

# Disputes that Raise Public Policy Issues: Special Problems in International Disputes

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ONE of the primary benefits of international arbitration is that many countries have ratified treaties that allow for the enforcement of arbitral awards, whereas there are hardly any similar treaties allowing for reciprocal enforcement of civil judgments. The most recognized treaty allowing for arbitral awards to be enforced is the 1958 “Convention on the Recognition and Enforcement of Foreign Arbitral

Awards, also known as the “New York Convention.” Due to the wide acceptance globally of the enforcement of international arbitral awards, a great majority of awards are voluntarily accepted and paid.

However, Article V of the New York Convention outlines specific grounds for vacatur of an arbitral award, including most notably the “public policy” exception. This article argues that by looking to the

“end” of the dispute at the beginning of the contractual relationship, parties can often address and avoid “public policy” issues that can subsequently affect enforceability of the award. Thus, counsel should consider public policy issues at the onset of the international business relationship as a risk mitigation and cost-savings measure.

### **I. Background and the Public Policy exception**

Arbitrators do not enforce their own awards. Rather, a successful party must resort to a court, usually in a foreign country, to recognize and enforce the arbitral award.<sup>1</sup> Domestic courts decide which arbitral awards they will enforce and which they will reject; the ones that are enforceable enjoy the full protections and resources (and police powers) of the country. In the United States, that would mean the full enforcement powers of the state in which the award is confirmed would be applied, allowing the sheriff to levy on assets and potentially garnish funds from local financial institutions to satisfy the arbitral award.

Recognition of foreign awards are mandated under the New York

Convention. They are treated much like a judgment under the Full Faith and Credit Clause of the U.S. Constitution.<sup>2</sup> However, there are exceptions to the New York Convention’s mandate. The public policy exception recognizes that each country (or “State” as it is often referred to in the international arbitration context) reserves the right for its courts to exercise ultimate control over both the procedure of an arbitration held within its borders and to the arbitral award being enforced within its borders often against its own citizens. In this regard, scholars agree that “public policy” considerations are less about the question of the “arbitrability” of the disputes, and more about the “compulsory jurisdiction of national courts prompted by public policy.”<sup>3</sup>

While there are other treaties between states that may apply to various international agreements and disputes in addition to the New York Convention, the discussion of public policy considerations in international disputes will have more practical implications when viewed in the context of the New York Convention.

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<sup>1</sup> ANTON G. MAURER, PUBLIC POLICY EXCEPTION UNDER THE NEW YORK CONVENTION: HISTORY, INTERPRETATION, AND APPLICATION, 355 (Jurisnet LLC, Rev. ed., June 1, 2013).

<sup>2</sup> *In Re Fotochrome*, 377 F. Supp. 26, 30 (E.D.N.Y. 1974), *aff’d sub. nom.*, 517 F.2d 512 (2d Cir. 1975).

<sup>3</sup> Homayoon Arfazadeh, *Arbitrability under the New York Convention: the Lex Fori revisited*, 17 *Arbitration International* 73-87 (2001).

**a. Public Policy exception:  
New York Convention  
Article V(2)(b)<sup>4</sup>**

As of July 2018, there were 159 parties to the New York Convention including the United States, which ratified the treaty with certain reservations, and for which the treaty became effective on December 29, 1970. Under the Supremacy Clause of the U.S. Constitution (Article VI, Clause 2), treaties made under its authority, constitute the “supreme law of the land,” applicable to all 50 U.S. states without further adoption requirements by each state. Accordingly, the New York Convention and its “public policy” exception to enforcement is relevant to every state.

The relevant language of Article V states:

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

(a) The subject matter of the difference is not

capable of settlement by arbitration under the law of that country; or

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

The interpretation of the phrase “public policy” in Art. V (2) (b) has varied by country. It is helpful to consider the drafting history of the phrase to determine the intent of the language ultimately agreed upon by the delegate-drafters. The United Nations Conference on International Commercial Arbitration proposed the language for adoption by UNCITRAL, which would then be open to accession by the member states of the U.N. Each member-state that ratified the Convention subjected itself to these terms.<sup>5</sup>

Prior to the New York Convention, the “Geneva Convention on the Execution of Foreign Arbitral Awards” of 1927 (“Geneva Convention”) essentially stipulated that arbitral awards made under the Geneva Protocol in conjunction with the International Chamber of Commerce, would be binding and enforced in accordance with the rules of the territory where

<sup>4</sup> Available at <http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/New-York-Convention-E.pdf>.

<sup>5</sup> See UNCITRAL, *New York Convention Overview*, available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html).

sought. However, the Geneva Convention was only ratified by 24 countries and did not include some of the most significant trading economies in the world at the time. Thus, it had limited effectiveness. However, under this prior convention, there existed a “public policy” precondition for enforcement. It was not specifically a ground for refusal of recognition and enforcement, rather the award would not even be examined if it was contrary to public policy.

The concept of “public policy” or “public order (*ordre public*)” had long been familiar in Europe whereas phrases such as “illegal” or “void” appeared in India and other countries.<sup>6</sup> There were also proposals to include the language “fundamental” violation of public policy. The discussions between the delegates reflected that they were concerned that a contract might not be in conformity with a country’s law while being fully compatible with the general principles of contract law and being in conformity with the parties’ desires for the contractual relationship. Ultimately, some delegates wanted to give national courts broader power while others wanted to limit the courts’ ability to review such awards, in order not to undermine the effectiveness of arbitral award enforcement.<sup>7</sup>

Importantly, Art. V (2)(1) and Art. V(2)(b) of the New York Convention require different levels of scrutiny. The first pertains to the State’s jurisdiction, which would serve as an absolute bar to the recognition of an arbitral award, irrespective of its findings. However, the second pertains to the merits of the case, and “sets standards to be respected by the arbitrators.”<sup>8</sup>

**b. The fundamental conflict between the parties’ “freedom of contract” and the “public policy” of domestic law**

The public policy exception language of the New York Convention was eventually adopted to recognize that there may be objections to enforcement of an award in a domestic court despite the technical compliance with the arbitral procedure of the seat of the arbitration and the parties’ agreement to the terms of the contract and arbitration. The delegates recognized that the parties to a contract generally have a right to the “freedom of contract” and “party autonomy” to decide on their own the terms and scope of their agreement. However, it has long been recognized globally that this “freedom of contract” is in fact limited by the “public policy” of the

<sup>6</sup> Maurer, *supra* n. 1, at 19.

<sup>7</sup> *Id.* at 18-23.

<sup>8</sup> Arfazadeh, *supra* n. 3, at 86.

domestic courts. Arbitration and its awards would not be allowed to strip courts of the fundamental right to oversee and protect its citizens from matters that violate public policy.

The concept of “public policy” was intentionally not defined by the New York Convention, and the language finally adopted allows the courts in a forum State the discretion to refuse to enforce the award: “Recognition and enforcement...*may* also be refused...”<sup>9</sup> The New York Convention certainly has a “pro-enforcement bias” as a result of the language the delegates chose.

The drafting history also makes clear that “public policy” was not meant to reference any international concept of the term. Parties should not equate the term to “*lex mercatoria*” or seek guidance on its interpretation from UNCITRAL or UNIDROIT principles. Rather, the sole interpretation of the

term “public policy” is left to domestic courts.

Importantly, however, the term does not necessarily mean the “domestic law” of a country. Although states have interpreted this term in a variety of ways, the vast majority recognize that the mere violation of domestic law is unlikely to amount to a ground to refuse recognition or enforcement on the basis of public policy.<sup>10</sup> In surveying the law in States such as Austria, Canada, England, Hong Kong, Singapore and the U.S., it becomes clear that the majority trend is to interpret the term “public policy” narrowly.

United States courts have held that “signatory countries should not be permitted to decline enforcement of such agreements on the basis of ‘parochial’ views of their desirability...”<sup>11</sup> The Second Circuit of the United States, in *Parsons v. Whittemore Overseas Co.*, held, “[e]nforcement of foreign arbitral

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<sup>9</sup> Art. V(2)(b).

<sup>10</sup> See, e.g., *Traxys Europe S.A. v. Balaji Coke Industry Pvt Ltd.*, (2012) 201 FCR 535 (Federal Court of Australia); *Petrotesting Colombia S.A. & Southeast Investment Corporation v. Ross Energy S.A.S.*, Corte Suprema de Justicia, Colombia, (2011); *Agence pour la sécurité de la navigation aérienne en Afrique et à Madagascar v. M. N'DOYE Issakha*, Court of Appeal of Paris, France (1997); *K.M. v. UABA. Sabonio Žalgirio krepšinio centras*, Supreme Court of Lithuania (2011).

<sup>11</sup> *Sherk v. Alberto-Culver Co.* 417 U.S. 506, 507 (1974), citing *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 92 S. Ct. 1907, 32 L. Ed. 2d 513 (1972).

awards may be denied on [the basis of public policy] only where enforcement would violate the forum state's most basic notions of morality and justice."<sup>12</sup> In fact, the U.S. Supreme Court eliminated "manifest disregard of the law" as a basis for vacating an arbitral award as not a violation of public policy in *Hall St. Associates v. Mattel*.<sup>13</sup> Recently, in 2017, a New York trial court vacated an arbitral award under "manifest disregard of the law," but was reversed on appeal consistent with *Hall Street*. In the N.Y. case, *Daesang Corp. v NutraSweet*, the appellate court held that nothing indicated the award violated "public policy."<sup>14</sup>

This author could only find one case in which the United States refused a foreign arbitral award citing a violation of "public policy." The United States District Court in the Northern District of Georgia in 1980 declined to award legal interest rate above 8%. The Court explained that the higher interest rate (15.5%) would "violate . . . basic notions of morality and justice" as

the interest rate would be a penalty.<sup>15</sup> This case has been cited in our courts regarding the enforcement of foreign *judgments*, but has otherwise not been applied in the same way by any other U.S. court to arbitral awards. In fact, the Southern District of New York in 2013 distinguished the Georgia case, holding that "[u]nlike here, the public policy in that [Georgia] case was a well-defined and specific principle expressed in case law. [Plaintiff] cites other cases in which courts have refused to enforce private contracts that contravened public policy, but those cases were not proceedings to recognize and enforce arbitration awards, and fail to account for the strong federal policy favoring arbitration."<sup>16</sup>

Another aspect of domestic law that is intertwined with the notion of "public policy" is the applicable procedure of an arbitration. This procedural law is determined by the seat of the arbitration (*lex arbitri*),<sup>17</sup> rather than the choice of law. Thus, when the seat of the arbitration is Charlotte, N.C., the local laws will

<sup>12</sup> Parsons & Whittemore Overseas Co. v. Societe Generale De L'Industrie Du Papier (RAKTA), 508 F.2d 969 (2d Cir. 1974).

<sup>13</sup> Hall St. Assocs., L.L.C. v. Mattel, Inc., 552 U.S. 576, 128 S. Ct. 1396, 170 L. Ed. 2d 254 (2008); Int'l Trading & Indus. Inv. Co. v. DynCorp Aerospace Tech., 763 F. Supp.2d 12 (D. D.C. 2011) (arbitrator's "manifest disregard of the law" could not serve as independent and additional ground for denying confirmation).

<sup>14</sup> *Daesang Corp. v. NutraSweet Co.*, 167 A.D.3d 1, 85 N.Y.S.3d 6 (N.Y. App. Div. 2018).

<sup>15</sup> *Laminoirs-Trefileries-Cableries de Lens, S. A. v. Southwire Co.*, 484 F. Supp. 1063, 1069 (N.D. Ga. 1980).

<sup>16</sup> *Yukos Capital S.A.R.L. v. OAO Samaraneftgaz*, 963 F. Supp.2d 289, 300 n. 8 (S.D.N.Y. 2013), *aff'd sub nom. Yukos Capital S.A.R.L. v. Samaraneftgaz*, 592 F. App'x 8 (2d Cir. 2014).

<sup>17</sup> Sherina Petit and Marlon Edge, *The Governing Law of Arbitration: Q&A*, Lexology, May 13, 2014.

apply to the procedure of the arbitration. Although parties have the freedom to contract, when they subject the seat of the arbitration to a location, their freedom to contract is limited by the local laws that then regulate matters of public policy within a given country, as it relates to the procedure of the arbitral process.<sup>18</sup> If there are serious irregularities in the procedure of the arbitration (e.g. bribery or lack of due process), then the “public policy” issue may arise again at the time of enforcement where the domestic courts have the right to review the arbitral awards to either confirm them to “domesticate” or vacate them.

## II. Specific public policy considerations

The public policy exception raises a variety of issues for attorneys to discuss with their clients, as these issues may affect the procedures in an international arbitration or the subsequent enforcement of an international arbitral award. This section presents a non-exclusive list of the most common of these issues.

### a. Employment law

The U.S. has long allowed companies to require arbitration of employment claims as part of the employment contract. These arbitrations can be confidential, binding, and non-appealable. However, other countries find the arbitration of employment disputes to be fundamentally unfair to the employee. In Europe, as a general rule, the courts consider the employee to be in an unfair and unequal bargaining position in the context of an employment agreement. Thus, as a matter of public policy, several European countries find the arbitration of employment disputes to be a violation of public policy, and such courts will not enforce an arbitral award on the subject matter.<sup>19</sup>

Additionally, the resolution of employment disputes often entails sensitive issues that some countries contend can only be resolved by the courts, as some countries have specific courts for employment disputes. In France, for example, international employees are guaranteed access to the French

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<sup>18</sup> Mark R. Cheskin and Hans H. Hertell, *Applicable Law to the Contract, Arbitration Agreement and Arbitration Procedure*, Global Perspectives (Fed. Bar Assn. 2015) available at <http://www.fedbar.org/Sections/International-Law-Section/Global-Perspectives/Fall-2015/Applicable-Law-to->

[the-Contract-Arbitration-Agreement-and-Arbitration-Procedure.aspx](http://www.fedbar.org/Sections/International-Law-Section/Global-Perspectives/Fall-2015/Applicable-Law-to-the-Contract-Arbitration-Agreement-and-Arbitration-Procedure.aspx).

<sup>19</sup> Yasmine Tarasewicz and Niki Borofsky, *International Labor and Employment Arbitration: A French and European Perspective*, 28 ABA J. Labor & Employment Law 349 (2013), available at: [www.jstor.org/stable/43489406](http://www.jstor.org/stable/43489406).

labor courts, even if they are not French citizens.<sup>20</sup>

Many global companies have employees overseas or some percentage of “expatriate” employees, and some U.S. companies find themselves sending employees on a temporary basis to foreign locations. A company’s employment agreement that includes an arbitration clause may give a U.S. based company a false sense of security that a dispute with their employee will be resolved in arbitration in a confidential proceeding, when the employee may have other remedies in foreign courts and arbitration might not be compelled.

While arbitration generally exists in some form in most EU-member states and in the UK, the national laws of each vary as to the extent to which employment-related issues can be arbitrated. In 2007, United Kingdom courts established the precedent that “a multinational business must be expected to be subject to the employment laws applicable to

those they employ in different jurisdictions.”<sup>21</sup> Thus, employment agreements are subject to the local UK laws that prohibit resolving workplace disputes through arbitration.<sup>22</sup> Likewise, German labor law forbids arbitration of employment disputes, but in Spain, while arbitration is simply not frequently used for individual workplace disputes, it is often used in collective matters.

In France, the labor courts have sole jurisdiction to resolve workplace disputes, and arbitration clauses in any employment contracts (even international contracts) are prohibited and generally unenforceable.<sup>23</sup> One exception exists where the employee agrees to arbitration *after the termination of the employment contract*. However, these arbitrations are quite rare in practice primarily because the employee, once terminated, has little incentive to agree to arbitration, which they may view as providing a benefit to the employer.

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<sup>20</sup> Cass. soc., 12 mars 2008, No. 01-44654; Cass. soc. (16 février 1999).

<sup>21</sup> *Samengo-Turner v. J&H Marsh & McLennan (Services) Ltd*, 2007 EWCA Civ 723; 2007 I.L.Pr. 52; 2008 I.C.R. 18.

<sup>22</sup> Tarasewicz and Borofsky, *supra* n. 19, at 351.

<sup>23</sup> French Labor Code (*Code du Travail*), Article L1411-4; *see also* Cherine Foty, *U.S. Supreme Court Holds That Individualized Employer-Employee Arbitration Agreements Must Be Enforced As Written*, KLUWER ARBITRATION BLOG (June 29, 2018) available at <http://arbitrationblog.kluwerarbitration.com/2018/06/29/u-s-supreme-court-holds-individualized-employer-employee-arbitration-agreements-must-enforced-written-2/?print=pdf>.



The right of the employee to go to the labor courts in France for their claims is deemed a “public policy” concern, and courts protect this right through the ample case law promulgated against global companies striking arbitration clauses in employment contracts as “null and void.” However, it should be noted that in the context of international employment contracts, there has been some variation in interpretation of this legal principle. In the Social Chamber, the courts have held that the clauses are not “null and void,” but rather inoperable against employees. In other words, the employee could proceed in arbitration if s/he so chooses against the employer, but the employer cannot force arbitration against the employee.<sup>24</sup>

The First Chamber of the French Supreme Court, however, has applied the “principle of validity of international arbitration clauses” in employment contracts, but only where the transactions involve the “economies of more than one state.” Interestingly, the courts allow the arbitrator to make the decision under the principle of competence-competence as to whether the clause is enforceable against the employee.<sup>25</sup> One of the arbitrators’

primary concerns in deciding the issue is whether their arbitral award will be enforceable, or whether the courts will ultimately refuse to confirm the award based on a violation of public policy.

In France, there also exceptions to the prohibition of arbitration for employment disputes for journalists with more than 15 years of seniority and disputes between salaried lawyers and their firms.<sup>26</sup> Arbitration would actually be required before certain panels<sup>27</sup> and the president of the Bar,<sup>28</sup> respectively. However, as these procedures are not voluntary, scholars have questioned whether these procedures are actually considered “arbitrations” in the true sense of the word.

There has been some discussion in the EU about recognizing arbitration in international employment contracts, but countries appear to be hesitant to relinquish the courts’ power to review such awards on the basis of public policy violations as a matter of protection for the weaker party, the employee.

While disputes with individual employees may be banned from arbitration in some jurisdictions, often collective bargaining

<sup>24</sup> Cass. soc., 16 fevrier 1999, No. 96-40643.

<sup>25</sup> Beatrice Castellane, *Arbitration in Employment Relationships in France*, 26 J. INT’L ARBITRATION 293 (2009).

<sup>26</sup> Tarasewicz and Borofsky, *supra* n. 19, at 358.

<sup>27</sup> See Article L7112-4 of the Labor Code.

<sup>28</sup> *Loi n° 71-1130 du 31 décembre 1971 portant réforme de certaines professions judiciaires et juridiques*, at Art. 7.

agreements are not banned. In Germany, for example, an arbitration agreement between unions and employers are valid and governed by the German Labor Court Law.<sup>29</sup>

In Russia, there has been a long history of holding that employment disputes are non-arbitral.<sup>30</sup> However, Russia appears to have adopted new legislation in 2018 that would allow the enforcement of arbitral awards on employment disputes in the context of professional sports, specifically those issued by the International Commercial Arbitration (ICAC) Court at the Chamber of Commerce and Industry of the Russian Federation under the Rules of Arbitration for Sports. The legislature promulgated the “Russian Sports Act” with the primary goal of making such awards enforceable in the field of professional sports. Unfortunately, as the legislation is in direct contradiction to the current civil code, scholars are skeptical that it will result in true recognition and enforcement of such awards.<sup>31</sup>

<sup>29</sup> Winifred E. Campbell, *Resolution of Labor and Employment Disputes in EU Nations*, (September 19, 2016), available at <http://mchattielaw.com/2016/09/19/resolution-of-labor-and-employment-disputes-in-eu-nations/>.

<sup>30</sup> Civil Procedure Code of the Russian Federation, Art. 22.1; see Maria Andrianova, *Arbitrability of employment disputes in professional sports in Russia*, CIS ARBITRATION FORUM (April 4, 2018), available at <http://www.cisarbitration.com/2018/04/0>

The “unenforceability” of an arbitral award on the subject of employment disputes varies by jurisdiction. Thus, it would behoove the company’s attorney to be aware of and to raise this issue with their client as they are considering employing persons in other countries.

### **b. Class Actions**

Like the considerations of collective bargaining in employment disputes, the United States has upheld that class action and collective action waivers in employment arbitration agreements are enforceable.<sup>32</sup> The U.S. has no public policy exception regarding the arbitration of class action disputes. Public policy considerations include the issues of due process, appointment of arbitrators, and class certification.<sup>33</sup>

Regarding due process, notice requirements for each member of the class must be acceptable under the public policy requirements of the local country where the arbitration is seated and where an

<sup>31</sup> *Id.*

<sup>32</sup> *Epic Systems Corp. v. Lewis*, -- U.S. --, 138 S. Ct. 1612, 200 L. Ed. 2d 889 (2018).

<sup>33</sup> Francisco Blavi and Gonzalo Vial, *Class Actions in International Commercial Arbitration*, 39 FORDHAM INT’L L. J. 793, 796 (2016), available at <https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=2447&context=ilj>.

award will be enforced. Jurisdictions vary as to whether an “opt-in” or “opt-out” method is sufficient to meet notice requirements. The arbitral award would be binding on all members of the class, so the court will want to establish that due process has been met for each member. In addition to the public policy exception, the award may be determined to be unenforceable under Article V(1)(a) of New York Convention, which requires proper notice to the parties.

Similarly, the appointment process for arbitrators can raise public policy issues. Does each member of the class have to select an arbitrator or vote to select the one that the class appoints? There must be some protections in place for those class members who do not agree to the arbitrator who has been appointed on their behalf. As arbitration is a “creature of contract,” such issues are best addressed in the negotiation and drafting of the agreement that leads to the arbitration to eliminate issues of consent of the class members.

Additionally, there is no general consensus on who determines the question of “class certification.” This is often seen as a different consideration from the arbitrator’s competence-competence responsibility to determine whether s/he

has jurisdiction. The determination of whether the parties can be considered a “class” is based generally on court’s domestic laws, such that if they are improperly applied, the final award may be unenforceable for failure to meet the country’s public policy considerations.

In other countries, the concept of international commercial class action has not fully developed. Some jurisdictions are concerned with the fact that the large numbers of parties would be bound to a single process and result.<sup>34</sup> The “class action” process is fundamentally different from multi-party or consolidated arbitrations, in that the claims may be more economical to hear them together before a single tribunal. Thus, some countries have difficulty allowing class actions in any other forum other than litigation.

In the U.S., class arbitration became more widely accepted after the 2003 *Green Tree Financial v. Bazzle* decision, where the Supreme Court explained that the arbitrator was to decide whether the class arbitration was allowed or not.<sup>35</sup> The Supreme Court has, however, limited the *Green Tree* decision to exclude class arbitration where there arbitration agreement was silent on class actions, as there is no

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<sup>34</sup> *Id.*

<sup>35</sup> *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003).

contractual ground for the parties to have agreed to arbitration on a class-wide basis.<sup>36</sup> In fact, as a result of U.S. case law, including the *Green Tree* case, arbitral institutions such as JAMS and AAA adopted specific “Class Action Rules.”

Some international arbitral institutions have not adopted class action rules and thus, if referenced in the agreement, could have the effect of prohibiting a class action arbitration. The ICC took the position in 2005 that class action arbitrations would have “adverse consequences for business and consumers” and it does not appear the ICC has reversed its position since that time.<sup>37</sup> However, where the arbitration agreement or the arbitration rules are silent on the application to class actions, some jurisdictions are allowing the arbitrators to make the decision on class action arbitrability.

In Europe, some countries have adopted legislation allowing arbitration for “group actions,” such as in Sweden, which allows an opt-in process.<sup>38</sup> In Colombia, a tribunal in Bogotá faced a class action initiated by shareholders arising out of the

merger of two banks.<sup>39</sup> Claimants contended that domestic courts had exclusive jurisdiction over class actions in Colombia. The Colombian Supreme Court rejected that argument, relying primarily on an arbitration agreement that provided no limitation on what claims could be submitted to arbitration.

One likely objection to the enforcement of a class action arbitration award is on the basis of individual procedural rights. However, this issue alone may not be sufficient to rise to the level of a public policy violation under domestic law, especially where a party can show significant efforts to inform the prospective and current class members of the arbitration.

### c. Punitive Damages/Interest

The concept of “punitive damages” is not accepted internationally because its sole function is to punish a party beyond the scope of purely economic damages. Some countries see the “punishment” process to be exclusive to the criminal system. Especially in civil law countries,

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<sup>36</sup> *Id.* at 444 (reversing the State Supreme Court’s ruling that where the contracts were silent in respect to class action, they consequently authorized arbitration, in favor of allowing such decision to be made by the arbitrator).

<sup>37</sup> Blavi and Vial, *supra* n. 33, at 808.

<sup>38</sup> *Id.* at 806.

<sup>39</sup> *Valencia (Colombia) v. Bancolombia (Colombia)*, (Apr. 24, 2003) - Arbitral Tribunal from the Bogotá Chamber of Commerce, digest by Eduardo Zuleta for Institute of Transnational Arbitration (“ITA”). See Blavi and Vial, *supra* n. 33, at 806.

punitive damages are uncommon. Where the local domestic law does not allow for such, an arbitral award including punitive damages could be vacated under the public policy provision. For that reason, an arbitrator might not award punitive damages if the substantive law of the forum does not allow for it. Redfern and Hunter observe that arbitrators “should examine the question of whether or not such damages may be awarded under the law applicable to the substance of the dispute.” For example, in an ICC case, the arbitral tribunal rejected a claim for punitive damages on the grounds, primarily, that such damages were not allowable under the *substantive law* in India.<sup>40</sup>

There is very little case law or published arbitral decisions that address the availability of punitive damages in arbitration, perhaps due to the unpopularity of the concept internationally and the confidentiality of arbitrations. One such case was the Spanish Supreme Court decision of November 13, 2001, in which the Court held that punitive damages awards were not contrary to Spanish public policy.<sup>41</sup>

Similarly, jurisdictions vary on the inclusion of interest in an arbitral award’s damages. Generally,

it is assumed that the prevailing party in arbitration is entitled to interest, either from the date of the default or from the date of the award, depending on the contract. In Muslim countries, however, Shari’ah laws may be applicable in the enforcement of an arbitral award. Even in agreements involving non-Muslim parties, Shari’ah law is necessarily applied if one of the parties is Muslim. Saudi Arabia has adopted the New York Convention, but its courts will point to the “public order reservation” in enforcement if any such arbitral award is contrary to Shari’ah law. Importantly, interest or “*riba*” is prohibited in Islam. Thus, the claimant generally has to prove that the award represented repayment of the principle amount and does not include an interest amount.<sup>42</sup>

The prohibition on interest imposed under Shari’ah law is divergent to and has created some conflict in application of the United Nations Convention on Contracts for the International Sale of Goods (CISG). Many Muslim nations that have ratified the CISG failed to adopt a reservation on the issue, and the CISG expressly allows damages in interest. Scholars indicate that these countries have “adopted the modern

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<sup>40</sup> ICC No. 8445 (India).

<sup>41</sup> Cited in Italian Supreme Court, decision of Jan. 19, 2007, No. 1183/2007, see Markus A. Petsche, *Punitive Damages in Commercial Arbitration: Much Ado about Nothing?*, 29 ARBITRATION INT’L 89, 99 (2013).

<sup>42</sup> Zafar Ranjha, *Public Policy and Foreign Arbitral Awards*, (January 16, 2015), available at <https://www.linkedin.com/pulse/public-policy-foreign-arbitral-awards-zafar-ranjha/>.

trend on the applicability of interest” although the practical implication may be that arbitral awards including interest are simply not sought to be enforced in Muslim countries.<sup>43</sup>

Additionally, consequential damages may also be challenged under the public policy exception, as Shari’ah law does not include such damages when calculating a party’s remedy. This restriction is based primarily on the prohibition on risk or uncertainty. It is felt that it is inappropriate for courts to award damages based on anticipated profits, because “only God can foresee the future.”<sup>44</sup> Again, this area presents a divergent application of the law under the CISG, where consequential damages are allowed so long as they were “foreseeable” to the contracting parties. Perhaps if future foreseeable damages can be shown with sufficient specificity, courts would allow such damages in an arbitral award as not having violated the country’s public policy.

Some countries may also allow a public policy challenge to an arbitral award on the basis of a penal legal rate of interest. In the *Laminoirs* case, one party objected that the arbitrators adopted a French legal rate of interest that violated the

enforcing forum’s public policy because the rate was “excessive” or “usurious.”<sup>45</sup> The legal interest rate of the forum state was allowed, but the amount over the legal interest rate was deemed a penalty and the court declined to enforce it on the basis of a violation of public policy.

There is a tendency in U.S. pleadings to include a demand for punitive damages and for interest to be awarded to the prevailing party. However, one ought to consider the location of potential enforcement as to whether such damages may be challenged on the basis of violation of public policy in the local jurisdiction.

#### **d. Intellectual Property/Real Property**

The notion of real property and intellectual property (IP) is that the rights and ownership of thereof can only be conveyed by the state, which establishes certain protections for owner.

The question of “validity” of a patent or other IP is normally determined by the state conferring such rights. In the U.S. and in some other jurisdictions, questions relating to patents and IP may be submitted to arbitration.<sup>46</sup> U.S. courts previously restricted the

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<sup>43</sup> Ahamed A. Syed, *A Comparison of the Shari’ah and the Convention on Contracts for the International Sale of Goods in International Business Transactions*, INTERNATIONAL LAW NEWS, Summer 2015.

<sup>44</sup> *Id.*

<sup>45</sup> *Southwire*, 484 F. Supp. at 1068.

<sup>46</sup> David W. Plant, *Arbitrability of Intellectual Property Issues in the United States*, AM. REV. INT’L ARB., 12-15 (1994); 35 U.S.C. 295(a).

scope of IP arbitrations and held that questions of patent validity are inappropriate for arbitration because such decisions “affect important questions of public policy and public rights.”<sup>47</sup> However, under 35 U.S.C. § 294, the U.S. now allows arbitration of disputes involving even patent validity.<sup>48</sup> Likewise, in some countries like Switzerland all aspects of IP are arbitrable, including the validity of IP rights.<sup>49</sup>

Other countries restrict arbitration to questions only as to the effect between parties—they would not allow an arbitrator to determine the “validity” of the IP.<sup>50</sup> Australia and France have laws specifically disallowing an arbitrator from dealing with the countries’ registration or the validity of a patent<sup>51</sup> and preclude arbitration for the infringement of

IP rights.<sup>52</sup> French courts include criminal sanctions with regard to infringement proceedings that a private judge or arbitrator cannot impose. However, contract disputes over trademark and trademark ownership issues generally can be arbitrated in France.<sup>53</sup>

Likewise, in Germany the law does not allow rights based on IP or patents to be created or rescinded by arbitral award.<sup>54</sup> In Japan, an arbitrator cannot invalidate a patent without first obtaining an invalidation decision from the Patent Office. Otherwise, such award would be unenforceable.<sup>55</sup> In China, because many patent disputes involve the validity of the patent itself, the People’s Republic of China has declined to recognize or enforce foreign arbitral awards regarding patent validity.<sup>56</sup>

<sup>47</sup> Beckman Instruments, Inc. v. Technical Dev. Corp., 433 F.2d 55, 63 (7th Cir. 1970); Lear, Inc. v. Adkins, 395 U.S. 653, 670, 89 S. Ct. 1902, 23 L. Ed. 2d 610 (1969).

<sup>48</sup> 35 U.S.C. § 294 (2006).

<sup>49</sup> Swiss Federal Office of Patents, decision of Dec. 15, 1975, *Swiss Review of Industrial Property and Copyright*, 36-38 (1976).

<sup>50</sup> Robert Briner, *The Arbitrability of Intellectual Property Disputes with particular emphasis on the situation in Switzerland*, Worldwide Forum on the Arbitration of Intellectual Property Disputes (1994), available at <https://www.wipo.int/amc/en/events/conferences/1994/briner.html>; Paris Convention for the Protection of Industrial Property of 1883, as amended in 1979.

<sup>51</sup> Decision of the Cour d’Appel de Paris of February 3, 1992, published in: *Propriété*

*Intellectuelle Bull. Documentaire de l’IRPI* 1992, III, 359; see also Jean Claude Dubarry and Eric Loquin, comment, 46 *Revue Trimestrielle de Droit Commercial* 293 (1993).

<sup>52</sup> Veena Anusornsen, *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, Theses and Dissertations*, 33 (2012), available at <https://digitalcommons.law.ggu.edu/cgi/viewcontent.cgi?article=1033&context=theses>.

<sup>53</sup> *Id.* at 65; see also Briner, *supra* n. 50, at 55.

<sup>54</sup> IAPPI, YEARBOOK 1991, Vol. VI, 11.

<sup>55</sup> IAPPI, YEARBOOK 1991, Vol. VI, 12.

<sup>56</sup> Zhong Cai Fa (仲裁法) [Arbitration Law] (promulgated by the Standing Comm. Nat’l People’s Cong., Aug. 31, 1994, effective Sept.

Depending on the nature of the IP dispute, if a primary question is the ownership or validity of the IP rights, counsel should look to the applicable IP laws to determine whether and to what extent the IP dispute should be arbitrated.

Similarly, courts in various jurisdictions have resisted allowing real property disputes to be arbitrable, on the basis that only the state can determine ownership and rights of real estate. In the UAE, the court found that the sale of “off-plan units,” without complying with the mandatory registration requirement provided for in Article 3 of Law 13 of 2008 regulating the interim property register in the Emirate of Dubai, could not be the subject matter for arbitration as contrary to public policy.<sup>57</sup>

In other jurisdictions, legislation had been unclear whether real property disputes were subject to arbitration. In Russia, the Constitutional Court ruled on May 26, 2011 that arbitration is a well-recognized means of dispute

resolution and that the public interest can be adequately protected by the use of rules that establish the procedure for arbitral proceedings. Thus, the compulsory registration of title of property, in the Court’s reasoning, has no relevance to the question of arbitrability and is not considered an obstruction to the arbitral tribunal’s ability to rule on real estate disputes.<sup>58</sup>

In the U.S., contractors and those who make improvements on real property are also afforded statutory rights for payment of work (mechanic’s liens). Yet in some states, courts have held that arbitration of a mechanic’s lien was improper because the power to enforce such liens is statutorily vested solely in the courts.<sup>59</sup>

Accordingly, when certain ownership rights are concerned either in real property or intellectual property, there may be enforceability issues on the basis of a violation of public policy.

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1, 1995), 1994 SUP. PEOPLE’S CT. GAZ. 127, art. 3, para. 2 (China); *see also* Wei Ha Wu, *International Arbitration of Patent Disputes*, 9 TECH. L. J. 51 (2012) available at [https://ir.nctu.edu.tw/bitstream/11536/107616/1/9\\_1\\_3.pdf](https://ir.nctu.edu.tw/bitstream/11536/107616/1/9_1_3.pdf).

<sup>57</sup> Essam Al Tamimi, *Arbitrators Dealing with Real Estate Property Disputes – Is it a matter of Public Policy?*, (June 2014) available at <https://www.tamimi.com/law-update-articles/arbitrators-dealing-with-real-estate-property-disputes-is-it-a-matter-of-public-policy/>; Dubai Court of Cassation Judgment 180 of 2011.

<sup>58</sup> Francesca Albert and Ekaterina Ushakova, *Constitutional Court confirms arbitrability of real estate disputes* (June 9, 2011), available at <https://www.international-lawoffice.com/Newsletters/Arbitration-ADR/Russia/Herbert-Smith-CIS-LLP/Constitutional-Court-confirms-arbitrability-of-real-estate-disputes>.

<sup>59</sup> *Tsombikos v. Brager*, 559 N.Y.2d 460 (N.Y. Sup. Ct. 1990); *see also* *Hearthshire Braeswood Plaza Ltd. Partnership v. Bill Kelly Co.*, 849 S.W.2d 380, 390-391 (Tex. App. 1993).



### e. Family Law

While practitioners in the U.S. may be familiar with the effective use of arbitration in family law,<sup>60</sup> there are many countries where family or domestic disputes are not arbitrable as a matter of public policy. The restriction on arbitration of family cases stems from the sensitive and personal issues between the parties that the state and church in local jurisdictions have sought to regulate or administer. Especially in custody cases, the conflict between church and state can play a large factor on the public policy issues.

The fundamental bases for restricting arbitration in family law disputes include protecting weaker parties; upholding the principle that any settlement between the parties does not shift the burden to the state in the form of welfare; and ensuring that arrangements are adequate to limit damage to the children or other family members. On the other hand, there are compelling state interests in allowing arbitration to relieve the court system of family law disputes. In the U.S., it has been noted that family law cases account for 40% of court filings and almost 70% of proceedings based

on the research conducted in 2003.<sup>61</sup> Allowing for arbitration of such matters can significantly reduce the volume of such matters.

Notably, in the United Arab Emirates (UAE) arbitration of domestic matters is widely accepted, but there are strong public policy considerations that may allow vacatur of certain arbitral awards. Article 3 of the Civil Code of the UAE states that:

Public policy shall be deemed to include matters relating to personal status such as marriage, inheritance, and lineage, and matters relating to systems of government, freedom of trade, circulation of wealth, rules of individual ownership and the other rules and foundations upon which society is based, in such a manner as to not conflict with the definitive provisions and fundamental principles of Islamic Shari'a.

Judicial decisions note that the effect of the public policy restrictions affect those decisions that are a "fundamental concern to

<sup>60</sup> See, e.g., N.C. GEN. STAT. § 50-41 et seq., available at [https://www.ncleg.net/EnactedLegislation/Statutes/PDF/ByArticle/Chapter\\_50/Article\\_3.pdf](https://www.ncleg.net/EnactedLegislation/Statutes/PDF/ByArticle/Chapter_50/Article_3.pdf).

<sup>61</sup> Wendy Kennett, *It's Arbitration, But Not As We Know It: Reflections on Family Law Dispute Resolution*, 30 INT'L J. LAW, POLICY AND THE FAMILY, 1-31 (2016).

society.”<sup>62</sup> Specifically, certain financial transactions are not permitted to be the subject of arbitration because they are potentially “usurious” under the UAE law, including cancellation of a debt by another debt and usurious interest in consideration of the deferment of the payment of debt.<sup>63</sup>

In other countries, the legislators may be moving towards a “U.S. model” to allow arbitral awards on family or domestic matters, but it is still not an accepted “norm” of society. Indeed, family law disputes are adjudicated in various forms in the states in America. In fact, the use of private (temporary) judges and parenting “coordinators” in California resulted from the reduced public funding for the court systems in certain areas, as well as the desire to quickly adjudicate such issues.

England and Wales formed the Institute of Family Law Arbitration (IFLA) in 2012, and it was shortly preceded by the Family Law Arbitration Group Scotland (FLAGS). Both were started with a view to promoting arbitration of family law disputes and providing a framework

for arbitral procedures.<sup>64</sup> Similar legislation has been adopted in Germany, Spain, Australia and Canada.

In England, courts have noted that it is more favorable for the parties to come to a resolution between them on the matters of separation and divorce arrangements, and such party autonomy should be upheld. However, courts did not automatically extend the IFLA’s scope to include matters involving children and custody. This highlights the U.K.’s continued concern for the best interest of the child, despite that decisions the parents have worked out among themselves. Indeed, in North Carolina there are several reasons an arbitral award in family law disputes may also be vacated, which include the court’s determination that an award of child support or child custody is not in the best interest of the child.<sup>65</sup> The enforceability of arbitral awards on the subject of family or domestic issues also varies by country.

#### **f. Illegality**

In the United States, there do not appear to be specific cases that have

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<sup>62</sup> Arfazadeh, *supra* n. 3, at 79.

<sup>63</sup> Civil Code of the UAE, Art. 733, available in English translation at [https://lexemiratidotnet.files.wordpress.com/2011/07/uae-civil-code-english-translation\\_.pdf](https://lexemiratidotnet.files.wordpress.com/2011/07/uae-civil-code-english-translation_.pdf).

<sup>64</sup> Kennett, *supra* n. 61, at 1.

<sup>65</sup> N. C. GEN. STAT. § 50-54, available at [https://www.ncleg.net/EnactedLegislation/Statutes/PDF/BySection/Chapter\\_50/GS\\_50-54.pdf](https://www.ncleg.net/EnactedLegislation/Statutes/PDF/BySection/Chapter_50/GS_50-54.pdf).

vacated a foreign arbitral award on the public policy basis of illegality of the contract. However, U.S. courts have certainly left open the door for such arguments.<sup>66</sup> Of course, domestic arbitral awards based on contracts for the sale of illegal substances or that involve elements of bribery, corruption or fraud will be vacated in the U.S. on the basis of violation of public policy under the Federal Arbitration Act.

Similarly, in Africa, there have been cases in which the enforcement of a judgment (or arbitral award) was disallowed on the grounds that the transaction was illegal. In Nigeria, for example, the court agreed that an arbitral award governing a transaction should be vacated when foreign exchange transaction occurred outside Nigeria (in England) and without the approval of the Minister as prescribed by Nigerian law.<sup>67</sup> Similarly, in Nigeria, the courts determined that fraud is not arbitrable. Fraud is considered a criminal matter because it is an illegal act that requires a higher standard of proof under Nigerian law.<sup>68</sup>

Therefore, counsel should anticipate that any illegal contract (regardless of the parties' freedom of contract) is subject to being vacated or refused to be enforced as a matter of public policy.

### III. Conclusion

"Party autonomy finishes where public interest begins."<sup>69</sup>

The fundamental issue in public policy considerations stems from "the principle that arbitration agreements should not be enforced when there is a substantial reason to believe that one party has never willingly agreed to relinquish the right to seek relief from the courts."<sup>70</sup> States reserve the right to define their own national public policy standards to protect their citizens in such circumstances. Thus, the primary purpose of the "public policy" defense was to provide a limited "safety-valve" allowing the national courts to refuse enforcement of awards that they

<sup>66</sup> *Antco Shipping Co. v. Sidermar S.p.A.*, 417 F. Supp. 207 (S.D.N.Y. 1976), *aff'd*, 553 F.2d 94 (2d Cir. 1977).

<sup>67</sup> *Dale Power Systems Plc v Witt & Bush Ltd*, 8 NWLR (pt. 716) (2001), 699.

<sup>68</sup> *BJ Exports & Chemical Processing Co. v Kaduna Refining and Petrochemical Co.*, Oct. 31, 2002, Mahmud Mohammed, Justice of the Court of Appeal, Court of Appeal, Kaduna Division, Nigeria (unreported).

<sup>69</sup> Leibniz University, Hanover, *Arbitration in International Intellectual Property Disputes*, available at <https://www.itwillbe.fun.eu/arbitration-in-international-intellectual-property-disputes.html>.

<sup>70</sup> Stewart E. Sterk, *Enforceability of agreements to arbitration: an examination of public policy defense*, 2 CARDOZO L. REV. 481, 544 (1980).

consider to be irreconcilable with their legal and societal systems.<sup>71</sup>

In international contract negotiations, it behooves attorneys to anticipate public policy considerations for clients, including the procedural rules in the states in which the arbitration will take place and where the award may be later enforced. Failure to do so may result in having the award ultimately vacated or refused for enforcement.

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<sup>71</sup> Mehmet Ali Akgun and Serap Zuvin, *Turkey: Public Policy Defence and Arbitration in International Commercial Law*, December 16, 2015, available at <http://www.mondaq.com/turkey/x/452312/Contract+Law/Public+Policy+Defence+And+Arbitration+In+International+Commercial+Law>.