third party malice"* which, the MP Funds claimed, had never been pleaded or alleged by the Plaintiff and was not argued before the Tribunal.

The Plaintiff thereafter sought, and initially obtained, permission to enforce the R$93 million Arbitral Award against the Defendants in the Cayman Islands.

The grounds advanced by the Defendants to set aside the Arbitral Award

It was not in dispute that Brazil is a party to the New York Convention[2] and that the question of whether the Court should refuse to recognise the Arbitral Award was therefore governed by section 7 of the Foreign Arbitral Awards Enforcement Law (1997 Revision) (the Law). The Defendants argued that the Court should refuse to enforce the Arbitral Award under section 7 of the Law on the following three grounds:

1. The Defendants themselves were not parties to the arbitration agreement in the PSA (or the PSA itself) and had not consented to arbitration - a ground on which the United States Courts, both at first instance and at the appellate level, had refused to recognise and enforce the Arbitral Award in the United States;
2. The decision of the Tribunal offends the principle of natural justice because the MP Funds were held liable in tort notwithstanding that no tort claim had been pleaded or argued; and
3. The Tribunal had purported to decide a matter that had not been submitted to it for decision.

The decision

Justice Mangatal held that the Purchaser and the Sellers were the only parties to the PSA and that it was *"clear that the MP Funds were intentionally, and as a matter of objective construction, not a party to the PSA"*. By extension the MP Funds were also not parties to the arbitration agreement contained in the PSA. Further, it was obvious on the face of the Non-Compete Letter that it did not contain or incorporate an arbitration agreement; it merely supplemented the PSA by providing an undertaking by non-parties to the PSA, i.e. the MP Funds. Accordingly, the MP Funds had made out their first ground for refusal, namely that they were not parties to PSA or the arbitration agreement.

The Judge also found that, even if the MP Funds *had* agreed to submit to arbitration, such agreement could only extend to the non-compete undertaking given in the Non-Compete Letter and not to the price adjustment mechanism under the PSA. Therefore, the Arbitral Award as against the MP Funds purported to determine issues that were not within the bounds or scope of any agreement to arbitrate.

[2] The Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

Whilst not strictly required to do so given her finding on the first ground, Justice Mangatal nevertheless went on to consider the Defendants' other two grounds for refusing to enforce the Arbitral Award.

As to the second ground, applying Cayman Islands standards of fairness and due process, Justice Mangatal agreed that the MP Funds could not reasonably have foreseen that they would be held liable as third parties in tort when the claim and relief sought before the Tribunal concerned a contractual obligation of their indirect subsidiaries. The Judge said that the MP Funds were entitled to be put on express notice of the proposal to award damages against them under section 148 of the Brazilian Civil Code, however, this had not been done. In the circumstances the MP Funds had discharged the burden of showing that there had been a breach of natural justice (applying Cayman Islands standards of fairness).

Closely related to the second ground, Justice Mangatal also held that it was not within the scope of the Tribunal's jurisdiction to award tortious damages to a contractual price adjustment amount because those grounds and that relief had never been advanced by the Plaintiff before the Tribunal. She therefore held that the third ground advanced by the Defendants should also succeed.

Comment

Whilst, as was accepted by the parties in this case, the New York Convention "aim[s]…to achieve the effective and speedy enforcement of international arbitration awards falling within its scope" and "envisages a process by which a party with a Convention award in its favour can enforce it in Convention jurisdictions", Justice Mangatal's well-reasoned decision is welcome confirmation that the Cayman courts will not allow Convention awards to be enforced locally if they offend basic principles of fairness and justice or otherwise fall within the scope of section 7 of the Law.

This case should be of interest to those seeking to enforce Arbitration Awards within the Cayman Islands. Parties seeking to bring arbitration proceedings should consider engaging with their Cayman lawyers at an early stage, to try to ensure that matters are dealt with at the Arbitration in a way that does not give rise to risks of the ultimate award being difficult or impossible to enforce.

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