There is a well established principle of transnational public policy that a State party cannot improperly invoke its own internal law to avoid its contractual obligation to arbitrate (the “Internal Law Principle”).

The Internal Law Principle contemplates a contract between a State (or a public administration within a State, or a State-owned entity) and a foreign contractor or investor containing an agreement to arbitrate. The applicable law is the law of the State party. Subsequently, a dispute arises between the contracting parties. The foreign investor wishes to submit the dispute to arbitration and invokes the arbitration agreement. The State Party responds that the arbitration agreement is invalid, and consequently the arbitral tribunal has no jurisdiction, on the basis of mandatory requirements in its own internal law.

This article examines the basis and application in practice of the Internal Law Principle. The Internal Law Principle considered here operates in private international law and international commercial arbitration through transnational public policy. There is an analogous principle in public international law, potentially applicable in treaty-based investment arbitration, in the form of the rule in Article 27 of the Vienna Convention on the Law of Treaties prohibiting the reliance by a State party on its internal law as a justification for its failure to perform a treaty. Article 27 does not apply to the type of problem under discussion, because international commercial arbitration involving a state party arises from contract and not by treaty.

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1 Article 27 of the Vienna Convention reads as follows:
“Article 27 Internal law and observance of treaties: A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty. This rule is without prejudice to article 46.” (Article 46 relates to provisions of internal law regarding competence to conclude treaties).
In certain circumstances the invocation of the internal law by a state party to escape a contractual obligation to arbitrate may implicate rules of public international law (such as sovereign immunity) or raise potential issues of inter-state responsibility (for example, in the case of a denial of justice).
Transnational public policy does not form part of the legal orders either of public international law, or any national legal order. The public policy of individual states is divided into domestic public policy and international public policy, with the latter being the (more restricted) public policy of the state as applied to international transactions. By contrast, transnational public policy is the ‘common core’ of the international public policy of many states, which by its very nature also reflects fundamental principles of public international law. It is the amalgam of the public policy of multiple forums, but is the public policy of no individual forum. It embodies the transnational consciousness and solidarity of international commercial arbitration.

Accordingly, transnational public policy is an expression of international arbitral practice, implicitly accepted by any party to an international arbitration agreement. The juridical basis for the application of transnational public policy is therefore the agreement of the parties, and the jurisdictional framework of international arbitration to which the arbitration agreement provides access. Transnational public policy therefore joins the terms of the contract between the parties, trade usages, and perhaps lex mercatoria, as part of the applicable law in the arbitration that in certain circumstance will prevail over the applicable national law(s) expressly chosen by the parties.

A. State Contracts and International Commercial Arbitration:
Contracts between a State or a public administration within the State and a foreign contractor or investor are commonplace in international commerce, particularly in relation to infrastructure development.

However, the foreign investor or contractor and the officials of the State party are likely to negotiate the contract from different perspectives. The foreign party contemplates a commercial relationship, governed by the normal practices and rules of international trade. The officials of the State party are accustomed to administrative contracts subject to special rules in their domestic law. The State party is also accustomed to the resolution of disputes arising from administrative contracts in its own administrative courts.

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4 Particularly the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention). Article V.2(b) of the New York Convention recognises public policy as a valid ground for the refusal of recognition and enforcement, thereby implicitly requiring international arbitral tribunals to consider and apply public policy in their awards.
These different perceptions might not be properly addressed at the time of the drafting of the contract. Individual terms are negotiated and modified, sometimes from one perspective and sometimes from another, in order to reach a set of mutually acceptable terms so that the contract can be executed. The resulting contract is a compromise of both domestic administrative law and international commercial law. The tensions or inconsistencies between these two systems of law are unresolved in the negotiations and the executed contract, but come to the forefront when a dispute arises.

One particular term that the foreign party usually insists upon in negotiations is dispute resolution in a neutral forum by means of international commercial arbitration. State parties often agree. However, many jurisdictions have mandatory legal rules regarding the resolution of disputes in administrative contracts. These rules often impose strict limits or special procedures on the arbitration or settlement of disputes involving state contracts or state assets.

There are good reasons, from the perspective of the State Party, to justify these restrictions, including preserving fundamental distinctions between the competence of civil and administrative tribunals, principles of good public administration (the settlement -or by extension private arbitration- of disputes involving state contracts or assets is open to abuse or perverse incentives if not subject to strict control), or commitment to the principle of the national treatment of foreign investors. The problems arise when the State Party has agreed to international commercial arbitration in breach of mandatory provisions of its own internal law.

A different set of problems arises where, instead of relying on pre-existing restrictions in its own law, the state actively seeks to use its internal law to frustrate the international arbitration after a dispute has arisen. A State party might regret its decision to agree to international commercial arbitration and seek to use its legislative, executive or administrative powers in various ways (discussed in more detail, infra) to prevent the international arbitration from taking place, and to bring the dispute back within the domestic legal system.

These then are the two basic circumstances that might call the Internal Law Principle into play: where the State Party seeks to prevent or frustrate an arbitration to which it has previously agreed, either through the reliance on pre-existing mandatory provisions of its domestic law, or the ex post facto use of its legislative, executive or judicial powers for this purpose.

B. The Rationale of the Internal Law Principle:
There are weighty reasons in favour of the rule of transnational public policy preventing the State from relying on prerogatives in its own law to avoid an arbitration agreement in a contracts with a foreign party. These include the
principles of *pacta sunt servanda*, good faith, abuse of rights, *venire contra factum proprium* (or estoppel as it is called in common law jurisdictions) which reduce to two lines of reasoning, one practical and the other ethical. Both for the security of international trade, and for obvious moral reasons, States should be bound by their agreements to arbitrate.\(^5\)

There is universal recognition of the principles of *pacta sunt servanda* and *venire contra factum proprium* by courts and tribunals throughout the world.\(^6\) Its specific application in the form of the principle that a State cannot rely its internal law to escape its international obligations is also widely recognised. It is a principle of public international law embodied in Article 27 of the *Vienna Convention on the Law of Treaties*, Article 7 of the International Law Commission’s *Articles on State Responsibility*,\(^7\) and receives a *de facto* recognition in Article II.1 of the 1961 *European Convention on International Commercial Arbitration* (the Geneva Convention). At a national level it has received statutory recognition in the arbitral legislation of some jurisdictions, notably Switzerland and Spain\(^8\), and in others such as France is well established by jurisprudence.\(^9\) The principle has been applied by international arbitrators in a number of well publicised awards that have been welcomed and approved by leading commentators.\(^10\)

Indeed, the repudiation of an arbitration agreement by a State Party may in some circumstances be a breach of international law, and this possible illegality provides a further justification for the Internal Law Principle. The repudiation of an arbitration clause based on internal law might be a violation of Article II.1 of the *Convention on the Recognition and Enforcement of Foreign Arbitral Awards* (New York Convention).\(^11\) It also “involves the denial of justice to the only

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\(^8\) See Articles 177.2 of the Swiss Private International Law Act 1987, and Article 2.2 of Spain’s Arbitration Act 2003.


\(^11\) Article II.1 reads: “Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise..."
tribunal which has jurisdiction and upon which the parties have agreed. The failure to afford access to tribunals has traditionally been treated as a peculiar and particularly grave instance of State responsibility.”12 It is an error for officials and lawyers of a State party to assume that its legislation enjoys the same primacy in an international contract as in a domestic contract. “The questions of conformity of national legislation with international law is a matter of international law...It is not enough for the State to bring a matter under the protective umbrella of its legislation, possibly of a predatory character, in order to shelter it effectively from any control by international law.”13

C. The Effect of the Internal Law Principle:
The Internal Law Principle operates so as to preserve an arbitration agreement (and therefore the jurisdiction of the arbitral tribunal) when the State Party relies on its internal law to challenge the validity of the arbitration agreement:

Example: Assume in State X that the law provided that the State could only enter into an arbitration agreement with the prior approval of the Council of Ministers. No approval was obtained from the Council of Ministers for the arbitration agreement included in a concession contract with a foreign investor. Assume further that the concession contract provided that the applicable law is the law of State X, and the seat of the arbitration is a city in State X. The arbitration agreement is therefore null and void in accordance with the internal law of State X. However, if State X raises the nullity of the arbitration agreement on the basis of its internal law in arbitration proceedings commenced by the investor, then transnational public policy provides the justification for the rejection of this defence and the affirmation of the validity of the arbitration agreement.

Certain consequences of the application of transnational public policy in this example are worthy of comment. The parties to the contract agreed on the application of the substantive and procedural law of State X. However, transnational public policy overrules not only the internal law of the State, but also the parties’ explicit acceptance of the State’s internal law. The Internal Law Principle overrules the personal law of the State, the applicable substantive law chosen by the Parties, and the law of the seat.

There is a resistance in some quarters to accept that national law, as an expression of the Legislative Power and more fundamentally of the will of the citizens of the State party, can in some circumstances be overruled by principles

between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration.”

that are not part of any national legal order or of the international legal order, but rather are a distillation of multiple laws and principles, and the values recognised by international jurists. The Internal Law Principle therefore embodies a tension between national sovereignty and international legal values.14

A consequence of the application of the Internal Law Principle in these circumstances is to enable a foreign investor to access an international arbitral tribunal (with its advantages of neutrality and enforcement) when a domestic investor is confined to a remedy in the State’s own courts. This appearance of a special treatment for the foreign investor might be objectionable in jurisdictions committed to the principle of national treatment for foreign investment.

D. The Definition of the Internal Law Principle:
It is possible to identify characteristics of the Internal Law Principle of transnational public policy that serve both to confine the principle within its proper ambit and also to distinguish the operation of the principle from analogous doctrines similarly derived from basic notions of contractual good faith.

Firstly, the Internal Law principle only applies when the State party seeks advantage in its own internal law. The principle does not prevent the State Party relying on favourable provisions of a foreign law, where applicable, to vitiate the arbitration agreement, or on principles of public international law. In these circumstances there is no improper use by the State of its own law, although its efforts to escape the arbitration agreement may be objectionable on other grounds.15

Secondly, the principle only applies to reliance by the State Party on its own law to vitiate the arbitration agreement. If the State and the foreign investor have chosen the State party’s law to govern their contractual relationship, then the

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14 A consequence of the application of the Internal Law Principle in these circumstances is to enable a foreign investor to access an international arbitral tribunal (with its advantages of neutrality and enforcement) when a domestic investor is confined to a remedy in the State’s own courts. This appearance of a special treatment for the foreign investor might appear objectionable in jurisdictions committed to the principle of national treatment for foreign investment.

15 For example, a State party raising the defence of sovereign immunity invokes a legal doctrine to escape from its prior undertaking to arbitrate. However, sovereign immunity is a doctrine of public international law, and so reliance on this doctrine cannot be treated as an example of a State’s reliance on its internal law to escape its obligation to arbitrate. In any event, there are more simple and direct ways for an arbitral tribunal to address a defence of jurisdictional immunity than invoking transnational public policy, such as an implied waiver (see LEW, MISTELIS AND KROLL Comparative International Commercial Arbitration (Kluwer Law International, 2003) at paragraphs 27-39 and 27-52; GEORGES R. DELAUME supra, at 786-787; GEORGES R. DELAUME Sovereign Immunity and Transnational Arbitration (1987) 3 Arbitration International 28-45) or inapplicability of sovereign immunity on the basis that an international arbitral tribunal is not an organ or representative of another State (see Preliminary Award in ICC Case Nº 2321 in 1974 in SIGVARD JARVIN & YVES DERAINS Collection of ICC Arbitral Awards 1974-1985 (ICC Publication 433, 1990) at 8-10).
State Party can rely on its internal law to deny all liability to the investor, and even to challenge the validity of the contract, provided it does so within the agreed arbitral procedure.

Thirdly, the principle condemns the State party’s bad faith use of its own law to escape its contractual obligation to arbitrate. The State can always rely on general principles of the applicable law (including its own law) to challenge the validity of the arbitration agreement. For example, a State Party may raise jurisdictional objections that the arbitration agreement was not in writing, or that the agreement binds a state entity with a separate legal personality and not the State itself\(^\text{16}\) or was obtained by fraud, but again should do so within the agreed arbitral procedure in accordance with the compérence/compérence principle.

Bad faith distinguishes the proper application of the Internal Law Principle from a legitimate exercise of the State’s sovereign right to legislate, regulate and restructure its legal relationships. For example, a State Party may abolish a state entity with whom a foreign investor has contractual rights, including a right to arbitrate. A legitimate exercise of this power would be accompanied by compensation or provision for the legal succession to another entity, or to the State itself, of the obligations of the defunct entity. However, if on the contrary the State Party legislated that the obligations of the defunct entity shall be deemed not to have been incurred, then the intention to escape from its obligations in bad faith is manifest and transnational public policy would protect the investor’s right to arbitrate.\(^\text{17}\)

E. The Application of the Internal Law Principle:
The application of the Internal Law Principle appears most commonly in the context of restrictions in the state’s power to arbitrate that existed but were ignored at the time of entering into the arbitration agreement, but which the State raises after a dispute arises. Outside this category of case, there are various arbitral pathologies where the principle has relevance. The reasoning in the cases referred to here often does not mention transnational public policy, and relies on other concepts, and particularly good faith. Transnational public policy is an evolving concept, and awareness of its content and application are still growing.

Notwithstanding other rationalisations for upholding such arbitration agreements, it is suggested that a single principle of transnational public policy can unite the rejection of State party challenges to an arbitration agreement in the following five circumstances:

\(^{17}\) See Société des Grands Travaux de Marseille v. East Pakistan Industrial Development Corporation, discussed below.
(a) Direct or Indirect Prohibition of State Party Arbitration Agreements: The internal law of a State Party may expressly prohibit an arbitration agreement by the State in particular circumstances (type of contract; foreign party, etc), or might indirectly prohibit an arbitration agreement by conferring exclusive competence over such contracts in the State’s own administrative courts.18

A consequence of the application of the Internal Law principle in these circumstances is that the classification of state contract in the domestic law of the state party—civil or administrative, public or private—is immaterial in an international commercial arbitration for the purposes of determining the jurisdiction of the arbitral tribunal.

(b) Failure to Follow Prescribed Procedures for the Execution of a State Party Arbitration Agreement: This might occur where:

(i) Where the internal law requires the arbitration agreement to be executed by a designated official or an official at a designated level, and a lesser official has executed the agreement. An well known example of a provision requiring the approval of an arbitration agreement by a designated official is the second paragraph of Article 1 of *Egyptian Law Nº 27/1994 concerning Arbitration in Civil and Commercial Matters* (as amended by Law Nº 9 of 1997 promulgated on May 19, 1997 and published on May 15, 1997):

"*Article (1)*

Without prejudice to the provisions of international conventions in force in the Arab Republic of Egypt, the provisions of the present Law shall apply to all arbitration between public law or private law persons, whatever the nature of the legal relationship around which the dispute revolves, when such arbitrations are conducted in Egypt or when the parties to an international commercial arbitration conducted abroad agree to subject it to the provisions of this Law.

In regard to administrative contract disputes, the arbitration agreement shall have the approval of the concerned minister or the official assuming his powers with respect to public juridical persons. No delegation of powers shall [be] authorized therefore."

The second paragraph of Article 1 was added following the decision of the Cairo Court of Appeal in *Organisme des Antiquités v G. Silver Night Company*19.

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18 For example, Article 24 of the Law concerning the Conduct of State Litigation in Yugoslavia, 1934 (considered in the Losinger case PCIJ, Ser A/B, no 67, pp.23-5): “Article 24.- Actions against the State may only be brought before the ordinary courts of the State.”

19 CA Cairo March 19, 1997; (1998) 23 ICCA Yearbook of Commercial Arbitration 169-174: 1997 Rev. Arb. 283. The Cairo Court of Appeal rejected the argument that administrative contracts could not be subject to arbitration because Article 10 of Law No. 47 of 1972 on the Egyptian State Council provided for the exclusive jurisdiction of the State Council to resolve disputes regarding public works contracts, supply or any other administrative contracts ....". The Court of Appeal held that Article 10 “serves to
confirming that Egyptian state entities were bound by arbitration agreements in administrative contracts.

However, notwithstanding the amendment, an attempt by an Egyptian state entity to rely on the non-compliance with the second paragraph of Article 1 of Egyptian Law Nº 27/1994 concerning Arbitration in Civil and Commercial Matters to escape its agreement to arbitrate an international context would be a breach of transnational public policy, and be properly rejected by the arbitral tribunal on the basis of the Internal Law Principle. Indeed, the very reasoning that an international arbitral tribunal might adopt to justify a refusal to apply the second paragraph of Article 1 on transnational public policy grounds was foreshadowed by the Cairo Court of Appeal in Organisme des Antiquités v G. Silver Night Company:

'[16] “It is without doubt that such an allegation,...is not in conformity with the general principle of good faith in the performance of obligation, which does not distinguish between civil and administrative contracts. In addition, this runs counter to the jurisprudence and practice in international commercial arbitration according to which State or public law entities may not reject an arbitration clause contained in their contracts by invoking legislative restrictions, even if they are genuine.

[17] “Moreover, if public law persons were allowed to free themselves from arbitration clauses which they inserted in a contract with a foreign party, on the basis that administrative contracts cannot be submitted to arbitration, this would shake the confidence of parties which deal with such entities and could cause serious damage to foreign investment and to development projects.’

(ii) Where the internal law requires a designated procedure to be followed prior to execution of the arbitration agreement (e.g. notifications or prior approvals) and this procedure was not followed.

 divide the jurisdiction between the State Council and the ordinary courts. It does not mean that it is forbidden to have recourse to arbitration to resolve disputes arising from administrative contracts.”


22 See, for example, Article 3 of the Arbitration Regulation of Saudi Arabia of 25 April 1983: “Government Agencies are not allowed to resort to arbitration for settlement of their disputes with third parties except after having obtained the consent of the President of the Council of Ministers. This ruling may be amended by resolution of the Council of Ministers.” or Article 31 of the Spanish Ley 33/2003, de 3 de noviembre del Patrimonio de las administraciones Públicas: “Art. 31: Settlement and Submission to Arbitration: There shall not be the judicial nor extrajudicial settlement in respect of the assets and rights of the Patrimony of the State, nor submission to arbitration of disputes arising in respect of them, except by means of a Royal Decree approved in the Council of Ministers, at the proposal of the Ministry of Finance with the prior report of the full Council of State.”
(c) Specific Legislation with the effect of Nullifying the Arbitration Agreement: There are various ways in which a State might use its legislative power to promulgate specific legislation to directly or indirectly nullify its agreement to arbitrate:

(i) By leaving without effect the arbitration agreements in a certain sector, as might occur particularly in the context of nationalisations and expropriations;\(^\text{23}\)

(ii) By dissolving a State entity subject to arbitration proceedings: This situation arose in *Société des Grands Travaux de Marseille v. EPIDC* where five days prior to the hearing in an arbitration between the Claimant and a corporation wholly owned by the Bangladeshi State, the President of Bangladesh issued an order abolishing the Respondent corporation, and vesting its assets in the Government on the basis that any outstanding claims may be the subject of an *ex gratia* payment for compensation by the State. The arbitrator held that this Order amounted to an expropriation without compensation in breach of Bangladesh’s obligations in international law. On the basis of Swiss public policy (as the public policy of the seat) the arbitrator declined to recognise the dissolution of the Respondent corporation, and also joined the State as a respondent in the arbitration (treating the State as the universal successor to the Respondent’s liabilities).\(^\text{24}\)

(iii) By abolishing the subject matter of the arbitration: An example of this use of internal law by a State also occurred in *Société des Grands Travaux de Marseille v. EPIDC* where the President of Bangladesh issued the Disputed Debt Order that provided that the obligations of the Respondent entity were deemed never to have been incurred.\(^\text{25}\) The arbitrator found that the Disputed Debts Order was a discriminating and confiscatory measure directed against the Claimant, with the sole purpose of frustrating the arbitration, and so disregarded its terms on the basis of Swiss public policy (as the public policy of the seat).\(^\text{26}\)


\(^{24}\) The Arbitrator recognised as persuasive authority on this point dicta in the English House of Lords that English law, may under defined conditions, refuse to accept either the creation or destruction of a foreign juristic person: see *Russian and English Bank v Baring Brothers* [1936] A.C. 405 at 428 (per Lord Atkin) and *Adams v National Bank of Greece S.A* [1961] A.C. 225 at 289-290 (per Lord Denning).

\(^{25}\) “Any debt, liability or obligation incurred by the erstwhile East Pakistan Industrial Development Corporation arising out of or in connection with any contract shall be deemed not to have been incurred, undertaken, entered into or made by the Bangladesh Industrial Development Corporation if such debt, obligation, liability or contract is or was the subject matter of any dispute.”

\(^{26}\) “Be that as it may, the tenor and intended effect of the Disputed Debts Order is wholly repugnant to Swiss conceptions of natural justice, fair dealing and the standards of morality binding upon sovereign Governments. The notion that a debt should become void and indeed nonexistent ab initio for no better reason that that the debtor has chosen to put it in dispute is an extreme example of what natural justice abhors – the person or the public authority setting itself up as a judge of its own cause. The lex fori
(d) State Reliance on an Anti-Suit injunctions issued by its own Judicial Power Nullifying the Arbitration Agreement: The State might seek to invoke its judicial power to paralyse an international commercial arbitration, and return the dispute to the domestic courts. To achieve this objective, the State might make an application to its own courts for a ruling on the validity under local law of the arbitration agreement, accompanied by an application for an injunction directed at the parties and/or the arbitral tribunal prohibiting the continuation of the arbitration pending the determination by the local court of the validity of the arbitration agreement. If the local court grants the injunction, then this is another instance of a State Party invoking its own internal law to escape its contractual obligation to arbitrate, and the arbitral tribunal is justified, on the basis of the Internal Law Principle of transnational public policy, to ignore the injunction (and even to declare it illegal\(^2\)), and to proceed with the arbitration.

A recent example of the use of its Judicial Power to try to escape the consequences of an arbitration agreement is Himpurna California Energy Ltd v Republic of Indonesia.\(^2\) This arbitration related to the energy sector in Indonesia, and the Respondent was the Indonesian State. An Indonesian State entity called Pertamina successfully applied to the Jakarta Central District Court for an injunction against both parties suspending the arbitral proceedings and providing for a fine of $US 1 million per day for breach of the order.

The Republic of Indonesia submitted that it was bound by the order of the Indonesian courts and that the arbitration could not proceed. The Arbitral Tribunal decided that the arbitration would proceed, but the place of hearing would not be the seat of the arbitration in Jakarta, but instead The Hague in The Netherlands (and therefore outside the jurisdiction of the Indonesian courts). The Republic of Indonesia did not appear at the hearing.

\(^{27}\) The injunction of course remains legal and binding within the jurisdiction of the national courts, which might create severe practical problems for a claimant, counsel, of members of the tribunal that are nationals, residents, or have assets within the jurisdiction (a matter referred to further in consideration of strategic questions in section F of this paper). However, the Arbitral Tribunal would be justified, on the basis of the principles of compétence/compétence and transnational public policy, to declare the anti-suit injunction illegal for international purposes. The clash of domestic courts (particularly the courts of the seat) and an international commercial arbitral tribunal on such an issue confirms the delocalisation of modern international commercial arbitration, and the emergence of its own transnational jurisdiction.

In its Interim Award the Tribunal held that the Republic of Indonesia had no sufficient cause not to appear, and therefore the Tribunal could proceed to determine the merits on the evidence before it. The Arbitral Tribunal held that the actions of the judicial authorities in Indonesia were imputable to the State, and so in relying on the injunction to explain its non-appearance the State was effectively relying on its internal law to escape its obligation to arbitrate. The Arbitral Tribunal relied upon a mix of arguments to strip the anti-suit injunction of any legal effect on the arbitration, including arguments relating to the factual and legal relationship between the Respondent State and Pertamina, public international law doctrines (State responsibility, denial of justice) and the Internal law Principle as an expression of transnational public policy:

“The Republic of Indonesia nevertheless argues in effect that the decision of the Jakarta Court paralyses its undertaking under the [arbitration agreement]. It has often been said that a state may not avail itself of internal legislation as a basis for disavowing its agreement to arbitrate…. The Republic of Indonesia’s reliance on a court injunction rather than a legislative enactment is not based on a significant distinction: ‘…the judgment given by a judicial authority emanates from an organ of the State in just the same way as a law promulgated by the legislature or a decision taken by the executive’. Eduardo Jiménez de Aréchaga International Law in the Past Third of a Century: Recueil des Cours I-1978, page 278.”

(e) **Reliance on Internal Law to Suspend Arbitral Proceedings:** Domestic law often provides for the suspension of civil litigation, including arbitral proceedings, to give priority to alternative legal processes involving the same parties or questions. Examples include administrative proceedings in respect of expropriation, bankruptcy proceedings, and, most importantly, criminal proceedings.

The principle that criminal proceedings have precedence over civil proceedings relating to the same subject matter (’*le penal tient le civil en l’état*’ in French law and ’*prejudicialidad penal*’ in Spanish law) is well established in many jurisdictions. The Spanish position is summarised in Article 44 of the *Ley Orgánica de Poder Judicial*, that establishes the general principle that the criminal jurisdiction is always preferential, and Article 114 of the *Ley de Enjuiciamiento Criminal*: 30

“**Article 114.**

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29 Interim Award paragraph 169.
30 The original Spanish reads as follows: “Promovido juicio criminal en averiguación de un delito o falta, no podrá seguirse pleito sobre el mismo hecho; suspendiéndole, si le hubiese, en el estado en que se hallare, hasta que recaiga sentencia firme en la causa criminal.
No será necesario para el ejercicio de la acción penal que haya precedido el de la civil originada del mismo delito o falta.
Lo dispuesto en este artículo se entiende sin perjuicio de lo establecido en el capítulo II, título I, de este libro, respecto a las cuestiones prejudiciales.”
On the initiation of the criminal proceeding in investigation of a crime or misdemeanour, a civil action over the same act shall not be able to continue, being suspended, if commenced, in the state in which it is at that time, until there is a final judgment in the criminal cause.

It shall not be necessary for the exercise of the criminal action that it has preceded the civil action arising from the same crime or misdemeanour....

Criminal proceedings over the same subject matter as arbitration raise competing public policy issues to weigh against the Internal Law Principle, particularly the constitutional rights to effective judicial protection and the right of defence,31 and the avoidance of contradictory decisions over matters involving matters involving criminal responsibility.32 In Egyptian law, Article 46 of Law Nº 27/1994 concerning Arbitration in Civil and Commercial Matters expressly addresses the relationship between arbitration and certain types of criminal proceedings:

“Article 46
If, in the course of the arbitral proceedings, a matter falling outside the scope of the arbitral panel’s jurisdiction is raised, or if a document submitted to it is challenged for forgery, or if criminal proceedings are undertaken regarding the alleged forgery or for any other criminal act, the arbitral panel may decide to proceed with the subject matter of the dispute without any reliance on the incidental matter raised or on the document alleged to be a forgery or on the other criminal act. Otherwise, the arbitral panel shall suspend the proceedings until a final judgment is rendered in this respect. Such measure shall entail suspension of the period for making of the arbitral award.”

An international arbitral tribunal normally retains a discretion to suspend the arbitration when faced with parallel criminal proceedings33, and therefore there is no imperative in the State invocation of its own law that might call the Internal Law Principle into play. However, the Internal Law Principle may be relevant in

31 Article 24.1 of the Spanish Constitution which reads “All persons have the right to the effective judicial protection of the judges and courts in the exercise of their rights and legitimate interests, without there being in any case a denial of the right of defence.” On the importance of Article 24.1 to the Spanish conception of public policy see DAVID J A CAIRNS The Spanish Application of the UNCITRAL Model Law on International Commercial Arbitration (2006) 22 Arbitration International 573-595;
32 See the commentary of Manuel Olivencia Ruiz in JULIO GONZÁLEZ SORIA (COORDINADOR) Comentarios a la Nueva Ley de Arbitraje (Editorial Aranzadi, SA. 2004) at 48-49.
33 See Committee on International Commercial Arbitration in Report of Sixty-Seventh Conference of the International Law Association, Helsinki (London, 1996) at 32 (Resolution) and 618-622 (Working Session). See also ALEXIS MOURRE Arbitration and Criminal Law: Reflections on the Duties of the Arbitrator (2006) 22 Arbitration International 95-118, especially footnote 101; (“In France, the rule according to which the civil judge has to stay his decision until the criminal judge’s decision if the same facts are at stake is set out by art. 4 of the Code of Criminal Proceedings. Case law, however, acknowledges that an arbitrator is not bound by that principle: Paris, 23 May 2002, 20 June 2002, Cahiers de l'arbitrage 2004/II, Gaz. Pal., 356–357. In Switzerland, the Swiss Federal Tribunal (119 (1993) II 386), held that an arbitral tribunal has no obligation to stay the proceedings pending a criminal action. The principle of a stay in case of criminal proceedings is unknown in many jurisdictions (England, Germany, Netherlands, Portugal, Greece)”).
a jurisdiction where there is an express prohibition on continuing with an arbitration while criminal or other special proceedings are in progress relating to the same subject matter, or where there is an element of bad faith in the position of the State Party.

F. Strategic Implications of Reliance on Internal Law:
The reliance of a State Party on its internal law to escape its obligation to arbitrate raises some interesting issues in arbitral psychology and strategy.

The reason a State Party relies on its internal law to escape an obligation to arbitrate often no doubt is that the argument is often obvious, particularly to the State’s own lawyers. To the State’s counsel, accustomed to the review of state contracts, a flaw such as the breach of an express prohibition on arbitration or the requirement of the approval of a designated official, must be raised in any subsequent arbitration. To the lawyer that is also a State official, the presentation of this jurisdictional objection, and the vindication of the mandatory requirements of domestic law, might appear a duty rather than a matter of counsel’s discretion.

Certain circumstances will no doubt confirm the State counsel in the view that the objection to jurisdiction must be raised, even if it will almost certainly fail. Counsel accustomed to a formalistic system of contractual or administrative law, or unfamiliar with doctrines of international commercial arbitration such as compétence/compétence and transnational public policy, will expect to see their domestic law vindicated, before national courts if not before the arbitral tribunal.34 If the arbitration arises from a controversial project or contract then the state counsel might operate in a climate of nationalistic rhetoric or even be subject to political pressure to vindicate national sovereignty. It is perfectly understandable why state counsel often raise objections to jurisdiction based on the internal law of the State Party, even if they do not expect this argument to be successful.

Sometimes, however, the State party, such as in the Himpurna and East Pakistan cases, does not simply raise internal law arguments before the arbitral tribunal, but uses the entire apparatus of the state, in its legislative, executive or judicial branches, to frustrate and defeat the arbitration. When internal law is used in this manner, then the strategy is best understood as intended to intimidate the claimant, with the intention being to make the potential costs of the arbitration to the claimant so high that the arbitration is discontinued.35 These costs include the

34 Cf Himpurna California Energy Ltd v Republic of Indonesia, supra, at paragraph 140: “Counsel for the Republic of Indonesia seem to think there is something extraordinary in the proposition that an arbitral tribunal could take account of organic dependence rather than formal division within the public sector.”

35 The anti-suit injunction in the Himpurna case was addressed to the Claimant and not the arbitral tribunal, and provided for a daily fine of SUS 1 million for breach of the injunction. However, in this case
value of assets within the jurisdiction vulnerable to seizure by the domestic courts of the state party, the personal exposure of investors or officers of the Claimant to domestic courts, and the value of the commitment of the claimant to its relationship with the state party or the jurisdiction generally.

As the use of internal law in this manner has an economic rather than juridical rationale, then the claimant prepared to bear the costs of a direct confrontation with the State Party can normally expect an international arbitral tribunal to resist and condemn the use of internal law to paralyse the arbitral proceedings. From a purely forensic perspective such an ‘arbitration frustration’ strategy is very damaging for four reasons. Firstly, the rejection of the compétence/compétence principle, and the reliance on internal law to escape the obligation to arbitrate involve bad faith on the part of the State Party. A forensic strategic that manifests serious procedural bad faith, with the consequent damage to the credibility of the client before the arbitral tribunal, is always questionable. Secondly, the initiation of the arbitration frustration strategy may create a dynamic of increasing and more extreme use of domestic measures to defeat the arbitration as the claimant resists the economic intimidation and the arbitral tribunal defends its jurisdiction. This dynamic of escalation exacerbates the bad faith of the State Party and entrenches the State Party in its strategy.

Thirdly, anti-suit injunctions or other legal measures directed at the arbitral tribunal are likely to most seriously affect the State party’s own appointee. The State Party’s appointment to the arbitral tribunal may be a practising member of the legal profession in the respondent State, or have connections with that State which make the potential costs to this arbitrator of, for example, ignoring an anti-suit injunction, much higher than for the other two arbitrators. The result of the State Party pressure may be that their own nominee is forced to resign. Again a forensic strategy that might remove the respondent’s own nomination to the tribunal, as in the Himpurna arbitration, is questionable. Finally, this strategy might raise the dispute to an inter-State level if the Home state of the Claimant takes the position that there has been a denial of justice and therefore a need for diplomatic protection. In this manner, this forensic strategy to address a contractual claim might create additional state responsibility in public international law.

Outside the actual dispute with the investor, the State party should also consider the costs of an arbitration frustration strategy in terms of negative publicity, a potential ‘chilling’ effect on other foreign investors and contractors, and

the Claimant needed to balance the costs of pursuing the arbitration with the benefits of an arbitral award, which included access to $US 290 million of political risk insurance. For a discussion of the incentives of the State and private parties in this arbitration and similar disputes in Indonesia and Pakistan see MARK KANTOR International Project Finance and Arbitration With Public Sector Entities: When Is Arbitrability a Fiction? 24 Fordham International Law Journal 1122-1183.
consequent rise in the cost of attracting investment as foreign investors or contractors require higher returns to compensate sovereign risk.

G. Conclusions

A State that enters into an arbitration agreement with a foreign investor must honour that arbitration agreement. The Internal Law Principle of international public policy is the mechanism to counter the use by the State Party of its own law to escape its agreement to arbitrate.

The problem of the reliance of the State on its own law to escape an agreement to arbitrate has arisen in a number of contexts, involving legislative, executive and judicial powers, and issues on consent, authority, and administrative jurisdiction. It is therefore not surprising that a broad range of doctrines and principles have been relied upon in cases and awards to hold the State to its agreement to arbitrate. The purpose of this paper is to demonstrate that there is a single principle –the Internal Law Principle– that unites these diverse situations that can be expressed in the simple statement that ‘a State party cannot improperly invoke its own internal law to escape its contractual obligation to arbitrate’.

An obstacle to the recognition of a single principle of this nature has been the efforts of many tribunals to base their decisions either in recognised doctrines of public international law or in doctrines of applicable domestic law (such as the distinction between civil and administrative contracts) or in a mixture of arguments from both legal orders. The Internal Law Principle finds support both in public international law (such as the obligation of signatories pursuant to Article II.1 of the *New York Convention on the Recognition and Enforcement of Foreign Arbitral Award* to recognise an arbitration agreement) and in the principle of good faith shared by most domestic legal systems. Nevertheless, and in light of the established recognition and acceptance of transnational public policy, it is suggested that the Internal Law Principle is based neither in public international law or any national legal order. The Internal Law Principle should be applied by international arbitrators as an expression of transnational public policy, with its ultimate justification in the universal principles of *pacta sunt servanda* and good faith.