International Project Finance and Arbitration with Public Sector Entities: When is Arbitrability a Fiction?

Mark Kantor*
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Abstract

This article reviews the events surrounding two prominent arbitration decisions related to two Indonesia geothermal power projects sponsored by CalEnergy Company, Inc. ("CalEnergy"), known as the Patuha and Himpurna projects, and a Pakistani power project developed by the Hub Power Company, Ltd. ("HubCo"). The aggressive involvement of local courts in the CalEnergy and HubCo proceedings does not reassure investors relying on the perceived neutrality of international arbitral institutions to mitigate the risk of uncertain justice in unstable countries. The author asks: Are problems between State entities in troubled developing countries and international project sponsors simply not arbitrable as a practical matter when economic and political crisis intersect in a highly corrupt economy? Or, are there means of protecting the arbitrability of investor-State disputes in the midst of such turmoil? This review concludes that few devices will be effective to overcome these hurdles. Thus, arbitration may in reality be a fiction in such circumstances upon which investors should not rely exclusively.
Professor Priyatna was visibly upset and said words to the effect that we had worked together closely as colleagues he hoped we would still be friends and that he was sorry but hoped I would understand that he had to leave.

I told him that a court ruling in The Hague delivered earlier that day had not stayed the arbitration and that therefore the hearings could continue.

He replied that when he was about to leave Washington on Sunday an Indonesian whom he did not know but who presented himself as coming that day from Jakarta to read him a letter said to be from a Minister warning him not to go forward with the arbitrations. He was not given a copy of the letter.

Professor Priyatna informed me that when he arrived at Schiphol airport on the morning of Monday 20th September, he was met by a Mr. Warrow who had come from Jakarta to read to him the same letter instructing him not to attend the arbitration hearings. With Mr. Warrow was Mr. Husein of the Indonesian Embassy.

Professor Priyatna apologised and said that he had been told he could not telephone or contact either Mr. Paulsson or myself and was placed in the Ibis Hotel at the airport with Embassy personnel. He identified to me at the airport Mr. Warrow, Mr. Husein, and a Mr. Hadianto also of the Embassy.

Professor Priyatna told me that he was being accompanied back to Jakarta . . . .

He was visibly upset throughout the entire discussion with me.

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which lasted about 10 minutes, and for some period was close to tears.¹

INTRODUCTION

Arbitration over international project financings in developing countries is not a dry topic. Recent high-profile arbitrations about project financings address allegations of bribes, kickbacks and corruption,² the collapse of entire economies,³ wholesale rejection of contracts,⁴ political crises and coups,⁵ claims of human

¹ Statement of Mr. Albert de Fina, one of three arbitrators in the cases concerning the impact of the suspension by the Government of Indonesia of two geothermal power projects sponsored by CalEnergy Inc. (“CalEnergy”). Mr. de Fina’s statement recounted a meeting at Schiphol Airport in The Netherlands with Professor H. Priyatna Abdurrasyid, the arbitrator appointed by the Government of Indonesia, on the day before hearings scheduled by the Arbitral Tribunal in The Hague. See Patuha Power Ltd. (Bermuda) v. Republic of Indon. (Interim Award, Sept. 26, 1999), 15 MEALEY’S INT’L ARB. REP. B-1, B-27-28 (2000) [hereinafter Patuha-ROI Interim Award]. That meeting followed investigatory efforts by Mr. de Fina, Mr. Jan Paulsson (President of the Arbitral Tribunal), and Professor Albert van de Berg to locate Professor Priyatna after learning that Professor Priyatna had failed to arrive at his chosen hotel and that his reservation had been cancelled by a staff member of the Indonesian Embassy. Id. at B-23-28.


³ Patuha-PLN Final Award, supra note 2, at B-30 (“Indonesia found itself in a calamitous economic crisis.”). The award quotes counsel to PT (Persero) Perusahaan Listruik Negara (“PLN”) as follows:

The Tribunal has to address the claims which are before it against the background of the economic collapse that preceded the presidential decrees in the last quarter of 1997 and made them necessary . . . . In 1998 to 1999, the Indonesian economy contracted by 15 percent, resulting in more than 5 million workers losing their jobs. The rupiah . . . has lost more than 80 percent of its value since the crisis first erupted . . . . Out of a population of 200 million, the number of seriously poor people in Indonesia is projected to reach 130 million in 1999 . . . .

Id.

⁴ Twenty-seven independent power projects (“IPPs”) were forced into suspension or renegotiation in Indonesia. See The Future of Independent Power Producers, INDON. COMM. NEWSL., Dec. 19, 2000. Nineteen Pakistani projects under construction were harassed or cancelled by the Pakistani government. See Hill, A Military Coup Doesn’t Change the Fact that Pakistan is Under Contract to Pay Western Power Producers for Electricity it Can’t Afford, PROJECT FIN., Nov. 1999, at 109. Intervention into power projects in recent years has not been limited solely to these two countries. For example, in August 1995, the State Government of Maharashtra, India, announced its intention to stop construction
rights violations,\(^6\) injunctions against arbitration,\(^7\) and awards in the hundreds of millions of U.S. dollars,\(^8\) as well as such outrageous extra-judicial interference as the forced return of Professor Priyatna from The Netherlands to Indonesia. The most prominent of these decisions relate to two Indonesian geothermal power projects sponsored by CalEnergy Company, Inc. ("CalEnergy") (now MidAmerican Energy Holdings Company), known as the Patuha and Himpurna projects, and a Pakistani power project developed by the Hub Power Company, Ltd. ("HubCo"). In the two Indonesian transactions, arbitrators continued with proceedings and issued large awards against the Republic of Indonesia ("Republic" or "GOI") and its State-owned electricity utility, PT (Persero) Perusahaan Listruik Negara ("PLN"), all despite anti-arbitration injunctions issued by an Indonesian court. In the HubCo transaction, conversely, the Pakistani Supreme Court upheld an anti-arbitration injunction stopping International Chamber of Commerce arbitration proceedings brought by HubCo against the Pakistani State-owned


5. See supra note 4 (discussing impact on private power projects of replacement of Ms. Benazir Bhutto by Mr. Nawaz Sharif as Prime Minister of Pakistan and later coup by General Pervez Musharraf). The fall of President Suharto from power in Indonesia is also intimately related to the many power project disputes in that country. See The Future of Independent Power Producers, supra note 4 (noting 14 independent power projects in which Suharto family or friends participated); Evelyn Iritani, The Ties that Bind: Firms Try to Steer Clear of Suharto Family Backlash, L.A. TIMES, June 6, 1998, at D1 (specifying 10 IPPs with ties to Suharto family members or friends).

7. See supra note 2 (upholding lower court injunction on public policy grounds); Patuha-ROI Interim Award, supra note 1, at B-11-12 (describing anti-arbitration injunction issued by Central Jakarta District Court). A similar injunction was sought, but never granted, in litigation about the Dabhol project in India. See Dabhol, Fight Goes to Court, INT'L GAS REP., Sept. 15, 1995.

electric utility, the Pakistan Water and Power Development Authority ("WAPDA"). Common to both sets of disputes were severe foreign exchange crises in the host country, allegations of corruption in obtaining the power contracts, and national political instability.

The aggressive involvement of local courts in the CalEnergy and HubCo arbitration proceedings does not reassure investors relying on the perceived neutrality of international arbitral institutions to mitigate the risk of uncertain justice in unstable countries. The results of these arbitrations must give one pause. Are problems between State entities in troubled developing countries and international project sponsors simply not arbitrable as a practical matter when economic and political crisis intersect a highly corrupt economy? Or, are there means of protecting the arbitrability of investor-State disputes in the midst of such turmoil?

The Indonesian and Pakistani controversies offer an opportunity to consider these issues, but the picture is not comforting. The local courts in both countries appeared intent on preventing arbitral enforcement of these high-profile public contracts. Broadly accepted judicial doctrines protecting international arbitration from judicial interference were ignored. The ability of the host State to take unilateral action in the midst of crisis was protected. Clear contractual language was given short shrift. Opposition to the right of foreign investors to employ arbitration was not limited to cases involving the State; local courts obstructed arbitration even in transactions solely between private parties. Conversely, the contractual and financial devices employed by international investors to force resolution of difficult disputes into independent arbitral proceedings had ultimate utility only if a valuable asset (political risk insurance) existed outside the reach of the host State. Perhaps this result is not very surprising; independent power projects in both countries were large, politically visible programs that had attracted significant local opposition even before the economic crisis hit Asia. Corruption in each country has been pervasive and allegedly reached the highest levels. Foreign investors were often represented by local interests. Notwithstanding rapid economic growth in the 1980s and 1990s, Indonesia and Pakistan are weak States with a history of instability and unreliable political and judicial systems. Moreover, the project contracts in question allo-
cated to these weak States the financial consequences of macroeconomic changes like a currency crisis no matter how difficult to absorb.

In an effort to evaluate the limits of effective arbitration, I will review the events surrounding these recent arbitrations. That review leads me to conclude that few devices will be effective to overcome these hurdles. Thus, arbitration may in reality be a fiction in such circumstances upon which investors should not rely exclusively.

Let us turn first to the Indonesian cases.

Professor Priyatna was the unfortunate GOI-appointed arbitrator in one of two arbitrations involving the geothermal power projects in Indonesia sponsored by CalEnergy. In December 1994, PLN and Perusahaan Pertambangan Minyak Dan Gas Bumi Negara ("Pertamina"), the State-owned petroleum company, entered into Energy Sales Contracts ("ESC") with special-purpose project companies established as subsidiaries of CalEnergy, respectively Himpurna California Energy Ltd. (Bermuda) ("Himpurna") and Patuha Power Ltd. (Bermuda) ("Patuha"). Under the Himpurna ESC, Himpurna agreed as contractor to develop a multi-unit power project at the Dieng geothermal field on Java. PLN in turn committed to pay a U.S. Dollar-denominated tariff for available electricity from that project for a period of thirty years. Similarly, Patuha agreed under the Patuha ESC as contractor to develop a generating facility at the Patuha geothermal field, also in Java, with PLN again agreeing to pay a U.S. Dollar tariff for a thirty-year period. At the same time, Pertamina and the respective project company entered into a Joint Operation Contract ("JOC") relating to operation of the geothermal field that would be the source of underlying energy. Each ESC and JOC was also "approved . . . on behalf of the Government of the Republic of Indonesia" by the Indonesian Minister of Mines and Energy, by signature at the end of the

9. See Patuha-PLN Final Award, supra note 2, at B-2. The following summary of facts is taken largely from the Patuha-PLN Final Award and from the author's personal knowledge of development and financing of Indonesian private power projects (and contains only information publicly available).

10. The characterization of the project company as "contractor," rather than "owner," was necessary to comply with Indonesian requirements for development of geothermal resources in cooperation with Pertamina.
documents. Moreover, the Indonesian Ministry of Finance issued letters (each, an “MoF Letter”) to each project company undertaking that “[a]s long as the [project company’s] material obligations which are due under the ESC and JOC have been fulfilled, the Government of the Republic of Indonesia will cause Pertamina and PLN, their successors and assigns, to honor and perform their obligations as due in the above-mentioned contracts.” The ESCs, JOCs, and MoF Letters in the two transactions were substantially identical, except as required by the identity of the project company and physical differences between the two power projects. Each ESC, JOC, and MoF Letter contained a provision under which disputes relating to the relevant document would be settled by arbitration in Jakarta, Indonesia, under United Nations Commission on International Trade Law (“UNCITRAL”) rules.

11. See Patuha-PLN Final Award, supra note 2, at B-2. In the early 1990s, the Minister of Mines and Energy had executed Energy Sales Contracts (“ESCs” or “ESC”) and Joint Operation Contracts (“JOCs” or “JOC”) for geothermal private power projects by signing under the word “guaranteed.” However, at about the time that Mines and Energy, PLN, and Pertamina were finalizing project documents for a number of geothermal power projects, the Republic of Indonesia (“Republic” or “GOI”) and PLN were negotiating project documents for a number of non-geothermal power projects under a general framework for private power projects. Id. at B-19-21. The general framework did not authorize the issuance of Government guarantees of the obligations of PLN under power purchase agreements. Instead, the practice developed of having the Indonesian Ministry of Finance issue letters of support substantially in the form discussed infra in the text. Consistent with this approach, the Ministry of Mines and Energy replaced the word “guaranteed” with “approved” for its signature on project documents for geothermal power projects, and the GOI issued letters of support for the geothermal projects as well.

12. Compare text of the Indonesian Ministry of Finance issued letter (“MoF Letter”), quoted in Patuha Power Ltd. (Bermuda) v. Republic of Indonesia (Final Award, October 16, 1999), 15 MEALY’S INT’L ARB. REP. B-1 (2000) [hereinafter Patuha-ROI Final Award], with text of MoF Letter, quoted in Himpurna California Energy Ltd. v. Republic of Indonesia (Final Award, Oct. 16, 1999), 15 MEALY’S INT’L ARB. REP. A-1 (2000) [hereinafter Himpurna-ROI Final Award]. The operative language in support letters from the MoF in other independent power projects was slightly different: “[T]he Government of the Republic of Indonesia will cause PLN, its successors and permitted assigns, to discharge PLN’s payment obligations under the [power purchase agreement] which are due and payable and unsatisfied by PLN.” See, e.g., AAP NEWSFEED, RELATING TO EEC, Sept. 2, 1998 (quoting MoF Letter relating to PT Energi Senkang power project); see also Patuha-ROI Final Award, supra at B-12-13 (discussing differences between phrase “to honor and perform their obligations as due” found in MoF Letters and phrase “to cause PLN . . . to discharge PLN’s payment obligations under the PPA”); see id. at B-14-15 (discussing restriction on guarantees).

13. See, e.g., Patuha-PLN Final Award, supra note 2, at B-4-5 (an example of the arbitration provisions in an ESC). The arbitration provisions in the Himpurna ESC
The actual formulation of the scope of authority of the arbitral tribunals differed as between the ESCs and the MoF Letters. Section 8.2 of the ESCs provided the following:

Disputes, if any, arising between PLN on the one hand, and PERTAMINA and/or COMPANY on the other hand, relating to this Contract or the interpretation and performance of any of the provisions of this Contract . . . shall be referred to and finally resolved by binding arbitration as set forth in Section 8.3 below.14

Section 8.3 of each ESC then further provided that disputes were to be settled by a three-member arbitral panel under UNCITRAL arbitration rules. The Secretary General of the International Center for Settlement of Investment Disputes ("ICSID") was designated as appointing authority and Jakarta was specified as the site of arbitration. Moreover, under Section 8.4 of the ESCs, the parties renounced statutory rights under the Indonesian Code of Civil Procedure and applicable Indonesian law and regulation to appeal the decisions of the Arbitral Tribunal ("Tribunal"), and agreed to not seek judicial intervention in the arbitral proceedings. In addition, the parties agreed that:

[N]o Party shall have any right to commence or maintain any suit or legal proceeding concerning a dispute hereunder until the dispute has been determined in accordance with the arbitration procedure provided for herein and then only for enforcement of the award rendered in such arbitration.15

The arbitration provision of the MoF Letters was simpler, but nevertheless was equally exhaustive. "Any dispute or claim arising out of or relating to this letter shall be settled by arbitration under UNCITRAL Arbitration Rules in effect at the time of the arbitration, in Jakarta and otherwise in accordance with the procedural provisions set forth in Section 8.3 of the ESC."16 Accordingly, the parties in the Himpurna and Patuha projects were

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14. Patuha-PLN Final Award, supra note 2, at B-4.
15. Id.
16. Patuha-ROI Final Award, supra note 12, at B-1.
diligent in their efforts to establish arbitration as the sole forum for resolution of disputes relating to the ESCs and MoF Letters, to the exclusion of national courts save only for actions to enforce any eventual arbitration awards. Perhaps counsel for the project companies left the negotiating table well satisfied by these provisions, but later events would demonstrate that even the best-drafted clauses can simply be ignored by local courts.

The ESCs provided for Indonesian law as the governing law. However, the parties to the ESC also agreed upon the following:

[T]he Tribunal need not be bound to strict rules of law where they consider the application thereof to particular matters to be inconsistent with the spirit of this Contract and the underlying intent of the Parties and as to such matters their conclusion shall reflect their judgment of the correct interpretation of all relevant terms hereof and the correct and just enforcement of this agreement in accordance with such terms.

The MoF Letters contained no explicit governing law clause, but did as noted above make reference to the “procedural provisions set forth in Section 8.3.” Nothing in the MoF Letters makes clear whether Section 8.3’s instruction to follow the spirit of the ESCs and the intent of the parties is “procedural” and thereby incorporated into the MoF Letters.

Once the project documents were put in place by the parties, the two project companies raised limited recourse finance on the strength of, inter alia, the contractual commitments by PLN, Pertamina, and the Government of Indonesia. As is customary for project financings, the rights of the project companies under those commitments were assigned to the project lenders as collateral security.

Financial closings for the project financings occurred in 1996 and 1997, and each project company commenced drilling, procurement, and construction activities upon the occurrence of the related closing. Those ordinary activities were, however, soon overtaken by extraordinary events in Indonesian and throughout the region.

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17. See Patuha-PLN Final Award, supra note 2, at B-11 (quoting Section 12 of ESC).
18. See id. (quoting Section 8.3 of ESC).
19. Patuha-ROI Final Award, supra note 12, at B-17.
In late 1997, the Indonesia economy shattered under the impact of the Asian financial crisis and shortly thereafter, in early 1998, the long-lived Suharto regime crumbled. Faced with U.S. Dollar tariff obligations towards twenty-seven independent power projects ("IPPs") like Himpurna and Patuha, and a Rupiah-Dollar exchange rate fluctuating from approximately 2,400 Rupiah to the U.S. Dollar in 1996, to rates as high as 16,000 Rupiah to the U.S. Dollar in 1998, PLN considered its obligations to purchase power from the IPPs incapable of being performed.\(^2\) The fall of the Suharto regime also unleashed pent up anger at manipulation of State contracts and concessions to benefit Suharto family members and friends, and claims of KKN (a Bahasa Indonesia acronym for corruption, collusion, and nepotism) surrounded the IPP contracts as well as virtually all other large State concessions. Soon, the Government of Indonesia unilaterally postponed a number of IPPs and placed several others on review status. Both Himpurna and Patuha were suspended and PLN declined to accept power from the two facilities.\(^2\)\(^2\)

In August 1998, after several months of unsuccessful efforts to restart the projects, Himpurna and Patuha initiated arbitration proceedings against PLN under the two ESCs and against the Republic of Indonesia under the two MoF Letters. Neither Himpurna nor Patuha named Pertamina as a respondent in the proceedings.\(^2\)\(^3\) At preliminary procedural meetings, PLN and the GOI declined to consent to a single consolidated proceeding covering both projects and claims against both PLN and the GOI, and all parties therefore agreed to four separate arbitrations.\(^2\)\(^4\) The order of proceeding, first against PLN and then against the Republic, was established early by the parties on the basis that the existence of liability on the part of the Republic would necessarily be premised on liability of PLN under the

\(^{21}\) In commenting on this position almost two years later, the Arbitral Tribunal noted that, despite the severe financial crisis, PLN had proceeded with commissioning of a wholly-owned power plant in August 1998. See Patuha-PLN Final Award, supra note 2, at B-31. Like many national utilities, PLN had long opposed IPP initiatives as over-priced. Other observers, however, have often attributed opposition to IPPs by state utilities to job preservation concerns and other anticompetitive motives.

\(^{22}\) Patuha-PLN Final Award, supra note 2, at B-2-3.

\(^{23}\) Id. at B-14.

\(^{24}\) Id. at B-5.
Therefore, when the arbitrations were initially commenced in 1998, the Republic appointed its arbitrator (Professor Priyatna) and signed Terms of Appointment deferring proceedings by the claimants against the Republic until final awards in the PLN arbitrations were rendered.

The two CalEnergy projects were the first IPPs to initiate arbitration in connection with alleged breaches of project obligations by Indonesia arising out of the Indonesian economic and political crisis. To the author's knowledge, only three of the other twenty-five Indonesian IPPs sought arbitration, and only one of those, involving the Karaha Bodas project sponsored by Florida Power and Light Co., has gone very far down the road of adversarial hearings. The other projects all awaited a possible renegotiation of their transactions, and as of this writing virtually all are still waiting. An important source of the explanation for the difference in conduct between CalEnergy and other project sponsors lies in the fact that CalEnergy had purchased US$290 million in equity political risk insurance from the U.S. Overseas Private Investment Corporation ("OPIC"), the U.S. federal agency charged with promoting American international investments, and from several private insurance syndicates on the Lloyd's of London market. Unlike many other IPPs, the

25. Id.
26. Id. at B-5-7.
27. See RI Wins Arbitration Hearing in Power Contract Dispute, JAKARTA POST, Mar. 29, 2000 [hereinafter RI Wins] (quoting Indonesian counsel that "[t]he arbitration lawsuit filed by the company against the Indonesian government was rejected by the arbitrators because it was considered flawed in terms of procedure .... Florida Power was considered to have violated the existing procedure because it combined three different cases in one lawsuit").
28. In mid-February 2001, PLN and IPP project company Sulawesi Energy Pty. Ltd. announced their agreement on a renegotiated power purchase arrangement reducing PLN's tariff obligations after almost two years of negotiations. In compensation for the tariff reductions, the 135 MW project will be permitted to expand capacity by an additional 50 MW to meet growing demand for power on the island of Sulawesi. The sponsors of Sulawesi Energy include Energy Equity Corporation Ltd. of Australia, El Paso Energy International of the United States, and PT Triharsa Sarana Jaya Purnama, an Indonesian company affiliated with Siti Hardiyanto Rukmana, former President Suharto's daughter. See Sulawesi Energy, PLN Reach Deal on Power Plant, JAKARTA POST, Feb. 17, 2001.
29. See Indonesia Doesn't Pay Awards, MidAmerican Energy Gets $290 Million on Political Risk Claim, 14 MEALEY'S INT'L ARB. REP. 1 (1999) [hereinafter Indonesia Doesn't Pay]. The existence of the insurance policies is not, of course, the only possible explanation of the conduct of CalEnergy in pursuing a strategy of arbitration rather than awaiting eventual negotiations. There are differences among the various Indonesian IPPs, including as to
CalEnergy projects thus had recourse to valuable assets located outside Indonesia. Moreover, in circumstances like those facing Himpurna and Patuha, OPIC and other insurers require covered investors to "take all reasonable measures to prevent the expropriatory action," which may include pursuing legal action before honoring the claim under the policy. Therefore, the whether allegations of corruption may be more or less well founded in particular cases. In addition, the Indonesian government has treated some projects differently than others. For example, the GOI and the owners of the not-yet-constructed Tanjung Jati A power project agreed to terminate the power purchase agreement. See Indonesia, Investor Agree to Revoke Power Purchase Contract, ASIA PULSE, Oct. 13, 2000. The corporate style of the investors may also be significant. See Paiton Energy Committed to PLN's Renegotiation Program, JAKARTA POST, May 12, 1999, (quoting Hashim Djojohadikusumo, Paiton's President Commissioner and principal behind Paiton's local partner PT Batu Hitam Perkasa, to effect that "they [MidAmerican] are confrontationists ... [t]hat's why they went to the arbitration court").

30. See OPIC's Investment Insurance: The Platypus of Governmental Programs and its Jurisprudence, 25 LAW & POL'Y INT'L BUS. 359, 389 (1993). OPIC will not require a covered investor to pursue such remedies when it would be futile to do so. Id. The Contracts of Insurance issued by OPIC covering the Patuha and Dieng projects contained OPIC's standard coverage under section 4.01(a) for expropriatory conduct, which provides for compensation if acts (other than acts that constitute breach of contract) attributable to the GOI deprive the insured party of its fundamental rights in its investment, violate international law, and continue for six months. Overseas Private Investment Corporation, Memorandum of Determinations: Expropriation Claim of MidAmerican Energy Holdings Company (formerly CalEnergy Company, Inc.), Contracts of Insurance Nos. E374, E453, E527, and E759 (Nov. 10, 1999), at 9-10 [hereinafter OPIC Determinations]. Moreover, the OPIC political risk insurance contracts for the Patuha and Dieng investments contained a non-standard (but not uncommon) provision entitling the insured party to compensation:

if valid, final arbitral awards have been obtained against PLN or Pertamina pursuant to the Project Agreements as a result of acts not covered by section 4.01(a) [i.e., not breaches of the Project Agreements attributable to the GOI, which are directly excluded from coverage under Section 4.01(a), and not acts taken by the GOI as purchaser, supplier, creditor, shareholder, director, or manager of the foreign enterprise, which are excluded from coverage under Section 4.01(a) by virtue of Section 4.03(b) of the Contracts], such awards have also been obtained against the GOI pursuant to the GOI Support Letters, such awards have not been paid for a period of 90 days, the nonpayment constitutes a violation of international law and deprives the investor of its fundamental rights in the insured investment, and the Foreign Enterprises [i.e., the project companies] were not in breach of the Project Agreements. Id. at 10. Thus, CalEnergy could recover under the OPIC insurance contracts if the GOI refused to honor the Final Awards on account of the MoF Letters in violation of international law. The OPIC Determinations concluded that the GOI had in fact violated international law. Id. at 11-13, 18-19. OPIC therefore determined that the GOI had deprived MidAmerican (CalEnergy) of its fundamental rights in its investments. Id. at 13-14, 19. Of particular interest, OPIC decided that non-payment of the arbitral awards by the GOI was itself a violation of international law in the circumstances. Id. at 18-19. In so doing, OPIC relied upon Comment h to Section 712 of the Restatement
project companies, their shareholders, and their limited recourse lenders had strong incentives to move forward with arbitration rather than awaiting an uncertain future of negotiations.

Although relations between the litigants in the Patuha and Himpurna disputes were apparently quite contentious, the arbitrators worked steadily towards final decisions. On May 4, 1999, the two tribunals issued parallel awards in favor of the project companies, holding that PLN had breached the ESCs. Accordingly, the tribunals terminated the ESCs and awarded damages to Himpurna of US$391,711,652 and to Patuha of US$180,570,322.\(^1\) In so doing, the Tribunal considered and rejected a number of alleged defenses raised by PLN, including the following claims: that the project companies failed to satisfy contractual requirements in the ESCs to engage in good faith settlement negotiations prior to initiating arbitral proceedings,\(^2\) that the notices initiating arbitration were procedurally deficient,\(^3\) that the presence of Pertamina was necessary before arbitration could occur,\(^4\) that the ESC violated several mandatory Indonesian laws at the time of its execution,\(^5\) and that Indonesian

\footnote{(Third) of Foreign Relations Law, which takes the position that "a state may be responsible \ldots if, having committed itself to a special forum for dispute settlement, such as arbitration, it fails to honor such commitment; or if it fails to carry out a judgment or award rendered by such \ldots special forum." \textit{See Restatement (Third) of Foreign Relations Law} §712 cmts. h, j (1999). In addition, OPIC relied upon Article II, Paragraph 1 of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention"), under which contracting States to the Convention agree to support and enforce agreements to arbitrate disputes. \textit{See Convention on the Recognition and Enforcement of Foreign Arbitral Awards June 10, 1958, art. II, para. 1, 21 U.S.T. 2517, 330 U.N.T.S. 38 [hereinafter \textit{New York Convention}].}

\(^1\) \textbf{Himpurna-PLN Final Award}, supra note 8, at A-57; \textbf{Patuha-PLN Final Award}, supra note 2, at B-48.

\(^2\) \textit{Patuha-PLN Final Award}, supra note 2, at B-12-13.

\(^3\) \textit{Id.} at B-13-14.

\(^4\) \textit{Id.} at B-14.

\(^5\) \textit{Id.} at B-18-23. PLN alleged that the ESC was illegal: (i) because it was not awarded by means of competitive tender, (ii) because the sale of electricity was priced in U.S. Dollars rather than Indonesian rupiah, (iii) because the legislation upon which the ESC was based permitted a non-Indonesian entity to be involved in power production in contravention of the Indonesian Constitution, and (iv) because the ESC did not reflect a true "meeting of minds" as to the meaning and effect of the project schedule appended to the contract. \textit{Id.} at B-21-23. PLN also claimed the unilateral right to terminate the ESC for an alleged non-consensual increase in generating capacity of the facilities, notwithstanding provisions in the ESCs entitling the project companies to increase capacity. \textit{Id.} at B-22-23. The Patuha Unit 1 increased from 50 MW to 80 MW. \textit{Id.; see also Himpurna-PLN Final Award, supra} note 8, at A-23 (noting increase in Himpurna Unit 1 from 20 MW to 60 MW).
law prevented an arbitral tribunal from ruling on a claim for termination of a contract but instead that only a judge could order such termination, 36 that decrees of the Government of Indonesia in 1998 suspending the projects excused PLN from breach, 37 that CalEnergy "may have used links with former President Suharto to win major contracts in Indonesia," 38 and that the doctrines of changed circumstances, force majeure, and good faith excused non-performance by PLN. 39

Having established PLN's liabilities under the ESCs, Himpurna and Patuha then moved forward with their claims under the MoF Letters against the GOI. Through May and into June 1999, the project companies and the Republic sparred

36. Patuha-PLN Final Award, supra note 2, at B-14-15.
37. Id. at B-15-18.
38. Id. at B-23. These "intimations of impropriety" became much more strident once the Arbitral Tribunal ruled against PLN and the GOI. Id. After the issuance of an interim award holding the Republic liable under the MoF Letters, the GOI's counsel renewed claims of corruption in the following terms:

[W]e and all parties involved in the energy sector in Indonesia, are well aware that CalEnergy and its subsidiaries and personnel not only did not tender for their ESC and JOC contracts as required by law, but clearly obtained them through what is now known in Indonesia as "KKN." Counsel for PLN refrained from making such assertions in their submissions in the recent arbitral references, simply because the payoffs for these contracts were done so circuitously and clandestinely that such assertions could not be proven. However, that kind of conduct continued throughout the course of the relationship of CalEnergy with its Indonesian contractual counterparts; in the manipulation of invoices so as to appear as though there were breach where none existed, refusal to pay their own contractors, paying huge amounts to their own personnel and head office which they later claimed as costs, falsely declaring that they had assigned their proceeds for the benefit of lenders, when now they intend to walk away with the full amount that they may obtain from awards or insurance without paying off their financing (this according to internet news), and providing false information and witnesses on points of fact and law so as to successfully pull the wool over the eyes of the tribunal so that the truth, being put forward by the Respondent, could no longer be seen through the Claimants' lies. It must be Claimants' familiarity only with the world of KKN that allows them to assume that everyone, even the Ministry of Finance and respectable law firms, engage in such illegal and improper practices.

Patuha-ROI Final Award, supra note 12, at B-9. Indonesian counsel for the Republic also accused the Claimants and/or their counsel of using "sophisticated surveillance devices to 'bug' the workrooms and telephones of counsel for PLN." Id. at B-8. No proof, "concrete or otherwise," was offered to support this allegation. Id. Indeed, after describing a series of requests by both the claimants and the arbitrators for evidence supporting these various assertions, the Tribunal concluded: "In sum, the Republic of Indonesia has made exceedingly serious allegations throughout the proceedings, but has failed to back them up with any evidence whatsoever." Id. at B-10.

39. Patuha-PLN Final Award, supra note 2, at B-30-33.
about the very existence of the Arbitral Tribunal, notwithstanding its appointment in the prior year. In early June, however, animosity between the two sides broke apart the carefully drafted arbitration provisions of the contracts. PLN and Pertamina served the project companies with notice of two lawsuits filed in the Central Jakarta District Court.\footnote{40. Patuha-ROI Interim Award, supra note 1, at B-8.} The first, brought by Pertamina, named the project companies, PLN, and the Republic as defendants and sought an injunction against continuation of the arbitral proceedings against the Republic. The second, initiated by PLN, sought annulment of the arbitration awards against PLN. In the Republic’s Statement of Defense submitted the next month in the arbitration proceedings, the GOI stated:

With respect to the court actions instituted by Pertamina against the Claimants, the Respondent and PLN in the District Court of Central Jakarta seeking an injunction to restrain this arbitral reference to proceed, in the event that such injunction were to be granted and the Claimants should nonetheless seek to proceed with this arbitration and the Tribunal should accede to such request, Respondent reserves the right to apply to the Indonesian courts or other Authorities for an order declaring contempt of court and for sequestration of the Claimants’ assets, not limited to any rights (any such are denied) which they may have under the Awards; and for orders for fines upon the Claimants and/or imprisonment.\footnote{41. Id. at B-10.}

Further, PLN apparently submitted pleadings to the Jakarta court stating that “PLN will take legal actions against [Mr. Job Taylor of Latham & Watkins, lead counsel for the project companies] both privately and criminally” for comments attributed to Mr. Taylor by an Indonesian newspaper that PLN considered to be defamatory and insulting to the Indonesian court system.\footnote{42. Id. at B-19-20.}

In late July, the Jakarta court issued an injunction halting execution of the PLN Awards, purporting to suspend the arbitration proceedings against the Republic, and imposing a fine of US$1 million per day against the project companies for violation of the injunction.\footnote{43. Id. at B-11, B-13-14.}

As a consequence of the Jakarta court’s injunction, and following a ruling by the Arbitral Tribunal that the Republic was
responsible for Pertamina's actions in maintaining the Jakarta litigation, in early September the Arbitral Tribunal issued an order holding the Republic in default of the Terms of Appointment of the Tribunal. 44 Under the terms of that order, the Tribunal also convened hearings on September 22 at the Peace Palace in The Hague, rather than Jakarta. The Arbitral Tribunal explicitly set the hearing location without changing the legal seat of the arbitration, 45 a decision with implications for the scope of available grounds for annulment of awards discussed below.

The reaction of the Indonesian side included filing an application with ICSID for removal of the Arbitral Tribunal on the grounds that the Tribunal displayed "express bias" against the Republic of Indonesia, acted with a "closed mind, in contempt of an Order of the Court of competent jurisdiction of Indonesia . . . in breach of natural justice," and "behaved in a manner in which the Republic is entitled to have lost confidence in the Tribunal's fairness, impartiality and respect of law." 46 Despite these entreaties, the Secretary General of ICSID did not remove any member of the Arbitral Tribunal.

The Republic also sought an injunction from the District Court of The Hague preventing the scheduled arbitration hearing. On the morning of September 20, however, the Dutch District Court denied the Republic's application to enjoin the proposed hearings at the Peace Palace. 47 The coercive removal of Professor Priyatna to Jakarta, recounted at the beginning of this Essay, then occurred on September 21. On September 22, the Republic failed to appear at the scheduled hearing. 48 At the hearing, the President of the Arbitral Tribunal made an oral statement of the events surrounding Professor Priyatna's failure to appear at the hearing and submitted for the record statements of two witnesses to the airport events. Mr. de Fina read his own statement of those events into the record. 49 The Tribu-

44. Id. at B-19-20.
45. Id. at B-19.
46. Id. at B-20.
47. Id. at B-22-23.
48. Id. at B-23.
49. The text of these oral statements and written statements describe the effort to locate Professor Priyatna when he failed to contact the other two arbitrators, the discovery that his booking at the agreed hotel had been cancelled by an Indonesian embassy official, telephone conversations with that official who denied knowledge of Professor
nal President then advised the claimants that a decision on default by the Republic had already been fully deliberated by the Arbitral Tribunal. 50 Interim Awards signed by the two remaining panelists were issued on September 26, 1999, granting default awards against the Republic of Indonesia. 51 Final Awards were issued on October 16. 52 In December 1999, OPIC and the Lloyds insurance syndicates honored claims under their political risk policies, and the project sponsor "closed the book" on Himpurna and Patuha. 53

While the project sponsor and the project lenders may have halted enforcement activities upon receiving the proceeds of the political risk policies, OPIC and the private insurance syndicates of course inherited rights under the awards against PLN and the Republic. Acting as subrogee of the claims of the project companies, OPIC demanded payment of the awards by Indonesia. Initially, the Indonesian Minister of Finance publicly rejected any prospect of paying the awards, 54 but Indonesia softened its position under political pressure from the U.S. government. However, U.S. impatience rose as discussions between the two governments dragged on for months, and remarks of U.S. Ambassador Robert Gelbard quoted in the press created a stir in Jakarta that the United States was threatening to seize Indonesian assets: "There is always the possibility of declaring expropriation . . . If we were to do this, it would result in a dramatic deterioration of the rupiah and would hurt Indonesia very much." 55 While the "seizure" interpretation placed on these words by critics may seem strained to international lawyers, the uproar in Indonesia further complicated intergovernmental discussions. According to local press reports at year-end 2000, OPIC and the Indonesian

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50. Id. at B-24 & B-28.
52. Patuha-ROI Final Award, supra note 12; Himpurna-ROI Final Award, supra note 12.
53. Indonesia Doesn't Pay Award, supra note 29.
government agreed to settle OPIC's claim on a payment schedule consistent with the Paris Club repayment schedule for Indonesian sovereign debt.\textsuperscript{56} By April 2001, however, OPIC and the GOI had in fact not yet reached final agreement on a settlement.\textsuperscript{57} There has been no public report as to the ability of the Lloyds insurance syndicates to recover on their subrogation claims, and no indication whether anyone will pursue recovery of amounts due under the awards in excess of the insurance policy payments.\textsuperscript{58}

As unusual as this tale might seem, the Himpurna and Patuha projects were not the only Indonesian transactions in which local courts have sought to enjoin international arbitration proceedings amidst the difficulties arising out of Indonesia's deep economic and political troubles. The most well-known independent power project in the country, the Paiton project, sponsored by Edison Mission Energy, Inc., Mitsui Corp., General Electric Corp. and others, also found itself in serious commercial and legal difficulties as a result of disputes with PLN.\textsuperscript{59} Hashim S. Djojohadikusumo, brother-in-law to one of President Suharto's daughters, was a major participant in the Paiton project, owning equity in the project company itself and controlling the coal company holding the long-term coal supply contract for the project.\textsuperscript{60}

Unlike the CalEnergy projects, which were developed under Indonesian regulations governing geothermal power projects, Paiton and many other IPPs were developed under decrees addressing IPPs generally. Consistent with those decrees, PT Paiton Energy Company was organized under Indonesian law as the project company to develop the US$2.9 billion Paiton I


\textsuperscript{57} Telephone conversation between the author and Thomas J. Mahaffey, Assistant General Council, OPIC, on February 14, 2001, and email exchange in April 2001 (on file with author).

\textsuperscript{58} As fines of US$1 million per day began accruing against the project companies by virtue of the terms of the anti-arbitration injunction issued by the Jakarta Central District Court in late July 1999, the Republic would most likely also be entitled under Indonesian law to seize the rights of the project companies in the two facilities in satisfaction of the hundreds of millions of U.S. Dollars of unpaid fines. There is no public report as to whether Indonesia has pursued this course of action and, if so, the reaction of the secured lenders.

\textsuperscript{59} \textit{Jakarta Court Puts an End to Paiton Lawsuit}, \textit{Jakarta Post}, Jan. 21, 2000.

\textsuperscript{60} Id. The following description of the Paiton project is based on the personal knowledge of the author, but contains only information publicly available.
power project. The Indonesian Ministry of Finance provided a support letter for PLN's obligations at the time of financial close in April 1995 (which support letter became the model for the later MoF Letters in other Indonesian IPPs). Limited-recourse debt financing support was provided by a syndicate of commercial banks, the Export-Import Bank of the United States, the Export-Import Bank of Japan, the Japanese Ministry of International Trade & Industry, OPIC, and a rated Rule 144A capital markets bond offering. As the first large IPP in Indonesia, Paiton became a lightning rod for critics of the private power program.

The Asian financial crisis enveloped Indonesia close to the same time as the Paiton project had reached the end of construction work and begun to prepare for generating electricity against payment by PLN of capacity and energy tariffs. Fueled by Hashim's involvement, the Paiton project suffered suspicion of involvement in corruption, collusion, and nepotism ("KKN"), although Paiton strongly denied these claims and offered to undergo an independent audit. As a result of the impact of the economic crisis, and employing the leverage created by the corruption allegations, PLN now sought reductions of over fifty percent in the tariff, among other concessions. PLN unilaterally limited its tariff payments to an amount based on an artificial exchange rate of 2,450 Rupiah to the U.S. Dollar (as it did with other IPPs) and began to refuse to accept energy from the Paiton facility. The project sponsors sought the political assistance of the U.S. and Japanese governments, who each had about US$900 million of exposure to the project by virtue of their financial support. Faced with stalemate, and now aware of the consequences of delaying court action until after the issu-

61. See T.M. Callahan, US$25b Indon. Power Play, Bus. Times, Nov. 27, 1999 [hereinafter Indon. Power Play]. The author noted the following:

In PLN's book, this is just another bad Suharto-era deal that benefited cronies and big foreign business at the expense of the people. Critics are quick to allege corruption because two of the former strongman's family members were involved in the project. Titiek Prabowo, one of Mr. Suharto's daughters, and Hashim S. Djohadikusumo, whose brother is married to Titiek, hold a combined 15 percent stake through PT Batu Hitam Perkasa. PLN president director Adhi Satriya has also accused Paiton in Jakarta's newspapers of corrupt practices that drove up the cost of the power project.

Id.

ance of an adverse award, PLN commenced a lawsuit in October 1999 in the Central Jakarta District Court against the project company, notwithstanding the mandatory arbitration clause in the Paiton-PLN power purchase agreement.\textsuperscript{63} In the Indonesian lawsuit, PLN sought a court order voiding the power purchase agreement, arguing that the contract was void ab initio by reason of corruption, overcharging for power, and inconsistency with Indonesian law.\textsuperscript{64} In a press conference, PLN President Director Adhi Satriya was quoted in Indonesian press reports as saying "[w]e filed the lawsuit at a local court rather than an arbitration court, because the issue in dispute is not the terms of contracts but the (contract awarding) process and the corruption, collusion, and nepotism involved in it."\textsuperscript{65} Paiton then initiated arbitration proceedings against PLN in Stockholm under the terms of the arbitration clause in the power purchase agreement.\textsuperscript{66} The Jakarta court responded by issuing an injunction in late November 1999 against those arbitral proceedings, backed by the threat of a US$600 million fine for non-compliance.\textsuperscript{67}

The lawsuit and arbitration proceedings escalated the battle with the project sponsors, over forty international banks and institutional investors and, most importantly, U.S. and Japanese government authorities crucial to Indonesia's efforts to recover from economic collapse. At the same time, the story of Professor Priyatna's removal from the CalEnergy arbitration in The Netherlands was circulating within the international community. Indonesian President Abdurrahman Wahid prudently responded by ordering in December a halt to PLN's combative litigation in favor of an interim settlement under which both sides agreed to avoid adversarial proceedings and to negotiate towards a long-term solution.\textsuperscript{68} PLN's President Director and its Director of Planning both promptly resigned in protest against the change in approach required by President Wahid.\textsuperscript{69} That in-

\textsuperscript{63} Indonesian Power Co. Moves to Cancel Contract, ASIA PULSE, Oct. 8, 1990.
\textsuperscript{64} EDISON INTERNATIONAL REPORT ON FORM 10-K, at 29-30 (Dec. 31, 1999).
\textsuperscript{65} Id.
\textsuperscript{66} Indon. Power Play, supra note 61; see also EDISON INTERNATIONAL REPORT ON FORM 10-K, supra note 64, at 30.
\textsuperscript{67} Jakarta Must Stop, supra note 62.
\textsuperscript{68} Id.
\textsuperscript{69} See Senior Exes of Indonesia's PLN Resign, ASIA PULSE, Dec. 21, 1999.
terim settlement remains in place, but a final resolution of the dispute has yet to be agreed upon.

A third Indonesian IPP is also known to have initiated international arbitration proceedings, the US$380 million Karaha Bodas project sponsored by Florida Power and Light Co. The Karaha Bodas project was “postponed” by the Indonesian government by decree in early 1998, and Karaha Bodas promptly commenced arbitration proceedings against PLN, Pertamina, and the Republic. Although the arbitration is confidential, the Indonesian press reported in March 2000 that the case against the Republic had been dismissed on procedural grounds. Unlike the CalEnergy and Paiton projects, none of the Indonesian State entities has sought local court involvement in the Karaha Bodas arbitration.

Court interference in international arbitration has remained a difficult issue as well for other non-project transactions in Indonesia in the aftermath of the financial crisis. According to press reports, in a case brought in South Jakarta District Court by PT Perusahaan Dagang Tempo over a pharmaceuticals distributorship dispute with foreign-controlled PT Roche Indonesia (“Roche Indonesia”), the local Court ignored mandatory domestic arbitration provisions in the underlying contract and ordered sequestration of Roche Indonesia’s assets, including land, factory, and inventories. Even more surprisingly, this order came before Roche Indonesia had an opportunity to defend itself at the court hearing. The Court later ordered Roche Indonesia to pay Rp 281 billion (approximately US$33 million) in damages for breach of contract. Roche Indonesia has appealed the decision, but has also stated that it will not pay the damage award “under any circumstances.”

Refusal to honor mandatory arbitration agreements was also a theme in Indonesian financial derivatives transactions during this period. In the U.K. case of Bankers Trust Co. v. PT Jakarta International Hotels & Development, the Commercial Court is-

70. Ri Wins, supra note 27.
71. See, e.g., Jakarta Must Stop, supra note 62.
72. “I wish to state categorically that Roche Indonesia will not be paying Rp 281 billion under any circumstances, and we believe that we will be successful with our appeal.” See Letter from Dieter Garbade, President Director, PT Roche Indonesia, to The Jakarta Post, reprinted in JAKARTA POST, June 23, 2000.
73. 1 Lloyd’s Rep. 910 (Q.B. 1999).
sued an injunction in December 1999 at the request of Bankers Trust restraining court proceedings in the Central Jakarta District Court brought by its Indonesian counterparty over a number of currency swap agreements between the two parties. The swaps had been documented under an ISDA Master Agreement containing a clause submitting disputes to arbitration before the London Court of International Arbitration. A similar injunction was issued by the Commercial Court in an unreported January 1999 case entitled Bankers Trust Co. v. PT Mayora Indah. Earlier proceedings in the Jakarta court had included an unsuccessful motion by Bankers Trust for replacement of the presiding judge on grounds of bias and claims by Bankers Trust that JIHD had forged evidence by presenting the ISDA Master Agreement to the court with the schedule containing the arbitration clause removed.

Before turning to the Pakistani example, several points about the Indonesian experience are worth addressing. First and most importantly, the crisis circumstances and corruption allegations surrounding large Indonesian infrastructure projects undoubtedly offer a significant explanation of the motives of the Indonesian parties in seeking court interference with arbitral proceedings. PLN found itself unable to honor large U.S. Dollar tariff obligations to a large number of projects as a result of the steep drop in the exchange value of the Rupiah and the general drop in demand for electricity resulting from the severe contraction of the Indonesian economy. While the Republic of Indonesia had access to foreign exchange reserves unavailable to PLN, the Republic was itself suffering a general foreign exchange and economic crisis requiring strict rationing of those vastly shrunken reserves. Legal arguments of changes in circumstances, impossibility of performance, hardship, and force majeure were unlikely to offer the Indonesian obligors an excuse from their payment obligations, as the energy project documents all contained very detailed force majeure and other provisions allocating the risks of foreign exchange fluctuations, change in law and payment defaults to the Indonesian side. As the Final

76. Patuha-PLN Final Award, supra note 2, at B-26-31.
Awards against PLN demonstrate, international tribunals regularly give effect to intentional contractual allocations of risk in preference to statutory or customary force majeure principles. Blocking arbitration, therefore, became an important objection, particularly once the awards against PLN brought home to the Indonesian government the weakness of its legal position.

The impact of de facto national insolvency was exacerbated by a widely-held belief among Indonesians that the IPP contracts were overpriced and obtained through corrupt means. Average tariffs of roughly 6.50 U.S. cents/KwH for Indonesian IPPs compared poorly with, for example, a weighted levelized tariff agreed to in late 1998 for a Bangladeshi IPP of 2.73 U.S. cents/KwH. Many Indonesians pointed to KKN as the explanation for this difference. Those concerns were compounded by disclosure of favorable arrangements for Suharto family members, such as the alleged deal in which the Paiton sponsors, among others, lent Hashim Djohadikusumo’s investment vehicle PT Batu Hitam Perkasa the money to purchase its fifteen percent shareholding in the Paiton project company, under terms whereby the loan was only to be repaid out of profits from the project company.


Batu Hitam owns 15% of the plant but didn't put in its own capital. Instead, its share of the equity in Paiton is a loan to be repaid from profits. 'In Indonesia, how the practice usually works is you lend the Indonesians their equity,' says an investor close to the deal. 'That of course raises the cost.' GE and Edison officials say they are small participants and the financing is above-board.
The KKN allegations created a potent motive for disregarding the arbitration provisions found in contracts allegedly obtained by defrauding the Indonesian government. It is impossible to quarrel with claims that Suharto family members and "cronies" systematically manipulated Indonesian public contracts to their extraordinary financial advantage, and with great ultimate harm to the ordinary citizens of the country. Transparency International has routinely listed Indonesia as one of the most corruption-ridden countries in the world, and at least fourteen of the twenty-seven IPPs have been linked to cronies or Suharto relatives in the Indonesian press.\(^\text{80}\) To the general population of Indonesia, it seems impossible to explain that contracts obtained through corruption must be enforced in accordance with their terms.\(^\text{81}\)

The undoubted existence of pervasive KKN misconduct in Indonesian contracts does not, however, explain all of the anti-arbitration injunctions emanating from Indonesian courts. No KKN allegations were reported, for example, in the disputes in the Roche Indonesia case or over the Bankers Trust currency swaps in PT Jakarta International Hotels or PT Mayor Indah. Instead, the pharmaceuticals distribution and derivatives cases ap-

\(\text{Id.}\) Apart from allegations of overcharging and corruption, the size of the tariffs in Indonesian IPPs can be explained by other factors as well, including the risk premium necessary to attract investors to finance first-of-a-kind transactions in a State with a checkered economic and political history, the higher cost of coal-fired power plants as compared with gas-fired turbines, and the impact of several years of subsequent competition between 1994 (the date of the first Indonesian contracts) and October 1998 (the date of the illustrative Bangladeshi contract) on the costs of international power project construction contracts and financing fees. Moreover, in the most high-profile project, the Paiton transaction, critics of the cost of that project neglect to mention that 0.75 U.S. cents/KwH of that cost was attributable to the expense of building roads, sea water intakes and a switchyard to be shared with neighboring power units, all as required by the Indonesian side. See Press Release on Paiton Project, Oct. 7, 1999, reprinted in Edison International Report on Form 8-K, (Oct. 20, 1999). The Paiton sponsors have consistently maintained that, after backing out the expense of the additional facilities required by Indonesia, the project's tariffs were fully competitive with similar path-breaking projects in emerging markets. Id. Still, important questions about the participation of Suharto family and cronies in IPPs remained unanswered and the allegations of overcharging and corruption fueled powerful currents within Indonesian society.


\(81\). The arbitrability of claims of corrupt inducement of contracts arises in U.S. disputes as well as disputes in lesser-developed countries. Some U.S. courts have required prior judicial review of analogous claims rather than permitting arbitrations to proceed. See William H. Park, International Forum Selection, 107-08 n.460 (1995).
PEAR to illustrate a visceral rejection by several Indonesian courts of international arbitration as an acceptable method of dispute resolution. Of even more concern, the issue of corruption is not, unfortunately, limited solely to KKN claims involving international investments in Indonesia. Serious questions also exist regarding corruption and unreliability of the Indonesian court system. Thus, the U.S. government has criticized the unreliability of Indonesian justice in decidedly undiplomatic words:

The court system does not provide effective recourse for solving commercial disputes. The judiciary is nominally independent, but irregular payments and other collusive practices often influence judicial outcomes. 82

Investors in Indonesia had no confidence in the impartiality or reliability of the Indonesian system of justice. Those concerns have been at the heart of the demands for mandatory submission to international arbitration made uniformly in project negotiations by international investors, lenders, and export credit agencies. Such problems also provide the energy behind unsubstantiated rumors that local courts were suborned or biased in many of the IPP and other disputes discussed above.

The last significant element of the Indonesian situation to be noted is the upheaval in political authority. For well over forty years, Indonesian President Suharto led a stable authoritarian government, backed by the support of the Indonesian military and many prominent business families. The Asian financial collapses, however, proved a shockwave too powerful for the Suharto regime to survive, triggering the strongman's resignation and a crisis of political succession, ethnic and religious division, and potential breakup of the Indonesian State that continues to reverberate today. The ensuing turmoil has created political vacuums and conflict. Coupled with the strength of the KKN allegations and the weakness of government institutions in the post-Suharto era, these circumstances have resulted in an opportunity for lower and mid-level actors to exercise unusual inde-

82. Indonesia: Investment Climate Statement 2000, Embassy of the United States of America, Jakarta, Indonesia, at A.4, available at http://www.usembassyjakarta.org/econ/investment2000-2.html. Similar allegations have been made about Pakistani courts. See infra notes 108, 163. As Professor Park of Boston University observes, an important practical element of negotiating arbitration clauses "involves choosing an arbitral situs where annulment of awards is not likely to be facilitated by a bribe to a legal judge." PARK, supra note 81, at 76.
pendence and autonomy. For example, Ministry and parliamentary figures were said to be reluctant to intervene into PLN's October 1998 decision to commence litigation against Paiton by reason of the volatile KKN claims. That autonomy was employed by PLN in a fashion that clashed spectacularly with other foreign economic and security interests of Indonesia.

What is perhaps most extraordinary about the Paiton dispute is the confrontation that Jakarta was willing to risk with some of its biggest supporters.

On top of being owned by powerful multinationals such as Mission Energy, Mitsui & Company and General Electric, most of the financing for Paiton's U.S. $2.5 billion power plant in East Java came from the U.S. and Japanese governments. The project was put together with the direct involvement of the U.S. Exim Bank, Japan Exim Bank, Japanese Ministry of Trade and OPIC.

According, to a newspaper report, Washington has over $800 million invested in the venture. That Jakarta was even willing to play this high-stakes game with such important friends is worrying.

The competing argument, of course, is that bribery investigations belong in the courts rather than private, confidential arbitration tribunals and that the role of important foreign governments and multinationals in the disputed transaction reinforces the need for a transparent and publicly accountable forum. The strength of that argument, however, has been undermined by the erratic course of justice in Indonesia's courts.

These Indonesian difficulties could be dismissed as sui generis to the sad problems of that country were it not for the equally high-profile dispute between HubCo and Pakistan over that country's largest power project. Although efforts to de-

83. "Frustrated by PLN's intransigence, Paiton has even asked the Indonesian government to become more directly involved in negotiations for its power purchase agreement with the state power utility. However, this appeal has fallen on deaf ears primarily because the issue is such a hot potato in Jakarta." Indon. Power Play, supra note 61.

84. Jakarta Must Stop, supra note 62.

85. Details of this transaction are taken from The Hub Power Company Limited Offering Memorandum dated October 5, 1994, with respect to an offer of up to 16,183,380 Global Depositary Receipts representing 404,584,500 new Ordinary Shares of Rupees 10 each at a price of US$10.825 per Global Depositary Receipt (as part of an overall issue of up to 26,529,800 Global Depositary Receipts), filed with the Luxembourg and Karachi Stock Exchanges and the Registrar of Companies, Islamabad, Paki-
develop a private power project by one or more of HubCo’s sponsors can be traced back to 1985, serious planning for the HubCo project began with a feasibility study in 1988. In August 1992, HubCo entered into a power purchase agreement with WAPDA providing for HubCo to develop a 1,292 MW power plant and sell the resulting power to WAPDA. The WAPDA power purchase agreement provided that, once the facility was successfully built, WAPDA would pay a monthly tariff in U.S. Dollars for both capacity and energy utilized. HubCo also entered into an Implementation Agreement and a Guarantee Agreement with the Islamic Republic of Pakistan ("GOP") under which the GOP guaranteed the obligations of WAPDA as power purchaser, the government-owned fuel supplier and the State Bank of Pakistan.

The project was initially sponsored by National Power PLC of the United Kingdom and Xenel Industries Limited of Saudia Arabia. Entergy Corp of the United States later became a significant HubCo shareholder as well. In addition to the shareholdings of its sponsors and promoters, HubCo made a rights offering for ordinary shares, listed on the Karachi Stock Exchange, and an international global depository share receipts offering, listed on the Luxembourg Stock Exchange. Together, the public shareholders in the domestic and international share offerings comprised approximately thirty-five percent of total shareholdings. Unlike the various Indonesian project companies, therefore, HubCo was a public company with significant numbers of public shareholders, many of them Pakistanis. As will become apparent, though, the implicit political risk protection afforded by widely distributed shareholdings inside and outside Pakistan proved unreliable.

In addition to the equity, the total project cost of approximately US$1.6 billion for the HubCo project was financed from a variety of lending sources. Subordinated debt of over US$425 million was provided by a GOP-controlled fund out of back-to-back loans made by the World Bank and the governments of Japan, France, Italy, and the United States and guaranteed by Pakistan. Senior debt of about US$712 million for the project company was funded by various commercial bank syndicates, the Commonwealth Development Corporation (an arm of the U.K.
government), and local Pakistani banks. The international bank syndicates received partial guarantees and insurance policies from the World Bank and Italian, Japanese, and French export credit agencies. The partial guarantees issued by the World Bank and the Export-Import Bank of Japan were in turn counter-indemnified by the GOP. Like the implicit political risk protection sought through the public share offerings, the implicit political risk protection afforded by the participation of the World Bank and the export credit agencies in the project, and the financial stake created by the GOP guarantee and counter-indemnitee, unfortunately also proved unreliable at the moment of need.

The Hub project represented an important precedent for the World Bank. The Bank had been heavily involved in the development of the Pakistani energy policy, starting in the mid-1980s. When Ms. Benazir Bhutto became Prime Minister for a second time in 1993, Pakistan’s energy policy continued in cooperation with World Bank authorities but with several alterations that later generated noticeable controversy. In all, nineteen IPPs began construction during the Bhutto era, with estimated project costs of about US$4.6 billion. Following Ms. Bhutto’s return to power, amendments to the HubCo project documents were executed increasing the amount of equity in the project company from twenty percent of project costs to twenty-five percent of project costs and increasing total project cost by about US$340 million.\textsuperscript{86} The HubCo project financing closed in the fall of 1994, and construction moved forward steadily. The power plant was commissioned and began selling power to WAPDA in March 1997.

It may be expected for such a large and unprecedented investment in a country with such a troubled history as Pakistan that the governing law and dispute resolution provisions of the project documents were investor-friendly. The parties included provisions in Clause 15 of the WAPD power purchase agreement selecting English law as the governing law and agreeing to submit “any dispute or difference of any kind whatsoever . . . between WAPDA and the company in connection with or arising out of this Agreement” to final settlement by mandatory arbitra-

\textsuperscript{86} Hill, \textit{supra} note 4.
The dispute resolution provisions specified that, if at the time of dispute the GOP had implemented the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States \(^8\) ("ICSID Convention"), then the dispute would be submitted to arbitration administered by ICSID.\(^8\)

Those provisions further stated that HubCo would be deemed to be a "foreign-controlled company" for purposes of the ICSID Convention, thus satisfying ICSID's jurisdictional requirements,\(^9\) so long as not less than thirty percent of the shares of HubCo were held by foreign investors. If ICSID arbitration was unavailable at the time of a dispute, then the proceedings would be conducted in London under the arbitration rules of the International Chamber of Commerce ("ICC").\(^9\)

The original power purchase agreement was executed between WAPDA and HubCo in 1992, at a time when Mr. Nawaz Sharif was Prime Minister of Pakistan. The initial controversial modification to the WAPDA power purchase agreement, the Supplementary Deed, was negotiated during Mr. Sharif's administration and executed on the first day of Ms. Benazir Bhutto's administration in 1993. Two additional modifications, the First Amendment and Second Amendment, were negotiated and entered into under the Bhutto government in 1994.

Politics, economics, and corruption allegations began to move towards center stage in 1996. By June 1996, Transparency International was naming Pakistan as second only to Nigeria in its corruption rankings and, in late 1996, Ms. Bhutto was dismissed as Prime Minister for a number of reasons, including claims of corruption and nepotism. Ms. Bhutto's husband, Asif Zadari, was convicted of corruption and imprisoned in Pakistan. Ms. Bhutto herself fled the country and was convicted in absentia. Both Mr. Zadari and Ms. Bhutto continue to strongly assert their innocence of these charges. In February 1997, Mr. Nawaz

\(^8\) See HubCo v. WAPDA, supra note 2, at 444 (quoting Clause 15.2 of WAPDA power purchase agreement).

\(^8\) Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Mar. 18, 1965, 575 U.N.T.S. 159 [hereinafter ICSID Convention].

\(^9\) See HubCo v. WAPDA, supra note 2, at 444 (quoting Clause 15.4 of WAPDA power purchase agreement). Pakistan has still not implemented the ICSID Convention.

\(^9\) See ICSID Convention art. 25(2)(b).

\(^9\) HubCo v. WAPDA, supra note 2, at 444 (quoting Clause 15.4(c) of WAPDA power purchase agreement).
Sharif again was elected as Prime Minister. Ironically, by the time of the final hearings before the Supreme Court of Pakistan discussed below, Mr. Sharif himself had been overthrown by a largely bloodless military coup led by Army Chief of Staff General Pervez Musharraf.92

Economic problems multiplied in the country and observers began to conclude that Pakistan had overestimated its need for power and underestimated its ability to pay for that power.93 Beset by political and economic pressures, the IPP projects, including HubCo, came under intense scrutiny for possible improper payments and preferences. Compounding these problems, the financial fortunes of WAPDA, never strong to begin with, deteriorated substantially. The foreign exchange pressure of U.S. Dollar-denominated power tariffs on the weakened State utility increased as growth rates stalled and the Pakistani Rupee lost value against the U.S. Dollar.

Soon after Mr. Sharif’s return to power, the Pakistani Government began to pressure the IPPs by refusing to cooperate in commissioning the plants, imposing a variety of unanticipated taxes and charges, delaying needed permits, and slowing fuel deliveries. Matters came to a head in early 1998, as the economic impact of the Asian financial crisis confronted Pakistan with additional unsought problems. In May, the Minister of Water and Power claimed “irrefutable proof” that IPP sponsors had paid bribes. Soon thereafter, seven power projects, including HubCo, received preliminary Notices of Intent to Terminate (“NIT”) their power purchase agreements.94 Each “NIT” (as these notices quickly became known in the international project community) contained identically worded charges of “kickbacks, over-invoicing and unlawful commissions” and “failure to maintain correct accounts and violations of the laws of Pakistan” but no details to support these assertions.95 Indeed, at no time throughout the Pakistani IPP crisis did the GOP release credible details of any of these corruption allegations, and each of the targeted project companies has denied the allegations and instead

93. See Hill, supra note 4.
94. Id.
95. Id.
claimed that the accusations were intended to intimidate the IPPs into reducing tariffs.

Although not directly part of this story, but crucial to understanding the international and fiscal environment in which the HubCo and Pakistani IPP crisis played out, in May 1998 India exploded nuclear devices and Pakistan responded with its own nuclear tests. These tests triggered mandatory U.S. sanctions, including an obligation on the part of the U.S. Government to seek to block "by voice and vote" most IMF, World Bank, and Asian Development Bank assistance to the testing countries. To the surprise of many, the United Kingdom, Western Europe, and Japan joined in blocking assistance from these multilateral institutions and limiting their own financial aid as a means of exerting leverage over Pakistan and India on non-proliferation issues. Since about forty percent of Pakistan’s state budget is funded by official aid from multilateral and government sources, the resulting dramatic slowdown in multilateral funding produced an acute foreign exchange crisis for Pakistan. Although the Western countries and Japan began to loosen restrictions when the potential for total Pakistani collapse became apparent, the country remained on a very short leash regarding access to assistance from multilateral financial institutions. Tensions between Pakistan and India remained high and, in May through July 1999, Islamic mujahadeen supported by Pakistani forces fought Indian troops in the Kargil incursion, leading Pakistan and India to the brink of war.

Once the GOP decided on a policy of pressuring the IPPs, HubCo came in for particularly egregious attentions. For a period of five days in May 1998, British executives of HubCo were confined to the power plant as de facto prisoners while armed police surrounded the facility and conducted a site search. The executives were released only after the British High Commissioner to Pakistan visited the site and protested the siege. Then, a number of HubCo executives were called in by the Ehtesab (the Accountability Bureau charged with investigating corruption). Others complained of armed men outside their houses at night. The Chief Executive Officer ("CEO"), a British expatriate, fled Pakistan along with several other senior HubCo officials. In October 1998, the Pakistani Federal Investigation

96. Id.
Agency ("FIA") raided HubCo’s corporate offices seeking evidence of corruption. The FIA took custody of HubCo corporate records and sought to arrest the new HubCo CEO, S. Khursaid Husain. The new CEO had been tipped off to the possible arrest and hid out for several days until "bail before arrest" was granted by the Sindh High Court.97

In parallel to these "on the ground" events, HubCo found itself in a number of litigation controversies. In May 1998, a consumer petitioned the Lahore High Court for relief, claiming that his power bill was too high because of corruption in negotiations over the HubCo power purchase agreement. The Lahore court issued a temporary order barring HubCo from making foreign remittances for payment of debt, dividends, or otherwise and reduced the monthly tariff rate from 7.2 cents to about 3.3 cents. Press reports captured the inattention to legal niceties by the Pakistani High Court: "Both orders were made to prevent undue harm to Pakistani consumers, said the court, which did not reach any findings on the corruption charges."98 On appeal to the Supreme Court of Pakistan, HubCo obtained partial relief from these orders—the company would be permitted to transfer foreign exchange outside Pakistan to pay its external debt but could not make dividends or other distributions to its foreign investors. The Pakistani Supreme Court also adjusted the tariff order of the Lahore High Court, moving it up to about 5.3 cents

97. Id. "Bail before Arrest" is a Pakistani procedure whereby the target of a criminal investigation can obtain an order of bail from a local court in advance of actually being arrested by the local authorities. This device is a novel notion that could develop a following in the United States with proper marketing. In a press interview, Husain showed a reporter a bail warrant alleging that in 1993 and 1994 Husain had employed fraud and corruption to procure HubCo’s power purchase agreement. Husain dryly noted to the reporter that until 1995 he had worked at an investment firm in London, which had no dealings with either HubCo or its principal sponsor. Id.

98. Id. This litigation before the Lahore High Court, of course, did not implicate the mandatory arbitration provisions of the project documents, as it was brought by an outsider to the contract pursuant to broad "public interest" jurisdiction of the Pakistani courts. Similar limitations on the protection afforded to investors by arbitration clauses became apparent in at least twenty separate lawsuits brought in India against the Enron-sponsored Dabhol Power project by labor representatives, politicians, community activists, environmental groups, and other opponents of that project. Like Pakistan, Indian law provides for "public interest" litigation. All of these cases were ultimately dismissed by the Bombay High Court or the Supreme Court of India, but only after two and a half years of continuing litigation. See Abhay Mehta, Power Play: A Study of the Enron Project, 117-20, 160-75 (2000). Abhay Mehta was one of the opponents of the Dabhol project and a plaintiff in the last lawsuit dismissed by the Indian courts.
per kilowatt hour (roughly sixty percent of the contract rate) while the lower court proceedings continued.\textsuperscript{99} All of these orders, of course, were inconsistent with the negotiated terms of the WAPDA power purchase agreement and made without detailed scrutiny of the corruption allegations.

In July 1998, HubCo invoked the arbitration clause of the WAPDA power purchase agreement and commenced ICC arbitration in London. In October of that same year, WAPDA informed HubCo that, after conducting an examination of the events leading to the execution of the three Bhutto-era amendments to the power purchase agreement, WAPDA had determined that the amendments “were illegal, fraudulent, collusive, without consideration, malafide and designed to cause wrongful loss to WAPDA and the GOP with consequential wrongful gain to HubCo as these documents were the result of criminal conspiracy,” and thus void ab initio and of no legal effect with regard to the rights and obligations of the parties under the power purchase agreement.\textsuperscript{100} Citing ambiguous language of the Supreme Court ruling, WAPDA unilaterally reduced its tariff payments to about 3.6 cents per KhW in November 1998 and demanded the refunding of Rp 16 billion as an overpayment, with eighteen percent interest.\textsuperscript{101} HubCo commenced suit immediately in the Sindh High Court, seeking an injunction restraining WAPDA from giving effect to these steps and from seeking resolution of the dispute in any forum other than ICC arbitration. The Sindh High Court issued an interim injunction preventing WAPDA from implementing its asserted determinations, but that order was ultimately not continued.\textsuperscript{102} In January 1999, WAPDA proceeded into Lahore High Court, arguing that the three amendments were unlawful and void and seeking an injunction against continuation by HubCo of the ICC arbitration proceedings. After a prompt hearing, the Lahore court granted the re-

\textsuperscript{99} See Hill, supra note 4. The actual history of litigation involving the HubCo project, of which the text is a mere summary, is highly complicated. See HubCo v. WAPDA, supra note 2, at 441-43, 446-47.

\textsuperscript{100} HubCo v. WAPDA, supra note 2, at 441.

\textsuperscript{101} Hill, supra note 4; HubCo v. WAPDA, supra note 2, at 441-42.

\textsuperscript{102} Peter Cornell & Arven Handley, Himpurna and Hub: International Arbitration in Developing Countries, 15 MEALEY'S INT'L. ARB. REP. 39, 41 (2000). The authors of this article practice with the law firm that represented HubCo in the ICC arbitration proceedings.
quested anti-arbitration injunction. In late January 1999, the Sindh High Court issued an order requiring the parties to ignore the injunction granted by the Lahore High Court. After a

103. Id. The HubCo dispute is not the only IPP transaction in which the Lahore High Court has failed to implement a mandatory arbitration provision. See U.S. Judge Stays $1.4 Billion Default Against Westinghouse, 14 MEALEY'S INT'L ARB. REP. 7 (1999). In WAK Orient Power & Light Ltd. v. Westinghouse Electric Corporation (E.D. Pa. Civ. No. MG-99-92), Transcript of Hearing reprinted in 14 MEALEY'S INT'L ARB. REP. F-1 (1999) [hereinafter Transcript of Hearing], the U.S. District Court for the Eastern District of Pennsylvania temporarily restrained WAK Orient Power & Light Ltd. from registering or seeking to enforce a sixty billion Rupee (over US$1 billion) default judgment obtained against Westinghouse and Raytheon entities. In 1995, WAK entered into a power purchase agreement with Karachi Electric Supply Corp. ("KESC"), the Karachi electricity utility, covering 450 MW of barge-mounted power plants at Port Qasim, Pakistan. WAK then entered into an Engineering, Procurement and Construction Contract ("EPC Contract") with Westinghouse and Raytheon, pursuant to which the two contractors undertook to construct the power facility. See Plaintiff's Memorandum in Support of Motion for Temporary Restraining Order, at 3-4, reprinted in 14 MEALEY'S INT'L ARB. F-13-14 (1999). The EPC Contract contained a mandatory arbitration clause providing for ICC arbitration in London. Id. at 4-5, F-14-15. Westinghouse apparently also entered into a further agreement regarding construction financing for the project. In addition, Westinghouse allegedly caused a US$11.5 million letter of credit to be issued in favor of WAK to support its contractual obligations. See Transcript of Hearing, supra at F-5. The proposed project failed to proceed, as WAK was unable to obtain construction financing. Westinghouse and Raytheon thereafter commenced arbitration proceedings under the EPC Contract. In turn, WAK began a court proceeding before the Lahore High Court, which rendered a sixty billion Rupee default judgment against the EPC contractors. The matter came before a U.S. District Court when WAK sought to enforce the default judgment in Pennsylvania. The U.S. Court enjoined recognition or enforcement of the Pakistani default judgment, pending further proceedings in Pakistan where Westinghouse had by now lodged an appeal against the default judgment. Id. at F-11-12. WAK's attorneys argued before the District Court that the Pakistani court proceedings related to the alleged construction financing commitment provided by Westinghouse, rather than the EPC Contract. Thus, according to WAK, the Pakistani litigation fell outside the scope of the arbitration clause in the EPC Contract. Westinghouse disagreed with this analysis of the contractual arrangements and court claims, and the U.S. District Court sided with Westinghouse pending further information about the litigation in Pakistan. Counsel for Westinghouse also raised during the hearing the prospect of judicial corruption in obtaining the Pakistani default judgment:

The judge, after six or eight months, without notice to us, entered a default judgment for over a billion dollars. We have prepared and filed an appeal of that judgment, which is clearly erroneous and improper.

A week before that judgment was entered in meetings that our clients had with the WAK principals, they said, if you don't give us the money we're entitled to, we're going to go get that judgment and we can get it any time we want — we're going to go get a judgment. And that's a declaration that's been put in the state proceeding [a proceeding in Pennsylvania state court by WAK to levy on property of CBS Corporation, as successor to Westinghouse], attesting to the implications of corruption associated with that allegation.

Id. at F-4.
variety of further applications and rulings, however, by February both the Sindh and Lahore High Courts had issued parallel orders restraining HubCo from pursuing arbitration. HubCo, having issued its own preliminary notices of intent to terminate the WAPDA power purchase agreement, petitioned the Supreme Court of Pakistan to review the Lahore and Sindh orders. The Supreme Court delivered its decision in June 2000.

A casual reader of the HubCo judgments issued by the Supreme Court of Pakistan could be forgiven for believing initially that HubCo had been successful in overturning the anti-arbitration injunction. The first judgment, by Acting Chief Justice Muhammad Bashir Jehangiri, covering forty-four pages in the original, is a detailed discussion of the case history, facts, and law applicable to the dispute. The judgment concludes that the HubCo-WAPDA arbitration agreement itself was freely entered into and valid regardless of allegations of corruption surrounding subsequent amendments. Moreover, the Acting Chief Justice noted that the proper law of the arbitration agreement was English law, the chosen law of the parties. Taking into account the doctrine accepted under both English and Pakistani law of separability of an arbitration clause from the remainder of an allegedly invalid contract, the Acting Chief Justice concluded that the allegations of invalidity of the WAPDA power purchase agreement were properly referred to ICC arbitration, and the Lahore court injunction should be lifted.

Only after finishing with the document, and reading at the bottom of the original the stamped words "NOT APPROVED FOR REPORTING," does it become apparent that the first document is only the minority judgment. In the following six-page

104. *HubCo v. WAPDA*, supra note 2, at 442.
105. See Majeed, *supra* note 92.
106. Cornell & Handley, *supra* note 102, at 41 n.100. A copy of the original judgment is available from the author upon request.
108. *Id.* at 455-56.
109. *Id.* at 451-53.
110. "It would thus be seen that allegations of invalidity even serious allegations of its being ab initio void are perfectly capable of being referred to arbitration." *Id.* at 451. "The ultimate analysis, therefore, is that [the appeal by WAPDA] is declared to have been rendered infructuous at the moment ... [The appeal by HubCo] is accepted and the impugned order ... of the High Court of Sindh ... and lift and recall the injunction preventing from proceeding with arbitration in ICC Arbitration Case No. 10045/OLG." *Id.* at 456.
majority judgment, by Justice Sh. Riaz Ahmad, the three-judge majority concluded that the anti-arbitration injunctions should be continued on public policy grounds. The bulk of the short judgment is devoted to a recitation of WAPDA's allegations of corruptions, as to which no findings of fact were of course ever made by the lower courts. The majority judgment fails to cite or to consider any doctrines of law or case law, including any of the Pakistani precedents discussed at length in the minority judgment. To the extent a rationale for upholding the injunc-

111. "Since these circumstances have been dealt with by our learned brother Muhammad Bashir Jehangiri, J in his proposed judgment, we need not repeat the same but the following salient features and circumstances noted by us have persuaded us to hold that these prima facie furnish evidence in support of the allegations made in respect of the disputed documents that the dispute is not arbitral as such should be decided by a Court of law as a matter of public policy." Id. at 457. The majority judgment further took note of several additional circumstances: (a) the absence of a revised schedule to the newly executed Supplemental Deed notwithstanding a reference to that schedule within the deed, (b) that certain portions of a schedule "were not signed by WAPDA but by Chief Economist of WAPDA," (c) that officers of WAPDA "left the service of WAPDA conveniently, one of whom was paid the huge amount of security which he provided at the time of joining service and joined the service of HUBCO at an exu-

112. The opinion of Justice Riaz Ahmad summarizes allegations by WAPDA as to (i) the "one sided benefit to HUBCO" of the increase in total project costs, (ii) the alteration of the debt-to-equity ratio from 80/20 to 75/25 which "allegedly burdened the WAPDA and gave undue advantage to HUBCO," (iii) the implementation of these modifications by amendments to the WAPDA power purchase agreement rather than being referred to experts as the WAPDA power purchase agreement specified for technical disputes, and (iv) the overruling of WAPDA's opposition to these changes by the Government after October 1993 elections restored Ms. Bhutto to power, "and it is not clear from the record how these hotly contested matters, for such a long time, were brought to an end suddenly and further for what considerations supplementary deed first amendment and second amendment were abruptly executed and so on whose be-

113. Compare the absence of any references whatsoever to Pakistani or English case law in the majority judgment with the extensive discussion in the minority judgment of English and Pakistani precedents on "separability" of an arbitration clause from other portions of an allegedly void agreement. See id. at 541-43 (discussing in minority opinion six Pakistani post-Independence precedents, four pre-Independence
tions is to be located in the majority judgment, it must be found in the following two sentences:

The allegations of corruption in support of which the above-mentioned circumstances do provide prima facie basis for further probe into matters judicially and, if proved, would render these documents as void, therefore, we are of the considered view that according to the public policy such matters, which require finding about alleged criminality, are not referable to Arbitration.

The disputes between the parties are not commercial disputes arising from an undisputed legally valid contract, or relatable to such a contract, for, according to the case of WAPDA on account of these criminal acts disputed documents did not bring into existence any legally binding contract between the parties, therefore, the dispute primarily relates to very existence of a valid contract and not a dispute under such contract.114

Thus, the Supreme Court of Pakistan upheld the anti-arbitration injunctions on the ground of public policy.115

The Supreme Court judgment appears to hold that allegations claiming a contract was procured through criminal con-

Imperial precedents, and two English precedents concerning the importance of the "separability doctrine"). Similar comparisons could be made regarding the respective degrees of attention given by the minority and the majority to Pakistani and English precedents concerning the proper law of the arbitration agreement, the appropriate scope of "public policy" as a bar to arbitration, the impact on arbitrability of allegations of corruption or fraud, and the scope of contractual submission to arbitration. In each case, the majority opinion either fails to discuss the topic at all or briefly states its conclusion without reference to any source of law. The absence in the majority judgment of any acknowledgment of precedents, let alone other authoritative or persuasive sources of law, is particularly striking in a court with a 50 year record of paying copious attention to its own prior rulings and rulings by British, Indian, and other common law courts.

114. Id. at 458.
115. Arbitration proceedings in the HubCo controversy did continue for a period of time after the Pakistani Supreme Court confirmed the anti-arbitration injunction, as shareholder Entergy Inc., not being a party to the Pakistani court litigation, pursued the proceedings. Entergy ultimately discontinued the proceedings without publicly stating a reason for its actions, but some observers link the discontinuance to the Supreme Court decision. Also, although HubCo subsequently applied to the Supreme Court for a review of judgment, that application was voluntarily dismissed pursuant to Section 4 of the Settlement Agreement made as of the 17th day of December 2000 among the GOP, WAPDA, and HubCo and finally resolving the dispute. See Naveed Anwar, December 17 Accord Payment Schedule: Pakistan to Pay HubCo $5.25 Million a Month, Bus. Rec., Dec. 23, 2000, available at http://www.brecorder.com; Majeed, supra note 92, at 437 n.13; Cornell & Handley, supra note 102, at 43.
duct are sufficient to support an injunction preventing arbitration of the resulting claim that the contract was void \textit{ab initio}.\footnote{As noted above, the majority judgment summarized the accusations made by WAPDA of improper conduct. The judgment did not, however, describe the standard of proof against which such unilateral allegations of fraud, corruption, or illegality should be tested as part of the process of determining whether the dispute is non-arbitrable. \textit{See} Majeed, \textit{supra} note 92, at 437. Hoping that the decision may be an aberration resulting from the highly politicized character of the HubCo dispute, that author has found a silver lining in the "incomplete reasoning" of HubCo v. WAPDA. "It may also be that this very omission has not closed the door completely on international arbitration in Pakistan." \textit{Id.}} As a factual matter, of course, this decision is especially surprising when the contract allegedly obtained through corrupt means was an amendment to the main contract, and the arbitration clause was located in the main contact, which was not the object of claims of criminal misconduct. The minority judgment raised the obvious issue: "[I]t is totally unclear how a valid contract can—itself—become contrary to public policy because of an allegation that a later amendment was the product of an illegal act."\footnote{Id. at 453. Even more oddly, the minority opinion notes that WAPDA accepted the validity of the arbitration agreement. \textit{Id.} at 451.}

Apart from the cart-before-the-horse nature of the application of the facts to the public policy argument, the majority judgment also neglected to discuss the perhaps inconvenient legal questions about the separability of the arbitration clause from the remainder of a challenged contract, the authority of arbitrators in the first instance to consider the scope of their own jurisdiction, the nature of the arbitration clause itself, or the parameters of a public policy analysis in this area. I will now turn to those concepts, and consider the practical impact of the Indonesian and Pakistani disputes.

As the HubCo minority judgment recognized, the separability doctrine asserts that an arbitration agreement is to be deemed independent of and separate from the contract within which it is contained.\footnote{\textit{See W. Lawrence Craig et al., International Chamber of Commerce Arbitration} 48 (3rd ed. 2000). This concept has been called "a conceptual cornerstone of international arbitration." \textit{Id.} The terms "separability," "severability," and "autonomy" are often used interchangeably as identifying this concept. Thus, the minority judgment in \textit{HubCo v. WAPDA} repeatedly refers to the separability doctrine. \textit{See} \textit{HubCo v. WAPDA}, \textit{supra} note 2, at 451-53. In contrast, the phrase "autonomy principle" is preferred by the authors of a leading treatise on ICC arbitration. While subtle distinctions might be discerned among the various titles bestowed on the doctrine, those distinc-}
rability principle, if a claim were presented to a judge that a contract dispute could not be heard in arbitration because the entire contract was void, the judge would be entitled to hear that argument.\textsuperscript{119} However, judicial intervention would be warranted only if the arbitration clause itself were asserted to be defective and invalid, not merely because it was part of a broader allegedly invalid contract. If the Court concluded that the autonomous arbitration provision was itself not affected by the alleged invalidity of the remainder of the contract, then the judge would be required by the separability doctrine to refer the dispute to mandatory arbitration in accordance with the autonomous arbitration clause.\textsuperscript{120} The minority in HubCo recognized this fundamental principle. The minority judgment asserted that "[u]nder English and Pakistan laws, Arbitration clauses contained in contracts are treated as separate and self-contained in that if it were not so, arbitration clauses would not at all survive attack on the main contract which is known as the doctrine of "separability."\textsuperscript{121}

The separability principle presumes that, even if the contract parties entered into an invalid contract, the parties nevertheless had a separate and enforceable intent that disputes should be resolved by a single forum, the arbitral tribunal.\textsuperscript{122} Such a legal fiction may be difficult to justify as a matter of logic.\textsuperscript{123} Nevertheless, the principle of an autonomous arbitration clause is considered bedrock of international arbitration, as otherwise the mere prima facie assertion of fraud in the inducement of a contract would operate to defeat the effectiveness of any arbitration clause. Eminent jurists and scholars have argued that broad international consensus on this autonomy doctrine exists,\textsuperscript{124} and supporting cases and legislation may be found in the United States, the United Kingdom, Switzerland, Sweden,
France, Germany, Russia, Belgium, and The Netherlands, as well as in the UNCITRAL Model Law on International Commercial Arbitration, which UNCITRAL claims has formed the basis in part for the arbitration laws of at least thirty-seven jurisdictions. Thus, if the separability principle had been applied in HubCo by the majority decision of the Pakistani Supreme Court, the court could have terminated the lower court’s anti-arbitration injunctions on the basis that the asserted invalidity of amendments to the WAPDA power purchase agreement did not undermine the effectiveness of the autonomous mandatory arbitration clause found in the original power purchase agreement. Interestingly, the minority judgment also took pains to conclude that, given WAPDA’s acceptance of the validity of the arbitration agreement in the underlying power purchase agreement, “no issue of ‘separability’ actually arises in this case.”

The minority also rejected the argument of WAPDA that an exception to the separability principle existed for contracts for illegal activities, quoting English case law that limited the claimed exception to such activities as a contract for cooperation between highwaymen, slavery, drug trafficking, or the sale of alcohol in Pakistan. The underlying power purchase agreement, said the Acting Chief Justice, “is a valid and entirely legal contract.”

In HubCo, of course, the power purchase agreement contained a contractual choice of English law as the applicable law, and English law recognizes the separability principle in both case law and in the English Arbitration Act 1996. By contrast, the Himpurna and Patuha energy sales contracts selected Indonesian law as the governing law. The Indonesian legal system has been described as “[o] ssified, opaque and unpredictable” and, if the conduct of the courts in the Paiton, CalEnergy, and similar cases is any indication, the separability principle is not accepted in practice by local jurists. Indonesia is, though, party

125. CRAG ET AL., supra note 118, at 50 n.15.
128. Id. at 452-53.
129. Id. at 453.
131. Patuha-PLN Final Award, supra note 2, at B-25.
to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention"), which states that "[t]he court of a Contracting State, when seized of an action in a matter in respect of which the parties have made [a written arbitration agreement], shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed."\textsuperscript{132} An argument can be made that this provision of the New York Convention itself embraces the separability principle, on the grounds that the phrase "the said agreement" refers solely to the written arbitration agreement. Thus, authority for a court to avoid referring a matter to arbitration is limited strictly to circumstances where the agreement to submit disputes to arbitration is itself void. However, contrary arguments can also be made from the text, and there is no indication that Indonesian courts have seriously addressed the question in published opinions.

Notwithstanding a general rule of separability, dicta in one well-known arbitration decision raises for consideration whether circumstances of proven bribery might be a special case in which the separability principle is not applicable. Professor Claude Reymond, the president of the ICC arbitral tribunal hearing the dispute between Westinghouse and National Power Corporation of the Philippines over a controversial nuclear power plant, remarked in a ruling on that matter:

There may be instances where a defect going to the root of an agreement between parties affects both the main contract and the arbitration clause. An obvious example is a contract obtained by threat. With regard to the impact of bribery, it would remain to be seen whether bribery, if proved, affects both the main contract and the arbitration clause and renders both null and void.\textsuperscript{133}

Professor Reymond’s observation is premised, though, upon proven bribery, not untested allegations as found in the Indonesian and Pakistani cases. He thus appears to presume an independent inquiry into the bribery allegations to have occurred

\textsuperscript{132} New York Convention art. II.3.

before the affected arbitration clause can be invalidated. Professor Reymond’s comment however is not inconsistent with a court-ordered stay of arbitral proceedings pending a judicial inquiry into the alleged bribery. If bribery going to the underlying creation of the main contract ought indeed be an exception to the general rule of separability, then the actions of the Indonesian and Pakistani courts may be construed as decisions to halt arbitration proceedings until the corruption allegations at issue were fully considered in a judicial forum. Still, the Indonesian and Pakistani courts did not require that the bribery allegations first be proven, but did assert a right to block deliberations by the arbitrators. The question accordingly arises whether it is the arbitral tribunal, or a court, that ought in the first instance consider such questions, or whether both forums may proceed on independent adjudication tracks.

The Pakistani Supreme Court concluded that the judicial system was the proper forum in which to consider the matter, and not the arbitration arbitral tribunal. Thus, by virtue of the injunction, the ability of the arbitrator in HubCo to examine their own jurisdiction was blocked. Certain of the litigation tactics of the State enterprises in HubCo, as well as the CalEnergy and Paiton controversies, are not so far removed from Western judicial precedents as to be wholly outside the mainstream of law in this area. The views of courts in Western countries appear to differ as the proper roles of the courts and arbitral tribunals in considering jurisdictional challenges in such circumstances. The general approach of U.S. courts to the timing of judicial intervention has been to permit an arbitral tribunal to proceed despite fraudulent inducement claims.\(^\text{134}\) The term “competence-competence” (literally, jurisdiction concerning jurisdiction) is often used to describe the principle under which an arbitral tribunal itself has the authority to decide whether it has jurisdiction to consider a dispute,\(^\text{135}\) although such authority may still be reconsidered by a court once a reviewable award has been rendered by the tribunal. The application of “competence-competence” doctrine may, however, have several different meanings.\(^\text{136}\) First, it may simply mean that, when a party claims an

\(^{134}\) See Park, supra note 81, at 91.
\(^{135}\) Craig et al., supra note 118, at 512.
\(^{136}\) Id. at 512-13.
arbitration clause to be invalid, the arbitrators need not halt arbitration proceedings and defer the issue exclusively to a court. The arbitrators would be entitled to proceed with their responsibilities, but a court may simultaneously consider the claim that the clause is invalid. Second, the phrase may refer to delaying judicial review of arbitral jurisdiction until after an award has been issued by the arbitral tribunal. The tribunal would consequently have an opportunity to consider its own jurisdiction before a judicial forum could address the point. Third, and only rarely, "competence-competence" may mean that the decisions of arbitrators as to their own jurisdiction are not judicially reviewable at all. In HubCo, the minority judgment relied on a number of Pakistani and English sources in apparent defense of the position that, where the arbitration clause is broadly written, courts must defer to the jurisdiction of arbitrators to decide the validity of a contract even in the face of challenges to the very existence of a legally binding contract. The minority further noted that any resulting award could, at the time of enforcement in Pakistan, be challenged "as to its validity on any ground whatsoever permissible under any Pakistani Law." The Acting Chief Justice, therefore, accepted "competence-competence," subject to review upon enforcement, but did not address challenges to arbitral jurisdiction in the Pakistani courts in circumstances in which enforcement occurs outside Pakistan. The majority judgment, of course, was silent on all of these issues.

The scope of judicial deference to the authority of arbitrators to determine their own competence is not well settled in the West. While U.S. courts have regularly deferred review of arbitral jurisdictions until after issuance of an award, the English courts have historically been more willing to intervene at an earlier stage. However, the recent English Arbitration Act 1996 ("English Act") appears to narrow this flexibility. Section 30 of the Act contemplates that the arbitrators may themselves decide the existence of a valid agreement to arbitrate and the matters properly submitted to arbitration in accordance with that agreement, while Section 67 entitles a court to review that decision

137. Id. at 452-53.
138. Id. at 456.
139. PARK, supra note 81, at 82.
140. CRAIG ET AL., supra note 118, at 558. The relevant part of the Act reads as follows:
in a subsequent court challenge to the jurisdictional determination.\textsuperscript{141} The English Act does, however, recognize the right of a party who is not participating in the arbitration proceedings to seek a court injunction on the ground that there is no valid arbitration agreement or that the subject matter is not arbitrable.\textsuperscript{142} The approaches taken by U.S. courts and by the English Arbitration Act thus permit the allegations of corruption or other fraudulent inducement to be tested first in the arbitration proceeding and only thereafter in a national court, unless the court action is brought by a non-participant in the arbitration. This procedural right afforded to non-participants by the English statute may be different, though, from the procedural right Pertamina sought to exercise by seeking injunctive relief from the Central District Court of Jakarta as a non-participant in the proceedings brought by Patuha and Himpurna against PLN and the Republic of Indonesia,\textsuperscript{143} as it is not clear whether the English Act affords a judicial forum to a party who, like Pertamina, is never named as a respondent in the arbitration by the claimant.

This difference, though, may be less important in a case where the non-participant is controlled by a participant, which appeared to the Tribunal to be the situation in the CalEnergy cases. The arbitral tribunal in Patuha and Himpurna was unpersuaded that Pertamina was not a participant in substance, holding that the Government had been in a legal position to control Pertamina and had failed to do so. The Tribunal noted that

\begin{enumerate}
\item unless otherwise agreed by the parties, the arbitral tribunal may rule on its own substantive jurisdiction, that is, as to—
\begin{enumerate}
\item whether there is a valid arbitration agreement,
\item ... ,
\item (c) ... what matters have been submitted to arbitration in accordance with the arbitration agreement.
\end{enumerate}
\end{enumerate}

English Arbitration Act ch. 23 § 30.

\begin{enumerate}
\item Craig et al., supra note 118, at 538-39. The English Act permits the Court proceedings about arbitral jurisdiction to be stayed only if the Court is satisfied that the arbitration agreement itself is not null and void, inoperative, or incapable of being performed. English Arbitration Act § 67.
\end{enumerate}

\begin{enumerate}
\item Section 72 of the English Arbitration Act states the following:
\begin{enumerate}
\item A person alleged to be a party to arbitral proceedings but who takes no part in the proceedings may question—
\begin{enumerate}
\item whether there is a valid arbitration agreement,
\item ... , or what matters have been submitted to arbitration in accordance with the arbitration agreement.
\end{enumerate}
\end{enumerate}
\end{enumerate}

English Arbitration Act ch. 23 § 72.

\begin{enumerate}
\item Patuha-ROI Interim Award, supra note 1, at B-8.
\end{enumerate}
Pertamina is constituted by law as a state enterprise, wholly owned by the Republic, and that its Board of Commissioners and Managing Directors serve by appointment of the President of the Republic. Moreover, the Tribunal concluded that the Republic's actual conduct offered no excuse from responsibility for the anti-arbitration injunction. Thus, "the Republic of Indonesia cannot be excused for an alleged inability to exercise its powers effectively . . . [and] the Republic of Indonesia has offered no proof of the slightest attempt to rein in Pertamina." The tribunal in the Indonesian cases appears to have reasoned that Pertamina was the alter ego of the GOI for purposes of holding a participant to its obligation to not interfere with arbitration proceedings to which it had voluntarily submitted.

Even more so than in the United States or the United Kingdom, the timing of intervention by European courts is flexible. The European Convention on International Commercial Arbitration provides that, if courts of a Contracting State are requested to rule on the question whether an arbitration agreement is null and void after arbitration has commenced, those courts "shall stay their ruling on the arbitrator's jurisdiction until the arbitral award is made, unless they have good and substantial reasons to the contrary." Thus, the European Convention begins at the same starting point as U.S. and U.K. precedents, by disfavoring judicial intervention. However, the European Con-

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144. Id. at B-29.

145. If a participant in an arbitration is responsible for conduct of controlled entities seeking to interfere with the proceedings, then logically controlled parties should also be within the scope of mandatory arbitration regardless of the actual terms of the arbitration clause. In Patuha and Himpurna, the contract negotiations sought to avoid this issue in part by prohibiting the contract parties (including Pertamina) from seeking judicial intervention: "no party shall have any right to commence or maintain any suit or legal proceeding concerning a dispute hereunder until the dispute has been determined in accordance with the arbitration procedure provided for herein and then only for enforcement of the award rendered in such arbitration." See Patuha-PLN Final Award, supra note 2, at B-4 (quoting § 8.3 of the ESCs). Interestingly, the District Court for the Southern District of New York in a recent decision involving a project finance transaction rejected an effort by the U.S. parent of a subsidiary, party to an arbitration agreement with an Argentina mining company, to compel the Argentine company to dismiss a court action against the parent in favor of arbitration under the mandatory arbitration clause between the subsidiary and the Argentine plaintiff. Minera Alumbrera Ltd. v. Fluor Daniel, Inc., 1999 U.S. Dist. LEXIS, at *6368 (S.D.N.Y. May 4, 1999).


147. European Arbitration Convention art. VI.3.
vention is explicit in recognizing that a court may intervene on jurisdictional issues prior to issuance of the award for "good and substantial reasons." The European treaty thus effectively establishes a rebuttable presumption in favor of delaying judicial intervention.

Several practical consequences of such a delay in judicial involvement should be apparent. Least controversially, the issue of ultra vires exercise of authority by an arbitral panel may be mooted by the panel's own determination that it lacks authority over the matter. More significantly, if court review of the authority of a panel to address a dispute is deferred until the enforcement phase of the dispute then, while enforcement may be refused in one State (for example, the host country in which the corrupt acts allegedly occurred), assets of the losing party may remain at risk of enforcement actions in other countries unless courts in those other countries give effect to the judicial determination of lack of arbitral jurisdiction by the first State. This is, of course, the risk to WAPDA left unaddressed in the majority judgment.

Such a situation raises the issue of international recognition of the jurisdictional decision of the court in the host country. Recognition of a court decision denying jurisdiction to the panel is an especially difficult question if the reviewing court is not located in the same State as the seat of the arbitration. The New York Convention entitles, but does not necessarily require, a court to refuse recognition and enforcement if the award "has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made." Accordingly, annulment of an award by a court at the seat of the arbitration, for example annulment of the awards against PLN by the Jakarta court, falls squarely within one of the enumerated defenses to enforcement under the New York Convention. As the quoted language makes clear, this defense extends to awards annulled by a court of the country under the law

148. Articles V.1 and V.2 of the New York Convention provide that "recognition and enforcement of the award may be refused by reason of one of the defenses enumerated in that Article. Id. art. V.1-2 (emphasis added). The equally official French version ("ne seront refusées") is more emphatic regarding the responsibility of the enforcement jurisdiction to decline to recognize or enforce an award falling within the terms of one of the defenses. See Park, supra note 81, at 76.
149. New York Convention art. V.1(e).
of which the award was made, and therefore the New York Convention also arguably contemplates deference to an annulment decision made by a court located in the jurisdiction of the choice-of-law clause in the contract.¹⁵⁰

A difference important to State and investors alike thus exists between the Himpurna and Patuha disputes, on the one hand, and the HubCo dispute, on the other. Recall that the PLN energy sales contracts in the Indonesian transactions specified Indonesian law as the governing law and provided that the seat of the arbitration would be Jakarta. Had the Central Jakarta District Court deferred its intervention unless after the issuance of the award, and then set the award aside for reasons of lack of arbitral jurisdiction or non-arbitrability, the successful claimants would have faced a difficult time enforcing their awards against PLN or the GOI in the courts of any State party to the New York Convention.¹⁵¹ In contrast, the WAPDA power purchase agreement in the HubCo transaction was governed by English law and the chosen situs of the arbitration was London. Unlike PLN, therefore, WAPDA would not have been able to employ the quoted provision of the New York Convention to block enforcement in third countries of an award in favor of HubCo. The potential, accordingly, exists for a race among litigators in the host State seeking a decision that the arbitral panel acted outside its authority and litigators in another State in which valuable assets are found seeking to realize on the arbitral award before it is voided by the first State.

These U.S., English, and European approaches might not offend the sovereignty of a State whose interest in a dispute is confined to passively serving as the seat of the arbitration proceedings. It is easy, though, to see greater sensitivity on the part of a reviewing court (whether the impulse be pure or self-interested) when the alleged corruption involves State authorities of


¹⁵¹. The claimants in Patuha and Himpurna looked to their equity political risk insurance policies for recovery rather than enforcement actions against PLN or GOI assets. The choice of Jakarta as the arbitral seat, therefore, had no impact on the recovery strategy of CalEnergy, and similar enforcement considerations could influence the negotiating position of insured investors in other project transactions regarding the location of the arbitral seat. See infra note 178 and accompanying text.
the home country. Regardless of how inappropriate the anti-arbitration injunctions might have been as a matter of law, it is not surprising that the Indonesian and Pakistani courts would consider intervening in disputes involving allegations of corruption with respect to public contracts and national programs, rather than leaving issues affecting public policy to be addressed in the first instance by international arbitral panels. These host State concerns would undoubtedly persist even if persuasive legal arguments could demonstrate that an enforcing jurisdiction would give effect to a court decision in the host State voiding the award on grounds that a dispute related to corruption allegations is not arbitrable in the host country. In contrast to national court proceedings almost everywhere, the intended neutrality of sentiment in arbitration undermines the prospect that local public policy perspectives constitute the framework within which the dispute is resolved. Moreover, the confidentiality of arbitration limits transparency and thus accountability for decisions on issues of public morals and effective governance.

Neither separability nor "competence-competence," however, occupied the attention of the Supreme Court of Pakistan in *HubCo. v. WAPDA*. Instead, notions of public policy dominated the thinking of that Court. The Pakistani Supreme Court intervened because "according to the public policy such matters [allegations of corruption], which require finding about alleged criminality, are not referable to Arbitration." By employing public policy interests to stay the HubCo arbitration proceedings, the Pakistani Supreme Court effectively asserted the primacy of Pakistani public policies regarding criminality as a factor overriding respect for the independence of arbitration institutions. Pakistan and Indonesia are, of course, not alone in applying public policy concerns to limit arbitration as a dispute settlement procedure. Ordinarily, though, matters of public policy become issues at the time of recognition and enforcement of arbitral awards, rather than arising as issues of original jurisdiction. To clarify the limits of the notion of public policy itself, it is nevertheless helpful to review the use of public policy, and its sister defense of non-arbitrability, to vitiate arbitral awards at the enforcement stage.

The New York Convention's public policy and non-arbitrability defenses to enforcement of arbitration awards "serve as an explicit catch-all for the forum's particular substantive public
Thus, the New York Convention explicitly authorizes a court in an enforcing country to refuse recognition and enforcement upon finding that "[t]he recognition or enforcement of the award would be contrary to the public policy of that country." However, the public policies contemplated by this provision of the New York Convention are those of the country where recognition and enforcement is sought, not the public policies of the host State of the investment. If HubCo had sought to enforce an award in Pakistan, of course, then the local courts would be authorized by applicable Pakistani law to apply Pakistani public policy principles in considering whether or not to permit HubCo to realize on the award. If, instead, HubCo sought to enforce an arbitral award against assets of WAPDA or the GOP in another New York Convention country, the court in that third country would consider its own public policies (not Pakistani policies) in determining if the public policy defense was available to refuse enforcement. The New York Convention, therefore, acknowledges the role of public policy in guiding the conduct of the enforcing State, but does not accord similar acknowledgment to the public policies of the State hosting the investor.

Utilizing public policy arguments as a shield against arbitral awards is most effective to a host State if the role of public policy in judicial decision-making is broadly conceived. However, U.S. and European cases generally limit the use of the public policy defense narrowly, out of concern that broad invocations of public policy could undermine the perceived advantages of a neutral arbitration forum. Thus, the Second Circuit has criticized a broad reach of the public policy defense in the following terms: "to read the public policy defense as a parochial device protective of national political interests would seriously undermine the Convention's utility." Instead, the court lim-

152. PARK, supra note 81, at 87. Note that the European Convention on International Commercial Arbitration does not incorporate a public policy defense to recognition and enforcement of awards, but does authorize refusal of recognition of an arbitration agreement if under the law of the enforcement forum the dispute is not capable of settlement by arbitration. European Convention on International Commercial Arbitration art. VI.2. See also PARK, supra note 81, at 130.
153. New York Convention art. V.2(b).
154. PARK, supra note 81, at 99.
ited the defense solely to breaches of "the forum state's most basic notions of morality and justice."\textsuperscript{156} To the contrary, opponents of a narrow reading of the public policy defense argue that a restricted notion of public policy "threatens the legitimate regulatory policies of both developed and developing countries."\textsuperscript{157} Such criticisms are not made solely by advocates of protection for developing countries such as Indonesia and Pakistan. In North America, the investor-State arbitration provisions of the North American Free Trade Agreement ("NAFTA") and the World Trade Organization have recently come under attack by environmental activists and others. Those activists have been angered by such decisions as the award in \textit{Metalclad Corporation v. United Mexican States},\textsuperscript{158} which upheld an indirect expropriation claim under NAFTA by a U.S. investor in a Mexican landfill project on the basis that regional and local Mexican government authorities had denied a local environmental permit without authority and improperly taken other steps to prevent the landfill site from being developed. Whether the opposition to arbitration consists of local interests in developing countries or international environmental activists, in each situation critics fear the ability of an "unaccountable, non-transparent" independent arbitration panel to ignore policy and political concerns of local authorities in favor of giving strict effect to the negotiated terms of a contract that later proves disadvantageous to local public interests. Such concerns are not unwarranted. It is in fact likely that the complicated governing law provisions in the Himpurna and Patuha energy sale contracts authorizing the Tribunal to depart from strict rules of Indonesian law when considered to be inconsistent with the spirit of the contract and the underlying intent of the parties,\textsuperscript{159} were in part intended to limit the ability of the Indonesian side to use the power of local law and regulation to undermine negotiated contract terms.

Public policy concerns are covered not only by the public

\textsuperscript{156} \textit{Id.}

\textsuperscript{157} PARK, \textit{supra} note 81, at 99 (quoting Armfelt, \textit{Avoiding the Arbitration Trap}, \textit{Fin. Times}, Oct. 27, 1992, at 17, cols. 1-4).

\textsuperscript{158} \textit{Metalclad Corporation v. United Mexican States}, (Aug. 2000), \textit{available at} http://www.naftaclaims.com. Activists have also objected to a string of decisions by World Trade Organization arbitral panels limiting the scope of environmental regulations that affect international trade.

\textsuperscript{159} See \textit{supra} note 18 and accompanying text.
policy defense, but by the "non-arbitrability" defense as well; "[t]he subject matter of the difference is not capable of settlement by arbitration under the law of that country." Like the public policy defense itself, the scope of the non-arbitrability defense also has the potential to be extremely broad; it is hard to conceive of a law that does not affect the interests of society at large. Thus, claims of non-arbitrability by reason of public policy concerns or statutory occupation of the field can be made in any area of legislative or regulatory enactment. Here too, though, the New York Convention is clear that the public policies at issue are those of the enforcement forum. Parties seeking to block arbitration therefore look to national laws and national courts to employ host-State authority to withdraw disputes from arbitral jurisdiction. In the United States, respondents in arbitrations have argued to courts that a host of issues are non-arbitrable; among them claims related to antitrust law, securities regulation, commodities futures regulation, truth in lending, civil rights, franchise statutes, patents, and bankruptcy. While "judicial suspicion of arbitration may have seen steady erosion since the mid-1970's, particularly with respect to contracts containing an international element," consumer advocates, environmental organizations, and human rights groups in the United States and other Western countries have instead grown more suspicious of arbitration as a system "captured" by pro-business elements. Outside the wealthy West and Japan, it is perhaps more accurate to say that suspicion of the "pro-foreign" and "pro-investor" bias of the independent arbitration process has always been high and is given expression in decisions such as HubCo and the various anti-arbitration injunctions issued by the Indonesian courts.

The foregoing review establishes two fundamental points. First, a substantial risk exists that courts in developing countries will intervene to halt arbitration of disputes between investors and public authorities of that country, particularly in circumstances of pervasive economic and political turmoil and corruption. Second, even Western jurisprudence on arbitrability issues is sufficiently flexible to accommodate interference by Western courts. Some may argue in favor of such a result, granting ulti-

161. So too, the European Convention on International Commercial Arbitration with respect to non-arbitrability of disputes. See supra note 152 and accompanying text.
162. PARK, supra note 81, at 98.
mate control of issues affecting the public exclusively to public institutions. Others, like the author, remain concerned with the reliability and accountability of public authorities in weak States, whether because of possible corruption or political influence on the local court system or because of the absence of experience with the best political and commercial practices. 163

Is arbitrability a fiction in these circumstances? If, as seems too often to be the case, rampant misconduct in a weak State assures that virtually every large public contract is at risk of corruption claims, will the presence of non-frivolous allegations of corruption effectively prevent foreign investors from obtaining the benefit of a neutral arbitral tribunal? To answer "yes" requires concluding that courts in many States of the world would react as have courts in Indonesia and Pakistan to the role of arbitral panels in deciding issues of great national sensitivity. Such a bleak conclusion may be an overgeneralization, failing to take account of the wide differences among the many countries in the developing world. It may also fail to take account of steps that project sponsors can take to mitigate the risks that local courts will intervene in arbitration proceedings without cause. It is worthwhile to consider the tools available to contract negotiations before reaching such a harsh determination.

While it should go without saying that a properly drafted arbitration clause is the first step, it must sadly be admitted that too many arbitration clauses in international project financings are drafted without an understanding of the potential limits to arbitrability. Care needs to be taken to assure that the language describing the scope of the potential disputes to be submitted to arbitration is sufficiently broad to encompass claims that the transaction was fraudulently induced by corrupt means or otherwise entered into in violation of applicable law. From the investor's perspective, there is no virtue in offering a local court the opportunity to claim that such a dispute falls outside the intent of the parties and the negotiated terms of the arbitration clause.

The question of whether or not parties to a particular arbi-

tation provision intend to cover claims of fraudulent inducement of the contract has been described as turning on "eye-crossing subtleties." While it is not clear exactly what the Pakistan Supreme Court meant in HubCo. v. WAPDA by commenting that "[t]he disputes between the parties are not commercial disputes arising from . . . [a] contract, or relatable to such a contract . . ., therefore, the dispute primarily relates to a very existence of a valid contract and not a dispute under such a contract," it is at least possible that the majority judgment sought to claim that disputes about criminal acts inducing creation of project documents fell outside the agreed terms of the arbitration provision. WAPDA's counsel did indeed argue "that the parties arbitration clause was of limited scope, inasmuch as it applied only to the meaning and interpretation of the agreement between the parties, its effect and its alleged breach by one or other of the parties." If such an argument was accepted by the Court, however, it does not appear consistent with other efforts to interpret similar language, as was recognized by the minority judgment. In the minority, the Acting Chief Justice stated that "learned counsel for HUBCO repelled the contentions of learned counsel for WAPDA" and recited with apparent approval the opinion of HubCo's counsel that "as a matter of English law, this arbitration clause is extremely broad in its scope and covered disputes well beyond the limited range suggested by WAPDA." The negotiated arbitration clause in the WAPDA power purchase agreement covered "any dispute or difference of any kind whatsoever . . . between WAPDA . . . and the Company in connection with or arising out of this Agreement . . ." That clause is slightly broader than the ICC Model clause, which encompasses "[a]ll disputes arising out of or in connection with the present contract." The phrase "in connection with," which is not mentioned in the portions of the HubCo majority judgment quoted above, covers a wide array of issues. Thus, the

164. PARK, supra note 81, at 107 n.460.
165. HubCo v. WAPDA, supra note 2, at 458 (emphasis added).
166. Id. at 450. Cf. supra note 65 and accompanying text for similar arguments by PLN in Paiton Controversy.
167. Id. at 450-51.
168. See HubCo v. WAPDA, supra note 2, at 444 (quoting Clause 15.2 of WAPDA power purchase agreement).
169. See CRAIG ET AL., supra note 118, at 88.
Supreme Court of India has held the phrase "arising in connection with" to be "of the widest amplitude and content and include[s] even questions as to the existence, validity and effect (scope) of the arbitration agreement."170

The arbitration clauses in Himpurna and Patuha, in contrast, employed phrases that might have created unnecessary problems of arbitrability. Section 8.2 of the ESCs, you will recall, covered "[d]isputes, if any, arising between PLN on the one hand, and PERTAMINA and/or COMPANY on the other hand, relating to this Contract or the interpretation and performance of any of the provisions of this Contract."171 In U.S. jurisprudence, such phrasing might be construed more narrowly than the HubCo clause. Thus, the Second Circuit has held that arbitration clauses in sales agreements using the words "arising under" or "relating to" did not extend to a tortious interference claim based on an allegation that an executive officer of the buyer had been bribed to approve inferior goods,172 although it did cover related fraudulent inducement, bribery, unfair trade practices, unjust enrichment, mail and wire fraud, and RICO claims.173 In another Second Circuit decision, the majority concluded that the phrase "any question or dispute arising or occurring under the contract" was broader than another clause covering "disputes or controversies under or arising out of the contract," and that the former phrasing would reach claims of fraudulent inducement while the latter would not.174 In contrast, the dissenting opinion found no meaningful difference between the two formulations, but would have held the fraudulent inducement claim non-arbitrable in both cases.175 The Fourth Circuit has interpreted the ICC-recommended phrase "in con-

170. See id. at 88 (quoting Renusagar Power Co. (India) v. General Electric Co. (U.S.)). As noted in the minority judgment of HubCo v. WAPDA, the courts of Pakistan have also employed this phrase—the "widest amplitude and content"—to uphold arbitrability of a dispute over proper authorization of a contract containing a submission to arbitration covering "any dispute in respect of interpretation of the agreement or concerning anything contained therein." See HubCo v. WAPDA, supra note 2, at 452 (citing Lahore Stock Exchange Limited v. Frederick J. Whyte Group (Group) Pakistan & Others (PLD 1997 SC 48)).

171. Patuha-PLN Final Award, supra note 2, at B-4.


173. Id. at 847-56.


175. Id. at 197.
nection with this Agreement” broadly to cover “every dispute between the parties having a significant relationship to the contract regardless of the label attached to the dispute.” To the contrary, the Ninth Circuit has held fraudulent inducement claims of a contract associated with the central contract to be outside the scope of the expression “arising hereunder.” Eye-crossing subtlety, indeed.

The lesson, perhaps, is that contract drafters should embrace broadly written provisions such as found in the WAPDA power purchase agreement, but that drafting skill alone cannot prevent a determined court from holding that fraud or corruption allegations render a dispute non-arbitrable.

A second issue is created by the choice of the situs of the arbitration itself. The location of the arbitration did not affect the local court decisions in HubCo, nor, in the end, did it affect the conduct of the two non-Indonesian arbitrators in Himpurna and Patuha. Still, the seat of the arbitration in the Indonesian disputes was Jakarta and the chosen governing law was Indonesian law. As noted above, the recognition and enforcement of any resulting award may be refused by courts applying the New York Convention if the award has been annulled by a court “in the country in which, or under the law of which, that award was made.” The responsibility of an enforcement court to give effect to an annulment of an award by a court at the arbitral seat should therefore be carefully considered by contract drafters. It has become more common in international project financings to accept host country situs for arbitration proceedings. Acceptance of host country situs has occurred particularly where, as is the case with the new Indian arbitration act, the proceedings will be considered under local law as an international arbitration notwithstanding the domestic situs. The resulting award would thus be entitled to the benefit of the enforcement provisions of the New York Convention.

Clauses submitting to local arbitration at host country seats are found in a number of Colombian infrastructure projects and

177. Mediterranean Enters., Inc. v. Ssangyong Corp., 708 F.2d 1458, 1463-65 (9th Cir. 1983).
elsewhere in Latin America, in several recent power purchase agreements for Indian projects, and under a large number of telecommunications concessions worldwide. As many of these projects have been financed on a limited recourse basis in the bank or institutional investor markets, local arbitral sites have passed the acid test of "financeability." Where the choice of the seat of the arbitration is a matter for negotiation, once assured that local law will treat the arbitration proceeding as an "international arbitration" for recognition and enforcement purposes, few investor’s counsel consider the implications of such a choice on enforceability of an eventual arbitration award in third countries. As many of the local obligors in those transactions do not have significant attachable assets outside the host State, it is also possible of course that investor parties have made a conscious decision to forego the broadest enforcement options in light of a determined negotiating position on the part of the local obligor. That would not, however, seem to have been a likely approach in the Indonesian disputes. Indonesia is a petroleum-exporting country, and the GOI and Pertamina (the national oil and gas monopoly) were both parties to project documents in these transactions. Litigators, therefore, would see prospects for enforcing awards against receivables owing to the Indonesian State on account of petroleum transactions. Similar opportunities exist whenever the State itself is an obligor and thus a variety of offshore assets exist. Equally, third country enforcement prospects should be kept in mind when the project generates hard-currency revenues.

The situation faced by Professor Priyatna in the Indonesian cases also raises an issue for contract negotiation. As an Indonesian national, Professor Priyatna was presented with serious personal risks in disregarding the injunction of the Central Jakarta District Court. While the other two arbitrators, Mr. Paulsson and Mr. de Fina, acted firmly in moving forward with hearings at the Peace Palace, the courage of Professor Priyatna in traveling to The Hague in an effort to attend the hearings demonstrates a level of commitment and responsiveness one cannot blithely anticipate of arbitrators, no matter how professional. To limit the risk that an improperly conceived local injunction can impede proceedings outside the host country by preventing the participation of a local arbitrator, it may be prudent to include in the arbitration clause a requirement that none of the arbitrators be
a national of the country of any disputant. Thus, the WAPDA power purchase agreement provided that "[n]o arbitrator . . . shall be a national of the jurisdiction of either party to this Agreement or of the jurisdiction of any of the Initial Shareholders." Such a rule has occasionally been incorporated into arbitration agreements as additional assurance of the neutrality of the arbitrators, but the risk of anti-arbitration injunctions is yet another reason to include the clause in arbitration provisions.

Merely selecting arbitrators from outside the host country, however, cannot affect the more obvious points of jurisdictional contact with that State; the nationality and location of assets of the project company and various other project participants. Many countries require that only locally-incorporated entities own or operate major infrastructure projects, and the principal tangible assets of an infrastructure project are usually found within the host State's territory. While project counterparties such as a power purchaser are invariably locally-organized, an arbitral tribunal may be willing to ignore the impact of the injunction on those entities if they are State-owned, reasoning as did the arbitrators in Himpurna and Patuha that the host government de facto and de jure controls the conduct of those entities. However, the risk to a project company of disobeying a local injunction is much higher. In such circumstances, the project company, its sponsors, and its international lenders must be prepared to abandon local assets and risk large fines on the company and even imprisonment for its officers and employees.

Why did the CalEnergy-sponsored projects take those risks, when the HubCo investors did not? One difference between HubCo, on the one hand, and Himpurna and Patuha, on the other hand, can easily be identified; US$290 million of equity political risk insurance issued by reliable insurers outside the host State. The decision by CalEnergy to risk the loss of power plant assets inside Indonesia in favor of recovery on the insurance policies is a simpler, though by no means easy, calculation than the difficulties faced by the international investors in HubCo. The decision to pursue arbitration must necessarily

179. HubCo v. WAPDA, supra note 2, at 445 (quoting Clause 15.4(d) of power purchase agreement).
180. Cf. Patuha-PLN Final Award, supra note 2, at B-22 (discussing PLN's unsuccessful argument that Indonesian law permitted only Indonesian-incorporated entities to participate in power production activities in that country).
have involved a decision to risk the loss of the power plants in Indonesia in favor of a more valuable asset, an arbitration award effectively entitling the investors to realize on the political risk policies. We may speculate that, without access to those insurance policies, the Himpurna and Patuha arbitrations might not have continued in the teeth of the local anti-arbitration injunction and related fines. Had the anti-arbitration injunction been issued before PLN’s liability became clear in the first set of arbitration, moreover, the investor’s balance of risk and reward might have shifted against continuing the proceedings.\textsuperscript{181} Thus, the Indonesian disputes illustrate the value of political risk insurance and illustrate as well the importance of moving swiftly in the arbitral proceedings to a decision on the merits.

The investors are not the only project parties faced with the need to balance these risks. So too are the host country actors. The governments of Pakistan and Indonesia both had to consider the risk that “[w]hatever its short-term benefits, using public policy as an excuse to disregard freely-negotiated obligations will chill future infusions of wealth-creating capital and technology, and may backfire to inhibit international commercial and financial cooperation.”\textsuperscript{182} The decision by President Wahid in

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{181} A point that might very well have motivated PLN to strike first in the Paiton controversy by seeking court protection before the project company could commence arbitration.
\item \textsuperscript{182} P:\textit{ark}, \textit{supra} note 81, at 140. The arbitrators in Patuha and Himpurna argued similarly:
\begin{quote}
However tempting it may be in the context of a particular case for a public-sector respondent to seek relief from liability by invoking illegality, the fact is that such a posture puts into question the reliability of undertakings of the country in question. When a country’s reputation as a contractual partner suffers, the terms on which it is able to attract foreign investment and financing are impaired. Indeed, this concern goes beyond whatever cost/benefit calculations might be made by the officials of a particular country at a particular time, because an over-readiness by international arbitrators to accept illegality defenses may harm an international mechanism which benefits numerous countries that rely on access to international funding, technology, and trade.
\end{quote}
\end{itemize}
\end{footnotesize}
the Paiton controversy to order PLN to withdraw its court case against the project company, in apparent recognition of the consequences of angering the U.S. and Japanese governments and their important multinational corporations at a time when those governments were necessary to Indonesian economic diplomacy, is perhaps a demonstration of that process at work. However, the Paiton example merely offers a case in which both the local litigation and the international arbitration were halted through political intervention in favor of negotiations. That same political intervention produced an interim agreement enabling the project company to continue to cover operating expenses and service interest on its debt, but like other Indonesian IPPs there is no indication that the Paiton dispute is near a long-term solution.

For many investors the speed of political intervention may seem glacial as the uncovered costs of a project in dispute (principally interest accruing on project loans and foregone equity distributions) increase throughout the suspension period. Thus, in Indonesia the initial decrees postponing projects were issued in December 1997 and January 1998 but, as this Essay goes to press in April 2001, no major fully-constructed IPP in Indonesia has yet finalized renegotiations with PLN. Just the unpaid interest costs of deferring a project’s revenue stream for thirty-six months creates large financial consequences. For example, simple interest of six percent per annum on, hypothetically, US$200 million of limited recourse loans during this period would increase project costs by at least US$36 million without regard to the impact of any compounding, all without any obvious source of revenue to cover those increased costs. If that project has a fairly common seventy-five to twenty-five percent debt-to-equity ratio, the impact of that increase in liability effectively destroys the equity returns to the project’s shareholders. Further, interest rate caps that expire during the extended period are difficult for a troubled project to renew, and thus lenders and investors may face substantially increased interest rate fluctuation risks.

The dispute between HubCo and WAPDA over the Hub project also is a case study in delay. That transaction erupted commercial lenders and other investors back into recently unstable markets much more promptly than observers might have expected at the time of the initial interference.
into commercial and political warfare in May 1997 and a final renegotiation was not concluded until December 2000. No dividends were paid to shareholders during that three and a half year period, although the Pakistani courts did permit debt service to continue. Still, another possible illustration of the ultimate recognition by a host country of the disadvantages of driving away investment capital is the provision of the Settlement Agreement among HubCo, WAPDA, and Pakistan ("Settlement Agreement") by which the parties "recognize each other's right to seek arbitration in accordance with the agreed dispute resolution mechanism contained in the Relevant Contract Documents within the applicable legal framework."

Although it is easy to conjecture that the phrase "within the applicable legal framework" was an addition required by Pakistan and WAPDA to preserve the array of tools afforded by the Pakistani legal system, the clause demonstrates the importance to HubCo of obtaining Pakistani recognition of arbitration as the proper dispute resolution mechanism. The presence of the clause in the Settlement Agreement also demonstrates the willingness of Pakistan's post-Sharif military government to grant that recognition as part of an economic bargain reducing the project's tariffs.

Like the Paiton dispute, political intervention also characterized the HubCo controversy, most notably from the World Bank; the IMF; and the U.S., Japanese, German, and U.K. governments, among others. Yet, at least thirty-eight months passed before the project and the GOP composed their differences. The limited effectiveness of political pressure on Pakistan should not surprise the reader. The multilateral financial institutions and the capital-exporting countries applying that pressure were torn by competing interests; among them, the need to assist Pakistan to regain economic stability, fears of inadvertently triggering either military confrontation with India or fundamentalist upheaval within Pakistan, the drive to increase transparency and

183. Section 3(b) of Settlement Agreement among HubCo, WAPDA, and Pakistan, as quoted in Anwar, supra note 115.

184. It may be too severe to characterize the effectiveness of the pressure as limited. Instead, it might be more accurate to describe that pressure as operating on a time scale far slower than might be hoped by project investors and lenders. Although only an opening of Pakistani records could prove the case, it is quite possible that but for concerted political pressure by the multilaterals, Western governments, and Japan, the consequences to HubCo would have been far worse.
reduce corruption in emerging markets, maintaining the integrity of the market-economy system of international investment, and the responsibility to assist in preserving the security of international investment in order to promote economic development. For the World Bank and the IMF, cutting off credit to the Government of Pakistan as a lever to compel Pakistan to respect the terms of the IPP contracts risked total disintegration of the Pakistani economy and the failure of the raison d’etre of these organizations to participate in Pakistani affairs. Equally, the U.K., Japanese, and German governments recognized that, given Pakistan’s lack of foreign exchange reserves, the only source of vital hard currency to cover WAPDA’s tariff obligations to the IPPs and Pakistan’s current trade obligations was fresh funds from the IMF and World Bank. Sharing the concerns of those institutions and governments, the United States was even more conflicted as it also was the only power capable of talking Pakistan and India away from nuclear confrontation. Thus are the strong made weak.

If local justice is uncertain and political pressure does not prove to be the simple swift answer to a lack of respect for contract clauses, then project sponsors must look to their own devices for protection. Those without the desire for, or access to, equity political risk insurance will consider whether means exist of altering the incentives embedded into the project transaction to encourage host States to comply with contract obligations and arbitration clauses. However, realigning economic interests does not always succeed in inducing moderate conduct. States that have made the decision to cease paying tariffs or otherwise honoring project obligations have also made the decision to forego the services purchased by compliance with those obligations, in this case the electricity generated by the power projects. In making that choice, both PLN and WAPDA were undoubtedly influenced by the recognition that, in light of the financial crises in their respective countries, an over-supply of power would now exist in their countries for several years. Absent constraints created by a crisis of insufficient power, the long-held anti-IPP sentiments of these monopoly State utilities and their employees were free to rise to the surface again. Accordingly, State power utilities in neither country had a positive incentive to cooperate.

It has also been important to investors to structure their transactions in a manner that compels the involvement of other
crucial public actors in the host State at times of dispute. These investment arrangements are often structured to impose a cost on other important local participants if the Ministry or utility most closely connected with the transaction engages in scorched earth tactics. It may also well serve project investors to consider building into their project structures a means of imposing on the defaulting party a material economic penalty as the price for non-compliance with arbitration clauses. One possible vehicle for this approach is to expand the scope of standby letters of credit issued by host State counterparties under project documents and concessions, so that the letters of credit secure compliance with submissions to arbitration, not solely tariff and other financial commitments. For such a course to be effective, however, the letter of credit obligors must be located outside the reach of local court action and, arguably, outside the reach of local political threats as well. Such letters of credit are often of a size sufficient to gain the attention of senior government officials seated at the Ministry of Finance rather than whichever sectoral Ministry holds the keys to cooperation with the project. Another potential device is to require the Ministry of Finance to issue directly to supporting Western governments financial assurances of economic and commercial performance by other State entities of project document obligations. Like political pressure, the effectiveness of these devices may also be limited. So, for example, the contingent liabilities created by the Pakistani counter-indemnities in favor of the World Bank and JEXIM in the HubCo transaction did not necessarily moderate the conduct of WAPDA or the GOP. Similarly, existence of the MoF Letters in the Indonesian cases was not an obvious source of cool water to douse hot flames of emotion and turmoil. Spreading

185. See Hill, supra note 4 (arguing that HubCo's decision in September 1999 to make claims leading to call on World Bank partial risk guarantee "set the full might of the World Bank and the IMF into action to settle both the HubCo and the wider IPP issues"). Hill was perhaps premature. As events ultimately developed, another 14 months would pass after that article was published before the Settlement Agreement ended the HubCo dispute. While perhaps swift by sovereign and multilateral standards, that pace of negotiations is painfully slow and costly by commercial standards. Moreover, access to the World Bank's partial risk guarantee is not assured. The terms of the guarantee compel the beneficiary to demonstrate that the project company's payment default on its covered loan was directly caused by breach of contract by the host State. The World Bank may require an arbitral award supporting that determination prior to making payment under the guarantee. Such a process is, of course, lengthy and uncertain.
the pain towards the most important host government authorities does not appear to be a silver bullet for these problems.

Letters of credit, and other devices for reallocating risk that may be created through the ingenuity of investors and their counsel, are thus not likely to eliminate the problems faced by IPPs in countries like Indonesia and Pakistan; not when the underlying causes are economic and political upheaval, rampant corruption, weak States, and contracts that allocate the risk of adverse macroeconomic events solely to the account of such States. It may, therefore, be the case that, in the end, arbitrability is indeed a fiction in such circumstances.