THE "PUBLIC POLICY" EXCEPTION- TETHERING THE UNRULY HORSE OF ARBITRAL ENFORCEMENT

Avindra Rodrigo

LL.B. (Hons) (Warwick), Barrister-at-Law (Gray's Inn), President's Counsel

Kasuni Jayaweera

LL.B. (Hons) London, Attorney-at-Law

Arbitration in the present era has emerged as a byword for the efficacious settlement of disputes. However, the transnational justice system created by arbitration is often incapacitated by the unruly horse famously known as the "public policy" exception. It has become very common, especially in Sri Lanka, for a party against whom an arbitral award is sought to be enforced, to often piggyback on 'public policy' to frustrate and delay the process of this otherwise efficacious dispute resolution mechanism.

In an age of globalization and where arbitration is increasingly becoming the preferred dispute resolution mechanism, proper fencing of the stables and tethering of this unruly horse is much needed. Legal practitioners who will be sitting astride the unruly horse must necessarily be aware of the parameters of this amorphous challenge to the enforcement of arbitral awards.

A. Birth of the Foal

The New York Convention[1] and Model Law[2] provide several grounds upon which the recognition and enforcement of an arbitral award may be refused. At the very outset, it is important to emphasize that the language used in the Convention is discretionary and not mandatory,

[1] Convention on the Recognition and Enforcement of Foreign Arbitral Awards – Article V
[2] UNCITRAL Model Law on International Commercial Arbitration.

allowing courts to exercise discretion in refusing recognition and enforcement based on such exception. Furthermore, given the pro-enforcement nature of the Convention, it has been recognized that as far as the grounds for refusal of enforcement of the award are concerned, they are to be construed narrowly.[3]

The Convention and Model Law provide that a State may refuse to recognize and enforce an award if doing so would be contrary to the public policy of the State in which enforcement is sought.[4] However, the term 'public policy' has not been defined. Lack of definition of the term has led to inconsistency and uncertainty in its application.

Interestingly, another aspect of public policy has been envisaged by the Convention as well as our Act[5] which is whether the subject matter of the dispute is contrary to public policy (arbitrability).

It is in the light of these observations that this article will proceed to succinctly discuss the internationally accepted parameters of public policy exception in the sphere of arbitration.

B. What is public policy?

The absence of a uniform definition of 'public policy' is due to the fact that the wording of the New York Convention and many national legislation based thereupon, referring to the exception in relation to the public policy of 'the State'. As such, it may substantially vary from one jurisdiction to another. Therefore, national Courts have attempted to define 'public policy' to

[3] Albert Jan van den Berg, "*The New York Convention of 1958: An overview*" https://www.arbitration-icca.org/media/0/12125884227980/new_york_convention_of_1958_overview.pdf
[4] Article V(2)(b) of the Convention and Article 36(1)(b)(ii) of the Model Law.
[5] Arbitration Act No. 11 of 1995, Section 4 and Section 34(1)(b)(i)

suit the legal system of each country. However, UNCITRAL in its guidelines on the Convention[6], has broadly defined 'public policy' as "*a safety valve to be used in those exceptional circumstances when it would be impossible for a legal system to recognize an Award and enforce it without abandoning the very fundaments on which it is based*."[7]

In Sri Lanka, the 'public policy' exception has been recognized to cover the enforcement of an award in breach of fundamental principles of law and justice in substantive as well as procedural aspects.[8] However, it is also held that not every error of law but only a violation of a fundamental principle of law applicable in Sri Lanka that would be held to be contrary to public policy.[9] Despite the absence of a universally accepted definition, almost all jurisdictions have held that the public policy exception shall be applied with great caution and recourse thereto shall only be made in exceptional circumstances.[10] Nevertheless, it must be appreciated that a national court, as one of the integral branches of the Government would be hesitant to enforce an Award which is contrary to the legislative policies espoused by the legislature in the form of laws and regulations. Due to the dearth of decided cases on the subject in Sri Lanka, reference shall be made to the respective statutes and judgments of other jurisdictions to recognize the parameters of public policy. Upon a careful perusal of statutes and decided cases on public policy in arbitration, it can be observed that violations of public policy have been identified at different stages of a contractual relationship.

This Article will now deal with each such category and consider the various jurisprudence in this regard, including that of Sri Lanka, and consider the instances where such violations have been held to be appropriate and sufficient to set aside or refuse enforcement of an arbitral award.

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[6] United Nations, "*UNCITRAL Secretariat Guide on the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958)*" 2016 Edition https://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/2016_Guide_on_the_Convention.pdf
[7] Ibid at page 24
[8] *Light Weight Body Armour Ltd*. vs. *Sri Lanka Army* [2007] 1 SLR 411 at p. 419.
[9] *Kiran Atapattu* vs. *Janashakthi General Insurance Co. Ltd.,* SC Appeal 30-31/2005 (Unreported).
[10] Sri Lanka see *Kiran Atapattu* vs. *Janashakthi General Insurance Co. Ltd*., SC Appeal 30-31/2005; England *Krombach* vs. *Bamberski* [2001] All ER (EC) 584 and India see *Penn Racquet Sports* vs. Mayor International Ltd Ex. P. 386/08 & EA Nos 451/2010, 704-705/2009 & 77/2010

B.1 Contracts furthering an Illegal Purpose

One of the most common substantive public policy violations which transcends national boundaries and result in the refusal of recognition and enforcement of an arbitral award is an award giving effect to an illegal or criminal activity, such as contracts for murder, terrorism, drug trafficking, prostitution etc. Where a Respondent adduces *prima facie* evidence that the award was based on an illegal contract, enforcing such an award would undoubtedly contravene public policy of the enforcing state, provided such illegality is recognized by the enforcing state.[11]

The rationale being that a party cannot by procuring an arbitral award, conceal that they are seeking to enforce an illegal contract, as public policy will not allow it.[12] If such restrictions are not deployed, arbitration could be misused to enforce contracts based on egregious illegality. However, it must be emphasized that enforcement is governed by the public policy of the *lex fori*. Accordingly, an award refused to be enforced in one jurisdiction for contravening public policy may be enforced in another.

B.2 Allegations of Bribery and Corruption in procuring a Contract

Allegations of bribery and corruption have been at the heart of several international arbitrations especially in the procurement of public contracts. In England, a few landmark cases have been decided on the question whether an award to enforce a contract which is not legal would be refused enforcement, based on an allegation of fraud or corruption in procuring it. In deciding the law in this regard, English courts have drawn a distinction between the enforcement of contracts to commit fraud or bribery vis-à-vis contracts which are procured by bribery.[13]

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[11] See *Lemenda Trading Co. Ltd.* vs. *African Middle East Petroleum Ltd.* [1986] QB 448, *Kaufman* vs. *Gerson* [1904] 1 KB 591.
[12] *Soleimany* vs. *Soleimany* [1999] Q.B. 785 at 800.
[13] *Honeywell International Middle East Ltd.* vs. *Meydan Group LLC* [2014] 2 Lloyd's Law Rep 133.

It is indisputable that corruption and fraud are universally denounced. However, English courts would not necessarily refuse enforcement on an allegation of bribery or corruption as the "*public policy of sustaining the finality of arbitral awards outweighs the public policy in discouraging corruption*."[14] It is explained that "*although commercial corruption is deserving of strong judicial and governmental disapproval, few would consider that it stood in the scale of opprobrium quite at the level of drug-trafficking.*"[15] It denotes that different weightage is accorded to various public policy issues, determinable and peculiar to the facts of each case.

Thus, English courts will not refuse to enforce an award giving effect to a contract procured by bribery.[16]

It has been established that, introducing a concept of tainting of an otherwise legal contract would create uncertainty, and in any event wholly undermines party autonomy. However, parties who have committed a criminal act could be prosecuted independent of the agreement.[17] Accordingly, a mere allegation or innuendos of corruption or bribery would not suffice to sustain a refusal of enforcement. The cardinal rule is that such allegations must be proven.

Interestingly, however, English case law demonstrates that even a finding of corruption in the procurement of a contract is in itself an insufficient ground to sustain a challenge to an award based thereupon. Accordingly, in England and most other pro-arbitration jurisdictions, predominant weightage is given to the public policy of sustaining the agreement of the parties to arbitrate their disputes. A similar approach is identified in Sri Lanka, where it was held that great caution should be exercised when applying Section 34(1)(b)(ii), particularly in the context that an arbitral award is the end result of arbitration proceedings, which give effect to the intention of the parties to a dispute to refer their dispute for arbitration.[18]

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[14] *Westacre Investment Inc*. vs. *Jugoimport-SPDR Ltd.* (at first instance) [1998] 3 WLR 770
[15] Ibid at 798-800.
[16] See *Sinocore International Co Ltd* vs. *RBRG Trading* (UK) Ltd, [2017] EWHC 251 (Comm)
[17] See *National Iranian Oil Company* vs. *Crescent Petroleum Company International & Crescent Gas* [2016] EWHC 1900 (Comm) and *R* vs. *V* [2008] EWHC 1531 (Comm).
[18] See *Kiran Atapattu* vs. *Janashakthi General Insurance Co. Ltd.,* SC Appeal 30-31/2005 (Unreported).

However, it is important to note that allegations of bribery and corruption must necessarily be proven in the arbitral proceedings. No further evidence shall be permitted to be adduced at the stage of enforcement. It is a well-established principle of law in Sri Lanka that Court "*cannot sit in appeal over the conclusions of the Arbitral Tribunal by scrutinizing and reappreciating the evidence considered by the Arbitral Tribunal… since the arbitral tribunal is the sole judge of the quantity and quality of the mass of evidence led before it by the parties - the only issue that needs consideration is whether the purported fundamental flaws of the award in question would tantamount to a violation of public policy*."[19] Additional or fresh evidence will only be permissible in extremely exceptional circumstances, where it can be demonstrated to the satisfaction of Court that such evidence was unavailable at the time of the first hearing, and that such new evidence is of such nature to entirely change the aspect of the case.[20]

B.3 Performance of a Contract

When considering the application of the public policy exception, the public policy of several jurisdictions become significant, such as the place of entering into the contract, place of performance and place of enforcement.

For example, a contract for the purchase of personal influence, though unenforceable for reasons of domestic public policy, if performed in Sri Lanka, would not fall into the class of contracts whose enforcement was contrary to public policy irrespective of their proper law and place of performance. Thus, where such a contract was to be performed abroad, it would be enforced in Sri Lanka unless it also was contrary to the domestic public policy of the country of enforcement.

Similarly, English courts recognized that different courts and tribunals might take different views as to the enforceability of contracts depending on their proper law and place of performance

[19] Supra note 9 at page 418.
[20] See *Westacre* supra note 15 and *National Iranian Oil Company* supra note 18.

and it has been held[21] that English public policy would not be offended if an arbitral tribunal enforced a contract which, though contrary to the domestic public policy of the place of performance, did not offend the domestic public policy of the country of its proper law or curial law.

B.4 Procedural Public Policy

If the process by which a dispute was adjudicated in the arbitral proceedings is contrary to fundamental procedural rules, enforcement of an Award delivered at the end of such process may be refused. For example, it is not atypical to refuse enforcement of an Award if financial impropriety on the part of the tribunal or a member thereof is proven by the losing party, as it is tantamount to a violation of procedural public policy. Other common examples are fraud in the composition of the tribunal, breach of natural justice, lack of impartiality, manifest disregard to the facts or some other significant procedural irregularity in following due process.

In Singapore, the International Arbitration Act ("IAA") provides[22] that, notwithstanding Article 34(1) of the Model Law, the High Court may set aside[23] the award of the arbitral tribunal if the making of the award was induced or affected by fraud or corruption or a breach of the rules of natural justice in connection with the making of the award by which the rights of any party have been prejudiced.

Singapore IAA is one such enactment where procedural public policy has been statutorily recognized.[24] This unique feature is not embraced by our Act. In a recent judgment in

[21] See *Westacre* Supra note 15.
[22] Section 24(a) and (b)
[23] It is noteworthy that procedural public policy has been recognized as grounds for setting aside an award as opposed to refusing enforcement.

[24] Similar provisions are also included in Arbitration Acts of England, Australia, India and New Zealand.

Singapore[25] it was held that Section 24 of the IAA contemplates a situation where the alleged fraud or corruption relates to the Award itself and not the underlying contract.

B.5 Enforcement of Award

Our Arbitration Act very clearly sets out under Section 34(1)(b)(ii) that Court may refuse recognition or enforcement of an arbitral award if it finds that that the award is in conflict with the public policy of Sri Lanka. Accordingly, the defence would only be allowed where the enforcement of the award would violate the forum country's most basic notions of morality and justice.

It is the trite law that the duty of the enforcing court only extends to find whether the purported fundamental flaws of the award in question would amount to a violation of public policy in Sri Lanka. Finality of awards is of paramount importance especially in international commercial arbitration. There is a recognized commercial international policy in favour of enforcing arbitral awards.

This is reflected in section 33 of our Arbitration Act, which places a mandatory duty upon court to enforce a foreign arbitral award but for its discretionary right to refuse recognition based on one of the section 34 exceptions.

Due regard must be cautiously given to whose public policy is relevant in enforcing an award. Upon a careful analysis of the cases discussed above it appears that more weight is placed upon the public policy of the place where the award is being enforced and that of the governing law, but less emphasis seems to be placed on the law of the place of performance.

[25] *Rakna Arakshaka Lanka Ltd.* vs. *Avant Garde Maritime Services (Pte) Ltd.* [2019] SGCA 33

Article V(2)(b) of the Convention also provides that an award would be refused if "*the recognition or enforcement of the award would be contrary to the public policy of that country*". "That country" refers unequivocally to the country where recognition and enforcement is sought. This interpretation is warranted because the purpose behind the exception was to permit a country to refuse enforcement of an award that was contrary to its own system.

C. Arbitrability and Public Policy

Arbitrability refers to the question of whether a particular dispute may or may not be settled through arbitration. It is a separate and distinct ground for refusing enforcement which is also coloured by considerations of public policy to what is contemplated in Section 34(1)(b)(ii). This view stems from the fact that the Convention refers to arbitrability and public policy as defences to enforcement in connected but two separate Articles; V(2)(a) and V(2)(b) respectively.

In-arbitrability is usually invoked at the very beginning of the arbitration process, as an argument for the tribunal to decline jurisdiction, while public policy is typically raised at the stage of enforcement or setting aside proceedings before the national courts. However, when faced with an in-arbitrable dispute, an arbitral tribunal may be required to decline jurisdiction. If it fails to do so, the enforcement of its final award may be successfully challenged if the national law of the state where enforcement is sought considers the dispute to be in-arbitrable.

The underlying rationale being that, due to the seriousness and criminality, certain disputes are best dealt by Courts in as much as greater means of investigation is needed to serve the public interest. Accordingly, criminal matters and matters relating to personal status (divorce, nationality, etc.) are typical examples of in-arbitrable disputes.

Arbitrability of a dispute differs from one jurisdiction to another. Whilst there is general consensus that disputes of a purely commercial nature are capable of settlement by arbitration,

views are more divergent when it comes to disputes involving matters that are not purely commercial, such as labour, intellectual property, securities transaction, insolvency and antitrust disputes.

In our Act, in addition to the arbitrability of a dispute that is contemplated in the grounds for refusal of enforcement of an award, Section 4 provides that a dispute coming within the purview of an arbitration agreement may still not be capable of being resolved by arbitration if it is "*contrary to public policy or, is not capable of determination by arbitration*".

In a decided case[26], where Section 4 of our Act was read in conjunction with Section 5, vis-à-vis party autonomy, the Court reiterated the right of a party to an arbitration to decide whether or not to object to the jurisdiction of a court where the same is invoked by the other party to the agreement. Where a party to such an agreement decides not to take up any objection to the exercise of jurisdiction by court, it is free to hear and determine the case or other proceeding, and in such a case Section 4 would not make it mandatory for the matter to be determined by arbitration.

In any event, when deciding the arbitrability of a dispute, English courts have emphasized that courts should lean in favour of giving effect to the arbitration clause to which the parties have agreed, if the circumstances allow to do so.[27]

D. <u>Conclusion</u>

The approach of courts have been far from consistent in the application and determination of principles of public policy. A certain level of latitude has to be given to national courts to decide on public policy, depending on the circumstances of each case. Parameters of public policy as

[26] *Elgitread Lanka (Private) Limited* vs. *Bino Tyres (Private) Limited* SC (Appeal) No. 106/08 (Unreported).
[27] *Astro Vencedor Compania Naviera S.A.* vs. *Mabanaft G. M.B.H.* [1970] 2 Lloyd"s Reports 267.

well arbitrability are bound to evolve over time especially to suit the commercial realities of international trade and commerce.

However, there is an emerging international consensus that public policy in the context of enforcement should be given a cautious and restrictive interpretation. Mere allegation or innuendo of a violation of public policy is insufficient to sustain a valid defence. A public policy must first be identified, and then it must be shown which part of the award is in conflict with such public policy.

When applying public policy as a ground of refusal of recognition or enforcement, Courts and parties should not lose sight of the fact that the right of the citizens to resolve their disputes by referring such disputes to arbitration is also a right endorsed by the law of the country and therefore arbitration itself is part and parcel of the public policy. Further when exercising its discretion to utilize the public policy exception courts must be careful not to permit an unsuccessful party in an arbitration use this exception as means of resisting and/or delaying the enforcement of an award.

Therefore, by adopting a more transnational perspective which views the public policy exception through a pro-arbitration lens and ensures international comity, would not only enshrine the fundamental principle of party autonomy, but also would help to create a greater degree of consistency in preserving the finality of an arbitral award, thus allowing Sri Lankan Courts to tether this once unruly horse.