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UPDATE

Arbitration stations – guidance from the Privy Council on the standard of due process when enforcing arbitral awards in the Cayman Islands

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In *Gol Linhas Aereas SA v MatlinPatterson Global Opportunities Partners (Cayman) II LP and others* [2022] UKPC 21, the Judicial Committee of the Privy Council upheld a decision of the Cayman Islands Court of Appeal, allowing the recognition and enforcement of an arbitral award made in terms of the New York Convention. In doing so, the board provided useful guidance on the scope to challenge enforcement by reference to due process arguments.

Background

The Respondent (**VRG**) is a Brazilian airline group that conducts business under the name of Gol Airlines. The first and second appellants (the **MP Funds**) are a Cayman Islands exempted limited partnership and a Delaware limited partnership respectively, which together conduct business as a private equity investment fund with its headquarters in New York. The third appellant (**MP LLC**) is the general partner of the two limited partnerships.

The dispute submitted to arbitration arose pursuant to a share purchase and sale agreement dated 28 March 2007, for the sale of the shares in the company which operated Gol Airlines. VRG asserted, in summary, that the airline's working capital had been overstated and that it had been fraudulently misled. Pursuant to an arbitration clause in the agreement, VRG commenced an arbitration under the ICC Rules of Arbitration, against the MP Funds in December 2007, seated in Brazil and applying Brazilian law. VRG succeeded and the arbitral award was issued on 2 September 2010.

The arbitral tribunal found the sellers and the MP Funds jointly and severally liable for the amount of the purchase price adjustment in the sum of R$92,987,672, together with interest and costs. The tribunal rejected VRG's legal argument for holding the MP Funds liable, which involved piercing the corporate veil, but found that the facts alleged and proved gave rise to a separate basis for liability on the part of the MP Funds: 'third party malice' under article 148 of the Brazilian Civil Code. Accordingly, the tribunal held the MP Funds jointly liable with the sellers for the sum of R$92.9m.

As set out below, the MP Funds had various complaints about the tribunal's decision, including that they had been found liable on a legal basis which had not been advanced by VRG (and on which they had no proper opportunity to present their case). The MP Funds therefore sought to set aside the award in the court in Sao Paolo (dismissed on 1 July 2011), on appeal (dismissed on 16 October 2012), before the Superior Court of Justice (dismissed on 12 December 2017) and lastly before the Supreme Court (dismissed on 4 August 2020). After this, it was accepted that the MP Funds had no further right of appeal in Brazil.

Meanwhile, in September 2016, VRG obtained an order *ex parte* from the Grand Court of the Cayman Islands, for permission to enforce the arbitral award under the Cayman Islands Foreign Arbitral Awards Enforcement Act 1975 (1997 Revision) (the **1975 Act**). The 1975 Act gives domestic effect to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (the **New York**

Convention) in the Cayman Islands.[1] The order was later set aside by the Grand Court over two years later, on 19 February 2019, following an application by the MP Funds and a detailed examination of their arguments, in which Mangatal J accepted the MP Funds' three broad arguments.[2]

However, VRG successfully had the order reinstated by the Cayman Court of Appeal (the CICA). The MP Funds therefore appealed to the Judicial Committee of the Privy Council, the highest appellate court for the Cayman Islands. The enforcement of the award was stayed pending the Privy Council's determination.

The decision

The board upheld the decision of the CICA, finding that none of the grounds relied on by the MP Funds justified refusal to enforce the award under the 1975 Act. Three broad issues were decided by the board:

- Issue estoppel. The MP Funds disputed the tribunal's jurisdiction over them and asserted that they were entitled to bring that challenge in Cayman, notwithstanding that the issue had already been decided against them in the court in Sao Paolo, because that court had only adopted a limited review of the tribunal's decision. The board disagreed and found that the decision by the Sao Paulo court did indeed involve an independent or *de novo* determination of that question and therefore gave rise to an issue estoppel on that question which was binding on the MP Funds and could not be challenged again in Cayman.
- Due process. The board rejected the MP Funds' argument that the tribunal had committed a serious breach of natural justice or due process by finding the MP Funds liable on a legal basis which had not been argued.
- Scope of submission. The board found that the award was not beyond the tribunal's scope and that the terms of reference should be given a liberal construction. For example, a claim for the amount of the contractual price adjustment could not reasonably be read as precluding the arbitrators from awarding damages in this amount for the loss caused by the failure to pay the sum.

This update addresses the board's determination on the due process issue in more detail.

Due process

The MP Funds sought to rely on the defence under article V(1)(b) of the New York Convention which applies where a party '*was otherwise unable to present his case*'. They alleged that the arbitral tribunal had found them liable on a separate legal claim (third party malice under article 148) which had not been argued by VRG nor raised with them by the tribunal.

Mangatal J accepted the MP Funds' argument at first instance: '*Applying Cayman Islands standards of fairness and due process, it is plain that the MP Funds could not reasonably have foreseen that they would be held liable as third parties in tort, for tort damages, when the claim against them, and relief sought throughout the arbitration, was to hold them responsible for a contractual obligation of their indirect subsidiaries*' (paragraph 172). The CICA overturned this and found that the defence did not apply. The MP Funds appealed the point further.

The board began its analysis by making observations on the test for due process. They acknowledged that the meaning and effect of article V(1)(b) of the 1975 Act is to be decided by applying the law of the Cayman Islands, not the law of the arbitration or where the award was made. However, as with any statute which incorporates and domesticates an international treaty, the interpretation and application of the language must take account of its origin in an international instrument intended to have an international currency. The standard of due process being imposed by the domestic statutory provision therefore still needed to be capable of applying to any international arbitration and the court should identify and apply basic

[1] The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 provides a regime for the recognition and enforcement of arbitral awards in contracting states. As the board noted at para 21, the New York Convention has been described as '*the single most important pillar on which the edifice of international arbitration rests* and *perhaps... the most effective international legislation in the entire history of commercial law*'.

[2] See our previous update at https://www.mourant.com/news-and-views/updates/updates-2019/grand-court-refuses-to-enforce-a-foreign-arbitral-award--holding-that-there-had-been-no-consent-to-arbitrate.aspx.

minimum requirements which would generally be regarded throughout the international legal order as essential to a fair hearing.

The board also noted the greater latitude afforded to judges in civil jurisdictions to form their own independent view of the law and that in Brazil an arbitrator may adopt a different legal basis for its decision from that argued by the parties, as long as this does not go beyond the allegations of fact and claimed relief. Indeed, the Brazilian courts had accepted this account of Brazilian law and rejected the MP Funds' argument.

The board ultimately concluded that, while the point was a difficult one to decide, the tribunal's failure to invite the MP Funds to comment on whether the facts alleged by VRG fell within article 148 of the Civil Code did not amount to so serious a denial of procedural fairness as to justify refusal to enforce the award. In particular:

- All the factual allegations which the tribunal found proved - and on which it based its decision - were in issue and had been argued (as accepted by the MP Funds) and VRG had also invoked the legal concept of '*malice*'. The only matter of which the MP Funds did not have notice was the legal provision imposing liability for third party malice (article 148).
- There is a range of views internationally on the extent to which a court or tribunal is expected to inform the parties if it proposes to adopt different legal reasoning.
- Brazilian procedural law and practice had a reasonable influence on the latitude afforded to the tribunal, given that it was chosen as the law of the arbitration and the parties were represented by Brazilian lawyers.
- Even if the particular legal reasoning adopted by the tribunal was not anticipated, it would not have been surprising to the MP Funds that, in the event that fraud was proved, they would be held liable to pay the amount of the adjustment to the price required.
- To justify a finding that a party was unable to present its case, proof was required not just that a procedure was adopted which was irregular or undesirable, but of fundamental unfairness which goes to the essence of the right to be heard. This had not been demonstrated.

Comment

The board's judgment on due process provides detailed guidance on the standard which applies to the enforcement of arbitral awards in the Cayman Islands. The standard of due process in other jurisdictions is given weight in the interpretation exercise, despite the meaning and effect technically being a matter of domestic (i.e. Cayman Islands) law.

The decision reached by the board is fact-specific but, from a common law perspective, harsh on a litigant which had not been apprised of a particular cause of action. The board's recognition of the Brazilian arbitral tribunal's leeway to develop its own independent legal reasoning, and respect for the view previously reached by the courts in the jurisdiction of the tribunal, may discourage award debtors from pursuing procedural unfairness points at the enforcement stage. It also serves as a reminder to plead all necessary causes of action at the outset to ensure that enforcement is not vulnerable to this type of challenge.

For more information on the routes to recognition and enforcement of foreign judgments and arbitral awards in the Cayman Islands, see our guide linked here or get in touch with our team.

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