PUBLIC POLICY AND INTERNATIONAL COMMERCIAL ARBITRATION

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INTRODUCTION[1]

Over the centuries, as international trade has developed, the merchant community has enjoyed a great degree of independence and self-regulation. The business practices and customs of this international community of merchants have been built primarily on principles of contract and are part of the law merchant.[2] Most states have chosen out of self-interest to participate in international trade, either directly or indirectly, by resort to these customs and contractual methods, which put all participants on roughly equal terms. States have allowed the business community considerable freedom to regulate international business transactions for several reasons, including the inadequacy of existing domestic laws with regard to the needs of international commerce and the difficulty in reaching a general agreement on, and indeed a lack of, a uniform inter-

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[1] In May, 1986, the author attended the VIIIth International Arbitration Congress in New York City. The Congress, organized by the International Council for Commercial Arbitration, takes place once every four years, each time in a different country, and draws large numbers of participants from around the world. The Congress was divided into two Working Groups: Comparative Arbitration Practice, and Public Policy in Arbitration. The author participated in the latter working group. It is partially from papers presented and discussions at the Congress that the author draws the material for this paper. All papers presented at the Congress may be found in COMPARATIVE ARBITRATION PRACTICE AND PUBLIC POLICY IN ARBITRATION (P. Sanders ed. 1987) [hereinafter COMPARATIVE ARBITRATION].

[2] The "law merchant" or "lex mercatoria" consists of generally accepted customs of merchants. These customs have standardized over the years and become a part of formal law. ORAN'S DICTIONARY OF THE LAW 240 (1983).

national law of trade.[3] Out of this void, the international community developed independent rules and principles that, while they arguably do not comprise a complete system, apply by custom and agreement to transactions and other relationships in international trade.

In this realm of international commercial transactions, arbitration has become the preferred method of dispute resolution.[4] Arbitration is preferred over judicial methods of dispute resolution because the parties have considerable freedom and flexibility with regard to choice of arbitrators, location of the arbitration, procedural rules for the arbitration, and the substantive law that will govern the relationship and rights of the parties. In addition, the arbitrators may be experts in the field involved, the proceedings will be private, and the process can avoid the delays that are associated with adjudication. Finally, international arbitration results in decisions that will usually have the force and effect of law.

While in some cases a state may impose arbitration on disputing parties contracting domestically,[5] in most international transactions arbitration will result only from the specific agreement of the parties. Arbitration is almost exclusively a creature of contract. The parties determine the content of the contractual agreement, and any requirement to arbitrate is dependent upon and subject to the will of the parties in almost all respects.

However, arbitration is not without limitations. States retain considerable power to intervene through domestic regulation and international treaties. Additionally, and specifically with regard to international commercial arbitration, arbitral awards arising out of this system of private international law are enforceable only through national judicial systems. This gives states ultimate supervision of arbitral practice and the substantive law that forms the basis of arbitral decisions.

Public policy, in its various forms, comes to bear upon private interna-

[3] Lalive, *Transnational (or Truly International) Public Policy and International Arbitration* in COMPARATIVE ARBITRATION, *supra* note 1, 257, ¶ 10, at 316. For an exception to the proposition in the text, see the discussion on the United Nations Convention on Contracts for the International Sale of Goods in footnote 32 *infra*.

[4] D. WILSON, INTERNATIONAL BUSINESS TRANSACTIONS IN A NUTSHELL (1984); Salter, *International Commercial Arbitration: The Why, How and Where*, 88 COMM. L.J. 381, 382 (1983); Perlman & Nelson, *New Approaches to the Resolution of International Commercial Disputes*, 17 INT'L LAW. 215, 225 (1983).

[5] For instance, in the U.S.S.R., "Arbitration is compulsory under the 1972 Moscow Convention for disputes with enterprises from other member states of the C.M.E.A." K. Bockstiegel, Public Policy and Arbitrability: Summary on National Laws, section on U.S.S.R. at 1 (unpublished Annex to Bockstiegel, *Public Policy and Arbitrability*, in COMPARATIVE ARBITRATION, *supra* note 1, 177, available from the Department of International Commercial Arbitration, T.M.C. Institute, P.O. Box 30461, 2500 GL The Hague, The Netherlands) [hereinafter *Summary*].

tional law and arbitral practice through this supervisory role. While public policy provides states with a tool for external constraint upon the relative freedom of the members of the international business community to determine relationships as they see fit, it also can provide the mechanism for freeing international commercial transactions from the stringent requirements of the domestic law of the forum state or foreign states.

The purpose of this article is to define and explore the role that public policy plays in this international forum, particularly as it affects the practice of international arbitration. The article first defines three levels of public policy: domestic, international, and transnational. Second, the application of public policy to international commercial arbitration is discussed, followed by an examination of international contracts and the choice of applicable law. Third, the article covers the parameters of public policy as specifically applied in the United States and other selected countries. The article concludes with a discussion of a truly international or transnational public policy that may transcend and possibly supersede domestic and international public policy.

Public Policy Concepts

Public policy is the final parameter of the law that, while it is reflected in and often expressed by statutory and constitutional statements of law, also dictates either consent or constraint, permission or prohibition, when statutes and constitutions are silent on a given matter. Public policy first exists at the domestic level within each individual state. Here, public policy represents those local standards or rules that are not subject to alteration or derogation by the parties and stand as an outside limit to the parties' freedom to contract.[6] Accordingly, the courts, either in an adjudicatory role or as enforcers of an arbitral award, may relieve a party from contractual duties or impose additional duties where a state's "most basic notions of morality and justice" require it.[7] Public policy may be the stated justification for striking down entire contracts or contract clauses or for refusing to enforce an arbitral award on grounds of immorality, unconscionability, economic policy, unprofessional conduct, and diverse other criteria. This will be hereinafter referred to as domestic public policy.

[6] Lalive, *supra* note 3, ¶ 7, at 260; Derains, *Public Policy and the Law Applicable to the Dispute in International Arbitration* in Comparative Arbitration, *supra* note 1, 227, ¶ 1. *See also* Lalive, *supra* note 3, ¶ 164, at 304, for discussion of transnational public policy.

[7] In the United States, public policy has been defined as "those mandatory norms that comprise a State's most basic notions of morality and justice.' " Schwebel & Lahne, *Public Policy and Arbitral Procedure* in Comparative Arbitration, *supra* note 1, at 205, (citing Parsons & Whittemore Overseas Co. v. Societe Generale de L'Industrie du Papier, 508 F.2d 969, 974 (2d Cir. 1974)).

Related to domestic public policy is international public policy. This term includes those standards or rules of a given state's domestic public policy that will also be applied by that state in an international context.[8] The two can be distinct in that many states will not strictly impose all of the constraints of their domestic public policy upon international trade, where more freedom and flexibility is generally viewed as a necessity.[9] Throughout this article, this will be referred to as a public policy view that is more restrictive, imposing higher standards or raising barriers where international trade or foreign interests are concerned.[10] This will be referred to as a restrictive view of public policy. While the latter view appears to be the more prevalent,[11] there is, as discussed below in the U.S. context,[12] a clear movement[13] toward the liberal view that a state's international public policy should be less restrictive, reflecting only the more absolute "hard core" standards of the given state.[14]

A third concept of public policy is that of a truly international or transnational public policy. The concept of transnational public policy, a much debated notion in itself,[15] is said to represent the existence of an international consensus as to universal standards or accepted norms of conduct that must always apply and provide limitations to public as well as private international relationships and transactions.[16] While transnational public policy is closely related to the international public policy of individual states,[17] they are clearly distinct. The former is less restrictive, representing the common fundamental values of the world community, while the latter inevitably reflects a particular or selfish character.[18] In a judicial forum,

[8] Lalive, *supra* note 3, ¶ 8, at 261. International public policy may be utilized to exclude foreign law that would otherwise be applicable or to cause the application of domestic "mandatory" rules. Derains, *supra* note 6, ¶ 1, at 227-28.

[9] Lalive, *supra* note 3, ¶ 8, at 261 and ¶¶ 56-59, at 275-76.

[10] *Id.* ¶ 60, at 276.

[11] *Id.*

[12] *See infra* text accompanying notes 41-67.

[13] "More and more we see a distinction between domestic public policy and international public policy gaining ground. The notion of the latter is more restricted than the former." Schwebel & Lahne, *supra* note 7, at 209 (quoting P. Sanders in Holtzman, *Commentary*, in 60 YEARS ON, A LOOK AT THE FUTURE (1984)).

[14] Lalive, *supra* note 3, ¶ 17, at 264.

[15] *Id.* ¶ 1, at 259 and ¶ 181, at 309. "[T]here is—of course—the growing recognition of a truly 'international' [meaning transnational] public policy." Bockstiegel, *supra* note 5, at 181. "[T]he concept that there may exist an 'international public policy' [meaning transnational public policy] is of extremely recent vintage." Schwebel & Lahne, *supra* note 7, at 206-07. *See generally* Lalive, *supra* note 3, for a strong argument in support of the existence of transnational public policy.

[16] Lalive, *supra* note 3, ¶ 182, at 309.

[17] *Id.* ¶ 7, at 314.

[18] *Id.* ¶¶ 7-8, at 314-15. "[T]here can be no total identity or assimilation between the

domestic courts have direct responsibility to domestic authority and are thus subject to local interests when applying a principle of transnational public policy.[19] In international commercial arbitration, a forum that in a sense is not tied to a domestic jurisdiction, the bias or "localization" may be less evident and the arbitrator may be in a better position to ascertain and understand the needs of the international community and call upon notions of transnational public policy.[20] Indeed, some writers have advocated that international arbitration can and should be completely independent of both procedural and substantive lex fori except where the parties provide otherwise.[21]

The Application Of Public Policy In Arbitration

Public policy can be raised by a party to an international contract containing an arbitration clause either as an objection to enforcement of the contract in its entirety or the arbitration clause specifically. It may be raised before the arbitrator during the arbitral proceeding or before a court in defense of an action to force arbitration or to oppose recognition or enforcement of an existing award.[22] Also, in theory, a court or arbitral tribunal may itself raise the issue on its own motion.[23]

The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958),[24] adhered to by about seventy countries including the United States,[25] provides for the enforcement of arbitral awards by national courts and the enforcement of arbitral agreements in international contracts.[26] The Convention provides that recognition or enforcement of an arbitral award may be refused where the competent authority in the state where recognition or enforcement is sought determines that: a) the subject matter of the dispute is not capable of settle-

two kinds of 'public policies' . . . . Similarly, the fundamental values and interests of a given State can hardly coincide fully with the values and fundamental interests of the international community." *Id.*

[19] *Id.* ¶ 88, at 284.

[20] *Id.* ¶ 102, at 287.

[21] A. Redfern, International Public Policy: The New Standard (unpublished written communication to the International Arbitration Congress; see *supra* note 1). "The subjectivist theory is that no law is recognized as having the power to govern an international contract unless the parties have decided that it is to do so." Derains, *supra* note 6, ¶ 20, at 235.

[22] Bockstiegel, *supra* note 5, at 186-89.

[23] Lalive, *supra* note 3, ¶ 6, at 313-14; Derains, *supra* note 6, ¶ 50, at 251.

[24] 3 U.S.T. 2517, T.I.A.S. No. 6997, 330, U.N.T.S. 38 (Dec. 29, 1970); as implemented in the United States by Chapter 2 of the U.S. Arbitration Act (also known as the Federal Arbitration Act), 9 U.S.C. §§ 201-208 (1982).

[25] J.S. McClendon & R. Goodman, International Commercial Arbitration in New York 4 (1986).

[26] Goodman, *Choosing a Place for International Arbitration: The New York Option*, 2 J. Int'l Arb. 39 (1985).

ment by arbitration under the law of that state; or b) the recognition or enforcement of the award would be contrary to the public policy of that state.[27]

The first ground for refusal refers to arbitrability. A particular state may object to allowing the submission to arbitration of certain issues or subject matter, preferring instead that the state's judicial body have exclusive jurisdiction. In the United States, disputes arising under or concerning the areas of antitrust, securities, and bankruptcy are examples. Arbitral clauses and awards in these areas have been subject to some limitations on enforceability.[28] The justifications for declaring some types of disputes non-arbitrable will often be grounded in a state's public policy, so the two grounds for refusal are not mutually exclusive and the delineation between the two may in fact be superfluous.[29] The second clause, referring specifically to public policy, allows for procedural or substantive objections that go beyond the issue of arbitrability, such as where a party claims violations of basic due process requirements.[30] Both clauses expressly refer to the law or public policy of the states where recognition or enforcement is sought. This reference is to the given state's international public policy as defined above,[31] which may or may not be the same as its domestic public policy.

The Law Of The Contract

In a domestic context, two parties contracting and performing a contract locally will be bound by their contractual agreement, subject to local law and custom. In their agreement they will generally take local law into account either expressly or implicitly. The parties may vary the provisions of the law to a certain extent but they will still be bound by mandatory provisions. If the two parties are from different states—for instance, Minnesota and New York—they might agree that Minnesota law applies rather than the law of New York; the parties have the freedom to select the state law upon which their contract is built. Minnesota law will then provide the substantive answers should a question of interpretation arise. The chosen law will fill in the gaps where the parties have by choice or default failed to reach agreement.

[27] New York Convention as codified in ch. 2, art. V(2)(a) and (b) of the U.S. Arbitration Act, 9 U.S.C. § 207 (1982).

[28] This is generally no longer the case. *See infra* text accompanying notes 41-67.

[29] Bockstiegel, *supra* note 5, at 183. *See also* von Mehren, *The Enforcement of Arbitral Awards Under Conventions and U.S. Law*, 9 YALE J. WORLD PUBLIC ORDER 343, 361 (1983).

[30] Schwebel & Lahne, *supra* note 7, at 216-17; Lalive, *supra* note 3, ¶ 146, at 299. The New York Convention, *supra* note 24, provides for claims of lack of due process in an article separate from that governing public policy. 9 U.S.C. § 207(V)(1)(b) (1982).

[31] A. Redfern, *supra* note 21.

The same process occurs in international commercial transactions, except presumably with a greater degree of conscious deliberation. Whereas domestically the parties will rarely specify a choice of law because the differences between Minnesota and New York law are minimal where the Uniform Commercial Code applies, parties dealing internationally are usually much more aware that whether their expectations are realized may depend to a great extent on the law that will be applied to the contract in the event of a dispute. Internationally, there generally are no laws that will automatically apply.[82] If the parties have not chosen a law, the arbitrator (or judge) must select the applicable law on the basis of conflict of laws principles, which must also be determined by the arbitrator (or judge). Even among western countries, substantive law can vary considerably and the parties should bargain accordingly. Through a choice of law clause in their agreement, the parties can select the law that will further their interests and, by the same action, eliminate other laws that might defeat their contractual purposes.

It is in this context of selecting and avoiding law that public policy, as it relates to freedom of the parties, must be considered. The issue is whether the parties by their agreement can freely choose a law governing the contract in order to escape mandatory laws or public policy of the states where they legally reside or where the contract will be performed. For instance, can the parties select the law of India in order to escape American and EEC competition laws even though the parties are from New York and London and the contract is to be performed in Germany? Or can an Egyptian party and a European party escape the Islamic injunction (public policy) against charging interest by selecting English law? It is clear that the parties can choose such laws. However, in an action to enforce an arbitral award, the question arises whether public policy prevents recognition or enforcement of an award that is based upon a substantive law chosen by the parties that conflicts with the public policy of the enforcing state.

With regard to both competition law and interest charges, the New

[82] As an exception to the statement in the text, on January 1, 1988, the United Nations Convention on Contracts for the International Sale of Goods (CISG) became effective in the United States. The official text is published in 52 Fed. Reg. 6264 (1987). Under articles 1(1)(a) and 6, contracts between enterprises from different states with places of business in states that have ratified or acceded to the convention will be governed by the convention unless the contracting parties have agreed to exclude some or all of its terms. The convention will also apply where conflict-of-laws rules lead to the application of the law of a contracting state (art. 1(1)(b)). The convention applies only to the formation of the contract of sale and the rights and obligations of the parties arising from the contract (art. 4). As of October 1, 1987, eleven countries have ratified or acceded to the convention: Argentina, China, Egypt, France, Hungary, Italy, Lesotho, Syria, United States, Yugoslavia and Zambia.

York Convention is clear.[33] The public policy of the state where recognition or enforcement is sought can be raised as a ground for refusing either recognition or enforcement.[34] So it seems that the parties cannot simply, by a choice of law clause, avoid an unwanted public policy or mandatory law of the state or states where enforcement might later be sought. However, limits on the freedom of the parties to choose applicable law to avoid other laws or public policy are still questionable in several respects. First, in an action for enforcement, the court might on its own motion, motivated by notions of comity, choose to concern itself with the public policy of other states—for instance, where performance occurred or where the non-resident party resides. Second, the argument has been made that the New York Convention and other similar treaties should refer to transnational public policy[35] rather than the public policy of the enforcing state.[36] If this were the case, an enforcing state could not object to recognition of the award unless its public policy grounds were also part of the international consensus or transnational public policy. Thus the parties' freedom to choose law would be much more potent.

Third, and more relevant to this article, difficult issues arise with respect to the role and responsibility of the international commercial arbitrator. The arbitrator derives his authority from the contractual agreement of the parties and is, arguably, solely responsible to those parties and subject to their intents and expectations. The question arises: should an arbitrator disregard the public policy of a state where enforcement may be sought (or where performance of the contract will occur or has occurred, or where the arbitration takes place) when the contractual choice of law refers to another state where the same limitations do not exist? In other words, should the arbitrator be concerned about the ultimate enforceability of the award when it entails the consideration of law or public policy that the parties sought to avoid? As discussed above,[37] the system of arbitration works in part because of the support provided through international treaties allowing for the enforceability of awards. Does this consent by the community of states impose upon the international arbitrator a duty to respect the laws and public policy of states that are affected by the contract but are excluded by a choice of law clause, whether or not the issue might be raised on enforcement? Although they are the subject of much discussion,[38] there is no clear resolution of these issues.

[33] *See supra* text accompanying notes 24-31.

[34] New York Convention, art. V(2)(b), *supra* note 27 and accompanying text.

[35] *See infra* text accompanying notes 107-16.

[36] A. Redfern, *supra* note 21.

[37] *See supra* text accompanying notes 24-31.

[38] For further discussion see Lalive, *supra* note 3, at 271-73, 304-06, and Derains, *supra* note 6, ¶¶ 50-56, at 251-54.

Public policy probably plays a much greater role in the theory of arbitration than in actual practice.[39] Internationally, a claim that an arbitral award contravenes public policy, while frequently asserted by parties, is rarely successful.[40] However, as trade becomes more internationalized, at least in the private sector, answers to these issues become more important because of the critical role public policy plays in the protection of those basic convictions, values, and interests that a given community holds, be it national or international.

International Arbitration And Public Policy In The United States

Many public policy issues have not been resolved, or even addressed, by American courts. However, because of the preeminent position of the United States in international trade, any direction taken by the American courts will strongly influence other countries. An exploration of American public policy as it arises within the context of international commercial arbitration is thus worthwhile.

While in international private law it now seems clear that parties generally have considerable freedom to choose the manner of dispute resolution and the substantive law that will apply to their contracts, this has not always been the case. In the early part of this century, American courts regularly invalidated arbitration agreements and choice of law clauses[41] as encroachments upon the judicial province and therefore contrary to public policy. However, in 1924, after enactment of a similar New York state law, Congress adopted the Federal Arbitration Act (FAA),[42] which indicated a willingness to allow parties to arbitrate and to choose the law that would apply. The courts gradually came to accept the parties' right to select both a forum and their own substantive law.[43]

In this public policy shift towards arbitration there has also been a recognition of the distinction between domestic and international contracts in arbitration. This distinction was clearly stated by the United States Supreme Court in *Scherk v. Alberto-Culver Co.*,[44] where the Court upheld an international commercial arbitration agreement that contained a choice of law clause. In *Scherk*, Alberto-Culver sought to initiate an ac-

[39] Bockstiegel, *supra* note 15, at 179.

[40] J.S. McClendon & R. Goodman, *supra* note 25, at 140. "[I]t is encouraging to report that the defense [of public policy] is succeeding less and less in modern courts. Courts are increasingly recognizing that narrow, nationalistic grounds of public policy that might be properly applicable in domestic cases are inappropriate in international cases." Schwebel & Lahne, *supra* note 7, at 209 (quoting Holtzman in *Commentary, supra* note 13, at 364).

[41] J.S. McClendon & R. Goodman, *supra* note 25, at 114.

[42] 9 U.S.C. §§ 1-14 (1982).

[43] J.S. McClendon & R. Goodman, *supra* note 25, at 115.

[44] 417 U.S. 506 (1974).

tion in federal district court based on claims of fraud in violation of section 10(b) of the Securities Exchange Act of 1934. The defendant sought to stay the proceedings while the parties arbitrated the dispute before the International Chamber of Commerce, as provided in the contract.

Alberto-Culver relied on an earlier case, *Wilko v. Swan*,[45] in which the Court held that an agreement to arbitrate could not preclude an action under section 12(2) of the 1933 Act.[46] The Court in *Wilko* had ruled that "the right to select the judicial forum is a kind of provision that cannot be waived under Section 14 of the Securities Act"[47] and that "Wilko's advance agreement to arbitrate any disputes subsequently arising out of his contract to purchase the securities was unenforceable under the [1933 Act.]"[48] The Court reached this conclusion notwithstanding the provisions of the FAA which reflect "a legislative recognition of the desirability of arbitration as an alternative to the complications of litigation"[49] and a desire "to place arbitration agreements upon the same footing as other contracts."[50] In other words the Court in *Wilko* decided that the public policy that favored *judicial* dispute resolution when securities law was involved preempted the public policy encouraging arbitration generally.

In *Scherk*, however, the Court found "crucial differences between the agreement involved in *Wilko* and the one signed by the parties here."[51] The contract signed in *Scherk* "was a truly international agreement . . . [involving] considerations and policies significantly different from those found controlling in *Wilko*."[52] According to the Court:

> [U]ncertainty [concerning the law applicable to the resolution of disputes arising out of the contract] will almost inevitably exist with respect to any contract touching two or more countries, each with its own substantive laws and conflict-of-laws rules. A contractual provision specifying in advance the forum in which disputes shall be litigated and the law to be applied is, therefore, an almost indispensable precondition to achievement of the orderliness and predictability essential to any international business transaction.[53]

In addition to recognizing the validity and necessity of choice of law clauses, this case clearly illustrates the distinction that the Court had

[45] 346 U.S. 427 (1953).
[46] 15 U.S.C. § 771(2) (1982).
[47] 346 U.S. 427, 435.
[48] 417 U.S. 506, 512.
[49] 346 U.S. 427, 431.
[50] H.R. REP. No. 96, 68th Cong., 1st Sess. 1, 2 (1924).
[51] 417 U.S. 506, 516.
[52] *Id.*
[53] *Id.*

made between domestic and international public policy. The Court in *Scherk* exhibited a strong preference for judicial restraint when international transactions were involved:

> The invalidation of such an agreement in the case before us would not only allow the respondent [Alberto-Culver] to repudiate its solemn promise but would, as well, reflect a "parochial concept that all disputes must be resolved under our laws and in our courts . . . . We cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts."[54]

The Supreme Court reaffirmed the *Scherk* ruling in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*,[55] a case that involved a suit under federal antitrust laws arising out of an agreement that contained a clause specifying arbitration in Japan under Swiss law. The Court referred to the Second Circuit Court of Appeals decision in *American Safety Equipment Corp. v. J.P. Mcguire & Co.*,[56] which reasoned that "the pervasive public interest in enforcement of the antitrust laws, and the nature of the claims that arise in such cases, combine to make . . . antitrust claims . . . inappropriate for arbitration."[57] In *Mitsubishi*, the court responded to this reasoning by noting:

> [C]oncerns of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international system for predictability in the resolution of disputes require that we enforce the parties' agreement, even assuming that a contrary result would be forthcoming in a domestic context.
>
> The *Bremen* and *Scherk* [decisions] establish a strong presumption in favor of enforcement of freely negotiated contractual choice-of-forum provisions. Here, as in *Scherk*, that presumption is reinforced by the emphatic federal policy in favor of arbitral dispute resolution. And . . . that federal policy applies with special force in the field of international commerce.[58]

In both *Scherk* and *Mitsubishi* we see an attitude toward the adoption or recognition of public policy that seeks to take into account the interests and needs of international trade notwithstanding the rules of domestic law,[59] and that specifically favors the freedom of the parties involved in international transactions to choose both the manner of dispute resolution and applicable substantive law. The Court gave no direct indication

[54] 417 U.S. 506, 520, quoting M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 9 (1972).
[55] 105 S. Ct. 3346 (1985).
[56] 391 F.2d 821 (2d Cir. 1968).
[57] *Id.* at 827-28.
[58] 105 S. Ct. 3346, 3355-57.
[59] Lalive, *supra* note 3, ¶ 59, at 275-76.

that it sanctioned the avoidance by the parties of American domestic public policy by a choice of law clause, but clearly stated that any domestic public policy limitations upon arbitrability of securities and antitrust disputes simply did not comprise a part of American international public policy.

The last decision in this line of cases concerning arbitrability is *Shearson/American Express, Inc. v. McMahon*,[60] which involved claims based on section 10(b) of the Securities Exchange Act and the Racketeer Influenced and Corrupt Organizations Act (RICO).[61] The dispute was between securities brokers and their U.S. customers, concerning a purely domestic transaction. The parties had signed agreements containing a provision that all controversies arising out of the transaction would be settled by arbitration under the rules of the securities industry.[62] The Supreme Court, in reversing the Second Circuit, held that the Federal Arbitration Act requires both the section 10(b) and RICO claims to be submitted to arbitration in accordance with the agreement to arbitrate.[63] Further, the Court held that the FAA establishes a federal policy favoring arbitration of even statutory claims unless it can be shown that Congress intended to preclude a waiver of judicial remedies for the rights at issue.[64]

The Court, in examining *Scherk*, stated that that decision has been distinguished from *Wilko* not so much because of its international context but because "under the circumstances of that case, arbitration was an adequate substitute for adjudication as a means of enforcing the parties' statutory rights."[65] The Court then proceeded to discuss the adequacy of arbitration in the context of section 10(b) claims. The Court, by its lack of comment, appears to deemphasize the domestic/international dichotomy upon which *Scherk* seemed to be explicitly based and may have removed the distinction altogether as it relates to arbitration of claims based on statutory rights. While it is therefore difficult to determine whether and to what extent the decision in *McMahon* owes its heritage to the international public policy established in *Scherk* and *Mitsubishi*, *McMahon* might be viewed as an illustration of how principles that gain strong acceptance in international public policy can have a direct, if unspoken, impact on domestic law.

[60] 107 S. Ct. 2332 (1987). This decision is discussed in depth in another article in this issue. *See* Shell, *Arbitration of Federal Statutory Rights after Shearson/American Express, Inc. v. McMahon: Commercial Arbitration Comes of Age*, 26 AM. BUS. L.J. 397 (1988).

[61] 19 U.S.C. §§ 1961-1968 (1982 & Supp. II 1984).

[62] 107 S. Ct. 2332, 2335.

[63] *Id.* at 2343, 2346.

[64] *Id.* at 2337.

[65] *Id.* at 2339.

It remains to be seen how and where American courts will impose international public policy limitations upon arbitrability and choice-of-law clauses. In construing the public policy defense under the New York Convention, the Second Circuit Court of Appeals once noted that "[e]nforcement of foreign arbitral awards may be denied on this basis only where enforcement would violate the forum state's most basic notions of morality and justice."[66] In any event, *McMahon* and its predecessors clearly support the exercise of judicial restraint when it comes to rejecting commercial arbitration clauses or awards on public policy grounds, whether it be in the domestic or international context.[67]

Public Policy In Other Jurisdictions

To illustrate public policy applications in other jurisdictions, a small but varied sample of countries was selected. Developed and developing countries and democratic, socialist, and Islamic environments are included in the sample.

Brazil

In the opinion of one of its leading international scholars, Brazil has a poor arbitral tradition.[68] Brazil has no specific statutes dealing with arbitration, although its Civil Procedure Code does accept it as a method for resolution of disputes.[69] There is, therefore, no special statutory treatment of the issues of arbitrability and public policy, and the judge is left with wide discretion in determining the parameters and applicability of public policy issues. The Code does include public policy considerations with regard to foreign decisions: "Laws, acts and decisions of another

[66] Parsons & Whittemore Overseas Co. v. Societe Generale de L'Industrie du Papier, 508 F.2d 969, 974 (2d Cir. 1974).

[67] "The international public policy of the United States covers a smaller field in order to promote foreign trade. The enforcement of a foreign award will, therefore, only be refused, if the arbitration violates the most basic notions of morality and justice." Bockstiegel, *Summary, supra* note 5, section on the U.S.A. at 1. For cases within a completely domestic context, the United States Supreme Court has stated that the public policy grounds for refusing to enforce an award turn on the

> examination of whether the award created any explicit conflict with other "laws and legal precedents" rather than an assessment of "general considerations of supposed public interests" .... [A] formulation of public policy based only on "general considerations of supposed public interests" is not the sort that permits a court to set aside an arbitration award.

United Paperworkers Int'l Union v. Misco, 108 S. Ct. 364, 373, 374 (1987) (quoting W.R. Grace & Co. v. Rubber Workers, 461 U.S. 757, 766 (1983)).

[68] Strenger, *The Application by the Arbitrator of Public Policy Rules to the Substance of the Dispute*, in Comparative Arbitration, *supra* note 1, 353, at 355.

[69] *Id.*

country, as well as any statements of will, have no effect in Brazil when being contrary to national sovereignty, public policy or *bonos mores*."[70]

In practice this judicial latitude has led to "strong and frequent hindrances [to international arbitration and awards] resulting from national public policy."[71] There is strong judicial sensitivity to domestic as contrasted with international interests, with accompanying strict adherence to mandatory rules.[72] This raises potential barriers to choice of law clauses and the enforcement of foreign awards: "In these circumstances, the understanding prevails that no contrary will of the parties and no contrary provisions of a foreign law may gain the upper hand, within the limits of the territory of one State, to a correspondent provision of territorial law."[73]

Brazil is not a signatory of the New York Convention. There is no acceptance in the law or in practice of a distinction between domestic and international public policy. There is, however, some indication of a slight thaw in the treatment of arbitration and in recognition of the role of international arbitration. This is evidenced by an expanding application of the principle of the autonomy of the will of the parties and a greater acceptance of current practices in international trade.[74]

Egypt

The Egyptian legal system is in the midst of conflict with regard to public policy and international arbitration. While there is formal recognition of arbitration as a legitimate means of dispute resolution, long and strongly held traditional values and substantive rules increasingly tend to obstruct the arbitral process. The 1968 Code of Civil and Commercial Procedures, articles 501-513, provides the framework for domestic arbitration.[75] Only two articles in the Code refer to international arbitration. Article 299 provides for enforcement of foreign arbitral awards on the same basis as foreign judicial decisions, and article 301 confirms the supremacy internally of international treaties to which Egypt is a party. Egypt is a party to the New York Convention.

Article 299 also specifies that, for a foreign arbitral award to be recognized, its subject matter must also be arbitral under Egyptian law.

[70] *Id.* at 353.

[71] *Id.* at 355.

[72] *Id.* at 354. For instance, as a mandatory rule, Brazil prohibits the remittance of royalties above 5%. An arbitral award for a higher level in accordance with the national law of the creditor "would be impossible to enforce in Brazil." *Id.* at 356.

[73] *Id.*

[74] *Id.* at 355.

[75] El-Kosheri, *Commentary on Public Policy Under Egyptian Law*, in COMPARATIVE ARBITRATION, *supra* note 1, 321.

Article 501, concerning domestic arbitration, prohibits arbitration "in matters which could not be the subject of a compromise."[76] These include, under article 551, matters of personal status and those concerned with "public order." Public order is not defined elsewhere in the Code and the definition is left for the courts. There have been no reported court decisions on substantive arbitrability, and doctrinal writings have been divided. One side, composed of "internationally oriented commercialists" and private international law scholars, favors a liberal view of public order while the other side prefers an interpretation with broad restrictions upon international arbitrability. This latter faction would also create two categories: 1) subject matter not arbitrable domestically or internationally, and 2) subject matter arbitrable domestically but not internationally.[77]

Egyptian courts have on occasion considered whether international public policy is broader or narrower than domestic public policy. In one case where procedural public policy was raised to prevent enforcement of an award, the Cour de Cassation in 1982 stated that:

> It is unacceptable to claim the exclusion of the applicable English law under the pretext that it violates Article 502(3) Procedures, even if we assume that this is true. The possibility of excluding the rules of the foreign applicable law is conditioned according to Article 28 of the Civil Code upon proof that these rules are contrary to public order in Egypt, i.e., in conflict with *social, political, economic or moral bases* which relate to the *supreme interests of the community*. Thus, it is not sufficient that they (the foreign rules) contradict a mandatory legal text.[78] (Emphasis added.)

Another case in 1982 raised an interesting and pertinent issue. The Cairo Court of Appeal was petitioned for enforcement of an award rendered in London in favor of a British company against an Egyptian trading company for breach of contract damages plus interest at eight percent per annum. The court enforced the principal amount of the award but refused to enforce the award of interest as being in violation of Egyptian public policy, which imposes a ceiling of five percent as the maximum rate of interest.[79] (Even the five percent interest is in violation of the fundamental Islamic ban on interest.) This case directly raises the conflict between strongly held traditional values and international commercial interests. While the case was appealed, the appellate court decision is not yet available. The court's ultimate decision on this case may clearly indicate its attitude with regard to whether Egypt has an international

[76] *Id.* at 321-22.
[77] *Id.* at 322-23.
[78] *Id.* at 325.
[79] *Id.* at 326.

public order that is more liberal or restrictive than its domestic public order.

Argentina

Argentine law holds to a relatively progressive view of both local and international arbitration. The National Code of Civil and Commercial Procedure contains articles that provide considerable detail on arbitral procedure[80] and provide for the recognition of foreign arbitral awards.[81] Argentina is not a party to the New York Convention. Both foreign and domestic proceedings and awards must be "compatible with essential principles of fairness and justice which are a part of . . . public policy."[82]

> Arbitral awards rendered outside of Argentina will not be recognized or enforced in the country if they run against Argentine principles of public policy or if they decide issues which cannot be arbitrated or if the arbitral agreement covers an issue submitted to the exclusive jurisdiction of the Argentine court.[83]

The Code indicates the non-arbitrability of certain aspects of company law, foreign investment law, and antitrust, trademark, and patent legislation. Matters where there is exclusive jurisdiction vested in the courts include constitutional issues, actions where the state is a party, and actions where the exercise of sovereign power is in question.[84]

It appears that the courts are willing to allow certain matters that are not normally arbitrable locally to be arbitrated in an international context.[85] There also has been recognition and enforcement of foreign arbitral awards that have acquired the force of res judicata in the foreign country and that "bring to bear specific policies and interests which will have a moderating impact" on domestic policy:[86]

> [The] principles of predictability and repose concerning situations already adjudicated through final decisions will certainly induce the Argentine judge to prudently consider public policy principles under Argentine law so as not to unnecessarily disturb the expectations of the parties to an arbitral procedure and the fluidity of international commercial and economic exchanges unless there are superior national interests and policies underlying the Argentine relevant norms and principles

[80] 1 INTERNATIONAL HANDBOOK ON COMMERCIAL ARBITRATION, Argentina Annex at 1 (P. Sanders ed. 1984) [hereinafter HANDBOOK].

[81] *Id.* at 2.

[82] Naon, *Public Policy and International Arbitration: An Argentine View*, in COMPARATIVE ARBITRATION, *supra* note 1, 329.

[83] *Id.* at 334.

[84] *Id.* at 330.

[85] *Id.* at 330-33.

[86] *Id.* at 334.

clearly overpowering the concerns for the stability on international commercial arbitral adjudications.[87]

On the other hand it is possible that the international nature of the proceeding or the award might cause it to be subject to additional limitations:

> [C]oncerns of national protection in certain vital aspects of Argentine economy related to international commercial and economic intercourse can also validly lead to exactly the opposite outcome. For instance precisely because the controversy is an international one, matters which can be normally arbitrated in Argentina may be rendered non-arbitrable outside of Argentina.[88]

An Argentine court will respect the parties' choice-of-law agreement and resulting awards unless there is evidence that they: a) violate general principles of morality and justice shared by Argentina and the international community; b) violate Argentine mandatory law where the place of performance is in Argentine territory; or c) violate foreign mandatory law of the place of performance which should receive application.[89] The Argentine courts will not give effect to a choice-of-law agreement where it appears to operate as a "fraude a la loi"[90] with regard to either Argentine or foreign law.[91]

U.S.S.R.

Article 63 of the Fundamentals of Civil Procedure allows the enforcement of foreign arbitral awards under agreements between the U.S.S.R. and foreign states or by international convention.[92] The U.S.S.R. is a party to the New York Convention and has concluded a number of bilateral agreements which contain clauses allowing a public policy exception to enforcement.[93]

Article 128 of the Fundamentals of Civil Legislation states that "foreign law is not applied if its application is contrary to the foundations of the Soviet system."[94] However, there has been very little opportunity for the development of Soviet public policy. The major reason for this is the fact that "in practice, there has been so far no case of recourse to the

[87] *Id.* at 335.
[88] *Id.* at 330.
[89] *Id.* at 331.
[90] "Fraude a la loi" literally means a fraud on the law or to defraud the law.
[91] Naon, *supra* note 82, at 331, n. 7.
[92] Razumov, *Public Policy as Condition for Recognition and Enforcement of Foreign Court Judgments and Arbitral Awards in the USSR*, in COMPARATIVE ARBITRATION, *supra* note 1, 348.
[93] *Id.* at 348.

Soviet courts for enforcement of foreign arbitral awards."[95] As some indication of the Soviet position on international public policy, one Soviet scholar has stated that:

> It should be noted, as a conclusion, that in the interests of stability and certainty of international trade relations and with the aim of further recognition and promotion of arbitration as the most adequate . . . way of settling [international] commercial disputes, it is necessary to construct very restrictively international multilateral and bilateral conventions and agreements providing for the [lessened] possibility to refuse enforcement of foreign arbitral awards because of the public policy considerations.[96]

France

Of all of the countries reviewed, France has the most developed and progressive policy with regard to the distinction between domestic and international arbitration. The Code of Civil Procedure provides separately for the two procedures—domestic arbitration in titles I through IV (articles 1442 to 1491), and international arbitration in titles V and VI (articles 1492 to 1507) in Book IV of the Code.[97] Title V provides specific procedures for international arbitration and title VI applies to the recognition and enforcement of awards rendered abroad or an international arbitral award rendered in France. Article 1492 provides that "an arbitration is international if it implicates international commercial interests."[98]

When the arbitration is international:

> As to arbitrability, the French law is very liberal concerning the subject matter of international arbitration. Any dispute which has arisen or may arise out of a specific legal relationship and in respect of which it is permissible to compromise may be the subject of an arbitration agreement. The [ability] to compromise assumes the freedom to dispose of one's rights.[99]

This includes disputes relating to patents (except as to validity), some bankruptcy matters, and questions relating to the applicability of antitrust rules (except where the violation of antitrust rules is the main and direct object of a claim submitted to arbitration).[100] Furthermore, while article 2060 of the Civil Code prohibits the arbitration of any matters concerning public policy, it is now accepted that arbitration is excluded only in

[94] *Id.* at 349.
[95] HANDBOOK, *supra* note 80, at U.S.S.R. 22.
[96] Razumov, *supra* note 92, at 352.
[97] HANDBOOK, *supra* note 80, at France 1.
[98] *Id.*
[99] *Id.* at 7.
[100] *Id.*

those cases where the arbitrator is directly invited to violate French public policy.[101] Additionally, in international contracts, the state and public enterprises are free to agree to arbitration, a freedom not allowed in domestic contracts.[102]

The parties enjoy great freedom in their choice of the applicable law. Under article 1496: "The arbitrator shall decide the dispute according to the rules of law chosen by the parties." If the arbitrator disregards the parties' choice, the award may be set aside under articles 1502 and 1504.[103] The law chosen may be a national law or a non-national system of law, such as *lex mercatoria*.

Where enforcement of an award issued in France is sought, article 1504 provides a limited list of grounds for setting it aside. As regards public policy, annulment will be available only if enforcement of the award is obviously contrary to *international* public policy.[104] If the award is an international award not issued in France, this is the only ground which may justify the denial of enforcement.[105] While international public policy is nowhere defined, prevailing opinion is that the enforcement of the award will be denied if it entails the application in France of a foreign legal rule that is clearly contrary to French public policy.[106]

Transnational Public Policy

As defined earlier,[107] truly international or transnational public policy refers to standards, principles, or accepted norms of conduct that represent a universal (or perhaps at least regional) consensus in the community of states. The existence of transnational public policy has been frequently debated[108] and it is not within the scope of this article to explore that debate. This section will focus instead on defining transnational public policy and examining how it operates.

It seems clear that transnational public policy is not wholly distinct from international public policy. The international public policy of the various states determines whether there is a consensus on a particular standard, so in a sense transnational public policy would seem to be a subset of international public policy. It might also be true that the international public policy of any given state would be influenced by an emerging consensus not yet a part of the state's public policy. However, at least

[101] *Id.* at 3.
[102] Bocksteigel, *Summary, supra* note 5, section on France, at 1.
[103] Handbook, *supra* note 80, at France 21.
[104] *Id.* at 26.
[105] *Id.*
[106] Bocksteigel, *Summary, supra* note 5, section on France, at 1.
[107] *See* discussion, *supra* text accompanying notes 15-21.
[108] *See* footnote 15 and citations therein.

in theory, international public policy, dependent as it is on the decisions within a given state, will retain to some extent (and probably to a great extent) a selfish character[109] while transnational public policy will transcend the interests of the various members and focus on the interests of the "community" and thereby represent a distinct set of standards.

The concept of transnational public policy is certainly not without precedent. The Law of Nations, a widely accepted concept, has long been a part of international public law. The principle of *jus cogens* in international public law parallels that of public policy in private international law and incidentally suffers much the same debate and dispute as to its existence.[110] *Jus cogens* or a "peremptory norm" can be defined as a "norm accepted and recognized by the international community of states as a whole as a norm from which no derogation is permitted and which can be modified only by a subsequent norm of general international law having the same character."[111] There are two different views as to the source of such norms or general principles of law. One holds that the phrase

> embraces such general principles as pervade domestic jurisprudence and can be applied to international legal questions . . . and the other view asserts that the phrase refers to general principles of law linked to natural law . . . , that is, the transformation of broad universal principles of . . . law applicable to all of mankind into specific rules of international law . . . . The former view . . . is the one prevailing today.[112]

Case law that indicates some reference to and acceptance of transnational public policy does exist, though it is not common,[113] and records of arbitral decisions incorporating the concept are quite rare.[114] However, where it has been used, and where it could be used, it can function in both a negative and a positive sense.[115] In its "negative" function it could be used to exclude the law applicable through a choice-of-law clause in the contract or to exclude a given state's public policy that contravenes the transnational public policy standard. In its "positive" sense "the main function . . . is to directly and positively influence the decision of the arbitrators, whenever fundamental and universal notions of contractual morality or the fundamental interests of international trade are involved" even though not specifically a part of the given choice of law of the

[109] Lalive, *supra* note 3, ¶ 7, at 314.

[110] G. VON GLAHN, LAW AMONG NATIONS 510-11 (5th ed. 1986).

[111] Vienna Convention on the Law of Treaties, art. 53.

[112] G. VON GLAHN, *supra* note 109, at 22-23.

[113] Schwebel & Lahne, *supra* note 7, at 206; Lalive, *supra* note 3, ¶¶ 50-53, at 273-74, and ¶ 101, at 287.

[114] Lalive, *supra* note 3, ¶ 4, at 259, and ¶¶ 100, 101, 108, 109, at 286-87 and 289.

[115] *Id.* ¶¶ 11, 16, at 261-62, 263-64.

parties.[116] Transnational public policy in both senses can govern the actions of the parties and the arbitrator who, while invested with authority by the parties, does arguably owe some (and perhaps ultimate) responsibility to the international "community."

CONCLUSION

The concept of public policy, domestic, international and transnational, will continue to be found more in discussion and theory than in application and actual practice.[117] This imbalance belies the importance of the role that public policy plays when it does come to bear on the circumstances.[118] Public policy is one of the important mechanisms that balance the need for freedom from the constraints of various states' domestic law with the legitimate desire of those states and the international community to protect and preserve basic notions of morality and justice. The discussions, debates and arguments regarding public policy will continue, and perhaps some consensus will emerge. Even without a consensus, however, the concepts increasingly will affect arbitral practice as international commercial arbitration continues to develop as the preferred method of dispute resolution and as the world of international trade moves toward an increasingly community perspective.

[116] *Id.* at 313.
[117] Bocksteigel, *supra* note 5, at 179.
[118] Lalive, *supra* note 3, ¶ 10, at 316.