

Kluwer Arbitration Blog

Egypt Court Annuls Award against Libya on the Substantive Ground of Fundamental Error of Law

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In a ‘ground-breaking’ precedential decision, *Al-Kharafi v Libya* (Judgment No. 39 of 130 JY, 3 June 2020), the Cairo Court of Appeal in Egypt ruled that it can review an arbitral award for fundamental errors of law that amount to a violation of public policy or equity and justice notions.

The decision relates to an *ad hoc* arbitration under the [Unified Treaty for the Investment of Arab Capital in the Arab States](#) (the “**Unified Treaty**”).

The original arbitration award was issued on 22 March 2013 ruling that the State of Libya was responsible for breaches of contract, national law and the Unified Treaty.

Background

In 2006, the Libyan Ministry of Tourism entered into a 90-year land leasing agreement (the “**Agreement**”) with Kuwaiti investor Mohamed Abdulmohsen Al-Kharafi (“**Al-Kharafi**”) for 240,000 m² of state-owned land in Tripoli for the construction and operation of a tourism complex.

The project was supposed to start 7 years after signing the Agreement; however, construction work never commenced. The Libyan Ministry of Economy cancelled the project in 2010 and terminated the Agreement.

Al-Kharafi launched an arbitration case in 2011 under the Unified Treaty claiming compensation from the State of Libya for failing to hand over the project land “free of occupancies and persons”, and hence delaying the construction, and for illegally cancelling the project and terminating the Agreement.

The arbitral tribunal was constituted under the Unified Treaty with Cairo chosen as the seat of the arbitration. The tribunal was composed of Dr. Abdel Hamid El-Ahdab (presiding arbitrator), Dr. Ibrahim Fawzi (Al-Kharafi’s nominee) and Justice Mohamed El-Kamoudi El-Hafi (State of Libya’s nominee).

The tribunal issued its final award on 22 March 2013 ordering Libya to pay:

- US\$ 5 million for losses and expenses;

- US\$ 30 million for moral damages;
- US\$900 million for lost future profits for 83 years, representing the length of the terminated Agreement;
- US\$ 1.94 million for arbitration costs and expenses; and
- 4% interest on all amounts awarded from the date of the arbitral award until full settlement of the said amount.

First annulment attempt

Libya brought an annulment action to set aside the arbitral award before the Egyptian courts, being the courts of the seat of arbitration.

On 5 February 2014, the Cairo Court of Appeal, in its Judgment No. 39 for 130 JY, dismissed Libya's annulment claim on the basis that an award rendered on the basis of the Unified Treaty is final, and may not be subject to any challenge before the courts of the member states. The court relied on Article 2(8) of the Unified Treaty's Annex, which provides that:

“[a]wards of an arbitral tribunal rendered in accordance with the provisions of this article shall be final and binding ... No appeal may be made against arbitration awards”.

No contradiction between ‘finality’ and ‘annulment’ proceedings

Libya challenged the judgment before the Egyptian Court of Cassation which vacated the judgment and referred the case back to Cairo Court of Appeal by virtue of its [Judgment No. 6065 of 84 JY, 4 November 2015](#).

The Court of Cassation ruled that the Unified Treaty prohibits challenging an arbitral award through the means of recourse set forth for national court rulings. The treaty, however, does not prohibit a party from initiating an annulment action, which is an exceptional mechanism for reviewing final awards on the limited grounds mentioned in the [Egyptian Arbitration Law No. 27 for 1994](#) (the “**Arbitration Law**”).¹⁾ These grounds are mainly concerned with due process and the integrity of the arbitration process itself, and do not allow the court to re-examine the case on the merits or facts, unlike an appeal.

The Court of Cassation further noted that every arbitration seated in Egypt is subject to the rules of procedure under the Arbitration Law, including the procedure for annulment proceedings, which aims at correcting and guarding against manifest mistakes and serious irregularities in the arbitral process.

The Court of Cassation observed that arbitration is neither an “absolute” system nor an “end in itself”; it is rather a “legal system” that has specific rules and essential boundaries. A tribunal is not allowed to exceed such boundaries or to violate the essential rules of justice and equity, or to deviate from the applicable legal and ethical obligations under the guise of finality of arbitration awards.

The court therefore held that there is no contradiction between the finality of the arbitral award and

the annulment procedure, and ordered the lower court to hear the annulment claim initiated by the State of Libya.

Second annulment attempt

On 6 August 2018, the Cairo Court of Appeal, in its Judgment No. 39 of 130 JY, dated 6 August 2018, dismissed the annulment claim of Libya again, but this time on the procedural ground that it lacks jurisdiction over arbitration awards issued under the Unified Treaty.

Libya appealed the decision again before the Court of Cassation. On 10 September 2019, the Court of Cassation, for the second time, overturned the decision of the Cairo Court of Appeal and referred the case back to the Cairo Court of Appeal, ordering it to decide the case on the merits. The Court of Cassation ruled in its [Judgment No. 18615 of 88 JY, 10 December 2019](#) that the Cairo Court of Appeal had erred in dismissing the case on the basis of a lack of jurisdiction.

The Court of Cassation reconfirmed that the Arbitration Law is the umbrella under which all arbitrations seated in Egypt are run, and the Cairo Court of Appeal, according to the Arbitration Law, has explicit jurisdiction to hear annulment actions against international arbitration awards.

Annulment on the basis of fundamental errors of law

The arbitration award returned for the third time to the Cairo Court of Appeal, which finally issued a decision on the merits by virtue of Judgment No. 39 of 130 JY dated 3 June 2020 (the “**June 2020 Judgment**”).

The court annulled the arbitration award on the basis of serious mistakes of law, noting that the tribunal had grossly and egregiously misinterpreted and misapplied the law, amounting to a failure to observe rules of public policy and the well-established notions of equity and justice.

The court disagreed with the tribunal’s method of calculating the compensation amount, and considered the compensation disproportionate to the damage incurred as a consequence of the claimed breach of obligations.

The tribunal had ordered Libya to pay US\$900 million for “lost profits resulting from real and certain lost opportunities”, while the investor had only invested US\$5 million at the time of bringing the case, and construction work in the project never commenced.

The court described the US\$900 million compensation to be “unfair” and “excessively unjust”, and to exceed the incurred damage in a “fatal, inappropriate and totally unjustifiable manner”.

The tribunal based its award for lost profits on four reports that Ernst & Young, Prime Global (Khaled El-Ghannam), Habib Khalil El-Masri and Ahmad Ghatour & Partners had prepared at the claimant’s request.

The court observed that the reports lacked credibility, as they were based solely on data and information provided by the claimant which were not independently verified, and which were

based on mere ‘abstract assumptions’ and ‘hypothetical speculations’ that lacked factual support.

Proportionality of compensation is part of the public policy rules

The Cairo Court of Appeal stated that the principle of proportionality of damages is an integral part of the international public policy rules, and an award should be set aside when the amount of compensation is manifestly disproportionate to the damage incurred.

Reference was also made to Article (9) of the Unified Treaty, which provides that compensation due to investors should be equitable and proportional to the damages incurred.

The arbitral tribunal had held that Article 224 of the Libyan Civil Code (confirmed by Libyan case law) provides for the right to compensation for lost profits if it is “real and certain”.

The Cairo Court of Appeal, however, warned that caution has to be taken when determining compensation for lost profits. The right to compensate for lost profits has to always be “mingled with justice” and not be interpreted or applied “in abstract or in a rigid way”. Compensation for lost profits has to be built upon solid grounds rather than mere “unrealistic aspirations”, “imaginary illusions” or “baseless perceptions”.

The court held that the tribunal had erred in calculating the compensation, as it considered the lost future profits expected over the 83-year period of a “potential” project that was never established to be “certain” and “real”.

The court said that the claimed damage resulted from losing the opportunity was “speculative”, “unrealistic” and too “remote” to be compensated. It did not take into consideration the circumstances of the host country and the fact that it is generally not an attractive touristic destination, in addition to the fact that it is suffering multiple and complicated challenges for foreign investment. These are all clear facts that the tribunal overlooked while calculating the expected lost future profits of the “potential” project.

Courts should not be left handcuffed before abuses of arbitral powers

The court considered the compensation amount to entail manifest exaggeration and overindulgences that renders the award extremely “unjust”, “abusive”, and “discriminatory”. It held that although courts’ ability to review arbitration awards is limited, a court may review an arbitration award where arbitrators exceed their powers by issuing an award that is “completely irrational” or exhibits a “manifest disregard of the law”.

The tribunal was described as violating the simplest “equity” and “justice” notions that are among the well-established general principles applicable to international law. The tribunal was further blamed for committing material and prejudicial errors of law, in addition to building the award upon factual findings that were clearly unsupported by the record. The Cairo Court of Appeal therefore decided to annul the arbitral award in its entirety.

Conclusion

Egyptian courts have always limited their review of arbitral awards to the exhaustive annulment grounds under Article 53 of the Arbitration Law. These grounds are mainly related to the validity of the arbitral process itself, or the basic procedural rights of the parties or the arbitral mandate (jurisdictional and admissibility issues). There are no express provisions under the Arbitration Law for directly challenging an award on ‘substantive grounds’ such as mistake of law or fact.

One of the annulment grounds, however, is violation of public policy rules, a ground which is wide enough to allow courts to review the merits or substance of an arbitral award.

Egyptian courts have in the past narrowly interpreted public policy ground and usually prevent its use as a backdoor appeal. For example, the Cairo Court of Appeal held that not every violation to a mandatory rule is a violation of public policy; public policy rules are only those related to the organization of the state and its higher values (Cairo Court of Appeal, Judgment No. 124 of 119 JY, 2 February 2010). The Egyptian Court of Cassation also held that the lack of reasoning is not considered a violation of a public policy rule that may lead to annulment of the arbitral award (Court of Cassation, Judgment No. 2698 of 86 JY, 13 March 2018). Also, the refusal by the arbitral tribunal to allow the joinder of the joint debtors was not considered a violation of due process or public policy rules (Cairo Court of Appeal, Judgment No. 70 of 123 JY, 9 March 2011). Generally, Egyptian courts annul an arbitral award on public policy grounds only if it is repugnant to fundamental social, economic and political interests of the society (Court of Cassation, Judgment No. 10132 of 78 JY, 11 May 2010).

The June 2020 Judgment of the Cairo Court of Appeal suggests, however, a possible shift in judicial attitude towards arbitration, as it demonstrates a willingness to review arbitral awards on substantive grounds such as manifest errors of law or fact, or substantive public policy rules.

The June 2020 Judgment is liable to being challenged before the Court of Cassation. It remains to be seen whether Al-Kharafi will continue the series of appeals by challenging it, and how the Court of Cassation will react if this case comes before it yet again.

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References

?1 The Arbitration Law entered into force on 22 May 1994.

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