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Re **The Public Policy Exception under Article V(2)(b) – Methodological Approaches**
Country Report Germany

I. The Definition of Public Policy in Recognition and Enforcement Proceedings by German Courts 2

II. The Methodological Approach of German Courts Towards the Public Policy Exception: Summary of the Relevant Case Law 3

A. Case Law Regarding Procedural Public Policy 3
1. Independence and Impartiality of the Tribunal 3
2. Due Process 4

B. Case Law Regard Substantive Public Policy 5
1. Violation of the *pacta sunt servanda* Principle 5
2. Illegality Due to Usury 6
3. Illegality due to Violation of EU and German anti-trust law 6

III. The Methodological Approach of German Courts Towards the Public Policy Exception: Analysis of Case Law 7

A. General Remarks 7

B. Interpretation of "Public Policy" 7

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I. THE DEFINITION OF PUBLIC POLICY IN RECOGNITION AND ENFORCEMENT PROCEEDINGS BY GERMAN COURTS

The basis for the recognition and enforcement of foreign arbitral awards[1] in Germany is sec. 1061(1) German Code of Civil Procedure which provides:

> "The recognition and enforcement of foreign arbitration awards is governed by the Convention of 10 June 1958 on the recognition and enforcement of foreign arbitral awards (published in Federal Law Gazette (Bundesgesetzblatt, BGBl.) 1961 II page 121). The stipulations of other treaties concerning the recognition and enforcement of arbitration awards shall remain unaffected hereby"[2]

The German Supreme Court commonly defines a breach of public policy under Article V(2)(b) of the New York Convention ("Convention") as a "severe defect that touches the very fundamentals of public and economic life".[3] According to established German commentaries, Article V(2)(b)'s public policy is violated if the recognition and enforcement of an award would lead to a result that is "evidently irreconcilable with the fundamental principles of the German legal order".[4] Courts require "grave" violations, "severe" defects, "evident" or "irreconcilable" violations of the legal order.[5] With regard to the procedural public policy defense, courts also refer to "compliance with the indispensable minimum standard of procedural fairness".[6]

From a conceptual point of view, the German Supreme Court applies the concept of *ordre public international*, i.e. a narrow understanding of the public policy exception of Article V(2)(b) of the Convention. However, under German law the differentiation between *ordre public international* and *interne* has little practical relevance as, compared to other countries, the domestic *ordre public interne* is already a very narrow.[7] The notion of *ordre public international* has, therefore, less of a practical than a declaratory function to show that German law follow a liberal pro-arbitration approach to international recognition and enforcement.

With regard to the burden of proof, it is established under German law that the award-debtor carries the burden to proove that the public policy defense of Article V(2)(b) cannot be established.[8] Nevertheless, courts can raise the public policy defense *ex officio*.

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[1] By comparison, the grounds for annulment are laid down in sec. 1059 German Code of Civil Procedure. The annulment grounds are modelled after the grounds for non-recognition and enforcement of Article V of the Convention.
[2] The provision is mainly of declaratory character as the New York Convention applies directly in Germany. *See* Article 59(2) Grundgesetz.
[3] BGH NJW 1986, 3027, 3028.
[4] Münch, *Art. V UNÜ*, in *Münchener Kommentar zur Zivilprozessordnung* (4th ed. 2013), para 70; Geimer, *sec. 1061*, in Zöller, *Zivilprozessordnung* (29th ed., 2011), para 31.
[5] Münch, *Art. V UNÜ*, in *Münchener Kommentar zur Zivilprozessordnung* (4th ed. 2013), para 70; Geimer, *sec. 1061*, in Zöller, *Zivilprozessordnung* (29th ed., 2011), para 31.
[6] Decision of the Higher Regional Court Cologne of 23 April 2004.
[7] Münch, *Art. V UNÜ*, in *Münchener Kommentar zur Zivilprozessordnung* (4th ed. 2013), para 69.
[8] Münch, *Art. V UNÜ*, in *Münchener Kommentar zur Zivilprozessordnung* (4th ed. 2013), para 3.

II. THE METHODOLOGICAL APPROACH OF GERMAN COURTS TOWARDS THE PUBLIC POLICY EXCEPTION: SUMMARY OF THE RELEVANT CASE LAW

In the following, the relevant German case law will be summarized (under B.) and analyzed (under C.), with a special focus on *how* the courts arrived at their decisions on public policy.

A. Case Law Regarding Procedural Public Policy

1. Independence and Impartiality of the Tribunal

German Federal Supreme Court, Decision of 1 February 2001:[9] Reversing the decision of the lower instance court, the Supreme Court recognized and enforced an arbitral award (seat in England).

The underlying dispute concerned the charter of a ship. In the arbitration, each side was to nominate an arbitrator within 14 days. The respondent failed to do so and, according to the applicable institutional rules, the arbitrator appointed by the claimant thus became the sole arbitrator to decide over the dispute.

In the enforcement proceedings, the award-debtor, among other things, argued violation of public policy on the basis that the sole arbitrator was initially nominated by other side and thus biased. The Court dismissed the defenses.

The Court found that the fact that a party-appointed arbitrator became sole arbitrator constituted, as such, no procedural violation. The Court also dismissed a possible public policy violation based on the alleged bias of the arbitrator. The Court held that there could only be a public policy violation if the bias had had actual affected the outcome of the award. Under the general burden of proof rules, this was for the award-debtor to prove, and the Court found that the award-debtor did not meet the burden of proof on this point.

German Federal Supreme Court, Decision of 15 May 1986:[10] The Court confirmed the recognition and enforcement of an award (seat in England).

The underlying dispute was about a ship charter in West India. In accordance with the party's arbitration agreement, the tribunal was to consist of two arbitrators, each nominated by a party. The award-creditor had nominated one arbitrator but the award-debtor failed to nominated its arbitrator within the required timeframe. The award-debtor did not take part in the proceedings.

The award-debtor resisted recognition and enforcement of the award in Germany on the basis that the arbitral tribunal was not independent and impartial.

In applying Article V(2)(b) of the Convention, the Court made the following general statements. First, the Court referred to case law of the German Constitutional Court according to which the impartiality and independence of the judiciary forms part of the

[9] BGH NJW-RR 2001, 1059.
[10] BGH NJW 1986, 3027.

German public policy. According to the Supreme Court, similar principles apply in arbitration proceedings.

Second, the Court stressed the need to differentiate between public policy for domestic awards, on the one hand, and public policy for international awards, on the other. Specifically, the Court declared inapposite a German Supreme Court case from the 1970s in which a similar arbitration agreement (i.e. one that allows a party-nominated arbitrator to become sole a sole arbitrator in case of default of the opponent) had been declared void. According to the Supreme Court, the 1970 case concerned a domestic award and therefore it did not apply to the recognition and enforcement of an international award. For international awards, the public policy defense is even more narrow. According to the Court, this "correspond[s] to the judicial practice of other European countries",[11] and serves the interests of international commerce.

Third, the Court held that a narrow public policy defense also corresponded to the very nature of arbitration. Party autonomy means that only a "severe defect that touches the very fundamentals of public and economic life" would qualify as a non-recognition or enforcement ground.[12]

Based on the aforementioned, the Court held that for a violation of impartiality and independence of an arbitral tribunal to qualify as a breach of international public policy, the award-debtor must to prove that the violation had an actual effect on the decision-making of the tribunal. In the case at hand, the Court found that such proof had not been provided.

2. Due Process

German Federal Supreme Court, Decision of 23 February 200:[13] The Federal Supreme Court recognized and enforced an arbitral award (seat in Belarus).

The underlying dispute was about the delivery of timber. After the award-creditor had commenced the arbitration, the award-debtor refused to take part in the proceedings arguing that there was no valid arbitration agreement. The Tribunal continued with the proceedings, sending all correspondence to the non-participating party. The Tribunal dealt with the jurisdictional objection of the award-debtor in the final award and held that it had jurisdiction over the dispute.

In the recognition proceedings, the award-debtor alleged a breach of due process because the tribunal had only dealt with its jurisdictional objection in the final award and not in an interim award.

The German Federal Supreme Court held that the recognition and enforcement of this award was governed by the that German-Soviet Treaty Regarding the Recognition of Arbitral Awards[14] and not the New York Convention. The Court referred to Article VII(1) of the

[11] BGH NJW 1986, 3027, 3028.
[12] BGH NJW 1986, 3027, 3028.
[13] SchiedsVZ 2006, 161.
[14] German-Soviet Treaty on General Issues of Trade and Maritime Transport of 1958 ("German-Soviet Treaty").

New York Convention, and the fact the enforcement regime under the German-Soviet Treaty was even more liberal and arbitration-friendly than under the New York Convention.[15]

The Court also held that the Belarusian arbitration law indeed required that the jurisdictional objection of the award-debtor be dealt with in an interim award, as opposed to in the final award. However, the Court found that this did not amount to a violation of public policy since it was no "severe defect that touches the very fundamentals of public and economic life".[16]

German Federal Supreme Court, Decision of 15 January 2009:[17] The Court recognized and enforced an arbitral award (seat in Italy).

The underlying dispute was about the construction of a factory to produce cotton wool bags. The award-debtor alleged a violation of public policy on the grounds that there was no proper notification of the appointment of the sole arbitrator in accordance with the agreement of the parties.

The Court, after referring to Article V(1)(b) of the Convention, found that Article V(1)(b) would have to be read together with both the constitutional due process requirement in Article 103(1) of the German Constitution (Grundgesetz) and Article V(2)(b) of the Convention. Accordingly, any violation of the due process requirement (or any other principle of procedural public policy) only leads to non-recognition or non-enforcement of the award, if the violation affected (or could have affected) the outcome of the dispute. It is for the party resisting enforcement to prove such causal link. In the case at hand, the Court found that the award-debtor failed to provide such proof.

B. Case Law Regard Substantive Public Policy

1. Violation of the *pacta sunt servanda* Principle

Bavarian Supreme Court, Decision of 20 November 2003:[18] The Court denied recognition and enforcement of an arbitral award (seat in Russia).

The underlying dispute was about the delivery of hydraulic cylinders. The party resisting recognition and enforcement argued that the parties had concluded a settlement agreement before the award was rendered, and that the award therefore violated the principle of *pacta sunt servanda* which would form part of German international public policy.

The Court followed this argument. It held that the principle of *pacta sunt servanda* indeed forms part of German international public policy. It found that, in such circumstances, recognition and enforcement of the award would "seriously violate any basic principle of fairness".[19] Moreover, according to the Court, disregarding the parties' settlement agreement

[15] The Court referred to P. Schlosser, *Das Recht der internationalen privaten Schiedsgerichtsbarkeit* (2nd ed. 1989), para 819. According to Schlosser, the German-Soviet Treaty does not allow a denial of enforceability on the ground of a violation of the arbitration laws of the *lex fori* (as opposed to Article V(1)(d) of the Convention).
[16] BGH SchiedsVZ 2006, 161, 164.
[17] SchiedsVZ 2009, 126.
[18] BayObLG, NJOZ 2004, 997.
[19] NJOZ 2004, 997, 999.

would undermine the trust and cooperation between the parties and thus hamper international commerce as a whole.

2. Illegality Due to Usury

Higher Regional Court Saarbrücken, Decision of 30 May 2011:[20] The Court recognized and enforced of an arbitral award (seat in Sweden).

The underlying dispute was about the sale of a dressage and breeding horse. The buyer sought rescission of the sale contract based on alleged deficiencies of the horse (a limping leg, insufficient sperm quality of the stallion and a back issue that would render the horse unsuitable for competition). The Tribunal heard several experts on those points and eventually dismissed all claims.

In the recognition and enforcement proceedings, the award-debtor asserted a violation of public policy based on the alleged discrepancy of purchase price (i.e. EUR 1,4 million) and the alleged actual value of the horse (i.e. EUR 100,000). According to the award-debtor, this discrepancy would render the sale void pursuant to the German concept of usury in sec. 138 German Civil Code, which according to the award-debtor, formed part of public policy.[21] In support of its argument, the award-debtor provided a new expert report.

The Court first held that the award-debtor was precluded from bringing new evidence in the recognition and enforcement proceedings. It noted that the facts pertaining to the alleged usury of the sale contract had already been known and discussed during the arbitral proceedings. The Court stressed that it the public policy defense could not be used to review, correct or supplement the arguments made during the arbitration.[22]

In any event, in an obiter dictum, the Court held that German case law regarding usury and sec. 138 German Civil Code did not form part of the international public policy of Article V(2)(b) of the Convention. According to the Court, any other solution would open the door to impermissible *révision au fond*.[23]

3. Illegality due to Violation of EU and German anti-trust law

Higher Regional Court Thüringen, Decision of 8 August 2007:[24] The Court recognized and enforced an arbitral award (seat in Switzerland).

The underlying dispute was about a licensing agreement between a Japanese and a German party with respect to precision glass manufacturing. Among other things, the award-debtor

[20] SchiedsVZ 2012, 47.
[21] Section 138, German Code of Civil procedure reads as follows: "(1) A legal transaction which is contrary to public policy is void. (2) In particular, a legal transaction is void by which a person, by exploiting the predicament, inexperience, lack of sound judgement or considerable weakness of will of another, causes himself or a third party, in exchange for an act of performance, to be promised or granted pecuniary advantages which are clearly disproportionate to the performance".
[22] SchiedsVZ, 47, 50.
[23] SchiedsVZ 2012, 47, 50.
[24] SchiedsVZ 2008, 44.

argued that the award violated European anti-trust law and thus public policy under Article V(2)(b) of the Convention.

The Court held that, in principle, European anti-trust law forms part of German public policy.[25] However, on the basis of the facts of the case, the Court found that the Tribunal's finding (i.e. that the agreement constituted no violation of European anti-trust law) was reasonable and that the prohibition of a *révision au fond* did not allow the recognizing/enforcing court to review the Tribunal's reasoning.

III. THE METHODOLOGICAL APPROACH OF GERMAN COURTS TOWARDS THE PUBLIC POLICY EXCEPTION: ANALYSIS OF CASE LAW

A. General Remarks

The cases summarized contain the characteristics, usually associated with German case law.[26] The reasoning is usually fairly detailed containing numerous references to academic writing.[27] This is particularly true with regard to German Supreme Court's decisions but higher regional courts' decisions often also tend be fairly elaborate.[28] In most decisions, courts explain that Article V(2)(b)'s notion of public policy needs to be interpreted restrictively.[29] Courts often stress the importance of the prohibition of a *révision au fond*.[30]

B. Interpretation of "Public Policy"

The German court decisions interpreting the public policy defense under Article V(2)(b)'s show several methodological characteristics.

First, in terms of the means of interpretation, German courts will attach great importance to any teleological interpretation (i.e. looking at the rationale of the provision).[31] For instance, the Supreme Court looked at the rationale of Article V(2)(b) to establish that the notion of public policy need to be interpreted restrictively.[32] Other means of interpretation seem to play a lesser role. Some decisions have used a textual interpretation (i.e. looking at the pure wording of the provision), but in general, the wording of a provision is seen merely as a

[25] Decision of the ECJ of 1 June 1999, C-126/97 (with regard to Art. 81 ECT as part of the *ordre public communitaire* with respect to Article V(2)(b) of the Convention).
[26] T.Henninger, *Europäisches Privatrecht und Methode* (2009), 46.
[27] Decision of the German Federal Supreme Court of 1 February 2001 (specifically with regard to the application of the Convention).
[28] Decision of the Higher Regional Court Saarbrücken of 30 May 2011. However, for a less elaborated decision, see decision of the Higher Regional Court Munich of 30 July 2012.
[29] Decision of the Federal Supreme Court of 15 May 1986; Decision of the Bavarian Supreme Court of 20 November 2003.
[30] Decision of the Higher Regional Court Cologne of 23 April 2004; Decision of the Higher Regional Court Thüringen of 8 August 2007.
[31] This is in line with the German case law in other areas. *See* T. Henninger, *Europäisches Privatrecht und Methode* (2009), 59.
[32] Decision of the Federal Supreme Court of 15 May 1986; Decision of the Higher Regional Court Thüringen of 8 August 2007.

starting point.[33] Systematic and historical interpretation seems to be used only sparingly with regard to Article V(2)(b)'s public policy defense.[34]

Second, German courts extensively refer to foreign statues, case law and scholarly writing in their interpretation of Article V(2)(b) of the Convention. This includes, for instance, case law of the European Court of Justice,[35] the French Cour de Cassation[36] and the Swiss Supreme Court, [37] the English Arbitration Act,[38] Belarusian[39] and Danish law,[40] as well as the UNCITRAL Model Law.[41]

Third, the case summaries above confirm that Article V(2)(b)'s public policy exception is often asserted but only rarely successful. German courts will always perform a case-by-case analysis on whether a violation of public policy occurred.

[33] Decision of the Federal Supreme Court of 30 June 1966, BGHZ 46, 74, 76.
[34] Decision of the Federal Supreme Court of 23 February 2006 (referring to the legislator's explanatory memorandum).
[35] Decision of the Higher Regional Court Thüringen of 8 August 2007; Decision of the Higher Regional Court Düsseldorf of 21 July 2004.
[36] Decision of the Higher Regional Court Saarbrücken of 30 May 2011.
[37] Decision of the Higher Regional Court Thüringen of 8 August 2007.
[38] Decision of the German Federal Supreme Court of 1 February 2001; Decision of the Federal Supreme Court of 15 May 1986.
[39] Decision of the Federal Supreme Court of 23 February 2006.
[40] Decision of the Higher Regional Court Saarbrücken of 30 May 2011.
[41] Decision of the Federal Supreme Court of 23 February 2006.