

Public Policy as a Limit to Arbitration and its Enforcement

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1. Introductory Note

As is obvious from the programme of our Conference today, the space available to each speaker is extremely limited. In due respect to my colleagues on the panel, I intend to comply with this limitation. However, therefrom, it is also clear that all I can do is to contribute to the overview regarding the most common grounds for refusing enforcement of arbitral awards under the New York Convention by a very short and necessarily eclectic approach. I will do that in this context by concentrating on the ground of PUBLIC POLICY.

But even in concentrating on Public Policy I will have to limit my presentation considerably, because this concept and its relevant applications could easily fill a full day conference by itself. Some older colleagues in the audience may perhaps still remember that, at the 1986 ICCA Congress in New York, my report dealing only with the relevance of public policy for arbitrability took a much longer time and many pages in the later publication.

2. The Concepts of Public Policy

Since that time, the topic of public policy has by no means become easier and clearer. Quite to the contrary, to avoid misunderstanding, one has to realize that a number of different concepts of public policy have developed both under the New York Convention and otherwise.

The scope of Public policy in the context of international arbitration goes wider than that of the New York Convention where it may be a defence against enforcement once the arbitral award is rendered and thus the issue appears only at the very end of the arbitral procedure. Public policy is also relevant for arbitrability and thus concerns the very beginning and basis of the arbitration, namely the arbitration agreement or arbitration clause, though this relevance may also still be used at the end as a defence against enforcement.

Furthermore, it should be noted that public policy plays a greater role in the theory of arbitration than in practice. As a last resort against the application of agreements, rules and awards which otherwise would have to be respected, its abstract role is indeed a fundamental one from the viewpoint of the respective legal system. Although in every state or other community with a separate legal system the codified and uncodified law reflects the basic convictions and values of that community, those responsible for the legal system in the community feel that even the correct application of the law, especially if its conflict of law rules lead to the application of rules or awards created outside the domestic jurisdiction, may hurt standards *"so sacrosanct as to require [their] maintenance at all costs and without exception"* (Cheshire and North) or, since the notion of public policy in private international law is not always identical to that in the field of arbitration,⁴ if a court feels that enforcement of the arbitral award *"would violate the forum state's most basic notions of morality and justice"* (US Supreme Court).

This description, in addition to the absolutely exceptional character of the principle, indicates the relativity of the very concept of public policy:

First of all, public policy is dependent on the judgment of the respective legal community. What is considered to be part of public policy in one state may not be seen as a fundamental standard in another state with a different economic, political, religious or social, and therefore, legal system.

In view of a regional or international community or legal system such as the European Union, only its common denominators in values and standards can be the basis for its eventual public policy, and they may obviously differ from those of the individual member states.

A second relativity is introduced by the time factor. The values and standards of communities are not stable, they change and develop. So does public policy since it is derived therefrom. Thus, with regard to arbitration, domestic public policies have changed over the years, influenced by a number of factors such as national developments in the political and legal system, the involvement of the national economy in international trade, political decisions such as the promotion of foreign investment. A similar change in time has come from international developments such as the coming into force of the New York Convention, the growing acceptance of arbitration by other states, and the growing infrastructure and legal security of international arbitration which has made it more difficult for states to adopt or keep a negative approach to arbitration if they wanted to participate in international trade and investment to the benefit of their countries. Although sometimes concepts of public policy were widened leading to greater restrictions in arbitrability in certain countries, the general trend is clearly that public policy limits to international arbitration have been reduced considerably. The growing acceptance of the doctrine of separability with regard to arbitration clauses in contracts has contributed its share to that development.

If we look not at the trend of development, but at the present point in time, a similar conclusion is possible: in the modern practice of courts and arbitral tribunals, public policy does not seem to be a major obstacle to international arbitration. At least that can be said for international as distinct from national arbitration.

In this context, attention should also be drawn to the distinction between public policy and public law. In most national legal systems public law will typically be mandatory, but, by no means also thereby automatically part of and reach the level of public policy. This is especially obvious for more technical rules of public law which do not reflect fundamental principles, but are only mandatory for reasons of legal efficiency.

In view of all these varying factors, it is not surprising that public policy has been receiving rather different denominations and interpretations in the major jurisdictions by their courts and authors. Just to mention a few, besides the term public policy, we find denominations such as *ordre public*, *lois de police*, and furthermore the distinction between domestic, international, transnational and

truly international public policy. All of these concepts, of course, also receive their own distinctive interpretations which, for obvious reasons, I do not have the space to go into here.

In order to, nevertheless, come to a common denominator, the Arbitration Committee of the International Law Association (ILA) has undertaken a research and exchange involving representatives of the major legal systems and arbitration experts which resulted in a Report with Recommendations of 2002. Again, here I cannot go into its details, but let me at least note that the Report is very helpful in establishing what can be considered a widely accepted notion of international public policy.

What we have to conclude from these concepts for our further considerations is, however, that before relying on public policy in a particular context or case, we have to make sure we understand which of these concepts is used or applicable and, furthermore, whether it has to be adapted in its relativity to the jurisdiction and the point in time at stake.

3. Public Policy as a Limitation to Arbitrability

While in the text of the New York Convention, the term *public policy* is expressly used only in Art. V(2)b, as mentioned before, the relevance of a public policy limitation starts much earlier, because Art. V(1)a and (2)a permit refusal of recognition and enforcement of an arbitral award due to lack of arbitrability.

As we all know, party autonomy and the specific rights of the parties derived therefrom to choose arbitration instead of national courts to settle their commercial disputes are the well known fundamental conditions for international commercial arbitration. If, therefore, the jurisdiction of the arbitrators can only go as far as the parties by agreement have authorized them, one has to add immediately, that this jurisdiction can also go only as far as the parties *can* authorize them. Limits of party autonomy thereby become limits for the jurisdiction of the arbitrators. The lack of arbitrability is such a limit, and often that limit is part of public policy.

Though it may be true that it is for historical reasons that the New York Convention deals with arbitrability and public policy in separate sections, the distinction as such does not seem superfluous. Legal rules restricting arbitrability need not necessarily be part of public policy. It may well be that such restrictions only have to be applied by arbitrators or courts if they form part of the law applicable to the dispute, but need not be considered as being so fundamental that they are part of the public policy of the state with the effect of having to be applied even if another law is applicable to the dispute. Thus, although rules limiting arbitrability will always be meant as mandatory rules not subject to change by party autonomy, it is important to note, since this is not always seen, that mandatory rules are not necessarily identical with public policy rules. Public policy requires further additional qualifications.

In this context, a note seems appropriate regarding the distinction between Objective Arbitrability and Capacity as Subjective Arbitrability, and that the traditional notions of arbitrability and capacity, as well as the dogmatic distinction between both, may need some reconsideration. The seemingly clear dividing line between both is that "arbitrability" answers the question *what* can be arbitrated, and that "capacity" answers the question *who* can submit to arbitration. Although it may satisfy the desire for dogmatic clarity to consider and treat both as different animals, dogmatic distinctions can, however, only be accepted as a reason for differences in the application of law if they are found to reflect different functions in the law. It is doubtful, however, whether this is so in all cases between arbitrability and capacity. The final effect for the arbitration agreement and for the arbitration procedure is identical: the arbitration agreement is invalid and the arbitrators lack jurisdiction, if either one of the two is missing. In regulating arbitrability on the one hand and capacity on the other hand, different means are employed to regulate the same question, namely whether arbitration is to be an accepted method of dispute settlement or not. If the term "arbitrability" is seen as answering that question, also regulating what is commonly understood as "capacity" is in fact a regulation of arbitrability by subjective criteria, namely by criteria connected with the parties in arbitration. And even if one wishes to stick to the traditional restricted concept of "arbitrability" as excluding such subjective criteria, one will have to admit that such objective arbitrability and capacity supplement each other, and that a realistic answer to the basic questions at stake, whether the arbitral agreement is valid and whether arbitration is admissible, can only be given if both aspects are examined. And the same connection is relevant for the legislator. If he wishes to prohibit arbitration for certain categories of disputes, he may employ either objective or subjective criteria. And although these two types of criteria may not always be available interchangeably, e.g., for the protection of minors one can only use subjective criteria and for the exclusion of certain antitrust matters only objective criteria may be available, they are used by legislators and considered in the practice of international arbitration in connection with each other.

Although this may mean a widening of a traditional dogmatic concept, therefore, in order to see public policy and arbitrability in their full context, it must be seen that public policy can lead to limitations or lack of arbitrability in two ways. Most commonly one will think in this context of certain fields of law or kinds of disputes which by their subject matter are excluded from arbitration and reserved for state courts such as certain antitrust matters. In this category, what is lacking, may be called "objective arbitrability". For, there is a second category where not the object of the dispute, but the subject involved leads to the same effect, namely that the dispute cannot be settled by arbitration. In the context of international commercial arbitration that concerns us here, this "subjective arbitrability" or "capacity" to submit to arbitration may be lacking especially for persons needing protection such as minors or for certain state institutions on the basis of national laws. Both with regard to objective and to subjective arbitrability, the exclusion of arbitration as a means for settling disputes may be considered of such

fundamental importance that it becomes part of public policy of the applicable law.

4. Public Policy as a Limit to the Procedure of Arbitration

Modern arbitration laws and modern arbitration rules, though containing certain rules on how the arbitral procedure may be conducted, give a wide discretion to the arbitrators in this respect. In fact, most of such rules are subject to possible changes by agreement of the parties which may be expressed ad hoc for the case at hand or by reference to the arbitration rules of one of the many national or international arbitration institutions.

Nevertheless, the New York Convention provides a number of grounds for refusal of recognition and enforcement which deal with procedural questions: In fact, in Art.V(1), paragraphs (b), (c), (d), and (e) deal with faults of the arbitral procedure.

Paragraph (b) with the lack of proper notice to a party,

Paragraph (c) with procedures going beyond the submission to arbitration,

Paragraph (d) with a composition of the tribunal or a procedure not in accordance with the agreement of the parties or the law of the place of arbitration,

and Paragraph (e) with an award which has not yet become binding.

However, such procedural faults are by no means automatically a breach of public policy.

First, as can be seen from the introductory sentence of Art. V paragraph (1), such faults become only relevant if a party invokes and proves them to the competent authority, while breaches of public policy can lead to refusal of recognition and enforcement independent of a party's action as can be seen from the introductory sentence of paragraph (2).

Second, while not every procedural fault contemplated in paragraph (1) is a breach of public policy, the fault at stake may be considered such a grave procedural of fundamental principles of due process in the respective jurisdiction that it crosses the much higher threshold of public policy.

One should add that the practical relevance of this procedural public policy is reduced by two factors: First, parties contesting an award will normally rely on the express procedural faults of Art. V (1) mentioned above. And secondly, a simple breach of mandatory rules of the applicable arbitration law both at the place of arbitration and in the enforcement state are not sufficient to establish a breach of public policy.

Nevertheless, the principle of procedural public policy has been recognized widely by national courts, if the proceedings deviate from basic principles of procedural law in such a way that they cannot any more be considered as a fair trial or due process,

particularly in cases of a lacking valid submission to arbitration, of unequal treatment of the parties regarding the constitution of the arbitral tribunal or the submission of evidence, of violations of the right to be heard, of lack of impartiality of the tribunal, and of awards resulting from fraud. It does not need further explanation that many of such breaches of procedural public policy are easier to list in the abstract than to prove in practice.

In this context, disputed areas in principle or in practice are the questions whether infringements of procedural public policy may also be accepted, if evidence is obtained in breach of fundamental human rights such as the right to privacy or if, contrary to a mandatory rule to provide reasons in the award, no reasons are given by the tribunal.

Finally, it should be noted that it may be considered relevant for a breach of procedural public policy whether remedies were available either to the arbitral tribunal itself, or to the arbitral institution whose arbitration rules were applicable, or to the local courts at the place of arbitration. In so far as public policy has the purpose to protect the parties, if a party has not used such remedies, the courts may not accept a breach of public policy at the stage of recognition and enforcement.

5. Public Policy as a Limit to Substantive Decisions in Arbitration

The starting point in considering what has been called *substantive public policy* is its exceptional character. All modern arbitration laws provide, and beyond, there is general agreement that it is a fundamental principle of commercial arbitration that its substantive decisions are not subject to appeal before the courts. In other words, claiming that the arbitrators misinterpreted the facts or misapplied the law of a case, is no ground for refusal of recognition and enforcement. It is the very intention of the submission to arbitration that the case be decided by a final and binding decision of the arbitrators.

From what we have seen so far, it is obvious that this is even more so for a claim that recognition and enforcement would infringe public policy. Even a clear misapplication of mandatory rules and public law rules of the applicable law is not sufficient, because as mentioned before, they are not automatically part of public policy.

In this context, one must also realize that Art. V(2) of the Convention reduces the application of the public policy limitation in two ways: First, its introductory sentence, by the word “may”, permits, but does not mandates refusal and thus gives the court discretion in this regard. And secondly, its paragraph (b) requires that not only the award as such, but its recognition and enforcement would be contrary to public policy.

If and when this is the case will depend on the concept and interpretation of public policy by the court and its national legal order and jurisdiction. As already mentioned in the beginning of this presentation, there is no world wide conformity in this regard. In fact, a great variety of approaches has been identified between what has been called the Maximal Judicial Review and the Minimal Judicial Review and again, there is no room here to go into details. Nevertheless, some common denominators and leading examples can be identified.

Most courts in most jurisdictions seem to have accepted to use their above described discretion by a policy in favour of arbitration to the effect that, in case of doubt, an award should be found to be enforceable. Here, one has to add, however, that in a number of states, this policy is less applied by the lower courts and more by the highest court of the jurisdiction. In practice, this leads to the unpleasant result that parties may have to spend years in several levels of the courts before receiving the authoritative and final decision.

Further, there seems to be wide recognition for the interpretation of the New York Convention to the effect that Art. V provides an exhaustive list of challenges to the award and, since that list does not include mistakes in fact or in law by the arbitrators, these latter cannot be relied on for a challenge, let alone for one under public policy.

Nevertheless, all this does not exclude that, in exceptional circumstances, the court may look into the substance of the case and find the recognition and enforcement of the decision to be contrary to public policy. Examples are cases where the fulfilment of the award would constitute a criminal offence, would enforce or protect prohibited activities such as terrorism, drug trafficking, money laundering, smuggling, or genocide.

A disputed and complex area in this context is the enforcement of certain mandatory economic laws which protect fundamental interests of the state or of the international community. Examples are certain foreign trade laws regarding currency restrictions and restrictions of import and export of certain goods, particularly the export of weapons or high technology knowhow, and embargo restrictions of the United Nations Security Council. Another disputed set of examples are laws protecting consumers, laws against price fixing and anti-trust laws of the state or of a regional character as those of the European Community. Sometimes, fundamental principles of private or commercial law may also be considered as part of public policy such as that of legal certainty protected by the rules prescription. The enforcement of awards granting punitive damages, not however of liquidated damages and compound interest, has also been considered as contrary to public policy in some jurisdictions where the concept of statutory punitive damages is unknown. And in front of this meeting of lawyers, I should not omit that the enforcement of what was considered excessive attorney fees has been challenged under public policy though with little success.

6. References and Sources

This necessarily short and eclectic presentation cannot provide room to the great number of sources, cases and legal writings relevant to our subject. A helpful international and comparative document is the Report with Recommendations on Public Policy by the ILA Arbitration Committee of 2002. A continuously updated collection of material and cases over many years is, of course, available by the *ICCA Yearbooks Commercial Arbitration* edited by Albert Jan van den Berg. Most recent detailed reports on the subject are available by Stephan Kröll as one of the co-editors in the just published book *Arbitration in Germany – The Model Law in Practice* (Böckstiegel, Kröll, Nacimiento, Kluwer 2007), as well as in a comprehensive article on *Public Policy in International Commercial Arbitration* by Bernard Hanotiau in the book which will be published very soon by Emmanuel Gaillard as editor on *Enforcement of Arbitration Agreements and International Arbitral Awards – The New York Convention 1958 in*

Practice. Interesting statistical reports have recently been published on setting aside procedures by Sarita Woolhouse for the 10th anniversary of the English Arbitration Act (Global Arbitration Review Vol.II Issue 1) and by Felix Dasser for Switzerland (25 *ASA Bulletin* 2007, 444seq.).

7. Future Perspective

Compared to the situation at the time of the Geneva Protocol and Convention in the Nineteen-Twenties and when the New York Convention was negotiated, drafted and put up for signature and ratification in and after 1958, we are certainly on safer ground. Today, it is obvious that the Convention on one hand contributed to and on the other hand has become part of the success story of international arbitration in general within the framework of international trade and investment.

International arbitration is, of course, imbedded in the general framework of international law and, in turn, international law reflects the challenges of the world community. Over the last decades, both by the United Nations and other government organisations, by the fora and exchanges provided by non-governmental organisations such as the ICC and ICCA, and by the almost unlimited number of publications and meetings discussing all issues of arbitration, the procedural and substantive legal framework of the international community, including that dealing with the recognition and enforcement of awards, has been developed into an impressive body of law and practice. The New York Convention was not only the starting point for this development, but its large number of ratifications also presents the highlight of respective codification.

In this context, public policy remains one of the last resorts to protect what is considered by states as their specific national sacrosanct taboos and interests. Though public policy is used less and less in practice as barring recognition and enforcement of arbitral awards, the many concepts and interpretations still found in practice and legal writings produce an unwarranted insecurity and lack of predictability. Further improvement efforts will have to focus primarily on the application of the Convention by national courts, who still need more information and expertise on the Convention. Much will also depend on the will and readiness of governments as well as courts for its effective implementation in a number of countries if the respondent is resident in that state. This may imply the need for structural changes in such countries regarding the local competence of courts for the recognition and enforcement of arbitral awards and for the application of the Convention. In many and particularly in large countries it may be unrealistic to even try to ensure that every local court and judge is sufficiently informed and equipped for such a task. Therefore the respective jurisdiction may have to be exclusively reserved for certain higher level courts, or perhaps at least negative decisions, i.e. against recognition and enforcement of foreign arbitral awards, may even have to be reserved for the highest court. Some states have already realized this difficulty and acted in this direction either by changes in the law or by internal directions to the courts.

Subject to fundamental reservations as contained in Art.V of the New York Convention which will have to be maintained though clarified, what we may see can be a true globalisation of procedural justice by arbitration to cope with the globalisation of international trade and investment.