Application of public policy doctrine summarised by the Supreme Arbitrazh Court

On 1 April 2013 the Presidium of the Supreme Arbitrazh Court of the Russian Federation (the "Presidium") published the review of cases involving application of a public policy clause (the "Review")¹. The Review sets out the Presidium's recommendations to the lower arbitrazh courts (i.e. the Russian state courts that hear commercial disputes) regarding public policy exclusions in cases on recognition and enforcement of foreign arbitral awards and foreign judgments. While the guidance contained in information letters of the Presidium is not mandatory, in practice it is widely relied upon by Russian arbitrazh courts in adjudicating cases.

Key issues

- The Review is intended as guidance for the Russian courts
- The courts should apply public policy exclusions only in exceptional circumstances
- Stipulating liability for breach of representations and warranties under foreign law does not in itself contravene Russian law
- Criteria for the recovery of liquidated damages are clarified

¹ Information Letter No. 156 dated 26 February 2013 "Review of Arbitrazh Court Cases Involving Application of a Public Policy Clause as a Ground for Denial of Recognition and Enforcement of Foreign Judgments and Foreign Arbitral Awards".
General approach to the application of public policy doctrine

The Review provides that public policy should be understood to mean the fundamental legal framework (principles) of the highest precedence and universality, having particular societal and public importance, which underpins the economic, political and legal systems of the state. As is stated in the Review, such fundamental principles include, without limitation, the principles of freedom of contract, equality of the parties to civil law relationships and their implied good faith, the commensurability of civil law liability with the consequences of offences, and the redress and judicial protection of infringed rights.

Despite such a broad definition of public policy, it is stated in the Review that public policy exclusions are extraordinary and arbitrazh courts should apply them only in exceptional circumstances. At the same time, when assessing the consequences of enforcement of foreign arbitral awards or judgments from the standpoint of public policy, the courts cannot review them on their merits.

The Review includes a number of examples illustrating how the courts are advised to combine these two approaches (a broad definition of public policy and its application only in exceptional cases), the most interesting of which are covered below.

Specific cases of application/denial of application of public policy exclusions

Denial of recognition and enforcement of a foreign arbitral award in relation to a contract entered into as a result of a bribe (clause 2 of the Review)

One of the examples involves recognition and enforcement of an international arbitral award in Russia which was rendered in a dispute between a foreign company and a Russian federal state unitary enterprise. Under the award, the enterprise was ordered to pay a debt to the foreign company deriving from a contract between them. However, when the foreign company sought to enforce the award in the Russian Federation, the enterprise objected, invoking the fact that a Russian court of general jurisdiction had found the enterprise’s CEO guilty of accepting a bribe from a representative of the foreign company to enter into the contract on terms known to be disadvantageous for the enterprise.

The courts, invoking public policy, refused to recognise and enforce the foreign arbitral award and noted that fighting corruption is a fundamental principle of not only Russian, but international law.

Recognition and enforcement of arbitral awards on the recovery of liquidated damages (clauses 5 & 6 of the Review)

The next example relates to an international arbitral award ordering recovery of liquidated damages from a Russian company that breached representations and warranties under an agreement with a foreign company. The award was recognised and enforced despite the Russian company’s arguments that the concept of representations and warranties was alien to Russian law and that recovery of liquidated damages in this case would be inconsistent with the compensatory nature of civil law liability (since the foreign company did not incur any loss as a result of the breach of representations and warranties).

The Russian courts held that since the contractual provision stipulating that liquidated damages were payable in the event of a breach of the representations and warranties had been agreed by the parties voluntarily, “the mere fact that Russian Federation law has no precise equivalent of this concept, which is generally in compliance with the fundamental principles of Russian Federation public policy, cannot constitute a ground for denial on the basis of public policy.”

In another example involving the recovery of liquidated damages, a Russian company argued that since the amount of liquidated damages was more than double the amount of principal debt and losses, their recovery would be punitive. In the Review it is stated that the mere fact that liquidated damages exceed the amount of losses actually incurred does not necessarily mean they are punitive in nature and contravene public policy, provided that the amount of liquidated damages awarded by the foreign tribunal is reasonable. Arbitrazh courts must assess “the extent to which specific liability imposed on a debtor is punitive”, taking into account the fact that “a number of concepts enshrined in Russian civil legislation do envisage stepping away from strictly compensatory measures of civil law liability”.

It is suggested in the Review that public policy doctrine be applied and recognition and enforcement of foreign judgments and arbitral awards be denied under the following circumstances (without limitation): 1) if the amount of liquidated damages is so anomalously high as to exceed...
many times over the amount of damages which the parties could have reasonably foreseen when entering into the agreement; 2) if in the course of agreeing the amount of liquidated damages there were obvious signs of abuse of the right of freedom of contract (e.g., exploitation of a debtor's weak negotiating position, infringement of the public interest and third party interests etc.).

**Recognition and enforcement of a foreign arbitral award despite objections by the debtor’s spouse, who is not a party to the arbitration, arguing that the award infringes her rights (clause 9 of the Review)**

In the next example covered in the Review, a foreign company filed suit in a Russian arbitrazh court seeking recognition and enforcement of a foreign arbitral award under which an individual debtor was ordered to pay a debt deriving from contracts he had entered into. The debtor and his spouse, who was joined to the proceedings in the Russian arbitrazh court, opposed recognition and enforcement of the award because the debtor’s spouse was not a party to the arbitration and the amount awarded ought to have been recovered from, among other things, the spouses’ matrimonial property. In this case the court decided not to deny recognition and enforcement on the basis of public policy, citing three reasons: 1) when a debt is being recovered at the demand of a creditor, the debtor’s share of matrimonial property may be separated for the purposes of levy execution against it; 2) when a spouse disposes of matrimonial property, there is a presumption that he/she is acting with the other spouse’s consent; 3) the spouse in this case did not initiate any legal action herself seeking invalidation of the transaction under which the matrimonial property was disposed of. As a result, the foreign company’s application for recognition and enforcement of the foreign arbitral award was granted.

**Assessment of arguments concerning the independence and impartiality of arbitrators in the framework of recognition and enforcement of foreign arbitral awards (clauses 11 & 12 of the Review)**

In two of the cases covered in the Review, the possibility of a public policy exclusion is analysed in circumstances where the independence and impartiality of an arbitrator that rendered an award is challenged.

From the cases described in the Review it follows that if during an arbitration an arbitrator discloses circumstances that may affect his independence and impartiality but none of the parties to the dispute files an application for disqualification of that arbitrator, then recognition and enforcement of the award does not violate public policy. However, if such an application for disqualification of the arbitrator is filed but not granted, this may serve as a basis for denial of recognition and enforcement of the foreign arbitral award for the reason that such recognition and enforcement would contravene Russian public policy.

**Conclusions**

Given that the definition of public policy contained in the Review is quite broad, many findings as to facts or the application of points of law contained in foreign arbitral awards and foreign judgments could potentially be construed as contravening public policy. That said, from the examples described in the Review it follows that public policy exclusions should indeed be applied only in certain exceptional cases. It is hoped that this restrictive approach to the application of public policy doctrine will come to prevail in the practice of applying Russian law.