Cayman Grand Court refuses to enforce foreign arbitral award in favour of Brazilian airline

The 19 February 2019 judgment of the Grand Court of the Cayman Islands in *VRG Linhas Aereas S.A. v Matlin Patterson Global Opportunities Partners (Cayman) II L.P. & Ors* is a rare example of the Grand Court refusing to enforce a foreign arbitral award, here on the grounds that the defendants were not parties to the arbitration agreement pursuant to which the award was rendered and that, even if they were, the award went beyond the scope of the arbitration agreement such that its enforcement would be contrary to the principles of natural justice and public policy.

Although the grounds on which the recognition and enforcement of foreign arbitral awards in a New York Convention[1] contracting state can be resisted are famously narrow, the judgment of Justice Mangatal promotes confidence that the Grand Court will refuse to enforce foreign arbitral awards in accordance with the Foreign Arbitral Awards Enforcement Law (1997 Revision) of the Cayman Islands (the "**Law**") in appropriate circumstances.

The arbitration

The three defendants to the Cayman enforcement proceedings (the "**MP Funds**") were private investment funds specialising in distressed investing. In 2005, the MP Funds were ultimate shareholders in an SPV that acquired Varig Logistica SA ("**Varilog**"), which operated a Brazilian aviation business. Varilog and its parent, Volo dB, purchased a passenger airline business through an SPV named VRG Linhas Aereas SA ("**VRG**"). In 2007, VRG was sold to another company, GTI SA ("**GTI**"). The parties to the Share Purchase and Sale Agreement (the "**PSA**") were Varilog and Volo dB as sellers and GTI as purchaser. The PSA included an arbitration clause pursuant to which the parties to the PSA agreed to submit disputes to arbitration seated in São Paulo, Brazil.

The MP Funds were not parties to the PSA containing the arbitration agreement but were parties to a separate "Non-Compete Letter", described as an addendum to the PSA, which was executed in favour of the purchaser.

In due course a dispute arose which was referred by VRG to arbitration in reliance upon the arbitration agreement in the PSA. VRG commenced the arbitration against not only the sellers (Varilog and Volo dB) but also the MP Funds on the basis that the MP Funds *"were the alter egos of Varilog and Volo dB*". The MP Funds disputed the arbitral tribunal's jurisdiction from the outset but participated in the arbitration under protest.

Ultimately the arbitral tribunal found in favour of VRG and rendered an award which, among other things, held the MP Funds liable in tort under a provision of the Brazilian Civil Code despite no tort claim having been pleaded

or argued, and in respect of which the MP Funds were not given an opportunity to be heard (the "**Arbitral Award**").

VRG then sought to enforce the US$55 million Arbitral Award against the MP Funds in the Cayman Islands.

Statutory enforcement framework in the Cayman Islands

Pursuant to section 7 of the Law, which gives effect to Article 5 of the New York Convention, enforcement of a New York Convention award shall not be refused save in the circumstances set out in sections 7(2) and (3), which broadly concern natural justice and public policy considerations.

The Cayman Islands proceedings

Following the grant of leave of the Grand Court obtained *ex parte* by VRG in October 2016 to enforce the Arbitral Award (the "**Enforcement Order**"), the MP Funds filed a Summons seeking that the Enforcement Order be set aside pursuant to section 7 of the Law.

The MP Funds asked the Court to exercise its discretion to refuse to enforce the Arbitral Award on three grounds:

1. the MP Funds did not consent to the arbitration in Brazil because they were not a party to any arbitration agreement; or alternatively
2. the Arbitral Award offended the principles of natural justice (and therefore the public policy of the Cayman Islands) because the arbitral tribunal found the MP Funds liable on a basis which was neither pleaded by VRG nor argued by any party to the arbitration; and
3. the arbitral tribunal exceeded its jurisdiction by deciding matters outside the scope of what the parties asked it to decide.

In a lengthy and considered judgment, Justice Mangatal concluded that the MP Funds were not parties to the arbitration agreement in the PSA because the Non-Compete Letter had neither incorporated nor amended that arbitration agreement. The Court therefore agreed with the MP Funds on the first ground, with the effect that enforcement of the Arbitral Award against the MP Funds in the Cayman Islands would be refused and the Enforcement Order obtained *ex parte* would be set aside.

Justice Mangatal nonetheless went on to consider the second and third grounds advanced by the MP Funds. In summary the Court held that, even if the Non-Compete Letter did have the effect of binding the MP Funds to arbitrate (which it did not):

1. That agreement would only have extended to the issue of non-competition. However, the Arbitral Award addressed broader issues and thus exceeded the tribunal's jurisdiction.
2. The tribunal exceeded its mandate by awarding damages in respect of a tort which was not pleaded and in respect of which the MP Funds did not have an opportunity to be heard.

Accordingly, the Court held that the MP Funds were not bound by the arbitration agreement, but that, even if they had been, enforcement of the Arbitral Award would have been refused on the basis that it contravened the principles of natural justice and public policy within the meaning of section 7 of the Law.

Comments

Although the New York Convention and the Law implementing it in the Cayman Islands are designed to ensure foreign arbitral awards are readily enforceable, this case is a reminder that such awards are not beyond reproach and that their enforcement will be refused if the Grand Court is satisfied that the award offends the natural justice or public policy considerations set out in section 7 of the Law.

Although in practice such refusals are rare, this case promotes confidence that foreign awards will not blindly be enforced in this jurisdiction.

Parties to arbitration agreements should be mindful of their ability to enforce foreign arbitral awards in the Cayman Islands, and consequently of the need to ensure that the arbitration agreement binds all necessary parties, that the agreement is appropriate in scope and that the arbitral award does not fall foul of section 7 of the Law. These issues are best considered at an early stage, either at the time of entry into the arbitration agreement or when it becomes apparent that any arbitral award may be enforced in the Cayman Islands.

[1] The Convention on the Recognition and Enforcement of Foreign Arbitral Award, New York 1958. The Cayman Islands has been a party to the New York Convention since 1980.

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