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THE NOTION OF TRANSNATIONAL PUBLIC POLICY AND ITS IMPACT ON JURISDICTION, ARBITRABILITY AND ADMISSIBILITY

Given the increasing influence of the concept of transnational public policy in both the commercial and the investment arbitration context and the critique attached to its application the author devotes this paper to an analysis of the scope and content of this concept and its impact on arbitral proceedings at the pre-merits stage. In particular, in a first part, the author gives guidelines on how to distinguish transnational public policy from other public policy concepts as applied in arbitral proceedings and gives guidance on how to determine its scope and content.

Thereafter, the author analyzes in detail the impact of the notion transnational public policy on the arbitral tribunal's affirmation or denial of jurisdiction, arbitrability and admissibility during arbitral proceedings.

The author concludes that given the flexible content of transnational public policy, parties and arbitral tribunals should be cautious and carefully verify the objective existence and meaning of transnational public policy when considering applying it. Violations of substantive public policy are not necessarily postponed to the merits stage, but rather can have an impact on the arbitral tribunal's assessment of jurisdiction, arbitrability and admissibility.

Key words: *Public policy – Jurisdiction – Arbitrability – Admissibility – Unclean hands – Universal standards.*

1. INTRODUCTION

“Public Policy; – it is an unruly horse, and when once you get astride it, you never know where it will carry you. It may lead you from the sound law. It is never argued at all but when other points fail.”¹

¹ Richardson v. Mellish, 2 Bing 229, 303 (1824) cited by M. Reisman, “Law, International Public Policy (So-called) and Arbitral Choice in International Commercial Arbitration”, *ICCA Congress series* 13/2007, 849.

This quotation from *Burroughs J. in Richardson v. Mellish, (England, Court of Common pleas, 1824)* stands as an example for the feeling of distrust and concern caused by the notion of “public policy.” Even though such concerns date back almost 200 years ago, they seem as prevailing and timeless as few other matters when it comes to the application of legal concepts. The very same concerns as voiced in this statement were recently pronounced by Michael Reisman, who put this statement at the beginning of his article “Law, International Public Policy (So-called) and Arbitral Choice in International Commercial Arbitration.”² In this article, Reisman explains his reservations about the application of transnational public policy in international arbitration. In particular, he refers to its “fleeting character” and expresses the fear that “the authorization of its application by international commercial arbitrators would lead to great uncertainty.”³ Furthermore, Reisman expresses doubts that transnational public policy is a legal concept with a verifiable judicial history. Instead he states that the “*invocation of transnational public policy becomes an easy way for those claiming to have an insight into the heart and the soul of international law to effect their own preferences without having to prove that they have become customary international law.*”⁴

Notwithstanding this criticism and these concerns as to the legitimacy of the application of the concept transnational public policy, recent developments in international arbitration show an increasing influence of the concept of transnational public policy on arbitral proceedings and awards, including already at the pre-merits stage.⁵ This increased impact of public policy considerations on international arbitration adjudication can be observed both in commercial arbitration and investment arbitration. In particular, as the author will show below recent investment arbitration adjudication shows that public policy concerns have already increasingly played an important role in the dismissal of a case at an early stage of the arbitration, that is, in the pre-merits phase.⁶ But also in the

² *Ibid.*

³ *Ibid.*, 849, 854. In support of his characterization of international public policy as “fleeting,” Reisman cites to a 2006 decision by the Swiss Federal Tribunal which observed, “The fleeting character of public policy may be inherent to the concept, due to its excessive generality; the wide scope of the almost countless opinions proffered in this regard would tend to prove it... As a commentator pointed out, all attempts to answer the numerous recurring questions raised by the interpretation of this concept merely resulted in raising further thorny or polemical questions.”

⁴ *Ibid.*

⁵ G. B. Born, *International Commercial Arbitration*, 2009, 2177.

⁶ *Plama Consortium Ltd. v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award of 27 August 2008, at para 146, available at <http://ita.law.uvic.ca/documents/PlamaBulgariaAward.pdf>; *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26, Award of 2 August 2006, at para 249, available at http://ita.law.uvic.ca/documents/Inceysa_Vallisoletana_en_001.pdf.

field of commercial arbitration the impact of public policy on the pre-merits phase, specifically on jurisdiction and arbitrability, has been frequently discussed.

In view of the concerns raised in the beginning of this paper as to the content and legitimacy of the application of the concept of transnational public policy, which becomes even more virulent if applied at an early stage of the proceedings, the author will *first*, attempt to define the scope and content of the notion of “public policy” in general and “transnational public policy” in particular as frequently applied in the international arbitration context. *Second*, the author will turn to an analysis of the impact of transnational public policy already on the pre-merits phase of arbitral proceedings, in particular the affirmation or denial of jurisdiction, arbitrability and admissibility of claims. *Third*, the author concludes this paper with the observation that the “fleeting” and evolving concept of transnational public policy has gained some contours both with respect to its content and through its continued and consistent application by arbitral tribunals. A trend can be observed that particularly in investment arbitration public policy concerns have an increasing influence on the pre-merits phase. Given this consistent and continued application in both international commercial and investment arbitration it seems that the “unruly horse” public policy has been substantially tamed.

2. SCOPE AND CONTENT OF THE NOTION “PUBLIC POLICY” AS FREQUENTLY APPLIED IN INTERNATIONAL ARBITRAL PROCEEDINGS

When approaching the issue of public policy in international arbitration, one needs to take into account that the notion of public policy is by its nature not capable of precise definition. It is a flexible concept which is subject to further evolution, and which has also been described as the “relativity of public policy.”⁷ Inasmuch as Reisman’s critique of the “fleeting” character of the concept of transnational public policy may be justified to a certain extent, the more important it will be to attempt to define the scope and content of this notion of “public policy.”

As Reisman pointed out, the legitimacy of the application of this concept in international arbitration depends on the determination and verification of its scope and content. If a consistent and continuous approach to the notion of transnational public policy can be identified in the commercial arbitration context its application may be justified. Thus, in the following part, the author attempts to give guidance on the definition of

⁷ P. Lalive, “Transnational (or Truly International) Public Policy and International Arbitration”, *ICCA Congress series* 3/1986, 258, 262.

the scope and content of the notion transnational public policy as developed by commentators and international arbitral tribunals.

Despite the difficulty to fully grasp the concept of “public policy,” a differentiation of the concept of public policy is frequently made with respect to its scope and content. First, one can distinguish “national public policy” from “international public policy,” which again differs from the related concept of “transnational public policy,” which is frequently referred to in international arbitration. Furthermore, another distinction is frequently made between “procedural public policy” and “substantive public policy.” The author will further describe each of these concepts below.

2.1. National, International and Transnational Public Policy

While all of three concepts referred to above as “national public policy,” “international public policy” and “transnational public policy” seem to relate to the same concept of “public policy,” they differ in scope and content. An arbitrator when being confronted with public policy issues should carefully analyze the applicable rules to the arbitral proceedings and be aware of the distinction between these three concepts of public policy before applying any of them. He should not only ask himself what public policy means or stands for before applying it in arbitral proceedings, but also conduct an analysis to which body and rules he should turn when purporting to consider public policy.⁸ This is particularly important in order to accommodate the legitimacy concerns with respect to the content and application of the concept transnational public policy raised by Reisman.

2.1.1. National Public Policy

When approaching this topic, one needs to distinguish between “national public policy” and “international public policy.” According to Catherine Kessedjian, national public policy is the more commonly used. She defines this notion as follows: “It is comprised of those fundamental rules, developed by each State, which are of utmost importance for that State’s society and from which citizens (and very often residents) of that State cannot derogate. It is territorial in nature.”

Given the territorial character of the notion of national public policy, its application in arbitral proceedings is subject to the determination of the applicable law. If the parties have agreed on a particular substantive law governing the dispute, the national public policy concept of the *lex contractus* must be applied.

⁸ R. H. Kreindler, Approaches to the Application of Transnational Public Policy by Arbitrators, *Journal of World Investment* 4/2003, 239 etc.

However, the public policy standards of the *lex contractus* are not always the only public policy standards which an arbitrator should apply before rendering an award. Under certain circumstances, the arbitrator should also take into consideration the public policy standards of other national laws, e.g., the *lex arbitri*, the *lex societatis* or the law of the place of the performance when confronted with public policy issues. To which extent the arbitrator is obligated to do so depends on whether the public policy violation constitutes a violation of a mandatory rule of e.g., the laws applicable at the arbitral seat or the laws of the place of enforcement.⁹

The reason for applying the concept of international public policy in international arbitral proceedings as derived from the applicable *lex arbitri* or law of the place of performance can be seen in the arbitrator's obligation to render a binding and enforceable award.¹⁰ E.g., Art. V 2 (b) of the 1958 New York Convention on the Recognition and Enforcement of Arbitral Awards ("New York Convention") provides that

The recognition or enforcement of the award would be contrary to the public policy of that country.

Thus, in order to comply with his duty to render a binding and enforceable award, the arbitrator must or in any event should also take into account the public policy of the country where recognition or enforcement of the award is sought or likely to be sought.

2.1.2. *International Public Policy*

This is where the notion of "international public policy" comes into play. When confronted with an objection to an application for recognition or enforcement of an arbitral award on grounds of a public policy violation, many State Courts differentiate between national public policy and international public policy. The concept of international public policy has also found its way into some State legislation.¹¹ Many State Courts have exercised a substantial degree of restraint when applying the notion of public policy under Art. V 2 (b) New York Convention, to the extent that not every violation of the national public policy but only a violation of international public policy can constitute a ground for the refusal of recognition or enforcement of an arbitral award.¹²

⁹ *Ibid.*, 241 etc.

¹⁰ P. Lalive, 258, 273; R. H. Kreindler, 239, 241.

¹¹ See, e.g., in France art. 1502 of the Code of Civil Procedure (1981); in Portugal art. 1096 (f) of the Code of Civil Procedure.

¹² E.g. in a recent decision the German Federal Court of Justice (BGH) held that not every violation of a German mandatory norm constitutes a violation of German international public policy (BGHZ III ZB 17/08). For further references to various decisions of other national courts such as U.S., French, Portuguese, Luxemburg and Italian court decisions, see G. B. Born, 2834, 2835, fn. 638.

Thus, a further definition of the term international public policy is called for which Pierre Lalive has described as follows: “*The concept of international public policy of a given community, here of a State, is made up of a series of rules or principles concerning a variety of domains, having a varying strength of intensity, which form or express a kind of ‘hard core’ of legal or moral values, whether in its negative or in its positive function.*”¹³ [Emphasis added]

According to this definition, international public policy is a subset of internal public policy. It is generally narrower than the latter¹⁴ and, by reason of its rootedness in internal public policy, specific to each State. Only the most fundamental norms of the national public policy form part of each State’s international public policy. This narrow application of international public policy standards within the recognition and enforcement context has recently been confirmed by the German Federal Court of Justice (“BGH”) by making an express differentiation between German national public policy and German international public policy, and clarifying that the latter is a narrower concept than the former.

In particular, the BGH held that not every arbitral award that is in contradiction with German mandatory norms constitutes a violation of German *ordre public*. Furthermore, the BGH clarified that not every violation of a German mandatory norm constitutes a violation of German international public policy. Rather, only a violation of the most fundamental norms, which reflect the legislator’s essential value system as such so that no party may derogate from them, could constitute a violation of the German international public policy.¹⁵

This description of the content of international public policy made by the German BGH is also in line with the above-referenced definition by Pierre Lalive inasmuch as only the “most fundamental norms” or, as Pierre Lalive put it, “hard-core” legal norms of a State’s national public policy are encompassed in the notion German international public policy.

Thus, referring back to the question whether and with which content an arbitrator should also apply, e.g., the public policy of the *lex arbitri* when being confronted with a public policy issue, the answer can be found in that State’s international public policy. If the public policy under the *lex contractus* differs from the public policy applicable at, e.g., the seat of arbitration or place of enforcement, inasmuch as the public policy issue would violate the mandatory international public policy of the *lex arbitri* or place of enforcement, the arbitrator should also apply the inter-

¹³ P. Lalive, 258, 264.

¹⁴ C. Seraglini, *Lois de police et justice arbitrale internationale*, 2001, 152, at para. 312.

¹⁵ BGHZ III ZB 17/08.

national public policy applicable at the seat or place of enforcement; otherwise, there is a risk that the award might be subject to annulment or refusal of recognition or enforcement.

Notwithstanding the above-referenced principles with respect to the applicable law which an arbitrator should take into consideration when being confronted with a public policy issue, given the transnational character of international arbitration, the arbitrator should also take into consideration the application of a “supranational” or “transnational” public policy.¹⁶

2.1.3. Transnational Public Policy

While international public policy is still State-made law, transnational public policy is understood to be detached from any specific legal system.

Catherine Kessedjin has defined the concept of “transnational public policy” as follows: “[T]ransnational public policy is composed of mandatory norms which may be imposed on actors in the market either because they have been created by those actors themselves or by civil society at large, or because they have been widely accepted by different societies around the world. These norms aim at being universal. They are the sign of the maturity of the international communities (that of the merchants and that of the civil societies) who know very well that there are limits to their activities.”¹⁷

Audley Sheppard has recently defined the notion of transnational public policy in a similar way: “By the term “transnational public policy” I mean those principles that represent an international consensus as to universal standards and accepted norms of conduct that must always apply. The concept of “transnational public policy”, is said to comprise fundamental rules of natural law, principles of universal justice, *jus cogens* in public international law, and the general principles of morality accepted by what are referred to as “civilized nations.”¹⁸

According to these two definitions, transnational public policy, in contrast to international public policy, is detached from a specific legal system. It is “truly international”¹⁹ in the sense that the most fundamental universal norms and values known to most legal orders and communities

¹⁶ P. Lalive, 258, 276 etc.

¹⁷ C. Keesdjan, “Transnational Public Policy”, ICCA Congress Series 13/2007, 857, 861–862.

¹⁸ A. Sheppard, “Public Policy and the Enforcement of Arbitral Awards: Should there be a Global Standard?”, *Transnational Dispute Management* 1/2004, 1, 3.

¹⁹ For the use of the term “truly international,” see P. Lalive, 258 etc. In many cases, the terms transnational public policy and international public policy are used interchangeably.

form this body of law. Transnational public policy seems to be understood as a set of overriding rules and principles which may be applied irrespective of the law governing the dispute or the law governing at the place of arbitration. Indeed such well-known commentators as Pierre Lalive, Catherine Kessidjian and Richard Kreindler conclude that it is the arbitrator's duty to apply this notion in international arbitration given its universal character and the duty to protect the universal legal order from any violations.²⁰

This concept of transnational public policy has also recently been applied in the context of corruption by an ICSID tribunal in *World Duty Free vs. Kenya*: “*In light of domestic laws and international conventions relating to corruption, and in light of the decisions taken in this matter by courts and arbitral tribunals, this Tribunal is convinced that bribery is contrary to international public policy of most, if not all, States or, to use another formula, to **transnational public policy**.*”²¹ [Emph. added]

Also other international arbitral tribunals have referred to the notion transnational public policy, inasmuch as they confirmed that there exist universal standards which override the parties' choice of law and which must be observed by the arbitral tribunal.²²

As can be derived from the above, the notion of public policy is threefold, which calls for a careful assessment which of the public policy notions should be applied in the specific context of the arbitral proceedings.

2.2. Procedural Public Policy versus Substantive Public Policy

Having distinguished the different concepts of public policy, their sources and application range, the arbitrator must identify the specific content of the respective public policy concept. With respect to the content, as explained above, these three concepts overlap. International public policy is generally narrower than national public policy. It necessarily comprises the essential and fundamental rules and values of a State's na-

²⁰ P. Lalive, 258, 313 etc.; C. Keesdjian, 857, 862 etc.; R. H. Kreindler, 239, 249.

²¹ *World Duty Free Company Ltd. v. Republic of Kenya*, ICSID Case No. ARB/00/7, Award of 4 October 2006, at para 157, available at <http://ita.law.uvic.ca/documents/WDFv.KenyaAward.pdf>.

²² See e.g., *Westacre v. Jugoimport*, ICC Case No. 7047, Award of 28 February 1994, *ASA Bulletin* 1995, 301, 332; *Hilmarton v. OTV*, ICC Case No. 5622, Award of 19 August 1988, *Yearbook of Commercial Arbitration* 19/1994, 115, at para 34; *Plama Consortium Ltd. v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award of 27 August 2008, at para 141 etc., available at <http://ita.law.uvic.ca/documents/PlamaBulgariaAward.pdf>; *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case. No. ARB/03/26, Award of 2 August 2006, at para 249, available at http://ita.law.uvic.ca/documents/Inceysa_Vallisoletana_en_001.pdf.

tional public policy. Transnational public policy by definition comprises the most fundamental norms of public policy which, ideally, each State should have embedded in its legal system and which thus should overlap with a State's international public policy.²³ Given this substantial overlap and the international character of international arbitration, not tied to any legal system, the author will focus below on the content of transnational public policy before discussing in detail its impact on the arbitral proceedings.

When discussing the content of public policy in general and transnational public policy in particular, a distinction is frequently made between procedural and substantive public policy. Procedural public policy governs the procedural aspects of an arbitral proceeding. Substantive public policy governs the rights and obligations of a party with respect to the subject matter of the dispute. Substantive public policy, by virtue also of the term "substantive," generally plays an important role when it comes to the merits of a case.²⁴

At the same time, as will be shown below, substantive public policy concerns are not limited to the merits stage. Recent adjudication, in particular in the investment arbitration context shows that substantive public policy concerns may also have an impact on the pre-merits phase of the arbitration, in particular on the arbitral tribunal's jurisdiction, the arbitrability of the subject matter and the admissibility of the claims. Before turning to that question though it will be necessary to distinguish procedural from substantive public policy.

In conformity with the above-referenced definitions to make out the content of transnational procedural public policy, one needs to identify those fundamental rules and norms governing arbitral procedure on which an international consensus exists as to their universal binding character. Even if there existed uniform arbitral procedural rules, which are contained in e.g., the IBA Rules on the Taking of Evidence in International Commercial Arbitration or the UNCITRAL Model Law, the New York Convention, national arbitration laws and international arbitration adjudication, not every such rule necessarily constitutes a transnational procedural public policy.²⁵ As explained above, only the most fundamental rules and values, which are universally accepted principles, form part of transnational procedural public policy.

Furthermore, in the context of the drafting of the UNCITRAL Model Law it has been discussed whether there exist differences between

²³ C. Keesdjian, 857, 859 etc.; R. H. Kreindler, "Standards of Procedural International Public Policy", *Stockholm International Arbitration Review* 2/2008, 143.

²⁴ Ph. Fouchard et al., *Fouchard Gaillard Goldman on International Commercial Arbitration*, 1999, para. 1661.

²⁵ R. H. Kreindler, (2008), 143.

Continental European law conceptions on the one hand and Anglo-American ones on the other as to the scope and content of transnational procedural public policy.²⁶ It has been argued that the former Continental European notion of procedural public policy relates more to public morals, health and safety, while the latter Anglo-American concept of public policy also embraces the fundamental aspects of procedural justice.²⁷

Notwithstanding these differences in approaches to transnational procedural public policy, certain fundamental procedural rules and values have emanated over the years within the framework of international conventions and arbitral adjudication. Those rules and values encompass, e.g., the requirement that arbitral tribunals be impartial, that the making of the award not be induced or affected by fraud or corruption, that equal treatment be observed in appointing the arbitral tribunal, that the rules of natural justice be upheld, and that the right to a fair or reasonable opportunity to present one's case be maintained.²⁸ Notwithstanding these principles, the content of transnational public policy is evolving and flexible, so that the content of procedural public policy remains subject to constant development and reassessment as to the truly universal character of those principles and future principles which might develop over the years.

The same is true for transnational substantive public policy. Just like transnational procedural public policy, the content of transnational substantive public policy is difficult to determine and the principles and values, once identified, remain subject to change and further development. Notwithstanding this *caveat*, certain rules and principles have evolved over the years which are of universal character such that they are considered to form part of the body of transnational public policy. Examples of substantive public policy cited by both international arbitral tribunals and by commentators include both positive and negative obligations such as, *inter alia*, the principle of good faith and the prohibition of abuse of rights, *pacta sunt servanda*, the prohibition against expropriation without compensation, and the prohibition against discrimination. Furthermore, fundamental principles such as the prohibition against corruption, genocide, piracy, terrorism, slavery, drug trafficking and prostitution also form part of transnational public policy as being *contra bonas mores*.²⁹

As will be shown below the transnational substantive public policy principles cited in this section do not only have an impact on the substantive law part of the dispute. Recent adjudication, in particular in the investment arbitration context shows that the application of transnational public policy principles plays already an important role when it comes to

²⁶ See A. Sheppard, 1, 4.

²⁷ R. H. Kreindler, (2008), 148.

²⁸ *Ibid.*, see A. Sheppard, 8.

²⁹ *Ibid.*, 4.

the determination of the arbitral tribunal's jurisdiction and the arbitrability and admissibility of the claims.

3. TRANSNATIONAL SUBSTANTIVE PUBLIC POLICY AND JURISDICTION

Whether or not a violation of transnational substantive public policy has an impact on the arbitral tribunal's jurisdiction has been subject to some discussion in the past.³⁰ When dealing with this question one needs to differentiate between treaty-based investment and contract-based commercial arbitration which respectively reveal a different approach to this question as undertaken by some arbitral tribunals.

In the contract-based commercial arbitration context, it has been frequently questioned whether a transnational public policy violation which potentially renders the underlying contract null and void also impeaches the arbitration agreement and thus the arbitral tribunal's jurisdiction. In investment arbitration, as will be elaborated further below, the issue is slightly different. In investment arbitrations the arbitration agreement generally is concluded or perfected once the investor accepts the Host State's offer to submit the dispute to arbitration. Thus, the issue is not so much the question whether an agreement to arbitrate is tainted by corruption and thus null and void, but more the issue whether the consent to submit to arbitration is still valid; thus whether an arbitration agreement can still be concluded. In this context recent ICSID awards such as the award in *Inceysa v. El Salvador* stand for the proposition that egregious transnational public policy violations such as manifest fraud may lead to a denial of jurisdiction. Thus, below, the author will first address the impact of public policy violations on the arbitral tribunal's jurisdiction in the commercial arbitration context before turning to the investment arbitration context where the issues are slightly different.

3.1. Commercial Arbitration

Interestingly enough, the investment arbitration position, i.e. that egregious transnational public policy violations may lead to an arbitral tribunal's denial of jurisdiction; has also been formerly expressed in the commercial arbitration context. In the well-known ICC award dating from 1963, Judge Lagergren had declined jurisdiction in a case involving bribery on grounds of a transnational public policy violation. He held that "*It cannot be contested that there exists a general principle of law recog-*

³⁰ A. Sheppard, J. Delaney, "Corruption and International Arbitration", 10th International Anti-corruption Conference, 1 etc., available at <http://www.10iacc.org/content.phtml?documents=106&art=167>.

nized by civilized nations that contracts which seriously violate bonas mores or international public policy are invalid or at least unenforceable and that they cannot be sanctioned by courts or arbitrators [...] Parties who ally themselves in an enterprise of the present nature must realize that they have forfeited any right to ask for assistance of the machinery of justice (national courts or arbitral tribunals) in settling their disputes.”³¹

However, nowadays Judge Lagergren’s position is no longer generally accepted in the commercial arbitration context.³² Whether or not an illegal contract, such as a contract tainted by corruption, can lead to a denial of jurisdiction by an arbitral tribunal can be answered by turning to the principle of separability of the arbitration clause.³³

According to the principle of separability of the arbitration clause, the illegality of the main contract generally does not affect the validity of the arbitration clause. Thus, even if the main contract is e.g. tainted by corruption and thus null and void, generally the arbitration clause would be considered to be separate from the main contract and thus not to be affected by the main contract’s nullity. Consequently, the arbitral tribunal would still be competent to hear the case and exercise its jurisdiction to decide the case.

Only in very limited cases have courts considered that the illegality of the main contract may also impeach the validity of the arbitration clause. For example, in *Westacre Investments Inc. v. Jugoimport – SDPR. Holding Co. Ltd.*, the English Court questioned whether in cases of gross violations of public policy the separability of the arbitration agreement could be upheld. In cases of bribery, the Court concluded that the public policy of sustaining international arbitral awards outweighed the public policy of prohibiting corruption.³⁴ Consequently, the Court did not hold that the arbitration agreement was impeached by the main contract’s illegality. This decision can be interpreted as a decision upholding the principle of separability, after the application of a balancing test.³⁵

Courts have held only in limited circumstances that the arbitration agreement may be deemed void *ab initio*, if the arbitration agreement forms an integral part of the main contract and if the main contract is il-

³¹ ICC Case No. 1110, Award [date unknown] 1963, *Arbitration International* 10/1994, 282, 293, 294.

³² A. Sheppard, J. Delaney, 2.

³³ A. Redfern, M. Hunter, *Law and Practice of International Commercial Arbitration*, 2004,⁴ 251.

³⁴ *Westacre Investments Inc. v. Jugoimport – SDPR. Holding Co. Ltd.*, English commercial Court, 2 *Lloyd’s Report*, 111, 126 etc.

³⁵ For further details about this case, see A. Sayed, *Corruption in international trade and commercial arbitration*, 2004, 47 etc.

legal by operation of law.³⁶ In the specific context of an illegal gaming contract, which also included an arbitration agreement, the English Court of Appeal held that the gaming contract itself was null and void by operation of law. Consequently, the arbitration clause, which formed an integral part thereof, was null and void as well in application of the English Gaming Act.³⁷

Notwithstanding this exception, generally, in commercial arbitral proceedings violations of transnational public policy do not have an impact on the arbitral tribunal's jurisdiction given the separability of the arbitration agreement. Only in very restricted circumstances has this principle not been upheld.

3.2. Treaty-Based Investment Arbitration

With respect to treaty-based investment arbitration, as explained above, the answer to the question whether a public policy violation could or should have an impact on the arbitral tribunal's jurisdiction cannot simply be answered by turning to the separability of the arbitration agreement principle.

In treaty-based investment arbitration, the agreement to submit the investment dispute to arbitration generally is deemed concluded once the investor accepts the Host State's offer to submit the dispute to arbitration as contained in the relevant bilateral or multilateral investment agreement ("BIT" or "MIT"). In this context, it has been discussed that only legal investments, which are in conformity with the relevant BIT or MIT provisions, enjoy protection under the investment treaty. Moreover, it has been concluded by international arbitral tribunals in the context of ICSID arbitration that the Host State's consent to submit an investment dispute to arbitration is limited to the condition that the investment is legal, in particular if the applicable BIT contains an "accordance with law" clause.³⁸ Thus, the doctrine of separability, which is applicable in the commercial arbitration context, is not necessarily applicable in such cases. No valid arbitration agreement would be concluded in cases of egregious substantive public policy violations for lack of the Host State's consent to submit the dispute to ICSID jurisdiction.

³⁶ O'Callaghan v. Coral Racing Ltd., English Court of Appeal, *The Times*, 26 November 1998.

³⁷ *Ibid.*

³⁸ Inceysa Vallisoletana S.L. v. Republic of El Salvador, ICSID Case. No. ARB/03/26, Award of 2 August 2006, at para 245–252, available at http://ita.law.uvic.ca/documents/Inceysa_Vallisoletana_en_001.pdf; Fraport AG Frankfurt Airport Services Worldwide v. Republic of Philippines, ICSID Case. No. ARB/03/25, available at <http://ita.law.uvic.ca/documents/FraportAward.pdf>.

Specifically, in *Inceysa vs. El Salvador*, the ICSID arbitral tribunal denied its jurisdiction by expressly relying on grounds of manifest transnational public policy violations³⁹ inasmuch as the investment had been tainted with fraud: “*International public policy consists of a series of fundamental principles that constitute the very essence of the State and its essential function is to preserve the values of the international legal system against actions contrary to it [...] It is uncontroversial that respect for the law is a matter of public policy not only in El Salvador, but in any civilized country. If the Tribunal declares itself competent to hear the dispute between the parties, it would completely ignore the fact, above any claim of an investor, there is a meta-positive provision that prohibits attributing effects to an act done illegally. This Tribunal considers that assuming competence to resolve the dispute brought before it would mean recognizing for the investor rights established in the BIT for investments made in accordance with the law of the host country. It is not possible to recognize the existence of rights arising from illegal acts because it would violate the respect for the law which, as already indicated is a principle of international public policy.*”⁴⁰

In applying these principles established by the arbitral tribunal in *Inceysa v. El Salvador* one can derive that in the context of investment arbitration, egregious substantive transnational public policy violations may have an impact on the arbitral tribunal’s jurisdiction. Even though this is not directly an issue to be addressed in this paper, in this context the author would briefly like to bring to the readers’ attention the issue of whether such a question should not rather be resolved at the merits stage since it relates to the question whether the investor enjoys substantive protection under the applicable BIT or MIT.

Nevertheless, as can be derived from the above, before applying the notion of transnational public policy arbitral tribunals have generally verified its scope and content and sought to legitimize its application. In certain cases arbitral tribunals even apply a balancing test with respect to conflicting public policy interests. Generally, only after careful verification have arbitral tribunals come to the conclusion that a public policy violation could have an impact on the arbitral tribunal’s jurisdiction.

4. TRANSNATIONAL PUBLIC POLICY AND ARBITRABILITY

Whether or not a dispute is arbitrable is both closely related to issues of the illegality of the arbitration agreement and to questions of pub-

³⁹ Even though the arbitral tribunal refers to “international public policy,” the universal character it attributes to it and the context reveal that indeed the arbitral tribunal referred to the concept of transnational public policy as described above.

⁴⁰ *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, at para 245–249.

lic policy. The question of enforceability of an illegal arbitration agreement can also be characterized as a question of arbitrability. At the same time, a dispute can be non-arbitrable because allowing the parties to resolve it by way of arbitration would constitute a violation of the State's public policy.

The arbitrability of the subject matter of the dispute may ultimately depend on the applicable public policy standards of the states concerned, particularly at the seat of the arbitration and the place of arbitration. However, certain issues arising in criminal, domestic relations, bankruptcy, real property and governmental sanctions are generally not arbitrable under the applicable law of most States.⁴¹

Generally though, most civil law systems have a rather broad statutory definition of arbitrability. E.g. Section 1030 German Civil Procedure Code provides: “*Any claim involving an economic interest [vermögensrechtlicher Anspruch] can be the subject of an arbitration agreement.*”

Section 177 (1) of the Swiss Law on Private International Law provides similarly and under both statutes the term “*vermögensrechtlicher Anspruch*” is to be interpreted broadly. Nevertheless, disputes which involve a public interest, e.g. criminal law matters, child custody, domestic relations are not considered to be arbitrable.⁴²

The similar is true under French law which provides in Article 2059 French Civil Code that “all persons may submit to arbitration those rights which they are free to dispose of” while Article 2060 provides that “*[o]ne may not enter into arbitration agreements in matters of status and capacity of the persons, in those relating to divorce and judicial separation or to disputes concerning public bodies and institutions and more generally in all matters in which public policy is concerned.*”

A similar generous approach to the arbitrability of a dispute has also been applied by U.S. Courts.⁴³ Thus, in light of the foregoing, generally disputes are arbitrable unless they concern a public policy issue; keeping in mind though that the public policy exception is generally interpreted narrowly and applied restrictively.⁴⁴ Public policy interests such as the State's monopoly to criminal law matters set certain limits to the arbitrability of a dispute e.g. involving corruption on the one hand. On the other hand, a contractual claim involving an economic interest arising out of a contract tainted by arbitration is nevertheless generally considered to be arbitrable.

⁴¹ G. B. Born, 771.

⁴² *Ibid.*, 777.

⁴³ See. e.g. *Mitsubishi Motors*, 473 U.S. at 639–640.

⁴⁴ G. B. Born, 790.

Consequently, disputes concerning a State's public policy are generally not arbitrable since. However, violations of transnational public policy, such as bribery which involve an economic interest, are generally arbitrable and do not have an impact on the arbitral tribunal's jurisdiction.

5. TRANSNATIONAL PUBLIC POLICY AND ADMISSIBILITY

As Jan Paulsson points out in his article "Jurisdiction and Admissibility," the concept of admissibility needs to be distinguished from jurisdiction.⁴⁵ While an arbitral tribunal's decision on jurisdiction is subject to judicial review, determinations as to the admissibility of a claim should be final. In contrast to jurisdiction, at the admissibility stage, the arbitral tribunal does not question whether a particular claim can be brought before a certain forum but rather questions whether the claim should be heard at all.⁴⁶

Against this background, it is easier to put certain recent ICSID awards such as *Plama v. Bulgaria* and *World Duty Free v. Kenya* into perspective in which the respective arbitral tribunal had dismissed the investor's claims inadmissible on grounds of egregious transnational public policy violations.

In *World Duty Free v. Kenya* the arbitral tribunal held that "*In light of domestic laws and international conventions relating to corruption, and in light of the decision taken in this matter by courts and arbitral tribunals, this Tribunal is convinced that bribery is contrary to the international public policy of most, if not all, States or, to use another formula, to transnational public policy. Thus, claims based on contracts of corruption or on contracts obtained by corruption cannot be upheld by this Arbitral Tribunal.*"⁴⁷ and that "*Claimant is not legally entitled to maintain any of its pleaded claims in these proceedings on the ground of ex turpi causa non oritur actio.*"⁴⁸

In *Plama vs. Bulgaria*, the arbitral tribunal expressly referred to the reasoning of the arbitral tribunal in *World Duty Free v. Kenya*. By concluding that the investment had been tainted by fraud, the arbitral tribunal dismissed the investor's claim on grounds of public policy violations

⁴⁵ J. Paulsson, "Jurisdiction and Admissibility", *Transnational Dispute Management* 6/2009, 601 etc.

⁴⁶ *Ibid.*, 617.

⁴⁷ *World Duty Free Company Ltd. v. Republic of Kenya*, ICSID Case No. ARB/00/7, Award of 4 October 2006, at para 157, available at <http://ita.law.uvic.ca/documents/WDFv.KenyaAward.pdf>.

⁴⁸ *Ibid.*, at para 179.

without going into the merits: “*In consideration of the above and in light of the ex turpi causa non oritur actio, this Tribunal cannot lend its support to Claimant’s request and cannot, therefore, grant the substantive protections of the ECT.*”⁴⁹

Both of these ICSID decisions stand for the proposition that egregious public policy violations should result in a dismissal of the case inasmuch as the arbitral tribunal should not even lend its assistance to a claimant bringing such claims. In other words, in referring to the definition provided by Paulsson above, an arbitral tribunal may dismiss claims whose enforcement would be in violation of transnational public policy as inadmissible.

The concept *ex turpi causa non oritur actio* has been also referred to as the unclean hands doctrine, which is rooted in Roman Law principles.⁵⁰ Pursuant to this principle no court should lend its assistance to a plaintiff who comes with unclean hands, e.g. who has committed a violation of transnational public policy.⁵¹ Accordingly, in application of this concept, claims which arise from an illegal action in violation of transnational public policy are to be dismissed as inadmissible without going into the merits of the dispute. Thus, in the light of the foregoing and the recent ICSID adjudication egregious transnational public policy violations may have an impact on the claims’ admissibility inasmuch as arbitral tribunals have held that such claims cannot be upheld and the arbitral tribunals thus refused to go into the merits of the dispute.

To a certain extent such an approach to public policy violations already at the admissibility stage can be perceived as a pre-evaluation and anticipation of the merits of the dispute. Even though the arbitral tribunal has not gone into the merits of the dispute it makes certain predictions that the claims would be without merit in view of the public policy violation and can thus not be upheld. This becomes especially clear in *Plama v. Bulgaria* in which the arbitral tribunal concluded that the investment did not even enjoy any substantive BIT protection in view of the gross public policy violations.⁵²

At the same time it also reveals a trend that international arbitral tribunals sanction transnational public policy violations quite strictly al-

⁴⁹ *Plama Consortium Ltd. v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award of 27 August 2008, at para 146, available at <http://ita.law.uvic.ca/documents/PlamaBulgariaAward.pdf>.

⁵⁰ L. Garcia-Arias, “La Doctrine des “Clean Hands” en Droit International Public”, Y.B. A.A.A 30/1960, 14, 16.

⁵¹ *World Duty Free Company Ltd. v. Republic of Kenya*, ICSID Case No. ARB/00/7, Award of 4 October 2006, at para 178.

⁵² *Plama Consortium Ltd. v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award of 27 August 2008, at para 146.

ready at an early stage of the arbitral proceedings. The extensive quotation to the principles such as *ex turpi causa non oritur actio*, which, as described above, forms part of the unclean hands doctrine, suggests that arbitral tribunals even feel compelled to sanction public policy violations already before entering into the pre-merits phase. Behind this approach might be the reasoning that otherwise an arbitral tribunal might be deemed to grant judicial assistance to someone who comes with “unclean hands.” And that would be “an affront to public conscience” as the arbitral tribunal in *World Duty Free v. Kenya* put it.⁵³

In view of this rigid approach by arbitral tribunals sanctioning violations of public policy already at an early stage of the arbitration, it becomes even more important to carefully verify the existence of a transnational public violation before applying such harsh sanctions. At least in *World Duty Free v. Kenya* the arbitral tribunal recognized the need for such a careful and restrictive approach towards the application of transnational public policy by stating “*But it has been rightly stressed that Tribunals must be very cautious in this respect and carefully check the objective existence of a particular transnational public policy rule in identifying it through international conventions, comparative law and arbitral awards.*”⁵⁴

Thereafter, the arbitral tribunal engages in an extensive analysis of the respective instruments and sources of international law before concluding that bribery is against transnational public policy. Only after carefully assessing the scope and content of the applicable public policy and after applying a balancing test which took into account that the Kenyan head of the State had also committed bribery, did the arbitral tribunal come to the conclusion that, nevertheless, Claimant’s claims should be dismissed on grounds of a transnational public policy violation.

6. CONCLUSION

Given the flexible content of transnational public policy, parties and arbitral tribunals must be cautious and carefully verify the objective existence and meaning of transnational public policy when considering applying it. Recent adjudication, particular in the investment arbitration context, shows that violations of substantive public policy are not necessarily postponed to the merits stage, but rather can have an impact on the arbitral tribunal’s assessment of jurisdiction, arbitrability and admissibility. It thereby reveals a trend that arbitral tribunals tend to sanction egre-

⁵³ *World Duty Free Company Ltd. v. Republic of Kenya*, ICSID Case No. ARB/00/7, Award of 4 October 2006, at para 178.

⁵⁴ *Ibid.*, at para 141.

gious violations of transnational public policy already at an early stage of the arbitral proceedings refusing to grant judicial assistance to a party with “unclean hands.” This trend however, bears some danger since it can be conceived as preemption of the merits. Thus, only after a careful assessment of the objective existence and meaning of transnational public policy and only in cases of clear and egregious violations of transnational public policy may its application at such an early stage in the arbitral proceedings be justified. At the same time, the continued and consistent application of transnational public policy standards in both commercial and investment treaty-based arbitration indicates that over the years arbitral tribunals have identified certain universal standards which must be applied in all fora. In this respect it seems like the “unruly horse” has been substantially tamed.