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Germany: Refusal to Allow Enforcement of an Annulled Award – How Long Can it Go On?

A Fresh Look at Article V (1) e) of the New York Convention

Munich Higher Regional Court July 30, 2012
and German Federal Court of Justice July 2, 2009

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Summary

The author considers whether a 2009 German Federal Court of Justice (Bundesgerichtshof – BGH) decision may have ramifications on the presently dominant view held by German doctrine and case law alike that awards annulled at their place of origin are incapable of being enforced in Germany.

Enforcement of foreign arbitral awards in Germany on the basis of "double-exequatur" – No; Policy considerations

Extraterritorial effects of foreign exequatur decisions – No; Enforcement of foreign arbitral awards in Germany on the basis of Article 1061 German Code of Civil Procedure (Zivilprozessordnung – ZPO) and the New York Convention; Scope of control by German courts

Enforcement of arbitral awards annulled at their place of origin – No; Conditions for the recognition of extraterritorial effects of foreign annulment decisions – Policy considerations

Article IX (2) European Convention; Article V (1) e) New York Convention

The Munich Higher Regional Court (*Oberlandesgericht* – OLG) recently again had to consider whether an arbitral award annulled at its place of origin could nevertheless be enforced under Article 1061 of the German Code of Civil Procedure (*Zivilprozess-ordnung* – ZPO). The OLG Munich dismissed the enforcement application (July 30, 2012, SchiedsVZ 2012, 339 sseq.). While that stance is in line with the current case law shaped by the German Federal Court of Justice (*Bundesgerichtshof* – BGH, *cf. e.g.* decision of May 12, 2007, SchiedsVZ 2008, 195 sseq.), and with the quasi-*unisono* doctrinal writings on the subject in Germany, a 2009 BGH decision (July 2, 2009, SchiedsVZ 2009, 285) has the potential to erode in the long run the stated certainty of that position, given the policy considerations it contains:

1. In 2009, the BGH ceased the longstanding practice under German law to allow, in addition to the "direct" enforcement of a foreign award on the basis of the New York Convention or the European Convention, the "indirect" enforcement of a foreign award through the recognition of a foreign enforcement judgment (exequatur) taken pursuant to the "doctrine of merger" (since BGH March 27, 1984, *NJW* 1984, 2765 sseq.). Based on the acceptance that in incorporating the operative part of the award, the foreign enforcement judgment had merged the award into a state court judgment rather than limiting itself to the mere declaration of the enforcement of the award, the foreign exequatur judgment was considered to be independently enforceable under German law pursuant to the rules governing the enforcement of foreign judgments. This was referred as the so called double-exequatur, given that, at the same time the award creditor retained the option to request "direct" enforcement of the award itself under the New York or European Conventions.

The 2009 BGH decision expressly puts an end to the double-exequatur enforcement option. As much as the BGH's considerations based on legal technicalities are interesting, the policy considerations expressed in the 2009 decision are of interest on a wider field:

The first policy consideration is based on the fact that the recognition of the sole enforcement judgment leads to the enforcement of an arbitral award in Germany under lower entry barriers than the recognition of the award itself. In fact, foreign judgments are recognized under the double condition of reciprocity and competent jurisdiction of the foreign court according to German rules on international jurisdiction (so-called "mirror principle"). The BGH expressly points to the fact that under those circumstances, the German courts are unable to examine independently whether the foreign award satisfies the conditions for its recognition under the relevant rules corresponding to the New York Convention[1]. Therefore, in order to procure the same standard

[1] Section 1061 ZPO.

to different arbitration parties, the independent examination of the award itself by German courts cannot be left to a foreign court in some cases, while in others it is not.

Furthermore, the BGH emphasizes that the foreign enforcement judgment which incorporates an award according to the doctrine of merger is limited, as a matter of public international law, to the recognition of said award on the territory of that foreign legal order. Such decision may not have an effect beyond the boundaries of the state whose judiciary is taking such decision. Therefore, whether the award itself may be enforceable in Germany is something to be decided by German courts, as a matter of public international law.

Finally, the BGH points to the consequence that the recognition of a foreign exequatur judgment would in practice undermine the very application of the New York Convention. According to its Article I (1), foreign arbitral awards are to be recognized and enforced in principle on the basis of the Convention, and in particular its Article V. To simply recognize a foreign exequatur judgment on the basis of the sole criteria of reciprocity and the "mirror principle" would fall short of the most favorable treatment clause of Article VII of the Convention, since it would mean in practice to disregard the criteria for the recognition of foreign arbitral awards under Article V of the Convention.

2. The 2009 decision of the BGH is to be fully approved, not only for the specific result to terminate the practice of double-exequatur for foreign arbitral awards[2]. It is also to be approved in so far as it clarifies the interplay of German courts with foreign jurisdictions when it comes down to appreciate the conditions for the recognition of foreign arbitral awards. Unfortunately, the lesson is not yet completely learnt when German courts are confronted with arbitral awards annulled by a foreign judgment.

The decision of July 30, 2012 of the OLG Munich mentioned in the beginning declares that a foreign judgment annulling an award in its country of origin is relevant under Article V (1) e) of the New York Convention and must (!) be recognized by German courts provided that the judgment was issued by the foreign court competent in this respect. In addition, as the decision considered a Ukrainian award definitively annulled by Ukrainian courts, recognition of the foreign annulment decision was subject to the verification that the annulment was based on one of the grounds provided under Article IX (1) of the European Convention (and not on public policy grounds, *cf.* Art. IX (2) of the European Convention). In this respect, the OLG Munich expressly states that the scope of examination by German courts does not extend to the verification as to whether the foreign court has correctly applied the relevant annulment grounds, as

2 *Cf.* H. Plassmeier, *SchiedsVZ* 2010, 82 *sseq.*

long as the judgement states that the annulment is based on these grounds. The foreign annulment judgment which passes that level of verification (competent jurisdiction and stated annulment grounds are European Convention grounds) has the effect that the award so annulled can no longer be enforced in Germany. According to the OLG Munich, an application for enforcement *"must be rejected according to Article V (1) e) of the New York Convention."*

The decision is in line with the approach taken by the BGH on the issue. In particular, in a 2007 decision, the BGH confirmed a judgment which refused the enforcement of a Belarus award *i.a.* on the ground that it had been annulled at its place of origin, in stating that according to Article V (1) e) of the New York Convention *"the recognition and enforcement of an award may be refused if it has been set aside by a competent authority of the country in which* [...] *the award was made*[3]*"*.

3. It is interesting to note that no theoretical underpinning is provided for that apodictic affirmation. It would, however, appear that after the 2009 BGH decision here above mentioned, and in taking into account the policy considerations it contains, some questions need to be answered.

If it is true that German courts should not defer to foreign exequatur judgments for the control as to whether a foreign award may be recognized in the German legal order, but such control should be independently exercised by the German courts on the basis of the applicable provisions corresponding to the New York Convention, it is not readily intelligible why the same should not be true with foreign annulment decisions. In simply recognizing the foreign annulment decision provided it is taken by the competent jurisdiction, German courts simply defer to the foreign courts with respect to the control as to whether the foreign award may be recognized in Germany. That seems to run against the very sensible policy consideration of the 2009 BGH decision.

The same is true with the policy consideration that foreign judgments in principle have effects only within the territory of that jurisdiction. With respect to the question whether a foreign arbitral award may be recognized in Germany, the New York Convention as a public international law instrument is available to determine that question. If it is a matter of public international law that a foreign exequatur decision may not prejudge for German courts the question whether a foreign award is to be recognized in Germany, it is not readily intelligible why the same should not be true with foreign decisions annulling the award. As a matter of public international law it would seem called for to apply the public international law instrument governing the subject issue rather than allowing the foreign court judgment to deploy its effects in this respect within the German legal order.

[3] BGH, May 21, 2007, SchiedsVZ 2008, 195.

Finally, in simply recognizing a foreign annulment decision, the autonomous application of the New York Convention by German courts is set aside in favor of the considerations by a foreign court, who does, for the purposes of the annulment, not apply the New York Convention. Here again, if the recognition of a foreign exequatur decision is regarded as undermining the very application of the New York Convention criteria for the recognition of the foreign award in Germany, why is the same not true if German courts simply recognize a foreign annulment decision instead of applying the New York Convention criteria to the question whether the award may or may not be recognized in the German legal order?

It seems that the policy considerations voiced by the BGH in its 2009 decision would make a strong case in favor of an independent control of foreign awards by German courts on the basis of the New York Convention criteria as incorporated into German law through Section 1061 (1) ZPO irrespective of an annulment decision by the courts at the place of arbitration.

4. It is true that Article V (1) e) of the New York Convention expressly allows that recognition and enforcement of a foreign award *"may be refused"* if the applicant can show that the award has been set aside by the competent courts at the place of arbitration.

However, in light of the purpose of Article V of the New York Convention as a whole and of the historical context in which the New York Convention came about, it is fair to say that the very existence of said provision is a left-over of the situation which governed the enforcement of foreign awards prior to the New York Convention[4]. By comparison to the governing system under the 1927 Geneva Convention, the essential change of paradigm of the New York Convention is the liberation of the arbitral award from the requirement to have been declared enforceable in the country of origin so as to show that it has become *final* within the meaning of Article 1 (d) of the 1927 Geneva Convention. In doing so, the perspective of looking at an award for its enforcement changed towards the sole country where the enforcement was sought for. The observation of possibly other than the New York Convention (Art. V (1)) requirements for the enforcement of an award abroad, as such may exist at the place of arbitration, should not be able to prevent the award from being enforceable in the enforcement jurisdiction. Therefore, the foreign award does not require anymore the rubber stamp of a foreign enforcement decision (exequatur). In this respect, the New York Convention has emancipated the arbitral award from the law at the place of its origin. This emancipation has continued since then and is ongoing with ever more speed. Just as arbitration in general has become an alternative rather than an exception to national means of dispute resolution, and arbitrators have gained judicial powers hitherto reserved to the judiciary, arbitral awards benefit from an ever growing acceptance of the whole system. In particular, the very proposition that an award annulled in its country of

4 *Cf. i.a.* Ch. Liebscher in *New York Convention Commentary* (ed. R. Wolf), 2012, Art. V, mn. 353 – 356.

origin ceases to legally exist *erga omnes* becomes outdated as national reticence to the system of arbitration as such diminishes.

Against this backdrop, the requirement under Article V (1) e) of the New York Convention, that the award has become binding, and that it has not been set aside, clearly represents a 1958 negotiating concession towards, and a left-over of the former concept that an award is rooted in the legal order of the place of arbitration[5]. It recognizes, and only recognizes the fact, that, if an award debtor were able to show that the award has not become binding (as opposed to "final") between the parties under the law where the award has been made, enforcement of such award *"may be"* refused. This perspective, and the overall purpose of the Convention as a whole, must have consequences on the construction of the *"set aside"* wording under Article V (1) e) of the New York Convention. The emancipation of the arbitral award from its local enforcement regime necessarily has consequences for the effects an annulment decision may have on the same award.

The first consequence is that an annulment decision at the place of origin does not, under the system of the New York Convention, necessarily have the effect to annihilate the award and deprive it from its effects in a global and absolute manner. As the BGH recognizes in its 2009 decision, a local court is not vested with the power to decide on legal situations with binding effect beyond its territorial boundaries. Interpreting Article V (1) e) of the New York Convention to the effect that it mandatorily gave effect to such decisions and excluded the recognition of arbitral awards set aside irrespective of the reasons and upon which grounds it is based would seem to disregard the very sensible policy consideration voiced by the BGH. In addition, it is not intelligible why the foreign decision accepting an annulment application, thus setting aside the award, should have stronger effects on German courts than the decision refusing the annulment application: it is undisputed that in the latter case German courts retain the independent control over the enforceability of the award so upheld by the foreign courts.

Therefore, in order to meet the policy considerations of the BGH as developed in its 2009 decision, Article V (1) e) of the New York Convention must be interpreted restrictively according to its real purpose (*"teleologische Reduktion"*): A foreign annulment decision may only be relevant and pass the entry test of being taken into account by German enforcement courts, if it is stated to be taken on the basis of one of the grounds recognized under Article V (1) a) – d) of the New York Convention. After all, it is not intelligible why the fact that an award had not been granted exequatur in the country of origin for reasons which may go beyond the Convention

[5] *Cf.* LIEBSCHER, *o.c.*, Art. V, mn. 355; see also E. GAILLARD, *Legal Theory of International Arbitration*, Nijhoff (Leiden-Boston), 2010, p. 30 *seq.*

grounds (Art. V (1) a) – d)), and thus possibly the corresponding decision refusing the exequatur, is irrelevant under the New York Convention (abolishment of double-exequatur), whereas the decision to annul an award, including for non-Convention grounds, may be relevant, or, as current German case law suggests, *shall* be relevant. In other words, why should annulment decisions have extraterritorial effects, if decisions on the enforceability clearly have not? Therefore, in order to allow a synchronic implementation of the purposes of the New York Convention – which, and this is important to stress, harmonizes the recognition and enforcement of foreign awards, not their setting aside – it is submitted that Article V (1) e) of the New York Convention must be restrictively construed to the effect that local set-aside decisions may only claim to be taken into account by the enforcement country if they are stated to be taken on the same Convention grounds for which enforcement could be refused (*i.e.* Art. V (1) a) – d)).

The immediate further consequence of such a restrictive interpretation of the scope of Article V (1) e) of the New York Convention is that it eliminates the relevance of annulment decisions taken for public policy reasons. As can be seen from Article V (2) b) of the New York Convention, the perspective of public policy violations is clearly from the enforcement forum.

Such solution corresponds to the enforcement situation in cases where the European Convention is applicable (*cf.* Art. IX (2) of the European Convention). In fact, one may question the soundness of differentiating between enforcement solutions depending upon the pure nationality of arbitrating parties, in particular where such differentiation is not mandatorily called for by the very provision of the New York Convention which purportedly justifies the differentiation:

As can be seen from the wording of Article V (1) of the New York Convention, the enforcement of an award which has been set aside in the country of origin is by far not prohibited under the system of the New York Convention. Article V (1) clearly states that the recognition and enforcement of such an award *"may be refused"* (*"darf nur versagt werden"*). Thus, refusal of enforcement under Article V (1) is by far not mandatory, but leaves discretion to the enforcement court.

Having this in mind, the application of the policy considerations voiced in the 2009 BGH decision still has a further consequence:

Even where a foreign award has been annulled on a stated Convention-ground, German courts should retain a control over the correct application by the foreign court of said Convention grounds. As the BGH correctly states in its policy considerations in the 2009 decision, the control as to whether a foreign award may or may not be recognized and enforced in Germany is a matter for German courts to verify. Comity may attenuate such control under the circumstances, owing to the fact that the

Convention grounds are internationally recognized criteria and that their differing application may have to be accepted within the realm of the New York Convention. Nevertheless, the control should allow to disregard purely local notions attributed to the different criteria of the Convention grounds[6]. Thus for example, annulment decisions on the stated reason of improper constitution of the arbitral tribunal (Art. V (1) d)) because an arbitrator did not fulfill local requirements of religion or gender, or on the stated reason that the agreed or local procedure was disregarded (also Art. V (1) d)) because the witnesses did not take a religious oath, may very well be disregarded in the enforcement procedure before German courts.

It is therefore submitted that the policy considerations contained in the 2009 BGH decision provide a new tool kit, the application of which would call for a self-contained interpretation of Article V (1) e) of the New York Convention. Based on the pro-enforcement purpose of the New York Convention, the balance between the claim to an independent control of a foreign arbitral award by German courts on the one hand and the limited reach of foreign decisions with respect to such control on the other hand requires that foreign annulment decisions are relevant for German courts under Article V (1) e) of the New York Convention only if they are reasonably based on one of the accepted grounds of the New York Convention allowing refusal to recognize an award (Art. V (1) a) – d)). Such a restrictive application of Article V (1) e) of the New York Convention would be covered, with respect to Germany's obligations under public international law, by Article VII of the New York Convention given that the relevant provisions of the New York Convention do in fact constitute the local German law on the recognition and enforcement of foreign arbitral awards (Section 1061 (1) ZPO).

5. There may, however, be a glimpse of hope: It is not without interest to note that both the most recent decision of the BGH on the issue of enforcement of an annulled award[7] and the decision of the OLG Munich here reported (*supra* 2.) do not satisfy themselves with the finding that the foreign award had been annulled at the place of origin, but explicitly continue to verify whether the award would have been capable of recognition and enforcement independently of such annulment decision. The wording of the BGH in its 2007 decision may almost be understood as a promise:

> *"To refuse recognition, the Higher Regional Court, however, has not simply found it sufficient –* ***without such approach to be explored further in this context*** *– that*

[6] For examples *cf.* J. Paulsson, "Enforcing Arbitral Awards Notwithstanding A Local Standard Annulment (LSA)" in *ICC Bulletin* Vol. I/N°9 (1998), p. 14 sseq.

[7] BGH May 21, 2007, SchiedsVZ 2008, 195.

> *the award had been annulled by the (competent) court of the country of origin. Quite to the contrary, the Higher Regional Court went on to examine whether the Highest Commercial Court [of Belarus] has annulled the award 'in fine rightfully', and has found the annulment justified."*

The BGH concludes:

> *"If therefore, according to the non-questionable findings of the Higher Regional Court, the award has been made, under violation of the procedural rules applicable to the arbitration, by only two of the three members of the arbitral tribunal, the award* ***already*** *cannot be recognized pursuant to Article V (1) d) of the New York Convention [...]"* (emphasis added)

The OLG Munich adopted exactly the same approach and did not satisfy itself with the apodictic declaration that if *"a foreign award is annulled in the country of origin, it can have no* [German] *domestic effects; there is no more room left for an enforcement declaration."* On the basis of that approach, the OLG Munich could have stopped there, given that the award had been annulled by the Ukrainian courts on the stated ground that the constitution of the arbitral tribunal was defective, and that ground was relevant under the European Convention (Art. IX (1) d)).

However, in a second, much larger part of the decision, the OLG Munich nevertheless undertook to explain why enforceability of the award was to be refused in Germany in any case:

> *"In addition, the enforcement declaration is to be refused also on the ground that the award, in so far as it contains the condemnation of the respondent to pay, violates Article V (2) b of the New York Convention (ordre public)."*

Thereupon, the OLG Munich deploys considerable efforts to explain why the public policy reasons, which had constituted an additional ground for the annulment of the award for the Ukrainian courts, had the effect to also violate German public policy, and that the award could not be enforced in Germany already on that basis independently of the fact that it had been annulled at the place of origin.

With respect to the independent control by German courts of awards presented to them for enforcement and the corresponding condition precedent that an award may be declared enforceable in Germany despite an annulment decision at its place of origin, one may therefore conclude with one auspicious, and one dropping eye: We are not yet there, but we will be getting there.