

Minor dissertation

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**Public policy and enforcement of international commercial awards -
curse or blessing?**

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I hereby declare that I have read and understood the regulations governing the submission of Master of Law dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

CHAPTER 1. INTRODUCTION- OBJECT AND PURPOSE OF PUBLIC POLICY	3
CHAPTER 2. PROVISIONS OF CONVENTIONS, LAWS, AWARDS AND REGULATIONS ON PUBLIC POLICY	6
2.1. PUBLIC POLICY IN INTERNATIONAL CONVENTIONS	6
2.1.1. <i>The Geneva treaties of 1923 and 1927</i>	6
2.1.2. <i>New York Convention 1958</i>	7
2.1.3. <i>UNCITRAL Model Law</i>	8
2.1.4. <i>ICSID Washington Convention 1965: no reference to public policy</i>	9
2.2. PUBLIC POLICY IN REGIONAL CONVENTIONS	9
2.2.1. <i>The European Convention of 1961</i>	9
2.2.2. <i>The Moscow Convention</i>	10
2.2.3. <i>Panama Convention 1975: "public policy of that state"</i>	10
2.2.4. <i>OHADA Uniform ACT</i>	11
2.2.5. <i>Other Conventions</i>	12
2.3. PUBLIC POLICY IN NATIONAL LEGISLATIONS	13
2.3.1. <i>National Legislation</i>	13
2.3.2. <i>Approach of the Courts</i>	14
2.4. CONCLUSION OF CHAPTER 2	16
CHAPTER 3. SEEKING A UNIFORM DEFINITION OF PUBLIC POLICY	17
3.1. GENERAL	17
3.2. THE CONCEPT OF INTERNATIONAL PUBLIC POLICY	17
3.3. TRANSNATIONAL PUBLIC POLICY	19
3.3.1. <i>Transnational public policy and foreign public policy</i>	19
3.3.2. <i>European Community treaty</i>	21
3.3.2.1. Some starting remarks	21
3.3.2.2. The Concept of European Public policy	21
3.3.2.3. Supremacy and Uniform Application	23
3.3.2.4. Direct Effect and Indirect Effect	25
3.3.2.5. Review of the Awards in Practice	26
3.3.2.5.1. General Considerations	26
3.3.2.5.2. Prima Facie Test	26
3.3.2.5.3. Effect Test	27
3.3.2.5.4. Equivalence Test	27
3.3.2.6. Conclusion on trans-European public policy	28
3.4. REASONS FOR THE ABSENCE OF A UNIFORM DEFINITION FOR PUBLIC POLICY	29
CHAPTER 4. THE CONTENT OF THE PUBLIC POLICY EXCEPTION	30
4.1. GENERAL	30
4.2. SUBSTANTIVE CATEGORIES OF PUBLIC POLICY	31
4.2.1. <i>Mandatory laws/Lois de police, règles impératives</i>	31
4.2.1.1. The Theory	31
4.2.1.2. The Practice	31
4.2.1.3. The relation between (international) public policy and mandatory rules	32
4.2.2. <i>Fundamental principles of law</i>	33
4.2.2.1. General	33
4.2.2.2. Special application: unlawful relief - punitive damages	35
4.2.2.3. Muslim Shari`a	36
4.2.3. <i>Contrary to good morals /public order</i>	38
4.2.4. <i>National interests/foreign relations</i>	42
4.3. PROCEDURAL CATEGORIES OF PUBLIC POLICY	43
4.3.1. <i>General</i>	43
4.3.2. <i>Lack of Jurisdiction</i>	44

4.3.3.	<i>Fraus legis</i>	45
4.3.4.	<i>Fraud/corrupt judge or arbitrator</i>	46
4.3.5.	<i>Breach of natural justice/due process</i>	47
4.3.6.	<i>Lack of impartiality</i>	48
4.3.7.	<i>Lack of reasons</i>	49
4.3.8.	<i>Manifest disregard of the Law</i>	49
4.3.9.	<i>Manifest disregard of the facts</i>	50
4.3.10.	<i>Res judicata</i>	51
4.3.11.	<i>Annulment at place of arbitration</i>	51
CHAPTER 5. EXTENT/SCOPE OF REVIEW BY THE COURTS		52
5.1.	WHOSE PUBLIC POLICY?	52
5.2.	THE SCOPE OF PUBLIC POLICY	53
5.2.1.	<i>General</i>	53
5.2.2.	<i>Substantive Public policy</i>	54
5.2.3.	<i>Procedural Public policy</i>	55
5.3.	WAIVER	55
CHAPTER 6. CONCLUSION		56
LIST OF ACRONYMS AND ABBREVIATIONS		60
BIBLIOGRAPHY		60
I- SOURCES		60
II- BOOKS		60
II- ARTICLES AND REVIEWS		62
III-REPORTS		62

CHAPTER 1. Introduction- object and purpose of public policy

Globalisation and internationalisation of trade and economic constraints have led to more and more legal conflicts, with the parties subject to the dispute coming from different states and legal systems.

More recently, developed methods of dispute resolution, like the non-binding methods of mediation and expert determination and the binding decisions from arbitrating tribunals, reduce the importance and take over the role of litigation of international legal disputes. However, the enforcement of final awards, whether received by litigation or arbitration, can only take place by means of, and support by, the power of courts of the enforcing state. They might not always agree with the decision of the arbitrators or the foreign judges or the judicial process in which the award seeking recognition and enforcement was made. According to the ILA, about ten per cent of all arbitral awards worldwide are denied recognition and/or enforcement due to various reasons¹. Though those ten percent are not only denied recognition and enforcement due to an incoherence with public policy, public policy plays a role as a bar to enforcement which should not be underestimated, recalling the skeptical comment of the English judge who said almost two hundred years ago, when referring to public policy: "It is never argued at all but where [all] other points fail."²

But what is that thing called public policy? Indeed, it is difficult to define the term. According to the Dictionary of Modern Legal Usage, public policy means:

"In the context of policy-making, this phrase connotes the art of ruling wisely – implementing sound public policy. The phrase refers, rather vaguely, to matters regarded by the legislature or by the courts as being of fundamental concern to the state and the whole of society.

In the context of contract law, public policy connotes an overriding public interest that may justify a court's decision to declare a contract void. In this context, too, the phrase is vague: "Public policy is a variable notion, depending on changing manners, morals [sic] and economic conditions. In theory, this flexibility of the doctrine of public policy could provide a judge with an excuse for invalidating any contract, which he violently disliked" (G.H. Treitel, The Law of Contract 424, 8th ed.1991)".³

Public policy comes into consideration at three different stages of the dispute-resolving process.

In the first stage, a court might not apply a certain legal system, a division thereof (e.g.

¹ Albert Jan van den Berg, International Arbitration Congress (17th : 2004 : Beijing, China) New horizons in international commercial arbitration and beyond / general editor: Albert Jan van den The Hague : Kluwer Law International, c2005. 2005 DH 341.522 NEW Page 287

² Bourrough J. in Richardson v Mellish (1824) 2.Bing. 229 at 252,[1824-34]All E.R.258

³ Bryan A. Graner, A Dictionary of Modern Legal Usage, Second Edition, Oxford University Press 1995

commercial law, heritage law), nor a certain provision, where this would influence the outcome in a way that would be contrary to the public policy of the law of the state where the decision is made (*lex fori*)

Secondly, public policy might be applied by an arbitrator or judge when making his decision on the merits of the case. This is less likely to happen in an arbitration process than in a litigation one, but it is possible because the parties involved in the arbitration are free to choose the law applicable to their dispute.

Finally, public policy is considered when the award needs to be recognized and/or enforced⁴. The country, where the award is thought to be recognized and/or enforced⁵, usually is a state where the losing party has sufficient liquid assets⁶. Especially in international arbitration, this state is not identical with the state where the arbitration took place and whose law governed the arbitration procedure, since both parties usually wish to solve their dispute in a “neutral” state⁷; In other words, in a state to which none of the parties has any connection. To enforce an arbitral award, or any foreign domestic award, the courts of the state where enforcement is sought, firstly have to regard the award as valid and binding for the parties involved. There are numerous different multilateral and bilateral treaties and conventions between states regulating when and why recognition might be refused but even in the absence of such treaties, by using the international procedural laws (so called autonomic procedural laws), incompatibility with the public policy is always a reason to refuse enforcement. This applies *unisono* to arbitral awards and awards achieved by means of litigation. Any award contrary to

⁴ Difference between recognition and enforcement: “Recognition on its own is generally a defensive process. It usually arises when a court is asked to guarantee a remedy in respect of a dispute that has been the subject of previous arbitral proceedings.(...) The award may have disposed of alle the issues raised in the new court proceedings, and so put an end to those new proceedings as *res judicata*, that is to say, as matters in issue between the parties which in fact have already been decided.(...) The legal force and effect of the foreign award will have been recognised, but the award itself has not been enforced.

(...)Enforcement goes a step further than recognition. A court that is prepared to grant enforcement of an award will do so because it recognises the award as validly made and binding upon the parties to it and, therefore suitable for enforcement. In this context, the terms recognition and enforcement do run together, one is the necessary part of the other.” Cited from Redfern and Hunter Chapter 10 sections 11 and 12.

⁵ Unless otherwise expressly marked the terms recognition and enforcement do run together, one is the necessary part of the other. For further description see explanation of recognition and enforcement in the footnotes.

⁶ Redfern and Hunter Chapter 10 section 07

⁷ Redfern and Hunter Chapter 10 section 16

the public policy of the courts of the enforcing state will not be recognised.

This principle of the public policy exception is enshrined in various international conventions, as in Article 5 II of the New York Convention or Article 36 of the UNCITRAL Model Law⁸, and has long been grounds for refusing recognition and enforcement of foreign awards. It is argued that the public policy exception to enforcement derives from each states` sovereignty and its right to exercise ultimate control over its legal system and monopoly of force and forms part of the *jus cogens*⁹ in international public law.¹⁰

Consequently, there is a tension which the courts and the legislature must resolve: On the one side the state does not want to enforce awards that contravene domestic laws, mores or public interests. On the other side, the state is bound by various conventions to enforce a final award, or at least risks negative diplomatic and economic consequences if it refuses the recognition of a foreign award without good reason. A restrictive enforcement policy would discourage market players to invest in cross-border investments, since they would face a high risk of not being able to execute awards in their favour.

To summarize: in the short term, a state might profit from using the public policy exception to prevent enforcement of awards bearing diverse disadvantages for the state or its policy. In the long run, the frequent usage of this “exception” will prevent the development of similar law systems and transnational law limiting economic growth and international trade worldwide.

Bearing in mind that the public policy exception is a natural right to every state, the question arises, whether public policy in the enforcement of foreign commercial awards constitutes a threatening curse for the winning party and international economy or a blessing for the state involved and the international systems that deal with conflict of law.

After overseeing the whole picture, an attempt to answer the aforesaid question can be made. In the following chapters, this thesis will review the development of the concept of public policy as a restriction to the enforcement of international awards. Starting with an overview of all the various conventions, laws and court decisions referring to public policy, the thesis will seek a definition of public policy and show the actual content and scope of public policy as a bar to enforcement of foreign commercial awards.

⁸ United Nations Commission on International Trade Law (UNCITRAL) Model Law on International Commercial Arbitration, adopted by UNCITRAL on 21.06.1985

⁹ *Jus cogens* is a synonym for customary law in international public law, in other words a law that has arisen out of a habit which was regular practice between states.

¹⁰ ELGAR Encyclopaedia of Comparative Law, edited by Jan M.Smits, published by Edward Elgar 2006, -DHR-340.203-ELGA, Page 574-576

CHAPTER 2. Provisions of conventions, laws, awards and regulations on public policy

The term “public policy” is one that is open to interpretation because it is not self-explanatory. As usual in law, it is the reserved right of the legislator to draft the legislation and to give the definitions of their terms in the laws. Only where terms are lacking a clear definition, there is space for the courts to fill the gap by giving a definition of their own. The definition itself has to consider the purpose and the content of the law. Therefore, it is necessary to start with a search for a definition of public policy in the most important international, regional and national legislative frameworks.

2.1. Public policy in international conventions

2.1.1. The Geneva treaties of 1923 and 1927

The Geneva treaties are historically important as they form the fundament of conventions for the enforcement of arbitral awards on which the later New York Convention and the UNCITRAL model law are built upon¹¹. The Geneva Protocol of 1923 had the objectives to make arbitration agreements enforceable internationally and to ensure that awards which underlie such arbitration agreements would be enforced in the territory of the state in which they were made. In other words: the Geneva Protocol of 1923 only provided enforcement for domestic protocol awards¹².

The Geneva Convention of 1927 went further, following the necessities of demand by international trade. It provided that an award would be recognized as binding and would be enforced in all member states, subject to certain conditions. One of these requirements was:

*that the recognition or enforcement is not contrary to the public policy or to the principles of the law of the country in which it is sought to be relied upon.*¹³

Unfortunately, the Geneva Convention of 1927 does not give a definition of public policy. However, it requires that the award shall not be contrary to “the principles of the law of the country in which it is sought to be relied upon”.¹⁴ By stating that an award would be open to attack on the grounds that it offended the legal principles of the forum state, the Convention

¹¹ Di Pietro, Domenico. *Enforcement of international arbitration awards : the New York Convention of 1958 / Domenico Di Piet London : Cameron May, 2001, Page 15*

¹² Redfern and Hunter Chapter 10 section 21

¹³ Geneva Protocol of 1927, Article 1 (e)

¹⁴ See Redfern and Hunter Chapter 10 section 22

implies that this is something different than public policy.

2.1.2. New York Convention 1958

The New York Convention (NYC) arose out of a preliminary Draft Convention on the enforcement of international arbitral awards prepared by the International Chamber of Commerce, after it became obvious that the system established by the Geneva Treaties of 1923 and 1927 no longer met the requirements of international trade.¹⁵

The NYC replaces the Geneva Convention of 1927 between states which are parties to both conventions.¹⁶ The purpose of the Convention is to standardize and simplify the recognition of international commercial arbitral awards to promote enforcement of such awards.

Recognition might only be denied, subject to Article 5. The NYC does not permit any review on the merits of an award and the grounds for refusal of recognition and enforcement are exclusive. There are five separate grounds on which recognition and enforcement might be refused at the request of a party. The enforcing court itself has two grounds denying enforcement which may be invoked at the courts own discretion (*ex officio*)¹⁷.

The first reason is an arbitration agreement regarded as invalid under the *lex fori*. The second reason is the award being contrary to public policy.

The draft committee originally recommended a provision which referred to awards “*clearly incompatible with public policy or with fundamental principles of law of the country in which the award was sought to be relied upon*”¹⁸. This wording was not adopted in full length, but the drafting committee noted its intention in the report to “*limit the application of the provision to cases in which recognition or enforcement would be distinctly contrary to the basic principles of the system of the country where the award is invoked*”.

Finally, the NYC Article 5 II b reads as follows:

Recognition and enforcement of an arbitral award also may be refused, if the competent authority in the country where recognition and enforcement is sought finds that:

a) (...)

b) *The recognition or enforcement of the award would be contrary to public policy of that country*

¹⁵ Schwebel, *A celebration of the United Nations Convention*, (1996) 12 *Arbitration International* 823

¹⁶ New York Convention of 1958 Article 7 II

¹⁷ Di Pietro, Domenico. *Enforcement of international arbitration awards : the New York Convention of 1958* / Domenico Di Piet London : Cameron May, 2001 Page 16/17

¹⁸ Report of the Committee on the Enforcement of International Arbitral Awards, March 1955 UN Doc. E/2704 and E/AC 42/4/Rev. 1, see comments on Article 5.

In contrast to the Geneva treaties, Article 5 of the New York Convention only refers to public policy and not to *the principles of the law of the country in which it is sought to be relied upon*. However, the NYC does not give a definition of the meaning of public policy or attempts to harmonize public policy or establishing a common international standard¹⁹.

2.1.3. UNCITRAL Model Law

The UNCITRAL Model Law of 1985 originates from an attempt to modernise the New York Convention. Believing that harmonisation of the enforcement practices of states, and the judicial control over the arbitration procedure, was to be achieved better by promulgation of a model or uniform law, the members of UNCITRAL drafted a model law instead of renewing the NYC.

Public policy is mentioned in Article 34 as grounds for setting aside an arbitral award by the courts of the seat of arbitration, and in Article 36, as grounds for refusing recognition and enforcement of a foreign arbitral award.

Serious discussions, during the drafting, concerning public policy in Article 34, arose between the United Kingdom delegation and the civil law delegations, regarding the scope of public policy. While the equivalent term *ordre public* in civil law also includes procedural irregularities, this is not necessarily the case under common law²⁰.

Finally, it was decided not to expand the list of the grounds for setting aside the award but the position was to be clarified in the Commission's report as follows:

*"It was understood that the term "public policy" which was used in the 1958 New York Convention and many other treaties, covered fundamental principles of law and justice in substantive, as well as procedural respects. Thus, instances such as corruption, bribery and fraud and similar serious cases would constitute a ground for setting aside [the award]. It was noted, in that connection, that the wording "the award is in conflict with the public policy of the State" was not to be interpreted as excluding instances or events in relation to the manner in which it was arrived at."*²¹

This clarification applying to the term public policy in Articles 34 and 36 can be seen as one of the first attempts, ever, to give a definition of the term in international conventions. Still the definition is pretty vague and leaves plenty room for "escape manoeuvres" by the enforcing courts of the member states.

¹⁹ Interim ILA report on: *Public Policy as a Bar to Enforcement of International Arbitral Awards* by Audley Sheppard, *Arbitration International* Vol.19 No.2 (2003) pp.217-248, Page221

²⁰ Borches, *Commentary on the Uncitral Model Law on International Commercial Arbitration*, Kluwer 1990, page 190 ff

²¹ United Nations Document A/40/17, Section 297

2.1.4. ICSID Washington Convention 1965: no reference to public policy

The ICSID was founded by the Washington Convention of 1965, in order to have a special forum for international investment disputes and at the same time to promote foreign, direct, and indirect investment²². Today, the Washington Convention is in force in more than 140 countries. Due to its nature as an investment dispute convention and its purpose to deal with disputes between an investor and a state, the Washington Convention does not expressly refer to public policy. However Article 52 sets out grounds for annulment of the award, which include corruption on the part of a member of the tribunal, serious departure from a fundamental rule of procedure and giving an award without reasons. Unless an ICSID award is successfully challenged under ICSID `s own internal procedures, every contracting state must recognise and enforce an ICSID award like a final award of its own national courts.²³

Enforcement of an ICSID award cannot be challenged in the courts of the enforcing country, neither on public policy grounds nor on grounds of sovereign immunity.²⁴

2.2. Public policy in regional conventions

2.2.1. The European Convention of 1961

The European Convention on International Commercial Arbitration was signed in Geneva on 21 April 1961, designed to deal with problems of establishing and operating procedures for commercial disputes between (western and eastern) European countries²⁵. Being more of a supplement to the New York Convention, it contains limitations upon the grounds of which an award covered by the Convention may be set aside by the courts of the issuing country. Any

²² Di Pietro, Domenico. *Enforcement of international arbitration awards : the New York Convention of 1958* / Domenico Di Piet London : Cameron May, 2001 Page 17

²³ Journal of International Arbitration 23 (1):1-24, 2006 Limits to Enforcement of ICSID Awards Page 4-18; Redfern and Hunter Chapter 10, section 55

²⁴ France, Cour de Cassation : public policy is not an issue to be considered by the judge when dealing with enforcement of ICSID awards.; from Journal of International Arbitration 23 (1):1-24, 2006 Limits to Enforcement of ICSID Awards Page 8 and 9; (see also Carias-Borjas, "the Decision of the French Cour de Cassation in SOABI v. Senegal in 1991" American Review of International Arbitration 354)

²⁵ Di Pietro, Domenico. *Enforcement of international arbitration awards : the New York Convention of 1958* / Domenico Di Piet London : Cameron May, 2001, Page 19

award set aside by reference to any other than these four grounds of the European Convention, which are quite similar to the first four grounds of the NYC, might still be recognised as a valid award and enforced in the courts of the member countries²⁶. Though the European Convention of 1961 does not deal further with recognition and enforcement of awards and refers this issue to be dealt with in other treaties, it is interesting to see the intention to ban public policy treaty-wide as a reason for valid annulment of an award. Bearing in mind the situation in 1961 between western and eastern Europe during the times of the Cold War, it must have been a prior concern of the European states to preserve the finality of awards and their reliability against public policy issues. The emphasis, in those days, would have been on “policy”, rather than “public”, owing to the political climate.

2.2.2. *The Moscow Convention*

The Moscow Convention of 1972 originally applied to the Eastern European states forming part of the Council for Mutual Economic Assistance²⁷. With the recent developments in Europe, of Poland, the Czech Republic, Hungary, Bulgaria and Romania having become members of the EU and having withdrawn their membership from the Moscow Convention; the Convention only applies to Cuba, Mongolia and Russia.

The Convention states that arbitration awards shall be regarded as final and binding, and that the award may be enforced in the same way as final decisions made in the courts of the country of enforcement within two years after the rendering of the arbitral award. The only grounds for refusal of enforcement are lack of jurisdiction, denial of fair hearing and the award having been set aside.²⁸ Public policy is not mentioned expressly in this convention, but possibly the grounds for refusal of enforcement form public policy.²⁹

2.2.3. *Panama Convention 1975: “public policy of that state”*

The Panama Convention of 1975 is an Inter South American Convention on International Commercial Arbitration and was signed by 12 South American states. The Panama Convention, strongly inspired by the NYC, represents a remarkable step away from the former hostility towards international arbitration, as reflected in the Calvo Doctrine³⁰.

²⁶ Redfern and Hunter Chapter 10, section 56

²⁷ Redfern and Hunter Chapter 10 section 57

²⁸ Redfern and Hunter Chapter 10 section 57

²⁹ Di Pietro, Domenico. *Enforcement of international arbitration awards : the New York Convention of 1958 / Domenico Di Piet London : Cameron May, 2001, Page 18*

³⁰ Redfern and Hunter Chapter 10 section 58

Under the Panama Convention, an arbitral decision or award that is not appealable under the applicable law or procedural rules shall have the force of a final judicial judgement. Its execution (enforcement) or recognition shall be ordered in the same manner as that of decisions of national or foreign ordinary courts. Recognition and execution of an award may be refused on the motion of the court only; that is, if Article 5 II applies, stating:

- (a) That the subject matter of the dispute cannot be settled by arbitration under the law of that State, or
- (b) That recognition or execution of the decision would be contrary to the public policy (“ordre public”) of that State.³¹

Unfortunately, the Panama Convention does not provide a definition of the term “public policy” or “ordre public”.

2.2.4. OHADA Uniform ACT

L'Organisation pour l'Harmonisation en Afrique du Droit des Affaires was created in 1993, to make commercial laws in Africa uniform. OHADA is open to member states of the Organization of African Unity, and to date 16 states³² have joined.

In 1999, a uniform arbitration law was adopted, which provides, in Article 31, that recognition and enforcement shall be refused if the award is manifestly contrary to a rule of international public policy of the member states. The system is supervised and interpreted by a special court in Abidjan (Côte d'Ivoire), to which appeal against decisions of the courts of enforcement is permitted. This uniform arbitration law is said to be the first attempt to harmonise public policy within several sovereign states³³.

Although Article 26 of the Uniform Act on Arbitration of the OHADA refers to a public policy exception, it does not give a definition of the public policy of its members. Since Article 32 of the Act provides the Common Court of Justice and Arbitration as the supreme body, it appears as if this Common Court would also have the jurisdiction to review public policy considerations of its Member States. In time, the Common Court will establish a definition of the applied public policy for the enforcement of arbitral awards in the OHADA Member States.

³¹ Redfern and Hunter Chapter 10 section 58

³² Benin, Burkina-Faso, Cameroon, Chad, Central African Republic, Côte d'Ivoire, Congo, Camores, Gabon, Guinea, Guinea-Bissau, Equitorial-Guinea, Mali, Niger, Senegal, Togo

³³ www.refer.org/camer_ct/eco/ecohada/ohada.html visited on the 10.01.2007

2.2.5. Other Conventions

The Montevideo Convention of 1979 requires, in Article 2 (h), that an award is “manifestly contrary to the principles and laws of the public policy [“orden publico”] of the exequatur state”, but once again, lacks a definition of public policy.

The Riyadh Convention of 1983, applying to mainly Arab states, refuses recognition according to Article 37 if the award is “contrary to the Muslim Shari`a, public policy or good morals of the signatory State where enforcement is sought”.³⁴ Though there is no definition of the term “public policy” in the convention, it is possible to conclude that public policy is something different than the Shari`a or good morals, since all three terms are listed after each other, indicating that they are terms of various meanings.

However, the later Amman Convention of 1987, open to membership by the Arab states, refers simply to “public policy” thereby renders any aforesaid interpretation of the term public policy obsolete in the Riyadh Convention³⁵. Though the Amman Convention is modelled on the Washington Convention, it is of limited international interest because it restricts submissions and pleadings to the Arabic language and the proceedings that it contemplates are thus not accessible to most parties to international commercial agreements³⁶.

The European Community Treaty is said to have some indirect influence on public policy by forcing the member states to interpret public policy in a way that is not contrary to the essential regulations of the Treaty. However, this point of view is very controversial as discussed in the literature, and, so far, there is no consent but that public policy or (ordre public) is, nowhere in the convention, referred to expressly.

After checking the international and regional conventions on enforcement, it may be concluded, that the UNCITRAL Model Law report is the only one that tries to give a vague idea of what could be meant by the term “public policy”. Though there are some aspects that work well for a negative definition of the term, where reference is made to public policy and something else, it is possible to conclude that the “something else” is not part of public policy.

³⁴ Convention of the Arab league on Enforcement of Arbitral Awards, made in Amman, 14.April 1987.

This Convention has not come into force, because it has not been ratified by the stipulated minimum of seven Arabic states. (See the *Interim ILA report on Public Policy as a Bar to Enforcement of International Arbitral Awards* by Audley Sheppard, *Arbitration International* Vol.19 No.2 (2003) pp.217-248, Page 224)

³⁵ Di Pietro, Domenico. *Enforcement of international arbitration awards* : the New York Convention of 1958 / Domenico Di Piet London : Cameron May, 2001, Page 19

³⁶ Redfern and Hunter Chapter 10 Section 60

According to this line of reasoning, good morals, the Muslim Shari`a and the principles of the law of the country in which the award is sought to be relied upon would not be included in the term “public policy”. But this result would strongly neglect the content of the UNCITRAL Model Law report and the various conventions, which refer simply to public policy. There is no convincing positive or negative definition in international and regional conventions. Consequently, the next step is to check the various national legislations to see whether they offer a definition of public policy.

2.3. Public policy in national legislations

2.3.1. National Legislation

The various national legislations use different terms when referring to public policy. Some expressly refer to “international public policy, while others refer to “national norms”.

The French legislation makes reference to the “ordre public international”³⁷, which means the same as the international public policy stipulated in the legislation of Algeria, Lebanon and Portugal³⁸. Quite similarly, Romanian and Tunisian legislation refers to the “*public policy as understood in private international law*”³⁹. Most national laws, like the German law (*ordre public*), refer simply to “public policy”, which is similar to the wording of the New York Convention and the UNCITRAL Model Law.⁴⁰

Other countries like Japan, Libya, Oman, Qatar and the United Arab Emirates refuse recognition of awards which are contrary to public policy and good morals. Yemen even refuses enforcement of awards contrary to the Muslim Shari`a.⁴¹

China refers to public policy, too, but refuses enforcement of any enemy states as part of public policy, such as Taiwan.⁴²

³⁷ Article 1502 of Title 5 of, Code de Procedure Civil (French Civil Procedure Act)

³⁸ Portugal Article 1096 (f) of the Code of Civil Procedure; Algeria 458 bis 23(h) of Decree No. 83.09, Lebanon Article 817 (5) of Decree- law no 90;

Cited from Page 224 of the *Interim ILA report on Public Policy as a Bar to Enforcement of International Arbitral Awards* by Audley Sheppard, *Arbitration International* Vol.19 No.2 (2003) pp.217-248

³⁹ Ibid

⁴⁰ Ibid

⁴¹ Ibid

⁴² Hakansson Cecilia, *Commercial Arbitration under Chinese Law*, Iustus Foerlag Uppsala 1999, Page

Finally, some countries do not refer to public policy explicitly. Austrian Law separates mandatory rules (*zwingendes Recht*) and the “*basic principles of the Austrian legal system*”. (*wesentliche Grundzüge des österreichischen Rechts*).⁴³ The Swedish courts refuse enforcement of a foreign award, “*if it would be clearly incompatible with the basic notions of the Swedish legal system to enforce the award*”. Under Polish Law, awards which “*offend the legality or the principles of social coexistence in the Polish People`s Republic*” are not enforceable. The Republic of Korea requires a foreign judgement to fulfil the “*good morals and the social order of the Republic of Korea*”, whereas China refuses enforcement of foreign awards only “*if it goes against social and public interest*”.⁴⁴

A very restrictive approach, that might still be a leftover of the Calvo-doctrine, is to be found in Brazil, which refuses enforcement if “*the decision is offensive to national public policy*”.

2.3.2. Approach of the Courts

Public policy has been applied by the Courts for a long time, and consequently there are some definitions to be found.

In the English case, *Egerton v. Brownlow* in 1853, the following definition was found by the court:

*“Public policy (...) is that principle of law, which holds that no subject can lawfully do that which has a tendency to be injurious to the public or against the public good”*⁴⁵ .

In this definition of the principle, it is noteworthy that a tendency to harm the public is enough to refuse the enforcement. Later definitions have stronger requirements. The Australian Jacob Morris stated in his extensive definition of public policy that:

“the phrase public policy appears to mean the ideas which, for the time being, prevail in a

207-208

⁴³ Article 595 (1).6 of the “*Östereichische Zivilprozessordnung*” (Austrian Code of Zivil Procedure)

⁴⁴ *Interim ILA report on Public Policy as a Bar to Enforcement of International Arbitral Awards* by Audley Sheppard, *Arbitration International* Vol.19 No.2 (2003) Page 224f, referring to

Sweden: Section 55(2) of the Swedish Arbitration Act 1999

Poland: Article 712 (1)(4), 1146 and 1150 of the Code of Civil Procedure 1964

Korea: Article 203 of Chapter 28 of the Code of Civil Procedure 1991

China: Article 260 of Chapter 28 of the Law of Civil Procedure 1991

⁴⁵ England: *Egerton v. Brownlow* (1853) 4 HLC 1

community as to the conditions necessary to ensure its welfare, so that anything is treated as against public policy if it is generally regarded as injurious to the public interest (...). It is well settled, that a contract is not enforceable if its enforcement would be opposed to public policy (...). Public policy is not, however, fixed and stable. From generation to generation ideas change as to what is necessary or injurious, so that public policy is a variable thing⁴⁶."

In the *Deutsche Schacht und Tiefbohrergesellschaft mbH. vs. Ras Al Khaimah National Oil Company*, the English Court found that public policy was violated, when "there is some element of illegality or that the enforcement would be clearly injurious to the public good, or possibly, that enforcement would be wholly offensive to the ordinary, reasonable and fully informed member of the public on whose behalf the powers of the state are exercised."⁴⁷

This more recent definition requires *illegality* or certain harm (*clearly injurious*) to public goods and when looking at other court decisions, it can be concluded that the trend goes towards a restrictive application of public policy with high requirements. The Hong Kong Court of Final Appeal in 1999 stated "that for refusal of an arbitral award under the New York Convention on public policy grounds, the award must be so fundamentally offensive to that jurisdiction's notion of justice that, despite it being a party to the Convention, it cannot reasonably be expected to overlook the objection"⁴⁸.

The German Bundesgerichtshof defines public policy very restrictively as *a violation of essential principles of German law (ordre public) (...) which is basic to public or commercial life or (...) contradicts the German idea of justice in a fundamental way*. A mere violation of the procedural law applied by the arbitral tribunal is not sufficient to constitute such a violation.⁴⁹

The Swiss Supreme Court, in 1994 concluded, that a decision violates public policy only if it violates fundamental legal principles to the extent that it is irreconcilable with the legal order and the applicable value system.⁵⁰ The United States applies a restrictive concept of the public policy exception. In *Parsons&Whitemore*⁵¹, Judge Smith decided that enforcement of

⁴⁶ Australia: *Re Jacob Morris (deceased)* (1943) N.S.W.S.R. 352

⁴⁷ England :*Deutsche Schachtbau und Tiefbohrergesellschaft mbH v. Ras Al Khaimah National Oil Company* (1987) 2 Loyd's Rep 246,254

⁴⁸ *Hebei Import and Export Corporation vs. Ploytek Engineering Co. Ltd* (1999) 2 HKC 205; reported in XXIV Yearbook 652

⁴⁹ BGH 12/07/1990 III ZR174/89, NJW 1990 page 3210

⁵⁰ Swiss Supreme Court 30.Dec.1994 YCA [Yearbook of Commercial Arbitration] XXI (1996)

⁵¹ *Parsons&Whitemore Overseas Co. Inc vs. Societe General de l'industrie du Papier RAKTA and*

the foreign award should only be denied where enforcement would violate the forum state's most basic notions of morality and justice.

Moreover, in 1974, the US Supreme Court recognized the difference between domestic and international public policy, by enforcing an agreement to arbitrate a claim in the context of international trade, which would have been restricted from arbitration if it were to arise from a domestic transaction.⁵²

A similar concept is used in various states today. The European civil law countries of Germany, Italy, Switzerland and France, expressly apply international public policy when considering enforcement of foreign awards. Argentina, Denmark, the Netherlands, Norway, Spain and Sweden apply public policy in international matters restrictively with a similar intention⁵³.

Bearing in mind the first definition of public policy, it becomes obvious that the term public policy becomes more complex over the years and has been divided into at least two different terms of international and national public policy.

This approach to differentiation, expressly or by application, between the *ordre public interne* and the *ordre public externe*, follows the need of respect to the finality of awards when considering an objection to enforcement on certain grounds (of illegality) and effectively endorses a restrictive concept of public policy.

2.4. Conclusion of Chapter 2

Since none of the above cited legislations contain a definition of the term public policy, it might be concluded that there is no such definition for the following reason: the legislator does not want to define the term in order to increase the term "public policy"'s flexibility and use by the judiciary to argue with public policy : "where [all] other points fail."⁵⁴

By necessity, the Courts, unlike the legislator, developed definitions of public policy. However, the judiciary itself usually is more or less strictly bound to reference cases, but there can always be a new reference case.

It is noteworthy that, although, these laws give an idea of what is meant by the term public policy, none of them gives an exact definition of it and even if there were a definition by one

Bank of America 508 F.2d 969 (2nd Cir.1974)

⁵² ILA 226, see also Born, International Commercial Arbitration in the United States (Kluwer, 1994) pp.527-545

⁵³ ILA Page 225

⁵⁴ Bourrough J. in Richardson v Mellish (1824) 2.Bing. 229 at 252,[1824-34]All E.R.258

domestic law, this would not apply to the meaning of the same term in other states. However, one uniformity has become visible among the various legal definitions: there seems to be a difference in most states between the public policy which is applied to domestic awards (national public policy) and the one which is used for the recognition of foreign awards (international public policy).

CHAPTER 3. Seeking a uniform definition of public policy

3.1. General

After we found out that there are extant definitions of “public policy” used by the various national courts, there might be such a thing as a uniform definition of public policy, or at least a uniform definition of the essence of public policy.

As seen above, it is hardly possible, if not impossible, to find such a thing as a worldwide uniform definition of the content of public policy. The various legal systems defend different economic, legal, moral, political, religious and social values at all costs and without exception. Therefore, it seems to be appropriate to focus on the concepts of public policy that are used in non-domestic awards. These concepts of international and transnational public policy and their applications have to be described, before having a closer look at the meaning of international public policy.

3.2. The concept of international public policy

The cited court decisions differentiate between public policy and international public policy. Also in the legislation, reference is made, for example, to “ordre public international”⁵⁵. This implies that international public policy is something different than domestic public policy. Under German law, a distinction between public policy and international public policy is made by referring to the term “ordre public” which is used as a synonym for international public policy in German law⁵⁶. The Court of Appeal of Milan has held that the public policy referred to in Article 5 II (b) of the New York Convention is the international public policy and not the domestic public policy of Italy⁵⁷.

⁵⁵ French Code of Civil Procedure

⁵⁶ Prof. Andrae Lehrstuhl für Bürgerliches Recht, Internationales Privat- und Verfahrensrecht sowie Rechtsvergleichung, Script „Anerkennung und vollstreckung auslaendischer Entscheidungen“ <http://www.uni-potsdam.de/u/lsandrae/vorlesung.html>“

⁵⁷ILA Page 219

International public policy is said to have a narrower scope than domestic public policy. International public policy, according to a generally accepted doctrine, is confined to violation of extremely fundamental conceptions of legal order in the country concerned.⁵⁸ Not every rule of law that is part of the domestic public policy necessarily forms part of the international public policy. However, there are some regulations that are only concerned with the international public policy, such as mandatory export regulations, etc., which cannot be violated in domestic trade but only in international trade.

A typical example would be the case of “Messageries Maritimes”, ruled by the Court of Cassation of France on 21 June 1950⁵⁹:

The case was based on a loan of Canadian gold dollars by the French company “Messageries Maritimes”, which tried to repay its bond holders in paper dollars, in accordance with a Canadian statute that came into being after the date of the loan; this statute had inherently devalued the dollar and prohibited gold clauses without discriminating between internal and international payments. The Court of Cassation ignored the Canadian statute and declared, in a now famous announcement, that the parties to such a contract were entitled to agree, even against the mandatory rules of a municipal law governing their contract, a gold value clause valid under a French law of 25 June 1928 in accordance with the French concept of international public policy.

This case demonstrates that the idea of public policy allowed the creation of a rule (of “substantive” private international law) specific to international payments and different from the rule of French law applicable to domestic payments. This new rule was that of the validity of gold clauses in international contracts. According to Dean Lerebours-Pigeonnière, the case is based upon a public policy

*“which does not underlie the particularism of French domestic life and, quite to the contrary, is based on the desire that private transfrontier relations be governed by an international legal order (...) the exception of public policy leads here to the creation within French domestic law of a kind of ius gentium parallel to the domestic common law”*⁶⁰.

Nevertheless, one could argue that international public policy still forms part of the public policy of that state, but is not necessarily applied in domestic cases.

⁵⁸ Professor Sanders in ILA Page 219

⁵⁹ Transnational (or Truly International) Public Policy and International Arbitration, ICCA Congress series no. 3 (New York/1986), pp. 258 – 318; Kluwer Law International Section 54

⁶⁰ Transnational (or Truly International) Public Policy and International Arbitration, ICCA Congress series no. 3 (New York/1986), pp. 258 – 318; Kluwer Law International Section 55

The distinction between public policy and international public policy brings with it that awards are rarely refused enforcement on grounds of (international) public policy.

3.3. Transnational public policy

3.3.1. Transnational public policy and foreign public policy

Transnational or truly international public policy is even narrower in its concept than international public policy. It is called transnational public policy, because it implies those rules which are so essential that they are to be found in the international public policy of a number of states. They are, so to speak, of universal application, forming part of natural law as principles of universal justice, peremptory in public international law being general principles of morality accepted among the “civilized nations”.⁶¹ Corruption, drug trafficking, smuggling and terrorism, are only some activities that would certainly contravene the moral or the legal principles of all those nations⁶²

However, it is very hard in practice to differentiate between transnational public policy and the phenomenon of an application of the international public policy of another state than the *lex fori* State. According to a basic notion of international private law, the essential validity of a contract depends on only one law which governs the whole contract, the so-called proper law- or *lex contractus*. The quasi-universal recognition of the principle of autonomy of the will, on the one hand, and the traditional conception of international public policy of the forum (assumed to aim solely at the protection of the fundamental principles of the *lex fori*), on the other hand, lead to a logical consequence: the violation of foreign rules (foreign to the *lex contractus* and to the *lex fori*) will, in general, not be sanctioned at all. Where public policy concerns of a state, different from the forum state, are applied, this phenomenon of solidarity is an application of “comity” in the traditional sense of the great Dutch Statutists or of Joseph Story, or an example of what Savigny called the “freundliche Zulassung”, i.e. of a factor aimed at correcting the rigidity of the territoriality of private international law⁶³.

A leading case, in this respect, is the decision *Regazzoni v. KC Senthia Ltd.*, decided in 1958 by the House of Lords. In an international contract, perfectly in order with regard to the

⁶¹ Buchanan, Public Policy in International Commercial Arbitration, 26 American Business Law Journal (1988) Page 511.

⁶² Ila Page 220

⁶³ 1986 A.C. 301; [1957] 3 All E.R. 286, J.1961. 1140,

from ICCA Congress series no. 3 (New York/1986) , Transnational (or Truly International) Public Policy and International Arbitration, pp 258-318, Page 278 section 72

English “proper law”, between two businessmen of which one was domiciled in England and the other in Switzerland, the English Court considered the contract null and void according to Indian law, which prohibited the trade of jute with South Africa, following the *apartheid* measures imposed on Indians.⁶⁴

It is very difficult to foresee the application of such foreign public policies by the courts of enforcement and there is only a handful of decisions where public policies foreign to the proper law of the contract and to the *lex fori* have been applied. They are, so to speak only a friendly gesture towards a friendly state.

Nevertheless, it is easier to differentiate between the application of foreign international public policy and transnational public policy, when looking at them from a technical point of view. A transnational public policy has to be agreed upon between several states⁶⁵. Often, there will be a multilateral treaty or international convention between the states. Regarding e.g. the trade of arms, there is the International Convention of the 17.June 1925 concluded under the auspices of the League of Nations on the repression of arms traffic.

Another more recent example might be the 1988 United Nations Convention against Illicit Traffic in Narcotic Drug and Psychotropic Substances (Vienna Convention), which is open to membership by any state fighting against money laundering.

The targeted goals of these conventions, subject to the measures that are considered in the conventions to reach these goals, form part of the public policy of each member state to the convention. The main characteristic of the transnational public policy is the uniform application of a certain policy in several states in contrast to the application of a foreign international public policy doctrine in one state.

If there is no convention, then there might be an established practice between the states to refuse the enforcement of awards due to certain grounds. The same (international) public policy applied in like situations is nothing else but transnational public policy.

⁶⁴ 1986 A.C. 301; [1957] 3 All E.R. 286, J.1961. 1140, from ICCA Congress series no. 3 (New York/1986) , Transnational (or Truly International) Public Policy and International Arbitration, pp 258-318, Page 278 section 73

⁶⁵ If the agreement was only between to states it would not be called transnational public policy but binational public policy

3.3.2. European Community treaty

3.3.2.1. Some starting remarks

A particularly interesting example of transnational public policy is the development of a European public policy⁶⁶. In the European Union, the member states are not united, like the United States for example, but nevertheless, there is some European legislation on certain issues.

It is surprising that it was only on the 1 of June 1999, that the European Court of Justice (ECJ) rendered its first decision expressly mentioning European public policy in the *Eco-Swiss*⁶⁷ case, stating that Article 81 of the ECT is part of European public policy. This statement of recognition, regarding the existence of a trans-European public policy, raises a number of further questions. The concept of European public policy, supremacy and uniform application of European law, its direct effect on the law of the European states, its content and the extent of the review of the award are the questions under consideration.

3.3.2.2. The Concept of European Public policy

The EC Treaty does not contain any direct reference to public policy. However, an indirect reference can be found in Article 65 of the ECT, which mentions as one of the measures in

⁶⁶ Shelkopyas, Natalya. *The application of EC law in arbitration proceedings* / Natalya Shelkopyas. Groningen : Europa Law Pub., 2003. 2003 DH 341.754 SHEL Page 174-178

⁶⁷ ECJ C-126/77, *Eco Swiss China Time Ltd. vs. Benetton International NV*, 9 Mealey's International Arbitration Report 1999, page 639, Further states:

"The Case was about the following: In 1986 Benetton concluded an eight-year licensing agreement with Eco Swiss (Hong Kong) and Bulova (New York). Under this agreement Benetton guaranteed Eco Swiss the right to manufacture watches and clocks bearing the words "Benetton by Bulova", which could then be sold by Eco Swiss and Bulova. All disputes arising out of the agreement were to be submitted to arbitration in conformity with the rules of the Netherlands Institute of Arbitration. The arbitral tribunal was to apply Netherlands law. No notification regarding the agreement had been filed with the European Commission and the agreement did not fall under a Block Exemption. Benetton gave notice of termination effective as of 24 September 1991 about three Years before the end of the fixed term, whereupon Eco Swiss and Bulova initiated arbitration proceedings against Benetton. In a partial award the arbitral tribunal decided that Benetton should compensate Eco Swiss and Bulova for the damage suffered due to the premature termination of the agreement. When the parties were unable to come to an agreement, the arbitrators made a final award. After various defence tactics the ECJ finally came to his decision recommending the enforcement of the award."

the field of judicial cooperation in civil matters “improving and simplifying (...) the recognition and enforcement of decisions in civil and commercial cases, including decisions in extrajudicial cases”. Various treaties, such as the Treaty of Rome, the NYC and the Brussels Conventions, regarding the enforcement of awards are ratified by all European states. All these treaties acknowledge the principle of the public policy exception⁶⁸.

Where court decisions of the member states decide on grounds of public policy, they leave the question open if this is their *lex fori* international public policy or European transnational public policy. Starting in 1969, the German Supreme Court held that the EC law belongs to German public policy to the extent that it establishes the foundations of the Common Market and is not just concerned with the expedient organization of affairs⁶⁹. The Austrian Supreme Court found in 1998 that the fundamental principles, like those of the internal market, have to be taken into account when considering the violation of public policy. The court held that this results from the principle of priority of the European Community law.⁷⁰

The ECJ itself refers to a concept of European public policy. There are two decisions of the ECJ that draw particular attention to this problem.

In the *Nordsee*⁷¹ case, the ECJ found, that:

“(...) if questions of [European] Community law are raised in an arbitration resorted to by agreement, the ordinary courts may be called upon to examine them either in the context of their collaboration with arbitration tribunals, in particular, in order to assist them in certain procedural matters or to interpret the law applicable, or in the course of a review of an arbitration award – which may be more or less extensive depending on the circumstances - and which may be required to effect in case of an appeal of objection, in proceedings for leave to issue the execution or by any other method of recourse available under the relevant national legislation.”

In *Eco Swiss*,⁷² the ECJ held, that:

⁶⁸ Shelkopyas, Natalya. *The application of EC law in arbitration proceedings* / Natalya Shelkopyas. Groningen : Europa Law Pub., 2003. 2003 DH 341.754 SHEL Page 174-178

⁶⁹ BGH 27/02/1969 NJW 1969 page 978

⁷⁰ OHG 23/02/1998 from “The healthy Award” Christoph Liebscher Page 27

⁷¹ ECJ 102/81 Nordsee Deutsche Hochseefischerei GmbH v. Reederei Mond Hochseefischerei AG&Co.KG [1982] ECR 1095 at para.455

⁷² ECJ C126/77 ECO Swiss China Time Ltd.vs.Benetton International NV, 9 Mealey `s International Arbitration Report 1999, Page 639

“it is in the interest of efficient arbitration proceedings that review of arbitration awards should be limited in scope and that annulment of, or refusal to, recognise an award should be possible only in exceptional circumstances (...). However, according to Article 3 (1)(g) of the EC Treaty, Article 81 of the EC treaty constitutes a fundamental provision which is essential for the functioning of the internal accomplishment of the tasks entrusted to the Community and, in particular, for the functioning of the internal market. The importance of such a provision led the framers of the Treaty to provide expressly, in Article 81 (2) EC that any agreements or decisions prohibited pursuant to that Article are to be automatically void (...). The provisions of Article 81 may be regarded as a matter of public policy (...).”⁷³

There is an increasing number of supporting voices for this idea found in literature. Mustill and Boyd⁷⁴, to mention just two of them, state that *“it appears that any point of EC law which is in the realm of public policy or ordre public may be raised by way of defence to proceedings to enforce the award.”*⁷⁵

From the decisions of the national Courts, the two ECJ decisions and the literature, it can be concluded that there are provisions of European law which do belong to public policy. As seen above, it is held that the public policy exception only applies if fundamental principles of the legal system are violated, but when is it the case with European public policy? Is the public policy exception, because of the *effet utile*, to be raised every time European law is violated. In other words, is all European law fundamental? And, if there is a differentiation, which principles are fundamental and which ones are not? Therefore, the question arises as to which provisions of the European law form part of this trans-European public policy.

3.3.2.3. Supremacy and Uniform Application

The principle of supremacy holds that in case of a conflict between directly effective EC law and the national law of a Member State, the EC law has priority. While Dr. Christoph Liebscher⁷⁶ strongly promotes this principle and states that it has been argued that, as a consequence of the principle of supremacy, all rules of EC law which have direct effect are

⁷³ECJ C126/77 ECO Swiss China Time Ltd.vs.Benetton International NV, 9 Mealey `s International Arbitration Report 1999, Page 639ff at paragraph 35 and following

⁷⁴ Sir Michael J. Mustill and Stewart C. Boyd, The Law and Practice of Commercial Arbitration in England, 2nd edition Butterworths, London and Edinburgh, 1989, Page 74ff

⁷⁵ Christoph Liebscher, European Public Policy- a black box? Journal of International Arbitration. Vol. 17 No 3 (2000) pp 73- 88, Page 76

⁷⁶ Christoph Liebscher, European Public Policy- a black box? Journal of International Arbitration. Vol. 17 No 3 (2000) pp 73- 88, Page 76

part of public policy. Other, mainly German, experts⁷⁷ doubt the limitless principle of supremacy. They build their argument on the technical aspect of how European Law is created.

Since the European Union does not have a constitution of its own, it legally only possesses the power to make laws concerned with issues which the member states have empowered the European Union to do so. This is called the principle of the *beschränkte Einzelermächtigung* (limited empowerment). Every topic on which the EU wants to rule with legal provisions first has to be permitted to it, usually by a law in every member state. This law, transmitting the capacity to rule on a certain topic, has to be in accordance with the constitution of the giving state. If it is against the constitution, it might be found null and void and, consequently, the EU law lacks its foundations. Furthermore, because the transmitting law only is a simple law, the EU law cannot be something better than the transmitting law. Consequently, every Member State's constitution has priority above all European Law.

Congruency might be found between those two schools of thoughts, in so far as that European Law has priority when in conflict with simple national Laws⁷⁸, to safeguard the uniform application of EC law throughout the Community.

The principle of uniform application of the law is a basic rule of national legal systems. In *Eco Swiss*, the ECJ referred to the principle of uniform application as follows:

“ it is manifestly in the interest of the community legal order that, in order to forestall differences of interpretation, every Community provision should be given a uniform interpretation, irrespective of the circumstances in which it is to be applied (...) it follows that, in the circumstances of the present case (...) community law requires that questions concerning interpretation of the prohibition laid down in Article 81 (1) EC (...) should be open to examination by national courts when asked to determine the validity of an arbitration award and that it should be possible for those questions to be referred, if necessary, to the Court of Justice for a preliminary ruling.”⁷⁹

It should be noted, that the ECJ first establishes the fundamental nature of Article 81 (1) of the ECT and afterwards refers to uniform application. Uniform application and supremacy alone, which is not even mentioned, is not seen by the ECJ to be a sufficient criterion alone.

⁷⁷ Zoe Honegger, Universität Freiburg U.i.e., Die unmittelbare Wirkung der Grundfreiheiten, Basics www.Universitaet-Freiburg.de follow the links to the publications about European public law.

⁷⁸ Law that is of lower rank than the constitution

⁷⁹ ECJ C126/77 *ECO Swiss China Time Ltd.vs.Benetton International NV*, 9 Mealey's International Arbitration Report 1999, Page 639af at paragraph 40

3.3.2.4. Direct Effect and Indirect Effect

There are provisions with direct effect and provisions without direct effect in the Member States in European Law.

Direct effect means that these rules create rights or obligations without further steps to be taken by the member states. According to Liebscher⁸⁰, provisions of primary law. or of a regulation, have direct effect, if:

- the content of the rights or obligations is clear and precisely formulated
- the provision is unconditional and unqualified and
- the institutions of the EC or the Member States are not allowed any margin of discretion if implementing measures are necessary.

According to Liebscher, it has been argued that all provisions of EC law with direct effect pertain to public policy.

From the definition of transnational public policy as a policy that has the same content among several states, this approach might be convincing. However, these direct effect public policy rules only would constitute a part of the real trans-European public policy, since some of the indirect rules would be uniform in content and application among the member states and therefore would be transnational public policy, too⁸¹.

The theory that all provisions of EC law with direct effect pertain to public policy, appears to be wrong, when considering that direct effect derives from the clear and precise wording and not from the content of the regulation. In the European Union, directives leave matters of great importance to the Member States, it would be strange, if direct effect would be the criteria to detect trans-European public policy. Furthermore, many regulations of European primary law have direct effect, but little relevance except for organisational issues. Why *should* they constitute part of trans-European public policy? Finally, it has to be mentioned, that the ECJ does not follow this theory, otherwise it could have simply referred to the direct effect of Article 81. Instead the ECJ pointed out the fundamentality and the importance of Article 81.

In its judgement, the ECJ bases the argument of Article 81 's fundamentality in the context of

⁸⁰ Christoph Liebscher, *the Healthy Award*, Page 39 af

⁸¹ Shelkopyas, Natalya. *The application of EC law in arbitration proceedings* / Natalya Shelkopyas. Groningen : Europa Law Pub., 2003. 2003 DH 341.754 SHEL Page 179

EC law on Article. 3 (1) g and Article 81 (2) ECT. Article 3 only promotes the protection of competition. Consequently, all European laws which are affecting competition somehow could be founded on the exceedingly wide goal proscribed by Article 3. This does not really appear to be a strong argument for fundamentality. Article 81 (2) declares agreements or decisions contrary to Article 81 (1) automatically void⁸². Together with the concept and the history of the European Union, favouring one big market within the borders of the union, the importance of competition and its fundamental role becomes clear.

The ECJ decision indicates that the borderline between provisions that belong to trans-European public policy is the principle of fundamentality.

3.3.2.5. Review of the Awards in Practice

3.3.2.5.1. General Considerations

Every trans-European public policy only can be applied, if the courts have means to control the awards. As already stated in Chapter 1, the public policy exception concerns arbitrary and foreign domestic awards in the same way. Although foreign domestic awards might face other restrictions, this can be argued *a minus a majore*, because even an arbitral award, which is based on the will of parties to be judged in this way, is subject to control of the public policy exception.

After the ECJ made clear in the *Eco Swiss* case that the courts of the member states have to check a violation of trans-European public policy⁸³, the question arising is, how and to what extent can a court check an award that is supposed to be final (at least for arbitrary awards), without violating the finality of the award?

There are three tests to be found, how public policy violations can be checked by the courts. Unfortunately, the ECJ has not stated clearly so far which test is to be favourable.

3.3.2.5.2. Prima Facie Test

Among other experts, Schlosser⁸⁴ promotes the prima facie test, and bases his promotion on the argument that the public policy exception "*is only justified where the non-conformity with*

⁸² Christoph Liebscher, European Public Policy- a black box? *Journal of International Arbitration*. Vol. 17 No 3 (2000) pp 73- 88, Page 80 af

⁸³ See also Shelkopyas, Natalya. *The application of EC law in arbitration proceedings / Natalya Shelkopyas*. Groningen : Europa Law Pub., 2003. 2003 DH 341.754 SHEL Page 119-122

⁸⁴ Peter F. Schlosser, Arbitration and European Public Policy in: *L Arbitrage et le Droit European* (Bruylant, Brussels 1997) pages 81-96 at page 83 and following

basic principles of morality and justice (...) is evident". The prima facie test only allows the public policy exception only where the public policy violation is visible on the face of the award/obvious/clearly visible in the award itself without considering the merits or the circumstances under which the award was given.

French⁸⁵ and Austrian⁸⁶ Courts have applied this test occasionally. However, there seems to be a tendency to apply this test only if the award was rendered in a European Community state, since otherwise, serious violation of public policy in the merits of the award might remain unchecked. The Austrian Courts have widened the test to authorise the enforcement court to review the award in a case where the arbitrators have failed to deal with the issues of illegality of the underlying contract between the parties.⁸⁷

3.3.2.5.3. Effect Test

The effect test checks if the solution found by the arbitral tribunal violates public policy. Violations of public policy which do not have this effect are irrelevant. The difference to the prima facie test, which also is focused on the solution is that the effect test also considers the circumstances and the case. There is a full review of facts and rules of law in so far as they might constitute a possible violation of public policy⁸⁸.

This test is applied by the German Courts.⁸⁹ The German High Court found: "*This is why, in this context, it is irrelevant if the arbitral tribunal wanted to circumvent German law or if it applied the law erroneously; this is because (...) only the facts and the result matter*"⁹⁰

3.3.2.5.4. Equivalence Test

The equivalence test only checks if the outcome of the award violated public policy like in the effect test. In a second step, the court then "*may supplant reasons expressed in the award*

⁸⁵ Case. 19 Nov. 1991 Grand Moulins de Strasbourg v. Continental France [1992] Rev. Arb. 76 from the Healthy Award Page 56

⁸⁶ OHG 23 February 1998 [1999] 24a Yearbook of Commercial Arbitration Page 923 ff, from the Healthy Award Page 56

⁸⁷ OHG 11 May 1983 [1985] 10 Yearbook of Commercial Arbitration Page 421ff from the Healthy Award Page 56

⁸⁸ See Christoph Liebscher, European Public Policy- a black box? Journal of International Arbitration. Vol. 17 No 3 (2000) pp 73- 88, Page 82 af

⁸⁹ Ibid page 67

⁹⁰ Ibid page 68

by others that, in its view, justify the holding".⁹¹ The difference, to the effect test, lies in the following: where an award would be rendered as contrary to public policy under the effect test, because of the merits, the court itself can find other reasons that justify the outcome, and uphold the award.

On the first view, this test appears to cope best with the problems in respect to the finality of the award and the public policy exception. The final award is upheld wherever possible, and public policy is respected, too. However it could be argued that the equivalence test violates essential provisions of material justice. The enforcement procedure is not supposed to be a supervisory instance to decide on the merits; especially since there is no procedural guarantee that the court guarantees the parties a due process. If there are new issues considered in the execution process, then the parties must not only have the possibility to represent their arguments on these issues, but also they have to prove them. This supervisory process appears to be a fundamental violation with respect to the finality of the award.

3.3.2.6. Conclusion on trans-European public policy

There is a trans-European public policy not only existing in theory but also applied by the courts. The criteria by which the public policy exception is to be found is not the principle of supremacy, nor the principle of uniform application of EC law, but the fundamental importance of the content of the provision/law. These fundamental provisions in European Community Law appear to be according to Schlosser⁹² and Liebscher⁹³:

- Articles 81 and 82 EC Treaty (competition regulations)
- The five freedoms (transnational trade, services, establishment, movement of capital and movement of workers)
- All provisions of the EC Treaty against discrimination based on nationality or gender and
- The compensation of the agent according to Article 19 of the Directive 86/653/EEC on commercial agents

⁹¹ Racine, see *the Healthy Award* Page 59

⁹² Peter F. Schlosser, *Arbitration and European Public Policy in: L Arbitrage et le Droit European* (Bruylant, Brussels 1997) pages 81-96 at page 85 Schlosser further states that a directive "will become part of European public policy from the moment when it had to be implemented", but he continues that "it may, however, occur that individual justice requires that (...) an arbitral award should be recognized even in such circumstances."

⁹³ Christoph Liebscher, *The Healthy Award* page 60

Any award violating these rules might be refused enforcement in the EC states. Schlosser states, however, that individual justice might require enforcement, even when in conflict with trans-European public policy⁹⁴.

3.4. Reasons for the absence of a uniform definition for public policy

As we have seen above, there are various scopes of public policies: simple public policy, international public policy and transnational public policy. After having concluded that there are transnational public policy systems existing and operating, the question arises whether a worldwide definition of what the contents of such a transnational public policy might be, can be provided.

Dr. Lew⁹⁵ observed that a totally comprehensive definition of normal public policy has never been found. He reasoned that this was because public policy reflects the fundamental economic, legal, moral, political, religious and social standards of every state or extra national community. This difference of public policy derives from the character or structure of the state or community and covers those principles and standards which are so sacrosanct to the state or community as to require their maintenance at all costs and without exception.

To put it in other words: every state has its own public policy and since there are many states, there are various public policies. As they differ from each other, there cannot be a definition that in its scope fully captures them all. *A majore a minus*, this can also be argued for international and transnational public policies.

However, there might be a fundamental element or several fields with a similar content of international or transnational public policy. Intrinsic to the nature of international public policy, this fundamental element might exist in the violation of basic notions of morality and justice of the forum state.

These basic notions of morality and justice will be examined in the next chapter

⁹⁴ See last footnote referring to Schlosser

⁹⁵ Lew, *Applicable Law in International Commercial Arbitration* (Oceana 1978) Page 532

CHAPTER 4. The content of the public policy exception

4.1. General

The concept of the international public policy exception includes a substantive and a procedural category. While the substantive public policy (*ordre public au fond*) tests the recognition of rights and obligations received from the award and its circumstances, the procedural public policy applies to the process in which the award was found.

The substantive category can be divided into four sub-categories, which are⁹⁶:

- (1) mandatory laws
- (2) fundamental principles of law
- (3) public order or good morals
- (4) national interests

The procedural category consists of the principles which are, more or less, fundamental to a guarantee of due process.

Some cases are boxed in more than one category. For example, corruption of the arbitrators could transgress the pertinent categories (1) to (4) and some procedural categories, such as the principle of a fair trial, independent judge, and so on.

Furthermore, different legal systems may classify certain prohibitions under different categories or might not recognize certain violations at all under the public policy exception.⁹⁷

International public policy consists of fundamental rules only because, in its application, it faces a major counter player, which is the finality of the award seeking enforcement. This is particularly the case for the enforcement of international arbitral awards. International arbitral awards are, in most states, enforced according to the regulations of the New York Convention. The NYC reflects a “pro-enforcement bias” giving effect, as far as possible, to the finality of international arbitral awards by discouraging the reinvestigation of issues in a national court that have already been determined, according to the will of the parties which choose to resolve their dispute by means of arbitration.

The United States of America strongly follows this “pro-enforcement bias”, although

⁹⁶ ILA report on: Page 227

⁹⁷ see discussion and definition of the term public policy in the Uncitral model law; United Nations Document A/40/17, Section 297

execution under U\$ 100 000, 00 is not profitable, due to excessively high execution costs⁹⁸. In the *Mitsubishi Motors Corp. vs. Soler Chrysler Plymouth Inc.*, the US Court of Appeal restated its strong presumption of favouring and upholding international arbitration awards with respect to international comity⁹⁹, respect for the capacities of foreign and transnational tribunals and sensitivity to the need of the international commercial system for predictability in the resolution of disputes.

In general the violation of public policy by the award has to weigh heavier than the principle of finality of the award.

4.2. Substantive Categories of Public Policy

4.2.1. Mandatory laws/Lois de police, règles impératives

4.2.1.1. The Theory

“A mandatory rule is an imperative provision of law which must be applied to an international relationship irrespective of the law that governs that relationship.”¹⁰⁰

To put it in other words: *règles impératives*, Anglice, mandatory rules, are prohibitive or preventive rules of a state. Provisions that are so essential to a state that they cannot be circumvented and demand enforcement without exception and overrule and displace the proper law in the conflict of laws by the *lex fori* are international mandatory rules (or *lois de police*)¹⁰¹ of the *lex fori* state. International mandatory provisions also prevail over law and regulations chosen by the parties. A mandatory provision is a provision that protects fundamental interests of the forum state`s policy that every time the state would enforce an award incompatible with its mandatory provision, it would violate the states policy, heavily.

4.2.1.2. The Practice

This theory is applied in a different way in practice. The courts of many countries have

⁹⁸ Professor Dr. Ralf A. Schütze, *Koordination und Konflikte im Transatlantischen Rechtsverkehr in Tagungsbericht der Fachgruppe Arbitration/Litigation/Mediation*, Page 3

⁹⁹ *Pervasive problems in international arbitration* / edited by Loukas A. Mistelis and Julian D.M. Lew. Alphen aan den Rijn : Kluwer Law International ; Frederick, MD : Sold and distributed in North, Cent 2006 DH 341.522 PERV Page 30-38

¹⁰⁰ ILA report Page 230

¹⁰¹ Natalya Shelkopyas, *the Application of EC Law in Arbitration Proceedings*; Europa Law Publishing, Groningen 2003 DH 341 754 SHEL Page 360.

concluded that not all of their respective prohibitive or proscriptive laws are relevant when considering whether or not to enforce a foreign award. In some of these countries every (international) public policy rule is mandatory, but not every mandatory rule forms part of the public policy.¹⁰² The Indian Supreme Court expressed this, when it found that: “in order to attract the bar of public policy, the enforcement of the award must involve something more than the violation of the law of India.”¹⁰³

France, by and large, regards its *loi de police* as part of its (international) public policy. While, in England, there seems to be no clear separation between public policy and mandatory rules, Switzerland does not regard mandatory rules as a part of public policy, but this does not change anything in the application, since, then, enforcement will be refused due to mandatory rules instead of public policy. Germany regards its mandatory rules (*zwingendes Recht*) as the highest/prior category of public policy rules, similar to the French approach.¹⁰⁴

4.2.1.3. The relation between (international) public policy and mandatory rules

This finding appears somehow strange since one would expect that the state enforces its mandatory rules without exception.

It gets even more complex when taking into account Professor Mayer’s statement, that there is a common observation that international public policy is narrower than internal public policy (because it focuses only on fundamental provisions) and has no relevance for the applicability of mandatory rules. This is due to the nature of mandatory rules to be necessarily applicable, regardless of how international the arbitration might be. In addition, the body of international public policy rules can in fact be wider than domestic public policy rules, because there are a number of mandatory rules, which apply exclusively to international relationships.¹⁰⁵

However the situation becomes clear, when looking at the German law system.

Under German domestic private law, only certain provisions can be derogated by the parties. All the other provisions cannot be derogated. Then, there is Article 34 EGBgb. The EGBgb, in Germany, regulates the conflict of laws. The Article states:

“Dieser Unterabschnitt berührt nicht die Anwendung der Bestimmungen des deutschen Rechts, die ohne Rücksicht auf das auf den Vertrag anzuwendende Recht den Sachverhalt

¹⁰² ILA Page 230

¹⁰³ AIR 1994 SC page 880 cited from ILA Page 231

¹⁰⁴ Christoph Liebscher, *the healthy award*, Page 353

¹⁰⁵ ILA Page 231

zwingend regeln.“

(This section [determining the proper law] does not apply, where mandatory rules of the German Law, which apply on the facts of the case without regard to the proper law of the contract, govern the subject)

The mandatory provisions which apply on the facts of the case without regard to the proper law of the contract are just a small scope of the prohibitive or preventive laws. This principle is also applied when it comes to the enforcement of foreign awards. Where an award violates these “international” mandatory rules, it is refused enforcement on the ground of international public policy.

So, the relation between public policy and mandatory rules, is as follows:

There are mandatory rules that do not form part of international public policy, because they do not regulate subjects that are fundamental enough to form part of international public policy. Such provisions might be the requirement of certain formal procedures to conclude a contract or to transfer ownership. Furthermore, there are mandatory rules that only form part of international public policy, because of their nature they only apply in international cases. Such provisions might be export laws or provisions relating to foreign investment.

The fundamental mandatory rules that form part of the international public policy mostly have a political background. There are various international provisions: competition regulations¹⁰⁶, currency controls, environmental protection laws, measures of embargo, blockade or boycott, or laws falling in the rather different category of legislation designed to protect the parties presumed to be in an inferior bargaining position, such as wage earners, consumers, shareholders and commercial agents¹⁰⁷

4.2.2. Fundamental principles of law

4.2.2.1. General

The phrase “fundamental principles” of law is used by some courts to apply broadly, they are general principles which contrast with specific legislative provisions. Among these principles are those of *pacta sunt servanda*, *venire contra factum proprium*, the principle of good faith (*bona fide*), the prohibition of uncompensated expropriation, the prohibition of discrimination,

¹⁰⁶ From the transnational public policy of the EC, which was investigated above, the competition provisions in Articles 81 and 82, as well as the five freedoms are fundamental mandatory provisions of EU law.

¹⁰⁷ See Professor Mayer in ILA Page 230

the freedom of the party to act in its disfavour (*volenti non fit injuria*) and the protection of those incapable to act¹⁰⁸.

It is well known, that these terms are interpreted in slightly different manners in different law systems, and that there will be no uniform interpretation of these principles. The core essence of the principles, however, basically is the same.

The principle of *pacta sunt servanda* includes the principle of the validity of the contract (*favor contrarius*) and the principle that every party has to do what they promised to the other party.

Inconsistent behaviour will not be tolerated, according to the principle of *venire contra factum proprium*. A party acting inconsistently might face being held up in particular on the acting, which is to its disadvantage. Together with the principle of bona fide, as well as the security of international transactions it prohibits, for example, that a state of public entity be allowed to invoke, after the execution of a contract, alleged irregularities such as the absence of those special powers which would for instance be required under domestic law for the signing of arbitration undertakings.¹⁰⁹

The principle of bona fide means, somehow utopically, that the parties trust the promises of each other. Not every action of the one party has to be questioned on its validity by the other party, unless the other party should have reasonable doubts. For example, where a party has a long-time business relationship with an agent acting on behalf of a principal, there the party does not need to question the power of representation of the agent, unless there is reasonable doubt.

The prohibition of uncompensated expropriation is only an essence of the principle of unjust enrichment, meaning, that nobody has to suffer unjustified losses. Today, this principle is often referred to as no expropriation without prompt, adequate and effective compensation.¹¹⁰

From the autonomy of the will, derives the principle *volenti non fit injuria*, which means that any action according to the will of the party, even if it is against itself, can never be injustice. Only in cases where the party is incapable to act, permanently or just temporarily, it has to be protected.

¹⁰⁸ ILA Page 233

¹⁰⁹ see ICCA para 139

¹¹⁰ Redfern and Hunter Chapter 11 Sections 31,32

4.2.2.2. Special application: unlawful relief - punitive damages

Punitive damages, exemplary damages and triple damages are reliefs that do not attempt to compensate actual losses of the enforcing party, but carry a penal element. They seek to punish the party in precedence cases, so the party has to adopt its behaviour. The idea behind this special form of damages is the following:

Real compensations or actual damages might be easily affordable for the prospective losing party, especially for multinational concerns. For them, it might be cheaper to pay the actual damages, than to change their products or behaviour. When faced with punitive damages however, the situation is different. The party feels the compensation because it consists of a penal damage. The winning party gets its compensations and some extra money, on which income tax might have to be paid. Punitive damages are extremely profitable for the winning party and lawyers often get percentages of the award if they are successful. In the US, f.e.g. costs are not part of the actual damage and cannot be demanded by the parties, the instrument of punitive damages is also used to compensate for the costs of the winning party.¹¹¹

One principle of law, at least in European states, is that only state courts can relieve punitive awards, and only where the punished violation falls into its scope. However, the substantive law of many countries does not allow exemplary or punitive damages at all.

In an ICCA Case¹¹², a claim for punitive damages was refused in an arbitration taking place in Geneva with New York Law as the proper law of the contract, on the grounds that damages beyond the compensatory damages constituted a punishment of the defendant which was held incompatible with Swiss public policy. German Courts have consistently ruled that awards warranting overcompensation are contrary to German public policy and enforcement of the punitive damage will be refused¹¹³. However, in accordance with Article 40 III EGBgb, parts of the award may be enforced, where the winning party seeks compensation for reasonable costs. Excessively high costs, especially payments that rely on the success of the claimant are not recognized¹¹⁴

¹¹¹ Christopher B. Kuner, The Public Policy Exception to the Enforcement of Foreign Arbitral Awards in the United States and West Germany under the New York Convention, *Journal of International Arbitration*, Vol. 7 No. 4 (1990) pp 71-92

¹¹² ICCA Case no 5946 reported in 1991 XVI Yearbook 97

¹¹³ Professor Dr. Ralph A. Schütze, *Koordination und Konflikte im transatlantischen Rechtsverkehr*, Tagungsbericht der Fachgruppe Arbitration/Mediation/Litigation Page 3

¹¹⁴ Ibid

As a notable exception, the United States and Australia¹¹⁵, seem to recognize foreign awards with punitive damages, and it has even been confirmed, that claims for punitive damages are arbitrable under US law¹¹⁶. This constitutes a pro-arbitration approach, and sets arbitration as a real alternative to litigation.¹¹⁷ However, there is a decision in the case of *Laminoirs – Trefileries-Cableries de Lens SA vs. Southwire Co.*, in which the Georgia court refused enforcement of the arbitral award. The award (which was in accordance with French law) concluded that the interest rates on the amount in dispute should rise by five per cent p.a., two months from the date of the award. This was seen by the Georgia court to be a penal element rather than a compensatory element and, therefore, the award was partially refused enforcement¹¹⁸.

Today, after the US courts even enforce arbitral awards awarding punitive damages, this case might be decided differently by the US courts.

4.2.2.3. Muslim Shari`a

The Muslim Shari`a is a school of law that is very different from most modern systems of law. Nevertheless, this religious law provides a number of provisions essential in those countries that do apply the Shari`a. Especially in Arabic states, this school of law is widely established, and enforcement of foreign awards is easily denied on grounds of the public policy violation of fundamental principles of the Shari`a.

Surprisingly the Shari`a, which consists of four major schools¹¹⁹, recognises arbitration in

¹¹⁵ ILA Page 233 for further information see: *XL Petroleum NSW Pty Ltd vs. Caltex Oil (Aust.) Pty Ltd* (1985) 155 CLR 448

¹¹⁶ ILA Page 233 for further information see: *Willis v. Shearson and American Express Inc.* 569 F Supp. 821 (DCNC, 1983)

¹¹⁷ ILA Page 233 for further information see: *In the matter of arbitration between Marco Barbier and Sheardson Lehman Hutton Inc.* (1991) 6 Mealey`s International Arbitration Reports 14 at B1

¹¹⁸ Christopher B. Kuner, *The Public Policy Exception to the Enforcement of Foreign Arbitral Awards in the United States and West Germany under the New York Convention*, *Journal of International Arbitration*, Vol. 7 No. 4 (1990) pp 71-92, Page 80 referring to *Laminoirs –Trefileries-Cableries de Lens SA vs. Southwire Co.* (484 F Paragraph 1063 ND Ga. 1980)

¹¹⁹ The Hanafi school, founded c.699-767 AD in Iraq; the Mâliki school, founded in c. 713- 95 AD in the City of Medina, the Shafi school founded around .769–819 in Ghazzah, Egypt; the Hanbali school founded in c. 780-855 AD in Bagdad ; from Saleh, Samir. *Commercial arbitration in the Arab Middle East : Shari`a, Syria, Lebanon and Egypt / Samir Saleh ; fo Oxford ; Portland, Or. : Hart Pub., 2006.* 2006 DH 347.090956 SALE Page 8

general where the following provisions are fulfilled¹²⁰:

- a) a dispute (judicial or extrajudicial)
- b) two competent parties willing to submit the dispute to an arbitrator, who though not a judge, must possess the qualifications of a qâdi (judge);
- c) the acceptance, by the appointed arbitrator to carry out his duty to adjudicate in the dispute
- d) the determination of the dispute according to the procedural rules of the Shari`a
- e) a prior agreement to arbitrate (arbitration clause) is not required

However, when it comes to the enforcement of foreign awards (from courts or by means of arbitration), it seems as if this is hardly possible under the Shari`a.

“It would be unrealistic to attempt a study of the enforcement of foreign awards by Shari`a courts, since too many adverse factors exist in Shari`a for the recognition and enforcement of foreign awards to be possible.

Among these factors is the Shari`a concept of arbitration as a closed and essentially religious process, the stringent conditions for qualification to sit as an arbitrator¹²¹, the very essence of the award, which, despite the initially contractual nature of the arbitration agreement, acquires ultimately judicial character, and finally, the division of the world into dar al-Harb and dar al-Islâm [unbelieving world and world believing in Islam]. All discourage further elaboration on the subject.

However, it is useful, to attempt to know what would constitute a foreign award under the Shari`a. Here again the matter is not dealt with in classical Shari`a treatises, and the answer must be based on fragmentary material. A foreign award is basically an award made under a law other than the Shari`a. The award thus fails to fulfil the main Shari`a requirements: the qualification of the arbitrator and the application of the Shari`a law. It is submitted that if one of the conditions demanded by Shari`a is not fulfilled, the award will be considered a foreign award. Conversely, it seems that the issue of an award in dar al-Harb which fulfils Shari`a conditions in all other respects would not confer a foreign character on the award.

A difficult and unresolved question arises in the case where the award is made under the domestic statute law of the Muslim Ruler and is thus subject to a domestic secular law other than Shari`a. From the Shari`a perspective, a secular domestic law, and a fortiori when it violates Shari`a tenets, is treated as a foreign law. In this respect, the co-existence of secular courts with Shari`a courts would, in practice, mitigate the complexity of the problem because

¹²⁰ Ibid Page 15,16

¹²¹ “In contrast to Western laws, which are generally increasingly liberal with regard to the qualifications required of arbitrators, and with Western practice, which often stresses the technical skills of arbitrators, Shari`a requires that rigid conditions be met in the person of the arbitrator. These conditions mainly concern Muslim faith, gender and knowledge of Shari`a. Under Shari`a the arbitrators have to possess the same qualifications of Shari`a judges. There are of course other highly desirable qualities required of an arbitrator, these relate mainly to his position and behaviour while conducting judicial hearings and in his private life.” Ibid Page 28

the enforcement of an award subject to domestic statute could, most conveniently, be sought before the secular courts.

Attempted enforcement before Shari`a courts would inevitably lead to a deadlock.”¹²²

However, the Shari`a is not applied in every country where Muslims live. The United Arab Emirates have, for example, become a member of, and ratified,¹²³ the New York Convention on the enforcement of international arbitral awards, thus they have a Shari`a-based law system. This is made possible by making a difference between commercial law (Western) and family and heritage law (Shari`a).

Saudi Arabia refuses to enforce awards dealing with the concept of profit (which is contrary to the Hanbali Muslim doctrine) and awards made by non-Muslim arbitrators and aleatory contracts¹²⁴.

Other states do not apply the Shari`a strictly. In Egypt or Syria, an award generally will be enforced if it does not guarantee legal interest- or in Kuwait, contractual interest- which would be accepted by Libyan law¹²⁵.

4.2.3. Contrary to good morals /public order

Certain activities are regarded as *contra bonos mores* (against good morals) virtually the world over. To mention some examples: piracy, terrorism, genocide, slavery, smuggling, drug trafficking, arms trafficking, human trafficking, fraud, bribery and paedophilia. Agreements with such activities are usually illegal and unenforceable.

Since traders of slaves, terrorists and pirates have found other means to solve their disputes, there are hardly any court decisions refusing enforcement of awards connected with such disputes. However there are two cases (though, dating back to 1855) concerned with slavery. The two cases involved the ships *Créole* and *Maria Luz*¹²⁶. The first case was

¹²² Saleh, Samir. Commercial arbitration in the Arab Middle East : Shari`a, Syria, Lebanon and Egypt / Samir Saleh ; fo Oxford ; Portland, Or. : Hart Pub., 2006. 2006 DH 347.090956 SALE, Pages 64,65

¹²³ signature May 2006, ratification November 2006

¹²⁴ ILA Page 234

¹²⁵ Ibid

¹²⁶ ICCA Para 113

decided by the Mixed Commission of London on 15 January 1855 and the *Maria Luz* by the Tsar of Russia on 17-29 May 1875. The two cases were slightly different, but raised the same basic question: should the rights of ownership of slaves be recognized, when such slaves were transported by the owner in a ship which failed to reach its final destination due to a mutiny of the slaves (*Créole*) or their liberation by the Japanese military (*Maria Luz*)?

Though both decisions come to different conclusions, they constitute significant landmarks in the law of nations (as transnational public policy was called at that time) with respect to human rights. The English award recognises the right of the owner of his slaves, and states:

*“We do not think it is necessary to refer to authorities to demonstrate that slavery, however odious and contrary to the principles of justice and humanity, may be recognized by the law of a given country, and that since it has in fact been established in several States, it cannot be contrary to the law of nations.”*¹²⁷

The Russian award of 1875 states that the Japanese government, having freed the slaves in keeping with its own laws and customs has not violated neither the general rules of the law of nations nor the provisions of particular treaties¹²⁸. Between the two awards lies about a quarter of a century, so it might well be possible that in this time the law of nations had changed significantly, and by 1875 slavery was contrary to *bonos mores* of all so-called “civilised Nations”. This thesis is supported by the American Civil War (1861-1865), which was, among other reasons, fought because of the contentious issue of slavery abolition and after which the winning Northern States abolished slavery in the whole of the United States.

Regarding terrorism, there is a recent decision of the Swiss Federal Tribunal. An English company had been forced by the Irish Republican Army to pay a ransom of 2 million Pound Sterling and serious threats had been made by the Irish organization towards the firm, and one of its managers in particular. The amount was transferred from Switzerland via various stopovers to a bank in Ireland. The legal point of dispute was the admissibility of a request by the UK for judicial assistance in criminal matters, of which the Swiss bank opposed. The Swiss bank based its objection particularly on the danger that the IRA would later similarly threaten some of the bank’s customers and the risk that the victim, having yielded to blackmail, be prosecuted under English law¹²⁹.

¹²⁷ *ibid* at Para 114

¹²⁸ *Ibid* at Para 115

¹²⁹ *Ibid* at Para 96

The Federal Tribunal rejected the opposition of the bank, reasoning that all the required conditions for judicial assistance were fulfilled and pointed out that, in all States, there exists a major public interest in the prosecution of terrorism, which must prevail over private interests of the businessmen and agents concerned. No bank and no State member of the legal community of western Europe, including Switzerland, could accept to become, through negligence, a turning point or basis for the financial operations of terrorist movements.¹³⁰

Probably, the most commonly known decision relating to good morals is the decision of the English Court of Appeal in *Soleimany vs. Soleimany*¹³¹ in 1998, where enforcement of an arbitral award was refused. The award dealt with a contract between father and son, which required the son to smuggle carpets out of Iran, in breach of Iranian export laws. The award under the chosen proper Jewish law recognized the illegality of the enterprise, but gave priority to the rights of the parties to the sale proceeds and awarded the son a share of the proceeds from the sale of the carpets.

Contracts concerning smuggling have given rise to judicial decisions in several states for a fairly long time. Mostly, they were considered null and void either on the basis of respect for foreign law, or because of solidarity with foreign States or by a sort of general and diffuse concern for contractual morality.¹³² Various German and French decisions from the boom period of smuggling in the first half of the 20th century, strongly apply this principle of good morals on cases concerned with smuggling. To quote a French judgement of about thirty years ago:

*“If French judges are not called upon to sanction in French courts the violations committed abroad against the public policy of a given State, nevertheless, they must consider as illegal and, therefore, devoid of validity smuggling operations which, as they violate foreign laws, do infringe as in the present case international public policy (...)”*¹³³

Another case related to smuggling was a case decided by the German Federal Court in 1982¹³⁴, where an insurance contract relating to cultural artefacts illegally exported from Nigeria was considered null and void and against *bonos mores* in the meaning of the German Code on Civil Procedure.

¹³⁰ Ibid at Para 97

¹³¹ England: *Soleimany vs. Soleimany* (1998) 3 WLR 811[1999] QB 785 (CA)

¹³² ICCA at Para 84

¹³³ Ibid

¹³⁴ Germany: German Supreme Court decision on Allgemeine Versicherung G.H. gegen E.K., E.K. BGHZ 59, Seite 82

The Italian Tribunal of Turin came to the conclusion in its judgement of a similar case in 1982 that Italian international public policy was always inspired by, and based upon, essential values that are expressly recognized by the UNESCO Convention of 1970 (which was not applicable on the case for several reasons), relating to measures aimed at prohibiting the illicit import, export and transfer of ownership of cultural goods¹³⁵.

With regard to bribery, the 1997 OECD Convention on Combating the Bribery of Foreign Officials in International Transactions,¹³⁶ reflects the international concern for the prevalence of corrupt trading practices: According to this convention, it is arguable that there is an international consensus that corruption and bribery are contrary to international public policy. The Court of Appeal in Paris recognized in 1993¹³⁷ that a contract having as its object a traffic occurring through the payment of bribes is, consequently, contrary to French international public policy and to the ethics of international commerce as understood by the large majority of States in the international community¹³⁸. Condemnation of corruption may consequently be characterized as either the application of a general principle of law recognized by “civilized nations”, or as the recognition of a substantive law of necessary application, or as a resort to a transnational public policy; notwithstanding the variety of the labels or expressions used, the same concept is, in fact, involved.¹³⁹

Other examples, of conduct contrary to bonos mores are contractual practices aimed at facilitating drug traffic, the traffic of arms between private persons, contracts aimed at favouring kidnapping, murder or violation of human rights.¹⁴⁰ Other activities are treated differently among the states. Casino contracts (e.g. betting) for example are illegal in some countries and not in others.¹⁴¹

The real problem, with the good morals principle, lies less in the fact that certain actions are contrary to good morals or public order, but rather in that the award itself will rarely carry the violation of good morals on its face.

¹³⁵ See ICCA Paragraph 33

¹³⁶ signed on 17 December 1997 and came to effect on 15 February 1999

¹³⁷ France: European Gas Turbines SA. Vs. Westman International Ltd. 30 September 1993 reported in the (1995) XX Yearbook Page 198

¹³⁸ See ILA Page 234,235

¹³⁹ See ICCA paragraph 120

¹⁴⁰ Ibid 129

¹⁴¹ ILA Page 235

The enforcing court has to dig deeper into the subject matter of the award and into the circumstances of which the decision was given. This re-examination might be contrary to the principle of the finality of the award, as already discussed above. Meanwhile, there seems to be a reasonable solution to this violation of the principle of the finality of the award: the enforcement court examines whether the deciding court or arbitrator has investigated and reasonably decided on the prospective violation of good morals. Where the deciding court or arbitrator has failed to do so, the enforcement court intervenes.

4.2.4. National interests/foreign relations

In the last categories of substantive international public policy, the decision about which national interests belong to the public policy, and which do not, is treading on ice. The courts' decisions vary significantly.

The US Court of Appeal, in *Parsons & Whittemore*,¹⁴² held that public policy was not the same as national policy in the sense of diplomatic or foreign policy. Consequently, it decided not to refuse enforcement of an arbitral award in favour of the Egyptian party simply because of tensions at that time between the US and Egypt. The award reasoned that the American defendant was in breach of contract in abandoning the construction, of a paperboard mill in Egypt, after Egypt had broken off diplomatic relations with the US just prior to the Six Day War. The US Court found that enforcement would be refused only where the conflicting national policy would forbid performance of the contract, i.e., in case there were a US-embargo against Egypt¹⁴³.

This US pro-enforcement attitude was confirmed in the later case, *National Oil Corp. vs. Libyan Sun Oil Corp.*¹⁴⁴, in which the court rejected a challenge to an award at the enforcement stage on the ground that it was in favour of Libya, as the defendant argued, a state known to sponsor international terrorism. The court noted that the US still recognized the government of Libya and had not declared war on it. The court said:

“To read the public policy defence as a parochial device protective of national political interests would seriously undermine the New York Convention’s utility. This provision was not meant to enshrine the vagaries of international politics under the rubric of public

¹⁴² *Parsons & Whittemore Overseas Co., Inc. vs. Societe Generale de l'industrie du papier RAKTA and Bank of America* 508 F. 2d 969 (2nd Cir. 1974)

¹⁴³ ILA Page 235

¹⁴⁴ *National Oil Corp. vs. Libyan Sun Oil Corp.* 733 F. Para. 800 at 819 (Delaware, 1990)

*policy*¹⁴⁵.

However, when it comes to awards that breach sanctions, or boycott legislations, the US has frozen assets of certain States, and their nationals, and refused enforcement of awards. Though it is possible to register a foreign award against such assets, it is not possible to execute the award without the permission of the Office of Foreign Asset Control.¹⁴⁶

4.3. Procedural Categories of Public policy

4.3.1. General

It is difficult to separate the procedural categories of public policy from the substantive category, and some provisions similar to the substantial categories might appear again. Furthermore, there is a problem with the application of procedural public policy, when enforcing arbitral awards under the New York Convention. Article 5 I mentions five procedural principles that can be raised by the parties and where they are found to be violated, they constitute a ground for resisting enforcement of the award. However, the enforcement court can not *ex officio* investigate these violations, and deny enforcement on grounds of Article 5 I unless a party has requested the court to investigate the grounds listed in Article 5 I.

This might derive from the autonomy of the parties, and show special respect to their decision to solve their dispute without the help of state courts. The consequence of this provision regulating that Article 5 I can not be investigated *ex officio*, is obfuscated.

On the one side, it is arguable by *lex specialis derogat lex generalis*, that those five provisions of Article 5 I are excluded from the *ex officio* public policy exception in Article 5 II (narrow approach). This argument is underscored by the wording of Article 5, which states in 5 I: "(...) only if *that party* furnishes to the competent authority where the recognition and enforcement is sought, *proves (...) [it] (...):*"

On the other side, the structure of Article 5 appears to favour a public policy under subsection II that includes the exceptions to be raised by the parties mentioned under subsection I (wide approach). This can be argued by the unusual approach of Article 5 to state special provisions first and then general provisions. Usually in cases where the argument *lex specialis derogat lex generalis* applies, the provisions start with a general concept and come to the exceptions afterwards. Furthermore Article 5 I stipulates that the burden of proof is on the party raising Article 5 I. Therefore, Article 5 II might regulate

¹⁴⁵ ILA Page 235

¹⁴⁶ Ibid Page 235

something different than sub-paragraph I and, consequently has to include the reasons stated under Article 5I for the pure reason of material justice.

The United Nations Commission`s definition provided in the UNCITRAL model law (see above), states that public policy includes procedural and substantive public policy. This does not lead any further, since the explanation by the Commission was not given in the NYC and even if it would apply in this Convention, it would not answer the question, whether the reasons listed under Article 5 I NYC are excluded from the general public policy mentioned under Article 5 II.

When looking for the possible intention/ reason of this ambiguous provision, it becomes obvious that a party can only try to resist enforcement by the five grounds in Article 5 I. The court may find that public policy is violated and refuse enforcement. But this does not answer the question whether the court can refuse enforcement on the grounds mentioned under 5 I by referring to public policy. The failure of the party, against which the award is to be enforced, to request to refuse execution might constitute a waiver or implies that the party does not see its rights violated in the course of the arbitration (*volenti non fit injuria*).

Since this question cannot be answered in a satisfactory way in theory, it will be necessary to look at the various court decisions and examine the practice. This will be necessary anyway, since procedural categories of public policy might be applied when refusing enforcement of foreign domestic court decisions or arbitral awards that do not fall under the NYC.

4.3.2. Lack of Jurisdiction

Where the awarding arbitrator or the awarding court lacks its jurisdiction from the enforcements courts point of view, procedural public policy appears to be violated.

With regard to foreign domestic court judgements the enforcement courts usually first tests, if the awarding court had jurisdiction by applying the enforcements court *lex fori* . In German this is called the “Spiegelbidtheorie” (Mirror theory). The enforcements courts *lex fori* usually consist of various rules to determine the jurisdiction, i.e. the choice of the court of jurisdiction by the parties and the principle of the closest connection. Where the foreign court lacks its jurisdiction according to this test, the enforcement court will deny recognition on the ground of lack of jurisdiction.¹⁴⁷

¹⁴⁷ Britta Rabbow-Geiss, Vorsitzende Richterin am Oberlandesgericht Stuttgart, “Die Vollstreckung ausländischer Schiedssprüche in Deutschland”, <http://www.cis-legal-reform.org/publication/articles-reports/vollstreckung-auslaendischer-schiedssprueche-deutschland.de.html> 15/2/2007

With regard to Arbitration there are some matters that cannot be solved by means of Arbitration. Matters related with consumer protection, anti-trust and competition cases (controversial), intellectual and industrial property rights are just some fields which usually fall under mandatory regulations that stipulate litigation in usually specialised domestic courts.

Where the dispute is about a subject open to arbitration, the validity of arbitration agreement has to be investigated. Where the arbitration agreement does not exist or is found to be null and void, the courts will not recognize the award.¹⁴⁸

With respect to the principle of state immunity, to which a state party might refer to resist recognition and enforcement, it seems to be agreed upon transnationally, that a State cannot subsequently claim immunity from jurisdiction after it has signed a contract like a usual private person or after it entered into an arbitration process¹⁴⁹. However the state might still be able to resist successfully execution of the award¹⁵⁰.

This principle is fundamental, because where it is violated; the parties are deprived of its guaranteed/proper judge.

4.3.3. *Fraus legis*

Fraus legis is given in the private international law of some countries, when parties manage to change or displace in an artificial although formally legal manner, the connecting factors used in the rule to determine the proper law and jurisdiction. The domicile, nationality, or *loci contrarius* (place of contract) usually are the connecting factors that are changed. Where this happens with the intention to bring about the application of a definite law, or to create a particular jurisdiction, and to derogate a law or a jurisdiction that could usually not be derogated and was mandatory therefore, fraus legis is given.¹⁵¹

There is a controversial discussion whether fraus legis forms part of public policy or is a principle on its own, since it consists of a fraudulent element. However in those legal systems, which only sanction a fraud upon the *lex fori*, it is very near the notion of public policy. In other states where fraud also is sanctioned upon the foreign law, it appears rather

¹⁴⁸ Ibid

¹⁴⁹ The state does not lose its immunity if it only appears in front of the arbitration court to raise the immunity exception.

¹⁵⁰ Redfern+Hunter Chapter 11

¹⁵¹ ICCA at Para 21

as an independent correction to the ordinary functioning of the conflict rules.¹⁵²

Fraus legis is a very rare ground on which courts base their decision. This comes from the very nature of the connection factors: Where a party legally can change the connection factors easily, there the legislator must have had the intention to allow the parties to change them easily and would not want to sanction their perfectly legal choice. Furthermore, where changing the connection factors is complex, permanently and can only take place under heavy expenses, it is tricky to prove the parties their real intention, keeping in mind, that they might have more reasons for their actions.

In the Australian *Golden Acres*¹⁵³ case, the choice of law clause was found not to be *bonna fide* and consequently not accepted by the court. The parties had entered into a contract for sale of land in Australia. To avoid Australian mandatory regulations, under which estate agents had to be registered, the parties choose the law of Hong Kong as their proper law.

Instead on the ground of *bonna fide*, the court could have also applied the mandatory provision: “lex res loci”.

The concept of *fraus legis* appears to be the counter player to the autonomy of the will of the parties regarding the applicable jurisdiction and law. Although there are arguments to be found in the literature¹⁵⁴ that in times where the autonomy of the will is internationally recognised it would be better to abolish the *fraus legis* principle and rather apply foreign corrective elements such as foreign *loi de police*, the principle serves a useful purpose: It protects the misuse of the autonomy of the will. A protection via foreign mandatory laws would not have the same effect, since parties could adopt foreign laws without such provisions, or choose to transnational laws.

4.3.4. *Fraud/corrupt judge or arbitrator*

There is an international consensus that enforcement of an award should be refused if its making was induced or affected by fraud or corruption¹⁵⁵. This is not surprising, since the impartiality of the judge or arbitrator is heavily affected.¹⁵⁶

¹⁵² ICCA at Para 22

¹⁵³ Australia: *Golden Acres Ltd. Vs. Queensland Estates Pty Ltd* [1969]Qd R 378

¹⁵⁴ ICCA at Para 23

¹⁵⁵ ILA at Page 237

¹⁵⁶ See Kurkela, Matti, 1951- *Due process in international commercial arbitration* / Matti Kurkela,

The UNCITRAL Commission held, that: “it was understood, that the term public policy (..) covered fundamental principles of law and justice in substantive, as well as procedural respects. Thus, instances such as corruption, bribery and fraud and similar serious cases would constitute a ground for setting aside [an affected award]”¹⁵⁷

Several States¹⁵⁸ have implied modified UNCITRAL model laws, which expressly provide that an award is contrary to public policy if “the making of the award was induced or affected by fraud or corruption”.¹⁵⁹ The ICSID Convention includes in Article 52 (c) as one of the grounds for annulment, that there was corruption on the part of a member of the Tribunal. Fraud implies some act of deceit perpetrated on the tribunal (e.g. falsified documents, perjured evidence) or on the other party.

Especially in cases with corruption, the question arises if such awards should be refused recognition and enforcement *per se*, or if the party not involved in the corruption should rather decide whether the misbehaving party should not be bound to this sick award. There are hypothetical scenarios thinkable, where a party might be better off with the sick award than with a healthy one. For example think about a case, where one of the three arbitrators has accepted money from one of the parties, and by convincing the other two arbitrators achieved nothing but the very opposite. So finally the award would be in favour of the sober party, which would not have been the case necessarily with a neutral tribunal. Should the sober party be disadvantaged by going through a new arbitration?

Further think of a case, where the prospective losing party (or the defendant) bribes one of the arbitrators, only to win time and to resist enforcement. Similar cases can be constructed for fraud.

A final answer to these questions cannot be given, the court practices vary significantly.

4.3.5. *Breach of natural justice/due process*

Natural justice is a very broad and vague term of procedural public policy, and one that fits to any complaint from the unsuccessful party. To avoid this term to become pointless, the

Hannes Snellman. Dobbs Ferry, NY : Oceana Publications, c2005. 2005 DH 341.522 KURK, Page 156-164, Stating the duty of the arbitrator to disclose any fact giving rise to doubt the impartiality.

¹⁵⁷ ILA see Footnote 126 of ILA Report

¹⁵⁸ Australia, New Zealand, India and Zimbabwe

¹⁵⁹ ILA Page 237

censured action must be a serious irregularity, or as the ICSID Convention states under Article 52 (d): “that there has been a serious departure from a fundamental rule of procedure”. A violation of the mandatory arbitration rules of the place of enforcement (which would allow the annulment of an equivalent domestic award) may not be a breach of due process, such as an award without reasons.¹⁶⁰

There are various principles, including equal treatment of the parties, fair notice (to both appointment of the tribunal and conduct of the proceedings, confidentiality (only in arbitration) and fair and even handed approach to the elucidation of evidence from both parties, but the most important principle is the right to present one’s case (“Audi Alteram Partem”).¹⁶¹

The principle of “*audiatur et altera pars*” basically summes up the concept of equality of the parties (principle of contradiction) ¹⁶²

4.3.6. Lack of impartiality

The Latin principle “*nemo iudex in causa sua*” bears the principle of impartiality in itself. Almost all systems of law recognise the impartiality of the judge to be a fundamental principle. According to German Supreme court decision, “the prohibition to decide in one’s own cause is a guarantee of the impartiality of the judge and the arbitrator and the respect of this principle belongs to those rules of procedure which are absolutely mandatory.”¹⁶³

This might be slightly different under New York arbitration law, where in a tribunal only the arbitrator not appointed by the parties has to be neutral and the other two can be slightly partial in favour of their appointing parties. However, where an arbitrator is challenged, he does possess the so called “*competence-competence*” to decide whether he might be a *iudex in causa sua* (judge in his case) or not.¹⁶⁴ Important with regards to impartiality might be, that the party usually has to challenge the arbitrator or the judge as soon as it gets knowledge of the partiality. Otherwise the party might have waived its right to rely on this

¹⁶⁰ ILA Page 238

¹⁶¹ See Kurkela, Matti, 1951- Due process in international commercial arbitration / Matti Kurkela, Hannes Snellman. Dobbs Ferry, NY : Oceana Publications, c2005. 2005 DH 341.522 KURK Chapter / Page 171-191 « Audia Alteram Partem » Page182

¹⁶² ICCA Para 146

¹⁶³ ICCA Para 145

¹⁶⁴ ICCA Para 150

ground.¹⁶⁵

4.3.7. Lack of reasons

There are a number of cases, where it has been argued that failure to give reasons is not a reason to refuse enforcement of a foreign award, even if this would be a mandatory requirement of any award made in the enforcement state.¹⁶⁶ However in theory an award is seen to be null and void, when they are rendered without a comprehensive explanations of the reasons leading to the decision eventually adopted. The reasoning is considered to be essential, since only by its analysis the parties can prove the court of the arbitral tribunal to be wrong.¹⁶⁷

4.3.8. Manifest disregard of the Law

Generally, a manifest disregard of the applicable law such as incorrect interpretation of the substantive law has been rejected being a sufficient reason to refuse enforcement.¹⁶⁸

Also the application of general rules of law, such as the *lex mercatoria* has not held being contrary to public policy. Austrian and French Courts¹⁶⁹ have decided, that public policy is

¹⁶⁵ ILA Page 239

¹⁶⁶See also the Redfern and Hunter at page 831 stating with regard to *Unreasoned awards involving public policy or mandatory law*:

“(…) it is common in U.S. arbitrations (but not in international practice more generally) for arbitrators to issue unreasoned awards. The lack of any requirement for a reasoned award has been held applicable to claims based on the federal securities laws. See *Antwine v. Prudential-Bache Securities, Inc.*, 735 F.Supp. 1331 (S.D. Miss. 1989); *Sobel v. Hertz, Warner & Co.*, 469 F.2d 1211, 1214-15 (2d Cir. 1972). See also *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 473 U.S. 614, 638 n.20 (1985) (noting that applicable institutional rules called for transcript of hearing and reasoned award); *John T. Brady & Co. v. Form-Eze Systems, Inc.*, 623 F.2d 261 (2d Cir. 1980) (rejecting public policy defence on grounds that award did not expressly say that penalty clause was enforceable, although it awarded damages equal to amounts specified in the clause).

Consider *Mitsubishi Motors'* holding that antitrust claims are arbitrable, provided that the enforcing court reserves the right to take a “second look” at the award. See *supra* pp. 279, 292-93. Is that consistent with the lack of any requirement of a reasoned award? Note, *Judicial Review of Foreign Arbitral Awards on Antitrust Matters After Mitsubishi Motors*, 26 *Colum. J. Transnat'l L.* 407 (1988).”

¹⁶⁷ Di Pietro, Domenico. *Enforcement of international arbitration awards : the New York Convention of 1958* / Domenico Di Piet London : Cameron May, 2001. Page 190

¹⁶⁸ Courts in Switzerland, France, England, Germany and the Philippines have decided this. See ILA page 239

¹⁶⁹ Gharavi, Hamid G. *The international effectiveness of the annulment of an arbitral award* / by Hamid G. Gharavi. The Hague ; New York : Kluwer Law International, c2002. 2002 DH 341.522 GHAR Page 77

not violated, where the award is based on international *lex mercatoria*¹⁷⁰. English Courts even recognise awards based on the basis of *lex mercatoria*, *ex aequo et bono* or amiable composition¹⁷¹. US courts manifest disregard of the law is generally a defence to resist enforcement of an award. However, the term disregard is interpreted narrowly, which implies, that the arbitrator appreciates the existence of a clearly governing principle but decides to ignore or pay not attention to it. The error must have been obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator¹⁷².

When dealing with *lex mercatoria*, the question arises, what are the main principles of the *lex mercatoria*? Reference to this set of rules cannot mean that the arbitrator enjoys an unlimited freedom. There are said to be the three general principles of the *lex mercatoria*¹⁷³:

- (a) the principle of autonomy of the will of the parties,
- (b) the principle of the closest connection, and
- (c) the principle of the legitimate expectations of the parties.

The third principle basically reflects the notions of the procedural categories of international public policy.

Where an award is obviously in break of one of these principles, there is a manifest disregard of the law. Consequently, this implies, that where an award is contrary to a provision of procedural international public policy its enforcement can be refused on the grounds of public policy. Since this would lead to a circular argument, there is no other solution, but to interpret the third principle extremely narrow.

4.3.9. *Manifest disregard of the facts*

An arbitral award contrary to the facts or fundamental perverse or irrationality is generally regarded as enforceable, since the parties wanted to solve their dispute by this arbitrary court. Whereas foreign court decisions might be refused enforcement where the award is

¹⁷⁰ Austria: Austrian Supreme Court, Norsolor SA vs. Pabalk Ticaret Ltd (1984) IX Yearbook 159

France: Compania Valenciana de Cementos Portland vs. Primary Coal. Inc Cass le civ. 22 October 1991 (1992) Rev. Arb. 457; decisions cited from ILA Page 240

¹⁷¹ D.S.T vs. Rakoil [1987] 2 Loyd`s Report 246 decision cited from ILA Page 240

¹⁷² ILA Page 150

¹⁷³ ICCA 153

contrary to the facts, perverse or irrational.¹⁷⁴

However, account must be taken regarding the exceptions or adaptations required by the higher principle of good faith, in particular in the field of proof. The arbitrator is bound by the principle of good faith when rendering the award and checking the proof. Where an arbitrator or a judge violates principles of taking the evidence properly, the due process principle is violated¹⁷⁵.

4.3.10. *Res judicata*

The principle “*ne bis in idem*” (not twice in the same matter) requires, that a court judgement is not enforced when it was contrary to or inconsistent with a prior judgement or a domestic judgement on the same matter. Also where an award has already been enforced and executed the *ne bis in idem* principle would be violated, if the award was enforced a second time. English Courts have ruled that this *res judicata* provision forms part of public policy.¹⁷⁶

In Italy and Norway, the principle of *res judicata* forms part of public policy.¹⁷⁷

In countries, like Germany¹⁷⁸ and France¹⁷⁹, where the principle of *res judicata* does not form part of international public policy, the unsuccessful party still can resist execution of the award by raising the *res judicata* principle.

4.3.11. *Annulment at place of arbitration*

According to the notion of Article 5 I NYC annulment at the place of arbitration does even not on the request of a party result in refusal of recognition, since the court “may” refuse enforcement but must not. Because the NYC is a good indicator for what is contrary to international public policy and what not, it can be concluded, *a majore ad minus*, that annulment of the award at place of arbitration alone cannot automatically lead to the refusal of recognition on the public policy grounds.

¹⁷⁴ ILA Page 240,241

¹⁷⁵ ICCA Para148

¹⁷⁶ England: E.D. & F. Man (Sugar) Ltd. V. Haryanto (no.2) [1991] 1 Lloyd’s Report 429

¹⁷⁷ Moss G.C. International Commercial Arbitration, Party Autonomy and Mandatory Rules, 1999, page 173 and 328

¹⁷⁸ German Code of Civil procedure 767 analogue

¹⁷⁹ France: CA Paris 9 June 1983 Iro-Holdings vs. Sétilex[1983] Rev Arb 497

CHAPTER 5. Extent/scope of Review by the Courts

5.1. Whose Public policy?

Bearing in mind, that every state theoretically has its own international public policy, the question arises, if it is only the public policy of the forum which is relevant to the exequatur court, or if there are circumstances in which enforcement of an award might be refused where it would not offend the substantive norms of the exequatur State.

There are cases, like the English case of *Regazzoni v. KC Sethia Ltd.*¹⁸⁰ decided in 1958 by the House of Lords or the famous *Borax*¹⁸¹ cases decided by German courts in the 1960's, where foreign public policy was found to be applicable with the result, that recognition of the awards was refused.

French Courts have follow a similar approach when they state: "If French judges are not called upon to sanction in French courts this violations committed abroad against the public policy of a given State, nevertheless, they must consider as illegal and therefore devoid of validity smuggling operations which, as they violate foreign laws, do infringe as in the present case international public policy (...)"¹⁸².

¹⁸⁰ England 1958 A.C: 301 [1957] 3 All E.R. 286 J 1961. 1140

The case was about an international contract between two businessman domiciled in Switzerland and England- a contract perfectly legal with regard to the English proper law, was considered null and void according to Indian law which prohibited the trade of jute with South Africa, following the apartheid measures imposed on Indians.

¹⁸¹ BGH 27 XII 1960, BGHZ 34, 169, NJW 1961 page 822; BGH 24 V 1962 NJW 1962 Page 1436

In the first case, the plaintiff, a reseller, had been unable to obtain from its own Danish Buyer a declaration of non-export and, for that reason, the German defendant has been unable to obtain delivery in the US and had been sued for damages as a result of the breach of contract. In the second analogous case, the buyer purchased Borax from the US in order to re-export it to Poland, and the dispute related to the validity of the insurance contract for maritime transport. In both Cases the BGH held that the contracts were null and void, since the violation of the American embargo was against good morals and so was the fraudulent behaviour of the parties. It is noteworthy, that these German decisions take into consideration a foreign public policy or but also national interests, when they state, that their decision is based on the absence of damage to the German economy and first and foremost the interest of the whole of the Western free world and, therefore, on the very interests of the Federal Republic.

¹⁸² ICCA Para 84

The English Court of Appeal has held in *Soleimany vs. Soleimany*¹⁸³ (1998), that enforcement of an award giving effect to a contract between father and son, which required the smuggling of carpets out of Iran, would be contrary to English public policy.

Among the various commentators the situation appears different to the actual practice of the courts. They see the English practice as exceptional and state, that it is almost universally accepted, that it is only the forums public policy that is relevant¹⁸⁴.

This question is insofar interesting as the application of a foreign public policy by the exequatur court constitutes an extraterritorial application of the foreign law. A state judge cannot, within the context of his own national private international law, go beyond the classical national concept of the states international public policy, unless he is called upon to respect rules or principles which are based on an international consensus which is, if not universal, at least sufficiently widespread. If the judge would apply foreign public policy rules directly, he would violate the concept of the territorial autonomy of the *lex fori* state.

There is said to be a tendency, according to which foreign public policy is applied where the following three conditions are simultaneously are realized¹⁸⁵:

- (a) that the contract has a sufficient connection with the foreign State the law of which has been violated
- (b) that such foreign law has a mandatory or imperative character and insists on being applied, according to its own criteria
- (c) that such foreign law aims at protecting interests which are not purely selfish but appear worthy of protection in a supranational perspective.

This tendency is insofar noteworthy, as it promotes uniform decisions on an international level (*internationaler entscheidungseinklang*). Therefore it might be concluded, that it is not possible to answer the question whose public policy is applied in general. It will always depend on the circumstances of the case and the states involved.

5.2. The scope of Public policy

5.2.1. General

¹⁸³ England Court of Appeal, *Soleimany vs. Soleimany* 1998

¹⁸⁴ ILA Page 242

¹⁸⁵ ICCA Para 86

As already mentioned briefly above, an important aspect of public policy is to what extent public policy is investigated by the enforcement court. A too narrow investigation might result in not enough public policy violations to be found, a too wide investigation might violate the finality of the award and will result in an anti enforcement policy.

Generally there is no reason to go into the issues again. For example the Paris Court of Appeal has held:

“The scrutiny of the Court (...) must bear not upon the evaluation made by the arbitrators with regard to the cited requirements of public policy, but on the solution given to the dispute, annulment only being incurred if enforcement of that solution violates the aforementioned public policy. The court may act ex officio in examining public policy.”¹⁸⁶

However material justice might require investigating the award. French and German courts: therefore have developed a theory of the so called “mitigated effect of public policy”. By this theory a distinction is made between the reaction of the public policy to the effects in France of a right already acquired abroad, and the reaction of public policy to the acquisition of a right in France. In the first case, the demands of public policy may be dismissed or attenuated, whereas in the second case, they apply with their full vigour. In other words: The stronger the impact/consequence of the award is in the country of enforcement, the stricter the public policy exception¹⁸⁷.

To give an example: where a foreign award demands payment of a certain amount for damages from an undertaking that has not other connection to the enforcement state than its bank accounts, the public policy bar will be likely to be at a low level. The situation might be different, where a party is required to perform certain parts of a contract when the undertaking is closely connected with the enforcement state.

It would be possible to argue, that this is a public policy that favours the nationals of a certain state. The enforcement state has a special duty to protect those undertakings that have a close relation to the state, which is why there is a public policy exception

However the real question is, if it would be better for international commerce to apply the same strict bar of public policy on all cases involved?..

5.2.2. *Substantive Public policy*

¹⁸⁶ France: Paris Court of Appeal, *Lebanese Traders, Distributers&Consultants vs. Reynolds* 27 October 1994 (1994) Rev. Arb. 709 cited from ILA 243

¹⁸⁷ ILA 228

Generally the Court will not need to look further than the award itself. Only when there are issues that have not been dealt with properly in the course of arbitration or litigation, the enforcement court will need re-open the facts. Where the award fails to investigate important matters the enforcement court will start investigation on its own motion. Where the award giving arbitrator/court deals with and investigates the question of concern, the enforcement court will most likely trust in the competence of the arbitrator/court and will not go into the issues again.¹⁸⁸

5.2.3. Procedural Public policy

Regarding the scope of public policy, the ILA states: "Where a party bases its objection to recognition or enforcement on procedural public policy the court may need to carry out a wider enquiry"¹⁸⁹. As to the extent of review by the courts (...), the enforcement court may be reluctant to consider arguments that were available at the time of the hearing and or could have been presented to the supervisory court in an application to have the award set aside"¹⁹⁰

Since this is all about Procedural public policy, the ILA report appears to be too strict. It cannot be that it is on the party to point out and prove procedural public policy violations. This would be a contradiction to the meaning of public policy as an instrument safeguarding certain procedural principles, which are so essential to the state, that they have to be protected by all means.

Therefore it might be concluded, that it will all depend on the nature of the procedural injustice, previous investigation of the matter by a supervisory court or (controversial) if the party has waived its right by not taking action against the procedural violation.

5.3. Waiver

Another question is, if the public policy exception can be waived ex ante in total or partly.

¹⁸⁸ France: Paris Court of Appeal *European Gas Turbines SA vs. Westman International Ltd.*, decision dated 30 September 1993 reported in (1995) Yearbook 198

Eco Swiss China Time vs. Benetton NV 1.june.1999, C126/97 [1999] 2 all ER (Comm) 44

England: *Westacre Investments Inc. vs. Jugoinport SDPR Holding Co. Ltd.* [1999] 2 Lloyd `s Report 65

¹⁸⁹ ILA Page 245

¹⁹⁰ Ibid 237

Bearing in mind, that a party cannot waive its rights to appeal for review or resist enforcement before the reasoned award has been submitted to the parties in some legislations, i.e. Germany and French Law, the question arises, whether the public policy exception is to the disposition of the parties at all.

The very nature of public policy as an instrument of the state to control essential notions and morals of its legal system, which also consists of mandatory rules, is not compatible with a public policy exception subject to the disposition of the parties in general¹⁹¹. In short, the public policy compatibility is checked on the courts own motion (ex officio).

However a waiver of public policy violations by the parties it might need to be interpreted. Especially in the field of procedural rules in arbitration, the duty to give procedural rules is mainly on the parties. The parties can agree upon certain procedural rules, because it is part of the autonomy of their will, as described above. Nonetheless they are not free to abolish certain procedural rules which warrant the procedural public policy principles since these principles are essential elements of public policy, unless they want to risk their award being unenforceable. The autonomy of the will of the parties is not without limits. This is without doubt true in cases of international substantial public policy. The parties cannot enforce contracts i.e. dealing with issues contrary to good morals (such as slavery). It would be inconsistent to argue, that the parties can enforce awards which are contrary to procedural public policy. Procedural public policy protects principles that are not less important as substantial public policy provisions. These procedural principles ensure, that justice is not only done, but seen to be done.

It would therefore be possible to conclude, that the autonomy of the parties will finds its borders in the rules of international public policy, and the parties cannot successfully waive expressively or implied the public policy control¹⁹².

However, courts might be willing to take a waiver of public policy in consideration where the violation of public policy has occurred, and interpret it among the very circumstances of the case.

CHAPTER 6. Conclusion

¹⁹¹ Beck, C.H. Practitioner`s Handbook on International Arbitration, 2002, Page 525

¹⁹² Of other opinion with further references see: Ylva Axelsen, Public Policy as a Bar to Recognition and Enforcement of International Arbitral Awards, 2004, Masterthesis at the School for Advanced Legal Studies, University of Cape Town

After having described the very nature and content of international public policy, the question raised in the beginning remains to be answered succinctly: Is the concept a public policy exception a curse or a blessing to international commercial awards?

It is a question which should not be answered simplistically with a yes or a no, especially after we have seen the diverse applications and contents of public policy.

From the perspective of the promoters of international trade and uniform laws, the international public policy exception might appear to be what an English Judge, in 1824 described as:

*“a very unruly horse, and when once you get astride it you never know where it will carry you. It may lead you from sound of law. It is never argued, but when other points fail.”*¹⁹³

It has also been argued¹⁹⁴ that the states like to dress their jockeys in the colour of their nations, meaning that nationals are more likely to profit from the public policy exception than foreigners.

However this point of view cannot be confirmed by the decisions which were dealt with in this thesis. The aforementioned phenomenon that there are a number of decisions in favour of the national parties, can be easily explained theoretically. A losing party cannot enforce an award. The winning party might need to enforce the award, where the losing party fails to pay on its own accord. The place where enforcement is sought is the state where the losing party has its assets. Normally, the party not only has assets in the state, but is connected closer with the state by other means, i.e. by domicile or nationality. The state then checks if the award seeking enforcement meets the public policy requirements and, where it does not, it rejects enforcement on the grounds of public policy.

Since there are only awards seeking enforcement against the party which has its domicile and nationality in this particular state, they are the only awards to be refused on grounds of public policy. Only in cases where the court is unsure whether the public policy rule is violated or not, the court might stress the public policy principle and come to the conclusion that it is not violated, that is why there seems to be a biased public policy.

From the perspective of the enforcement state, the public policy exception constitutes a necessary instrument to warrant the state`s sovereignty and the autonomy of its legal system and represents a means to safe guard the most important notions of its legal system, even in

¹⁹³ Richardson v. Mellish (1824) 2 Bing. 228; [1824-34] ALL ER Rep. 258

¹⁹⁴ Ylva Axelsen, Public Policy as a Bar to Recognition and Enforcement of International Arbitral Awards, 2004, Masterthesis at the School for Advanced Legal Studies, University of Cape Town

cross-border disputes.

From the perspective of the winning party, the public policy exception might constitute the unforeseeable risk being unable to enforce an award after time-consuming, and expensive, litigation or arbitration processes. Bearing in mind that the notions of public policy are flexible and apt to change in terms of content and application over time, the fear of the winning party is reasonable. On the other side, the public policy exception exists for quite some time already, and has become more predictable by steady application by the courts, but leaving some risk open.

From the perspective of the losing party, the public policy exception appears to be the last bar to stop enforcement. The losing party should not rely upon the public policy exception since it is rarely applied.

Finally we should examine the perspective of the arbitrators. An arbitrator has the duty not only to render a fair award but also to render a valid and enforceable award. That is what the parties involved in the arbitration expect from the arbitrator. An arbitrator, even a very experienced one, cannot know every public policy provision of the countries possibly involved or even those worldwide. In practice, this will be recognized as a heavy burden for the arbitrator, having to deal with the “unpredictable” phenomenon of the public policy exception.

The only solution to this problem, for the arbitrator, is to render the award cautiously, investigate all the issues in dispute and warrant internationally recognised standards of due process, to be sure to meet the public policy requirements of the majority of states. This ensures that international arbitral awards are of high quality and involve fair reasoning. Due to the very nature of the arbitral process, a process without a second instance, this constitutes a necessary control of the arbitral awards. Consequently, it would be possible to argue that the public policy exception, by forcing arbitrators to apply high standards to their awards, safeguards the international recognition of international commercial arbitral awards while promoting international arbitration. In other words: from an arbitrators point of view, the international public policy exception represents the necessary control of certain standards needed in international arbitration.

However, it is obvious that the present situation of diverse worldwide notions of public policy cannot be said to be the best possible one. The International Law Association Recommendations on the Application of Public Policy as a Ground for Refusing Recognition or Enforcement of International Arbitral Awards (2002) provides a useful guidance to national enforcement court judges.

In short, these recommendations provide the following¹⁹⁵:

- (a) *the pro-enforcement bias of the New York Convention calls for a narrow concept of public policy;*
- (b) *Article 5 II NYC addresses international, not domestic public policy, which is primarily limited to fundamental principles pertaining to justice and morality and rules designed to serve the essential social, economic or political interest of a state;*
- (c) *Article 5 II NYC speaks of international public policy of the enforcement state, with the consequence that the source of international public policy is a national one, unless a consensus emerges among states, in which case one generally speaks of transnational public policy;*
- (d) *When a party could have relied upon a public policy objection in the arbitration, but did not, it is barred from raising such objection at the enforcement stage. (note: this only applies to Article 5 I NYC)*

Finally, the question raised in the title, whether the public policy constitutes a curse or a blessing to the enforcement of international commercial awards, can be answered: The international public policy exception is neither good nor bad, but simply necessary in the process of enforcement of international commercial awards.

¹⁹⁵ Albert Jan van den Berg, International Arbitration Congress (17th : 2004 : Beijing, China) New horizons in international commercial arbitration and beyond / general editor: Albert Jan van den The Hague : Kluwer Law International, c2005. 2005 DH 341.522 NEW Page 288

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The New York Convention

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