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International Arbitration Case Law

School of International Arbitration, Queen Mary, University of London
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Award Name and Date: Anatolie Stati et al. v. The Republic of Kazakhstan, [2017] High Court of Justice, Queen’s Bench Division, Commercial Court, EWHC 1348 – Judgement – 6 June 2017

Case Report by: Djurdja Lazic**, Editor Diego Luis Alonso Massa***

Summary: The High Court of Justice declined Claimants’ request to dismiss Kazakhstan’s petition to amend its original application to set aside an arbitral award on the basis that the award would contravene English public policy by reason of alleged fraud discovered after the issuance of the award. The High Court ruled that prior decisions by Swedish and the U.S. courts dismissing the State’s application to set aside the award did not create an estoppel, that the State could rely on evidence obtained after the award was issued to prove its claim of fraud, and that there is sufficient prima facie evidence that the award was obtained by fraud. The Court concluded that the interests of justice required that the fraud allegations, including the effect of the fraud, be examined at a trial and be decided on their merits.

Main Issues: Estoppel; Registration and Enforcement of an Award under the Arbitration Act of 1966; New York Convention; Public Policy; Energy Charter Treaty

Justice: Sir Robin St John Knowles

Claimants’ Counsel: Thomas Sprange QC (King & Spalding); Ruth Byrne (King & Spalding)

Defendant’s Counsel: Ali Malek QC (Herbert Smith Freehills); Christopher Harris (Herbert Smith Freehills); Paul Choon Kiat Wee (Herbert Smith Freehills)

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Digest:

1. Relevant Facts

In 2010, Moldovan nationals Anatolie Stati, his son Gabriel Stati, and two of their companies commenced arbitration proceedings against Kazakhstan under the Energy Charter Treaty (ECT). Claimants alleged that they invested more than US \$1 billion to revitalize previously-neglected oil and gas fields and to construct a state-of-the-art liquefied petroleum gas (LPG) plant in Kazakhstan. According to Claimants, when their investment began to become profitable, Kazakhstan launched a targeted campaign of intimidation and harassment designed to pressure Claimants into selling their investments to a state-owned oil company at a low price.

Kazakhstan disputed the claim, arguing that Claimants badly managed the fields and also violated domestic law. It also argued that the Claimants' corporate ownership was nontransparent and questionable. As a result, Kazakhstan had to interfere to save the companies from financial collapse.

An arbitral Tribunal seated in Stockholm concluded that Kazakhstan violated the ECT's fair and equitable treatment standard. The majority of the Tribunal ordered Kazakhstan to pay the Claimants more than US \$500 million in damages, US \$199 million of which were awarded for the alleged value of the LPG plant.

At the center of the dispute is the valuation of the LPG plant and whether Claimants willfully misled the State and consequently the Tribunal regarding the value of the plant. During the arbitral proceedings, Claimants had alleged that they invested more than US \$245 million in the development and construction of the plant. They relied on a number of indicative bids for the acquisition of the LPG plant, with one State-controlled entity bidding US \$199 million to acquire the plant (¶ 17). The State, on the other hand, argued that the plant had failed and that the valuation proposed by the Claimants was incorrect. The Tribunal, following the Claimants' recommendation and statements, based its assessment of the valuation of the plant on the government bid of US \$199 million to obtain the LPG plant (¶ 17). The Tribunal concluded that it was "not persuaded by [the State's] and their experts conclusions that the LPG plant was a failed project and must be considered to have a negative value and no damages at all can be claimed by the Claimants. If that were so, [the State] would not have been ready to invest further expenses in the completion of the Plant, after [the State] had taken control of the Plant." (¶ 19). The Tribunal concluded that particularly relevant to its determination of the value was "an offer . . . made for the LPG plant by State-owned [company] . . . for USD 199 million. The Tribunal considers that to be the relatively best source of information for the valuation of the LPG plant among the various sources of information submitted by the Parties regarding the valuation for the LPG Plant during the relevant period of the valuation date accepted by the Tribunal." (¶ 19).

2. Procedural History

On December 19, 2013, Kazakhstan was ordered by an arbitral Tribunal constituted under the ECT and seated in Sweden to pay damages in the excess of US \$500 million to the Claimants in a dispute concerning the exploration and extraction of hydrocarbons in Kazakhstan.

Kazakhstan applied to the Svea Court of Appeal (Stockholm Court of Appeal) to set aside the award.

Claimants sought to enforce the award in the UK (England and Wales) and the United States under the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention). The Claimants' UK enforcement application was initially granted on February 28, 2014, and on April 7, 2015, Kazakhstan applied to set aside the permission, arguing that no valid arbitration agreement existed, that the Tribunal was invalidly constituted, and that serious procedural errors prevented Kazakhstan from presenting its case to the Tribunal (¶¶3-5).

Shortly after Kazakhstan had asked the English court to set aside the enforcement permission, the government also successfully filed a judicial assistance application in U.S. court, which resulted in a subpoena against a third party, compelling the production of documents. According to Kazakhstan, these documents revealed that Claimants committed fraud by concealing material information from the arbitral Tribunal (¶34). Kazakhstan then asked the English court to amend the English application to include the argument that enforcement of the award would violate English public policy because Claimants committed fraud. The English application was stayed pending a ruling by the Stockholm Court of Appeal on Kazakhstan's application to set aside the award (¶7).

On December 9, 2016, the Swedish court dismissed Kazakhstan's application—which Kazakhstan amended to include the argument that the award is invalid as it would contravene Swedish public policy by reason of fraud by the Claimants. Meanwhile, the U.S. court rejected Kazakhstan's request to amend the set-aside application to add the alleged fraud (¶8).

Before the High Court, Claimants argued that the Swedish and the U.S. court decisions preclude Kazakhstan from successfully claiming that enforcement of the award would violate English public policy on the ground of fraud, and they requested the English court to dismiss the set-aside application. According to Kazakhstan, however, while the Swedish court's decision precludes it from pursuing the three points it initially argued in the English application, the amended application should proceed to trial as prima facie evidence of fraud exists that was only discovered after the arbitral award was issued (¶11).

3. Analysis of Legal Issues by the High Court of Justice

3.1. Public policy and enforcement

The High Court commenced its ruling with a brief summary of the relevant legal principles on the enforcement of arbitral awards in England, more specifically the Arbitration Act of 1996. Citing Sections 103(1) and (3) of the Act, the Court emphasized that the recognition or enforcement of a New York Convention award should not be refused unless doing so would be contrary to public policy of England, and that Section 103 of the Act "embodies a pre-disposition to favor enforcement of the New York Convention." (¶11). The Court added that the public policy exception in Section 103(3) is meant to maintain "the fair and orderly administration of justice." (¶11).

To determine whether an award was obtained by fraud or is contrary to public policy, "some form of reprehensible or unconscionable conduct [must have] contributed in a substantial way to the obtaining of the award." (¶11). According to the Court, "[i]t may be sufficient to

show that a party ‘had deliberately and dishonestly failed to disclose [material] in the arbitration and made submissions or called evidence which deliberately and dishonestly continued that concealment and misled the Tribunal’ and that the material would have had ‘an important influence on or would probably affect the result of the arbitration.’”(¶ 11). The Court warned, however, that public policy considerations, especially when relied upon to resist enforcement, “should be approached with extreme caution.” (¶ 11).

The Court went on to outline the two-part test to determine whether a New York Convention award should be set aside on the ground of fraud: 1) the evidence establishing the fraud was not available to the party alleging the fraud at the time of the hearing; and 2) there is prima facie evidence of fraud sufficient to overcome the extreme caution of the courts to set aside an award on the ground of public policy. (¶ 11). Furthermore, if the fraud alleged is perjury, “the evidence must be so strong that it would reasonably be expected to be decisive at the hearing, and if unanswered must have that result.” (¶ 11).

The fraud allegation in the present case centers on the Claimants’ initial damage claim with respect to the total cost of the LPG plant (¶ 24). The Tribunal—which based its damages valuation on the evidence supplied by the Claimants, witness testimony, and expert reports—awarded the Claimants US \$199 million for the plant. However, during proceedings before the Swedish court, and after the award had been issued, additional information challenging the Claimants’ original cost claims came to light (¶ 26). In particular, it was revealed that Claimants and a third-party (Parkwood) were related, a fact Claimants failed to disclose during the arbitration (¶ 26). Furthermore, a contract signed between Parkwood and the Claimants in February 2006 for the construction of the LPG plant and amounting to US \$115 million (a figure that later increased) was discovered through U.S. disclosure proceedings after the arbitration (¶ 27). According to Kazakhstan, the concealed contract shed light on a purchasing scheme between the Claimants and Parkwood that dishonestly overestimated the value of the LPG plant (¶ 28-32).

The newly discovered evidence was presented to the Swedish court, and Claimants were required to respond to the inconsistencies outlined by the State with respect to the value of the plant, including: the large, unspecified management fees paid by Claimants to Parkwood and amounting to US \$44 million; misrepresentation regarding the cost of equipment purchased by the Claimants from Parkwood, pursuant to which Claimants paid US \$124 million for equipment allegedly worth no more than EUR 31 million; purchases by Claimants amounting to US \$72 million for equipment that was allegedly never delivered; and overestimated interest on construction cost amounting to \$60 million for much lower construction costs. (¶ 27-33). According to the State, Claimants failed to provide consistent and clear answers regarding the inconsistencies revealed during the Swedish set-aside proceedings (¶ 34). The overblown and false costs were dishonest and had a cascading effect on everyone involved, including the Claimants’ auditors, the State bidder, the arbitral Tribunal, and the resultant arbitration award (¶ 34).

3.2. Availability of evidence of the alleged fraud

With respect to the first element of the two-part test, the High Court concluded that “the State did not have access before the Award to the evidence of the alleged fraud on which it now seeks to rely, and that the evidence of the alleged fraud could not with reasonable diligence have been discovered before the Award had the State used reasonable diligence.” (¶ 79). According to the Court, Claimants failed to disclose in their financial statements their relationship to Parkwood, meaning that most likely the auditors were also in the dark. They

also failed to disclose the contract with Parkwood, which was only discovered during the U.S. enforcement proceedings. The Court rejected Claimants' argument that the State had access to numerous documents before the issuance of the award, and it ruled that the Claimants, "if dishonest, are not to escape if the right stone was not turned over by the State." (¶ 73).

3.3. Effect of the alleged fraud

After determining that the State could not have discovered with reasonable diligence the necessary documents that shed light on the fraud prior to the award, the Court had to determine the effect of the alleged fraud. Taking into consideration the information provided by Kazakhstan, including the allegation that the true value of the LPG plant was misrepresented and inflated, the High Court concluded that it was necessary to establish whether the government bidder, as well as the arbitral Tribunal, relied on the false information provided by the Claimants (¶ 38). The High Court concluded that "there is the necessary strength of prima facie case that the alleged fraud would have made a difference to the Tribunal. And that, in asking the Tribunal to rely on the KMP Indicative Bid in circumstances (concealed from the Tribunal, as from the bidder) of the alleged fraud, there was a fraud on the Tribunal." (¶ 48).

3.4. Decision of the U.S. Court

The High Court also addressed the U.S. court's decision refusing the State's motion to amend its application to set aside the award on the ground of fraud (¶ 50). The U.S. court ruled that broadening the scope of the proceedings to determine whether Claimants misled the foreign arbitration panel when presenting evidenced related to the value of the plant would not be in the interest of justice (¶ 51). Reading the U.S. court's decision narrowly, the High Court found that the U.S. court did not decide the question of whether the KMG Indicative Bid affected the Tribunal's award (¶ 52). The High Court also added that the U.S. proceedings were stayed pending the decision of the Swedish court, and the State filed a motion for reconsideration by the U.S. court, advancing the position that in order to invoke the public policy defense under Article V(2)(b) of the New York Convention, "the alleged fraud need not be relied upon by the arbitral Tribunal." (¶ 54-55).

3.5. Decision of the Swedish Court

The High Court also discussed the decision of the Swedish court, which allowed that the initial application to set aside be amended to include allegations of fraud, but nonetheless dismissed the request as being insufficient to consider the award invalid.

Under Swedish law, an arbitral award is invalid on the basis of false evidence if it is clear that: 1) the false evidence was directly decisive to the outcome of the case; or 2) the false evidence had an indirect impact on the arbitral Tribunal in its analysis of the dispute so that it "appears to be obvious that such indirect influence has been of decisive significance for the outcome of the case." (¶ 60).

Applying this test, the Swedish court ruled that "the allegedly false information in the annual reports did not directly constitute any basis for [the Tribunal's] assessment of the value of the LPG [P]lant." (¶ 59). In sum, the court concluded that "none of the circumstances argued by [the State] in this respect – neither separately nor together – are such that [the Award], or the

manner in which it arose are manifestly incompatible with fundamental principles of Swedish law.” (¶ 59).

Reviewing the relevant parts of the Swedish decision, the High Court concluded that the Swedish court did not deal with the issue of indirect impact, and that it merely concluded that the bid itself was not false evidence as it did in fact exist. (¶ 64, 66). Thus the issue presented by the case still remained undecided.

3.6. Estoppel

Having carefully reviewed previous decisions on the matter, the High Court found that no court had decided the question of alleged fraud. “Neither the Swedish Court nor the US Court nor English Court has, although material has been put before those Courts that would allow them to decide that question.” (¶ 80). Furthermore, the Court noted that Article V(2)(b) of the New York Convention refers to the “public policy of the country of enforcement,” and that “[r]elevant public policy can and does differ from country to country. It is correct to say that the Swedish Court did not decide whether under English law public policy required the application to enforce the Award in this jurisdiction to be refused.” (¶ 84). While the Court agreed with the Claimants’ position that importance should be placed on the finality of international awards and the courts of the supervisory jurisdiction, it added that in exceptional cases, such as this one, the Court should intervene (¶ 89).

4. Decision

Finding that the State was not able with reasonable diligence to discover the fraud prior to the award, that there is prima facie evidence that the fraud affected the award, and that no prior court addressed the ground raised by the State, the Court decided to grant the State’s permission to amend the application to set aside the award. Subject to any developments before the Swedish and the U.S. courts, the Court also decided to give directions for a trial (¶ 95).