

**To:** International Bar Association  
Sub-Committee on Recognition and Enforcement of Awards

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**Subject:** Public Policy and Serbian Arbitration Law in Practice

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## 1 Introduction

This report analyses the concept of public policy as applied in the context of recognition and enforcement and setting aside of arbitral awards in the Republic of Serbia ("**Report**").

Primarily, the Report briefly introduces the general legal framework for recognition and enforcement and setting aside of arbitral awards in Serbia. Therewith, it focuses in particular on statutory regulation of public policy exception (Section 2). Further, the Report examines the concept of public policy endorsed by Serbian courts when deliberating on these issues (Section 3). The Report additionally encloses a catalogue of certain key decisions elaborating on the concept of public policy in this setting (Section 4). A table of these decisions is attached as appendix to this Report.

## 2 Public Policy in Serbian Statutes

The New York Convention on Recognition and Enforcement of Foreign Arbitral Awards ("**NYC**") entered into force in Serbia (then a member state of the federal Yugoslavia) in October 1981. To date, the NYC is an integral part of the Serbian legal system, standing above the national legislation in the hierarchy.

Soon after ratifying the NYC, in 1982, Serbia enacted its Private International Law Code ("**PIL**"), which introduced its own system for recognition and enforcement of foreign arbitral awards and its own definition of public policy. While the recognition and enforcement of foreign arbitral awards was later

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excluded from the scope of this statute, the concept of public policy as such still remains defined therein.

In that respect, Serbian law currently defines public policy as the "*foundations of the social order as defined by the Constitution*".<sup>1</sup> This approach was, however, recently criticized as inadequate – since the constitution that had been in force at the time PIL was enacted was much more explicit and precise in setting out the "*foundations of the social order*", as opposed to constitutions that followed.<sup>2</sup> Presently, defining public policy would boil down to referring to the basic human and minority rights guaranteed in the Constitution.

In 2006, Serbia enacted its current Arbitration Act ("**SAA**") which anticipates contravention of the *effects* of an award with Serbian public policy as (mandatory) ground for refusal of recognition and enforcement of such award.<sup>3</sup> However, the SAA does not further define the concept of public policy.

Still, the definition expressed in the PIL should be instructive, as uniformity of legal system mandates that legal standards be used and defined consistently throughout the entire legal system. In that sense, for as long as PIL is in force in the current form, public policy should be defined as "*foundations of the social order as defined by the Constitution*".

It may be expected that this definition will be changed in the near future, although the exact timing of such change is not yet foreseeable. A new private international law act is currently being prepared for enactment and is expected to eliminate this definition of public policy altogether. It so remains to be seen how courts will react to future requests for recognition and enforcement or setting aside of arbitral awards, *i.e.* whether they will find the way to maintain the current interpretation based on the PIL definition or chart a completely new course.

### **3 Public Policy in National Court Practice**

#### *3.1 Recognition and enforcement of arbitral awards*

Public policy was, admittedly, not often discussed in cases concerning recognition and enforcement of foreign arbitral awards. Moreover, no decisions refusing recognition and enforcement on these grounds were found.

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<sup>1</sup> PIL, Arts. 4, 91 and (former) 99(3).

<sup>2</sup> Higher Commercial Court, Case no. Pvž. 391/2008, Decision of 5 May 2008.

<sup>3</sup> SAA, Art. 66(2).

Still, when considered, public policy was defined rather restrictively, as several courts held:

*"[...] public policy should be narrowly interpreted, and it has to relate to fundamental principles of justice on which the legal system rests".<sup>4</sup>*

and

*"[...] the merits of the award are not immune to the public policy, but the error would have to be cardinal and lead to unacceptable consequences."<sup>5</sup>*

and

*"[...] public policy is a category narrower than just a sum of mandatory provisions of law and includes only those domestic norms which protect the most basic values of our order [...] A foreign arbitral award would be refused recognition if it were contrary to the foundations of the social system as defined by the Constitution of the Republic of Serbia".<sup>6</sup>*

In interpreting the concept of public policy, Serbian courts did not differentiate between domestic and international public policy. Moreover, courts held that there was no need to make such distinction, as the SAA had not established a different regime for domestic and foreign arbitrations.<sup>7</sup>

### 3.2 *Setting aside of arbitral awards*

Defining public policy in setting aside procedures is not much different from the approach taken in cases for recognition and enforcement. In fact, both of these procedures are regulated by the same statute, in essentially the same manner.

In that regard, a court held that one should not examine whether the effects of the award are contrary *"to any legal act of the Republic of Serbia"*. Rather, one has to determine whether the enforcement of the award, or its very existence, would

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<sup>4</sup> Commercial Appellate Court, 6 Pvž 1132/2011, Decision of 28 December 2011, p. 3; Commercial Appellate Court, 6 Pvž 215/2011, Decision of 16 March 2011, p. 5.

<sup>5</sup> Commercial Appellate Court, 6 Pvž 215/2011, Decision of 16 March 2011, p. 5; Commercial Appellate Court, 6 Pvž 460/2010, Decision of 13 September 2010, p. 7.

<sup>6</sup> Commercial Appellate Court, 6 Pvž 460/2010, Decision of 13 September 2010, p. 7; Commercial Court in Belgrade, 3 I 2716/2010 6 December 2010, p. 6.

<sup>7</sup> Commercial Court in Belgrade, 3 I 2716/2010 6 December 2010; Commercial Appellate Court, 6 Pvž. 460/2010, Decision of 13 September 2010, p. 7; Commercial Appellate Court, 6 Pvž 215/2011, Decision of 16 March 2011, p. 5.

jeopardise "some of the basic principles on which the public order of the Republic of Serbia is based upon".<sup>8</sup>

Moreover, the Serbian Supreme Court further held that:

*"there is no breach of public policy in every case of violation of a mandatory norm of domestic law. Something more is needed – that is, that the content of the violated norm concerns certain fundamental values of the social order".<sup>9</sup>*

### 3.3 Further guidance from recognition and enforcement of foreign court judgments

Contravention with public policy is also one of the grounds for refusal of recognition and enforcement of foreign court judgments. The few decisions in those proceedings shed further light on the interpretation of public policy in Serbian court practice.

In fact, certain judgments provided particular examples of what is undoubtedly deemed procedural public policy within the meaning of PIL: the principles of fair hearing, independence and impartiality of the court, prohibition of rendering decisions in a fraudulent manner, right to appeal, use of one's native language in the proceedings etc.<sup>10</sup>

While, of course, not all of these principles may be equally applicable in arbitration (e.g. the inability to use one's native language in arbitration was expressly held not to have impaired the principle of party equality, and was thus found not to be contrary to public policy), many could actually provide adequate guidance also in arbitration-related cases.

## 4 Catalogue of Particular Cases

No decisions were found to have refused recognition and enforcement due to violation of public policy.

The catalogue below will, however, record decisions which contemplated the issue of public policy but found that there was either no violation thereof or no authority to review the merits of the award.

Given the difference in types of procedures conducted for recognition and enforcement on the one hand, and for setting aside on the other, the following catalogue will address the parties to these proceedings as (i) "proponent" and "counter-proponent" in case of recognition and enforcement; and (ii) "plaintiff" and "defendant" in case of setting aside.

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<sup>8</sup> Commercial Appellate Court, Pž 2765/2013, Decision of 23 January 2014.

<sup>9</sup> Supreme Court of Serbia, Prev. 226/1999, Decision of 9 December 2000.

<sup>10</sup> Commercial Court in Belgrade, Case no. IV-P 96/2007, Decision of 18 June 2008; Higher Commercial Court, Case no. Pvž. 391/2008, Decision of 5 May 2008.

#### 4.1 *Recognition and Enforcement of Arbitral Awards*

##### 4.1.1 *Commercial Appellate Court, Case no. 6 Pvž 215/2011, Decision of 16 March 2011*

The main dispute arose in connection with a construction project. The counter-proponent alleged that its obligation in the underlying agreement was conditional and that the award established that the proponent failed to perform its obligations under such agreement. The counter-proponent thus considered the award contrary to the basic principles of contract law and consequently contrary to public policy.

The court of first instance upheld the motion for recognition of the award, and such decision was appealed to. The appellate court upheld the first instance decision, holding that the award did not demonstrate any "cardinal" error, and that the courts were precluded from reviewing the award in the merits. Counter-proponent's allegations were, according to the appellate court, supposed to be discussed solely during the arbitration proceedings.

Additionally, when contemplating on all grounds for refusing recognition of an award, the appellate court pointed that the public policy exception might include a situation where the award was affected by or resulted from a criminal offence.

##### 4.1.2 *Commercial Appellate Court, Case no. 6 Pvž. 460/2010, Decision of 13 September 2010*

The main dispute pertained to a lease agreement between the Government of Serbia and Montenegro and a Curaçao company. The resulting award ordered the government to pay a certain amount of money to the company.

The award was recognised in the first instance, and the Serbian Attorney General appealed alleging that the first instance court mistakenly refused to evaluate the effects of the underlying agreement within deliberations on public policy. In fact, the main thrust of the appeal focused on the idea that recognition of the award based on a null agreement indirectly gives effect to such agreement, despite its nullity.

The Attorney General particularly alleged that public policy was indeed violated because, *inter alia*: (i) the underlying lease agreement had been concluded fraudulently and had contained elements of corruption; (ii) the official signing the agreement did so without observing the required procedures; (iii) the negotiations were also conducted without the necessary procedures; (iv) the underlying agreement was actually not an agreement but only a basis for further negotiations; (v) the agreement lacked essential elements required by the law and was thus null; and (vi)

the signing official was criminally prosecuted for fraud and abuse of position (although the criminal proceedings were still pending at that time).

The court ultimately held that, as the same arguments were addressed in the arbitration itself (and the arbitrators deemed them unfounded), a request to the court to refuse recognition because the award had allegedly legalized fraudulent behaviour would require the court to review the merits of the award. The court found itself unauthorized to do so. The effect of the award is the matter scrutinized when it came to public policy, not the effect of the agreement underlying the initial dispute. An obligation to pay an amount of money is the usual effect of both court judgments and arbitral awards. Furthermore, the court emphasized that not all violations of mandatory rules of law amount to violation of public policy, which protects only the most vital values of a system.

#### 4.1.3 *Commercial Court in Belgrade, Case no. 3 I 2716/2010, Decision of 6 December 2010*

The case revolved around an international sales contract. A Swiss arbitrator ordered the debtor to pay the principal debt increased by an interest rate of 12% *per annum*.

Opposing recognition, the counter-proponent *inter alia* alleged that the arbitrator applied the interest rate much higher than stipulated in the governing law. Therefore, the rate was allegedly usurious and contrary to public policy.

The court, however, held that the effects of the award in question, that respondent was obliged to pay a certain amount of money, were the usual effects of court judgments and arbitral awards, whereas public policy is a narrow concept which is there to protect only the most vital values. The objection as to the interest rate could only have been raised in the arbitration, and could not prevent recognition of the award as the court was not authorised to revise the merits of the award.

#### 4.2 *Setting Aside of Arbitral Awards*

##### 4.2.1 *Supreme Court of Serbia, Case no. 226/1999, Decision of 6 December 2000*

The initial dispute revolved around a consulting agreement where the defendant was supposed to assist the plaintiff in offering certain materials to the army of a third country.

The issue discussed in the setting aside proceedings was whether the plaintiff and the third country's ministry of defence concluded their agreement with or without the assistance of the defendant. The plaintiff alleged that the consulting agreement, a basis for the disputed award, was concluded as a consequence of corruption, and that it was null.

The court held that the consulting agreement itself was recognised in domestic law, and that the defendant had fulfilled all of its obligations. It, however, further implied that the existence of corruption could have influenced its decision on setting aside. In essence, one of the reasons for the court's refusing to set the award aside was the fact that the plaintiff failed to prove corruption, both in the setting aside proceedings and in the arbitration proceedings.

## 5 Appendix

No.	Identification of the decision	Summary of the public policy argument	Substantive	Procedural	Enforcement denied	Enforcement accepted
<b>I Recognition and Enforcement of Foreign Arbitral Awards</b>						
1.	Commercial Appellate Court, 6 Pvž 215/2011  16 March 2011	Although the merits of an award are not immune to the public policy exception, the arbitrators' error would have to be cardinal and would have to lead to unacceptable consequences.	<b>n/a</b>			<b>X</b>
2.	Commercial Appellate Court, 6 Pvž 1132/2011  28 December 2011	Only a violation of fundamental principles of justice may be deemed violation of public policy. The court is not authorised to review the merits of the award under the guise of public policy exception.	<b>n/a</b>			<b>X</b>
3.	Commercial Appellate Court, 6 Pvž 460/2010  13 September 2010	Public policy is to be interpreted restrictively, as it is a category narrower than the sum of mandatory rules of law. Errors must be cardinal and lead to unacceptable consequences, and refusal of recognition would follow from the award being contrary to the foundations of the social order as defined in the constitution.	<b>n/a</b>			<b>X</b>
4.	Commercial Court in Belgrade, 3 I 2716/2010	Payment of a certain amount of money is a usual effect of court decisions and arbitral awards. Claims as to the applied interest	<b>X</b>			<b>X</b>



No.	Identification of the decision	Summary of the public policy argument	Substantive	Procedural	Enforcement denied	Enforcement accepted
5.	<p>6 December 2010</p> <p>Commercial Court in Belgrade, 4 P 359/2013</p> <p>2 October 2013</p>	<p>rate are contemplated within arbitration itself and cannot be discussed within public policy exception.</p> <p>Contracts for sale are recognised in domestic law, so the effects of awards based on such contracts are not contrary to public policy.</p>	<b>n/a</b>			<b>X</b>
<b>II Setting Aside of the Domestic Arbitral Award</b>						
6.	<p>Commercial Appellate Court, PŽ. 2765/2013</p> <p>23 January 2014</p>	<p>Grounds for nullity of a contract are not necessarily grounds for setting aside due to violation of public policy. Public policy is narrower than the sum of mandatory rules and the award would be set aside only if its performance or existence violated some of the basic principles underlying the Serbian public order.</p>	<b>n/a</b>			<b>X</b>
7.	<p>Supreme Court of Serbia, Prev. 536/1995</p> <p>24 January 1996</p>	<p>If a transaction is permitted in domestic law, one cannot claim nullity of the relevant contract. Consequently, there would be no violation of public policy.</p>	<b>n/a</b>			<b>X</b>

No.	Identification of the decision	Summary of the public policy argument	Substantive	Procedural	Enforcement denied	Enforcement accepted
8.	Federal Court, Gžs. 20/1996 31 October 1996	Even if the underlying contract were permitted under domestic law, the award could have still been contrary to public policy if a debtor received substantial amounts without any work done.	<b>X</b>		<b>X<sup>11</sup></b>	
9.	Supreme Court of Serbia, Prev. 226/1999 9 December 2000	Corruption in the transaction underlying the disputed award might have led to setting aside. As the plaintiff failed to prove corruption, both in the setting aside proceedings and in arbitration, setting aside was refused.	<b>X</b>			<b>X</b>

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<sup>11</sup> While this particular decision did set aside the challenged award due to violation of public policy, the Supreme Court reversed this in the following (see item 9 below) and found that the award was not contrary to public policy.