

# Kluwer Arbitration Blog

## Repudiation of International Arbitration Agreements and the Public Interest

Jan Paulsson (Three Crowns LLP) · Monday, February 16th, 2009 · Three Crowns LLP

Rex has recently installed himself as the benevolent dictator of a resource-rich country where many live in poverty. He took power from a government he accuses of having distributed national wealth in a grossly unfair manner. He proclaims a policy of redistributive justice, and enjoys passionate popularity among the vast disadvantaged segments of the population. He accuses foreign business interests of having colluded with formerly powerful national elites.

In pursuit of his policies, Rex will naturally find it convenient, as he sees fit, to abrogate treaties, laws, and contracts. His political majority will support him – and so will the legislators and judges he has put in office.

Yet Rex has a thorn in his side: international tribunals. Rex insists that he respects the rule of law. In particular, he affirms adamantly that he abides by international law. But by “law” he means the rules that need to be put into place to further his policies, proclaimed to be in the national interest. He finds it intolerable that an external authority should be allowed to determine what is lawful, or that international obligations accepted by his predecessors should be given effect.

Let us leave aside the subject of the tyranny of the majority within a nation, which has occupied political philosophers for a very long time. Let us instead consider the consequences of Rex’s options as he seeks to escape external limits to his authority.

Current events in the real world reflect a resurgence of attempts by various Rexes to tame the authority of international tribunals. One way is pure politics: to lambast the international system as inherently biased and dominated by regressive forces. International judges and arbitrators are easy targets who cannot make effective retort.

Another way is to fight law with counter-law. To neutralize international obligations, why not pass new laws, or indeed constitutional amendments, forbidding the international adjudication of claims involving the interests of the State? Why not decree the unenforceability of any awards that recognize obligations which Rex has nullified?

Such temptations are not new. History has known many precursors of Rex, and international tribunals have not looked with favor on attempts to defeat international law in this fashion. It may be useful to recall these precedents. That will be the first short topic below. But, secondly, we should also go back to first principles and ask: to what extent are such attempts to erase obligations

legitimate even as a matter of national law? And thirdly we might adopt an attitude of coldest realism, acknowledging that (whatever is said about the rule of law) we are considering a country effectively subjected to the rule of Rex, who may very well impose his will whatever international tribunals say. If this is so, has he in fact acted in the best interests of his people?

International norms. In its judgment in *The SS Wimbledon* (1923), the PCIJ observed that international obligations restrain the exercise of sovereign prerogatives. The court nevertheless held that the right to assume international obligations is itself an “attribute of State sovereignty” and accordingly held Germany to obligations which (so Germany argued) contravened a national mandatory norm. We might say that a failure by international tribunals to acknowledge a state’s power to make meaningful promises would diminish it. (See J. Paulsson, “El poder de los Estados para hacer promesas significativas a los extranjeros” available at <[https://www.arbitration-icca.org/officers-and-members/MEMBERS/Jan\\_Paulsson.html](https://www.arbitration-icca.org/officers-and-members/MEMBERS/Jan_Paulsson.html)>.)

The Vienna Convention on the Law of Treaties provides in Article 27: “A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.” The International Law Commission’s 2001 draft Articles on State Responsibility similarly set down that the wrongfulness of an act “is not affected by the characterization of the same act as lawful by internal law” (Article 3).

In the context of disputes between states and private foreign parties, the proposition was articulated as follows in an oft-cited ICC award from 1971:

*“...international ordre public would vigorously reject the proposition that a State organ, when dealing with foreigners, having openly, with knowledge and intent, concluded an arbitration clause that inspires the cocontractant’s confidence, could thereafter, whether in the arbitration or in execution proceedings, invoke the nullity of its own promise.”* (ICC Case 1939, cited by Y. Derains, 1973 *Revue de l’arbitrage* 145)

Among a great number of cases adopting the same approach is the seminal award on jurisdiction in *Benteler v. Belgium* (1983) (see J. Paulsson, “May a state invoke its internal law to repudiate consent to international commercial arbitration? Reflections on the *Benteler v. Belgium* Award” *Arbitration International*, Vol. 2, No. 2 (1986) at 90). The Belgian government objected to arbitral jurisdiction on the grounds of an article of its Civil Code which allowed “public law entities” to agree to arbitration only by means of an international treaty. The case involved a contract between private German parties and the state of Belgium itself. The tribunal, comprised of internationally renowned arbitrators (Reymond, B?ckstiegel, Franchimont), rejected Belgium’s objection after a full review and analysis of authorities and argument. They accepted, in effect, a presumption that public law entities have the capacity to agree to international arbitration, and that this presumption had acquired the status of a substantive international norm overriding contrary national law.

These and a host of other authorities provide powerful support for the proposition that a state may not invoke its own law to vitiate international agreements to arbitrate concluded by its organs – whether this interdiction is viewed as a matter of *ordre public* or one of general principles of law. Indeed Switzerland, a venerable seat of international arbitration, in 1987 enacted a federal act on private international law which, in Article 177(3), adopted this norm as a matter of mandatory national law; in other words, Swiss law rejects arguments that such foreign national laws can vitiate arbitration agreements.

If this rejection of purportedly nullifying national law applies to pre-existing, general enactments (such as the Belgian Civil Code), it is yet stronger in the face of subsequent decrees.

National law. This observation should lead us to a new inquiry. Leaving aside the international challenge to Rex's laws of convenience, how do they stand up as national laws in the first place? This is a simple yet profoundly significant question which seems not to have been adequately explored despite the long history of claims by foreigners against states. The importance of the issue should be apparent. Purported laws must themselves be lawful. A text is not to be accepted as an expression of national law just because national officials deem it expedient; if it violates national rules of recognition (i.e. norms of the type often found in a constitution) it simply is not law.

International tribunals have no national *lex fori*; their members do not act as officials of any state. Yet they are routinely called upon to deal with national norms: to acknowledge, interpret, and apply them. When they do so, they are not paralyzed by declarations issued by Rex or his legislators or judges. Nor, if Rex has muffled the judiciary, should such an abuse of power be allowed to have the effect of neutralizing the authority of international tribunals. This idea is vital. If Rex's decrees violate fundamental laws of his country, an international tribunal empowered to apply that national law should not give effect to them – and is under no obligation to wait for the national courts (if ever) to make such a determination. Rex would of course prefer that the constitutionality of his decrees not be subject to testing by any standard other than his will, but, once again, the international tribunal is empowered to determine national law where it applies – and in so doing it is proper for it to refuse to recognize unlawful laws. Whatever may be its *de facto* fate within the territory controlled by Rex, an international decision rendered on this basis is entitled to recognition everywhere else.

In other words, our mind's door opens to a more profound understanding of the function of international tribunals when they deal with matters of national law. An international tribunal may reject a discriminatory law because it contravenes a treaty signed by Rex's predecessor (which therefore is part of the national law), or a statute which disregards a prohibition of retroactivity contained in the Constitution, or indeed a purported modification of the Constitution which violated its own rules for amendment. This is not the application of international law. If the fundamental national law provides that constitutional amendment requires a certain type of parliamentary or popular ratification, a purported enactment that does not satisfy the requirement should be rejected by arbitrators as non-law. In this sense, an unlawful enactment may be seen as a species of denial of justice: an attempt to subvert the legal process by the deployment of purported laws which are contrary to the law.

Realpolitik. Even if it turns out that “the will of Rex” cannot define the law, might it be defensible to say that his disregard of law is beneficent – a welcome shortcut to the achievement of his progressive aims? By all means, let us not resile from the assumption that this Rex has benevolent intentions. Yet as events unfold history has not given us many such dictators. The promises of enlightened policies crumble, again and again, in the face of absolute power and its corrosive effects. That is of course the essential point of the rule of law.

But recall that Rex's country is rich in resources, and foreigners will not be able to resist the lure of opportunity even if he runs roughshod over the rights of those who dealt with the ancient regime. They may well be sufficiently enticed by opportunity that they enter the country on Rex's terms, knowing that he may treat them as he pleases.

This is not, however, a brilliant outcome for the country. Such entrants will exact their price in the guise of a risk premium of macroeconomic proportions. A multitude of foreigners are happy to invest in Switzerland against the safe prospects of very modest returns. In less secure environments, the risk is priced at a vast premium, with willing entrants reduced to a few risk-takers who may not be the most reliable partners. An enormous surplus must be generated and paid out, with value lost to the local economy. In the meanwhile, moreover, the development of proper governance is retarded due to Rex's arbitrary regime.

This discussion has focused on Rex's attempts to avoid law. It would be an unfortunate mistake for Rex to disregard the possibility that his anti-law initiatives (couched as "full sovereignty") will come back to haunt him the day he seeks to rely on international law. He might consider the words of another powerful leader, Vladimir Putin, who was reported in *Russiatoday*, on January 9, 2009, to castigate Ukraine for having gone to the Kiev Economic Court to prohibit the transit of Russian gas through Ukrainian territory. Ukraine has violated international norms, Mr. Putin complained. Under the gas transit contract, any disagreement should be resolved by international arbitration in Stockholm: "If they keep acting in such a 'civilized' way," he was reported as saying, "the order will never be restored." Yet that is the world of states ruled by Rex and his likes.

International legal processes built up over generations are valuable tools. Wreck them, Rex, at your cost- and at that of your people.

*Jan Paulsson*

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This entry was posted on Monday, February 16th, 2009 at 8:28 am and is filed under [Arbitration Institutions and Rules](#), [Arbitration Proceedings](#), [Domestic Courts](#), [Enforcement](#), [International Courts](#), [International Legal Theory and Teaching](#), [Investment Arbitration](#)

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