

Public Policy as a Ground for Refusal of Recognition and Enforcement of Arbitral Awards with Special Focus on Georgia

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Abstract

Enforceability of domestic and foreign arbitral awards offers comparable advantages to parties which would otherwise are not available to them through litigation in the court system. Such a certain and efficient means of resolving dispute is brought under question when recognition and enforcement is refused for some narrow grounds. Violation of public policy proves to be one of the most pervasive and vague ground as far as its practical application leads to diverse outcomes differing from county to country. The objective of the thesis is to analyze international as well as Georgian approaches and practices, to establish clear notion of public policy and specific concepts for its application in the light of current Georgian legislation and case-law, as well as provide comparative analysis of respective countries' practices. This paper will address the necessity for a restrictive interpretation of public policy ground. To conclude, I provide evaluation and suggest recommendations for Georgia on the application of of public policy as a ground for refusing the recognition and enforcement of domestic and foreign arbitral awards. As a result, the paper will serve pro-enforcement policy while coming up with the consistent applicability of public policy ground.

To Ano Togonidze

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LIST OF ABBREVIATIONS:

ADR	Alternative Dispute Resolution
Art.	Article
Co.	Company
Com.	Commercial
Ed.	Editor/Edition
Eds.	Editors
F. Supp.	Federal Supplement
IBA	International Bar Association
ILA	International Law Association
ILA Final Report	International Law Association, Final Report on Public Policy, New Delhi Conference (2002) Committee on International Commercial Arbitration.
ILA Interim Report	ILA Interim Report on Public Policy as a Bar to Enforcement of International Arbitral Awards, London Conference, (2000).
ILA Resoluion 2/2002	International Law Association Resolution 2/2002, International Commercial Arbitration, Annex - Recommendation on the Application of Public Policy as a Ground for Refusing Recognition or Enforcement of International Arbitral Awards
L.N.T.S.	League of Nations Treaty Series
NY	New York
NY Convention	United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards
Para.	Paragraph
SAC Russia	Presidium of the Supreme Arbitrazh Court of Russia
UNCITRAL	United Nations Commission on International Trade Law
U.N.T.S.	United Nations Treaty Series
US	United States of America
Vol.	Volume
Y.B.	Yearbook

Introduction

International economic cooperation is inextricably linked and dependent upon the evolution of business arbitration. Arbitration of business disputes proves to be twofold beneficial, fostering the national welfare as well as serving for the shared interests of the international commercial community.¹ As one of the effective and reliable methods of ADR, arbitration offers certain degree of flexibility and high level of party participation. “The great paradox of arbitration is that it seeks cooperation of very public authorities from which it wants to free itself”.² Therefore, the efficacy of arbitration as rights-based procedure can be undermined with the refusal for recognition and enforcement of the arbitral award. It was the goal of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards³ “to better meet the needs of the international business community with a mechanism that promotes the worldwide effectiveness of international arbitration”⁴ and “to lay a foundation for the uniform application of the courts around the world”.⁵ Despite carrying pro-recognition and pro-enforcement posture, NY Convention Art. V para. 1 names five grounds constituting deficiency of an award with the burden of proof on the contesting party and two conditions out of which the first deals with arbitrability of an award while the second one addresses the issue of the violation of public policy under the para 2.

Under the NY Convention Art. V (2) (b), recognition and enforcement of an arbitral award may be refused if the recognition or enforcement of the award would be contrary to the forum’s public policy. The more clear-cut this provision sounds for the theoretical purposes the more

¹ William W. Park, *Arbitration of International Business Disputes, Studies in Law and Practice*, (New York: Oxford University Press, 2006), 4.

² Jan Paulsson, *The Idea of Arbitration*, (United Kingdom: Oxford University Press, 2013), 30

³ United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention of 1958), [hereinafter referred as NY Convention], Jun. 10, 1958, 330 U.N.T.S. 38

⁴ C.H.Beck, Hart, Nomos, Dr. Reinmar Wolff (ed.), *New York Convention: Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 10 June, 1958 Commentary*, (US and Canada: Hart Publishing, 2012), 29

⁵ *Ibid.*, 30

fluid becomes its concept when applied in practice. The issue is troublesome as far as public policy is the category that can not be stereotyped, therefore its precedent application is of no force for the court interpretation which primarily strives for uniformity (1),⁶ its concept differs from country to country and alters on a case-by-case basis (2), the scope of application is often unjustifiably either narrowed down or expanded, depending on the pro or anti-enforcement needs (3).

“Public policy is a very unruly horse and when once you get astride it you never know where it will carry you”⁷ and Georgia is not an exception where the introduction of this notion brought controversy. In 1997 Georgia adopted the “Law on the Private Arbitration”⁸ which was the first official piece of legislation recognizing this particular institute of ADR. After the collapse of the Soviet Union, the need for alternative ways of dispute resolution (apart from the common courts system) increased as far as already existing so called “Soviet Arbitration Courts” presented political institutes whilst ignoring one of main features of the commercial arbitration – party autonomy. Article 43 of the above mentioned law defined three major conditions when the court was authorized to change the arbitral decision, none of which specified “public policy” as a ground for refusal of recognition and enforcement of arbitral award.

The concept of “public policy” for the purposes of arbitration proceeding was firstly introduced by the “Law of Georgia on Arbitration” in 2009 which came into force on January 1, 2010.⁹

According to the Explanatory Note¹⁰ as to the draft Law of Georgia on Arbitration was based on

⁶ Dirk Otto, Omaia Elwan, *NY Convention Art 5.1. – (2); Commentary on Article 5(1)(2), in Recognition and Enforcement of Foreign Arbitral Awards: A Global Commentary on the New York Convention* (Herbert Kronke, Patricia Nacimiento, Dirk Otto & Nicola C. Port eds.), (Netherlands: Kluwer Law International, 2010) 367.

⁷ *Burrough, J., Richardson v Mellish* 2 Bing. 252 (1824); quoted by Lord Bramwell in *Mogul Steamship Company Ltd. v McGregor, Gow and others*, 66 L. T. Rep. 6 (1892).

⁸ Law of Georgia on Private Arbitration, Doc. No. 656, Parliament of Georgia, 17/04/1997-01/01/2010. Parliamentary Gazette, 17-18, 05/05/1997, LEPL Legislative Herald of Georgia (Ministry of Justice).

⁹ Law of Georgia on Arbitration, Doc. No. 1280, Parliament of Georgia, 19/06/2009, Actuate Date: 01/01/2010. LHG, 13, 02/07/2009, LEPL Legislative Herald of Georgia (Ministry of Justice).

¹⁰ *Explanatory Note for the Draft Law on Arbitration*, Project No. 07-6/336. Ministry of Justice of Georgia, Date of submission to Parliament: 30.08.05; Committee hearings: 20.23.09; Discussion Date: 27.30.09.

the UNCITRAL Model Law,¹¹ which in the art. 45 establishes the grounds for refusing recognition or enforcement of arbitral awards, including the case when the court finds that the recognition or enforcement would be contrary to the public order of a state as noted in para. 1. (b) b.b of the previously referred article. Law of Georgia on Arbitration corresponds to the NY Convention, which came into force by the Resolution of Parliament of Georgia February 3, 1994. Contrary to the former legislation, Law of Georgia on Arbitration exhaustively defines grounds for refusal of recognition and enforcement of arbitral award, including the ground of public order. It is of relevance to note that NY Convention and UNCITRAL Model Law name “public policy” as a ground for refusal, while the Law of Georgia on Arbitration refers to the concept of “public order”. Although, reflecting on the Model Law and NY Convention can be assessed as a step-forward for Georgia, there is a certain degree of concern whether uniform laws lead to uniform applicability of this concept.

There are several factors that fuelled an effort to conduct a research on this particular issue. Arbitration as an institution is still “fearful” concept for Georgia. Although introduced 7 years ago, it still has not gained substantial trust from the commercial counterparts. In this regard, courts are found to be more trustworthy means of dispute resolution due to the state-element, as elusive as it may seem on the surface. Although, since the introduction of the Law of Georgia on Arbitration, the trend is upright as far as former legislation was improved and embraced internationally accepted standards. Since the Rose Revolution in November, 2003 there is a gradual growth of foreign investments and commerce, accompanied with highly costly disputes. There is a crucial need that parties engaged in business choose more flexible and time-efficient way of dispute resolution. Secondly, cases before the year of 2010, thus before the introduction

¹¹ UN Commission on International Trade Law [hereinafter referred as UNCITRAL] Model Law on International Commercial Arbitration [A Proposal for National Legislation], comprising of *The 1985 Text of the UNCITRAL Model Law on International Commercial Arbitration and The 2006 Amendments to the UNCITRAL Model Law on International Commercial Arbitration*. UN General Assembly Resolution 61/33 of Dec. 4, 2006, online at <http://www.uncitral.org/pdf/english/clout/MAL-digest-2012-e.pdf> (visited on Mar. 2, 2014)

of Law if Georgia on Arbitration do not the define public policy. However, there is a threat that cases after the introduction of notion of public order may be interpreted inconsistently, which undermines the uniformity of the concept. There are only a limited number of local authors who addressed this issue, because it had been relatively newly applied in practice. It is extremely beneficial to observe court practices from the very initial stages in order to define the direction of the interpretation of the ground and access whether it deviates from the internationally accepted standards. Lastly, to choose public policy and judicial review as the major topic of the thesis is conditioned by the sensitivity of the issue and constant concern expressed over its interaction and application by the international legal community. The combination of these general and specific factors led to address unexplored field of the interaction between Georgian Courts and commercial arbitration and to identify country-specific application of the controversial public policy ground.

From the legal practitioner's perspective, the sensitivity of the issue stems from the institutional interaction between the arbitration and common courts system. While avoiding traditional adjudicative process and consequently refusing to utilize the right to recourse to the common courts system, parties to an arbitration agreement avail themselves with the right to choose arbitrators, the possibility that the decision will be made by arbitral tribunal and rely on the enforcement of the award. When addressing the review by the courts it is initially noticeable that such a review impairs party autonomy which on the other hand proves to be the cornerstone of arbitration. It is the will of the parties to knowingly and voluntarily head to arbitration as far as they are determined not to apply legal rules to the particular dispute. "We should not make arbitration into a parallel system of litigation".¹² Such a depreciation of the party autonomy partly devaluates arbitration as an institution. Since parties already put preference on private arrangement with private arbitral tribunal would not it be unfair and conceptually contrary to the

¹² Paul F. Kirgis, *The Contractarian Model of Arbitration and its Implications for Judicial Review of Arbitral Awards*, *Legal Studies Research Paper Series*, Paper # 06-0037, St. John's University, School of Law, NY, February, 2006, 7.

parties' free will when they decisively chose arbitration over court proceedings? The questions which naturally arise are how "alternatively" is then dispute resolved and how much it differs from the traditional adjudicative process.

Examining from the contrary position, the fact of being private process does not exclude the possibility that arbitration results in having public effect, which can be reasonable argument why the award which is already binding decision on the dispute is subject to recognition and enforcement procedure by the courts. In addition to the standpoint of reasonability, control over the arbitral award can even be necessary to ensure fairness of decision-making authority. Ultimate goal of the arbitral tribunal is the resolution of dispute in a fair and principled manner, which is dramatically different with the objective of upholding contract at all costs.¹³

Taking into account the finality of arbitral award and judicial review by the courts should be viewed as complementing procedures rather than competitive concepts. Although, in order to avoid possible clashes and discrepancies this clearly requires limited and restricted application of public policy.

Primary objective of this paper is to examine basic concepts and issues regarding the public policy under the NY Convention, to present short survey of basic issues, to define the notion of public policy in Georgia and its scope of application in arbitration, to discuss the case law by the courts of Georgia and establish general standard of review, to assess the main discrepancies leading to unpredictable application of the concept and elaborate recommendations for Georgia in order to eradicate judicial inconsistency. Secondary objective of this paper is to provide brief comparative analysis of the same issue from other countries, specifically experiences from post-soviet ones. Going beyond the current picture, after the Soviet-era predictability, introduction of arbitration brought doubts. On the other hand, this fostered simultaneous development of the

¹³ Jan Paulsson, *The Idea of Arbitration*, (United Kingdom: Oxford University Press, 2013), 99.

institution which can be helpful for general projections as to the evolution of arbitration in Georgia. For this purpose, thesis will reflect upon current practices and review the issue in comparative perspective.

To introduce the structure, first chapter will provide profile on the basic concept and legislative framework of public policy in the enforcement proceeding, introduce notion, role, types, content of public policy, scope of judicial review, application of public policy on the domestic, international and supranational level and address “contrary to public policy” as a ground for refusal of enforcement or recognition under the NY Convention and UNCITRAL Model Law. Second chapter will analyze legal framework for public policy under the Georgian legislation, including general provisions as to the definition of public policy concept in Georgian legislation and application of public policy as a ground for refusing recognition and enforcement of arbitral awards under the Article 45 1 b (b.b.) of the Law of Georgia on Arbitration. Subsequent section will provide case law analysis for domestic and foreign arbitral awards through grouping, thoroughly examining and scrutinizing relevant cases from Appeal and Supreme courts. Third chapter will identify main findings of the research and elaborate recommendations for Georgia. Major hypothesis comprise of whether Georgian legislative framework reflects on the pro-enforcement spirit and meets standards of the NY Convention, whether public policy concept is interpreted broadly, departed from the factual background of the case or misapplied, meaning limited to the principles of law, whether court justification for refusal of recognition or enforcement is perfected in terms of domestic arbitral awards, whether recognition or enforcement of public policy is subject to domestic public policy standard and tentative scope of review.

Analytical and comparative framework of the research guarantees tackling this issue in a balanced way, providing reasonable solutions for Georgia as an economically upcoming country.

Chapter 1. Profile on the Basic Concept and Legislative Framework of Public Policy in the Enforcement Proceedings

Present chapter will provide short survey of basic issues in respect of public policy briefly addressing the notion, scope, types of public policy and will subsequently analyze legislative framework under the NY Convention art. V 2 (b) and under the UNCITRAL Model Law art I (b).

1.1 General concept of public policy and its types

1.1.1 Notion and role of public policy

The notion of public policy successfully defied all attempts to reach uniform definition and proves to be elusive concept.¹⁴ “Like a chameleon, it seems to be seriously influenced by its environment, surrounding circumstances, and the purposes for its use.”¹⁵ The role of public policy is firstly ascertained by the state which defines its concept as a matter of legitimacy. Although vagueness and illusiveness of the concept creates space for free interpretation, it serves far-reaching goal. Uniform interpretation of this concept would lead to undermining each state’s independent authority to legally define its own term resulting from domestic sovereignty. Apart from the general overview from the standpoint of a state, exercise of control by courts over the arbitration brings all the benefits of the latter proceeding under question. When discussing arbitration in relation with the court’s power to review, it becomes evident that two potentially conflicting positions are to be reconciled. Having control but at the same time striving for golden equilibrium is what makes refusal for public policy carrying some significant, but all too often non-obvious risk.

¹⁴ Kojo Yelpaala, *Restraining the Unruly Horse: The Use of Public Policy in Arbitration, Interstate and International Conflict of Laws in California*, (Vol 2, Transnat’l Law.: 1989), 379-380.

¹⁵ *Ibid.*, 381

Although Lord Denning stated that “with a good man in the saddle, the unruly horse can be kept in control”¹⁶, it still remains “a treacherous ground for legal decision”¹⁷ as well as “a very unstable and dangerous foundation on which to build until made safe by decision”.¹⁸ The doctrine of public policy is although being flexible is perceived to be paradoxical in its nature. The most perfect description is that it is helpful as a tool, but dangerous as a weapon.¹⁹ “It should operate only as a shield to the enforcement of foreign awards which bear unwanted (re-) solutions. However, it can also be a sword in the hands of controllers who want to limit the mobility or finality of international awards”.²⁰ Be it tool or weapon, the concept still remains double edged sword, especially because once permissible practice and interpretation may be utterly reversed and proscribed.²¹

The role of public policy was precisely defined by the Court of Appeal of Hamburg, which emphasized that apart from public interest, public policy infringement can include violation of basic civil rights, rules concerning fundamental principles of political and economic life, when arbitral award is incompatible with the concepts of justice of the forum state.²²

As it was recommended on the International Law Association, Committee on International Commercial Arbitration, whether interpreting anew or following precedent track the highest value for efficiency should be to balance between finality and justice.²³ While freeing arbitral

¹⁶ *Enderby Town Football Club Ltd v The Football Association Ltd* (1971) Chapter 591, per Lord Denning MR, 606.

¹⁷ *Janson v Driefontein Consolidated Mines Ltd* A.C. 484, (1902) 500.

¹⁸ *Ibid.*

¹⁹ Mistelis L., [248] International Law Association - London Conference (2000), Committee on International Commercial Arbitration, “*Keeping the Unruly Horse in Control*” or *Public Policy as a Bar to Enforcement of (foreign) Arbitral Awards*, International Law FORUM du droit International, Jan 1., 2000, 248.

²⁰ *Ibid.*

²¹ *Esso Petroleum Co. Ltd v Harper’s Garage (Sturport) Ltd* A.C. 269, (1968), 322-324.

²² Mauro Rubino-Sammartano, *International Arbitration, Law and Practice*, foreword by The right Hon. The Lord Mustill, 2 ed. (Hague, The Netherlands: Kluwer Law International, 2001), 503.

²³ International Law Association, *Final Report on Public Policy*, New Delhi Conference (2002) Committee on International Commercial Arbitration, Recommendation 1(a) “*the finality of awards rendered in the context of International Commercial Arbitration should be respected save in exceptional circumstances*”.

award from judicial control mechanisms promotes finality,²⁴ enhancing fairness calls for court supervision at certain extent. This concept evolve around the psychology of the winner and the looser as well. As a common practice, arbitration winner usually prefers finality, as far as it is in its best interest, while loser questions reasonableness of the decision and contests it by wanting judicial scrutiny.²⁵ For the research purposes, public policy will be analyzed as a weapon, and judicial review will be contemplated as a safety net guaranteeing that “arbitration will not be a lottery of erratic results”.²⁶

1.1.2 Public policy v *ordre public*

As terminological as it may sound, classification of notions public policy and *ordre public* lead to conceptual application of these terms by the states. In both cases, application usually reaches various national and international dimensions²⁷. Public policy in its legal sense proves to be a broader concept compared to *ordre public*. According to the ILA Recommendation on the Application of Public Policy as a Ground for Refusing Recognition or Enforcement of International Arbitral Awards,²⁸ Article 1(d) defines that public policy of any state includes:

“i) fundamental principles, pertaining Justice and morality, that the State wishes to protect even when it is not directly concerned ii) rules designed to serve the essential political, social or economic interests of the State, these being known as “*lois de police*”²⁹ or “public policy rules” and iii) the duty of the State to respect its obligations towards other States or international obligation”.

²⁴ However this is not true in all cases. For example, Belgium enacted “non-review” standard of awards in 1985. According to the *Belgian Code Judiciaire* Article 1717(4) (before amendment of May 19, 1998), eliminating all grounds to vacate awards which resulted in the counter-effect. See., W.W. Park, *Why Courts Review Arbitral Awards*, Festschrift fur Karl-Heinz Bockstiegel 595 (2001), 600.

²⁵ Park, *Arbitration*, 148.

²⁶ *Ibid.*, 151

²⁷ Matti S. Kurkela, Santtu Turunen, and Conflict Management Institute (COMI), *Due Process in International Commercial Arbitration*, 2nd Ed. (New York: Oxford University Press, 1951) 83.

²⁸ International Law Association, *Resolution 2/2002*, International Commercial Arbitration, Annex - *Recommendation on the Application of Public Policy as a Ground for Refusing Recognition or Enforcement of International Arbitral Awards*, Article 1(d)

²⁹ “*Lois de police* include things such as protecting weaker parties (employees, consumers etc) economic order (competition law, currency regulation) and prohibition of corruption. As, such, one can draw a close link between a domestic concept of public policy and the principles that can be derived from *the lois de police*”. John D.H. Wires, *The Public Policy Sword and the New York Convention: A Quest for Uniformity*, (January 4, 2009).

This is a subtle attempt to define conceptually the notion of public policy without interfering each state's autonomy to establish what is considered public policy as far as "there are as many shades of public policy as there are national attitudes towards arbitration".³⁰ Although defining conceptually does not exhaustively define the notion. Inherent ambiguity is conditioned by the fact that it is still the state who in case of willing so, may include the principles "when it is not directly concerned" (i), it is still the state who defines essentiality of the interests (ii) and once again public policy remains "the body of principles and rules recognized by a State" according to the article 1 (c) of ILA Recommendation.

ILA recommendations do not address *ordre public* separately, except the case when for the purposes of authenticity Interim Report³¹ utilized terms for synonymous meaning. Major difference is that continental lawyer speaks of *ordre public* where in the anglo-american law of conflict of laws the term public policy is used.³² Deriving from this practical difference, *ordre public* can still be viewed as something less and more restrictive compared to public policy. German Bundesgerichtshof (1990)³³ limited *ordre public* to "German idea of Justice in a fundamental way"³⁴ provided that "arbitral award contravenes a rule which is basic to public or commercial life."³⁵ Initially, according to the Ad Hoc Committee set up by the Economic and Social Council of the United Nations, provision made reference to awards and identified two conditions: "*clearly* incompatible with public policy or with the *fundamental* principles of law (*ordre public*) of the country in which the award is sought to be relied upon."³⁶ This initial difference distinctively discussed *ordre public* as fundamental principles of law, which was worth discharging. As it was explained by the drafting committee, such a formulation of the clause simply served the purpose to limit the application of the provision to the cases when the recognition or

³⁰ J. Lew, L. Mistelis, S. Kroll, *Comparative International Commercial Arbitration*, (Kluwer Law International, 2003), 720.

³¹ ILA *Interim Report on Public Policy as a Bar to Enforcement of International Arbitral Awards*, London Conference (2000).

³² Gerhart Husserl, *Public Policy and Ordre Public* 25 Va. L. Rev. 37 (1938-1939).

³³ BHG, 12 July 1990 – III ZR 174/89, NJW 1990, 3210.

³⁴ *Ibid.*

³⁵ *Ibid.*

³⁶ See., 1927 Geneva Convention Art. 1 (e).

enforcement was “distinctly contrary to the basic principles of the legal system of the country where the award is invoked.”³⁷ If this separation of *ordre public* from public policy was provoked solely for the amplification effect, then it would be justified to note that the former one does not expand the scope of latter one while it can be used in a more restrictive manner.

Moreover, it would be unreasonable to assume that *ordre public* expands public policy’s scope; even such an assumption leads to dire consequences. It would deteriorate already inherently vague term and make its application more abstract while loosing touch with the practically applicable laws as well as defeating a purpose for such a definition.

For the purposes of the research the notions of “public policy” and “*ordre public*” will be viewed in line with the prevailing legal opinion thus not being contradictory concepts. Quite the opposite, they will be referred as synonymous, interchangeable notions with a high degree of equivalence.³⁸

1.1.3 Application of public policy on the domestic, international and supranational level

Threefold standard of public policy is conditioned by the level of its applicability. Public Policy doctrine embraces application on the domestic, international and supranational level. Against all odds, this threefold distinction is inevitable for notion’s efficient operation and stems from the idea of “differing purposes of domestic and international legal relations”.³⁹ This chapter will briefly address application of public policy on the domestic, international and supranational level and most certainly examining applicable standard of public policy towards for the enforcement of a domestic and foreign arbitral award.

³⁷ *Report of the Committee on the Enforcement of International Arbitral Awards*, 28 March 1955, UN Doc. E/2704 and E/AC. 42/4/Rev.1.

³⁸ Albert Jan Van den Berg, *The New York Arbitration Convention of 1958, Towards a Uniform Judicial Interpretation*, T.M.C. Asser Institute – The Hague, (Deventer, Boston: Kluwer Law and Taxation Publishers, 1994), 359.

³⁹ *Ibid.*, 360

When applying a standard of a domestic public policy, object of such enforcement is domestic award. Therefore, courts exercise extensive power and it need not act in accordance with the international public policy. “What is considered to pertain to public policy in domestic relations does not necessarily pertain to public policy in international relations”.⁴⁰ Violation of domestic public policy derives from the violation of respective state’s national legislation and anything which in its essence equals to the violation of the most basic fundamentally defined principles of moral and justice. Consideration of public policy in domestic matters is different from the public policy for international purposes and recognition or enforcement of foreign arbitral awards is largely dependent on the international public policy standard.⁴¹

At the first sight, international public policy standard proves to be paradoxical for two reasons. Firstly, although bringing public policy on the upper *international* level, the scope of application limits, rather than expands.⁴² Secondly, no matter how *international* standard gets, the question of what constitutes international public policy and its violation is decided by the national judge.⁴³ “Somewhat simplified a state’s “international public policy” or “*ordre public international*” is that which affects the essential principles governing the administration of justice in that country and is essential to the moral, political, or economic order of such country”.⁴⁴ Therefore, despite its international application, international public policy never departs from the domestic law. Viewing international public policy from the prism of domestic on one hand may lead to the application of purely domestic public policy, narrowed down extensively and on the other hand,

⁴⁰ *Ibid.*

⁴¹ Otto and Elwan, *Commentary*, 366

⁴² See., Pierre Mayer, *Effect of International Public Policy in International Arbitration*, in Loukas A. Mistelis/Julian D.M. Lew, *Pervasive Problems in International Arbitration* (Kluwer Law International, 2006), 61.

⁴³ Otto and Elwan, *Commentary*, 366

⁴⁴ *Ibid.*

it may lead to the application of those paramount rules which were solely designed to be utilized in international commercial disputes.⁴⁵

For the purposes of Article V. 2 (b) of the NY Convention, recognition or enforcement of an award may be refused (by relevant competent authority of a state where award is sought to be enforced) if that authority finds that enforcement is contrary to the public policy of *that country*. It is true that such a provision does not provide explicit or implicit reference towards the applicable standard of public policy. It is generally recognized that such a reference to the country not only includes pure domestic public policy, but also embraces international public policy.⁴⁶ Quite justified that Lew classifies international public policy as of “*national international*” one.⁴⁷ To emphasize, the element of “nationality” does not mean each country’s capacity to impose their domestic rules upon cases which is decided by the another state, as international public policy “cannot be affected by the access into that legal system of a foreign provision (or decision) which conflicts with them”.⁴⁸

The notion of supranational public policy is a bone of contention among judges, practicing arbitrators and legal scholars. The concept which was initially introduced by P. Lalive in the report to ICCA Congress in 1986 and its reasonability as a standard it still questioned. Supranational Public policy so-called “truly international public policy” comprises of “fundamental rules of natural law, the principles of universal justice, *Jus Cogens* in public international law and the general principles of morality accepted by what is referred to as civilized nations.”⁴⁹ It is quite justified objection that the content of supranational public policy is

⁴⁵ P. Lalive, *Transnational (or Truly International) Public Policy and International Arbitration* in ICCA Congress Series No. 3 (New York, 1986) 275.

⁴⁶ E. Gaillard and J. Savage (eds.) Fouchard Gaillard Goldman on *International Commercial Arbitration*, (Kluwer Law International, 1990) 1710.

⁴⁷ Julian D.M. Lew (ed.), *Contemporary Problems in International Arbitration*, (The Netherlands: Martinus Nijhoff Publishers, 1987), 83.

⁴⁸ Rubino-Sammartano, *International Arbitration*, 506.

⁴⁹ Van den Berg, *Judicial Interpretation*, 361.

covered by the international public policy itself.⁵⁰ Although, extracting common fundamental standards of the international community can be good legal theory, in practice this standard will overlap with the international public policy. It is of utmost importance, that the distinction between these two standards is not addressed by the NY Convention. Standing solely on the “*common standards of national policies*”⁵¹ and “*fundamental concepts embodied in international conventions or other international instruments*”⁵² makes this standard left without legal basis. Such a definition clearly indicates that supranational public policy loses touch with the NY Convention required *public policy of that country* where recognition or enforcement is sought which goes beyond standard of international public policy as well as main objective of this research.

To conclude, since supranational public policy departs from the NY Convention referring to ‘genuinely international public policy’,⁵³ for the purposes of the upcoming chapters - domestic public policy standard will be applicable in internal domestic relations and for the recognition and enforcement of foreign arbitral awards international public policy standard should be applied.

1.1.4 Content of Public Policy

In ascertaining whether there is a violation of public policy it is essential it establish its content which brings light on its definition as well as on its application. Public policy as a ground itself is an example of “intertwining of the procedural and substantive in arbitration,”⁵⁴ thus comprising of more uniform principles in the sense of recognition by the states: procedural and substantive

⁵⁰ *Ibid.*

⁵¹ Lew, *Contemporary Problems*, 83.

⁵² *Ibid.*

⁵³ Gaillard and Savage, *Commercial Arbitration (1990)*, 1712.

⁵⁴ Kurkela and Turunen, *Due Process*, 17.

public policy. A number of scholars believe that such a distinction is merely artificial⁵⁵. Although, if we assume that public policy as a notion already includes fundamental substantive issues together with the procedural principles⁵⁶ it would be unreasonable to reject the need for distinguishing between them. This section is subject to two restrictions: it limits only to the conceptual definition of contents of public policy and therefore, addressing only to violation grounds inextricably linked with international commercial arbitration. The purpose of this section is to address two types of public policy and describe the difference between them. It should be noted that such a basic and brief analysis on this extensive issue is deemed to provide foundation for further analyzing case-law in Georgia for the purposes of Chapter II.

1.1.4.1 Procedural public policy

Although, in its simple meaning, procedural public policy refers to the proceedings of the arbitration taking into consideration procedural values, it is still obscure concept to be tackled with. Linkage with the arbitral proceedings makes it clear that procedural public policy derives from the principle of due process.⁵⁷ Although there is a certain degree of contention whether procedural public policy overlaps with the Article V.1 (b) of the NY Convention⁵⁸ or whether it is something more than any violation of due process should not fall under the violation of public policy. To my judgment, it would be unreasonable to limit due process only to the cases where party against whom award was invoked was not provided with the proper notification about the arbitral proceedings, or about the appointment of an arbitrator or was unable to present his case. To emphasize, inability to present its case can not automatically constitute violation of due

⁵⁵ Adam Booc, *Observations on the Definition of Public Policy (Ordre Public) in Swiss Arbitration Law*, (Budapest: Akademiai Kiado, 2012)

⁵⁶ Jean-Francois Poudret and Sebastin Lesson, *Comparative Law of International Arbitration*, (London: Sweet & Maxwell, 2007), 756

⁵⁷ Fouchard, Gaillard, Goldman on *International Commercial Arbitration*, E. Gaillard and J. Savage (eds) (Kluwer Law International, 1999) at 947 *citation* “Due process embodies in the broader concept of procedural public policy”.

⁵⁸ See., ILA Final Report, 7.

process as well as violation of procedural public policy. For the purposes of the latter one, narrowed-down procedural public policy standard is applied, which means that mere procedural defect is excluded from the list of violation grounds. This is a price that commercial counterparts as reasonable businessperson pay assuming it “as a risk inherent in an agreement to submit to arbitration.”⁵⁹

One of the procedural issues within the procedural public policy is its application. When assuming that there is an overlap between art. V 1 (b) and art. V 2 (b) under the NY Convention, it should be expressly noted that the former one is invoked by the input of the defendant (thus the burden of proof is allocated on the contesting party seeking to refuse it) whereas the latter one calls for competent authority. Even if in practice, opposing party will use the defense provided by the both provisions, then it should be reiterated that public policy exception is a safety net for the cases which do not fall under the art. V (1) provided that “award suffers under such a severe defect that it should violate the forum’s most vital interests”.⁶⁰

The issue of procedural public policy calls for subtle examination. According to the UNCITRAL case digest “violation of party’s right to be heard could constitute a violation of procedural public policy, but only if there was a causal link between such violation of the right to be heard and the content of award”.⁶¹ On one hand, public policy does not necessarily require that each and every argument be expressly dealt with the arbitral award,⁶² then to what extent should each argument be dealt by the tribunal so that award should meet procedural public policy standard. On the other hand, violation is assessed in relation with the content of award. This should

⁵⁹ *Parsons & Whittemore Overseas Co., Inc v Societe Generale de l’industrie du papier (RAKTA)*, 508 F.2d 969, 975 (2d Cir. 1974).

⁶⁰ Anton G. Maurer, *The Public Policy Exception Under the New York Convention, History, Interpretation and Application* (New York: JurisNet, 2012), 67-70.

⁶¹ UNCITRAL 2012 Digest of Case Law on the Model Law on International Commercial Arbitration, [hereinafter referred as UNCITRAL 2012 Digest of Case Law], (New York: UNCITRAL Secretariat, Vienna International Center, 2012) 161.

⁶² *Ibid.*

require approach so that not to interfere into the substantial public policy while establishing a causal link.

Since procedural public policy is “basic principles upon which the procedural system is based or express fundamental procedural principles,”⁶³ its list is not exhaustive. It includes, but is not limited to: violation of the right to be heard (right to present the case, right to fair notice, right to address the case of the opponent and the right to be given consideration by the arbitral tribunal)⁶⁴ (a), breach of natural justice/due process (b), fraud/corrupt arbitrator (c), lack of impartiality(d), lack of reasons(e), violation of the principle *res judicata*⁶⁵ (f), annulment at place of arbitration (g)⁶⁶, lack of valid arbitration agreement⁶⁷ (h), malicious use of process (acting in a bad faith, for example attempt to obtain an award where already exists out of court settlement) (i)⁶⁸ and violation of party-agreed time limits⁶⁹ are also included in the list. ILA final report referred to unequal footing in the appointment of the tribunal and excluded manifest disregard of the law, manifest disregard of the facts from the list.⁷⁰

Listing these grounds reveals that procedural public policy is violated only in severe cases, which as a result go beyond the grounds enlisted in Article V 1 since *lex specialis derogate legi generali*. Its purpose is not to regulate virtually any case of public policy infringement, but to provide back-up mechanism to be operated by the competent authority. Such a non-exhaustive list and gradual concrete determination of the grounds makes procedural public policy more practical in its application.

⁶³ *Ibid.*

⁶⁴ Rubino-Sammartano, *International Arbitration*, 514; Otto and Elwan, *Commentary*, 387-391.

⁶⁵ Otto and Elwan, *Commentary*, 387-394.

⁶⁶ ILA Interim Report

⁶⁷ Ulrich Haas, *New York Convention*, in Frank-Bernd Weigand (ed.) *Practitioner's Handbook on International Arbitration*, Verlag C.H. Beck, (2002), 399, 522 (2002)

⁶⁸ *Ibid.*, Otto and Elwan, *Commentary*, 387-394

⁶⁹ Otto and Elwan, *Commentary*, 337

⁷⁰ ILA Final Report, 7.

1.1.4.2. Substantive Public Policy

Substantive public policy refers as to the subject matter of an award. “It justifies the refusal of recognition and enforcement of an award when its result does not comply with the fundamental principles of the state in which recognition is sought”⁷¹. It embraces the principle of *pacta sunt servanda*⁷² and the principle of good faith (embracing the principle of *culpa in contrahendo*). Some of the noteworthy prohibitions refer to the abuse of rights, uncompensated expropriation constituting violation of proprietary rights⁷³, discrimination activities which are contrary to *bonos mores*.⁷⁴ Substantive public policy includes not only purely substantive mandatory rules but also the rules which can be shared, subject to special application. It is expanded to violation of fiscal laws⁷⁵, consumer protection laws⁷⁶, competition and anti-trust laws.⁷⁷

To group, substantive categories of public policy includes mandatory laws/*lois de police* which prove to be imperative provisions of the law with general and special application (1), fundamental principles of law as more general principles compared to specific legislative provisions (2) good morals/public order (3) and national interests/foreign relations⁷⁸ (for example, export or import restrictions)(4).⁷⁹

From the observations on the substantive public policy it can be summarized why some scholars advocate limiting the scope of NY Convention Article V 2 (b) to substantive issues.⁸⁰ On the surface, procedural public policy seems to reiterate previously mentioned grounds (Art. V 1 NY Convention) and presents itself as technical, procedure related standard, while substantive public

⁷¹ Poudret and Lesson, *Comparative Law*, 859.

⁷² Stefan Michael Kroll, § 1061 in Karl-Heinz Bockstiegel et al. (eds.), *Arbitration in Germany, The Model Law in Practice* (Kluwer Law International, 2007) 556.

⁷³ Ibid., 556s. Otto and Elwan, *Commentary*, 403.

⁷⁴ ILA Final Report, 6.

⁷⁵ Otto and Elwan, *Commentary*, 382-384; ILA Final Report, 7.

⁷⁶ Otto and Elwan, *Commentary*, 384; ILA Final Report, 7.

⁷⁷ Otto and Elwan, *Commentary*, 382-384; ILA Final Report, 7; Kroll, *Arbitration in Germany*, 555s.

⁷⁸ Otto and Elwan, *Commentary*, 384, ILA Final Report, 7; Kroll, *Arbitration in Germany*, 555s.

⁷⁹ ILA Interim Report, 17-24.

⁸⁰ Wolff (ed.), *NY Convention*, 414.

policy directly addresses violation of the essential, fundamental and so widely recognized principles by essence of the award. It is not reasonable to prefer one over other. Be it substantive or procedural public policy application, what is dealt with is not the award itself, but whether its recognition or enforcement contradicts public policy.⁸¹

1.1.5 Scope of Judicial review

Resistance of award while being review by the court is determinative. On one hand, arbitral award loses its practical value⁸², on the other hand advantages offered by the arbitration, such as time efficiency and flexibility are utterly undermined, if award is refused for recognition or enforcement. Uniform approach as to what extent is court authorized to review an award has not yet been elaborated. This section briefly discusses two mainstream as well as opposing approaches as to the reviewing an award for its public policy conformity and defines the standard of judicial review to be applied for the purposes of Chapter II. The usage of collocation *judicial review* as a section title is not a matter of coincidence. Although, some scholars address the review by the court as *judicial control*⁸³, such a reference in its literal meaning reinforces court power, unequivocally indicating not on a certain degree of control functions enjoyed by the courts, but the court's extensive power to interfere. This approach leads to assumption of viewing judicial review as risk management mechanism,⁸⁴ rather than control.

Unresolved tension between the minimalist and maximalist approaches lies onto contradictory positions hold by both standards. Minimal judicial review approach is in line with the spirit of the NY Convention, thus removing any stumbling block as to the enforcement of the arbitral

⁸¹ Maurer, *Public Policy Exception*, 70.

⁸² See., Tibor Varady, John J. Barcelo III, Arthur T. von Mehren, *International Commercial Arbitration, A transnational Perspective*, Vth edition., (U.S.: Thomson Reuters, 2012), 911.

⁸³ See., Robert Merkin, Louis Flannery consultant ed., *Arbitration Law*, (London, Singapore: Lloyd's Commercial Law Library, 2004) 897; also, Matti S. Kurkela, Hannes Snellman, *Due Process in International Commercial Arbitration*, (NY: Oceana publications, 2005), 167.

⁸⁴ Park, *Arbitration*, 147.

awards.⁸⁵ Being in support of the narrowed-down public policy application, it precludes court review to be extended to substantive issues. Such a prohibition limits court's power only to procedural and formal issues to be examined, which as a result restricts its powers to review dispositive part of the award, explicitly excluding investigation of established facts or the applied law.⁸⁶ In the application of this standard certain dualism can be witnessed. One sub-theory limits court's control only to ascertaining whether tribunal took into consideration applicable public policy standard.⁸⁷ Pitfall of such a theory is that even if tribunal applied "wrong" standard of public policy, court is not entitled re-examine an award which renders judicial examination useless. The other sub-theory limits judicial review only to the cases, where arbitral award itself constitutes "obvious, effective and concrete violations of public policy".⁸⁸ This theory is deemed to be too restrictive. If the subject of court investigation is awards consistence with the general concept of public policy, then it should result in once in a while application of standard omitting some serious violations. Moreover, determinant factor to constitute public policy violation is usually award's effect, possible negative outcome in its post-award period, which is as well not considered by the theory. Since NY convention clearly indicates "*contrary to public policy*" ground this standard slightly contradicts convention's aim to set a filter and address non-obvious, non-concrete violations of public policy. Mild substandard suggests to ascertain compatibility with public policy of arbitral award in relation to the issues of the dispute.⁸⁹ Since this theory is more centered onto solution's violation of the public policy it is the most reasonable out of the three.

Minimal Judicial review application is subject matter to certain dualism; although limited on merits, it fails to effectively define the extent of court interference. ILA shares reassessment of

⁸⁵ Otto and Elwan, *Commentary*, 367.

⁸⁶ Kroll, *Arbitration in Germany*, 555.

⁸⁷ Bernard Hanotiau and Olivier Caprasse, *Public Policy in International Commercial Arbitration*, in Emmanuel Gaillard/Domenico Di Pietro (eds.), Nanou Leleu-Knobil (Ref. ed.), *Enforcement of Arbitration Agreements and International Arbitral Awards – The New York Convention in Practice* (UK: Cameron May, 2008) 812.

⁸⁸ *Ibid.*, 813

⁸⁹ *Ibid.*

facts approach although makes it conditioned provision to be exercised by the court only when a) mere review is not sufficient and b) scrutiny of the facts of the case guarantees more lucidity as to the violation of public policy.⁹⁰ Apart from this cumulative requirement general rule requires existence of a strong *prima facie* argument of violation of *lois de police*. As it was lately agreed by the ILC Committee judicial review expanded to the underlying evidence and any new evidence, only in a limited number of cases.⁹¹ Maximal judicial review permits entirely free, total review of the award. Such an examination means that the nature of the review is extended as to the investigations of the legal and factual circumstances relating to the case.⁹² Although maximal judicial review is practical imputing total review of an award, the threat which looms over its applicability is not its scope but to which extent it can be enjoyed by the courts. It would be one of the false assumptions to propose that maximal judicial review is in favor of the courts, although it can be to the detriment of arbitration. Court review does not raise its authority compared to arbitration when it exercises the the right to review. Quite the opposite, it enhances arbitration recognizing it as an institution and simultaneously reminding that private dispute does not mean extinguishing public interests. Judiciary itself can be frustrated - “arbitration is not a system of *junior varsity trial courts* offering the losing party complete and rigorous *de novo* review.”⁹³ Therefore, the ambit can lie onto the maxim that “the court is not entitled to substitute arbitrator’s findings with its own conclusions.”⁹⁴

To emphasize maximal judicial review is in line with the understanding of the NY Convention Art. V (2) (b) and presents reasonable standard of review: Courts are entitled to freely and totally

⁹⁰ ILC, *Resolution 2/2002*, Article 3(c), 2.

⁹¹ ILC *Final Report*, Recommendation 3(c), 11.

⁹² Emmanuel Gaillard and John Savage (eds.), Fouchard Gaillard Goldman on *International Commercial Arbitration*, (Kluwer Law International: 1999) 925.

⁹³ Katherine A. Helm, *Where does the Buck Stop?* *Dispute Resolution Journal*, vol. 61, no.4 (Nov. 2006 – Jan. 2007) (NY, Broadway: American Arbitration Association) 8.

⁹⁴ Otto and Elwan, *Commentary*, 367.

examine an award operative part as well as reasoning and underlying dispute⁹⁵ in a balanced way and restrained manner.

1.2 “Contrary to Public Policy” as a ground for refusal of enforcement or recognition under the NY Convention and UNCITRAL Model Law

This section provides overview as of the “contrary to public policy” ground within the international legislative framework. NY Convention Article V (2) (b) is the founding provision on the public policy exception. It is all often invoked ground, although rarely granted one.⁹⁶ It states: “Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where the recognition and enforcement is sought finds that: [...] b) The recognition or enforcement of the award would be contrary to the public policy of that country”.

Certain aspects to be emphasized: firstly, term *of that country* refers to the public policy of the enforcing state.⁹⁷ Secondly, when referring to the NY Convention as *founding* the public policy defense it should be understood that the public policy as simplified as it is was truly founded by it. Although, initial bases was provided by the Geneva Convention⁹⁸ Article 1(2) e which expanded violation of public policy so as to the cases where “it was contrary to the principles of the law of the country in which it was sought to be relied upon”.⁹⁹ Drafting committee supported an idea to exclude any references, so as to avoid any broad scope.¹⁰⁰ Thirdly, “subject matter of public policy defense – is not award itself but its recognition and enforcement that needs to stand public policy test”.¹⁰¹ Fourthly, discretionary power deriving from Article V (2) entitles courts to refuse the enforcement or recognition on the domestic level, although

⁹⁵ See, Wolff (ed.), *NY Convention*, 414.

⁹⁶ *Ibid.*, 405.

⁹⁷ Alan Redfern, Martin Hunter, Nigel Blackaby, Constantine Partasides, *Law and Practice of International Commercial Arbitration*, 4th ed., (London: Sweet & Maxwell, 2004) 458.

⁹⁸ Convention on the Execution of Foreign Arbitral Awards (Geneva, September 26, 1927).

⁹⁹ Wolff (ed.), *NY Convention*, 403.

¹⁰⁰ *Ibid.*, 404.

¹⁰¹ Wolff (ed.), *NY Convention*, 414.

recognizing that this does not preclude enforcement in the international context.¹⁰² Fifthly, it should be amplified that provision is of permissive nature, rather than mandatory carrying pro-enforcement spirit since competent authority *may* refuse, it is not forced to refuse once ground is present.¹⁰³ Sixthly, it is the right utilized *sua ponte* by the courts.

Public policy for the purposes of NY Convention embraces concept of domestic public policy as well as narrowed-down application of international public policy.¹⁰⁴ As for, “what constitutes a violation of public policy is largely a question of fact and is to be decided on an ad hoc bases”.¹⁰⁵

UNCITRAL Model Law was introduced to ensure that NY Convention’s application will be smooth one thus to modify convention for incorporation into their domestic legislation and for the purpose of giving effect to it.¹⁰⁶ Model Law Article 36 (1) (b) (ii) is structured in the similar manner as its NY Convention counterpart. Therefore, both provisions share most importantly permissive nature and *sua ponte* right to raise a motion by the enforcement judge is still maintained. Although, in the preceding Art. 34, similar ground proves to be presented for the set-aside procedure, two distinguishing features must be considered: first, is scope of application. While Article 34 is limited territorially, Art. 36 is not subject to strict territorial requirement not taking into account location of the place of arbitration and irrespective of the state where award was rendered and considering that such a court is located in the Model Law member country.¹⁰⁷ It is confirmed by enormous case law, that application of Model Law art. 34 (2) (b) does not imply review as to the substance of an award,¹⁰⁸ whereas respective article of the NY Convention enshrines total review of an award.

¹⁰² Hanotiau and Caprasse, *Public Policy in International Commercial Arbitration*, 803.

¹⁰³ *Ibid.*, 802

¹⁰⁴ See., Wolff (eds.), *NY Convention*, 391.

¹⁰⁵ van den Berg, *Judicial Interpretation*, 376.

¹⁰⁶ Wires, *The Public Policy Sword*, 4.

¹⁰⁷ Issak I. Dore, *The UNCITRAL Framework for Arbitration in Contemporary Perspective*, International Arbitration Law Library, (London/Dordrecht/Boston: Graham & Trotman/Martinus Nijhoff, 1993), 125-126.

¹⁰⁸ UNCITRAL 2012 Digest of Case Law, 161.

1.3 Conclusion

As a strategic projection, first chapter analyzed public policy as being “unruly horse” and investigated it as “a dangerous weapon” not as a “helping tool”. Since thesis is subject to geographical limitation, first chapter brought the light onto the most important issues through briefly examining them.

First chapter addressed the notion of public policy, defined its scope and types and analyzed legislative framework under the NY Convention art. V 2 (b) and under the UNCITRAL Model Law Article (1) (b). While acknowledging conceptual controversies, I defined the notion and role of public policy; addressed the issue of terminological classification of public policy versus *ordre public* and established their synonymous application. Defined applicable standard of public policy for the further chapters: domestic public policy standard will be applicable in internal domestic relations while for the recognition and enforcement of foreign arbitral awards international public policy standard should be applied for the purposes of NY Convention. I addressed contents of public policy. On one hand, for the procedural public policy enlisted grounds indicated violation only in extremely severe cases, and it serves the purpose to provide back-up mechanism to be operated by the competent authority. On the other hand, enlisted and defined substantive public policy grounds suggest that it directly addresses violation of the essential, fundamental and widely recognized principles by essence of the award. Scope of judicial review discussing minimalist and maximalist approaches led to the conclusion that, it is the latter standard to be adopted as long as free and total examination of an award is fulfilled in a balanced and restrained manner. Subsequently I discussed “contrary to public policy” as a ground for refusal of enforcement or recognition under the NY Convention and UNCITRAL Model Law through presenting drafting background and providing literal interpretation of the clause.

Established standards and specified concepts discussed in Chapter I will be used for the examination of the efficacy of Georgian model in regard to the violation of public policy as a ground for refusal for recognition and enforcement of domestic as well as foreign arbitral awards.

Chapter 2. Public Policy as a Ground for Refusal of Recognition and Enforcement of Domestic and Foreign arbitral awards in Georgia

Chapter 2 will adopt applicable standard of public policy as defined in the Chapter 1. Proceeding chapter aims to provide extensive research through analyzing legal basis of public policy in regard to arbitration and referring to general provisions, identifying peculiarities as well as drawbacks of Georgian Law on Arbitration and examining case law for both, domestic as well as foreign arbitral awards.

2.1 Legal framework for public policy under the Georgian legislation

This subsection provides applied concept of public policy in Georgia through analyzing general provisions as well as specific public policy exception in arbitration. Proceeding subsection will identify and enlist peculiarities of Georgian legislation which affect enforcement and recognition of arbitral awards in Georgia. As indicated in the section 1.1.2, for the purposes of the subsequent subsections public policy and *ordre public* adopted by the Georgian Law on Arbitration will be used as synonymous and equivalent notions.

2.1.1 General provisions as to the definition of public policy concept in Georgian legislation

Civil Code of Georgia¹⁰⁹ provides three major provisions to be considered for the purposes of defining the public policy. One can be found in the General Provisions of the Civil Code, while the other two can be found in the general norms for regulating transactions.¹¹⁰ According to Article 2 (4) application of customary norms is conditioned by the fact that they should not

¹⁰⁹ Civil Code of Georgia [hereinafter referred as Civil Code], Doc. No. 786, 26/06/1997, Parliamentary Gazette, 31, 24/07/1997, online at http://www.law.yale.edu/rcw/rcw/jurisdictions/asw/georgia/Georgia_code_civil.pdf (visited on Mar. 17, 2014)

¹¹⁰ *Ibid*, Title II, Chapter I.

contravene either with the universally recognized principles of justice and morality or with the public order. It should be noted that customary norms comes into action when there is absence of the law itself. From this approach, public order is leaned upon as of paramount value when regulation goes beyond the powers of the law. More importantly, for the purposes of this article, public order was defined as a compilation of economic, political and moral principles public order of absolute necessity.¹¹¹ According to the art. 54, a transaction is deemed to be unlawful and immoral and consequently, void when it either violates rules and prohibitions determined by law or contravenes the public order, principles of morality. This provision gives extensive interpretation of what constitutes public order. It includes but is not limited to fundamental principles of commerce (for example, freedom of entrepreneurship) necessary for compelling and stable market as well as principal legal values (such as, party autonomy).¹¹² It embraces violation of the rules and prohibitions defined by the law and on the contrary, the infringement of latter one sometimes constitutes violation of public order; in both cases, it inflicts not only concerned parties' but also state and public interests.¹¹³ Article 61 defines parties' confirmation of a void transaction which results in valid one if the agreement or the transaction itself does not contravene principles of morality and the requirements of public order. If conversion of void transaction into the valid one was the right enjoyed by the parties without any further reference, then it would mean that law entitled parties to benefit from their wrongdoing. Making such a conversion subject to the requirement of public order, again amplifies the fact that it is fundamental concept deriving from the law but also embracing certain degree of morality.

Introduction of the public order was provoked by the the French *Code Civil* as a defense mechanism of state and public interests.¹¹⁴ French concept of public policy derives from French public opinion which considers principles of universal justice having absolute international value

¹¹¹ Civil Code of Georgia, *Commentary*, Book I, *General Provisions of the Civil Code*, (Tbilisi: Samartali, 2002) 31.

¹¹² *Ibid.*, 176-182

¹¹³ *Ibid.*

¹¹⁴ Lado Chanturia, *Introduction to the General Provisions of Georgian Civil Code*, (Tbilisi: Samartali, 2000), 362-364.

and basic rules on which French social, political and economic life is organized.¹¹⁵ It is applied as a complementary concept as to the law regulation and exceeding it in the context of adopting principal moral values and fundamental principles of justice.

2.1.2 Application of public policy as a ground for refusing recognition and enforcement of arbitral awards under the Article 45 1 b (b.b.) of the Law of Georgia on Arbitration

Introduction of the public policy for arbitration purposes apart from the Civil Code application owes to the Law of Georgia on Arbitration. Former Law on Private Arbitration¹¹⁶ was so imperfect and defected as to not cover internationally established principle of KOMPETENZ-KOMPETENZ. Neither did it consider recognition and enforcement of the foreign arbitral awards in Georgia. The grounds for the appeal of an award were too vague. It obliged notary authentication for the enforcement, which complicated the procedure as well as made it costly. It explicitly noted that arbitral proceedings were not independent and permitted court intervention which was notoriously contrary to the nature of arbitration.

According to Article 43 of the former Law of Georgia on “Private Arbitration” court was entitled to consider party’s claim and alter an award only if: A) the award is contrary to Administrative and Criminal law; B) there is a violation of the rules (set by parties’ agreement or established by this law) arbitration proceedings and dispute resolution; C) an arbitrator committed a crime under article 189 of the Criminal Code of Georgia, which is established by the valid judgment, except the cases, where it has not affected on the arbitral award. As illustrated, none of these grounds refer to public policy while procedural violations (closest notion to the procedural public policy) are taken into account. Being adopted on the model of

¹¹⁵ Jean-Louis Delvolve, Jean Rouche, Gerald H. Pointon, *French Arbitration Law and Practice, a Dynamic Civil Law Approach to International Arbitration*, 2nd ed.(The Netherlands: Kluwer Law International, 2009), 154.

¹¹⁶ The word private was eventually and justifiably excluded by the Law of Georgia on Arbitration. Arbitration is in essence private and alternative dispute resolution mechanism.

UNCITRAL Model Law led to the inclusion public policy as a ground for refusing recognition and enforcement of arbitral awards under the Article 45 1 b (b.b.) of the Law of Georgia on Arbitration. According to Article 44 (1), competent authority for the domestic arbitral award to be enforced is Court of Appeal, while for the arbitral awards rendered outside of Georgia the competent court is the Supreme Court of Georgia. Article 45 exhaustively enlists the grounds provided by the UNCITRAL Model Law 36 1 b) II and NY Convention V (2) (b).

Law on Arbitration Article 45 1 b (b.b.) states: “Recognition and enforcement of an arbitral award, irrespective of the country in which it was rendered, may be refused if: [...] b) if the court finds that: [...] b.b.) The arbitral award is contrary to public order.”

Taking into account the absence of this provision in the law on Private Arbitration, adoption of this wording may be small step in arbitration, but a giant step for Georgia.

Although, three significant drawbacks should be identified:

Firstly, the exact wording of the Article 45 1 b (b.b.) is different from the wording of the NY Convention V (2) (b) and UNCITRAL Model Law 36 1 b). Convention and Model Law explicitly state that the subject of review is not an award itself, but whether recognition or enforcement of the award is contrary to the public policy.¹¹⁷ Law on Arbitration does not refer to enforcement and recognition, thus it examines whether award itself is contrary to public policy. In fact, such a formulation changes and more correctly, distorts not only the language of the NY Convention but also the internationally accepted test of the judicial review. In *Kersa Holding Co. Luxembourg v. Infancourtage, Cour Supérieure de Justice Luxembourg* reasoned that court can not define whether arbitral award is incompatible with the public policy; it may only ascertain whether the execution of Belgian award was of such nature as to affect that public policy of Luxembourg; this

¹¹⁷ Maurer, *Public Policy Exception*, 70; see also, Emmanuel Gaillard, *International Arbitration Law, Extent of Court Review of Public Policy*, New York Law Journal, Vol. 237-NO. 65, Apr. 5, 2007; Jacob Grierson, *Court Review of Awards on Public Policy Grounds: A recent Decision of the English Commercial Court Throws Light on the Position under the English Arbitration Act 1996*, MAELEY's International Arbitration Report, Commentary, Vol. 24, #1, Jan. 2009.

led to a principle of “attenuated public policy”.¹¹⁸ In *Arduina Holding V. v. J.S.C Iujno-Verboyanskaya Company*,¹¹⁹ International Commercial Arbitration Court in Moscow examined case regarding refusal to pay the debt. Since court found no proof of money transfer to debtor, it ruled that enforcing an award would be contrary to public policy. The decision was review by the Arbitrazh Court of East Siberia, which expressly noted that subject of examination is not an award itself, but its recognition and enforcement and its link with the violation of public policy. Public policy as a ground is in itself nebulous concept and with this seemingly innocuous wording of Article 45 1 b (b.b.) Georgian Law contravenes with the NY Convention pro-enforcement policy. This inconsistency can still be rectified taking into consideration Law of Georgia on Normative Acts which defines the hierarchy of normative acts, ranking of the international agreements and treaties in the system of normative acts of Georgia¹²⁰. Article 7.3 International Treaties and agreements (c) have prevailing power, superior judicial authority over Georgian Law (e). Therefore, even if Georgian law sets different judicial review standard NY Convention will prevail in terms of recognition and enforcement of foreign arbitral awards.¹²¹ Although this is utterly dependant on the common courts system, it is desirable that this purely legislative drawback be rectified with the case law applying restrictive public policy in line with NY Convention.

Secondly, Article 45 1 b (b.b.) is different from the NY Convention V (2) (b) as far as it omits which state’s policy is to be taken into account. By the virtue of NY Convention recognition and enforcement is refused if a competent authority finds that the recognition or enforcement of the

¹¹⁸ Julian D.M. Lew, Loukas A. Mistelis, Stefan Kroll, *Comparative International Commercial Arbitration*, (The Hague, the Netherlands: Kluwer Law International, 2003) 730.

¹¹⁹ *Arduina Holding V. v. J.S.C Iujno-Verboyanskaya Company*, Federal Arbitrazh Court of the East Siberian Circuit, Case No. A58-2103/05, October 16, 2006

¹²⁰ Law of Georgia on Normative Acts, Document No: 1876, 22/10/2009, Legislative Herald of Georgia, 33. 09/11/2009.

¹²¹ The same practice is in Russia. According to Article 15 of Russian Constitution, in case of inconsistency NY Convention will take precedence over the Russian Arbitration Legislation. See., Nikoforov I., “*Interpretation of Article V of the New York Convention by Russian Courts*”, *Journal of International Arbitration* 25 (6) (2008) 787.

award is contrary to the public policy *of that country*.¹²² This means that public policy exception is geographically restricted thus is relative, being limited to the public policy of the enforcement state. Absence of indication is not drastic pitfall although it is still noticeable. Especially if we take into consideration the very same article 45 1 (b.a.); if in respect to arbitrability legislator felt the need to explicitly indicate *according to Georgian legislation*, dispute can not be subject matter of arbitration, then why in regard to public policy ground there is an omission of the indication? For example, Hungarian Arbitration Act, Section 59 (b) specifically notes that court refuses enforcement of the award if in its judgment award is contrary to the rules of *Hungarian public order*.¹²³ It is true, that domestic courts are not obliged to follow the decisions of courts from foreign countries,¹²⁴ but neither does it preclude enforcement state's court from considering public policy of the other countries. It is agreed that public policy is obscure and by not indicating restriction to the state, Georgian legislation fails to narrow down public policy concept which fosters broad interpretation. While international practice strives to narrow down its scope, Georgia seems to flow into the opposite direction. Therefore it is desirable to include Georgian public order or make it country-specific otherwise.

Thirdly, it is reasonable to doubt understanding of the public policy by the courts in Georgia. The Geneva Convention¹²⁵ justifiably rejected Article 1(2), where violation of public policy equaled to the violation of public policy "principles of the law of the country in which it was sought to be relied upon."¹²⁶ There is a considerable doubt that courts in Georgia will treat public policy in its application as principle of law which is contrary to Georgian Legislation.

¹²² See, Section 1.2.

¹²³ Zsolt Okanyi, *Arbitration in Hungary in Domestic and International Matters*, (Alapszin Kiado: 2009), 58; see also, Zsolt Okanyi, Peter Bibok, *Arbitration in Hungary, CMS Guide to Arbitration*, Vol. I, 413-415. Online at http://eguides.cmslegal.com/pdf/arbitration_volume_I/CMS%20GtA_Vol%20I_HUNGARY.pdf (visited on Mar. 18, 2014)

¹²⁴ Klaus Peter Berger, *Private Dispute Resolution in International Business Negotiation, Mediation, Arbitration*, 2nd ed, Vol. 2: Handbook (The Netherlands: Kluwer Law International, 2009) 681.

¹²⁵ Convention on the Execution of Foreign Arbitral Awards (Geneva, September 26, 1927).

¹²⁶ *Ibid.*

Therefore for the purposes of judicial consistency it is of utmost importance to treat this sensitive issue with the due care and ensure its upright application.

Certainly Georgian Law on Arbitration repeats permissive language of the NY Convention and UNCITRAL Model Law. In the light of above mentioned drawbacks, it should be noted that Georgian Law on Arbitration lacks certainty to meet NY Convention's pro-enforcement bias.

2.2. Case Law Analysis

Since the Georgian Law on Arbitration came into force only in 2010, I will sum up the cases over the last four years. This section will analyze relevant case law when the object of refusal for enforcement or recognition on the ground of public policy was firstly, domestic award (sub-section 2.2.1) and secondly, foreign arbitral award (sub-section 2.2.2.). I will define major trend of the Georgian courts in respect to applicable standard and content of public policy together with the scope of judicial review. For the effective analysis on the issue, comparison with the relevant case law from countries other than Georgia will be provided.

2.2.1 Case Law Analysis for Domestic Arbitral Awards

For the purposes of conceivable observation, case law will be grouped in three categories out of which two presents violation of the procedural public policy, whereas the third one refers to the infringement of substantial public policy.

2.2.1.1. Case study 1: Partial administration of justice as violation of procedural public policy

*Debt Recovery and Management Group v. Alliance Group Capital*¹²⁷ is a controversial case bringing the question if the existence of conflict of interest *per se* leads to the violation of public policy. In this case Tbilisi Court of Appeals refused to enforce an arbitral award rendered by the "Tbilisi

¹²⁷ *Debt Recovery and Management Group v Alliance Group Capital*, Case No. 2b/2130-11 (Tbilisi Appeal Court, July 20, 2011).

Chamber of Arbitration” on April 8, 2011. The issue of conflict of interest emerged in relation to the fact that, one of the founders of Claimant’s corporation (who owed 67% of shares) was simultaneously founder of the “Tbilisi Chamber of Arbitration” (where it owned 16.65% of shares) which created substantial doubt as to the impartiality of of the arbitral tribunal. Focal points for the discussion:

Firstly, as paradoxical as it might seem, court envisioned the fact that there is no statutory definition of the public policy and neither did it clarify what the public order was for the purposes of this case. Being forgetful about its interpretative function to bring the light to the vague concepts left obscure by the legislation, it merely considered *the logic of the provision* and emphasized that conflict of interest at hand was substantial violation of public policy, without even examining the factual background of the dispute. One one hand, court refers to the absence of public policy on the statutory level but, even if there is not a definition, the same statutory provision obliges it to make a decision about based on *sufficient ground*. This case is not simple with clear-cut outcome. Court should have ascertained what causal link existed between a founder as an outsider in this dispute and arbitral tribunal. Superficially, founder was not an arbitrator in this dispute he merely owned shares in the arbitral institution, therefore there was nothing to suggest partiality of the arbitral tribunal. Court failed to explain *sufficient* ground for doubt as to impartiality of the arbitration court. Moreover the case at hand is not subject to non-waivable red list of IBA Guidelines.¹²⁸ More certainly it falls under the waivable red list.¹²⁹ Therefore, general standard of examination called for a reasonable third person test. For example, comparison of the relevant shares attached to founders influence on the decision-making process; although not directly connected to the dispute, analyzing founder’s economic interest in the matter at stake would have brought the light as to the partiality issue. Taking into

¹²⁸ International Bar Association, *Guidelines on Conflicts of Interest in International Arbitration*, (NY, 2004).

¹²⁹ *Ibid.* Explanation to General Stanard 2.

account the fact that IBA 2.2.1. names the ground when *arbitrator* holds shares, either directly or indirectly, this case called for thorough examination because founder did not act as an arbitrator.

The other decisive point is a fact that this issue emerged only at the stage of recognition and enforcement and it was brought by Respondent. According to the Law of Georgia on Arbitration Article 31, if a party who knew about the violation of requirement under the arbitration agreement and yet proceeded without stating his objection to such non-compliance shall be deemed to have waived its right to object.¹³⁰ Therefore Respondent was obliged to disclose information and it should have challenged impartiality of the arbitral tribunal before the case reached enforcement stage and became a subject of judicial review. In *Hebei Import & Export Corp. v. Polytek Engineering Co. Ltd*¹³¹, final Court of Appeal ruled that party waived its right to object enforcement as “it simply proceeded with the arbitration as if nothing untoward had happened.”¹³² It is unjustified to store challenging ground as potential weapon in order to use it in case of discovering yourself in the shoes of losing party. In Section 11 of the Russian Information Letter No. 156¹³³ court explicitly indicated, that party is entitled to challenge arbitrator and failure to use this right, results in the waiver of the objection; on this ground, the award was held to be in compliance with the procedural public policy.¹³⁴

In *Polytek Engineering Co. Ltd v. Hebei Import & Export Corp.*,¹³⁵ court reasoned that “principle of natural justice demands that arbitration proceedings, like litigation, must not only be conducted fairly but also be seen to be conducted fairly”. Peculiarity of this case lies within the fact that firstly, founder is not a Claimant, and secondly founder is not an arbitrator either. Absence of

¹³⁰ Article 31 - Waiver of right to object is similar to UNCITRAL Model Law Article 4.

¹³¹ *Hebei Import & Export Corp. v. Polytek Engineering Co. Ltd*, Yearbook of Comm. Arb'n XXIV a (1999) 676-677.

¹³² *Ibid.*, 669

¹³³ Information Letter No. 156, *Review of the Arbitrazh Courts' Practice of Considering Cases Concerning the Application of Public Policy as a Basis to Refuse the Recognition and Enforcement of Foreign Judgments and Arbitral Awards*, Presidium of the Supreme Arbitrazh Court (“SAC”), Feb. 26, 2013, published in Apr. 2013.

¹³⁴ Vasily Kuznetsov, Section 3: *Country Chapters Russia in The European, Middle eastern and African Arbitration review 2014* (Global Arbitration Review, 2014).

¹³⁵ *Polytek Engineering Co. Ltd v Hebei Import & Export Corp.*, Yearbook Comm. Arb'n XXIII (1998), 680.

obviously biased bonds makes partiality issue attached to not tribunal, but to the legal entity – Tbilisi Chamber of Arbitration as an institution. In this sense case is hybrid. Conversion of partiality into the invalidation of arbitral agreement (biased authority in general, as the court questioned validity of an agreement) is somewhat confusing, especially when proper reasoning is not proffered. We can not exclude the possibility that public policy can be violated by the arbitral authority, but questioning validity of arbitral agreement for this purpose is making procedural public policy standard of review rather complicated process. In addition, even if we invalidate agreement, this would mean the following: first, we “save” losing party who store challenging ground as a sword (clearly unfair practice) and secondly, conflict of interest as a ground for violation of public policy will disappear as it can always be gorged by the invalidation of party agreement.

2.2.1.2. Case Study 2: Breach of due process constituting violation of public policy

Subsequent issue I will address in terms of procedural public policy comprises of the cases when originals of the arbitration proceeding did not include protocols of the oral hearing, when the award did not contain descriptive section and when party was not duly notified.

Case of concern is that of Supreme Court of Georgia *Ltd “T-A” v. Ltd. “S.S. P-A”*.¹³⁶ Ltd. “T-A” applied to the Court of Appeal and asked for the enforcement of the award, dated July 9, 2012. Tbilisi Court of Appeal, chamber of civil cases, left the application unexamined. As the court reasoned since in the *originals of the arbitration proceeding did not include protocols of the oral hearing*, it was impossible for the court to examine whether arbitral award violates public policy. Therefore, Court of Appeal found that motion did not comply with the recognition and enforcement requirements of the Law of Georgian on Arbitration and admissibility requirements set by the

¹³⁶ *Ltd “T-A” v. Ltd. “S.S. P-A”*, Case No. as-1369-1291-2012, (Supreme Court of Georgia, Oct. 15, 2012).

Civil Procedure Code of Georgia. In this case court reasoned that lack of protocols of the oral hearing precluded it from conducting effective judicial review. In this way court emphasized the importance of examination of the ground whether arbitral award violates public policy. This case is closely related to a number of cases, where lack of reasons constitutes violation of public policy with the difference that in case *Ltd "T-A" v. Ltd. "S.S. P-A"* absence of reasons could not be ascertained. Appeal courts in Georgia have shared a view that "unless the reasons are given in its award, it is impossible to verify whether it has properly used the powers which the parties granted to it."¹³⁷ Therefore, non-reasoned domestic award is deemed to be invalid in Georgia.¹³⁸ This position can be narrowing down the scope of party autonomy granted under the Model Law. According to the Law of Georgia on Arbitration, Article 39. 3 non-reasoned award is valid if parties agreed ex ante, for example in the Arbitration Agreement that award can be non-reasoned or settlement exception, when during the arbitral proceedings parties settle their dispute and arbitral tribunal approves the settlement of the parties in accordance with the agreed terms by way of rendering an arbitral award. UNCITRAL Model Law Article 31 permits non-reasoned award rendering if "parties have agreed that no reasons are to be given". Viewing this issue from the timing perspective, UNCITRAL Model Law does not specify that firstly, "parties have agreed" necessarily means arbitration agreement and secondly, it does not state when this agreement can be reached, ex-ante, in between or ex-post. Therefore, Georgian Legislator seems to limit party autonomy in this regard.

In case *LTD "Credit Express" v. Shavleg Gurgendze*¹³⁹ Kutaisi Appeals Court refused recognition and enforcement of an award rendered by the "Batumi Standing Arbitration" dated on 26 January, 2012. According to this award, Shavleg Gurgendze had to pay 3560, 31 Gel in favor of

¹³⁷ Jean-Louis Delvolve, Jean Rouch, Gerald H. Pointon, *French Arbitration Law and Practice*, (Kluwer Law International, 2003), 174.

¹³⁸ The same view is shared by Italy. See., article 823 (3) of the Italian Code of Civil Procedure, online at: <http://www.arbitrations.ru/userfiles/file/Law/Arbitration%20acts/Italian%20Code%20of%20Civil%20Procedure.pdf> (visited on Mar, 10, 2014)

¹³⁹ *LTD Credit-Express v. Shavleg Gurgendze*, Case No. 2/b-257-2013 (Kutaisi Appeal Court, Apr. 18, 2013).

Ltd. “Credit-Express” and he was given time period for meeting obligation. After the lapse of this period, realization of the property securing the load was ordered. Kutaisi Appeal Court commenced its reasoning with the Article 45 1 (b.b.) of the Georgian Law on Arbitration. Court defined public order “as a rule governing community rooted legal, social, political or economic relations, which is essential for the existence of the very society. Any unlawful action is automatically violating public order. Although public order can be violated by the action which is not illegal however, is obviously contrary to the abovementioned rule.”¹⁴⁰ This definition was provided for procedural public policy reasoning, when party was not duly informed. Arbitration claim together with the attached materials and meeting minutes were sent by was never handed over to Respondent. Court noted that parties in arbitration are on equal footing and each of them should be given right to fair hearing. Therefore, arbitral proceeding where one party was not duly notified and the award rendered as a result of such a proceeding was held to be contrary to the legal order in Georgia. Moreover, court noted that charging respondent with 4 times more penalty than principal amount was contrary to the economic and social system of the country.¹⁴¹ The principle of fair hearing “requires that each party be provided with the opportunity to present its factual and legal argument and to acquaint itself with and rebut that raised but its opponent.”¹⁴² “Arbitrator has a duty inform a party of the arguments and evidence of the other party and allow the former to express an opinion thereon”.¹⁴³ Violation of this internationally recognized principles results in the violation of public policy. “Violation of due process may thus fall either under V(1) b or article V 2 b. embraces procedural irregularities”.¹⁴⁴ This reasoning as well as ruling of the Kutaisi Appeal court is an exemplary one as far as it exhaustively defines the concept of public policy not only generally, but also in relation to the case-specific details. This

¹⁴⁰ [Translation provided by an author]

¹⁴¹ See., Supreme Court of Republic of Latvia Decision, case No. SPC-43/2007, (Riga: Court Practice in the Cases of Issuance of the Writ of Execution for the Enforcement of the Arbitral Awards, 2008), where court reasoned that arbitral award violated good-faith principle as far as it exceeded main debt six times.

¹⁴² Gaillard and Savage eds., *International Commercial Arbitration*, (1990) 949.

¹⁴³ Van den Berg, *Judicial Interpretation*, 307.

¹⁴⁴ *Ibid.*, 300.

may as well be conditioned by the fact that case itself was easy to resolve because of its serious breach of due process. Despite this, case at hand provides reliable standard of procedural public policy examination.

2.2.1.3 Case Study 3: Penalty for late payment – violation of public policy?

As far as this issue is being examined under the substantive public policy in the domestic awards and this is a specific issue relevant legal regulation should be invoked. According to the Georgian Civil Code, Title V. penalty for late payment (hereinafter referred as “penalty”) is additional remedy for securing an obligation together with the earnest money and debtor’s guarantee. For the purposes of arbitration it is essential to define whether penalty is a mandatory statutory provision or not. In terms of economic concerns relating to the violation of public policy when prohibition exists on the domestic level, enforcement of an award with the compound interest awarded for compensatory purposes does not automatically violate public policy.¹⁴⁵ Article 416¹⁴⁶ defines parties’ discretionary power to determine this mean of securing performance of an obligation under the contract while Article 417¹⁴⁷ defines penalty as [pre] determined amount of money to be paid by the obligor if he either fails to perform or performs improperly. Therefore, penalty is not a mandatory rule. It is upon the parties will to consider it in the contract. Article 418¹⁴⁸ (2) entitles parties to determine a penalty that may exceed the possible damages. It is important to note that this article permits estimation over the possible damages, not over the principal amount of money.

Article 420¹⁴⁹ entitles court to reduce penalty when two requirements are cumulatively met: a) court should take into account all the circumstances of the case and b) penalty proves to be *disproportionately high*. Practices differ in this sense. For example, Swiss Supreme court enforced an

¹⁴⁵ See, for example, *Laminoirs-Trefileries-Cableries de Lens, S.A. v Southwire Co.*, 484 F. Supp. 1063, 1068-1069 N.D. Ga., 1980; *Seller of soybean flour v Buyer of soybean flour*, Yearbook Comm. Arb’n XVII (1992) 491.

¹⁴⁶ See., Civil Code of Georgia.

¹⁴⁷ *Ibid.*

¹⁴⁸ *Ibid.*

¹⁴⁹ *Ibid.*

award with the compound interest; despite the fact that it was of excessive and unreasonable, Swiss Supreme court ruled that it did not violate Swiss public policy.¹⁵⁰

Certain trends and pitfalls can be identified in regard to the Georgian practice:¹⁵¹

In the case, *Bized Holdings Georgia v. Dematrashvili*¹⁵² Tbilisi Court of Appeals partially enforced the award. Disputed part referred as to the calculation of penalty. Ltd “Millenium Group Standing Private Arbitration” set fixed penalty rate amounting to USD 180 per day. This rate was altered by the Appeal court’s decision with the monthly penalty calculated from the principal contractual amount with the rate 0.05% equaling to 30 USD per day. Court ruled that the penalty was contradictory to fundamental principles of law of obligations, therefore to the public order. In the Case LTD “Credit Plus” v. Gela Zarqua¹⁵³ penalty rate was so low (0.1% per day) that Tbilisi Appeal Court was not left with the choice but to enforce an award. In case *Medinservice v. Best Pharma and Vasileva*¹⁵⁴ penalty lost its mandatory nature in the rendered award; as far as parties’ agreement was limited to the value of the goods and it did not cover compensation for lost profits. Court reasoned that it was unjustifiable imposition of the additional costs and found it contradictory to the fundamental legal principles rooted in the governing law of obligations and thus ruled in favor of the violation of public order. In case *BasisBank v. Kapanadze*¹⁵⁵ Tbilisi Court of Appeals relied on the Article 420 of the Civil Code of Georgia and ruled that penalty rate 0.17 per day was disproportionately high, violating public policy and drastically reduced penalty to 2% per month.

First inadequacy to be identified is that case law does not indicate linking bridge between disproportionately high penalty and violation of public order. Courts persistent verification that disproportionately high amount *consequently* violates public policy is not sound. It is highly

¹⁵⁰ *Inter Maritime Management SA v Russin & Vecchi*, Yearbook Comm. Arb’n XXII (1997), 789.

¹⁵¹ See., Michael D. Blechman, *Assessment of ADR in Georgia*, Report, USAID/Georgia, EWMI (JILEP), October, 2011.

¹⁵² *Bized Holdings Georgia v Dematrashvili*, Case No. 2b/2747-11 (Tbilisi Appeal Court, Sept. 12, 2011).

¹⁵³ LTD “Credit Plus” v Gela Zarqua, Case No. 2b/1596-11 (Tbilisi Appeal Court, June 21, 2011).

¹⁵⁴ *Medinservice v Best Pharma and Vasileva*, Case No. 2b/987-11 (Tbilisi Appeal Court, Mar. 31, 2010).

¹⁵⁵ *BasisBank v Kapanadze*, Case No. 2b/1604-11, (Tbilisi Appeal Court, May 31, 2011).

desirable that courts define this link and to correctly define it. For example, in Russia, Presidium of the SAC denied enforcement of arbitral award rendered by the “Arbitrazh Court of the City Moscow” on the case *FGC UES OJSC v FNK Engineering LLC*¹⁵⁶ stating that: “the courts may consider the proportionality of a penalty awarded by an arbitral tribunal, since public policy includes, inter alia, a concept of proportionality of civil liability to the consequences of a breach”.¹⁵⁷

Georgian case law observation gives an impression as if courts and arbitral institutions are disagreeing not on the public policy violation but over calculation rates. All too often, courts rely on the Civil Code Article 420. It is true that courts are authorized to reduce exceedingly high penalty, but that does not give them power to undertake a role of savior in each and every case. There is hardly any party who is ‘happy’ with the penalty. Initially, every debtor has disagreement with the award. If such a trend continues, this will bring hostile attitude towards arbitration.

It is not argued that award should include calculation method as it was decided in the case Supreme Court of Republic of Latvia Decision in Case No. SPC – 10/2008¹⁵⁸ where such an award suffered lack of motivation because of absence of contractually defined penalty.

However, limiting public policy to mere calculations is erroneous path to follow. Criteria for examination should be based on the fact that the purpose penalty is a compensation of damages not the unjust enrichment of a creditor.¹⁵⁹ Russian case law suggests that the proportionality of a penalty shall be scrutinized even if arbitral tribunal ruled on this issue.¹⁶⁰ Although, examining proportionality of a penalty does not mean to compare it only with the arbitral awards rate and

¹⁵⁶ *FGC UES OJSC v FNK Engineering LLC*, Ruling of the Arbitrazh Court of the City Moscow, Case No. A40-57217/12-56-534 June 21, 2012; Resolution of the Federal Arbitrazh Court of the Moscow Circuit, Case No. A40-57217/12-56-534, October 3, 2012.

¹⁵⁷ Vasily Kuznetsov, Section 3: *Country Chapters Russia in The European, Middle Eastern and African Arbitration Review 2014*, (Global Arbitration Review, 2014). See also, Resolution of the Presidium of the Supreme Arbitrazh Court, Case No. A40-57217/12-56-534, April 23, 2013.

¹⁵⁸ Court of Republic of Latvia Decision in Case No. SPC – 10/2008, Court Practice in the Cases of Issuance of the Writ of Execution for the enforcement of the arbitral awards, Riga 2008; See also, Inga Kacevska, Section 3: *Country Chapters: Latvia in The European, Middle eastern and African Arbitration review 2014*, (Global Arbitration Review, 2014).

¹⁵⁹ *Ibid.*

¹⁶⁰ *Ibid.*

thus compete with arbitral institution. It is desirable if court makes comparisons what is average penalty for similar violations in its own practice, taking less subjective standard. Also, Georgian practice neglects reasonable foreseeability at the time when contract was concluded. According to Russian practice, award would be found contrary to the Russian public policy if:

“the amount of damages is so extremely high that it exceeds many times over the amount that the parties could have reasonably foreseen at the time of the conclusion of the contract, there was clear indication of abuse of the freedom of contract (eg. abuse of poor bargaining power of the other party) at the time of agreeing on the amount of damages.”¹⁶¹

The most noteworthy Latvian decision, as opposed to Russian experience, went to another extreme. In a case *Supreme Court of Republic of Latvia decision in Case No. SPC-41/2008* Supreme Court reasoned that “a state is not responsible for the violations of the arbitral process and has not undertaken to eliminate every mistake made by the parties’ chosen arbitral institution”.¹⁶² This statement is reasonable if we view the issue from the standpoint that court should not replace arbitration, even in post-award period. Parties autonomy exercised in terms of appointment of arbitrator’s also involves the risk of erroneous decisions. According to Donald Rumsfeld, for financial purposes risks are categorized as *known known*, *known unknown* and *unknown unknown*.¹⁶³ Risks undertaken by the parties in arbitration are of known nature, the fact that calculation may turn out to be erroneous is of the unknown category. Therefore, penalty for late payment goes in the category of *known unknown*. Had it been *unknown unknown* courts could have hypothetically replaced arbitral institutions.

To summarize, it should clearly be emphasized that the purpose of judicial review is not to attack arbitrators’ calculation, rather to double-check and thus to defend legitimate interests of the debtor (private interest) for the purposes of public policy (state interest) compliance.

¹⁶¹ Kuznetsov, *Russia*.

¹⁶² Supreme Court of Republic of Latvia Decision, Case No. SPC-41/2008, (Court Practice in the Cases of Issuance of the Writ Execution for the Enforcement of Arbitral Awards, Riga, 2008); See also, Inga Kacevska, *Section 3: Country Chapters: Latvia in The European, Middle Eastern and African Arbitration review 2014*, (Global Arbitration Review, 2014).

¹⁶³ Alastair Hudson, *The Law of Finance* (Sweet & Maxwell, 2009), 831.

2.2.2 Case Study Analysis for Foreign Arbitral Awards

This section aims to analyze all the cases in the practice of the Supreme Court of Georgia since the introduction of the Law of Georgia on Arbitration which invoked public policy exception. I will identify certain peculiarities as far as limited number of cases does not let me make tendency statements in which direction public policy exception develops. On one hand this can be positive. Supreme Court of Georgia has not yet established practice, contrary to the Appellate Courts and these initial conclusions as to the reasoning and ruling of the court may foster similar case examination for future, for the benefit of pro-enforcement.

2.2.2.1 Case Study 1: over the issue of invalid arbitration clause leading to the violation of public policy

Case of concern is that of Supreme Court of Georgia *Omsk Oblast Judge of Court of Arbitration and Ltd. "L. & A. Q. O-A" v. Ltd. "K-I"*.¹⁶⁴

Background of the dispute: According to the decision of the Omsk Oblast Court of Arbitration 10 May, 2012 Ltd. "K-I" (hereinafter referred as "opposing party") was charged with 1 704 990 Russian rubles in favor of Ltd. "L. & A. Q. O-A". The winner party adhered to the Court of Arbitration of the Omsk Oblast with the motion to compulsorily enforce the decision. Supreme Court of Georgia was addressed by the Judge J. Y. of the Omsk Oblast Court on December 13, 2012 in order to recognize and enforce this decision on the territory of Georgia within the framework of the "Convention on the legal assistance and legal relations on the civil, family and criminal cases" Article 53. According to the files attached to the decision, it came into force on June 11, 2012 and parties were informed about the proceedings on the present case. Having viewed the motion and accompanying documents submitted to the court, Supreme Court of

¹⁶⁴ *Omsk Oblast Judge of Court of Arbitration and Ltd. "L. & A. Q. O-A" v. Ltd. "K-I"*, Case No. v-799-sh-97-2012, (Supreme Court of Georgia, Jun. 25, 2013).

Georgia came to the conclusion to refuse the recognition and enforcement on the following grounds:

According to the “Convention on the legal assistance and legal relations on the civil, family and criminal cases”, Article 53 the motion for the compulsory enforcement should be presented to the competent court of the contracting party, where decision is subject to the enforcement. It can also be submitted to the court where First Instance decision was made. This court should transmit the motion to the court which is competent to rule on this motion. Article 55 of the Convention subparagraph d) states that permission for the compulsory enforcement may be denied in case of absence of the document which confirms agreement of the parties on the issue of contractual jurisdiction. In this case, according to the arbitration agreement 10.2, in case of failure to reach an agreement, the dispute was to be decided by the Court of Arbitration according to the Claimant’s residence. Court reasoned that arbitration agreement was not valid. According to the Law of Georgia on Arbitration, arbitration agreement is valid, if parties specify the court to resolve a dispute, which parties failed to do so. The court emphasized that, unlike Georgia, according to the Russian Federation Law, arbitration courts are part of the common courts system. If the agreement was to be examined, it was unclear parties agreement leads to common courts or arbitration. The agreement was signed between the Georgian and Russian companies. In case Claimant was Georgian company, then it would be utterly incomprehensible which court was to be applied for. According to the Civil Procedure Code of Georgia, Article 21, if court jurisdiction is not unequivocally established, then parties may agree to establish the court’s jurisdiction. The agreement has to be made in writing. Therefore, even if contractual jurisdiction relates to common courts system, parties still have to have an agreement on a particular court, which they address for dispute resolution. Taking this into account, in this case, there was no contractual agreement regarding jurisdiction. According to the “Private International Law of Georgia”, Article 68, 2 (d) the decision is not recognized foreign court

rendered a decision is not considered to be competent according to the Georgian Legislation. In this case, Omsk Oblast Arbitration Court, whose decision was requested to be compulsorily recognized by the parties, is not considered to be a competent court according to the Georgian Legislation. Since in the present case, decision was made by the unauthorized court, it was found contrary to the public policy and its enforcement on the territory of Georgia was prohibited according to the Law of Georgia on Arbitration Article 45 1 b (b.b). Therefore, Supreme Court of Georgia refused the recognition and enforcement of the decision of May 10, 2012.

Supreme Court examined international public policy standard. It commenced reasoning by adhering to the conventional principle of party autonomy to contractually define jurisdiction. The exact wording of the clause made it clear that parties failed to designate arbitral institution. The dispute was to be decided by the *court of arbitration* according to the *Claimant's residence*. This clause refers the dispute to an uncertain arbitration institution. The meaning is so obscure that is impossible to construe it in such a way to give the agreement any certainty for two reasons: firstly, Supreme Court correctly noted that Parties choice of *court of arbitration* led to two-way interpretation because of country-specific approaches. In Russia court of arbitration is a part of the common courts system, whereas in Georgia arbitral institution is a separate entity. Court of Arbitration for Georgian party is somewhat of contradictory term, questioning the intent of the parties – whether they wanted court system or arbitration. Valid arbitration clause has to demonstrate departure from the courts system, which can not certainly be established here. Secondly, making dispute resolution jurisdiction subject to Claimant's residence made the clause twofold uncertain with no degree of reliance. Supreme Court justifiably noted that if Claimant turned out to be Georgian party then it would be incomprehensible which “court” to address, when in fact it agreed on arbitration. Although, reasoned in a persuasive manner, Supreme Court did not explain how fundamental is validity of the arbitral clause to the enforcement and what is its' interaction with the public policy exception. Court should, at least, indicated that “the

principle that a valid arbitration agreement requires courts to refer parties to arbitration is firmly established. It is major prerequisite for the success of arbitration as an international dispute settlement mechanism.”¹⁶⁵ While applying domestic public policy it should be emphasized that it did impose domestic rules. Second reference to the domestic public policy was used as an “even if” back-up argument by the Supreme Court. It noted that even if parties meant common courts system, Civil Procedure Code of Georgia still required indication to the specific court. Under *First Options of Chichago Inc. v Kaplan* “the rules is that the parties must specifically empower the arbitrators to decide jurisdictional issues; if the parties do not such issues are to be decided by the courts.”¹⁶⁶

Although justification why the Omski Oblast court was unauthorized to rule on this dispute was provided, Supreme Court did not elaborate on the issue what relation it did have with the violation of public policy and why the lack of valid arbitration agreement led to the violation of public policy. Supreme Court did not define the term Public policy and certainly did not it refer to NY Convention. This was not the case in *N-C-dze” v. Law Firm Ltd. –is*¹⁶⁷ where common courts system addressed the issue of validity of the arbitration agreement, violation of the public policy and the link between the two. In terms of validity of arbitration agreement, Court of First Instance stated that criteria of assessing the validity of arbitral agreement remain the same as in terms of general agreements. It expressly stated that criteria include the intent, form and content of the clause itself. Recourse to arbitration should necessarily mean that common courts loose the right to rule on this issue and there should be exclusion of the dispute resolution in such a system. In this case, parties did not agree on the essential requirement of the valid arbitration agreement – to name arbitral institution as the only dispute resolution mechanism as far as the

¹⁶⁵ L. Mistelis, J.D.M. Lew, *Applicable Laws and procedures in international commercial arbitration, Section C: Jurisdictional Issues in Arbitration*, (UK, London: University of London, 2005) 20.

¹⁶⁶ Paul D. Friedland, *Arbitration Clauses for International Contracts*, 2nd ed., (NY, Huntington: Juris Publishing, 2007) 92.

¹⁶⁷ *N-C-dze” v Law Firm Ltd.–is*, Case No.as-804-858-2011 (Supreme Court of Georgia, Jun. 27, 2011).

clause included two methods of dispute resolution: courts or arbitration. According to Eisemann, valid arbitration agreement should “exclude the intervention of state courts in the settlement of the conflict, at least before an award is issued”.¹⁶⁸ Although, in this case Appellate Court of Georgia set aside the award, it made an interpretation of what constitutes public policy under the Law of Georgia on Arbitration Article 42 1 (b.b)¹⁶⁹ which was shared by the Supreme Court consequently. Public order was defined as an imperative rule set by the law, legal basis, violation of which, in itself causes violation of the public order.¹⁷⁰ Supreme Court found that apart from the clause itself, there was a violation of present one's own case, as far as no evidence was examined and it not only reiterated appellate court's ruling but also applied public policy concept stating that *basic principles of law under the statutory Law of obligations* were infringed which relevantly constituted violation of public policy. It is confusing, that Supreme Court in fact interprets public policy in a way which was rejected by the Geneva Convention, where violation of public policy occurred when the enforcement of an award was *contrary to the principles of the law of the country in which it was sought to be relied upon*. It is reasonable to doubt such an interpretation. Especially, if we consider that this case included some moral aspects, for example deceit on the hearings; therefore it was highly desirable that judiciary did not limit itself only to the legal matters.

2.2.2.2 Case Study 2: Limiting the use of conflict rules under the shield of public policy

Case *JSC “P” v. LLC. “L”*¹⁷¹ to be examined refers to an arbitral award of the United Mediation Court of Riga, dated on September 14, 2011 that party JSC “P” sought to have recognized and

¹⁶⁸ Frédéric Eisemann, *La clause d'arbitrage pathologique*, *Commercial Arbitration Essays in Memoriam Eugenio Minoli*, (Torino: Unione Tipografico-editrice T (U.T.E.T.), 1974) 130.

¹⁶⁹ Article 42, Grounds for challenging and setting the award aside. 1. An arbitral award rendered in Georgia may be set aside by the court only if: [...] b) The court finds that [...] b.b.) the award is contrary to public policy.

¹⁷⁰ [Translation provided by an author]

¹⁷¹ *JSC “P” v. LLC. “L”*, Case No.a-492-sh-11-2012 (Supreme Court of Georgia, July 6, 2012) online at http://www.newyorkconvention1958.org/index.php?lvl=notice_display&id=1364 (visited on Mar. 18, 2014)

enforced on the territory of Georgia before the Supreme Court of the respective country. LLC. “L” challenged an enforcement on the ground that arbitral award went beyond the scope of arbitration agreement. It based an argument on the fact that mortgage contract which was mentioned in the award was not related to the subject matter of the arbitral agreement breaching Law of Georgia on Arbitration article 45(1)(a)(a.d.).¹⁷²

The Supreme Court of Georgia granted recognition and enforcement of the arbitral award. Court reasoned that rendered award itself did not contain any rulings including a mortgage contract through examining operative part of an award. On its own motion Supreme Court proceeded to ascertain whether the award was contrary to public policy under Article 45(1) (b.b.) of the Arbitration Law. It is to be observed that Supreme court could have proceeded without examining public policy exception ground because it already examined dispute under 45(1) (a)(a.d.). “Recognition and enforcement of an award may be refused, on the basis of Article V (1) (c) of the NY Convention only if the party against whom enforcement is sought alleges and proves that the arbitrators have transgressed the boundaries of their authority. A court may however refuse *ex officio* to recognize and enforce an award which satisfies the conditions of Article V 1 c of the NY Convention and violates its national public policy (Article V (2) (b)).”¹⁷³ Thus doing so, Supreme Court excluded any doubt that award did not violate national public policy. According to the interpretation of the Supreme Court of Georgia, public policy is a fundamental principle in relationships governed by civil law and is applied as one of the important factors limiting the use of conflict rules. “Normal operation of choice of law rules is subject to a public policy limitation.”¹⁷⁴ This approach was adopted by the court. It limited the use of conflict rules through referring to the national law of Georgia. In examining whether the

¹⁷² This article is identical to the Article V (1) (c) NY Convention.

¹⁷³ Mercedesh Azeredo da Silveira, Laurent Levy, *Transgression of the Arbitrator's Authority: Article V (1) (c) of the New York Convention*, in Emmanuel Gaillard/Domenico Di Pietro (eds.), Nanou Leleu-Knobil (Ref. ed.), in *Enforcement of Arbitration Agreements and International Arbitral Awards – The New York Convention in Practice* (UK: Cameron May, 2008) 642.

¹⁷⁴ Monrad G. Paulsen, Michael I. Sovem, “Public Policy” in *the Conflict of Laws*, 56 Colum. L. Rev. (1956) 969.

arbitral award contradicted the rules provided in Articles 276(2) and Article 301(11) of the Civil Code of Georgia (“the Civil Code”),¹⁷⁵ it concluded that the award did not uphold or relate to the sale of collateral in order to satisfy a claim and LLC. “L” did not claim that recovered amount was insufficient to satisfy the claim. The Civil Code provisions were held inapplicable and the award was not deemed to be contrary to public policy.

Although award was recognized and enforced, this case is a good example to examine whether national court’s parochial approach seeking to protect domestic interests¹⁷⁶ influences judicial review procedure in Georgia. Supreme Court applied maximal judicial review examining the dispositive part of an award as well as conducting fact-finding. It is true that based on the parties’ submissions and case materials, the Supreme Court found that the mortgage contract was not subject to an arbitration agreement, although it was referred in the award of the United Mediation Court of Riga dated 14 September 2011. The decisive point was the fact that dispositive part of the award does not order the sale of the collateral pledged under mortgage contract no. 1. Otherwise, it truly was case which went beyond the scope of arbitration agreement. Still, court felt the need either to back-up its reasoning with the public policy exception argument or to exclude it in order to ensure certainty of its own decision. In *Parsons & Whittemore Overseas Co. v. Societe Generale de L’Industrie du Papier (“RAKTA”)*¹⁷⁷ court stated that NY Convention “does not sanction second guessing the arbitrator’s construction of the parties’ agreement.” In a case at a hand, it can be considered that arbitration institution second-guessed if mortgage was related to the agreement and did not mention it in the resolution part of the

¹⁷⁵ *JSC “P” v. LLC. “L”*, Case No. a-492-sh-11-2012, Supreme Court, July 6, 2012: “The essence of the above-mentioned provisions is that a creditor will be deemed to be satisfied even when the money recovered from the sale of mortgaged property does not suffice to extinguish the claim secured by the mortgage. These provisions determine the extent of property liability of the debtor and, consequently, the preconditions for satisfying the creditor’s claims. It should be noted that the provisions are of discretionary nature which can be amended by agreement of the parties.”

¹⁷⁶ Emmanuel Gaillard, *The Urgency of Not Revising the New York Convention*, in Albert Jan van den Berg (ed.), 50 Years of the New York Convention. ICCA International Arbitration Conference, ICCA Congress Series, 2009 Dublin Volume 14 (Kluwer Law International, 2009) 698.

¹⁷⁷ *Parsons & Whittemore Overseas Co., Inc v Societe Generale de l’industrie du papier (RAKTA)*, 508 F.2d 969, 975 (2d Cir. 1974).

decision. Recently in Russia, in a case *Hipp GmbH & Co. Export KG v. LLC "SIVMA. Infant food" & CJSC "SIVMA"*¹⁷⁸, Commercial Court of the City of Moscow considered objections to award recognition and enforcement based on arbitrators' substantive contract interpretation raised under the article V 1 (c) of the NY Convention, whereas International Arbitral Centre of the Austrian Federal Economic Chamber in Vienna noted that challenges to awards based on objections to the arbitrators' substantive contract interpretations should be dismissed as far as they are not constituting a true Article V(1)(c) defense and consequently such objections are dismissed.

It is evident that Supreme Court of Georgia did not drastically need to refer to public policy exception. However, it had to address this argument because it examined award itself, not an enforcement or recognition of an award and its' possible violation of the public policy. This explains Supreme Court's urgent need to discuss public policy as important factor limiting the use of conflict rules in Civil Code of Georgia; whether under these provisions LLC. "L" could have availed himself of limiting property liability. Provisions were discretionary nature since parties failed to reach an agreement they are held inapplicable.

Standard of review was flawed. Indeed, Supreme Court exercised review on the merits, since it undertook fact-finding on basis of the documents attached to the arbitral award together with the witness statements. In the international commercial arbitration court applied domestic public policy, limiting this concept only to the two relevant provisions in the Civil Code of Georgia. Equating public policy to the law can be assessed as a deviation from the concept of international public policy.

¹⁷⁸ Dilyara Nigmatullina, Russian Courts Misinterpreted Article V (1) (c) of the NY Convention, AIA, 2011 online at <http://cisarbitration.com/2011/06/07/russian-courts-misinterpreted-article-v1c-of-the-new-york-convention/> (visited on Mar. 21, 2014)

2.2.3 Conclusion

Presented specificities of Georgian experience are revealed not only in its legislation but also in the review by the courts. To my judgment, any misleading practice as to the recognition or enforcement of domestic as well as foreign arbitral awards is substantially bolstered by the “Law on Arbitration” statutory provision on the examination of an award (and not the examination of recognition or enforcement of an award) against public policy. This is a red line which accompanies every single decision rendered by the Kutaisi and Tbilisi Court of Appeals and the Supreme Court of Georgia. Therefore, test of judicial review is flawed on the statutory level which is depicted on the respective case law.

In terms of domestic arbitral awards, violation of procedural public policy is witnessed in the partial administration of justice and breach of due process. Regarding the former one, court did not define public order in the light of the circumstances of the case, it did not establish causal link between the conflict of interest and public order violation, it did not explain what constituted *sufficient* ground for doubting partiality of the arbitration court. Moreover, it introduced a new reasoning as to the conversion of partiality into the invalidation of arbitral agreement. Although without relevant reasoning this is short-sighted path to follow. Even if we assume invalidation of arbitral agreement as a possible solution, we should have justification not to undermine public policy as a ground for refusing recognition and enforcement of arbitral award. Regarding the latter one, breach of due process constitutes violation of public policy. Appeal Court specifically relies on the reasoning that illegal action violates public policy. However, legal actions obviously contrary to public policy also violate it. In terms of due process, court defined the concept of public policy in respect to the circumstances of the case. Penalty for late payment is one of the controversial issues and it is the only example of violating substantive public policy in Georgia. As a standard practice courts have adopted “blaming

culture” and forget that examining proportionality of a penalty as defined by the arbitral tribunal does not mean to compete with arbitral institution. In each and every case, courts automatically reason that penalty is contradictory to fundamental principles of law of obligations, therefore to the public order. It failed to indicate what can be disproportionately high amount, also to identify a linking bridge between disproportionately high penalty and violation of public order. In spite of taking into account the reasonable foreseeability standard and conducting reasonable person test it equals public policy violation to the Article 420 of the Civil Code of Georgia which is certainly *faux pas*.

In terms of foreign arbitral awards jurisdictional practice is not firmly established. Practice of the Supreme Court of Georgia did not define application of domestic or international public policy and the scope of judicial review - whether court has maximal or minimal control over an award is left under question. Regarding the invalid arbitration clause leading to the violation of public policy, Supreme Court narrowed public policy to the domestic one. Although in case of international public policy application the result could have been the same, limiting public policy to the *basic principles of law under the statutory Law of obligations* definition righteously rejected by the Geneva Convention has to be assessed fallacious. Moreover, court tackled the issues of pathological clauses, unauthorized arbitral tribunal and invalidity of arbitration clause in relation to the public policy and it did not define the causal link. Court solely indicated to the Law of Georgia on Arbitration Article 45 1 b (b.b) and not even once mentioned the NY Convention. Public policy was also used as a rule limiting the use of conflict of law rules. In this regard, Supreme Court’s judicial review is conditioned by the fact that it examines whether award itself is contrary to public policy. Although it did not express view on the scope of judicial review, since Supreme Court reviewed dispositive part of an award and undertook substantial fact-finding, it was more of a total review of an award rather than minimal. Supreme Court freely and totally

examined an award, although the reasoning was erroneously based on the domestic public policy (Civil Code and Conflict of Law Rules of Georgia).

To conclude, legislative framework and case law in Georgia reveal a need for improvement and uniform application, respectively.

Chapter 3: Main Findings and Recommendations for Georgia

Lessons for and from Georgia reveal that the content, concept and applicable standard of public policy as well as scope of judicial review is obscure and inconsistent. The picture that emerges when analyzing public policy exception application is a very mixed one. The following chapter will introduce main findings and provide recommendations in order to strengthen enforceability of arbitral awards in Georgia in line with the spirit of the NY Convention.

PITFALLS OF LEGISLATIVE FRAMEWORK:

FINDING 1: Law of Georgia on Arbitration Article 45 1 b (b.b) examines whether award itself is contrary to public order, which contravenes to the wording of the NY Convention V (2) (b) and UNCITRAL Model Law 36 1 (b), examining whether recognition or enforcement of the award is contrary to the public policy.

VECTOR 1: Georgia should adopt an approach of “attenuated public policy” where subject of examination will be not an award itself, but whether its recognition and enforcement is contrary to public order. There are two possible consecutive scenarios in order to rectify inconsistency: i) Law of Georgia on Arbitration Article 45 1 b (b.b) should be amended respectively to the NY Convention V (2) (b) and UNCITRAL Model Law 36 1 (b). ii) Before such an amendment Court of Appeals (Tbilisi and Kutaisi) and Supreme Court should take into consideration NY Convention and UNCITRAL Model Law provisions as far as according to Law of Georgia on Normative Acts Article 7. 3 International Treaties and agreements (c) have prevailing power over the Georgian Law (e).

FINDING 2: Law of Georgia on Arbitration Article 45 1 b (b.b) omits which state’s policy is to be taken into account. Public policy is a geographically restricted, relative category and the need for enforcement state’s public policy indication is requisite. Article 45 1 (b.a.) in respect to

arbitrability defines that dispute can not be subject matter of arbitration *according to Georgian legislation*. Therefore, absence of indication to the country is easily conspicuous, naturally broadening the concept of public policy application.

VECTOR 2: Law of Georgia on Arbitration Article 45 1 b (b.b) should be amended with the reference to the Georgian public order. This will narrow down the scope of public order application.

FINDING 3: According to the Law of Georgia on Arbitration, Article 39. 3 a non-reasoned award is valid if parties agreed in the Arbitration Agreement that no reasons are to be given in the motivational part of an award (a) or settlement exception, when during the arbitral proceedings parties settle their dispute and arbitral tribunal approves the settlement of the parties in accordance with the agreed terms by way of rendering an arbitral award (b). UNCITRAL Model Law Article 31 deems non-reasoned award valid if “parties have agreed that no reasons are to be given”. Georgian Law limits party autonomy and sets more complicated procedure compared to UNCITRAL Model Law: firstly, “parties have agreed” necessarily means arbitration agreement and secondly, it does not state when this agreement can be reached, ex-ante, in between or ex-post period.

VECTOR 3: Law of Georgia on Arbitration, Article 39. 3 should be amended so to provide the same level of party autonomy as UNCITRAL Model Law Article 31. Arbitration agreement requirement should be replaced with the Agreement between the parties wording and parties should be granted this right regardless of the timing.

INCOMPREHENSION OF THE PUBLIC POLICY CONCEPT:

FINDING 4: Georgian courts interpret the concept of public policy as an equal category to the principles of law which is a dangerous and already by-passed stage by the Geneva Convention, which rejected “principles of the law of the country in which it was sought to be relied upon” as a ground for violation of public policy in Article 1(2). Considerable number of cases either indicate on the *the logic of the provision*¹⁷⁹ or to the *basic principles of law under the statutory Law of Obligations*¹⁸⁰, even where some moral aspects are present. In addition, the definition which is provided by the court all too often is so hypothetically alienated from the factual background of the case, that in the end, such an elucidation makes no difference as to the outcome.

VECTOR 4: Public order should be interpreted closely, in the light of the circumstances on a case-by-case basis. Definition by the court should not be too remote from the actual background of the dispute. Otherwise, courts will provide purely theoretical conceptual definition, without the functional application of notion. As case law analysis suggest, legal order is covered by the public order, whereas courts do not embrace moral order as an interlinked significant part of the public order in Georgia. Such an approach can not be justified. It is highly desirable that courts filled the gaps of the legislation with its interpretation and elaborate on the concept, rather than apply the same tool of general definition already done by the legislator. Element of moral order is what makes public policy float above the pure statutory provisions; therefore, it should be embraced by the Georgian courts.

¹⁷⁹ *Debt Recovery and Management Group v Alliance Group Capital*, Case No. 2b/2130-11 (Tbilisi Appeal Court, July 20, 2011).

¹⁸⁰ *N-C-dze v Law Firm Ltd.-is*, Case No.as-804-858-2011 (Supreme Court of Georgia, Jun. 27, 2011).

DEFICIENCY OF JUSTIFICATION IN TERMS OF DOMESTIC ARBITRAL AWARDS:

FINDING 5: In terms of domestic arbitral awards, when Court of Appeals (Tbilisi and Kutaisi) tackle with the procedural public policy most cases include partial administration of justice and breach of the due process. In both cases, courts failed to establish causal link for example, between the conflict of interest and public order violation. Also, court did not take into consideration at which stage conflict of interest issue emerged. It introduced a possible path of resolving conflict of interest issue, such as a conversion of partiality prohibition into the invalidation of arbitral agreement.

VECTOR 5: It is of utmost importance that Court of Appeals define what is procedural public policy and emphasize causal link. Lack of ratiocination and descant, absence of relevant reasoning, mere reference to the existence of conflict of interest, which consequentially and automatically violates national public policy is not persuasive and justified. When upholding the decision, court should take into account at which stage conflict of interest issue emerged and who reported it. Automatically upholding a decision in favor of the losing party of the arbitral proceeding may sometimes equal to saving a party who stored it as challenging ground in case he was found to be losing one. Regarding the conversion of partiality prohibition into the invalidation of arbitral agreement, which is a sensitive issue touching upon the party autonomy, should be noted that if court applies such a principle it should define specific pre-requisites as far as it is venturesome to invalidate arbitral agreement on the ground of presence of conflict of interest which will result in extinguishing the very same ground as a ground for violation of public policy.

FINDING 6: In terms of domestic arbitral awards, when Court of Appeals (Tbilisi and Kutaisi) tackle with the substantive public policy most cases include penalty for late payment. Case law analysis reveals that when addressing this issue Court of Appeals competes with the arbitration.

In fact, this is not a judicial review anymore, rather courts' disagreement over the arbitration about the calculation rates. Case law reveal that courts all too often reduce penalty defined by the arbitral tribunal, which undermines arbitral tribunal's and arbitration's competence as an institution. It should be emphasized that judicial review in this regard is not subject to any of the requirements. In other words, no efficient test is established by the courts.

VECTOR 6: The Court of Appeals should adopt standard review and set uniform rules under which it would only reduce the penalty. Court should take into account all the circumstances of the case and should reduce it only when penalty is found to be disproportionately high. This proportionality test shall not be scrutinized against arbitral tribunal's award, but according to the average penalty for similar violations in its own practice (a) and exceedance over the amount that the parties could have reasonably foreseen at the time of the conclusion of the contract (b). Such a practice will lead to more reasonable and objective test application to the penalty as a violating ground of public policy.

MISAPPLICATION OF DOMESTIC PUBLIC POLICY TO THE RECOGNITION AND ENFORCEMENT OF FOREIGN ARBITRAL AWARDS:

FINDING 7: Georgia applies domestic public policy to the recognition and enforcement of foreign arbitral awards which contravenes with the NY Convention Article V 2 (b). Problematic issue is the fact that Supreme Court applies purely domestic public policy and not even the narrow concept of "international" public policy enshrined in the Convention, limiting public policy to the basic principles of Laws of Obligations under the Civil Code of Georgia.

VECTOR 7: Such a misapplication creates considerable doubt as to the emerging tendency in the courts – insisting on the primacy of the national court system over the international commercial arbitration. To overcome a pernicious practice, it is highly advisable that Supreme Court of

Georgia adopts the notion of international public policy, rejects purely domestic standard and thus, complies with the NY Convention. Moreover, court should base its reasoning on the NY Convention while in none of the cases of the Supreme Court referred to the Convention and relevant provision.

TENTATIVE SCOPE OF REVIEW TO THE RECOGNITION AND ENFORCEMENT OF FOREIGN ARBITRAL AWARDS

FINDING 8: Based of limited number of cases, it is troublesome to enunciate that extent of judicial review goes as to the merits as a standard scope of review. Indeed, Supreme Court exercised review on the merits, since it undertook fact-finding on basis of evidence together with the witness statements. Pervasive issue is whether court subjected an award to total control generally or with respect to public policy as such. In any of the scenario, court established maximal review. It should be noted that scope review was somewhat imperfect as far as court applied domestic public policy. Still the scope of review remains as changeable category, not explicitly addressed by the Supreme Court of Georgia.

VECTOR 8: Since there is a risk that “certain states invoke public policy as a pretext and not as a true reason not to enforce an award under the NY Convention”¹⁸¹ it is highly recommended that Supreme Court defines reliable scope of judicial review for reasonable predictability of the dispute resolution outcome. Also, in the long run, with the increase of referral as to the recognition and enforcement to the Georgian Common Court system will increase, it is advisable to share the practice of Russia¹⁸², Republic of China¹⁸³ and others, who issued Information

¹⁸¹ Emmanuel Gaillard (General ed.), *The Review of International Arbitral Awards*, IAI Series No. 6 (NY: Juris Net and International Arbitration Institute, 2008)

¹⁸² See., supra note 131; Anton V. Asoskov, Alexey I. Yadykin, *Russian Higher Arbitrazh Court Releases Long-awaited Draft Information Letter on Public Policy*, Arbitration Quarterly, Issue No. 1 - January, 2013, 6

¹⁸³ See, *Circular of the General Office of the State Council regarding some problems which need to be clarified for the Implementation of the Arbitration Law of the People's Republic of China*, 8 June, 1996

Letters, circulars which serve as guidelines. Although not binding, they are authoritative documents as far as they reflect the legal position of the Court of Cassation. This will also be beneficial for the Supreme Court's self-determination of its own position in regard to the applicable standard of public policy and the scope of judicial review.

With this analytical and comparative work, I identified drawbacks of legislative framework and misguided practices in regard to the public policy exception application in Georgia in respect of domestic as well as foreign arbitral awards, summarized main findings and proposed recommendations. Since commencement of this research was conditioned by the fact that there is a small number of works in this field and public policy exception is left unspoken by the local practitioners as well as arbitral tribunals, I believe with this research I contributed former works and suggested issues to put thinking caps on. Limitation of the thesis is analyzed case law. Since Law on Arbitration came into force in 2010 and public policy exception was introduced, I covered cases as much extensively as the current case law entitled me to. Suggestions for further research will be in regard to the refusal of recognition or enforcement of foreign arbitral awards. With the strengthening of commercial arbitration in Georgia, I reckon parties acting on the international business avenue will address Georgian Courts for the recognition or enforcement of arbitral awards, which will bring diverse material to work on for the interested researchers.

The objective of this research was to summarize and unify application of public policy exception by the Georgian courts. Identified pitfalls and suggested vectors for improvement will foster reinforcement of arbitral institutions and cultivate trust towards arbitral tribunals in Georgia.

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