INTERNATIONAL COMMERCIAL ARBITRATION AND STATES AND STATE-CONTROLLED ENTERPRISES: SOME COMMENTS ON A RECENT ICC CONFERENCE

CHRISTOPHER R. SEPPALA*

International commercial arbitration involving states and state-controlled enterprises is an important subject to lawyers engaged in international construction as so many international construction contracts are signed with state enterprises and provide for the settlement of disputes by arbitration.[1] This subject was one of the themes of a conference held by the Court of Arbitration of the International Chamber of Commerce (I.C.C.) in Paris from 11 to 13 October 1983, to celebrate the Court's sixtieth anniversary.

Prof. Dr. Karl-Heinz Böckstiegel of the University of Cologne presented the main paper on this topic at the conference.[2] Although it is more than 80 pages in length and deals with a variety of different aspects of this topic, one aspect of the paper is of special interest to contractors. This is Dr. Böckstiegel's discussion of the question whether, in the context of an international arbitration to which a state-controlled corporation is a party, there are any circumstances in which the corporation's controlling shareholder, the state, could or should be held liable for the acts of the corporation. Stated differently, are there any circumstances in which arbitrators could or should "pierce the veil" of the corporation and disregard its legal separation from the state?

The subject is an important one for contractors because many international construction contracts are signed with state-controlled corporations, typically in developing countries, and yet much of the risk in international construction depends not on the conduct of the state-controlled corporation acting as the employer but on the actions or inactions of its controlling shareholder, the state itself, along with the instrumentalities and officials of the state. Although the state, as a separate legal entity, can have no responsibility in principle for the obligations of its subsidiary corporation, the manner in which the state exercises its powers in such matters as taxation, exchange controls, customs, public utilities and services (electricity, water, telephone, sewage), not to mention the

* B.A., Harvard University; J.D., Columbia University; Partner, Law Offices of S. G. Archibald, Paris. The author gratefully acknowledges the assistance of Laird M. Robertson, Esq. in the preparation of this article.

[1] Approximately one-third of all arbitration cases at the International Chamber of Commerce (I.C.C.) in Paris apparently involve states or state institutions. See Prof. Dr. Karl-Heinz Böckstiegel, "The Legal Rules Applicable in International Commercial Arbitration Involving States or State-controlled Enterprises", at p. 13 (12 Oct. 1983) [hereinafter cited as "Paper"], in I.C.C. Conference Handbook (binder distributed to conference participants).

[2] See *id.* In addition to Dr. Böckstiegel's paper, Prof. Dr. Ivan Szasz, a member of the Presidential Board Arbitration Court at the Hungarian Chamber of Commerce, provided an eastern European perspective with a paper on "Public Corporations as Parties to Arbitration—Procedural Aspects". Other speakers at the conference included prominent representatives of the international business community and two respected legal authorities on international commercial arbitration, Professors Berthold Goldman and Pierre Lalive.

funding of its subsidiary, can have a vital impact on the cost and feasibility of a construction project. Indeed, a state effectively enjoys the power of life or death over its subsidiary and the projects that the subsidiary has undertaken.

Like any private company, a state is interested in maintaining the solvency of its investments. Thus, if a state-controlled corporation gets into difficulties under a construction contract with a foreign contractor, it is not unknown for the state to exercise certain of its powers in a manner "friendly" to its subsidiary corporation and/or detrimental to the contractor. In cases where the state fails strictly to respect the separate legal existence of its subsidiary, does the state run the risk that, like any other parent company, it may be held liable by international arbitrators for its subsidiary's obligations?

One of the merits of Dr. Böckstiegel's paper is that it indicates the cases where such liability may be established. Dr. Böckstiegel begins his discussion of this subject with a proposition with which few would argue, namely, that there should be a general presumption that the legal separation between the state and the state-controlled corporation—if the corporation has been given legal personality of its own under the national law of its corporate seat—has to be respected. A state-controlled corporation he says, should ordinarily be considered to be subject to the same legal rules that apply to privately-owned corporations. Having begun with this presumption, Dr. Böckstiegel then says there are, nevertheless, "exceptional cases" where the lifting of the corporate veil "must be considered possible and necessary". He cites four cases, as follows:

(1) Estoppel—Actual or apparent authority of the state

According to Dr. Böckstiegel, Article 7 of the Vienna Convention of the Law of Treaties and a Harvard Law School draft for a convention on the responsibility of states both support the theory that a state may be responsible for the acts of a state-controlled corporation where the corporation had actual or apparent authority to represent the state. This corresponds, of course, to the ordinary rules of agency in the domestic law of most countries.

(2) Functional identity with the state

A somewhat similar situation arises when a state empowers a state-controlled corporation to perform certain public functions normally reserved to the state itself. Dr. Böckstiegel points out that investment and development contracts between states and state-controlled corporations often contain clauses dealing with such aspects of public authority as taxation, expropriation, exploitation licences and concessions and transfer authorisations. In this connection, he states that if "contracts dealing with such matters are concluded by corporations with the permission of the state, then the invalidity of such clauses may not be claimed later-on on the basis of the legal separation between the

corporation and the state".[3] While one would wish to know more precisely what Dr. Böckstiegel means by "with the permission of the state", this theory, like the first one above, does not appear very different from the estoppel principle or the rules of agency in domestic law.

Dr. Böckstiegel goes on to state that whether a specific function is to be considered as one of public authority may not necessarily have to be decided on the basis of the law of the state of the corporation but could be decided on the basis of the *lex fori*.

(3) Evasion of obligations—Abuse of rights

The theory which may offer potentially the widest range of grounds for piercing the corporate veil is the civil law theory known to French lawyers as *abus de droit* (abuse of right). It is a generally accepted principle in both national and international law, Dr. Böckstiegel says, that a state may not abuse legal forms and rights to evade obligations. This principle has been applied to lift the corporate veil under national law and, in his opinion, should in appropriate cases be applied by international arbitrators.

A classic example he cites for the application of this theory is the case where a state uses its law-making power to liquidate a state-controlled corporation in order to enable the corporation to escape its obligations under a contract with a third party.[4] Such use of legislative power constitutes an abuse of contractual rights for which the state should, Dr. Böckstiegel suggests, be liable in damages.

(4) Responsibility for acts of public authority

With respect to whether and under what circumstances state-controlled corporations may excuse their performance of contractual obligations by claiming *force majeure* due to acts of public authority of their own state, Dr. Böckstiegel says the basic approach must be that the state-controlled corporation should be neither privileged not discriminated against in comparison to privately-controlled corporations. He proposes a set of rules to govern this situation. Under his rules, a state-controlled corporation should not, in principle, be

[3] Paper at pp. 27–28.

[4] Dr. Böckstiegel cites *Société des Grands Travaux de Marseille* (France) v. *East Pakistan Industrial Development Corporation*, I.C.C. Case No. 1803 (1972), a case in which the President of the People's Republic of Bangladesh is reported to have issued various decrees that enabled a state-owned corporation, against whom arbitration proceedings were pending in Switzerland, to escape obligations owing to a foreign contractor, the claimant in those proceedings. These decrees provided, *inter alia*, for the abatement of all arbitration proceedings against the state-owned corporation, its dissolution and the extinguishment of its debts. The sole arbitrator (Andrew Hunter, Q.C.) refused to give effect to these decrees on the grounds, *inter alia*, that they were discriminatory and confiscatory and violated Swiss *ordre public* (public policy). Although his award was subsequently annulled by the Swiss courts, the decision of the Swiss Federal Supreme Court has been severely criticised both by Professors Pierre Lalive and Karl-Heinz Böckstiegel. For extracts of the award and the Swiss Federal Supreme Court's decision, see *Yearbook—Commercial Arbitration* (1980), Vol. 5, pp. 177 *et seq.* and pp. 217 *et seq.*

allowed to claim *force majeure* in the case of an act of state in the form of an "administrative act" (as distinguished from an act of state in the form of a "general law"). However, this presumption could be rebutted if the state-controlled corporation can establish prima facie that the administrative act concerned was caused by general considerations not connected with the contract in dispute (or this sort of contract), unless the private contracting party proves, in its specific case, that the general considerations were not the main reason for the administrative act concerned.

Principles similar to those applicable to administrative acts, according to Dr. Böckstiegel, should apply to a "law for an individual case". By contrast, a "general law, due to its *per definitionem* general character", will have to be recognised as *force majeure* unless, Dr. Böckstiegel says, the private contracting party supplies at least prima facie evidence that it was the state's interest in not fulfilling its contractual obligations "which played a role in initiating the law".[5]

* * * *

In a summary of this kind, it is not possible to do justice to Dr. Böckstiegel's pioneering work, even on this one aspect of his paper. The above summary, however, gives the broad outlines of his proposed rules for the lifting of the corporate veil of state-controlled corporations.

One question of growing concern which is raised by Dr. Böckstiegel's paper is whether a state-controlled corporation must be treated as an entity separate from the state merely because the national law of its state of incorporation or corporate seat so provides and regardless of whether the corporation lacks any effective autonomy from its principal shareholder, e.g. financial autonomy and independent power of decision over its affairs? In effect, must any division of a state be regarded as a separate legal entity, and be respected as such by international arbitrators, *solely* because the state's national law so provides? Is the characterisation of the national law of the corporate seat or place of incorporation decisive on this question?

In the confused state of law and practice that prevails in some developing countries, governments and public officials in those countries may pay little or no respect to such legal niceties.[6] Departments of a state and state-controlled

[5] A case in point is the English House of Lords' decision in *C. Czarnikow Ltd. v. Rolimpex* [1979] A.C. 351. This concerned contracts for the sale of sugar between a Polish state enterprise (a legal entity separate from the state under Polish law) and a foreign buyer. By issuing a decree having the force of law, the Polish Government imposed a general ban on the export of sugar. The Polish seller declared that the decree constituted *force majeure* under the contracts and thereby excused the seller's performance. Although the contracts concerned nearly two-thirds of the quantity of sugar allocated by the Polish Government for export, there was no evidence of collusion or conspiracy between the seller and the Government of Poland. Instead, there was evidence that the ban was instituted to relieve an anticipated shortage in the home market. In these circumstances, the House of Lords held that the seller had validly invoked *force majeure* under the contracts. Lord Wilberforce indicated that he would not deny a state corporation the right to invoke the state's action as *force majeure* absent "clear evidence and definite findings" to the effect that the action was taken "purely in order to extricate a state enterprise from contractual liability".

[6] The confusion may be compounded when the foreign contractor neglects, as he sometimes does, to ascertain the precise legal nature under local law of the state entity or state-controlled enterprise with which he is contracting.

corporations may, as a practical matter, appear indistinguishable. Yet, when disputes under contracts with foreign contractors arise and lawyers are called in, the separate legal personality of the state-controlled corporation may be resurrected and vigorously asserted, perhaps to the surprise and consternation of the foreign contractor. In such a situation, is an arbitral tribunal bound to respect the national law of the corporate seat or place of incorporation which provides that the corporation is a separate entity, even though such a result would be very difficult to justify in the particular case according to legal principles generally accepted by most other nations?

* * * *

The general answer to this question under international law is that determination of an entity's corporate status does not depend exclusively on national law under all circumstances. In *Case Concerning The Barcelona Traction, Light & Power Co.*, 1970 I.C.J. 3, the International Court of Justice acknowledged that the separate status of a corporate entity may be disregarded in exceptional circumstances. Specifically, the Court concluded that "the process of lifting the [corporate] veil, being an exceptional one admitted by municipal law in respect of an institution of its own making, is equally admissible to play a similar role in international law . . ."[7]

More recently, the United States Supreme court dealt with a similar issue in *First National City Bank* v. *Banco Para El Comercio Exterior de Cuba*, No. 81-984, slip opinion (17 June 1983), a case originally brought in the United States federal courts by a Cuban trading enterprise to collect on a letter of credit issued by a United States bank. The defendant United States bank asserted a right to set off the value of its assets that were seized and nationalised by the Cuban Government. Notwithstanding the fact that the Cuban enterprise was established as a juridical entity separate from the state under Cuban law, the Court determined that a set-off was justified.

Due respect for the actions taken by foreign sovereigns and for principles of comity between nations, the U.S. Supreme Court said, led to the conclusion that government instrumentalities should "normally" be treated as independent from their sovereign if they have been established as separate juridical entities.[8] At the same time, however, the Court emphasised that while the law of the state of incorporation determines issues relating to the *internal* affairs of a corporation, it should not be dispositive when the rights of third parties *external* to the corporation are at stake.[9] According to the Court (*per* Justice O'Connor),

[7] 1970 I.C.J. 38–39; see also *First National City Bank* v. *Banco Para El Comercio Exterior de Cuba*, No. 81-984, slip opinion at pp. 17–18, n. 20 (U.S. 17 June 1983) (quoting *Barcelona Traction*). While the corporation in *Barcelona Traction* was privately owned, there is no reason why public ownership should alter this principle, as the U.S. Supreme Court has acknowledged. See slip op. at p. 19.

[8] Slip op. at p. 16.

[9] *Id.* at p. 10.

giving conclusive effect to the law of the chartering state in determining whether the separate juridical status of its instrumentality should be respected "would permit the state to violate with impunity the rights of third parties under international law while effectively insulating itself from liability in foreign courts".[10] Thus, the Court did not regard Cuban law as dispositive but chose to determine the status of the Cuban trading enterprise in accordance with principles of equity "common to both international law and [U.S.] federal common law".[11] The application of these principles led the Court to allow the claim against the Cuban state to be set off against the claim of the Cuban trading enterprise.

The *Banco Para El Comercio* decision is consistent with Dr. Böckstiegel's general thesis. In not deferring to the dictates of the law of the place of incorporation, and in applying principles common to international law, the decision provides authority for the view that the status of a state-controlled corporation should be determined in accordance with neutral legal principles independent of purely national law. The decision has support in United States precedent,[12] and is consistent with recent French authority.[13] It represents a

[10] *Id.*

[11] *Id.* at p. 11.

[12] In support of its central holding in *Banco Para El Comercio*, the U.S. Supreme Court cites the case of *Federal Republic of Germany* v. *Elicofon*, 357 F.Supp. 747 (E.D.N.Y. 1972), *aff'd*, 478 F.2d 231 (2d Cir. 1973), *cert. denied*, 415 U.S. 931 (1974). See slip op. at pp. 22–22; see also *id.* at p. 21, n. 25. The U.S. district court in *Elicofon* found that the plaintiff-intervenor, an East German museum that was a separate juristic entity under East German law, was an "arm and agency" of the Government, and therefore lacked standing to bring suit since the East German Government was not recognised by the United States (358 F.Supp. at p. 756).

The Supreme Court cites *Elicofon* for the proposition that a foreign government should not be allowed to create juridical entities for the mere tactical purpose of avoiding international obligations. See slip op. at p. 22 (citing 358 F.Supp. at p. 757). More generally, the *Elicofon* case stands for the proposition that the law of the place of incorporation need not be controlling as to the status of a state-controlled corporation. The district court in *Elicofon*, before concluding that the museum was under the complete domination and control of the East German Government, engaged in an extensive factual analysis of the relationship between the museum and the Government, an analysis apparently based on United States legal principles (358 F.Supp. pp. 753–756).

[13] The French *Cour de Cassation* has held that an Algerian bank, which was owned by the Algerian State but constituted as a legal entity separate from the State under Algerian law, could not recover on a guarantee issued in its favour by a French corporation when the Algerian State had confiscated all the assets of the principal debor, the French corporation's Algerian subsidiary. *Crédit Populaire d'Algérie* v. *Sapvin*, Judgement of Feb. 14, 1978, *Revue Critique de Droit International Privé* 1980.707.

The principal debtor corporation, Sapvin Algérie, had been purchasing wine in Algeria for export to France. It financed these purchases with credit from the Crédit Populaire d'Algérie, the state-owned bank. Sapvin Algérie's credit was guaranteed by its French parent company, Sapvin Marseille. After the Algerian State nationalized, without compensation, all the assets of Sapvin Algérie, the Crédit Populaire d'Algérie brought an action in France against Sapvin Marseille, based on the latter's guarantee, to recover the balance of Sapvin Algérie's debts outstanding at the time of the nationalization. The *Cour de Cassation* ruled that the Crédit Populaire d'Algérie was an "*émanation*" (emanation) of the Algerian State, and held, in effect, that the act of the Algerian State in confiscating the assets of Sapvin Algérie was tantamount to an act of the Crédit Populaire d'Algérie. The confiscation prejudiced Sapvin Marseille's right as guarantor to be subrogated to the rights of Crédit Populaire d'Algérie against Sapvin Algérie. This discharged Sapvin Marseille of its guarantee obligation, by virtue of Article 2037 of the French Civil Code, which provides that a guarantor is discharged when an act of the creditor prejudices the right of the guarantor to be subrogated to the rights of the creditor against the principal debtor. Thus, the act of the Algerian State in nationalizing the assets of Sapvin Algérie apparently was deemed to be the act of the Crédit Populaire d'Algérie for purposes of Article 2037.

significant departure, however, from the more traditional approach taken by the English courts.[14]

Once having determined that Cuban law was not controlling, the Supreme Court chose to base its decision on an ostensibly narrow ground, namely, that a foreign governmental entity should not be able to bring suit in a United States court without also subjecting itself to its adversary's counterclaim involving the foreign government,[15] when the foreign government itself is the only real beneficiary of the suit.[16] Moreover, the Court rejected any "mechanical formula" and, particularly, any standard based on whether the instrumentality performed a "governmental function".[17] In deciding the case narrowly, the Court may simply have wanted to avoid unnecessarily broad pronouncements in an evolving area of the law. In addition, however, the Court apparently recognised that it was the application of a somewhat mechanical formula or standard, specifically, whether the Cuban trading corporation was really an *alter ego* of the Cuban Government, which led the lower court, the United States Court of Appeals for the Second Circuit, to its errant conclusion that the U.S. bank was not entitled to a set-off.[18]

Both Dr. Böckstiegel's work and the *Banco Para El Comercio* decision contribute to the development of international standards for the resolution of the problem of the status of state-controlled corporations. Wider recognition and use of such standards, independent of purely national law, should permit fairer treatment of contractors working abroad with state-controlled corporations. Application of such standards is particularly appropriate in the context of international commercial arbitration.

[14] The English courts have generally been reluctant to disregard any legal separation between a state-controlled entity and its sovereign state. The U.S. Supreme Court, in a footnote acknowledging its partial rejection of the English approach to this problem, see *id.* at pp. 15–16, n. 18, discusses the major English cases, including *I Congreso del Partido* [1983] A.C. 244 (Cuban state-controlled trading enterprises accorded separate status because distinction between state-controlled enterprises and their governing state, while possibly artificial in appearance, is accepted in England and other states); *C. Czarnikow Ltd.* v. *Rolimpex* [1979] A.C. 351 (Polish state-controlled trading enterprise accorded separate status and allowed to claim that government export ban was *force majeure* because clear evidence and definite findings to the contrary were absent); *Trandtex Trading Corp.* v. *Central Bank of Nigeria* [1977] 2 W.L.R. 356 (Central Bank of Nigeria not treated as an *alter ego* or organ of Nigerian Government for purposes of determining whether it could claim sovereign immunity).

Although English courts have been reluctant to remove the corporate veil of a foreign state-controlled corporation, they have not felt bound to decide such questions solely under the law of the place of incorporation. For example, in *Trendtex Trading Corp.*, Lord Denning specifically stated: "I do not think that [the test] should depend on the foreign law alone. I would look to all the evidence to see whether the organisation was under government control and exercised governmental functions". [1977] 2 W.L.R. at p. 375. For a discussion of the willingness of English courts to apply English law in analysing the status of foreign state-controlled corporations, see Petitioner's Reply Brief at pp. 12–13, in the *Banco Para El Comercio* case.

[15] The Supreme Court emphasised that the Cuban Government itself could not have brought suit on the letter of credit in a United States court without waiving its sovereign immunity and answering for the seizure of the United States bank's assets (slip op. at p. 19).

[16] *Id.* at p. 21. Significantly, the original Cuban trading enterprise that held the letter of credit was dissolved several weeks after the suit was initially filed. All the enterprise's rights or claims were then vested in Cuba's central bank and various state enterprises (*id.* at p. 3).

[17] *Id.* at p. 22 and n. 27.

[18] See *id.* at p. 7 (quoting 658 F.2d 913, 917–20 (2d Cir. 1981)).