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Lithuania Has Restrained the Unruly Horse of Public Policy

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Public policy remains one of the most popular grounds used by the parties to oppose the recognition and enforcement of an arbitral award. Its vague content also makes its application in court greatly challenging – academics still refer to public policy as the "unruly horse". This creates a significant responsibility for the courts to find an efficient way of determining the scope of this legal instrument. If they fail to do so, inconsistent or broad application may cause the severe infringement of the legal expectations of the parties to arbitration and significantly decrease countries' reliability among investors.

This post analyzes the newest case law of the Supreme Court of Lithuania ("SCL") on the application of public policy. In the last couple of years the SCL decided a number of cases where public policy was applied, and the SCL consistently followed a pro-arbitration approach. This has also been reflected in the 2015 World Bank's "Ease of Doing Business" economies rankings, where Lithuania was placed 3rd among 189 countries in contract enforcement, and was recognized for the high quality of its judicial process.

Moreover, although Lithuania is a modest player in comparison to the countries with long lasting arbitration traditions, its recent case law, analyzed below, provides a meaningful input to the arbitration community in the interpretation of the public policy clause. It (i) provides guidance on how courts should use their discretion to apply public policy *ex officio*, (ii) explains the substantial content of the measure in question and, more accurately, to what extent bad faith might be treated as an infringement of public policy, and finally, (iii) provides viable alternative tools to anti-suit injunctions, which were forbidden by the European Union Court of Justice ("EUCJ") judgment in the *West Tankers* case.

As the Court of Appeal of Lithuania is the court of first instance to review claims regarding the recognition and enforcement of foreign arbitral awards, the SCL is the appellate and final instance to review these cases. Just recently, the Court of Appeal decided a couple of cases where the requests were brought to grant the recognition and enforcement of arbitral awards against Lithuania. After the Court of Appeal had decided that these awards violated public policy and rejected the private parties' requests to enforce them, the SCL was entrusted with an important task to review these judgments and to answer the question whether Lithuanian courts had managed

to demonstrate a sufficiently arbitration-friendly approach in the cases where the interests of Lithuania were at stake.

In June 2014, the SCL reversed the decision of the Court of Appeal and granted the recognition of the *ad hoc* award under the 1994 Italy-Lithuania BIT in the case *Luigiterzo Bosca v the Republic of Lithuania*.

In that case the arbitral tribunal has declared that (i) it had jurisdiction over the investor's claim for the compensation of indirect damages, (ii) Lithuania had breached its obligation to accord the investor fair and equitable treatment, and it (iii) directed Lithuania to compensate to the investor 80 percent of the arbitration costs. The recognition and enforcement procedure of this award was initiated in Lithuanian courts.

Although the parties had reached a settlement agreement in respect to the award, the Court of Appeal decided that the award infringed public policy. It ruled that the investor acted in bad faith by seeking compensation for lost profits and a declaration that Lithuania's acts had been illegal, as the investor had previously won a case in national courts and received their compensation in direct damages. Therefore, the SCL had to respond to the question whether the fact that investors had received compensation for the costs they incurred in national courts deprived them of their right to request compensation for lost profits.

The SCL formed a number of key rules in relation to the application of the public policy clause. Firstly, the question arose whether courts could rely on a public policy exception without party's request. Although the SCL stressed that the courts' power to apply Article V(2) of the New York Convention ["NYC"] *ex officio*, the judiciary was also obliged to consider whether the arbitral tribunal analyzed relevant issues which might be treated as a violation of public policy. The court noted that, if the tribunal provides arguments why certain issues should not be considered in violation of public policy, those arguments may be treated as important criteria negating violation. Moreover, the courts should consider the parties' procedural behavior both when examining the case in arbitration and during the procedure of recognition of the arbitral award. If a respondent did not raise questions relevant to ascertaining a violation of public policy, respondent's silence indicates a common will of the parties. The court should in such a case provide sufficiently strong arguments why the parties' will should be ignored.

Secondly, the NYC should be interpreted by taking into consideration the decisions of foreign courts as they might be useful from a comparative point of view. The SCL referred to the relevant case law of the United Kingdom, United States, Germany, France and Canada. The reliance on foreign case law as a source for interpreting the NYC has also persisted in later jurisprudence.

Thirdly, it was explicitly concluded that public policy within the NYC should be interpreted as an international one, which encompasses fundamental legal principles. The SCL approved its intention to interpret public policy narrowly:

> "[lack of] good faith [as violation of public policy] should be understood and interpreted not broadly, as a person's general lack of sufficient attentiveness or carefulness, but narrowly, as a person's deliberate attempt to jeopardize fundamental values: fraud, corruption, or other evidently illegal activity."

The SCL stressed that filling a claim to investment arbitration, where the tribunal finds its jurisdiction and the infringement of fair treatment, should not be treated as an act of bad faith.

Fourthly, a procedural question arose whether the court should inform the parties about its intention to apply Art V(2) of the NYC *ex officio* before rendering the judgment. The SCL stressed that the need to inform the parties should arise in situations when the court finds a new element of international public policy. The parties may not be informed about the court's intention to apply public policy only if there exists a guaranteed right to appeal.

Lithuanian case law further evolved in the recently-decided *Gazprom v. Republic of Lithuania* case, in which the question of application of the public policy exception arose once more.

The arbitral tribunal has found that Lithuania infringed the arbitration clause of the shareholders agreement concluded with Gazprom by bringing certain requests to the Lithuanian courts and obliged Lithuania to withdraw a number of requests. Lithuania argued regarding the recognition of this award that, similarly to the EUCJ judgement in the *West Tankers* case, arbitral tribunals are prohibited from obliging Member States' courts to dismiss a case. After the Court of Appeal applied public policy and denied the recognition of the arbitral award, Gazprom appealed to the SCL. The SCL referred the case to the EUCJ by raising the question whether the recognition of an arbitral award complies with the Brussels I requirements of mutual trust in the administration of justice in the European Union.

The EUCJ rendered its judgment in May 2015. The EUCJ decided that Brussels I does not affect the application of the NYC in relation to the recognition and enforcement of foreign arbitral awards. To be more accurate, the EUCJ stressed that the act of an arbitral tribunal prohibiting a party from bringing certain claims before a court of a Member State cannot deny the judicial protection provided by the Member States' courts. Therefore, Lithuania's failure to enforce the recognized award may not warrant the imposition of penalties by another Member State's court.

The SCL rendered its judgment in regards to Gazprom's request to grant the recognition of the arbitral award in October 2015. The expanded panel of judges of the SCL overruled the judgment of the Court of Appeal and declared that the award, which obliges Lithuania to withdraw certain claims in its national courts, should be recognized and enforced. The SCL relied on the conclusions provided by the EUCJ.

The recent judgment of the SCL demonstrates major positive influence and input of the Lithuanian case law to the arbitration community. It has been clearly decided by a Member of the NYC that although *West Tankers* prohibits Member State Courts to

require a party to an arbitration agreement to withdraw requests brought to the courts of another Member State, such request might be brought to a competent arbitral tribunal, and the arbitral award in question should still be recognized by the Member States of the European Union.

The cases discussed above demonstrate both procedural and substantial evolution of the interpretation of the Art. V(2)(b) of the NYC within Lithuanian case law. They show strong determination of the Lithuanian judiciary to restrict the scope of the international public policy and to interpret it narrowly, while guaranteeing the effective, pro-arbitration application of the NYC. The latest Lithuanian courts' jurisprudence indicates the consistent application of the relevant provisions, which has made a significant contribution to the modern attitude towards the public policy clause.

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