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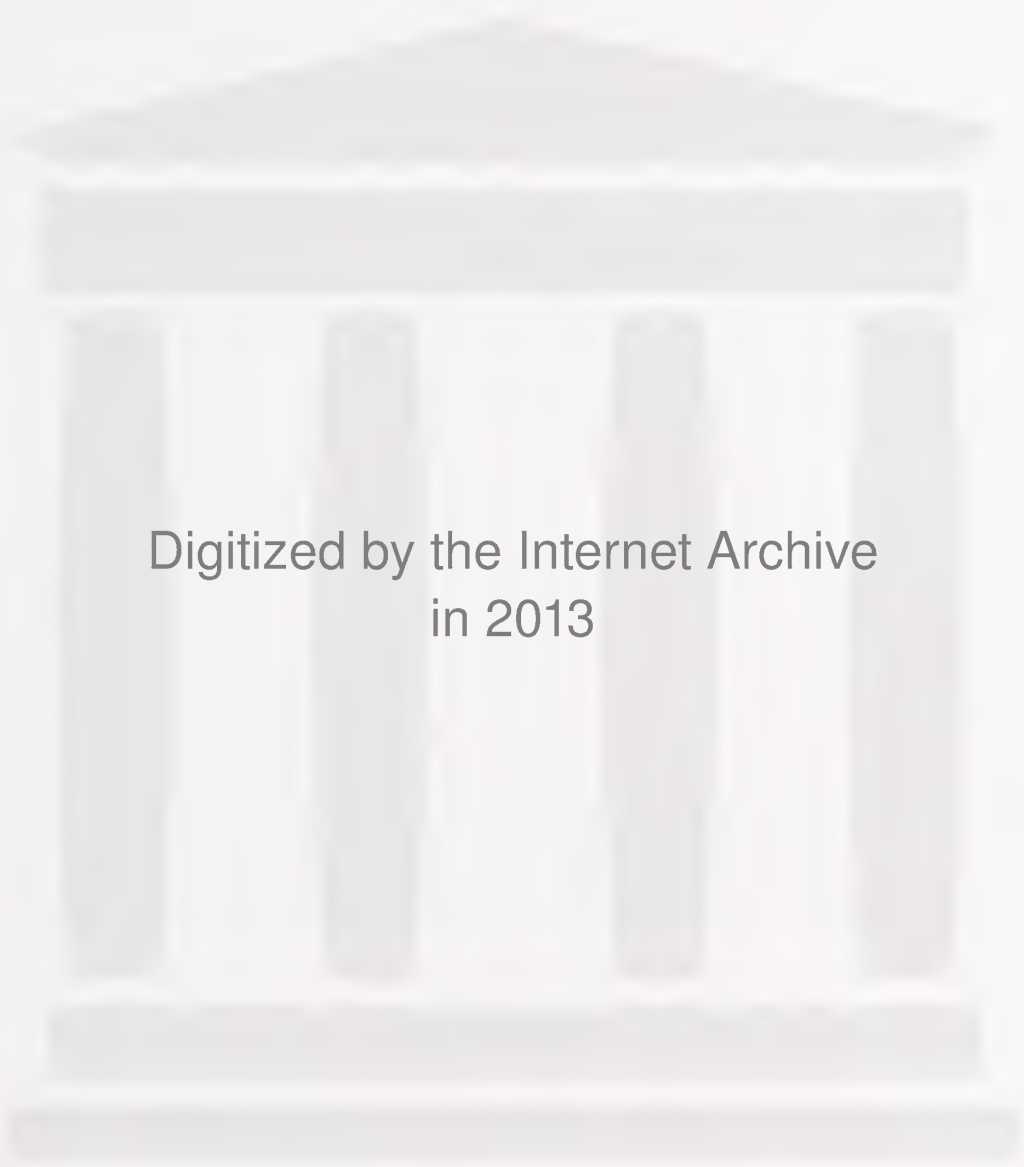

PUBLIC POLICY DEFENSE IN INTERNATIONAL COMMERCIAL ARBITRATION

by

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TABLE OF CONTENTS

CHAPTER I

INTRODUCTION

Over the past two decades, trade and commerce between the United States and China has increased enormously. Ideally, in most cases trade and commerce leads to friendly relations. However, it must be recognized that disputes can arise when parties are disappointed about any given transaction. One dispute resolution method that has led to a large degree of acceptance is international commercial arbitration.

Arbitration is different from litigation in that it is based on party autonomy. The parties have the right to select arbitrators, tailor arbitration procedures, and choose the law governing their disputes.[1] However, arbitration is not a closed legal system. In fact, an effective international arbitration system is based on vigorous enforcement of arbitration agreements and arbitral awards by national courts. Accordingly, when national courts are called on to enforce arbitration agreements and arbitral awards, it is inevitable that the enforcement will be subject to judicial review. Thus, although arbitration is known as a private dispute resolution mechanism, it is not totally out of the control of national courts. Usually, national courts will interfere with the international commercial arbitration in three different ways. First, a party may bring a suit in a court in spite of an existing arbitration agreement. Then the court may be called upon by the other party to enforce the arbitration agreement. Second, a party who prevailed in the previous arbitration proceeding may ask a national court to enforce the arbitral award against the losing party. Third, a party who dissatisfied with an arbitral award may ask the competent court of the country where the arbitration took place to set aside the award. In the enforcement of an arbitration agreement, judicial review only concerns the validity of the

agreement itself, including whether the subject matter can be arbitrated and whether the parties lack capacity to enter into the agreement. However, in the enforcement of an arbitral award, the scope of judicial review is much broader. It may include not only the validity of the arbitration agreement, but also the arbitration procedure and the contents of the award.[2]

Lack of uniform standards of judicial review will be detrimental to the development and expansion of international commercial arbitration. If different countries adopt different standards in reviewing arbitration agreements and arbitral awards, the parties will face questions such as whether an arbitration agreement is enforceable and whether an arbitral award could be enforced in a particular country even if they eventually prevail in the arbitration. Moreover, if national courts adopt very stringent standards in reviewing commercial arbitration, the parties may be reluctant to choose arbitration as a means of alternative dispute resolution. Thus the need for predictability in international commerce calls for unifying national standards in reviewing international arbitration. The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards was the first broadly accepted international agreement. The agreement aims to consolidate international arbitration at the global level.[3] Under the New York Convention, refusal of enforcement of foreign arbitral awards is only permitted in limited circumstances. However, the New York Convention contains a public policy defense in Article V Section 2(b). Since national interpretations of public policy may differ greatly, that Section may frustrate the purpose of the Convention. One commentator noted that "the effectiveness of international commercial arbitration depends on the predictable enforcement of arbitral

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[1] *See* HENRY J. STEINER ET AL., TRANSNATIONAL LEGAL PROBLEMS, at 742 (4th ed. 1994).
[2] *See* Javier Garcia De Enterria, *The Role of Public Policy in International Commercial Arbitration*, LAW & POL' Y INT' L BUS 389, 395 (1990).
[3] United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done at New York, June 10, 1958, 21 U. S. T. 2517, T. I. A. S. No. 6997, 330 U. N. T. S. 38(hereinafter, "New York Convention")

agreements and awards."[4] In fact, public policy defense has been deemed as a loophole in the New York Convention.[5]

The purpose of this thesis is to examine how public policy defense functions in international commercial arbitration and whether it will block the development of international commercial arbitration.

Chapter II deals with the role of public policy in international private law. This Chapter examines the origins of public policy in common law countries and its functions in international private law. It is difficult to evaluate public policy as a precise concept because of its relative nature. Nevertheless, to limit its application in international private law, legal scholars have tried to clarify differences between domestic public policy, international public policy and transnational public policy.

Chapter III discusses the legal history of the New York Convention and analyzes the role of the public policy exception under the Convention.

Chapter IV gives an overview of the judicial application of the public policy exception in the United States. The case law shows that American courts narrowly read public policy defense in determining the arbitrability of subject matters, the propriety of arbitration procedures and the content of arbitration awards. This Chapter also analyzes why American courts adhere to a narrow construction of public policy defense.

Chapter V examines how Chinese courts apply the public policy exception in practice. It seems that Chinese courts broadly, sometimes even incorrectly, invoke the public policy exception to refuse enforcement of arbitration agreements or arbitral awards though enacted laws indicate a narrow construction.

Chapter VI discusses the role of the public policy exception in the future. It seems unlikely that the public policy exception will be removed from international arbitration

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[4] *See* Michael F. Hoellering, *International Arbitration under U. S. Law and AAA Rules*, Disp. Resol. J., Jan. 1995, at 25.
[5] *See* Enterria, *supra* note 2, at 391.

any time soon. However, the tendency of narrowly reading the public policy exception has created the basis for development of the notion of a transnational public policy, a policy that would facilitate predictability in international commercial arbitration.

CHAPTER II

THE ROLE OF PUBLIC POLICY IN PRIVATE INTERNATIONAL LAW

A. Origins of Public Policy and Its Functions in International Private Law

The concept of public policy was recognized in English law as early as the fifteenth century.[6] It first developed from the area of conflict of laws. The emergence of conflict rules is attributed to thriving international transactions. When confronted with a dispute involving foreign facts, the judge first had to determine which law governed. During the past centuries, every nation in the world developed its conflict rules to determine the applicable law in foreign-related cases.[7] However, if the forum court found that the foreign law created an obligation pernicious to local morality and social order, the court could reject application of foreign law, even if it should have been applied according to the forum court's own conflict rules. Obviously, the underlying reason for the development of public policy is that "no country can afford to open its tribunals to the legislature of the world without reserving for its judges the power to reject foreign law that is harmful to the forum."[8] In practice, courts generally are reluctant to decide cases upon public policy grounds because of its ambiguity and vagueness in its meaning. Judge Burrough pointed out that "public policy was a very unruly horse and you never know where it will carry you once you get astride it."[9] The concept of *ordre public* in civil law countries is analogous to public policy, and operates to exclude application of foreign law

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[6] *See* Knight, *Public Policy in English Law*, 38 L. Q. Rev. 207 (1922).

[7] Story, an American legal scholar, viewed comity as the compelling forces behind the development of conflict rules. He thought that public policy exception was vestigal to his comity idea and it will decline in importance when nations grew jurisprudentially together. On the contrary, Savigny, a German jurist, believed that the compelling forces behind the development of conflict rules were not comity, but the need of international business and commerce. However, both of them agreed that in practice the application of public policy should be vigorously discouraged.

[8] *See* Bodenheimer, *The Public Policy Exception in Private International Law: A Reappraisal in the Light of Legal Philosophy*, 12 SEMINAR 51, 64(1954).

in certain circumstances. However, the scope of *ordre public* is much broader than public policy. It includes any domestic legal provisions that are mandatory in nature and can not be excluded by private agreement.[10]

The primary role of public policy and *ordre public* in international private law is to negate the effect of foreign legislation or judicial judgement. The initial function of public policy is to empower the court of forum to reject foreign laws repugnant to the forum's sense of morality and decency. Traditionally, it has been held that agreements for prostitution,[11] purchase of a slave,[12] and incestuous marriage[13] are voidable for violation of basic moral standards generally accepted by human beings. Nonetheless, national courts rarely reject foreign laws only on the ground of moral repugnancy because standards of morality change over time. Moreover, courts are very cautious to declare the foreign law as uncivilized and inhumane.[14]

A second function of public policy is to prevent injustice in extreme circumstances. The court rejects foreign law not for its moral repugnancy, but the harsh result of application of foreign law in a particular case. This is known as "residual discretion" in common law countries, and it is employed to avoid an unjust or unconscionable result in certain circumstances.[15] However, "residual discretion" is not a generally accepted principle in private international law. "Residual discretion" is triggered only when application of foreign law will cause a particular hardship in the case.[16]

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[9] *See* Richardson v. Mellish, 130 Eng. Rep. 294, 303 (Ex. 1824).
[10] *See* Husserl, *Public Policy and Order Public*, 25 VA. L. Rev. 37, 38 (1938).
[11] *See* Robinson v. Bland, 97 Eng. Rep. 717, 725 (K. B. 1760).
[12] *See* Somerset v. Stewart, 98 Eng. Rep. 499 (K. B. 1772); Cf. Santos v. Illidge, 141 Eng. Rep. 1404 (C. P. 1860) (contract for sale of slaves held not illegal).
[13] *See* Cheni v. Cheni (1963) 2 W. L. R. 17.
[14] *See* Murphy, *The Traditional View of Public Policy and Order Public in Private International Law,* 11 GA, J. INT' L & COMP, L. 591 (1981).
[15] *See* V. DICEY & J. MORRIS, CONFLIC OF LAWS, at 74 (9th ed. 1973). See also Qureshi v. Qureshi (1972) Fam. 173, 199: "The Court already has adequate power to refuse to recognize the legal rule of the domicile where it would cause injustice in a particular case." (Opinion of Sir J. Simon).
[16] *See* Nygh, *Foreign Status*, *Public Policy and Discretion*, 13 I. C. L. Q. 39, 49 (1964).

A third function of public policy is that it empowers the court to apply its own law when there is a strong relationship between forum and transaction.[17] This application might occur when, for example, an American company enters into a contract to sell goods to an enemy country of America. When the case was submitted to the American court, the court might reject foreign law even if it should be applied under American conflict rules. The rationale would be that American public policy bars the application of foreign law in the situation.

B. Relativity of the Concept of Public Policy

Because of its vagueness and ambiguity in meaning, the possibility of abusing public policy in practice has long been recognized by the judiciary. National judges may make arbitrary decisions under the guise of public policy. It has been said that "the principal vice of the public policy concepts is that they provide a substitute for analysis."[18] Legal scholars and practitioners have tried to give public policy a precise definition to avoid any arbitrary use. However, public policy has been called "one of the most elusive and divergent notions in the world of juridical science."[19] It is very difficult to give public policy an objective definition because its contents concern both the matters of place and time.[20]

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[17] *See* Paulsen & Sovern, *"Public Policy" in the Conflict of Laws*, 56 COLUM. L. REV. 969, 1016 (1956). (In the United States, Professor Brainerd Currie proposed a theory, which was known as "government interest analysis". Under interest analysis, the court should not blindly defer to the conflict rules of forum when deciding on the choice of law issues. On the contrary, the court should identify all competing interest in the case. If a competing interest is determined by the forum court to be expressed by the foreign law, the forum court must apply the foreign law only when the forum has no interest in the application of its own policy).

[18] *Id*, at 1017.

[19] *See* Horsmans, *L' arbitrage et' Order Public Interne Belge*, 2 Rev. Arb.79, 80 (1978). Conflict of laws scholars have offered various definitions of public policy, such as: "legal precepts which evidently and principlally serve to guarantee in the state the political, economical, and moral order established by the…sovereign" and "the principles upon which is based the political organization of a civil society…" *See* also Havicht, *The Application of Soviet Laws and the Expectation of Public order*, 21 AM. J. INT' L L. 238, 244 (1927). However, all these definitions are subjective.

[20] *See* Bockstiegel, *Public Policy and Arbitrability*, in COMPARATIVE ARBITRATION: PRACTICE AND PUBLIC POLICY IN ARBITRATION 177, 181 (P. Sanders ed. 1987).

First, public policy is a national phenomenon. Every country has its own economical system, social structure and tradition, and has therefore developed a different legal system. For example, national legal systems of most countries have been generally divided into two categories: civil law countries and common law countries. They share different legal traditions. Even in civil law countries or common law countries, national legal system may differ from each other. An action, which may be deemed as violative the public policy of one country, may not be seen as violating the public policy of another country. However, in a certain regional community that shares common value and standards, there may develop a similar public policy.

Second, public policy is a matter of time.[21] Marx pointed out that a national legal system always reflects morality, economics, legal tradition and politics of certain country.[22] So, when a country modifies its morality, economy or other social aspects, the legal system in turn evolves. It not surprising that in a certain country an action, which may previously be deemed as violative of public policy, may now be acceptable.

Because of the relativity of public policy, many legal scholars have noticed the difficulty of defining public policy.[23] It is now generally accepted that public policy is a judicially administered principle defined by the use courts find for it.[24]

C. Differences between Domestic Public Policy, International Public Policy and Transnational Public Policy

Concerning international commercial arbitration, some legal scholars have distinguished the concepts of domestic public policy, international public policy and transnational public policy.[25] The differences between these concepts are very important

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[21] *See* Enterria, *supra* note 2.
[22] *See* MARX, 2 FLORILEGIUM OF MARX , at 176 (2th, 1989).
[23] *See* D. LLOUD, PUBLIC POLICY: A COMPARATIVE STUDY IN ENGLISH AND FRENCH LAW 24-26 (1953).
[24] *See* Husserl, *supra* note 10. *See* also Katzenbach, *Conflicts on an Unruly Horse: Reciprocal Claims and Tolerances in Interstate and International Law*, 65 Yale L. J. 1087, 1091-92 (1956).
[25] *See* Jay R. Sever, *The Relaxation of Inarbitrability and Public Policy Checks on U. S. and Foreign*

in arbitration practice. By introducing the concepts of international public policy and transnational public policy, legal scholars and practitioners try to limit the role of public policy in international commercial arbitration.

Domestic public policy refers to mandatory legal provisions expressed by legislative enactment, constitutional constraints, or judicial practice within individual states. These legal provisions can not be contracted around by private parties. When public policy is applied to arbitration, national courts may refuse to enforce arbitration agreements or arbitral awards violative of the forum state's most basic notions of morality and justice.[26]

Compared with domestic public policy, international public policy is a narrower concept. It only refers to laws and standards by which individual states govern international commercial arbitration. That means only part of domestic public policy consists of international public policy. So, what might be considered against public policy in domestic arbitration may not block the enforcement of arbitration agreements or arbitral award in international commercial arbitration. In France, Article 1498 of the French *Nouveau Code de Procédure Civile* refers specifically to international public policy, and provides that foreign arbitral awards be unenforceable only when they are contrary to international public policy in France.[27] Emergence of international public policy arises from "the special features of international cases and the problems with mechanical application of domestic order public rules to international situations."[28] The more liberal international public policy would foster coherence and predictability in international commerce.[29]

Arbitration: Arbitration out of Control, 65 Tul. L. Rev. 1661, 1663. *See* also Enterria, *supra* note 2.

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

[27] *See* CODE DE PROCEDURE CIVIL [C. PR. CIV] § 1498 (1986).

[28] *See* Enterria, *supra* note 2, at 401.

[29] *See* Kenneth-Michael Curtin, *Redefining Public Policy in International Arbitration of Mandatory National Laws*, 64 Def. Couns. J. 271, 280 (International public policy has been defined as a type of balancing of interest test. National courts should consider not only its own domestic public policy, but also the public policy of interested nations and the needs of international commerce. The rules of any one state

Another analogous concept is transnational public policy. Transnational public policy refers to those universally accepted standards and values.[30] Applying transnational public policy to international arbitration, the reviewing court should look to fundamental general principles of law to decide whether arbitration agreements or arbitral award are enforceable. Although the content of transnational public policy may be derived from international public policy of individual nations, it does not belong to national legal systems.[31] In this way, transnational public policy differs from both domestic public policy and international public policy. Some legal scholars have noted that "transnational public policy further removes the public policy umbrella from purely domestic policy considerations than does international public policy."[32] However, application of international public policy has caused debates in arbitration circles. If there really exists a transnational public policy, then what is the exact content? How could it bind national courts in reviewing arbitration agreements or arbitral awards? Should there be a multilateral treaty to fix the content of transnational public policy and to impose upon signatory countries an international obligation to defer to such transnational public policy? Should transnational public policy be only part of customary international law? There are still many questions needing answers before the concept of transnational public policy is generally accepted.

D. Public Policy in Enforcement of Foreign Judgement

Public policy has also been broadly invoked as a defense against recognition and enforcement of foreign judgments. Thus, the forum courts can use public policy to vacate a foreign judgment rendered by an alien court. In this situation, the court utilizes public policy to avoid negative consequences arising from the enforcement of foreign

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should prevail only if warranted by the nature of the dispute and the legislative policy).

[30] *See* Sever, *supra* 25, at 1663.

[31] *See* Lalive, *Transnational (or Truly International) Public Policy and International Arbitration*, in COMPARATIVE ARBITRATION: PRACTICE AND PUBLIC POLICY IN ARBITRATION 257, 310 (P. Sanders ed. 1987) (summarizing some general principles of the content of transnational public policy).

judgments.[33] Because national courts are more likely to apply stringent public policy in enforcement of foreign judgments, the parties seeking enforcement of such judgments before national courts may encounter more obstacles than those seeking enforcement of foreign arbitral awards. For example, American courts may refuse recognition of a foreign judgment on public policy grounds if recognition "injures the public health, the public morals, the public confidence in the purity of the administration of law, or. . .undermines that sense of security for individual rights, whether of personal liberty or of private property, which any citizen ought to feel."[34] In China, the requirement is even more stringent. The enforcement should be granted only if the foreign judgment does not violate basic principles of Chinese law, sovereignty, national security and public interest.[35] In practice, public policy has been used by American courts as "a catch-all, covering cases of lack of jurisdiction, inadequate notice, and fraud, among others."[36]

Moreover, the United States is not a party to any international judgment convention, so enforcement is a matter of comity and follows the procedures of state law. The foreign judgement will not be given conclusive effect in the United States if the court finds that the foreign judgment is repugnant to the public policy of the state where enforcement is sought.[37] American courts may consider public policy of individual states when they are asked to enforce a foreign judgment. However, the public policy exception has been narrowly applied by American courts to the enforcement of foreign arbitral awards. Since

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[32] *See* Curtin, *supra* note 29, at 282.
[33] *See Cf.* Von Mehren, *Recognition and Enforcement of Foreign Judgements-General Theory and the Role of Jurisdictional Requirements,* in 167 RECUEIL DES COURS: COLLECTED COURSES OF THE HAUGE ACADEMY OF INTERNATIONAL LAW 1980, II, at 47 (1981) (stating that "a society is not prepared to make its legal machinery available where the consequences would deeply offend its views of justice and morality").
[34] *See* Somportex Ltd. v. Philadelphia Chewing Gum Corp., 318 F. Supp. 161, 169 (E. D. Pa, 1970).
[35] *See* ZHONGHUA RENMIN GONGHEGUO MINSHI SUSONGFA (The Code of Civil Procedure) (Adopted at the 4th Session of the Standing Committee of the 7th National People' s Congress of the People' s Republic of China, and promulgated by the President on April 9, 1991), Article 268.
[36] *See* Enterria, *supra* note 2, at 401.
[37] *See* James H. Carter, *A-1 Litigating in Foreign Territory: Arbitration Alternatives and Enforcement Issues,* N98DBWB ABA-LGLED A-1, A-24.

arbitration is based on the parties' agreement, the parties must bear the risk and normally are estopped from opposing the recognition or enforcement of the resulting award on public policy or other grounds.[38]

Recent cases decided by American courts indicate a deviation from stringent adherence to the public policy exception in enforcement of foreign judgments. In International Hotels Corp. (Puerto Rico) v. Golden,[39] a case involving enforcement of a foreign judgment based on gambling debt permitted by applicable foreign law, the court held that a foreign judgment based on gambling debts was not contrary to New York's public policy even though gambling contracts were illegal and therefore unenforceable under New York law. The court further reasoned that "legalization of betting and the operation of bingo games, as well as a strong movement for legalized off-track betting, indicate that New York public does not consider authorized gambling a violation of some deep-rooted tradition of the commonwealth."[40] In another American case, Tahan v. Hodgson,[41] the court even enforced a foreign default judgement. After finding that an Israeli court entered a default judgment based on notice requirements inconsistent with American notice requirements, the court said that Israeli notice requirements were not "so repugnant to fundamental notions of what is decent and just that American public policy requires non-enforcement of the Israeli judgment."[42] Moreover, other cases indicate that American courts may enforce foreign judgments awarding loss of goodwill and attorney's fees,[43] court costs,[44] and prejudgment interest,[45] which are generally prohibited by American law.

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[38] *See* Von Mehren & Patterson, *Recognition and Enforcement of Foreign-Country Judgements in the United States*, 6 Law & POL' Y INT' L BUS. 37, 61 (1974).
[39] *See* 203 N. E. 2d 210 (N. Y. 1964).
[40] *Id*, at 213.
[41] *See* 662 F. 2d 862 (D. C. Cir. 1981).
[42] *Id*, at 866.
[43] *See* Somportex Ltd. v. Philadelphia Chewing Gum Corp., 453 F. 2d 435 (3d Cir. 1971) (the court upheld a $94000 British judgement against a U.S. defendant consisting partly of loss of goodwill and attorney' s fees).

A general study of the public policy exception to the enforcement of foreign judgments in a particular country is helpful for understanding how public policy functions in that country's arbitration system. Public policy is such an amorphous concept that its content depends on national courts' judicial interpretation. Although the scope of public policy in the enforcement of foreign judgments may be different from that in the enforcement of foreign arbitral awards, national courts should not impose a more stringent requirement in reviewing foreign arbitral awards than in reviewing foreign judgments. A national court, which narrowly interprets public policy exceptions in the enforcement of foreign judgments, seems unlikely to broadly invoke such exceptions in the context of international arbitration.

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[44] *See* Desjardins Ducharme v. Hunnewell, 585 N.E.2d 321 (Mass. 1992) (the Massachusetts Supreme Court enforced a Canadian judgement awarding court costs).

[45] *See* Ingersoll Milling Machine Co. v. Granger, 833 F.2d 680 (7th Cir. 1987) (the court enforced a Belgian judgement that included prejudgment interest).

CHAPTER III

PUBLIC POLICY DEFENSE IN THE NEW YORK CONVENTION

A. Geneva Protocol on Arbitration Clauses and Geneva Convention on the Execution of Foreign Arbitral Awards

Before the enactment of the New York Convention, there were two important multilateral treaties dealing with international commercial arbitration: the Geneva Protocol on Arbitration Clauses (Geneva Protocol) and the Geneva Convention on the Execution of Foreign Arbitral Awards (Geneva Convention).[46]

The Geneva Protocol was the first step adopted by international society in seeking for consolidation of international commercial arbitration at the global level. Its primary purpose is to facilitate universal recognition and enforcement of arbitration agreements and arbitral awards in signatory countries. Except for establishing the basic principle of party autonomy, Article I of Geneva Protocol provides that each of the contracting states should recognize the validity of an arbitration agreement to the extent that the subject matter can be arbitrated under its law.[47] Concerning the enforcement of arbitral awards, Geneva Protocol only requires the signatory country to enforce the arbitral awards made in its territory, and there is no provision dealing with whether each signatory country has the obligation to enforce arbitral awards rendered in other countries.[48] Since arbitrations don't usually take place in the country where the party is seeking enforcement, most foreign arbitral awards can not be enforced under the arrangement of the Geneva

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[46] Protocol on Arbitration Clauses, League of Nations, Geneva, 1923, signed at Geneva, 24 September 1923, 27 L.N.T.S.157. Convention on the Execution of Foreign Arbitral Awards, League of Nations, Geneva, 1927, signed at Geneva, 26 September 1927, 92 L.N.T.S.301.

[47] *See* Article I, Protocol on Arbitration Clauses, 27 L.N.T.S.157.

[48] *Id.* Article III (providing that the contracting states undertake only to "ensure the execution by its own authorities and in accordance with the provisions of its own national laws of arbitral awards made in its own territory under the preceding articles.").

Protocol. Moreover, the Geneva Protocol only provides that the enforcement must be in accordance with provisions of national law of the enforcement country. The Protocol fails to specify what the proper standards of judicial review are when national courts are called on to enforce foreign arbitral awards.

These problems have been partly resolved in the Geneva Convention which was promulgated as a supplement to the Geneva Protocol. The Geneva Convention specifically provides that an arbitral award covered by the Geneva Protocol shall be recognized as binding and shall be enforced if such award has been made in any contracting state.[49] Thus, the enforcement obligation is not limited to arbitral awards made within the territory of the enforcing country. Other provisions of the Geneva Convention mainly deal with circumstances under which a foreign arbitral award could be enforced.

In the modern view, the standards of judicial review set by the Geneva Convention are quite stringent. Some provisions are especially disadvantageous to the party who seeks enforcement of an arbitral award. First, several conditions must be satisfied before an arbitral award can be enforced. Those conditions include: (1) the arbitration agreement is valid under the applicable law; (2) the subject matter is arbitrable under the law of enforcing states; (3) the constitution of the arbitral tribunal is in accordance with the parties' agreement and the law governing the arbitration procedure; (4) the award has become final in the country where it has been made; (5) the recognition or enforcement of the award is not contrary to the public policy or to the principles of law of the enforcing state.[50] Second, even if the above mentioned conditions have been satisfied, national courts shall refuse to enforce an arbitral award if it is found that the award has been set aside by the country in which it was made, the losing party was not given an opportunity to present his case, or the arbitrators exceeded the scope of matters submitted

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[49] *See* Article I, Convention on the Execution of Foreign Arbitral Awards, 92 L.N.T.S. 301.

for arbitration.[51] Third, the party who seeks enforcement bears the burden of proving the finality of the arbitral award, the validity of the arbitration agreement and proper constitution of the arbitral tribunal.

Because of those defects in both the Geneva Protocol and Geneva Convention, they were not generally accepted as an instrument to enforce international arbitration agreements and international arbitral awards. Few countries outside Europe accepted the Geneva Protocol and Geneva Convention.

B. New York Convention

After Second World War, the globalization of world economy called for uniform standards to enforce arbitration agreements and arbitral awards at the international level and the liberation of international commercial arbitration from stringent control of national courts. Eventually, the United Nations Economic and Social Council created drafts of a multilateral convention, which aimed to encourage enforcement of arbitration agreements and arbitral awards in signatory countries and create unifying standards by which arbitral awards can be enforced.[52] These drafts were recently promulgated as the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards of June 1958. The New York Convention was so successful that it has been accepted by over one hundred countries, including all major developed countries in the world.[53] One commentator has stated that "the New York Convention can be considered as the most important Convention in the field of arbitration and as the cornerstone of current international commercial arbitration."[54]

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[50] *Id.*
[51] *Id.* Article II.
[52] *See* ALBERT J. VAN DEN BERG, The NEW YORK ARBITRATION CONVENTION OF 1958 6 (1981), at 7-8.
[53] *See* ZHAO XIUWEN, GUOJI JINGJI MAOYI ZHONGCAI FA (International Economic and Trade Arbitration Law) (1995), at 322.
[54] *See* VAN DEN BERG, *supra* note 52, at 1.

Compared with the Geneva Protocol and Geneva Convention, the provisions of the New York Convention are more favorable to international commercial arbitration. The New York Convention imposes upon contracting states an obligation to enforce arbitral awards made in any other signatory country.[55] It also reduces and simplifies the procedure and requirements for the party seeking recognition and enforcement of an award.[56] However, the most important achievement of the New York Convention is its pro-enforcement philosophy. The party who challenges the arbitral award should bear the burden of proving the existence of refusal grounds contained in Article V of the New York Convention.

Article V of the New York Convention provides:

1. Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:
   (a) The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or
   (b) The parties against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or
   (c) The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or
   (d) The composition of the arbitral authority or the arbitral procedure was not in accordance with the law of the country where the arbitration took place; or
   (e) The award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, the award was made.

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[55] *See* New York Convention, supra note 3, Article I,
[56] *Id*, Article IV,

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.

Like the Geneva Convention, the New York Convention also expressly recognizes public policy as a defense against recognition or enforcement of a foreign arbitral award. Since the New York Convention is the most important instrument for the party who seeks enforcement of an international arbitral award, a careful analysis of the Convention itself will be helpful for understanding the role of public policy in international commercial arbitration.

First, Article V(2)(b) provides that the court of the enforcing country may refuse recognition or enforcement of an arbitral award, deemed contrary to that country's public policy. Although it only refers to the application of public policy of the country where enforcement is sought, other provisions imply that other contracting states' public policy may also be concerned. Article II(3) requires the court of the contracting state to enforce the parties' arbitration agreement unless the court finds that the agreement is null and void.[57] A party may institute court proceedings in his own country in spite of the existence of an arbitration agreement, and the court may invalidate the arbitration agreement on the ground of public policy violation and assume jurisdiction over the dispute. Moreover, Article V(1)(e) provides that the court may refuse to enforce an arbitral award at the request of the party if such arbitral award has been set aside in the country where the arbitration took place.[58] A losing party to an arbitration who intends to avoid enforcement of the arbitral award may ask for the award to be set aside in the country where the arbitration took place. However, the New York Convention is silent on

[57] *Id*, Article II (3).

what circumstances enable the national court to set aside an arbitral award, and the procedures governing setting aside arbitral awards have been left to the legal regimes of individual states. Nevertheless, most countries' arbitration laws permit the court to set aside an arbitral award on the ground of public policy violation.[59] Therefore, an international commercial arbitration may be affected by the public policy of the country where enforcement is sought, the country where the arbitration took place, and the country that likely assumes jurisdiction over the dispute.

Second, since an international commercial arbitration may concern public policy of any contracting state, the scope of the public policy exception in the New York Convention can not be determined by reference to its text alone.[60] Moreover, different versions of the Convention also make it difficult to interpret the public policy exception precisely. The French text of the New York Convention uses the term "*ordre public*", whereas the English text uses the term "public policy". It is generally understood that the meaning of "*ordre public*" in civil law countries is broader than the term "public policy" in common law countries. However, the drafters of the New York Convention desired to limit the scope of the public policy exception as much as possible.[61] A comparison of the same exception contained in the Geneva Convention and the New York Convention also reveals that national courts should narrowly interpret the public policy exception. Article I(e) of the Geneva Convention provides that an arbitral award will be enforced if "the

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[58] *Id*, Article V (1) e.

[59] *See* ZHONGHUA RENMIN GONGHEGUO ZHONGCAIFA (Arbitration Law of the People' s Republic of China), (Adopted at the 9th Session of the Standing Committee of the 8th National People's Congress of the People' s Republic of China, and promulgated by the President, on August 31, 1994, effective from September 1, 1995), Article 58 (providing that the People' s Court shall set aside an arbitral award which is contrary to public policy of P.R.C). *See* also UNCITRAL' s Model Law on International Commercial Arbitration, Article 34,

[60] *See* Parsons & Whittemore Overseas Co. v. Societé Generale de l'Industrie du Papier (RAKTA), supra note 26, at 973 (stating that the legislative history of the public policy exception in the New York Convention offers no certain guidelines to its construction).

[61] *See* G. HAIGHT, CONVENTION ON THE RECOGNITION AND ENFORCEMENT OF FOREIGN ARBITRAL AWARDS-SUMMARY ANALYSIS OF RECORD OF THE UNITED NATIONS CONFERENCE MAY/JUNE 1958 71 (1958) ("As regards paragraph 2(b) [of what is now Article V],the working Party felt that the provision allowing refusal of enforcement on grounds of public policy should

recognition or enforcement of the award is not contrary to the public policy or to the principles of the law of the country in which it is sought to be relied upon."[62] However, the New York Convention only authorizes national courts to vacate the arbitral award on the ground of public policy. A general understanding is that the concept of "the principle of the law of the country" is much broader than public policy.[63] Therefore, a foreign arbitral award, which violates principles of the law of the country where recognition or enforcement is sought, may still remain in accordance with that country's public policy rules. Obviously, the absence in the New York Convention of reference to the principles of the law of the enforcing state suggests that the scope of the public policy exception in the New York Convention is intended to be more narrow.[64] This explanation is also in accordance with the pro-enforcement philosophy and the goal of the New York Convention to integrate international arbitration at the global level, which would otherwise be impeded by a broad reading of the public policy exception in the New York Convention.

Third, Article V(1) provides five grounds under which the national court may refuse recognition and enforcement of a foreign arbitral award upon the request of a party.[65] All those grounds are related to arbitration procedure. Article V(2) authorizes the court of the enforcing state to vacate an arbitral award on the ground of non-arbitrability of the subject matter or violation of public policy even where the party does not raise such

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not be given a broad scope of application").

[62] *See* New York Convention, supra note 3, Article I (e).

[63] *See* Enteria, supra note 2, at 406.

[64] The differences in the two the conventions have been construed in different ways. *See* Contini, *International Commercial Arbitration: The United Nations Convention on the Recognition and enforcement of Foreign Arbitral Awards*, 8 AM. J. COMP. L. 283, 304 (1959) (according to Contini this change illustrates that "the conference decided that the court of enforcement is the proper forum to determine whether the subject matter of a dispute is capable of settlement under the law of the country of enforcement…", an apparent narrowing of the public policy provision). *But see* Quigley, *Accession by the United States to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 70 YALE L. J. 1049, at 1071 ("The decision not to add the second phrase may be read as a broadening of the definition of that term").

[65] *See* New York Convention, *supra* note 3, Article V(1) (a)-(e)

defense before the court. Article V(1) provides for some basic requirements of fairness and justice for the international commercial arbitration that are grounded in public policy notions. The public policy exception contained in Article V(2) has been deemed as a residual clause under which the national court may set aside an arbitral award that is not covered by those specified grounds in Article V(1). However, it must bear in mind that Article V(1) and Article V(2) have different functions in the New York Convention. Article V(1) is designed to maintain the basic justice in international commercial arbitration and give the judicial remedy to a party who is the victim of an unjust arbitration. The main purpose of the public policy exception in Article V(2)(b) is not only to prevent injustice in a particular arbitration but also to maintain the basic social and legal order in the enforcing state. For example, if a foreign arbitral award required the losing party to take action, which would violate the United States export restriction, American courts may refuse to enforce the award on the ground of public policy. However, this case may not involve the issue of procedural fairness. The starting point for the national court to invoke the public policy exception is not whether the arbitration is an unjust one, but whether recognition or enforcement is contrary to the most basic notions of morality and justice.[66] Since the public policy exception is designed to protect national interests, this also explains why the New York Convention authorizes the national court to invoke the public policy exception on its own motion. In practice, reading public policy exception as a residual clause to Article V (1) may increase the possibility of disguised use of the public policy exception by national courts. National courts may refuse to enforce the awards because they merely conceive the awards as the result of unfair arbitration, and not that recognition or enforcement will be contrary to the basic notions of morality and justice of the enforcing state. As one commentator noted, it

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[66] *See* Parsons & Whittemore Overseas Co. v. Societé Generale de l'Industrie du Papier (RAKTA), supra note 26, at 974.

could really do harm to international commercial arbitration if national courts try to utilize the public policy exception to attain justice in individual arbitration cases.[67]

Fourth, the use of the permissive term "may" in the English version of Article V means that national courts have discretion to determine whether a foreign arbitral award is enforceable even if it is contrary to the public policy of the enforcing state.

Fifth, a public policy defense was incorporated into the New York Convention as an essential political tool to encourage reluctant member states to join the New York Convention. Professor Behr said that in the enforcement of foreign judgments "the public policy requirement is indispensable. Moreover, in the long run, it is sensible to preserve an ultimate safeguard against unforeseen and unforeseeable divergences between domestic law and the laws of different jurisdictions."[68] In this aspect, public policy has the same function, although the New York Convention concerns recognition and enforcement of foreign arbitral awards. In fact, the inclusion of the public policy exception in the New York Convention was used to quiet potential objections to ratification of the Convention by member states.[69]

Generally speaking, for a long time the public policy exception has been deemed as a loophole in the New York Convention. Although the context of New Convention itself does not provide any guidance for a national court to interpret the public policy

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[67] *See* ZHAO XIUWEN, supra note 53, at 156.
[68] *See* Volker Behr, *Enforcement of United States Money Judgements in Germany*, 13 J.L. & Com. 211, 224 (1994).
[69] *See* Barry, *Application of the Public Policy Exception to the Enforcement of Foreign Awards under the New York Convention: A Modest Proposal*, 51 TEMP. L. Q. 832, 839 (1978) (the existence of an escape clause was used to quiet potential objections to ratification of the New York Convention by the United States).

exception, in practice it is read narrowly by most national courts. Therefore, until now the public policy exception in the New York Convention has not become an obstacle to the development of international commercial arbitration.

CHAPTER IV

JUDICIAL APPLICATION OF PUBLIC POLICY EXCEPTION IN THE UNITED STATES

A. Historic Hostility to Arbitration by American Courts

Before the enactment of the Federal Arbitration Act, American courts had historically been hostile to arbitration. Arbitration agreements were generally unenforceable. The party could withdraw from the arbitration at any time before an award was rendered. In an 1814 case, Tobey v. County of Bristol,[70] Mr. Justice Story characterized the American judicial perception of arbitral adjudication in negative terms:

> Courts of equity do not refuse to interfere to compel a party specifically to perform an agreement to refer to arbitration, because they wish to discourage arbitrations, as against public policy. On the contrary, they have and can have no just objection to these domestic forums, and will enforce, and promptly interfere to enforce their awards when fairly and lawfully made, without hesitation or question. But when they are asked to proceed further and to compel the parties to appoint arbitrators whose award shall be final, they necessarily pause to consider, whether such tribunals possess adequate means of giving redress, and whether they have a right to compel a reluctant party to submit to such a tribunal, and to close against him the doors of the common courts of justice, provided by the government to protect rights and to redress wrongs.

This judicial hostility of American courts was molded to a large extent by English attitudes toward arbitration.[71] In England, arbitration was perceived as an infringement on judicial authority. Arbitrators merely "attempted to play judge" and could not render "cogent adjudicatory determinations."[72] As a consequence, American courts generally

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[70] *See* Tobey v. County of Bristol, 23 F. Cas. 1313 (C. C. D. Mass. 1845) (No. 14065).
[71] *See* G. WILNER, DOMKE ON COMMERCIAL ARBITRATION (rev. Ed. 1984).
[72] *See* Thomas E. Carbonneau, *The Reception of Arbitration in United States Law*, 40 Me. L. Rev. 263, 266.

distrusted arbitration as a means of alternative dispute resolution and were doubtful of arbitrators' competence to decide cases.

However, unlike English courts which had traditionally engaged in merits review of arbitral awards, American courts usually refrained from reviewing the merits of arbitral awards, and would readily grant enforcement once arbitral awards were rendered. This tradition has significantly influenced legislation and practice in the field of arbitration in the United States.[73]

B. Legal Regime for Enforcement of Foreign Arbitral Awards in the United States

a. Enactment of the Federal Arbitration Act

During the early twentieth century, judicial hostility to arbitration was obviously out of date in light of commercial realities in the United States. Businessmen need a speedy, low cost and predictable arbitration system, which outweighed primary concerns about the maintaining justice in arbitration. Congress passed the Federal Arbitration Act (FAA) in 1924, which "ended the era of would-be judicial hostility to arbitration in the United States."[74] Since the FAA preempts state arbitration laws directly in conflict with the FAA,[75] it was the first time that the United State established a national policy encouraging arbitration as a viable alternative to litigation for dispute resolution. Section 2 of the FAA declares that arbitration agreement are "valid, irrevocable, and enforceable…"[76] Moreover, the FAA established very limited grounds for judicial review

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[73] For example, Judicial second-guessing of arbitral determinations was not expressly integrated into United States' law on arbitration. In England, rendering an arbitral award without reasons was a means of avoiding judicial supervision of the merits, but this practice was adopted in the United States simply for historical reasons. *See* Carbonneau, *Rendering Arbitral Awards with Reasons: Elaboration of a Common Law of International Transactions*, 23 COLUM. J. TRANSNAT' L L. 581-586 (1985).

[74] *See* TOM CARBONNEAU, CASES AND MATERIALS ON COMMERCIAL ARBITRATION (1997), at 38.

[75] *See* Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Jr. Univ., 489 U.S. 468, 477 (1989); See also Island Territory of Curacao v. Solitron Devices, Inc., 489 F. 2d 1313, 1319 (2d Cir. 1973) (noting the FAA does not preempt state law to the extent that state law permits, regulates, and establishes a procedure for the enforcement of a foreign money judgment).

[76] See 9 U. S. C. § 2.

of arbitral awards, excluding the possibility of a review of the merits. Section 10 of the FAA specifically allows courts to reverse arbitral awards on four grounds:

(a) Where the award was procured by corruption, fraud, or undue means.
(b) Where there was evident partiality or corruption in arbitrators, or either or them.
(c) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.
(d) Where the arbitrators exceeded their powers, or so imperfectly execute them that a mutual, final, and definite award upon the subject matter submitted was not made.

Although the FAA does not specifically address public policy violations, American courts recognize public policy as a common law ground to vacate a domestic arbitral award. But even in domestic arbitration, the court can not arbitrarily invoke public policy exception. A court' s refusal to enforce an arbitral award is limited to situations where enforcement "would violate some explicit public policy that is well defined and dominant, and is to be ascertained by reference to the law and legal precedents, and not from general considerations of supposed public interests."[77]

b. The United States Becomes a Signatory to the New York Convention

The United States was initially opposed to the New York Convention and did not sign the Convention when it was adopted on June 10, 1958. American delegates felt that certain provisions of the Convention were in conflict with some American domestic laws.[78] However, as a result of increasing support for the Convention in 1960's, American government began to consider signing the New York Convention. Finally, the United States became a signatory on September 30, 1970. The New York Convention is incorporated in Chapter Two of the Federal Arbitration Act, which governs the

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[77] *See* United Paper Workers' International Union, AFL-CIO v. Misco, Inc, 484 U.S. 29, 43, 108 S.Ct. 364, 373-374, 98 L. Ed. 2d 286 (1987).
[78] *See* House Comm. on Judiciary, Foreign Arbitral Awards, H. R. Rep. No. 1181, 91st Cong., 2d Sess. 1970, 1970 U. S. C. C. A. N. 3601, 1970.

enforcement of foreign arbitral awards in the United States. As the Supreme Court said of the Convention in Scherk v. Alberto-Culver Co.,[79] "the principle purpose underlying American adoption and implementation of it [the Convention], was to encourage the recognition and enforcement of commercial arbitration agreements in international contracts and to unify the standards by which agreements to arbitrate are observed and arbitral awards are enforced in the signatory countries."

Section 10 of the FAA partially overlaps with Article V of the New York Convention. However, some defenses contained in Section 10 of the FAA, such as fraud, duress, and bias on the part of the arbitrators,[80] are not set forth in the New York Convention. The question is whether those defenses not set forth in the New York Convention can be implied grounds for refusing enforcement of a foreign arbitral award. Various judicial interpretations suggest that the New York Convention trumps the FAA if there is conflict between the two. In Yusuf Ahmed Algahanim & Sons v. Toys "R" Us, Inc.,[81] a case involving enforcement of a foreign arbitral award in the United States, Toys "R" Us, Inc. who opposed enforcement argued that the award should be vacated or modified under the FAA because it was irrational and in manifest disregard of the law and the terms of the parties' agreement.[82] The court held that the grounds set forth in Article V were the exclusive ones provided by the Convention and the FAA may supplement the Convention only to the extent that they do not conflict.[83] Thus, the party can not directly raise those defenses to oppose enforcement of a foreign arbitral award in the United States. However, the public policy exception in the New York Convention is such an ambiguous concept that the party opposing enforcement may raise those defenses as violations of public policy of the United States. In fact, duress, fraud, bias on the part of the arbitrators,

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[79] *See* Scherk v. Alberto-Culver Co., 417 U. S. 506.
[80] *See* Section 10, FAA, 9 U. S. C. (1994).
[81] *See* Yusuf Ahmed Algahanim & Sons v. Toys "R" Us, Inc., 126 F. 3d 15, 20 (2d Cir. 1997).
[82] *Id*, at 18.
[83] *Id*, at 20.

and manifest disregard of law have been raised by the losing parties as the general argument that enforcement would be contrary to basic notions of morality and justice of the United States.

C. General Consideration of the Public Policy Exception under the New York Convention

The first American case dealing with public policy exception under the New York Convention was Parsons & Whittemore Overseas Co., Inc. v. Societe Generale De L' Industrie du Papier (RAKTA).[84] It was also the first case in which the United States courts enforced a foreign arbitral award under Chapter 2 of FAA.

In that case, an American company, Parsons & Whittemore Overseas Co., Inc., entered into a contract with RAKTA to construct, start up, and manage for one year a paperboard mill in Alexandria, Egypt. The contract included an arbitration clause. The Agency for International Development, an American government foreign aid agency, agreed to finance the project, supplying funds to purchase Letters of Credit in Overseas' favor. Work proceeded as planned until the Arab-Israeli Six-Day War broke out in 1967. By this time, the project was well advanced in construction but not yet completed. Because of anti-American hostility and personal safety issues resulting from the United States's support of Israel, the majority of the Overseas work crew left Egypt. About this time, Egypt broke diplomatic relations with the United States and ordered all Americans out of the country except for those who could qualify for a special visa. Also, the Agency for International Development cut off its funding for the project. Overseas abandoned the project for the time being and notified RAKTA that the postponement was excused by the force majeure clause in their contract. RAKTA, unwilling to wait, went ahead and completed Overseas' work and then sought damages through arbitration. The final award was rendered in favor of RAKTA, and RAKTA sought to enforce the award in the United

[84] *See* Parsons & Whittemore Overseas Co., Inc. v. Societe Generale De L' Industrie du Papier (RAKTA),

States. Overseas presented five different defenses, but the court denied all of them and enforced the award.

Concerning public policy defense, Overseas based its argument on the fact that the United States Agency for International Development had withdrawn financial support for the project. Therefore, Overseas argued, as a loyal American citizen, it had to abandon the project. Overseas attempted to equate the United States' national policy with the United States' public policy. However, the court ruled that the public policy defense could be used to deny enforcement of a foreign award "only where enforcement would violate the most basic notions of morality and justice of the state where enforcement is being requested."[85] The court said that United States' national policies such as the international politics of the United States and its relations with Egypt could not be equated with public policy. The United States falling out with Egypt did not involved the most basic notions of morality and justice recognized in the United States. Refusal to enforce on this basis would create a major loophole in the Convention' s mechanism for enforcement.[86]

Parsons is clearly the leading American case on interpretation of the public policy defense of the New York Convention. Following Parsons, American courts generally gave a narrow construction of the public policy exception in international commercial arbitration.

D. Arbitrability and Public Policy

The FAA itself does not specifically address the issue of arbitrability of subject matter. However, under Article II(3) and Article V(2)(a) of the New York Convention, American courts may refuse to enforce arbitration agreements or arbitral awards if the subject matter can not be arbitrated under American laws. The problems of arbitrability

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supra note 26.
[85] *Id*, at 974.
[86] *Id.*

have been classified into two categories: contractual inarbitrability and substantive inarbitrability.[87] Contractual inarbitrability does not involve public policy issues and only refers to disputes not within the scope of the parties' arbitration agreement.[88] Substantive inarbitrability concerns whether the "subject matter can be lawfully submitted to arbitration."[89] If a subject matter is deemed to be vital to public interest, it may be excluded from arbitration by national laws. In this regard, public policy and arbitrability overlap in arbitration practice. Substantive inarbitrability has traditionally been invoked in public law claims. In the United States, this problem has been raised in the area of antitrust law, securities law, patent law, ERISA claims, bankruptcy, and liquidated and punitive damages claims.[90] The courts consider that arbitration is not a proper forum to settle the statutory claims since the arbitration procedure is so informal, and arbitrators may be incompetent to correctly interpret public law issues.[91] However, after signing the New York Convention, American courts adopted a highly internationalist view of transnational cases and were reluctant to strike down arbitration agreements or arbitral awards on the ground of non-arbitrability of subject matter. Therefore, disputes, such as securities and antitrust matters that may not be arbitrated under domestic law could be submitted to arbitration in an international context.

a. Antitrust Statutes

In American Safety Equipment Corp. v. J.P. McGuire & Co.,[92] the court was for the first time confronted with the question of whether an antitrust claim was arbitrable. The case involved a license agreement that contained an arbitration clause. The licensee brought an action for declaratory judgment of antitrust violations in certain paragraphs of

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[87] *See* CARBONNEAU, supra note 60, at 18.
[88] *Id.*
[89] *Id.*
[90] *See* Sterk, *Enforceability of Agreement to Arbitrate: An Examination of the Public Policy Defense*, 2 CARDOZO L. REV. 481, 482 (1981).
[91] *See* William W. Park, *National Law and Commercial Justice: Safeguarding Procedural Integrity in International Arbitration*, 63 TUL. L. REV. 647, 700 (1989).

the license agreement. The licensor made a motion under the FAA to stay the declaratory judgement, pending arbitration for all issues. The court held that antitrust claims were inappropriate for arbitration and gave three major reasons to support its holding. First, a claim under the antitrust laws is not merely a private matter. "The Sherman Act is designed to promote the national interest in a competitive economy; thus, the plaintiff asserting his rights under the Act has been likened to a private attorney-general who protects the public's interest. Antitrust violations can affect hundreds of thousands—perhaps millions—of people and inflict staggering economic damage."[93] Second, arbitration procedure is not suitable for settling antitrust claims since "the issues in antitrust cases are prone to be complicated, and the evidence extensive and diverse."[94] Third, it is improper for commercial arbitrators to decide these types of issues of great public interest.

However, in Coenen v. R. W. Pressprich & Co.,[95] the court ruled that arbitration was a proper forum to settle antitrust claims because the agreement to arbitrate was made after the dispute arose.[96] The court reasoned that the parties already knew what they were agreeing to arbitrate and the agreement to arbitrate in that case "may be regarded as an agreement to arbitrate a specific existing dispute."[97] Therefore, the court limited the holding in American Safety to future dispute clauses.

Finally, in Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.,[98] the Supreme Court recognized that antitrust claims were arbitrable when it was called on to enforce an international arbitration agreement. The claims arose from an agreement among Japanese, Swiss and Puero Rican corporations to grant distribution rights to vehicles manufactured

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[92] *See* American Safety Equipment Corp. v. J.P. McGuire & Co., 391 F. 2d 821(2d Cir. 1968).
[93] *Id*, at 826.
[94] *Id*, at 827.
[95] See Coenen v. R. W. Pressprich & Co., 453 F. 2d 1209(2d Cir. 1972).
[96] *Id*, at 1214.
[97] *Id.*
[98] See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U. S. 614 (1985).

by Mitsubishi and bearing both Chrysler and Mitsubishi tradermarks. The agreement contained a clause providing for arbitration by the Japanese Commercial Arbitration Association. After a dispute arose, Soler brought an antitrust claim in the United States District Court. However, Mitsubishi and the Swiss corporation requested that the court compel arbitration in accordance with the agreement. The Supreme Court held that antitrust claims were arbitrable. The court concluded that "concerns of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes required that we enforce the parties' agreement, even assuming that a contrary result would be forthcoming in a domestic context."[99] Mitsubishi has been deemed a landmark decision in the development of international commercial arbitration in the United States. Because of the decision in Mitsubishi, non-arbitrability of antitrust claims is no longer an available defense for the parties who intend to block enforcement of an international arbitration agreement or a foreign arbitral award.

b. Securities Acts

In 1953, the Supreme Court in Wilko v. Swan declared that the claims brought under the Securities Act of 1933 were nonarbitrable.[100] First, the court construed that the Securities Act prohibited waiver of a judicial remedy in favor of arbitration by agreement made before any controversy arose.[101] Further the court reasoned that arbitration was not suitable for settling securities issues because of the informal arbitration procedure and the absence of effective judicial review of arbitration.[102]

However, in Scherk v. Alberto-Culver Co.,[103] the Supreme Court held that securities issues were arbitrable. Alberto-Culver Co. was an American company. In order to expand

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[99] *Id*, at 628.
[100] *See* Wilko v. Swan, 346 U. S. 427 (1953).
[101] *Id*, at 431.
[102] *Id*, at 435.
[103] *See* Scherk v. Alberto-Culver Co., *supra* note 79.

its overseas operations, the company decided to purchase from Fritz Scherk, a German citizen, three enterprises owned by him, together with all trademark rights to these enterprises. Thereafter, a sale contract was negotiated in the United States, England, and Germany, signed in Austria, and closed in Switzerland. The contract contained a clause providing for arbitration of any controversy or claim by the International Chamber of Commerce in Paris. Yet, when a dispute arose, instead of going to arbitration in accordance with the contract, Alberto-Culver Co. brought suit in American District Court, alleging that Fritz Scherk violated the Securities Exchange Act of 1934. The Supreme Court held securities issues were arbitrable. The Court distinguished Scherk from Wilko in that Scherk involved a truly international agreement.[104] After referring to the necessity to maintain predictability in international business transactions, the Court said that refusing enforcement would "surely damage the fabric of international commerce and trade, and imperil the willingness and ability of businessmen to enter into international commercial agreements."[105]

In Shearson/American Express Inc. v. McMahon,[106] the Supreme Court held that securities issues could be arbitrated even in a purely domestic arbitration unless it is contrary to congressional command. However the party who opposing arbitration should bear the burden to prove that Congress intended to "preclude waiver of judicial remedies for statutory rights at issue." Moreover, "any such intent will be deducible from statute's text or legislative history or from inherent conflict between arbitration and statute's underlying purpose."[107]

Finally, in Rodriguez de Quijas v. Shearson/American Express Inc.,[108] Wilko was overruled. The Supreme Court ruled that the holding in Wilko was inconsistent with the

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[104] *Id*, at 514.
[105] *Id*, at 516.
[106] *See* Shearson/American Express Inc. v. McMahon, 482 U. S. 220 (1987).
[107] *Id*, at 247.
[108] *See* Rodriguez de Quijas v. Shearson/American Express Inc., 490 U. S. 477 (1989).

underlying spirit of FAA favoring arbitration, and securities issues were able to be arbitrated both internationally and domesticly.[109]

Obviously, American courts adopted a more flexible policy and loosened the substantive inarbitrability defense in international commercial arbitration. As more and more statutory claims, such as under RICO[110] and ERISA,[111] are deemed arbitrable, it is believed that "public policy objections-as criteria independent of statutory law-are not available to resist the recognition of an international commercial arbitration agreement in the United States."[112]

E. Public Policy and Due Process

Article V(1)(b) of the New York Convention authorizes a court to vacate an award when "the party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case."[113] This clause was also referred to as the "due process" clause reflecting the basic requirement of procedural fairness in international arbitration. It should be noted that the procedural requirements contained in the FAA are more rigorous than the due process clause in the New York Convention. Some defenses, such as fraud, impartiality of the arbitrators, and corruption, are not explicitly stipulated in the New York Convention. If the arbitration took place in the United States, those defenses are available to a party who asks the American court to set aside an arbitral award.[114] However, if a party were seeking enforcement of a foreign arbitral award, would these

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[109] *Id*, at 482.
[110] *See* Shearson/American Express Inc. v. McMahon, *supra* note 106 (holding that the RICO claim for treble damages was arbitrable).
[111] *See* Bird v. Shearson Lehman/American Express Inc., 926 F. 2d 116 (2d Cir. 1991).
[112] *See* Hans Dolinar and E. R. Lanier, *Public Policy Objections to the Recognition and Enforcement of Foreign Arbitral Agreements and Awards: Perspectives on Austrian and American Law*, in PUBLIC POLICY AND INTERNATIONAL COMMERCIAL ARBITRATION (1997).
[113] *See* New York Convention, *supra* note 3, Article V (1) b,.
[114] *See* Yusuf Ahmed Algahanim & Sons v. Toys "R" Us, Inc., *supra* note 81.

defenses constitute a violation of the American public policy and thus block enforcement of the awards?

a. Fraud

The following cases deal with the question whether the existence of fraud constitutes violation of American public policy.

In Indocomex Fibres Pte., Ltd. v. Cotton Company International, Inc.,[115] Indocomex Fibres, an American company, contracted to sell raw cotton to a British buyer. The American seller did not ship the cotton, alleging that the British buyer's letter of credit was deficient. The buyer claimed breach of contract, and the dispute was submitted to the arbitrators of the Liverpool Cotton Association in the United Kingdom. The arbitrators rendered an award in favor of the British buyer. The buyer then filed a petition with the American District Court requesting that the award be recognized and enforced. The American seller responded that the buyer committed fraud by presenting a deficient letter of credit. The alleged deficiencies included omission of delivery destination and inadequate repayment guarantees. The court held:

"It is unnecessary for the Court to detail defendant' s specific allegations of fraud committed by plaintiff because defendant's allegations involve the merits of the contractual dispute and as such are issues not properly before this court. A court will not reconsider the merits of the breach of contract dispute which is subject to arbitration."[116]

The court further stated that fraud under the FAA "required a showing of bad faith during the arbitration proceedings, such as bribery, undisclosed bias of the arbitrator, or willfully destroying evidence, and further required that such evidence of fraud was unavailable to the arbitrator during the course of the proceeding."[117] The seller did not allege that plaintiff concealed information from the arbitrator, that the arbitrator was not

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[115] *See* Indocomex Fibres Pte., Ltd. v. Cotton Company International, Inc., 916 F. Supp 721 (1996).
[116] *Id.*
[117] *Id.*

privy to relevant information, that proceedings were suspect in any way, or that evidence of fraud was discovered only after the arbitration proceedings. The seller merely claimed that the arbitrators' decision was faulty. Such an objection could not constitute fraud under the FAA. In other words, the fraud allegations would have to relate to the arbitration process itself and not to the merits of the claim being arbitrated.

In another case involving fraud, Biotronic Mess-und Therapiergeraete, GmbH & Co., v. Medford Medical Instrument Co.,[118] there was a series of three contracts concluded between a German manufacturer and an American distributor. A dispute arose, that was followed by arbitration. The American distributor chose not to attend the hearing in Switzerland, although the distributor was fully aware the hearing was taking place. The German manufacturer obtained an award and sough enforcement in an American District Court. The American distributor alleged that the German company procured the award by fraud because the German company only submitted two of the three contracts to the arbitrators. Those two contracts favored the German company's case. The arbitrators never saw the third contract which favored the American company' s case. The American company argued this was fraud in violation of public policy. The German company responded by arguing that in an adversarial system of justice, the failure of one side to prove the other side' s case can not constitute fraud. The federal court agreed with the German manufacturer, holding that a party can not complain about the non-production of evidence when the complaining party had the opportunity to produce the evidence but failed to do so. The court further stated that there was not sufficient evidence to support a finding of fraud, and the award should be enforced.

The above mentioned cases indicate that fraud refers only to some irregularity in the arbitration process. However, the courts have implied that once the existence of fraud is proved the enforcement could be denied on the ground of a public policy violation.

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[118] *See* Biotronic Mess-und Therapiergeraete, GmbH & Co., 415 F. Supp. 133 (1976).

b. Corruption

Corruption is a serious procedural irregularity. However, in a recent case, AAOT Foreign Economic Association (VO) Technostroyexport (Techno) v. International Development and Trade Services, Inc. (IDTS),[119] an American federal court enforced an award even though the party contended that the award was rendered by a corrupt foreign tribunal. The case involved a series of purchase contracts between Techno and IDTS. After disputes arose over IDTS's performance under the contracts, both parties went to arbitration before the International Court of Commerce and Industry of the Russian Federation in Moscow. Following the initiation of the arbitration, Sicular, an IDTS interpreter, approached the secretary of the arbitration court, and inquired about the possibility of bribing the court.[120] Both the secretary and his superior firmly responded that they could assist IDTS "sort out" the arbitration in exchange for one million dollars. The intended bribe ended inconclusively after a series of communications with the secretary over the next two months, during which time Sicular ostensibly sought to gather further evidence and establish that the arbitration court and its officials were corrupt. Finally, the tribunal rendered an award in favor of Techno for approximately $200 million. Techno filed a petition in the district court to confirm the award under the New York Convention. IDTS alleged the enforcement of the award rendered by a corrupt foreign tribunal was contrary to the public policy of the United States.[121] The court determined that IDTS had knowledge of facts indicating the tribunal was corrupt prior to commencement of the arbitration hearing, and yet IDTS remained silent until an adverse

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[119] *See* AAOT Foreign Economic Association (VO) Technostroyexport v. International Development and Trade Services, Inc., 139 F. 3d 980 (1998).

[120] According to IDTS' s testimony, Sicular acted on her own intiative and to test the integrity of the court.

[121] *See* AAOT Foreign Economic Association (VO) Technostroyexport v. International Development and Trade Services, Inc., supra note 119.

award was rendered. Such inaction was considered equal to IDTS waiving its right to assert public policy exception as a basis for rejecting the arbitration award.[122]

c. Duress

In Transmarine Seaways Corp. of Monorovia v. Marc Rich & Co. A. G.,[123] the issue was whether duress constituted violation of the public policy of the United States. Marc Rich, the party opposing enforcement, argued that, because its opponent had secured a new agreement with Marc Rich by refusing to comply with the original agreement until a new one was negotiated, the new agreement has been secured by duress.[124] The court stated that "duress is not present unless a party is so overborne that it loses its options."[125] The court found that Marc Rich did not provide sufficient evidence to prove the existence of duress. However, the court ruled that "agreements, exacted by duress contravene the public policy of the nation…and accordingly duress, if established, furnishes a basis for refusing enforcement of an award under Article V(2)(b) of the Convention."[126]

d. Prior Relationship with the Arbitrators

In Commonwealth Coatings Corp. v. Continental Casualty Co.,[127] involving a domestic arbitration, the arbitrator failed to disclose that, at an earlier time, he had been engaged and paid as a consultant for the party who appointed him. Although no actual bias existed, the court vacated the award and held that "any tribunal permitted by law to try cases and controversies not only must be unbiased but also must avoid even the appearance of bias."

However, American courts were reluctant to strike down an arbitral award only for some prior relationship between the parties and the arbitrators in international

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[122] *Id.*
[123] *See* Transmarine Seaways Corp. of Monorovia v. Marc Rich & Co. A. G., 480 F. Supp. 352 (S. D. N. Y. 1979).
[124] *Id*, at 358.
[125] *Id*, at 359.
[126] *Id.*
[127] *See* Commonwealth Coatings Corp. v. Continental Casualty Co., 393 U. S. 145, 89 S. Ct. 337 (1986).

commercial arbitration. In Fertilizer Corp. of India v. IDI Management, Inc.,[128] an arbitrator failed to disclose that he had served on two occasions as counsel for the prevailing party in other arbitration. Relying on Commonwealth, the losing party asked for the award to be set aside, arguing that the arbitrator' s non-disclosure was contrary to the public policy of the United States. The court rejected the contention and said that "public policy defense should be narrowly construed" and "awards should not be vacated only because of an appearance of bias."

F. Content of Arbitral Award and Public Policy

Usually, the judicial review of foreign arbitral awards is limited to the arbitration procedure. However, national courts may utilize the public policy exception to review the content of awards.

a. Manifest Disregard of Law

In the United States, the opposing party occasionally alleges manifest disregard of law as the defense against enforcement of foreign arbitral awards.[129] Since the New York Convention does not expressly provide for such defense, the question is whether manifest disregard of law by arbitrators is contrary to the public policy of the United States.

In Sidarma Societa Italiana di Armamento SPA v. Holt Marine Industries,[130] the court said that "to vacate an arbitration award for manifest disregard of law there must be something beyond and different from a mere error in the law or failure on the part of the arbitrators to understand or apply the law." The court's holding implied that under certain circumstances manifest disregard of law may be contrary to the public policy of the United States.

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[128] *See* Fertilizer Corp. of India v. IDI Management, Inc., 517 F. Supp. 948 (S. D. Ohio 1981).

[129] *See* Wilko v. Swan, supra note 100 (stating that "the interpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation).

[130] *See* Sidarma Societa Italiana di Armamento SPA v. Holt Marine Industries, 515 F. Supp. 1302 (S.D.N.Y.), aff'd, 681 F.2d 802 (2d Cir. 1981).

However, in the United States, an arbitrator is not required to give reasons in his award.[131] This practice is also accepted by many other countries in international commercial arbitration. Lack of reasons in foreign awards makes it difficult for courts to determine whether arbitrators misinterpreted the law. Moreover, it has been suggested that American courts "should not attempt to apply the manifest disregard test when the governing law of the arbitral dispute is foreign because the difficulty of determining a manifest disregard of the law in the context of a foreign legal issue. . .makes application of a nonstatutory ground undesirable."[132] In fact, the American courts have limited application of manifest disregard test to extreme circumstances such as when arbitrators intentionally ignore the applicable law.[133] Thus, it seems unlikely that the losing party will succeed in blocking enforcement of foreign arbitral award by alleging manifest disregard of law as a violation of public policy of the United States. In Brandeis Intsel Ltd. v. Calabrian Chemicals Corp.,[134] one federal court openly abandoned the manifest disregard test. After reiterating that the public policy exception should be construed narrowly, the court said that the manifest disregard defense was not available under Article V of the New York Convention to a party seeking to vacate an award of foreign arbitrators based on foreign law.[135]

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[131] *See* Holtzmann, National Report United States in Yearbook Vol. IX (1984) IX at 62.
[132] *See* Kolkey, *Attacking Arbitral Awards: Rights of Appeal and Review in International Arbitrations*, 22 INT' L LAW, 693, 699 (1988).
[133] *See* Drayer v. Krasner, 572 F. 2d 348, 352 (2d Cir.).
[134] *See* Brandeis Intsel Limited v. Calabrian Chemicals Corporation, 656 F. Supp. 160.
[135] The court said that "salutary goal and purpose will be better achieved by applying to proceedings brought in this country to enforce foreign arbitral awards the narrow concept of public policy...Defining public policy as used in the Convention to include manifest disregard of law...would require an American court to consider whether foreign arbitrators had disregarded governing foreign law. It is one thing to ask an American judge to hold American arbitrators guilty of a manifest disregard of American law. It is quite another to ask an American judge to determine whether foreign arbitrators manifestly disregarded the internal, substantive law of a foreign nation by which the parties agreed in their contract to be bound." Suppa, at 167.

b. Punitive Damages

In the United States, punitive damages traditionally are not allowed in contract cases unless there was malicious conduct in addition to a contract breach.[136] Given that most international arbitration involves contractual disputes, would it be contrary to the public policy of the United States if arbitrators awarded punitive damages in accordance with the governing law? In an early American case, Laminoirs-Trefileries-Cableries de Lens, S.A. [LTCL] v. Southwire,[137] one court's answer was yes. Laminoirs involved a purchase agreement for steel wire between an American company and a French firm. The contract provided that the laws of Georgia governed the contract to the extent that they did not conflict with the laws of France.[138] After a dispute arose over the price to be paid by Southwire, both parties went to arbitration. Relying on French law, the arbitral tribunal rendered an award in favor of LTCL, requiring Southwire to pay interest for the unpaid sum at the legal rate of nine and one half percent to ten and one half percent, plus an additional five percent per annum for damages to be levied two months after the award was issued.[139] When an American federal court was called on to enforce the award, Southwire contended that the rates were usurious, and enforcement was contrary to the public policy of the state of Georgia. The court upheld the awarded interest rate even though the rate was higher than what Georgia law generally allowed. However, the court found that the additional five percent interest would be unacceptable under American and Georgia case law since it had no reasonable relation to actual damages and therefore constituted a penalty. Citing Article V(2)(b), the court struck down the additional five percent interest award. The decision in Laminoirs has been criticized since it seems to

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[136] *See* Margaret Pedrick Sullivan, *The Scope of Modern Arbitral Awards*, 62 Tul. L. Rev. 1113, 1127.
[137] *See* Laminoirs-Trefileries-Cableries de Lens, S.A. v. Southwire, 484 F. Supp. 1063 (N.D. Ga. 1980).
[138] *Id*, at 1067.
[139] *Id*, at 1068-69.

"ignore the idea of an international public policy, which prohibits the automatic extension of domestic principles to international arbitration."[140]

In the United States, recent debates on awarding punitive damages in international commercial arbitration focused on whether arbitrators have authority to award punitive damages.[141] Some legal scholars believe that arbitrators may not award punitive damages absent an express provision in the arbitration agreement authorizing this relief. Others believe that arbitrators may award punitive damages unless the parties expressly prohibit the award of this relief in the arbitration agreement.[142] In Willoughby Roofing & Supply Co. v. Kajima International, Inc.,[143] the Eleventh Circuit Court held, "there is no public policy bar which prevents arbitrators from considering claims for punitive damages."[144] Now it is a safe assumption to conclude that if awarding punitive damages is within the authority of arbitrators and in accordance with the governing law it will not be contrary to the public policy of the United States.

G. Summary

The above-mentioned cases indicate that American courts have rarely struck down foreign arbitral awards or arbitration agreements on the ground of public policy violations. In fact, it is believed that public policy can only be invoked to vacate an award in theory.[145] On the outside, the reason is that American courts usually distinguished international public policy from domestic public policy and give the former a more narrow construction. As the Supreme Court in Scherk v. Alberto-Culver Co. said, a truly international agreement involved considerations and policies significantly different from

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[140] *See* Enterria, *supra* note 2, at 424.
[141] *See* Sullivan, *supra* note 136.
[142] *See* John Y. Gotanda, *Awarding Punitive Damages in International Commercial Arbitrations in the Wake of Mastrobuono v. Shearson Lehman Hutton, Inc*, 38 Harv. Int' s L. J. 59, 67.
[143] *See* Willoughby Roofing & Supply Co. v. Kajima International, Inc., 598 F. Supp. 353 (N. D. Ata. 1984), aff'd per curiam, 776 F. 2d 269 (11th Cir. 1985).
[144] *Id*, at 361.
[145] *See* Eloise Henderson Bouzari, *The Public Policy Exception to Enforcement of International Arbitral Awards: Implications for Post-NAFTA Jurisprudence*, 30 Tex. Int'1 L. J. 205, 206.

those controlling in a domestic contract.[146] The Court's holding greatly relied on the international character of the contract and implied that a concept of international public policy, narrower in scope than the domestic policy, must prevail in international transactions.

One commentator has observed that international public policy is a type of balancing interests test, under which national courts should consider not only their own domestic public policy but also the public policy of interested nations and the needs of international commerce.[147] In fact, American courts constantly state the following reasons to support a narrow reading of public policy in international commercial arbitration.

First, the courts should respect party autonomy. Concerning enforcement of an arbitration agreement, the Supreme Court noted that where an agreement was negotiated and made "by experienced and sophisticated businessmen, [then] absent some compelling and countervailing reason…[the agreement]…should be honored by the parties and enforced by the courts."[148] Concerning enforcement of an arbitral award, the Supreme Court in Parsons found that when the parties agree to submit disputes to arbitration they relinquish their legal right to judicial remedy and should bear the risk inherent in arbitration.[149] Thus, the party is generally estopped from opposing the enforcement of the award on public policy grounds except in extreme circumstances.

Second, when the court narrowly reads the public policy exception, it respects the notion of comity. This theme is reflected in the court's holding in Mitsubishi which emphasized "concerns of international comity, respect for the capacities of foreign and

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[146] *See* Scherk v. Alberto-Culver Co., *supra* note 79.
[147] *See* Kenneth-Michael Curtin, *supra* note 29.
[148] *See* The Bremen v. Zapata Off-Shore Co., 407 U. S. 1, 12 (1972).
[149] *See* Parsons & Whittemore Overseas Co., Inc. v. Societe Generale De L' Industrie du Papier (RAKTA), *supra* note 26, at 975.

transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes."[150]

Third, the needs of international commerce also require a narrow construction of the public policy exception. In the Bremen v. Zapata Off-Shore, deciding to enforce a choice of forum clause, the Court said that "the expansion of American business and industry will hardly be encouraged if, notwithstanding solemn contracts, we insist on a parochial concept that all disputes must be resolved under our laws and in our courts. . .We can not have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts."

Fourth, American courts usually highlight the underlying spirit of the New York Convention and strictly adhere to the pro-enforcement philosophy. A broad reading of public policy will frustrate the goal to establish a uniform standard to enforce arbitration agreements and arbitral awards.

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[150] *See* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., *supra* note 98, at 629.

CHAPTER V

JUDICIAL APPLICATION OF PUBLIC POLICY IN THE PEOPLE'S REPUBLIC OF CHINA

A. Overview of Arbitration Practice in China before Acceding to the New York Convention

Before acceding to the New York Convention, China had two arbitration systems: the domestic arbitration system and the foreign-related arbitration system.[151] Domestic arbitration in China was not normal arbitration but a mixture of arbitration, government administration and litigation.[152] The domestic arbitration commissions were actually government agencies and the arbitrators were government officers.[153] When one party applied for arbitration, the other party was obliged to respond. Moreover, the arbitration award was not final since if one party was not satisfied with the award, he might make a request to the Chinese court for a final judgement on the dispute through the litigation process.[154] This kind of Chinese domestic arbitration was the product of the system of state planned economy. However, in contrast to domestic arbitration, China had adopted a more flexible approach to international commercial arbitration. The foreign arbitral awards were deemed final and would be enforced by the People's Courts, although China had long been without domestic laws and regulations governing the enforcement of foreign arbitral awards. As Mr. Ren Jianxin, who was the President of the Supreme People' s Court, said in 1981, that "the enforcement [of foreign arbitral awards] is in fact

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[151] It has been accepted in China that the foreign-related arbitration involves the dispute where the party is foreigner, disputed property locates in foreign countries, or execution of the contract occurred in foreign countries.

[152] *See* GUI MINGJIE, ZHONGUO ZHONGCAI ZHIDU (Arbitration System in China) (1995), at 207.

[153] *Id.*

[154] *Id.*

fully secured so long as [the awards] are fair and not in violation of the Chinese laws and policies."[155] However, the conditions for enforcement were quite stringent. The requirements of fairness and non-violation of Chinese laws and public policies made it difficult to succeed in seeking enforcement of foreign arbitral awards in China. An even more serious problem is that absent relevant laws there were no guidelines or procedures for Chinese courts to enforce foreign arbitral awards.

B. China's Acceding to the New York Convention and Implementing Laws and Regulations

The impetus for China to adoption of the New York Convention was economic considerations. After the Chinese government adopted an "open door" policy, China became an attractive place for foreign investors because of its cheap labor and abundant natural resources.[156] When disputes arose, foreign investors usually favored international commercial arbitration. However, the absence of an effective legal regime for enforcement of foreign arbitral awards deterred foreign investors from investing their money in China. Thus, it was necessary for China to create a favorable climate for foreign investors. As then Premier Zhao Ziyang explained to the Standing Committee of the National People's Congress, "The ratification of the Convention. . .is aimed at meeting the demands of implementing the policy of opening China to economic cooperation with foreign countries and facilitating the country's foreign trade."[157]

On December 6, 1986, the Standing Committee of the National People's Congress adopted a decision declaring that China would accede to the New York Convention.[158] In

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[155] *See* Ren Jianxin, China' s Foreign Economic and Trade Arbitration, 2 CHINA' S FOREIGN TRADE 4, 5 (1981).

[156] *See* ZHAO XIUWEN, supra note 53, at 3.

[157] *See* China to Ratify Convention on Foreign Arbitration, Xinhua General Overseas News Service, Nov. 27, 1986, Item No. 1127093.

[158] *See* Quanguo Renmin Daibiao Dahui Changwu Weiyuanhui Guanyu Woguo Jiaru 'Chengren ji Zhixing Waiguo Zhongcai Caijue Gongyue' de Jueding (Decision of the Standing Committee of the National People' s Congress with Respect to China' s Accesion to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards) (adopted Dec. 2, 1986), ZHONGHUA RENMIN GONGHEGUO

order to assure implementation of the New York Convention in practice, the Supreme People's Court issued a Notice on the Implementation of China's Accession to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards to higher and intermediate level courts.[159] With respect to jurisdiction, the Notice provided that Intermediate People's Court should assume the jurisdiction over the disputes involving enforcement of foreign arbitral awards.[160] Moreover, the Notice specifically addressed that in determining whether enforcement should be granted the court should look to Article V of the New York Convention. If no exceptions are present, the court must enforce the award in accordance with the Code of Civil Procedure.[161]

On August 31, 1994, China promulgated its first arbitration law which governs both domestic and international arbitration.[162] The main purposes of the Chinese Arbitration Law were to bring about a fundamental reform of the Chinese domestic arbitration system and to strengthen the foreign-related arbitration regime in China. Thus, the Chinese Arbitration Law set forth a basic legal framework for the development of arbitration in China. The principles contained in Chinese Arbitration Law, such as contractual freedom and different treatment of domestic arbitration and international arbitration, indicate that China is attempting to integrate its arbitration system at the international level.

QUANGUO RENMIN DAIBIAO DAHUI CHANGWU WEIYUANHUI GONGBAO 560 (1986).

[159] *See* Guanyu Zhixing Woguo Jiarude Chengren Ji Zhixing Waiguo Zhongcai Caijue Gongyue de Tongzhi, ZHONGHUA RENMIN GONGHEGUO ZUIGAO RENMIN FAYUAN GONGBAO 40 (1987).

[160] According to the Notice, the party seeking to enforce foreign arbitral awards must apply to intermediate level people' s courts. A court will have jurisdiction over a dispute: (1) where a party resides or possesses a household certificate, in cases of enfocement sought against a natural person; (2) where a legal person has its principle place of business, in cases of enforcement against a legal person; and (3) where a natural or legal person' s property is located, in cases of enforcement sought against a party with no residence, household registration, or place of business in China but who owns property in China.

[161] *See* ZHONGHUA RENMIN GOUNGHEGUO MINSHI SUSONGFA, *supra* note 35.

[162] *See* ZHONG HUA RENMIN GONGHEGUO ZHONGCAIFA, *supra* note 59.

C. Judicial Application of the Public Policy Exception in China

In China, the enforcement of arbitration agreements and arbitral awards is governed by the Chinese Arbitration Law, the Code of Civil Procedure and the New York Convention.

a. Enforcement of Arbitration Agreements

According to Chinese Arbitration Law, an arbitration agreement shall be void if the agreed matters for arbitration exceed the range of arbitration matters as specified by law. In contrast to its United States counterpart, the Chinese law on arbitrablility is based upon express provisions of law. Article 2 and Article 3 of the Chinese Arbitration Law explicitly deal with the problem of arbitrability. Article 2 provide that contractual disputes and other disputes over rights and interests in property between citizens, legal persons and other organizations that are equal subjects may be arbitrated.[163] Article 3 specifies some disputes that may not be arbitrated. Those disputes include marital disputes, adoption, guardianship, support, succession disputes and administrative disputes that laws require to be handled by administrative authorities.[164] The language in Article 2 is similar to that of Article 2 of the General Principles of Civil Law (GPCL), which defines the subject matters regulated by GPCL.[165] Article 2 of GPCL provides that GPCL regulates property and personal relationships between citizens, legal persons and other organizations that are equal subjects. The only difference between those two Articles is that Article 2 of Chinese Arbitration Law does not refer to personal relationships. In fact, Article 3 provides that some personal relationships are not arbitrable.[166] Most Chinese legal scholars believe that personal relationships could not be arbitrated because of public

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[163] *Id*, Article 2.
[164] *Id,* Article 3.
[165] *See* ZHONG HUA RENMIN GONGHEGUO MINFA TONGZE (General Principles of Civil Law of the People' s Republic of China) (Adopted at the 4th Session of the Standing Committee of the 6th National People' s Congress of the People' s Republic of China.), Article 2.
[166] *See* ZHONG HUA RENMIN GONGHEGUO ZHONGCAIFA, *supra* note 59, Article 3.

policy consideration.[167] Nevertheless, the language in Article 2 is quite abstract so that any business dispute can be arbitrated if it does not fall into Article 3. In fact, special laws, which are designed to regulate a particular area of the Chinese economy, generally provide for arbitration as the means of alternative dispute resolution. For example, Article 79 of Provisional Regulation on Issue and Purchase of Stocks provides that any dispute arising from issue or purchase of stocks can be referred to arbitration. The similar provision can also be found in Copyright Law and Technology Contract Law, which had been deemed non-arbitrable under the American law. In China, so many subject matters can be arbitrated that the court rarely resorts to public policy in deciding whether subject matters can be arbitrated.

However, in a recent case, Shanghai Far East Aero-Technology Import & Export Corporation (SFAIC) v. Revpower Limited,[168] the Shanghai Intermediate People's Court assumed jurisdiction over the dispute in spite of the arbitration agreement between the parties. The case involved a contract under which SFAIC and Revpower cooperated to produce industrial batteries in Shanghai. The contract contained an arbitration clause providing that the Arbitration Institute of the Stockholm Chamber of Commerce would arbitrate all disputes arising from the contract. When SFAIC breached the contract, Revpower brought the dispute to arbitration in accordance with the contract. At first, SFAIC participated in the arbitration and submitted its defense and counterclaims. However, before the tribunal rendered its award, SFAIC withdrew from the arbitration and initiated court proceeding before Shanghai Intermediate People's Court. Shanghai Intermediate People's Court assumed jurisdiction over the same dispute and said that, since the dispute involved fraud, allowing arbitration was contrary to Chinese public

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[167] *See* ZHAO XIUWEN, *supra* note 53, at 168.
[168] *See* ZHAO XIUWEN, XIANGGANG DE ZHONGCAI ZHIDU (The Arbitral System of Hong Kong) (1997), at 296.

policy.[169] Finally, the tribunal rendered an award against SFAIC for $6 million plus interest. When Revpower sought enforcement of the award before the Shanghai Intermediate People's Court, the court refused to dismiss SFAIC' s claims. However, under the pressures from Supreme People's Court and various American governmental agencies, Shanghai Intermediate People's Court finally dismissed the case and admitted the finality of the arbitral award. In this case, the legal issue was quite simple. If the fraud occurred during the contractual negotiation, it may have affected the validity of the arbitration agreement. If the fraud occurred in the performance of the contract, the dispute was still within the scope of an ordinary business dispute, which could be arbitrated under Chinese law. There were no violations of Chinese public policy in any way. Nevertheless, the Shanghai Intermediate People's Court spent almost two years on this case. The Revpower case has caused some negative effects on international commercial arbitration in China. Revpower had appealed to the Trade Representative of the United States requiring the United States to impede China from participating in the WTO, because the Chinese government failed to undertake its obligations under the New York Convention.[170] Obviously, if Chinese courts arbitrarily invoked public policy to vacate arbitration agreements, foreign investors would lose their confidence in the Chinese arbitration system.

b. Enforcement of Foreign Arbitral Awards

Prior to enactment of the Chinese Arbitration Law, the application of the New York Convention in appropriate cases was required under Article 260 of the Code of Civil Procedure. Article 260 authorized the People's Court to refuse enforcement of a foreign aribtral award if the party furnished evidence that:

(1) There was no arbitration clause in the contract or the parties did not reach an arbitration agreement after a dispute arose;

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[169] *Id*, at 309.

(2) The parties against whom the award was invoked were not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or were otherwise unable to present his case not for his own reason;

(3) The composition of the arbitral tribunal or the arbitral procedure was not in accordance with the arbitration rules selected by the parties;

(4) The award dealt with a difference not failing within the scope of the arbitration agreement, or it contained decisions on matters that could not be arbitrated under the law.

Moreover, if the People's Court determined that the enforcement of the foreign arbitral award was contrary to the public interest of the People's Republic of China, the enforcement should be refused.[171]

Article 260 of the Code of Civil Procedure closely resembles Article V of the New York Convention. Both recognize public policy as a defense against enforcement of foreign arbitral awards.

However, it is confusing that the Chinese Arbitration Law does not contain the public policy exception to block enforcement of foreign arbitral awards. Article 70 and Article 71 of the Chinese Arbitration Law provide that the People's Court can set aside or refuse to enforce a foreign arbitral award if the party proves that:

(1) The parties neither included an arbitration clause in their contract nor subsequently concluded a written arbitration agreement;

(2) The party against whom the enforcement is sought was not notified to appoint an arbitrator or to take part in the arbitration proceedings or the party against whom the enforcement is sought was unable to state his opinions due to reasons for which he is not responsible;

(3) The formation of the arbitration tribunal or the arbitration procedure was not in conformity with the rules of arbitration; or

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[170] *Id.*

(4) The matters decided in the award exceed the scope of the arbitration agreement or are beyond the authority of the arbitration institution.

Since the Chinese Arbitration Law was enacted after the Code of Civil Procedure, it should preempt relevant provisions in the Code of Civil Procedure.[172] However, Chinese Arbitration Law does not provide for the public policy exception, would it still be an available defense for the party who opposes the enforcement of a foreign arbitral award? According to Article 142 of GPCL,[173] if there is a discrepancy between Chinese law and the international treaty to which China is a party, the treaty shall be applied. Since China is a signatory to the New York Convention which recognizes the public policy exception, the generally accepted answer is that under the New York Convention the public policy exception is available for the party who opposes enforcement of foreign arbitral awards in China.

Public policy is an ambiguous concept and its application depends on judicial interpretation. Lack of reported cases makes it difficult to systematically analyze how Chinese courts apply public policy exception in practice. Nevertheless, in a few reported cases, the results are quite frustrating. In those cases, Chinese courts construed Chinese public policy broadly and sometimes incorrectly invoked the public policy exception to block enforcement of foreign arbitral awards.

In Bailing (Hong Kong) Ltd. v. Zhanjiang Yancheng Industrial Ltd Co.,[174] the Shenzhen Intermediate People's Court refused to enforce a foreign arbitral award on the ground of a public policy violation. The case involved a joint venture contract between Yancheng and Bailing. After a dispute arose, Bailing initiated arbitration before the China

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[171] *See* ZHONGHUA RENMIN GONGHEGUO MINSHI SUSONGFA, *supra* note 35, Article 260

[172] In China, if there are contradict provisions between two laws, the law, which is enacted lately, should preempt the previous law. However, the condition is that both law at the same level (the laws have been divided into three levels: constitution, basic law and local law).

[173] *See* ZHONGHUA RENMIN GONGHEGUO MINFA TONGZE, *supra* note 165, Article 142

[174] *See* GUO XIAOWEN & XIAO ZHIMING, ZHONGGUO GUOJI JINGJI MAOYI ZHONGCAI WEIYUANHUI SHENZHENFENHUI ANLIXUANBIAN (Selected Arbitration Cases of China

International Economic and Trade Arbitration Commission Shenzhen Sub-Commission (CIETAC). Since the case involved an enormous amount of money, the arbitration fee should have been about $214040 according to the arbitration rule. However, Bailing was in serious financial trouble at that time and was unable to pay such an amount of money. Upon request of Bailing, the Secretariat of CIETAC agreed to reduce the arbitration fee to $180000. The tribunal rendered an award against Yancheng, and thereafter Bailing instituted a court proceeding before the Shenzhen Intermediate People's Court seeking enforcement of the award. However, the court said that Article 76 of the Chinese Arbitration Law required parties to pay arbitration fees required by regulations. It violated mandatory provision of the Chinese Arbitration Law that Bailing did not pay the full arbitration fees, so enforcement of the award would be contrary to public interest of China.[175] The court erred in two ways in reaching the holding. First, it did not analyze whether Article 76 was a mandatory provision. Second, even if Article 76 was a mandatory provision, the court would still have to analyze whether Article 76 was designed to protect general interest of society. Only if both of those conditions were satisfied, could the court consider to refuse to enforce the award on the ground of public policy violation. The court's holding in Yancheng has been criticized by most Chinese legal scholars and practitioners.[176] It has been thought of as a result of interference from local government. Since Yancheng was the biggest local state-owned enterprise, and it would have faced bankruptcy if the arbitral award had been enforced. In order to protect the local interest, local government imposed great pressures on the court, and finally, the court made "a policy decision."[177]

International Economic and Trade Arbitration Commission Shenzhen Sub-Commission) (1995), at 209.
[175] *Id.*
[176] *See* CHENG AN, GUOJI JINGJI MAOYIFA WENXUAN (Selected Articles on International Trade Law) (1996), at 109.
[177] *Id.*

In another case, Ju Ren (Hong Kong) Ltd Corp. v. Haizhongbao Ltd Corp.,[178] the Shenzhen Intermediate People's Court refused to enforce a foreign arbitral award on the grounds of a public policy violation. The case involved a purchase contract between Haizhongbao and Ju Ren. Under the contract, Haizhongbao agreed to sell Ju Ren thirty tons of yellow-fin tuna. After Haizhongbao delivered the first ten tons of yellow-fin tunas, Ju Ren found the tuna delivered did not meet the standard of quality provided by the contract. Ju Ren refused to accept the remaining twenty tons of yellow-fin tuna. Haizhongbao commenced arbitration before CIETAC. At the same time, in order to collect evidence for the arbitration, Haizhongbao applied for interim relief before Guangzhou Intermediate People's Court, seeking sequestration of one sample tuna from the delivered tuna. Ju Ren participated in arbitration and raised counterclaims. After the first hearing, the tribunal issued a procedural award, and decided to retain an expert to appraise whether the sample tuna sequestrated by Guangzhou Intermediate People's Court met the quality requirement under the contract. Thereafter, Ju Ren itself also submitted one tuna to tribunal and claimed that it was the same as those already delivered. The expert issued two reports. The first report was based on the sample tuna sequestrated by the Guangzhou Intermediate People's Court, the second report was based on the tuna submitted by Ju Ren. However, the results of two reports were same. Relying on both reports, the tribunal rendered an award against Haizhongbao. Then Ju Ren sought enforcement of the award before the Shenzhen Intermediate People's Court. The court refused to enforce the award on the ground of public policy exception. The court said the procedural award only required appraisal of the sample tuna sequestrated by the Guangzhou Intermediate People's Court. Therefore, it infringed Haizhongbao's procedural right where the tribunal accepted the second report. The court held that enforcement would violate Chinese public policy. In its holding, the court did not explain

[178] See GUO XIAOWEN & XIAO ZHIMING, *supra* note 174, at 238.

what kinds of procedural rights under Chinese laws had been infringed and whether the infringement constituted a violation of public policy if it existed.

Noticing problems arising from capricious use of the public policy exception by local courts, China has established an internal system by which enforcement actions involving foreign arbitral awards are monitored. In its Notice on Handling Awards Involving Foreign Interest and Foreign Arbitral Awards, issued in August 1995, the Supreme People's Court required any People's Court to first receive approval from the superior people's court in the same jurisdiction before refusing enforcement of a foreign arbitral award. Furthermore, any superior court that decides to uphold a People's Court refusal to enforce a foreign arbitral award must, in turn, report its decision to the Supreme People's Court prior to finalizing the decision to refuse enforcement.[179] To some extent, the Notice effectively prevents local courts from arbitrarily invoking public policy exception to vacate foreign arbitral awards. In 1997, of fifteen cases, ten were recognized and enforced, only four were denied for procedural irregularities as specified by the New York Convention. None of these decisions were based on the public policy exception.[180]

According to the text of the law, arbitration practice in China and the underlying spirit of the New York Convention, Chinese court should narrowly construed public policy exception.

First, China has traditionally distinguished international arbitration and domestic arbitration. In contrast to international arbitration, judicial review of domestic arbitration is more stringent. In domestic arbitration, the scope of judicial review includes not only the procedural matters but also the merits of the award. For example, under Article 58 and Article 63 of the Chinese Arbitration Law, the court may set aside or refuse to enforce a domestic arbitral award if it finds that the main evidence for ascertaining the

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[179] *See* ZUIGAO REMMIN FAYUAN GUANYU CHULI SHEWAI ZHONGCAICAIJUE DE TONGZHI (Notice On Handling Awards Involving Foreign Interest and Foreign Arbitral Awards).

[180] *See* ZHONGGUO GUOJISHANGHUI ZHONGCAI YANJIU ZHONGXIN NIANBAO (Yearbook of

facts is insufficient, or the application of law was truly incorrect.[181] However, under Article 70, which governs enforcement of foreign arbitral awards, it is generally accepted that the judicial review of foreign arbitral awards should be limited to procedural matters. Thus, the Chinese Arbitration Law itself indicates that a more flexible standard should be adopted in international commercial arbitration.

Second, Article 268 of the Code of Civil Procedure provides that a foreign judgment is not enforceable if it violates basic principles of Chinese law or sovereignty, national security or public interest. The concept of public interest has been used in contrast to the concept of basic principles of Chinese law. Thus, it seems that the scope of the two concepts are not identical and public interest may be more narrow than basic principles of Chinese law.[182] However, even if China stated that the foreign arbitral awards must not violate basic principles of Chinese laws, a narrow reading of the public policy exception should still apply since not every violation of specific provisions of law constitutes a violation of the basic principles of Chinese law.[183]

Third, since China acceded to the New York Convention, the Convention itself has become the source of law in China. When the court is called on to enforce a foreign arbitral award, it must consider the underlying spirit of the New York Convention.

Fourth, the impetus for China to join the New York Convention was to facilitate its foreign trade. However, as one commentator has said that if the Chinese government hopes to increase investor confidence it is important that the public policy exception is "not too broadly defined."[184]

However, there are still two problems in the present Chinese legal regime for enforcement of foreign arbitral awards that must be resolved by Chinese legislators.

China International Chamber of Commerce Arbitration Research Institute) (1998).

[181] *See* ZHONGHUA RENMIN GONGHEGUO ZHONGCAIFA, *supra* note 59, Article 58, Article 63

[182] *See* ZHAO XIUWEN, *supra* note 168.

[183] *Id.*

[184] *See* Bruce R. Schulberg, *China' s Accession to the New York Convention: An Analysis of the Regime of*

First, the courts must be prevented from refusing enforcement of a foreign arbitral award only because of protecting local interests. As in the Bailing,[185] when the courts can not find other reasons specified by the laws, they usually resort to the public policy exception as the last recourse if the enforcement will jeopardize the local interests. Although the 1995 Notice has, to some extent, foreclosed arbitrarily invoking the public policy exception by local courts, it is merely an internal notice and not a law.[186] Strictly speaking, it is not legally binding on junior courts.

Second, if the court refuse to enforce the arbitral award, the decision is final and can not be appealed. Since in China only Intermediate People's Courts have jurisdiction over the disputes involving enforcement of foreign arbitral awards, the senior courts, including the Supreme People's Court, are in fact foreclosed from interpreting public policy issues. It will impede China from developing a uniform and consistent application of the public policy exception in judicial practice.

D. Judicial Application of Public Policy Exception in Hong Kong

In 1997, China resumed sovereignty over Hong Kong and adopted the policy of "one country, two systems". As for its legal system, Hong Kong maintains a common law tradition. Prior to 1997, in Hong Kong, enforcement of arbitral awards created in other jurisdictions, including the Mainland, was governed by the New York Convention. After reunification, the New York Convention continues to apply to international arbitral awards. However, the New York Convention is an international agreement, and it no longer applies to the enforcement of arbitral awards between the Mainland and Hong Kong. In August 1999, the Mainland and Hong Kong reached an agreement to set up a new enforcement mechanism. Under the new arrangement, the court shall adopt the same standards as Article V of the New York Convention to review arbitral awards made in the

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Recognition *and Enforcement of Foreign Arbitral Awards*, 3 J. Chinese L. 117, 142.

[185] *See* GUO XIAOWEN & XIAO ZHIMING, *supra* note 174.

[186] *See* ZUIGAO REMMIN FAYUAN GUANYU CHULI SHEWAI ZHONGCAICAIJUE DE TONGZHI,

Mainland or Hong Kong. Moreover, the new arrangement also contains the public policy exception. The enforcement of the award may be refused if the court in the Mainland holds that the enforcement is contrary to the public interests of the Mainland. Likewise, if a court in Hong Kong rules that the enforcement is contrary to the public policy of Hong Kong.

Like other common law countries, the courts in Hong Kong narrowly read the public policy exception. In Paklito Investment Ltd. v. Klockner East Asia Ltd., the court refused to enforce a CIETAC arbitral award.[187] The tribunal rendered an award based on an expert report. However, the tribunal did not give the parties an opportunity to examine the report. The court held that the procedural irregularities were so serious that enforcement should be refused. Concerning Klockner's public policy defense, the court said if the defendant could not prove that he was absolutely unable to present his case, the court would not consider public policy issues. After citing Parsons,[188] the court further stated that the public policy defense should be narrowly construed. Finally, the court said that the case did not involve public policy issues.

In another case, Zhejiang Province Garment Import and Export Co. v. Siemssen & Co (Hong Kong) Trading Ltd.,[189] the court rejected the defendant's public policy defense. The case involved enforcement of a CIETAC arbitral award that required the defendant to compensate the plaintiff for a certain amount of tariff paid to Chinese customs by plaintiff. The defendant contended that enforcement of the award was contrary to the public policy of Hong Kong since it was equal to requiring the defendant to pay taxes to a foreign country. The court noted that a part of the tariff could be refunded from Chinese customs if the defendant performed its obligation under the contract. Since the defendant

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supra note 179.

[187] *See* ZHAO XIU WEN, *supra* note 168, at 337.

[188] *See* Parsons & Whittemore Overseas Co., Inc. v. Societe Generale De L' Industrie du Papier (RAKTA), *supra* note 26.

[189] *Id*, at 235.

totally repudiated his contractual obligation, the plaintiff could not collect the money from Chinese customs. The purpose of the award was to require the defendant to compensate the plaintiff' s loss. So, it did not concern public policy issues.

From 1989 to 1994, about sixty cases involved enforcement of CIETAC arbital awards in Hong Kong, and except for Paklito, all have been enforced by the courts.[190]

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[190] *See* TAO CHUNMING & WANG SHENGCHANG, ZHONGGUO GUOJI JINGJI MAOYI ZHONGCAI-CHENGXU LILUN YU SHIWU (China International Economic and Trade Arbitration-Procedural Theory and Practice) (1996), at 84-85.

CHAPTER VI

CONCLUSION-THE POSSIBILITY OF REMOVING THE PUBLIC POLICY DEFENSE FROM INTERNATIONAL COMMERCIAL ARBITRATION

Until now, the public policy exception has not been a major obstacle to the development of international commercial arbitration. However, the risks of the public policy exception are self-evident. The flexible interpretation of the concept has been deemed as an invitation to legal anarchy. In fact, every country could pursue its own policies and disregard the notion of community interests or the interests of other countries.[191] This flexibility jeopardizes the effectiveness of international commercial arbitration as a means of alternative dispute resolution. At least one commentator has suggested removing the public policy exception from the New York Convention,[192] leaving the party who believes the award is unjust to invoke the remaining provisions of the New York Convention. The losing party could also ask for the award to be set aside in the country where it was rendered. However, it must be noted that the purpose of the public policy exception is not only to maintain fairness of arbitration but also to provide for a means by which individual nations can protect the integrity of their national legal systems. That is why the New York Convention authorizes the national court to invoke the public policy exception on its own motion. It has been stated that no country will risk opening its legal system to foreign or private jurisdictions.[193] If this notion is still upheld by most countries, and enforcement of arbitration agreements or arbitral awards is still

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[191] *See* H. STEINER & D. VAGTS, TRANSNATIONAL LEGAL PROBLEMS (3d ed, 1986), at 350.
[192] *See* Kristin T. Roy, *The New York Convention and Saudi Arabia: Can a Country use the Public Policy Defense to Refuse enforcement of Non-domestic Arbitral Awards?* 18 Fordham Int' 1 L. J. 920, 954.
[193] *See* Bodenheimer, *The Public Policy Exception in Private International Law: A Reappraisal in the Light of Legal Philosophy*, 12 SEMINAR 51, 64 (1954).

dependent on national courts, it seems that it is not the time to remove the public policy exception from the New York Convention.

Generally speaking, the public policy exception may cause two major problems in international commercial arbitration: jeopardizing the finality of arbitral awards and uniformity of judicial review by national courts.

First, under what circumstances can national courts invoke the public policy exception to vacate arbitration agreements and arbitral awards? In contrast to other defenses under Article V of the New York Convention, only the public policy exception is dependent on judicial interpretation of national courts. If national courts read the public policy exception broadly when called on to enforce arbitration agreements or arbitral awards, it will jeopardize the finality of arbitral awards. Most countries, like the United States, limit application of the public policy exception to extreme cases, where enforcement will be contrary to the basic notions of morality and justice of the forum. Thus, to some extent, the finality of the award can be assured.

Second, even though most countries narrowly read the public policy exception or recognize international public policy, the problem of uniformity still exists since international public policy belongs to the domestic legal regime, and may has different scope in different countries. Thus, some legal scholars advocate the concept of transnational public policy, which can unify the standards of national judicial review at the international level.[194] The tendency to narrowly read the public policy exception provides a favorable circumstance under which a truly transnational public policy could develop. Once a transnational public policy has been formed, the public policy exception will no longer be an uncertained factor in international arbitration.

However, recent trends in international commercial arbitration, such as the delocalization movement, may cause some trouble in the future. Delocalization generally

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[194] *See* Kenneth-Michael Curtin, *supra* note 29.

refers to "the emerging state practice of lifting domestic restrains to purely international arbitration."[195] Under the delocalized approach to international commercial arbitration, the laws of the nation where the award is rendered should not interfere with the process by allowing judicial review of either the arbitration agreement or award. For example, in Belgium, the law forbids judicial intervention in international arbitration that occurred in Belgium no matter how the arbitration was conducted.[196] So, the losing party has no recourse until the award is moved to the enforcement stage. Professor Park has observed that the trend is to shift the control function from the arbitral situs to the execution forum.[197] However, when the laws of the nation where arbitration occurred loosen control on international arbitration, what are the reactions of the enforcing nation? The enforcing nation would most likely resort to the public policy exception to prevent unfairness and return to a hostile relationship with arbitration.

Moreover, coupled with this delocalization movement, more and more countries allow international arbitrators to decide on public-law issues. In the United States, the non-arbitrability defense is almost unavailable for the parties. Professor Carbonneau has stated, "The widening of arbitration's mission in international commerce to include regulatory law conflicts is a hazardous enterprise."[198] In fact, as more public law issues are deemed arbitrable, national courts are more likely to interfere with arbitration on the grounds of public policy violations. As the court in Mitsubishi warned, if arbitrators incorrectly apply American antitrust law, the court will invoke public policy exception to vacate the resulting award. Therefore, "judicial review of the contents of awards, at least

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[195] *See* Jay R. Sever, *supra* note 25, at 1687.
[196] *See* Law of March 27, 1985 (Belg.), enacting CODE JUDICIARE art. 1717.
[197] *See* William W. Park, supra note 91, at 684.
[198] *See* T. CARBONNEAU, LEX MERCATORIA AND ARBITRATION: A DISCUSSION OF THE NEW LAW MERCHANT 1 n. 1 (1990), at 19.

for their conformity with public policy, is the cost for letting the statutory claims go to arbitration."[199]

Professor Enterria has proposed to introduce interest analysis into international commercial arbitration to limit the application of the public policy exception.[200] The basic idea is that the national court may invoke the public policy exception only when there is a strong relationship between the forum and the underlying transaction.[201] However, interest analysis has limited functions in international arbitration. Since the party usually seeks enforcement of an award in a country where the losing party has assets, the presence of assets is sufficient to establish a connection between the transaction and the forum. Thus, it seems that generating a truly transnational public policy is the best way to deal with the problems caused by the public policy exception in international commercial arbitration. Given time, international society may accept a well-defined transnational public policy which will make international arbitration more effective and more predictable. However, since every country's legal system differs, it may take a long time to develop internationally accepted and fundamental principles of public policy.

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[199] *See* William W. Park, *supra* note 91.
[200] *See* Enterria, supra note 2, at 406.
[201] *Id.*

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