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Public Policy as Ground for Refusal of International Arbitral Awards - A Comparison Between Different Judicial Practices

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Abstract

The New York Convention is considered as the main pillar of the international arbitration and the most effective transnational legal instrument in international trade. But the most important challenge that the Convention is facing is a uniform application by the Member States. Article V of the Convention containing several grounds for refusal of recognition and enforcement of arbitral awards, could be deemed as an obstacle to achieve this goal. The most controversial ground is the public policy that affects the uniform application of the Convention and the predictability of the arbitration process. Then the lack of a definition for public policy has opened the door for different interpretations in different countries.

The questions that the paper at hand deals with are the following: What are the consequences for the lack of a definition for the public policy ground in the New York Convention? Is it necessary to revise the New York Convention to address this issue?

In order to answer these questions, the paper at hand will present some court decisions in order to elaborate the mentioned challenge and find an appropriate solution.

Keywords: international arbitral award, recognition and enforcement of foreign arbitral awards, judicial practice, New York Convention on Recognition and Enforcement of Foreign Arbitral Awards (1958), public policy

1. Introduction

1.1 Problem

According to article 5(2)(b) of the New York Convention, a court can refuse recognition or enforcement of a foreign arbitral award if it is contrary to the public policy of that country. The article clearly talks about the public policy of the country where the enforcement is sought. A very important issue that one would expect here, is the definition of public policy which is very broad and open-ended term. But neither article 5 nor any other article of the New York Convention provides any definition in this regard. The Convention even does not make it clear whether it concerns the domestic public policy or international. This issue has caused many discussions about the interpretation and execution of the provision and made it the most controversial ground for refusal of recognition and enforcement of an arbitral award since the lack of a specific definition for public policy has opened the door for various interpretations in different countries. This and the broad meaning of public policy has turned this ground into the most invoked one by the parties resisting recognition and enforcement of a foreign arbitral award.[1]

1.2 New Trend and Remaining Challenges

Over the past decades, some member states, have moved towards a liberal and pro-enforcement interpretation and even adjusted their legislature in order to support international arbitration. However, there are still courts in countries, such as Iran that uses the broad language of the Convention in order to refuse the enforcement of foreign arbitral awards. This approach jeopardizes the uniformity of the application of the Convention and thereby its success.

[1]. Born, Gary. International Commercial Arbitration: Part III. vol. 2. Alphen aan den Rijn: Kluwer Law Internat, 2009, p. 2827.

1.3. Hypothesis

The goal of this paper is to demonstrate that there are still contradicting approaches towards the public policy concept by the courts of the member states, the challenges that the public policy ground pose to the New York Convention, and why it is necessary to revise the text of the Convention to solve the problem. For this purpose, we will first discuss the common and accepted definitions of the public policy concept. In order to illuminate the broad scope of this definition, we will mention several related court decisions and court arguments.

1.4 State of Research

The public policy exception is discussed by renowned legal scholars in several books and articles, including Albert van den Berg, Gary Born, and Herbert Kroenke. But the unique characteristics of the article at hand is presenting cases from Iranian courts. Iran, a member of the New York Convention, is an attractive country for the foreign investors, due to its oil and gas production and relatively big population. Therefore it should be interesting to look at the approach of the Iranian courts and the way they construe and implement the Convention.

2. Method

The research is based on a comparative method that includes studying scholarly literature and investigating the court decisions.

2.1 Goal

The goal is to analyze the court decisions in different countries and find out how they interpret the public policy ground, to understand the basis for the interpretation and address the question whether this basis is acceptable. For this purpose, some famous court decisions from different countries will be presented and discussed.

2.2 Sources

The court decisions in the western countries are systematically recorded in yearbooks and analyzed extensively in numerous articles and books by renowned scholars. But the research on recognition and enforcement of arbitral awards in Iran is limited to few publications (mainly Master's or Ph.D. thesis).

3. Results

Each country has its own definition of public policy. Certainly, public policy consists of mandatory provisions of a country. But there is disagreement about the relationship between these provisions and public policy. Different opinions have been expressed by commentators in this regard.

3.1 Definitions

Most commentators view public policy in domestic law as absolute respect of mandatory provisions. Others believe that not every mandatory provision is within public policy realm. Based on this view, the mandatory provisions do not have equal value and weight in private law and should be divided into those with public policy relevance and those with no public policy relevance. This differentiation is based on public interest that shall not be endangered by the will of people.

Some other commentators believe that domestic public policy consists of principles of moral and justice that shall not be violated by the parties to a contract based on mutual agreement. These principles may be reflected in the constitution or other legal sources of a country and are higher in number compared to notions related to international public policy.

It is obvious that applying mere domestic public policy for the annulment of domestic arbitral awards is proper and permissible, but its application for refusal of recognition and enforcement of international arbitral awards should be doubted seriously, and no commentator has supported it. In fact, the application of pure domestic public policy principles that based on most commentators' view consist of mandatory provision of the country, is not compatible with international arbitration. Many countries have even explicitly permitted an agreement between parties that violates against mandatory provisions and consider their agreement as valid. This means that they differentiate between domestic and international public policy and refer to the latter in regard to international arbitration.[2]

Here we should mention that in rare cases some national courts have referred to domestic public policy in order to refuse enforcement of a foreign arbitral award. In 1983, the Australian Supreme Court in a decision refused the enforcement of an arbitral award rendered in Holland based on its violation against domestic public policy. In its verdict, the court said that article 5(2)(b) of the New York Convention does not differentiate between the domestic

[2] Iranshahi, Alireza. Eteraz be Ray-e Davari-ye Tejari-ye Beyn Ol-Melali, Dissertation in Private Law, Daneshgah-e Shahid Beheshti: 1388, p. 202.

and international public policy, but it explicitly refers to the public policy of the enforcement country. Another example is a decision of New Delhi court that denied the enforcement of an award rendered in London because it was violating India's public policy. The court believed that the arbitrators had ignored Indian party's defense who had referred to a force majeure export ban.

3.2 International Public Policy

International public policy that by some commentators has been described as a reflection of justice seeking sentiment of a society, constitutes only a limited part of the public policy of a country which applies to international trade.[3] This type of public policy can create an obstacle for a foreign judgment, contract, or arbitral award in order to protect social and legal principles that are in a judge's view fundamental to the country. Based on this notion, the international public policy is a collection of the values of a country and their violation cannot be tolerated by the society even in international affairs.[4] We should keep in mind that in private law, international public policy is not a common thing among all countries.

Nowadays, one can say that the refusal of enforcement of an international arbitral award is only justifiable when the award contradicts the international public policy of the enforcing country. Based this view, some countries have even replaced the the domestic public policy with the international one in their laws regarding international arbitration. These countries, such as France and Switzerland, differentiate between international and domestic public policy and consider international arbitral awards as part of international public policy.[5]

3.3 Historical Perspective

Looking at the history of the New York Convention, we realize that the drafters of the convention had the international public policy in mind and not domestic, since in addition to the public policy, the Geneva Convention 1927 mentioned also the legal principles of the enforcing country, but the drafters of the New York Convention decided to remove it.[6] The purpose of this decision was to narrow the scope of the related refusal ground.[7] The differentiation between the domestic and international public policy means issues that fall into the public policy in internal affairs, do not necessarily concern the international affairs. Therefore the number of issues that fall into the category of international public policy are far less than those that fall into the category of domestic public policy.[8] Based on the judicial practice of member states of the New York Convention and the interpretation of the judges, one can conclude that in order to determine the framework for the international public policy, commonly acknowledged international norms should be followed and not national and non-universal ones.

3.4 Cases

Karaha Bodas Company, L.L.C. ("KBC") concluded contracts with Perusahaan Pertambangan Minyak Dan Gas Bumi Negara ("Pertamina"), the Indonesian state oil company, and P.T. PLN (Persero) ("PLN"), a state-owned electric utility company to carry out a common project in Indonesia. The contracts provided for dispute settlement by arbitration in Switzerland pursuant to the Arbitration Rules of the United Nations Commission for International Commercial Law ("UNCITRAL Rules"). 4 years later, the project was suspended by a Presidential Decree. KBC initiated arbitration in Switzerland, and an award was rendered in its favor. KBC sought enforcement of the award in several countries, including Canada. Before the Alberta Court of Queen's Bench, Pertamina and PLN argued that enforcement of the award would violate public policy because by finding that the defendants were liable for breach of contract, the arbitrators implied that the defendants should have performed under the contracts in defiance of the Presidential Decrees that had suspended the project. The court rejected their argument and held that Pertamina and PLN were state-owned companies and therefore could not claim that their liability for non-performance would violate public policy.[9]

In 1998, an English court denied the enforcement of an arbitral award based on public policy ground. In Soleimany vs. Soleimany, a father and son were exporting carpets from Iran to England. Iranian law prohibited such export. A dispute on the proceeds of sale arose, and it was submitted to arbitration by the Beth Din, applying Jewish law.

[3] Engle, Rachel. Party Autonomy in International Arbitration: Where Uniformity Gives Way to Predictability, The Transnational Lawyer, Vol. 15, 2002, p. 342.

[4] Fouchard, Philippe, Emmanuel Gaillard, Berthold Goldman, John Savage, and Philippe Fouchard. Fouchard, Gaillard, Goldman on International Commercial Arbitration. The Hague: Kluwer Law International, 1999, p. 955.

[5] Ibid., p. 205.

[6]. Born 2009, op. cit., p. 2827.

[7]. Van den Berg, Albert Jan. The New York Arbitration Convention of 1958, The Hague, T.M.C. Asser Institute 1981, p. 361.

[8]. Van den Berg, A J. New Horizons in International Commercial Arbitration and Beyond. The Hague: Kluwer Law International, 2005, p. 309.

[9]. http://www.newyorkconvention1958.org/index.php?lvl=notice_display&id=581 (last visited on 08.01.2015).

Without considering the illegality of the business, the Beth Din made an award in favor of the son. In enforcement proceedings in England,

the father claimed that the illegality was contrary to English public policy. The English judge stated that the parties "cannot by procuring an arbitration conceal that they, or rather one of them, is seeking to enforce an illegal contract." The judge added, "Public policy will not allow it". Since under English law

the contract was illegal, the court refused the enforcement of the award.[10]

This case demonstrates the fundamental nature of the concept of public policy.

In Parsons & Whittemore Overseas ("Overseas"), an American corporation, and Societe Generale de L'Industrie du Papier ("RAKTA"), an Egyptian corporation, Overseas, the defendant, argued, among other things, that the enforcement of the award would violate U.S. public policy. It said that the end of diplomatic relationships between U.S. and Egypt had been reason why it could not carry out its contractual obligations in Egypt. The court held that the New York Convention does not provide any guide on how to interpret the public policy ground. Considering the history of the convention and the intention of its drafters, the court decided for a pro-enforcement approach. The court held that public policy should be construed narrowly since any other interpretation would "vitiate the Convention's basic effort to remove pre-existing obstacles of enforcement." The court concluded that the public policy provision should be construed narrowly, and the enforcement of foreign arbitral awards may be denied only where enforcement would violate the forum state's most basic notions of morality and justice. Furthermore it held that public policy defense could "easily be dismissed" and

that refusing enforcement based on the United States' falling out with Egypt would convert the defense into a "major loophole in the Convention's mechanism for enforcement." Therefore, the court confirmed the enforcement of the arbitral award.[11] The court's arguments in this case have been widely acknowledged and applied in similar future cases.

Before the Court of Appeal in Celle (Germany), the defendant argued that the enforcement of an award rendered by ICC Court would violate the public policy due to some flaws in the arbitral procedure and the fact that the award contained a penalty that in defendant's view was disproportionate. The German judge held that enforcement of an arbitral award was denied when there was a violation of international public policy and the international public policy "is a rule subject to a less strict regime than domestic arbitral decisions." Based on this argument, the court concluded that there "is a violation of international public policy only when the consequences of the application of foreign law in a concrete case is so at odds with German provisions as to be unacceptable according to German principles. This is not the case here."[12]

The French Cour de Cassation supports a similar interpretation. It has held that only "flagrant, effective and concrete" violations of international public policy were relevant since they were against fundamental concepts of morality and justice.[13]

The mentioned decisions support a narrow interpretation of the public policy ground and in fact correspond with the history and the goals of the New York Convention. Based on this approach, enforcement of a foreign arbitral award is denied only when it would lead to a fundamental breach of public policy, and this is the case when fundamental mandatory laws are affected. However, the member states do not follow a uniform approach in this regard. Some countries tend to interpret the public policy ground widely which is an unfortunate situation.

3.5 Broad Interpretation of Public Policy Ground

In 1997, a Chinese court issued a verdict that shows how the public policy ground could lead to inappropriate results.[14] China International Economic and Trade Arbitration Commission (CIETAC) had rendered an arbitral award in favor of a U.S. heavy metal band. The band had suffered financial damages because their concert had been cancelled by the Chinese Ministry of Culture. The Chinese officials justified their decision by claiming that the band performers engage in "outrageous acts" in their concerts. But the Supreme Court of China denied the enforcement of the award, arguing that the award violates the national sentiments and social and public order. Thus the court interpreted the public policy ground widely and caused many concerns since the door was opened the

[10]. http://www.mwe.com/info/pubs/MIAR.pdf (last visited on 08.01.2015).

[11]. http://www.newyorkconvention1958.org/index.php?lvl=notice_display&id=714 (last visited on 07.01.2015).

[12]. http://www.newyorkconvention1958.org/index.php?lvl=notice_display&id=371 (last visited on 08.01.2015).

[13]. Van Den Berg 2005, op. cit., pp. 489-494.

[14]. Anusornsena, Veena. Arbitrability and Public Policy in Regard to the Recognition and Enforcement of Arbitral Award in International Arbitration: The United States, Europe, Africa, Middle East and Asia. , 2012, pp. 155-156.

door for the Chinese court to choose a similar approach and interpret the public policy ground based on their as they wish.[15]

However, the Supreme Court of China has prescribed an automatic appeal process in order to create consistency in the refusal of enforcement of foreign arbitral awards. Based on the new procedure, when a Chinese court decides to refuse the enforcement of an award, the case will be forwarded to a high court. And in case that the high court confirms the decision, it will be submitted to the Supreme Court. The new system has clearly some disadvantages. It is very time consuming and harms the goal of the convention regarding an effective and rapid enforcement of foreign arbitral awards. At the same time, it helps to have a more unified approach towards enforcement of foreign arbitral award and makes it for the courts more difficult to deny enforcement. Between 2002 and 2006, 4 out of 9 awards submitted to the Supreme Court of China have been enforced.[16] Only in one case, the wards was based on public policy ground. Thus, China, one of the biggest world's economies makes efforts so the decision of its courts comply more and more with the New York Convention. Even though the Chinese courts have not referred to international public policy but the it is obvious that the Supreme Court of China is using this ground cautiously.

Turkey is still an unfortunate example among the member states of the New York Convention in the application of public policy ground for the refusal the enforcement of arbitral awards. In Osuuskunta METEX Andelslag vs. Türkiye Electrik Kurumu Genel Müdürlügü General Directorate, the ICC arbitrators in Zurich applied Turkish law to the merits and the Swiss law to the procedure of the case. Despite the fact that procedural law had no effect on the final award, the Turkish Supreme Court held in 1995 that the arbitrators have violated the public policy of Turkey by not applying the Turkish law on the procedure.[17] This decision is the result of ambiguity in the definition of public policy and the effect of domestic considerations.

Iran is also among the countries where the application of the public policy ground could lead to unfortunate results. In Jahan Profil vs. Ascotec Steal, the defendant appealed the decision of the court of first instance regarding recognition and enforcement of an arbitral award rendered by London Chamber of Commerce. Tehran's appeal court, branch 15, held that referring the dispute to arbitration in the case at hand was a violation of article 139 of the constitution of the Islamic Republic of Iran and denied recognition and enforcement of the award arguing that it was against the mandatory laws related to arbitration and against the public policy of the country.[18] The mentioned article says:

"The settlement, of claims relating to public and state property or the referral thereof to arbitration is in every case dependent on the approval of the Council of Ministers, and the Assembly must be informed of these matters. In cases where one party to the dispute is a foreigner, as well as in important cases that are purely domestic, the approval of the Assembly must also be obtained. Law will specify the important cases intended here."

One can observe a similar approach in the decisions by some other Iranian courts. For instance, the Iranian Supreme Court, branch 21, in an award rendered in 1987 held that based on article 139 of the constitution, the state-owned Aviation Company Iran's cannot attend arbitration, and the court has jurisdiction to deal with the merit of the dispute. Using the same argument, the same court in 1994 rejected the objection of ASP, a subsidiary of the state-owned Saderat Bank, against an arbitral award.[19]

4. Discussion

4.1 General Trend

In the absence of a clear definition for the public policy ground in the New York Convention, many national courts have chosen to construe the public policy ground narrowly and deny enforcement of a foreign arbitral award based on this ground only in exceptional cases. This approach is based on the concept of international public policy and fundamental principles of morality and justice. In other words, these courts consider only those categories of domestic public policy that are internationally acceptable. They sacrifice national interests over international convergence and uniformity. Some countries, such as France, have institutionalized this approach by replacing the term "public policy" by "international public policy" in their legislature.

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[15]. Moser, Michael J. Managing Business Disputes in Today's China: Duelling with Dragons. Alphen aan den Rijn: Kluwer Law International, 2007, p. 274.

[16] Xia, Xiaohong. "Implementation of the New York Convention in China." International Commercial Arbitration Brief 1, no. 1 (2011): 20-24, here pp. 21-22.

[17] Moses, Margaret. The Principles and Practice of International Commercial Arbitration. Cambridge: Cambridge University Press, 2008, p. 218.

[18] Award No. 543, 02/09/2014.

[19] Zeraat, Abbas. Qanun-e Ayin-e Dadrasi-ye Madani dar Nazm-e Hoqooqi-ye Iran, Tehran: Khat-e Sevvom, 2003, p. 1292.

4.2 Need for Reform

But these volunteer steps cannot remedy the whole issue. Public policy is an unpredictable ground and can lead to decisions that serve domestic interests. As described, there are still several national courts around the world that use the broad sense of public policy in order to dump foreign arbitral awards and protect political or economical interests of their own country which is an unpleasant situation for achieving the goals of the New York Convention.

This leads us to the conclusion that a uniform approach in application of the New York Convention needs more than just encouraging the member states to chose a liberal and progressive approach. It means that the text of the New York Convention needs a revision. And as long as this revision has not taken place, the door is open to any member state to interpret the public policy ground at will.

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