

**The Ability of a State-Owned Enterprise to Declare Force Majeure
Based Upon Actions of the State**

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A party's obligations under a contract may be discharged where "performance is made impracticable without their fault by the occurrence of an event the non-occurrence of which was a basic assumption" at the time the parties entered into the agreement.¹ A *force majeure* (or Act of God) is the contract term for such an event. Contracts often contain a *force majeure* clause in order to specify the parties' obligations in the case of such an event. A *force majeure* clause is "a contractual provision allocating the risk if performance becomes impossible or impracticable as a result of an event or effect that the parties could not have anticipated or controlled."² In terms of international law, this may lead to a situation where a state owned company is discharged from its obligations under a contract with a private entity because an action of the controlling state has brought about the event. If a government regulation or order, foreign or domestic, whose non-occurrence was an assumption underlying the contract, makes performance impracticable because of compliance, then it will discharge the parties.³

The general understanding is that a state enterprise should be treated in the same manner as a private enterprise being neither privileged nor disadvantaged by its relation to the state.⁴ However, the aforementioned contract law leads to an inequitable result as applied to a situation where a state enterprise has induced the state into actions that make performance impossible. As a result, arbitration panels will scrutinize the actions of the state closely in order to see whether or not they were taken to benefit the state enterprise. In other words, the state cannot purposefully

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¹ RESTATEMENT (SECOND) OF CONTRACTS § 261 (1996).

² BLACK'S LAW DICTIONARY 657 (7th ed. 1999).

³ RESTATEMENT (SECOND) OF CONTRACTS § 264 (1996).

enact laws and regulations that will allow a state enterprise to be released from an unfavorable contract without consequences.

There is no strict definition for state enterprise, but it is often described as “any commercial enterprise predominantly owned or controlled by the state or by state institutions, with or without separate legal personality.”⁵ Generally, the starting point for whether a state enterprise may claim *force majeure* from public actions of the state is the contract itself.⁶ If there is an explicit provision regarding situations in which the *force majeure* clause may be invoked, then the state enterprise will be bound by it.⁷ The question of whether a state enterprise may invoke a *force majeure* clause based upon actions of the state is one that has arisen infrequently. However, certain factors may be extrapolated from the courts’ and arbitration panels’ rationales in the few cases that have discussed the issue.

There are three criteria that an arbitration panel may weigh when deciding whether a state enterprise can justifiably invoke the *force majeure* clause in a contract based upon actions of the state that brought about the circumstances that precipitated the *force majeure*. The three factors are: (1) the state enterprise must possess a legal identity distinct from that of the state in commercial transactions; (2) the state enterprise must not be in collusion with the host state to bring about the action that precipitated the *force majeure*; and (3) the action of the host state must be either an act of state or a political decision of national sovereignty outside of the state’s purely pecuniary interest in the commercial transaction.⁸

⁴ See *id.* at 47.

⁵ K.H. BOCKSTIEGEL, ARBITRATION AND STATE ENTERPRISES: SURVEY ON THE NATIONAL AND INTERNATIONAL STATE OF LAW AND PRACTICE 34 (1984) [hereinafter “BOCKSTIEGEL, ARBITRATION”].

⁶ See *id.* at 38.

⁷ See *id.*

⁸ See K.H. Bockstiegel, *The Legal Rules Applicable in International Arbitration Involving States or State-controlled Entities*, in 60 YEARS OF ICC ARBITRATION 117 (1984).

I

In order to declare *force majeure* regarding an action of the state, the state enterprise must first show that it possesses a legal identity separate from the state and that its day-to-day operations are not directly controlled by the state. In other words, the state enterprise must have the ability to unilaterally make binding decisions in commercial transactions. If under the national law of the host country, the state enterprise has a separate legal identity, then it will generally be accepted as an entity separate from the state.⁹

In *Czarnikow Ltd. v. Centrala Handlu Zagranicznego*, the House of Lords ruled that a *force majeure* clause in a contract could be invoked where the state enterprise possessed a legal identity separate from the state under its domestic law.¹⁰ In 1974, Rolimpex, a Polish state enterprise, entered into a contract with Czarnikow, an English company, for the sale of 11,000 tons of sugar. Only 6,000 tons of sugar were delivered prior to the breach of contract by Rolimpex.¹¹ The contract defined *force majeure* regarding state actions pursuant to Rule 18(a) of the rules promulgated by the Refined Sugar Association.¹² The relevant part of the definition provided for release from contract obligations if delivery was “prevented or delayed directly or indirectly by government intervention . . . beyond the seller’s control”¹³

In late 1974, the Polish Minister of Foreign Trade and Shipping signed a resolution banning all exports of sugar due to projected shortfalls.¹⁴ Rolimpex was held to be independent from the state enough that it could rely on the ban as a *force majeure*.¹⁵ The House of Lords noted that, under Polish law, Rolimpex had its own legal personality.¹⁶ Although its actions

⁹ See BOCKSTIEGEL, ARBITRATION, *supra* note 5.

¹⁰ See *Czarnikow Ltd. v. Centrala Handlu Zagranicznego* (“Rolimpex”), 1978 Lloyd’s Rep. 305 (1978).

¹¹ See *id.* at 305.

¹² See *id.*

¹³ See *id.*

¹⁴ See *id.* at 307.

¹⁵ See *id.* at 310.

¹⁶ See *id.*

generally were subject to the Polish Ministers' abilities to "tell [it] 'what to do and how to do it,'" Rolimpex unilaterally made decisions regarding its commercial transactions.¹⁷ The company, acting as any private enterprise, obtained sugar from the Sugar Industry Enterprises represented by the Union of Sugar Industries in Poland, and then sold it on the world market for a commission.¹⁸

In another case, the Foreign Trade Arbitration Commission of the Soviet Union heard a dispute over a contract entered into in July 1956, by Jordan Investments, Ltd. (hereinafter "Jordan Inv.") of Israel and All-Union Foreign Trade Corporation (hereinafter "All-Union") to provide 650 tons of heavy fuel oil to Israel.¹⁹ In November 1956, the Soviet Ministry of Foreign Trade denied the necessary export license and further barred performance of the contract altogether.²⁰ The *force majeure* clause was, in turn, invoked by All-Union.²¹

In that case, All-Union possessed a separate legal identity under the laws of the Soviet Union.²² Article 19 of the Soviet Civil Code and All-Union's corporate bylaws stated that it was independent of the state and served as a legal person in commercial transactions.²³ However, All-Union was also unconditionally subject to the authority of the Ministry of Foreign Trade.²⁴ The panel, relying on All-Union's status under Soviet law, dismissed the complaint because the identification of the corporation with the state lacked foundation.²⁵ As a result of the dismissal, both the denial of the export licenses and the explicit prohibition against executing the contract were satisfactory to release All-Union from any liability in accordance with the *force majeure* clause.

¹⁷ *See id.*

¹⁸ *See id.*

¹⁹ *See* Jordan Investments, Ltd. v. All-Union Foreign Trade Corp., 27 I.L.R. 631 (1958).

²⁰ *See id.* at 631-2.

²¹ *See id.* at 632.

²² *See id.* at 636.

²³ *See id.*

²⁴ *See id.* at 634.

The converse is also true for the state where the state enterprise enters into an agreement and breaches the contract while citing *force majeure*. The state cannot be brought in as a party to the Agreement merely because it approved the project.²⁶ The Egyptian General Organization for Tourism and Hotels (hereinafter “EGOTH”) and Southern Pacific Properties (hereinafter “SPP”) entered into an agreement for the construction of two tourist centers, one of which would be located near the Giza pyramids.²⁷ Due to a worldwide campaign against the Agreement, the Egyptian government canceled the project, and declared the area around the pyramids public property.²⁸ A French appellate court reviewing the decision of the arbitration panel, the International Center for settlement of Investment Disputes (hereinafter “ICSID”), held that the counter-signature of the Agreement by the Minister of Tourism, preceded by the words “approved, agreed and ratified,” did not bind Egypt as a party.²⁹ The Egyptian law governing EGOTH explicitly gave it a separate legal personality regarding commercial transactions.³⁰ EGOTH also possessed an independent organization, budget, and was subject to the same tax laws as governed private companies.³¹ Thus, where a state enterprise has a separate legal identity that may allow it to declare *force majeure* in light of actions by the state, the corporate veil may not be pierced simply because the state approved the contract.

Therefore, for the state enterprise to be able to declare *force majeure* regarding an action of the state, it must first have a separate legal identity. That is, it must have the ability to unilaterally enter into binding contracts in commercial transactions.

²⁵ See *id.* at 636.

²⁶ See *Arab Rep. of Egypt v. S. Pac. Prop. Ltd. and S. Pac. Prop. (Middle East) Ltd.*, 86 I.L.R. 475 (1984).

²⁷ See *id.* at 477.

²⁸ See *id.* at 479.

²⁹ See *id.* at 476-7.

³⁰ See *id.* at 487.

³¹ See *id.*

II

Second, the state enterprise must not be in collusion with the state to bring about the action that precipitated the *force majeure*.³² Under such circumstances, to claim *force majeure* would be an abuse of the machinery of the state.³³ A French appellate court observed that:

It would be extremely shocking if a national company like Air France or, *a fortiori*, a public organization, were allowed to protect itself behind its public law status in order to evade its contractual obligations . . . If such a solution were accepted, it would become all too easy for enterprises with a special (public) status to be excused from performing their contracts. It would suffice for them to provoke a withdrawal from authorization and thereafter to rely on *force majeure*. There would then be no longer any balance nor security in juridical relations.³⁴

In other words, the state enterprise cannot request that the government undertake official actions that will allow them to cancel what may become an unfavorable contract and avoid liability by invoking the *force majeure* clause.³⁵ The House of Lords relied heavily on the fact that there was no collusion between the state and its enterprise in holding that Rolimpex could rely on the sugar ban as *force majeure*. Rolimpex did not induce the sugar ban, and the director and general manager of Rolimpex actually protested the ban when first informed of it by the Ministry.³⁶ The ban was an action of the state wholly separate from the interests of Rolimpex under the contract.

There was also no collusion between the state and EGOTH in *Southern Pacific*. On May 28, 1978, the General Investment Authority (hereinafter "GIA"), by resolution, withdrew its prior

³² See *id.* at 46.

³³ See *id.* at 45.

³⁴ Pierre Lalive, *Arbitration with Foreign States or State-controlled Entities: Some Practical Questions*, in CONTEMPORARY PROBLEMS IN INTERNATIONAL ARBITRATION 295 (D.M. Lew ed., 1986) (citing *Air France* case, Cour de cassation, April 15, 1970, D 1971, 107).

³⁵ See BOCKSTIEGEL, *ARBITRATION*, *supra* note 5, at 46.

³⁶ See Czarnikow, 1978 Lloyd's Rep. at 307.

approval of the Pyramids Oasis Project.³⁷ The following month, a presidential decree was issued, invalidating a previous decree that had allowed the land on the Pyramids Plateau to be used for “tourist utilization.”³⁸ These actions were taken at the behest of other state agencies. In May 1978, the Ministry of Information and Culture, along with the President of the Egyptian Antiquities Authority, urged the Ministry of Tourism to protect the pyramid site in accordance with the Antiquities Protection Law of 1951.³⁹ Thus, the actions of the state were pursuant to existing Egyptian law, and were not undertaken at the behest of EGOTH.

Thus, as these cases show, the state enterprise must not pressure or work with the government to obtain state actions that will allow it to cancel an unfavorable contract without liability.

III

Finally, the actions of the state that prevent the fulfillment of the contract must be a political act of national sovereignty.⁴⁰ The government cannot make policy choices that are intended to directly undermine the status of the contract.⁴¹ In other words, the actions taken by the state must be pursuant to its own objectives; they must be outside of its pecuniary interest in the commercial transaction in question. Rolimpex provides an example. In August 1974, Poland suffered heavy rainfall and flooding that destroyed much of its sugar beet crops.⁴² Only 1,432,000 tons were actually produced, resulting in a shortfall in the domestic market.⁴³ In response, the Council of Ministers passed a non-binding resolution to ban all exports and cancel

³⁷ See *S. Pac. Prop. (Middle East), Ltd. v. Arab Rep. of Egypt*, 32 I.L.M. 933, 949 (1993).

³⁸ See *id.*

³⁹ See *id.*

⁴⁰ See BOCKSTIEGEL, *ARBITRATION*, *supra* note 5, at 46.

⁴¹ See *id.*

⁴² See Czarnikow, 1978 Lloyd's Rep. at 307.

⁴³ See *id.*

all licenses.⁴⁴ Afterwards, the Minister of Foreign Trade issued a similar decision with the force of law.⁴⁵ Clearly, the state had independent reason, besides its interest in Rolimpex's commercial transaction, to ban the export of sugar.

In Egypt's case, ICSID stated that "as a matter of international law, [Egypt] was entitled to cancel a tourist development situated on its own territory for the purpose of protecting antiquities."⁴⁶ The right of eminent domain was exercised for a public purpose.⁴⁷ The Egyptian Government did not attempt to negotiate a more favorable deal with another company. It was a decision by the state pursuant to its interest in preserving national artifacts and antiquities.

Furthermore, the decision by the Soviet Union to ban the implementation of All-Union's agreement with Israel, although not ruled upon by the arbitration panel as a legitimate state action, had political undertones nonetheless. On October 29, 1956, Britain, France, and Israel invaded Egypt in response to Gamal Abdal Nasser's nationalization of the Suez Canal, a vital waterway to the West especially in regards to oil imports. The Soviet Union openly opposed the invasion. The ban on oil exports to Israel reflected more the Soviet Union's interests in the Cold War aspects of the Suez Crisis than its interests in All-Union's transaction.

Thus, a state enterprise cannot avoid liability under the terms of the contract unless the state's actions, resulting in the *force majeure*, serve a political purposes, separate from the state enterprise's transaction. Put another way, the state must have been acting according to its powers of national sovereignty.⁴⁸ The policy choices of the state must have been pursuant to its own objectives outside the commercial transaction in question.⁴⁹

⁴⁴ See *id.*

⁴⁵ See *id.*

⁴⁶ S. Pac. Prop., Ltd., 32 I.L.M. at 967.

⁴⁷ See *id.*

⁴⁸ See BOCKSTIEGEL, ARBITRATION, *supra* note 5, at 46.

⁴⁹ See *id.*

CONCLUSION

The state enterprise is generally viewed under the law in the same manner as a private enterprise. However, in the context of *force majeure* the state enterprise possesses the potential to illegitimately cancel unfavorable contracts by inducing the state to bring about an intervening occurrence in order to make performance impracticable in such a way that the *force majeure* clause may be invoked. Because of this inequitable result, arbitrators carefully scrutinize such state actions in order to see if there was an actual *force majeure* or a breach by the state enterprise. There are three criteria weighed in concluding whether the state action constituted a breach in fact. These three factors are: (1) the state enterprise must possess a legal identity distinct from that of the state in commercial transactions; (2) the state enterprise must not be in collusion with the host state to bring about the action that precipitated the *force majeure*; and (3) the action of the host state must be either an act of state or a political decision of national sovereignty outside of the state's purely pecuniary interest in the commercial transaction. A conclusion about the legitimacy of a state enterprise's breach as a result of *force majeure* is generally based upon the congruence of at least two of these factors.