

## **The Public Policy Exception to Recognition and Enforcement of Arbitral Awards under Armenian Law<sup>1</sup>**

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Under Armenian law, the concept of *ordre public* (հասարակական կարգ, հանրային կարգ) is used in different contexts<sup>2</sup> as exceptional grounds for regulating or derogating from otherwise applicable legal norms. For example, the RA Constitution, Art. 43, provides that certain civil rights may be limited to "maintain public order", and the RA Civil Code, Art. 1258, prohibits application of foreign law if "application would clearly contradict the legal basis (public order) of the Republic of Armenia". Similarly, the RA Commercial Arbitration Act, Arts. 34.2(2)(b) and 36.1(2)(b), tracking the UN Convention on Enforcement and Recognition of Foreign Arbitral Awards ("NY Convention"), Art. 5.2(b) and the UNCITRAL Model Law on International Commercial Arbitration ("UNCITRAL Model Law"), provide that an RA court may refuse to recognize or enforce an arbitral award if "the award is contrary to the public order of the Republic of Armenia". This article focuses on the "public policy exception" in the context of the RA Commercial Arbitration Act in light of Armenian and international practice under the NY Convention and the UNCITRAL Model Law.

Since this article is in English and the law being discussed is in Armenian, it may be useful to start by clarifying the terminology which is used in English, Armenian, and international practice to refer to the concept of *ordre public*, as well as to define its function

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<sup>1</sup> We wish to express our thanks to AUA Law Department Dean Thomas Samuelian for his helpful comments and guidance in preparing this article.

<sup>2</sup> The concept of Public Order is also referred to in the RA Family Code, Article 152, and in numerous international treaties, e.g., the International Covenant on Civil and Political Rights, the European Convention on Human Rights, which under the RA Constitution and Law on Legal Acts, are part of the law of the Republic of Armenia.

in the legal system. In English, *ordre public* is referred to more or less interchangeably in such phrases as the *ordre public exception* or *public policy exception*, which are grounds for derogating from otherwise applicable legal norms.<sup>3</sup> In particular, for the purposes of the Model Law, the United Nations Commission on International Trade Law (UNCITRAL) affirmed that *public policy* in English was to be interpreted as the equivalent of *ordre public* in French as a term of art.<sup>4</sup> Functionally, it may either prohibit the application of or give the court discretion to refuse to apply a foreign legal act (treaty, contract provision, foreign judgment, arbitral award, order) “to avoid an unacceptable derogation from values that the court sees as fundamental to its own legal system.”<sup>5</sup> In the context of arbitration, it gives the domestic court discretion to derogate from the international norm favoring enforcement of arbitration awards in limited circumstances. This intention is well summarized by the Italian representative to UNCITRAL: “the aim was to provide for a minimum of court control and supervision.”<sup>6</sup>

In Armenian, references to public order are translated in different ways:

հասարակական կարգ (RA Constitution, Art. 43, International Covenant on Civil and Political Rights, Art. 12, European Convention on Human Rights, Art. 6), հանրային կարգ (RA Civil Code, Art. 1258, RA Commercial Arbitration Act, Arts. 34(2)(2)(b) and 36(1)(2)(b)), New York Convention, Art. 5.2(b)).

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<sup>3</sup> Catherine Kessedjian, *Public Order in European Law*, 1 Erasmus Law Review 25, 26 (2007); Roel de Lange, *The European Public Order, Constitutional Principles And Fundamental Rights*, 1 Erasmus Law Review 3, 8 (2007) (on difficulties in translating and comparing the concepts of *ordre public*, *public order*, *public policy*)

<sup>4</sup> ¶ 38. The Chairman said that “public policy” was a translation of the French term “ordre public” and meant the fundamental principles of law.” (discussing Art. 34.2) UNCITRAL Model Law on Commercial Arbitration, Travaux Préparatoires, 318 Meeting. <http://www.uncitral.org/pdf/english/travaux/arbitration/ml-arb/318meeting-e.pdf>.

¶ 9. Mr. Graham (Observer for Canada), supported by Mr. Rickford (United Kingdom), said that his delegation had understood the term ‘public policy’ in the sense of the French ‘ordre public’, rather than in the restricted common law sense.” (discussing Art. 36.2) UNCITRAL Model Law on Commercial Arbitration, Travaux Préparatoires, 330th Meeting. <http://www.uncitral.org/pdf/english/travaux/arbitration/ml-arb/330meeting-e.pdf>.

<sup>5</sup> J. Bloom, *Public Policy in Private International Law and Its Evolution in Time*, p. 2.1.

<sup>6</sup> UNCITRAL Model Law on Commercial Arbitration, Travaux Préparatoires, 318 Meeting. ¶ 46. <http://www.uncitral.org/pdf/english/travaux/arbitration/ml-arb/318meeting-e.pdf>.

RA Commercial Arbitration Act, Articles 34(2)(2)(b) and 36(1)(2)(b) were taken from the UNCITRAL Model Law on International Commercial Arbitration, Articles 34.1(b) and 36.1(b) and are the same in almost every country of EU and also the Russian Federation:

34(2)(2)(b) An arbitral award may be set aside by the court ... only if: ... (b) the court finds that: ... (ii) the award is in conflict with the public policy of this State.

36(1)(2)(b) Recognition or enforcement of an arbitral award, irrespective of the country in which it was made, may be refused only: ... (b) if the court finds that: ... (ii) the recognition or enforcement of the award would be contrary to the public policy of this State.

As of April 2008, no official commentary to the UNCITRAL Model Law on International Commercial Arbitration has been issued; however an explanatory note on the Model Law on International Commercial Arbitration states that violation of public policy is to be understood as "serious departures from fundamental notions of procedural justice."<sup>7</sup>

Although the grounds for setting aside as set out in article 34 (2) are almost identical to those for refusing recognition or enforcement as set out in article 36 (1), a practical difference should be noted. An application for setting aside under article 34 (2) may only be made to a court in the State where the award was rendered whereas an application for enforcement might be made in a court in any State. For that reason, the grounds relating to public policy and non-arbitrability may vary in substance with the law applied by the court (in the State of setting aside or in the State of enforcement). (para. 46 of the Commentary)

[...] violation of public policy (which is to be understood as serious departures from fundamental notions of procedural justice) [...] (para. 47 of the Commentary)

As of April 2008, there is no Armenian domestic judicial precedent or practice with respect to enforcement of foreign arbitral awards by the Armenian courts, and no directly binding international precedent. In general, there is little international precedent regarding

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<sup>7</sup> Explanatory Note by the UNCITRAL Secretariat on the 1985 Model Law on International Commercial Arbitration (2006). This note is for informational purposes only; it is not an official commentary on the Model Law.

setting aside arbitral awards on the basis of the public policy exception, except the legislative intent of the drafters that this exception should be rarely invoked, because the international norm favoring arbitration would be vitiated by the uncertainty and inconsistent interpretations arising from such discretionary judicial action. For this reason, commentators have focused on the drafters' intent and the purpose of these legal instruments to present and develop interpretations consistent with that intent and purpose.

One of the primary goals of the New York Convention and the UNCITRAL Model Law, both of which were adopted by the RA National Assembly without any major reservations or conditions, is to create a uniform, internationally accepted mechanism for the alternative resolution of commercial disputes. Ultimately, these acts aim to promote economic welfare and fairness by reducing the risks and costs of international commercial activity. This goal is best promoted by assuring convergence of interpretation of the key provisions of these legal acts. For this reason, the intent of the drafters and international practice are of special significance for the development of judicial practice in Armenia regarding the interpretation of the RA Commercial Arbitration Act. To assure that the New York Convention and RA Commercial Arbitration Act achieve their goals, the judiciary of each country needs to interpret these acts in a manner consistent with their intent and international practice in order to achieve the goals sought by the executive and legislative branches in adopting these legal norms. As a relatively late adherent to these norms, Armenia and its courts have the benefit of international practice, which should facilitate the development of a body of effective domestic judicial practice in this field.

The various interpretations of the public policy exception stress different strands of underlying policy: (1) sovereignty and a jurisdiction's right and duty to regulate its own territory and citizens which has both legislative and enforcement components, (2) anti-forumshopping/equality before the law. Thus, many legal systems enshrine this exception in

seemingly broad terms, for purposes of conflict of laws, adjudicatory or legislative jurisdiction,<sup>8</sup> but apply it sparingly in practice, and disfavor its use with respect to recognition and enforcement of arbitral awards.

It is important, however, to focus on the public policy exception in the specific context of international arbitration, which by its very nature is intended to transcend certain traditional bounds of domestic law to achieve certain benefits for each country, while providing safeguards against abuse.

The Travaux Préparatoires for the New York Convention, Art. 5.2(b), on which the UNCITRAL Model Law and the RA Commercial Arbitration Act provisions are based, give some insight into what the phrase "contrary to public policy" did not intend, since the Travaux Préparatoires record various formulations that were rejected by the drafters:

- (1) "contrary to the fundamental law (public ordre)", proposed by the Brazilian representative and rejected,
- (2) "illegal", proposed by the Israeli representative and rejected,
- (3) "blocked by res judicata" in the state, proposed by the Italian representative and rejected. (to prevent forum shopping, in particular, by its own nationals which each jurisdiction has a special interest in, from the point of view of regulating its nationals and assuring equality before the law. Nationals should not be permitted to evade their national law or obtain a different outcome, simply because they chose to arbitrate, rather than litigate).

The rejected formulation (1) of the Brazilian representative, also advocated by the Iranian and Peruvian representatives, is virtually identical to the provision of the RA Civil Code, Art. 1258. In short, although the RA Commercial Arbitration Act and the RA Civil Code use the same words for public order հանրային կարգ, the gloss in the RA Civil Code

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<sup>8</sup> For example, Canada and the UK:

“Canadian courts will not recognize or enforce a foreign law or judgment or a right, power, capacity, status or disability created by a foreign law that is contrary to the forum’s fundamental public policies, its “essential public or moral interest”, or its “conception of essential justice and morality.”

Approximately the same norm can be found in the English legal system:

“English courts will not enforce or recognize a right, power, capacity, disability or legal relationship arising under the law of a foreign country, if the enforcement or recognition of such right, power, capacity, disability or legal relationship would be inconsistent with the fundamental public policy of English law.” L. Collins, gen. ed., *Dicey & Morris on the Conflict of Laws*, 13th ed. (London, Sweet & Maxwell 2000) Rule 2, para. 5R-001.

– "bases of legal order" – was different, at least for the drafters of this provision. Hence, even if the Armenian courts had given, or give, a binding interpretation of the RA Civil Code, Art. 1258 in the future, there are solid grounds for distinguishing and finding it inapplicable to the RA Commercial Arbitration Act, Arts. 34, 36. Moreover, RA Civil Code, Art. 1258, functions as an exception to the general conflict of laws rules set forth in Arts. 1253-1257. These articles call for application of foreign law in certain circumstances regarding civil-law relations involving foreign persons or cases having nexus with foreign law. Thus, the RA Civil Code definition of public order is to be read as a conflict of laws provision, calling for the application of Armenian law to disputes adjudicated in Armenia when foreign norms directly conflict with fundamental basis of Armenian law, rather than as a provision defining public order for the purpose of setting aside an otherwise properly adjudicated arbitral award.

Moreover, the Travaux Préparatoire for the Model Act rely and reconfirm the drafter's intent expressed in Travaux for the New York Convention. For example, the Italian representative to UNCITRAL commented: "The New York Convention used the same concept (article V, para. 2 (b)). That convention had worked satisfactorily so far."<sup>9</sup>

The Observer for Argentina further clarified that his delegation considered that "*ordre public*" constituted a body of fundamental principles which included also due process of law, and that "the subparagraph implied a guarantee of protection against serious procedural injustice in the arbitration proceedings."<sup>10</sup> This sense of public policy was adopted by the Commission, as summarized by the Chairman, "namely the fundamental principles of law, without differentiating between substantive and procedural law."<sup>11</sup>

The US representative further clarified that "he thought it should not be so broad as to include mistakes by arbitrators, mistakes of fact of any kind or newly discovered evidence,

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<sup>9</sup> UNCITRAL Model Law on International Commercial Arbitration, 318 Meeting, ¶ 46.  
<http://www.uncitral.org/pdf/english/travaux/arbitration/ml-arb/318meeting-e.pdf>.

<sup>10</sup> Travaux Préparatoire, Meeting 318, para. 47

<sup>11</sup> Travaux Préparatoire, Meeting 318, paras. 56, 57

but should be restricted to situations where the award was procured by fraud, corruption or undue means."<sup>12</sup>

The Italian Commissioner's comment which was cited earlier, but is worth repeating, also underscores the drafter's intent that this exception should be given limited scope: "The aim was to provide for a minimum of court control and supervision."<sup>13</sup>

This concept has been applied in the US courts and summarized in commentaries on US law in this sphere, e.g., the Restatement (Third) of The Foreign Relations Law of the United States § 488, Reporters' Notes 2. "United States courts have construed the public policy exception to the enforcement of foreign arbitral awards narrowly..." The US Court of Appeals for the Second Circuit, one of the premiere international forums for commercial legal disputes, warned: "To read the public policy defense as a parochial device protective of national political interests would seriously undermine the Convention's utility. This provision was not meant to enshrine the vagaries of international politics under the rubric of 'public policy.'" *Parsons & Whittemore Overseas Co., Inc. v. Société Générale de l'Industrie du Papier (RAKTA)*, 508 F.2d 969, 974 (2d Cir. 1974).

While US jurisprudence in this sphere provides a long-standing source of useful guidance, European practice may be more directly relevant to Armenia, given the proximity and partial direct applicability of European Court practice and precedent in Armenia. It is important to note that the public policy exception under European Community Law is highly compartmentalized and conditioned by the overall goal of constructing a European legal order. For this reason, it is important to clarify the context in which the domestic court deems it appropriate to invoke the public policy exception when a conflict between domestic and European Law arises. For example, the derogation in a case involving prevention, investigation or prosecution of a criminal offense raises a different set of public policy

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<sup>12</sup> Travaux Préparatoires, 318th Meeting, para. 61

<sup>13</sup> Travaux Préparatoires, 318th Meeting, para. 46

concerns and domestic state interests than a commercial contract or the recognition and enforcement of a foreign arbitral award. That said, the tendency in the economic cases, regardless of the specific sphere or country, is: "public policy exception, as interpreted by the ECJ, is similar in all internal market areas, whatever the freedom at stake and whatever the specific area of the law." In European jurisprudence, as in US practice, "The general rule of interpretation is . . . a restrictive one."<sup>14</sup>

Initially, when the EU was first formed the founders were sensitive to the diverse backgrounds and the necessity to provide some flexibility in order to prevent undesirable friction and allow for convergence. This is reflected in the evolution of the ECJ interpretation of public policy exception from deference to greater constraint, reflecting growing consensus and convergence. In early cases nearly 35 years ago, for instance, *Yvonne van Duyn v. Home Office* of 1974, the court found that the member states had a unique responsibility in defining their public policy.<sup>15</sup> The court followed a traditional viewpoint by stating that public policy was a territorial concept (i.e., a specific public order for each member state) that may evolve over time. The ECJ thus recognized that member states needed the flexibility to change the content of their public policy to reflect changes in their societies and their economic activities.

More recently, the ECJ has favored interpretations to reflect and promote convergence of law and integration of market activity within the EU, showing less deference to the content of the member state's public policy. Particularly in *Bouchereau* case<sup>16</sup>, the court set two criteria which are necessary for the public policy rule: first, it must address a *real* and *severe enough* dangerous violation of that rule, and second, the goal of the public policy rule must be to protect a fundamental interest of society of the state.

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<sup>14</sup> Kessedjian, "Public Order in European Law," 1 *Erasmus Law Review* 27 (2007).

<sup>15</sup> Case 41/74, *Yvonne van Duyn v. Home Office* 1974 ECR, 01337 at 01351.

<sup>16</sup> Case 30/77, *Regina v. Pierre Bouchereau* [1977] ECR, 1999. *see also*, Case 7/78, *Thompson* [1978] ECR, 02247.

Thus, the ECJ has limited the discretion of States to use public policy exception to such an extent that there are now only a few extreme cases where the states are permitted to apply the exception. Moving toward narrower application provides that this exception should only be invoked for the prevention of disorder in the legal system. Under this interpretation, "public order would be synonymous with public security and an orderly way of life in the public sphere. That sense comes closer to 'prevention of disorder' as referred to in the limitation clauses of articles 8 and 10 ECHR."<sup>17</sup>

The emerging body of Russian Federation jurisprudence also shows the same tendencies and may be persuasive as it arises from a similar legal, cultural and political context. Much of Armenia's legal system and culture parallels that of the other post-Soviet states, including the Russian Federation. The highest economic court in Russia issued an Informational Letter regarding the interpretation of public policy in the context of enforcement of arbitral awards. In its 2005 Information Letter No. 96, para. 24, the RF Supreme Arbitration Court reaffirmed the basic principle that the Russian Arbitration Court must abstain from readjudicating an arbitral award on its merits based on the RF Law on Arbitral Tribunals, Art. 46.1. The RF Supreme Arbitration Court further clarified in para. 29-31, that in the Russian Federation, public policy is interpreted as the foundations of the social system of the Russian state. The public policy reservation is possible only in those special cases when the application of a foreign statute might create a result inadmissible from a point of view of Russian legal conscience, giving as specific examples an award based on counterfeit documents, or if the enforcement of the award in the specific case would be contrary to the principles of fairness to the parties, good faith, or adequacy of compensation. While these latter principles could be read broadly to permit fairly extensive review of an

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<sup>17</sup> Roel de Lange, *The European Public Order, Constitutional Principles And Fundamental Rights*, 1 *Erasmus Law Review* 3, 9 (2007).

award on the merit, they are meant to be read in the context of the specific case which involved egregious unfairness between the parties.<sup>18</sup>

### **Conclusion**

Although the public policy exception under the RA Commercial Arbitration Act will be an issue of first impression for the RA Courts, the courts will not be writing on a tabula rasa. The drafters of the Model Law, as well as the NY Convention, expressed their intent and goals. The Armenian executive and legislative have determined it is in Armenia's interests to adopt these legal acts for the purposes of promoting Armenia's economic welfare and international trade, by securing for Armenian nationals access to this uniform alternative dispute mechanism for their commercial disputes in Armenia and around the world. In a small minority of cases, a few jurisdictions courts have set aside awards on the basis that the rule of law applied conflicted with that which the court in the enforcing state would have applied, in effect relitigating the case on its merits and undermining the entire purpose of international arbitration. However, the vast majority of states have adopted a narrower interpretation of the public policy exception that draws a distinction between an award that is merely inconsistent with the letter of domestic law ("illegal") and an award that violates the enforcing of state's public order by offending the society's fundamental sensibilities regarding fairness, public morality and/or important state policies. To secure maximum benefit from the NY Convention and the RA Commercial Arbitration Act, the RA Courts should follow the dominant interpretation developed and adopted by the US, RF, most European and post-Soviet states.

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<sup>18</sup> In the specific case, a German joint venture partner won an arbitral award for \$20 million cash as compensation for a put of its shares to the Russian partner in a company, when the German company's investment commitment had been an in kind contribution of used equipment which had never been made. RF Supreme Arbitration Court Information Letter No. 96 (2005), para. 29.