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The Impact of the *Benetton* Decision on International Commercial Arbitration

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What do we expect of international commercial arbitration? It is fair to say that we expect a relatively quick and efficient form of dispute resolution in matters of international commerce. We also expect an outcome – an arbitral award that is final and enforceable. And here, at this critical point, we may meet the "unruly horse" of public policy, as Chief Justice Hobart once put it over 300 years ago. But it was Lord Denning who added the consoling words: "With a good man in the saddle, the unruly horse can be kept in control. It can jump over obstacles. It can leap the fences put up by fictions and come down on the side of justice."[1]

There are two danger zones for such encounters. The first danger zone is the court that is to deal with a request for the recognition or enforcement of an arbitral award. Article V(2) of the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("the New York Convention")[2] provides that the recognition and enforcement of an award may be refused if this would be contrary to the public policy of the receiving country. So, public policy may be an impediment to the enforceability of an arbitral award. That is the first danger zone, but there is a second one to worry about as well. Many jurisdictions – including the Netherlands – provide that their own procedural law applies to an arbitration if the seat of that arbitration is in their territory; and many national arbitration laws offer remedies against an arbitral award that is contrary to public policy. So, for example, Article 34 of the UNCITRAL Model Law[3] provides: "An arbitral award may be set aside … if the court finds that the award is in conflict with the public policy of this State." Dutch law – closely modelled on the UNCITRAL Model Law – has a similar provision. Article 1065(1)(e) of the Dutch Code of Civil Procedure (CCP) provides that "[S]etting aside of the award can take place only on one or more of the following grounds …: the award, or the manner in which it was made, violates public policy or good morals."[4] Here, public policy may be an impediment to the finality of the award.

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[1] Enderby Town Football Club Ltd. v. The Football Association Ltd. [1971] AC 591, at 606. The author owes this quote to Dr. Loukas Mistelis.

[2] 330 U.N.T.S. 3 (1958).

[3] U.N. Doc. A/40/17, Annex I, adopted by the United Nations Commission on International Trade Law on June 21 1985; 24 I.L.M. 1302 (1985).

[4] For an English translation of the Dutch Arbitration Act, *see* PIETER SANDERS & ALBERT JAN VAN DEN BERG, THE NETHERLANDS ARBITRATION ACT 1986: ENGLISH, FRENCH AND GERMAN (1987).

Public policy is a potential source of trouble, hence the emblematic "unruly horse". Public policy may be a direct threat to the finality and enforceability of an arbitral award by opening up a realm of protracted litigation in a national court system, if it is not taken seriously by an arbitral tribunal in the course of conducting an arbitration. But then – bearing in mind Lord Denning's words – this threat serves the higher purpose of ensuring that justice is done.

Public policy is a rather complex legal concept, especially in the area of international commercial arbitration. It creates a kind of perplexity. Broad answers may be given easily; more detailed answers are apt to provoke further questions and to call for finer distinctions. Within a single national legal system, public policy (or *ordre public* as its French equivalent is called) may already have multiple meanings with varying legal effects. On an international, comparative level, it is even more difficult to come to definite conclusions beyond the common, but not very illuminating denominator of "basic norms of morality and justice".

It is generally held that public policy has a formal, procedural side as well as a material, substantive aspect. However, judging from available literature and case law, issues of procedural law have received far greater attention than matters of substantive law. Basic norms of civil procedure include rather trivial – that is, from a legal, conceptual point of view – notions, like the imperative of a fair hearing of both parties, equality of the parties before the tribunal and an absolute ban on tampering with witnesses or written evidence. Lawyers are well aware of these basic standards of justice and procedural issues are usually handled with due care in international arbitrations.

But what about matters of substantive law? It is precisely in this substantive area of public policy that the decision of the European Court of Justice (ECJ) on June 1, 1999 in the matter between *Eco Swiss China Time Ltd. of Hong Kong* and *Benetton International N.V. of Amsterdam* ["*Benetton*"],[5] left its traces. How permanent these traces will be remains to be seen, and Von Quitzow may have exaggerated by calling the *Benetton* decision "one of the most important ones in recent times",[6] but the latest edition of *SCHMITTHOFF'S EXPORT TRADE* contains no fewer than four references to this case.[7] This contribution is aimed at giving a quick overview of the case and its consequences for international commercial arbitration; its focus will be on the international, comparative dimension of the ECJ decision, omitting as much as possible the more arcane realms of Dutch arbitration law and Dutch civil procedure.

The clear message of the ECJ in the *Benetton* decision was that EU competition law based on Article 81 of the Treaty establishing the European Community ("EC Treaty")[8] is public policy for the purpose of the setting aside or annulment of an arbitral award as may be provided in the national rules of a Member State. The caveat "for the purpose of"

[5] Case C-126/97, XXIV Y.B. COM. ARB. 629–39 (1999); 1 STOCKHOLM ARB. R. 41–52 (2000).

[6] Carl Michael von Quitzow, *The Benetton Judgment and its Practical Implications on Arbitration*, 1 STOCKHOLM ARB. R. 36 (2000).

[7] LEO D'ARCY, SCHMITTHOFF'S EXPORT TRADE: THE LAW AND PRACTICE OF INTERNATIONAL TRADE (2000).

[8] 1997 O.J. (C 340) 173–308.

may sound over-cautious, but the point is that in civil law jurisdictions public policy is typically a multi-faceted concept. In essence, in civil law jurisdictions public policy concerns the fundamental legal and moral convictions of a given jurisdiction. It is a traditional part of the legal toolbox that allows courts – and arbitrators as well, it should be added – to favour certain domestic rules on the one hand (especially in the context of private international law), and on the other to eliminate the consequences of unwanted, immoral behaviour (declaring contracts or obligations resulting from such immoral behaviour null and void). It also allows courts to avoid the consequences of foreign rules or institutions that are not appreciated (particularly in the context of private international law).

Of course, this is a broad sketch that calls for finer distinctions and classifications that, moreover, may vary from one civil law jurisdiction to another. Public policy in private international law should be distinguished from public policy in private law in general, and the latter should be carefully distinguished from public policy in the context of civil procedure. In civil procedure, at least in Dutch law, public policy marks a clear exception to the prevailing doctrine of judicial restraint in view of the autonomy of the parties to draw the boundaries of a dispute. When rules of public policy are at stake, a court can – or, rather, should of its own motion ("*ex officio*" and "*sua sponte*") – apply such rules and should even set out to discover the facts that would justify the application of such rules of public policy. Finally, a distinction can be made between national, domestic public policy and international public policy, although it should be borne in mind that the adjective "international" may be slightly misleading, as so-called international notions of public policy should always pass through the filters of a national legal system in order to become operative and effective.

A few key facts will allow the reader to follow the development of the *Benetton* case. On July 1, 1986, Benetton, Eco Swiss and Bulova entered into a trademark licence agreement for a period of eight years. Benetton was to contribute its name, Bulova was to contribute quality control and its name, and the purpose of this combined effort was to enable Eco Swiss to manufacture, market and distribute stylish timepieces; fashion watches, that were to be branded "BbB" (Benetton-by-Bulova). The contract contained an arbitration clause that provided for arbitration under the rules of the Netherlands Arbitration Institute.[9]

In June 1991, Benetton gave notice of termination to Eco Swiss and Bulova, because of serious misgivings about royalties and royalty statements. Eco Swiss and Bulova did not accept this unilateral termination and commenced arbitration proceedings in the Netherlands on the basis of the arbitration clause. There were two parallel arbitrations;[10] this article concerns only the first of these.[11]

In 1993, the arbitral tribunal gave a partial award ("PFA"), in which the arbitrators disposed of Benetton's misgivings and held that the licence agreement continued to be in

[9] *Available at* <www.nai-nl.org/english/info2.html>.
[10] Netherlands Arbitration Institute Arbitration Nos. 1325 and 1616.
[11] Netherlands Arbitration Institute Arbitration No. 1325.

full effect between the three parties. On that basis, the tribunal ordered Benetton to compensate Eco Swiss and Bulova for damages caused by the unilateral termination of the licence agreement. The parties did not reach a settlement as to the quantum and the arbitration proceedings continued. In June 1995 the tribunal gave its final award ("FAA"). The tribunal ordered Benetton to pay approximately US$29 million plus costs and interest to Eco Swiss and Bulova.

Dutch arbitration law offers two remedies against an arbitral award: setting aside and revocation. Setting aside (or annulment) is appropriate where the award or the way in which it was made is contrary to public policy.[12] Revocation may be an even more serious matter. Article 1068 of the CCP provides that an arbitral award may be revoked if the award is based on forged documents or fraud committed during the arbitral proceedings (but discovered after the award was made), or where documents that would have had an influence on the decision were withheld from the arbitral tribunal as a result of actions of the other party.

In 1995 Benetton sued Eco Swiss and Bulova in the Court of First Instance in The Hague, seeking to set aside both awards – the PFA and the FAA – on a number of grounds, including the ground that the awards were in violation of Article 81 of the EC Treaty, which provision was to be regarded as a rule of (Dutch) public policy, because the awards gave effect to an agreement that was in violation of Article 81 of the EC Treaty. At the same time, Benetton began revocation proceedings in the Court of Appeals in The Hague, claiming that the awards were the result of fraud committed during the proceedings and that Eco Swiss had withheld essential documents. Furthermore, after having secured – as a result of further court action – a provisional stay of enforcement against a bank guarantee, Benetton made applications for a stay of enforcement of the FAA on the basis of both pending actions.

[12] Art. 1064 and art. 1065(1)(e) of the CCP. Art. 1064 reads as follows:

(1) Recourse to a court against a final or partial final award which is not open to appeal to a second arbitral tribunal, or a final or partial final award rendered on arbitral appeal, may be made only by an application for setting aside or revocation in accordance with this Section.
(2) An application for setting aside shall be made to the District Court with whose Registry the original of the award shall be deposited by virtue of article 1058(1).
(3) An application for setting aside may be made as soon as the award has acquired the force of *res judicata*. The right to make an application shall be extinguished three months after the date of deposit of the award with the Registry of the District Court. However, if the award together with leave for enforcement is officially served on the other party, that party may make an application for setting aside within three months after the said service, irrespective of whether the period of three months mentioned in the preceding sentence has lapsed.
(4) An application to set aside an interim arbitral award may be made only in conjunction with an application for setting aside a final or partial final award.
(5) All grounds for setting aside shall, on pain of being barred, be mentioned in the writ of summons.

Art. 1065(1) reads as follows:

(1) Setting aside of the award can take place only on one or more of the following grounds:
    (a) absence of a valid arbitration agreement;
    (b) the arbitral tribunal was constituted in violation of the rules applicable thereto;
    (c) the arbitral tribunal has not complied with its mandate;
    (d) the award is not signed or does not contain reasons in accordance with the provisions of article 1057;
    (e) the award, or the manner in which it was made, violates public policy or good morals.

The application for a stay of proceedings in connection with the setting aside action first reached the Dutch Supreme Court after the Court of Appeals in The Hague had found in favour of Benetton and stayed enforcement of the final award pending the court proceedings. Eco Swiss (Bulova had already dropped out of the proceedings) filed a Supreme Court (cassation) appeal. In 1997, the Dutch Supreme Court decided to refer the matter to the ECJ; to that effect five questions were asked in a request for a preliminary ruling under Article 234 of the EC Treaty.[13] The ECJ gave its judgment on June 1, 1999. Although it upheld that Article 81 of the EC Treaty was a rule of public policy for the purpose of setting aside, Benetton's claims were nevertheless denied as a result of national procedural hurdles that the ECJ was unwilling or unable to remove. In February 2000, on the basis of the ECJ decision, the Dutch Supreme Court quashed the decision of the Court of Appeals of The Hague and referred the case to the Court of Appeals of Amsterdam. However, the Court of Appeals of Amsterdam did not have to deal with the matter, because not long after the referral the case was settled.[14] This settlement also brought an end to the revocation suits and the main action for setting aside that by that time lay dormant pending the outcome of the ECJ and Dutch Supreme Court proceedings.

The *Benetton* case is rather complex (as has been written about by more than one Dutch legal commentator) not just because of the various actions and remedies (H.J. Snijders complained about what he called "procedural density"),[15] but also because of the multiple legal questions that were involved. Many of these questions deal with matters of Dutch civil procedure, which cannot be easily explained to an international audience. However, an outline of the main themes will suffice for the present purpose of examining the ECJ decision.

To start with, the licence agreement contained some clauses which affected European markets in their relation to other markets. These clauses – which Benetton claimed violated Article 81 of the EC Treaty – were not covered by a block exemption; neither had the agreement been notified to the European Commission. From a strict European Union competition law point of view such a defect cannot be repaired at a later stage. It should be stressed that neither during the contract negotiations nor during the arbitration had the parties ever raised issues of EU competition law in relation to their contract. Only after the arbitration did Benetton make the claim that the licence agreement was actually null and void and that the awards – which gave legal effect to an agreement that was null and void – should be set aside because they violated Article 81 of the EC Treaty, which according to Benetton, was a provision of (Dutch) public policy. Moreover, enforcement of the awards would again violate Article 81 of the EC Treaty.

The PFA in which the arbitral tribunal ordered that the licence agreement remain in full force and effect, had become final as a result of the lapse of the statutory three

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[13] Both decisions are reported in XXIII Y.B. COM. ARB. 180 (1998).
[14] The second Dutch Supreme Court decision is reported in XXV Y.B. COM. ARB. 475–85 (2000).
[15] Annotation by Snijders in Nos. 206 & 207 NEDERLANDSE JURISPRUDENTIE 1998.

months' period given to pursue the remedy of setting aside, during which no such application had been made. Consequently, the findings of the PFA had become binding on the parties (the doctrine of *res judicata*). In the ensuing court proceedings this gave rise to rather intricate questions about the status of a virtually undisputed factual finding by the tribunal that the agreement "as such" existed. Should such a finding be construed as a mere factual finding that a given contract existed or as meaning (implying) that the contract between the parties was consequently not null and void (i.e., free from whatever legal impediment or defect that would entail the contract's nullity), although no such legal issues (not only absence of violation of Article 81 of the EC Treaty, but also absence of force, or error or abuse of economic power, just to quote a few pertinent areas of Dutch contract law) had been the object of dispute between the parties. The Dutch courts went a long way to extending the scope of the *res judicata* rule in favour of the latter interpretation.

Finally, there was a serious problem with the principle that in Dutch civil procedure it is the parties who determine the ambit of their dispute. From the principle of party autonomy it follows that the parties set the boundaries of the dispute that is submitted to a court or an arbitral tribunal. A court and a tribunal also have to decide the dispute on the basis of what is submitted to them by the parties; a court is not allowed to go beyond the lines drawn by the parties, and arbitrators are not allowed to do that either, for by doing so, they would step outside the terms of their appointment and exceed their mandates (which by itself would be yet another ground for setting aside the award). However, there is one marked exception to this principle: the principle does not apply when public policy issues are at stake. In that event, a court and an arbitral tribunal are obliged to go beyond what is given and submitted by the parties to arrive at the truth. Hence, Benetton's insistence that this procedural public policy and public policy as a ground for annulment of an arbitral award were actually one and the same principle. However, this proved to be a bridge too far for the Dutch Supreme Court.

Faced with a number of delicate legal questions and the much-debated consequences of some recent case law of the ECJ,[16] the Dutch Supreme Court decided to make a request for a preliminary ruling under Article 234 of the EC Treaty. To that effect, five questions were formulated by the Dutch Supreme Court, and the ECJ first chose to answer the second one.

The Dutch Supreme Court set out from the position that Dutch arbitration law offers the possibility of setting aside an arbitral award on the ground that the award is contrary to public policy. The Supreme Court added that this would only be the case if the terms of this award or its enforcement would conflict with a mandatory legal rule so fundamental that no restrictions of a procedural nature should be allowed to prevent

[16] More specifically, ECJ Cases C-312/93, Peterbroeck, Van Campenhout & Cie v. Belgian State [1995] ECR I-4599 and C-430 & 431/93, Van Schijndel & B. Van Veen v. Stichting Pensioenfonds voor Fysiotherapeuten [1995] ECR I-4705.

the application of this rule. Furthermore, the Supreme Court stated that in Dutch law, the mere fact that a prohibition of competition law is not applied, is not generally regarded as being contrary to public policy. The Dutch Supreme Court asked whether, if it is found that an arbitral award violates Article 81 of the EC Treaty, should a Dutch court then allow a claim for annulment of that award, if the claim would otherwise comply with Dutch statutory requirements?

"Do we really have to use the front door of public policy?" is the reluctant question that lurks behind the polite, academic language of the Dutch Supreme Court. It is obvious that the question asked was not an inspiring one as the Supreme Court was hoping that the ECJ would answer in the negative (this message was not lost on several Dutch commentators). The ECJ, however, gave a very clear and straightforward answer:

> A national court to which application is made for annulment of an arbitration award must grant that application if it considers that the award in question is in fact contrary to Article 81 of the EC Treaty, where its domestic rules of procedure require it to grant an application for annulment founded on failure to observe national rules of public policy.[17]

In its reasoning the ECJ stressed the interests of efficient arbitration proceedings, underlining its own ruling that a tribunal is not a court and cannot make a reference under Article 234 of the EC Treaty,[18] and finally taking the unequivocal position that Article 81 of the EC Treaty "constitutes a fundamental provision which is essential for the accomplishment of the tasks entrusted to the Community and, in particular, for the functioning of the internal market".[19] The ECJ even went on to state that the provisions of Article 81 of the EC Treaty "may be regarded as a matter of public policy within the meaning of the New York Convention".[20]

Having arrived at this rather far-reaching point of view (for in the traditional civil law way of reasoning, public policy in the context of private international law as specified in the New York Convention, is a sub-set of the rules that qualify as public policy in a domestic context), the ECJ took one step back. In answering the fourth and fifth questions asked by the Dutch Supreme Court, the ECJ found that Community law does not require a national court to refrain from applying domestic rules of procedure with respect to *res judicata*. In other words, the Dutch concept of public policy as a ground for setting aside should now – at least in the area of EU competition law – be distinguished from the notion of public policy in Dutch civil procedure that allows or rather requires a court to broaden the ambit of a dispute set by the parties because public policy is at stake. The ECJ thus gave the Dutch Supreme Court the possibility to reject Benetton's claims on the basis of procedural impediments that would not have applied had the ECJ insisted on a full public policy treatment of Article 81 of the EC Treaty.

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[17] ECJ, Case C-126/97, ¶ 41.

[18] ECJ, Case 102/81 Nordsee v. Reederei Mond [1982] ECR 1095; also reported in VIII Y.B. COM. ARB. 183–91 (1983).

[19] ECJ, Case C-126/97, ¶ 36.

[20] ECJ, Case C-126/97, ¶ 38.

What are the Consequences of the *Benetton* Decision?[21]

First of all, the ECJ has clearly shown the supremacy of Article 81 of the EC Treaty, both with respect to domestic setting aside proceedings and also with respect to Article V(2) of the New York Convention. It is fair to say that the *Benetton* decision obliges an arbitral tribunal to apply Article 81 of the EC Treaty (and EU competition law in general). Therefore arbitrators and counsel need to be particularly cautious when dealing with certain types of agreements.

A real problem – at least from a Dutch perspective – is whether this obligation to apply EU competition law is now an *ex officio* obligation for an arbitral tribunal. Strictly speaking, the ECJ did not address this question. However, it may be argued that in the *Benetton* decision, Article 81 of the EC Treaty is not – in the words used by the Dutch Supreme Court – a mandatory rule so fundamental that no restrictions of a procedural nature should prevent its application. In other words; yes, the rule belongs to public policy, but it is a restricted rule, the application of which may be curtailed by specific procedural rules. When the parties have deliberately chosen to ignore Article 81 of the EC Treaty, arbitrators are still caught in the unlucky middle. When they follow suit and ignore Article 81 of the EC Treaty as well, the award may be challenged and is subject to setting aside. When they broaden the scope of the dispute, they run the risk of being accused of exceeding their mandate, which may also result in the annulment of the arbitral award. Whatever the tribunal does may result in setting aside of the award as well as protracted litigation. However, there are practical ways to get around this problem, at least from a Dutch perspective. Whenever they feel that EU competition law issues are at stake, although the parties may have reasons of their own to remain silent about such matters, arbitrators may order a hearing (personal appearance of the parties) and ask questions; request the parties to address certain issues in their briefs; produce documents or retain experts; or even enlist the support of the European Commission.

While the *Benetton* decisions are unique, there is other case law dealing with similar issues. I refer to an interesting article by Kurt Heller,[22] who mentions two fairly recent Austrian Supreme Court decisions of February 23, 1998 and May 5, 1998.[23] Apparently the Austrian Supreme Court faced less procedural impediments, because in both cases the arbitral awards were effectively set aside.

I would also like to point out a close parallel between the ECJ's *Benetton* decision and *Mitsubishi v. Soler Chrysler Plymouth* of the U.S. Supreme Court.[24] This 1985 decision introduced the so-called "second look test"; U.S. courts may exercise control over arbitral

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[21] I am particularly indebted to a number of publications that appeared after the ECJ decision: Christoph Liebscher, *European Public Policy After Eco Swiss*, Am. Rev. Int. Arb. 81–94 (1999); Christoph Liebscher, *European Public Policy: A Black Box*, 17(3) J. Int. Arb. 73–88 (2000); Karl Johan Dhunèr, *EC Competition Law and National Arbitration Procedure*, 1 Stockholm Arb. R. 24–32 (2000); Carl Michael Quitzow, *The Benetton Judgment and its Practical Implications on Arbitration*, 1 Stockholm Arb. R. 33–40 (2000).

[22] Kurt Heller, *Constitutional Limits of Arbitration*, 1 Stockholm Arb. R. 7–21 (2000).

[23] Austrian Supreme Court, February 23, 1998, WBl. 1998, 221; Austrian Supreme Court, May 5, 1998, EvBl. 1998/179, Ecolex 1998, 765.

[24] 473 U.S. 614 (1985); 105 S. Ct 3346, 87 L.Ed 2d 444.

awards insofar as competition law is concerned. It is not unlikely that the ECJ took this U.S. decision into account as an example for its own *Benetton* decision. The ECJ also allows a national court a second look at a case that resulted in an arbitral award if an application for setting aside or annulment is made that otherwise satisfies the criteria for such an action.