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– The Clayton Utz Lecture

Karl-Heinz Böckstiegel

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[www.kluwerlaw.com](http://www.kluwerlaw.com)

LCIA  
70 Fleet Street  
London EC4Y 1EU  
telephone: +44 (0)207 936 7007  
fax: +44 (0)207 936 7008  
e-mail: [lcia@lcia.org](mailto:lcia@lcia.org)  
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# Enterprise v. State: the New David and Goliath?

The Clayton Utz Lecture\*

by KARL-HEINZ BÖCKSTIEGEL\*\*

## ABSTRACT

The traditional scenario of states as the only subjects of international law and the only ones having capacity to raise international claims against other states in legal proceedings has gone. Private enterprises international trade and investment no longer depend on the discretion of their home states in the context of diplomatic protection as to whether a claim should be raised against another state.

Similar to the situation of private persons claiming international protection of human rights such as the European Convention on Human Rights, private enterprises are today accepted as subjects and holders individual procedural and substantive rights in international law.

In the context of international arbitration, this is particularly the case through the thousands of BITs and multilateral treaties such as the ICSID Convention, the Energy Charter Treaty, NAFTA and the law of the European Community. In addition to these instruments of public international law, thousands of contracts between states or state institutions on the one side and private enterprises on the other side provide for and are processed in normal commercial arbitration under the rules of the ICC, the LCIA, UNCITRAL and similar arbitral institutions.

Such arbitral proceedings between state parties and private enterprises are imbedded in a more diversified legal framework and the scope of the applicable law is wider than in normal commercial arbitrations. The article tries to show a number of specific procedural and substantive considerations that have to be taken into account and particularly presents examples and recommendations

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\*\* Prof. em. of International Business Law at University of Cologne; Chairman of the Board of the German Institution of Arbitration (DIS); recent President of the International Law Association (ILA); Hon. Vice-President and former President of the LCIA; former President of the Iran–United States Claims Tribunal, The Hague; former Panel Chairman of the United Nations Compensation Commission (UNCC); member of the ICC Arbitration Commission; arbitrator and president of arbitration tribunals in many national and international arbitrations of the ICC, ICSID, NAFTA, UNCITRAL, AAA, and others.

regarding the distinction between the state and state enterprises and the responsibility for acts of state.

## I. ARBITRATION IN TODAY'S INTERNATIONAL LEGAL FRAMEWORK

AS WE all know, the world community today, on the one hand, has reached unprecedented levels of international trade and investment, but on the other hand, is also facing unprecedented challenges, particularly from terrorism.

International law reflects these two sides of the coin, particularly on the one hand by an unprecedented level and volume of international treaties and international organisations, but on the other hand, by lacking efficient instruments against terrorism and human rights violations.

In this context, international dispute settlement is one of the success stories. It provides more options and is used in practice more than ever before in history for the peaceful solution of disputes. The role of the International Court of Justice today is of much more significance than in earlier times. Even for politically most sensitive disputes it has been possible to form and use specific judicial bodies, as I have experienced in my function at the Iran–United States Claims Tribunal at The Hague. The World Trade Organisation's dispute settlement machinery is widely used.

At the non-governmental level, international commercial arbitration has become the generally accepted method of dispute settlement between private enterprises including a worldwide enforcement of arbitral awards by the New York Convention of 1958.

At the regional level, the European Union has a fully available court system for the by now vast body of European law in the European Court of Justice (ECJ) in Luxemburg. The European Convention on Human Rights offers legal protection to Europeans against their own and foreign states by its separate Court in Strasbourg. In Asia, the Kuala Lumpur Regional Centre for Arbitration (KLRCA) has been available for a long time. And in North America, NAFTA provides a widely used arbitration system for the protection of investors.

In addition, some arbitration institutions formed at the national level play an important role not only for domestic but also for international disputes. Examples are the Hong Kong International Arbitration Centre (HKIAC), the China International Economic and Trade Arbitration Commission (CIETAC), the Singapore International Arbitration Centre (SIAC) in Asia, as well as in Europe the national arbitration institutions in Austria, Germany, Sweden and Switzerland, and in the USA the American Arbitration Association. This is probably also the case for the arbitration centres in Australia though I am not aware of the details. I am aware, however, that ICSID has concluded Memoranda of General Arrangements according to Article 63(a) of the Washington Convention with both the Australian Commercial Disputes Centre in Sydney and the Australian Centre for International Commercial Arbitration in Melbourne in order to facilitate holding investment arbitration proceedings in Australia.

## II. THE RECENT RISE IN INVESTMENT ARBITRATION

Within the growth of international arbitration in general, the more recent success story is that of investment arbitration. In the past, the long history though limited volume of investment arbitration gave a most diversified picture. It included certain judgments of the Permanent Court of International Justice, the International Court of Justice, and quite a number of ad hoc arbitrations, most of them dealing with oil and other natural resources. In most of these cases, due to the doctrine of diplomatic protection, only states were parties to the dispute, even if they concerned the interests and investments of private corporations from those states.

However, that situation has changed. Private investors are no longer merely objects of an inter-state dispute, but today most often are directly participating as claimants against foreign states. I leave open the question whether that can be considered as the rising of David against Goliath, because some of these private claimants, as large multinational companies, may well have more resources available than a rather small state being a respondent.

In this new development, a first group were the almost 4,000 cases of the Iran-United States Claims Tribunal in The Hague. Its many decisions are a particularly valuable source on many procedural and substantive questions, due to the fact that all decisions of that tribunal are published in the 33 volumes of its jurisprudence.

Investment treaties, however, present the real new milestone in this long history of investment arbitration. The by now more than 2,400 bilateral investment treaties (BITs) present an unprecedented codified legal framework regarding both procedural and substantive aspects of investment arbitration. The political and economic deal was clear: many states became aware that, for their economic development, they needed the financial resources as well as the technical and managerial know-how of foreign companies. But these companies were only ready to make substantial investments in such a foreign state if they were assured of a reliable legal framework, particularly protection against the threat of expropriation and a chance to make profits. In similar, though by no means identical, ways the BITs transfer this deal into a legal instrument. They provide binding obligations of international law between the host states and the home states of the companies, but on the other hand provide that the private investor can directly sue the host state without having to depend on the diplomatic protection of its home state who may sometimes hesitate to pursue claims due to political or diplomatic considerations.

In addition to BITs, one also has to look at multilateral treaties dealing with international investment. The great number of legal instruments constituting the European Community, among many other issues, deal with many aspects of investments between the Member States subject to the jurisdiction of the ECJ, but we cannot deal with this jurisdiction any further here. More similar to the issues arising in BITs is the protection and jurisdiction provided in the Energy Charter Treaty which has recently come into force and has already led to some arbitrations. Further, Chapter 11 of the North American Free Trade Area

(NAFTA) provides rules under which many arbitrations have already been conducted regarding all three member states, Canada, Mexico and the USA.

Indeed, as we all know, this modern legal framework for disputes between state parties and foreign private enterprises is not only available, it is also being used in a continuously rising number of arbitrations. It is difficult to be fully informed in this regard. While all ICSID and most other treaty cases are being reported in publications, most of the many investment cases under the rules of commercial arbitration institutions such as the ICC are normally confidential though some reporting takes place by current Internet services or later abstract summaries on decisions.

From my own cases as arbitrator over recent years, I have the impression that the majority of disputes between states and foreign investors occur either in the context of privatization programmes, or where a change of government takes place in the host state and the new government does not wish to continue with earlier policies or contracts of its predecessor.

### III. THE MORE DIVERSIFIED LEGAL FRAMEWORK

In arbitrations between states and foreign private parties, the scope of applicable procedural and substantive legal rules is considerably wider than that to which we are accustomed in commercial arbitration. It may, in particular, include the following.

#### *(a) Public International Law*

Obviously, whatever the respective investment treaty provides on procedure and substance will be of primary importance for the arbitral tribunal. But in addition to the investment treaties already mentioned, other treaties may come into play, both bilateral treaties such as the BITs between the host state and the home state of the foreign investor, and multilateral treaties such as the Vienna Convention on the Law of Treaties. With regard to the substantive legal rules to be applied by the arbitral tribunal, the rules regarding the protection standards for foreign private property developed by international courts and arbitral tribunals and accepted as part of customary international law are of special importance.

#### *(b) National Law*

Investment contracts between the state and the foreign private enterprise will often contain a choice of law clause referring to the national law of the host state. Sometimes, to prevent the state manipulating its law later in its own favour and with negative effects for the investor, such contracts may also include a stabilisation clause ruling that the national law shall be applied as existing at the time of conclusion of the contract.

Also the investment treaty will often provide in some way for the application of the national law of the host state in so far as it is not overruled by provisions of the BIT itself. Furthermore, national laws dealing specifically with foreign investment

in the host state may come into play and provide additional rulings to be respected.

For ICSID arbitrations, Article 42 of the ICSID Convention provides for a combined application, namely primarily for the law chosen by the parties, or in the absence of such a choice, for the application of the national law of the host state and ‘such rules of international law as may be applicable’.

*(c) Jurisdiction of National Courts*

Quite frequently, state parties try to refer their disputes with foreign investors to their national courts while the investor insists that either a clause in the contract or a treaty provides for arbitration. The resulting jurisdictional dispute may turn out quite differently before the courts, on the one hand, and before the arbitral tribunal, on the other hand. It is also not uncommon that a national court will issue anti-arbitration injunctions against the investor, the arbitral tribunal or the arbitral institution. During my time as president of the LCIA, I was exposed to this situation several times. Mostly, arbitral tribunals have insisted on the validity of the state’s submission to arbitration, but this may mean that the members of the tribunal may not be able to exercise their function in the host state, which is a particular difficulty if that submission to arbitration provides for a place of arbitration in the territory of the host state.

*(d) Contracts*

Contracts become relevant in two different ways. First, if a contract has been concluded between the foreign investor and the host state or its state institutions, its provisions will have to be taken into account. Secondly, even if the foreign investor has concluded contracts regarding his investment with other private enterprises or state enterprises, if measures of the host state take away or otherwise negatively affect the economic interest provided in such contracts, such measures may be considered as tantamount to expropriation under the BIT and lead to an obligation to pay compensation by the host state.

In this context, an issue often occurring in recent cases and often discussed in recent legal writings is whether and under which conditions breaches of contracts are turned into breaches of the BIT by what is commonly called an umbrella clause in the BIT. However, though I have had to deal with that issue as an arbitrator in some of my own ICSID cases, I do not have the time to go into details here in that regard.

*(e) Arbitration Rules*

The procedural framework for the arbitration may be set up by certain procedural provisions in the investment treaty, be it BIT or NAFTA, and also by reference to other treaties such as the ICSID Convention. But one also finds references to ‘normal’ commercial arbitration rules such as those of UNCITRAL, the ICC, the LCIA or the Stockholm Chamber of Commerce. In fact, the

regularly published statistics of ICC arbitrations show that every year more than 10 per cent of all ICC cases involve states as parties.

*(f) International Business Practice*

International business practice may have to be taken into account in various ways depending on the specific case. Insofar as the applicable substantive legal rules leave open questions, these may have to be answered taking into account international business practice, because host states have to accept that foreign investors conduct their activities in this context. This may also be relevant for judging measures of the host state regarding the question whether the investment has been subjected to discriminatory or expropriatory treatment.

*(g) Arbitration Practice*

As in international commercial arbitration between private enterprises, also in investment treaty arbitration, international arbitration practice may become relevant regarding questions not expressly dealt with in the treaties, national law and arbitration rules regarding certain procedural or substantive questions. For procedural issues, examples may be the use of the new Evidence Rules of the International Bar Association as a guidance on the handling of questions related to multiparty arbitration, if more than two parties are involved in the dispute. For substantive issues, while commercial arbitral awards are seldom published, many more sources are available for arbitration between states and private enterprises, because many of the decisions in this field are now published, not only all of those of the Iran–United States Claims Tribunal, but also most ICSID and many other investment awards.

Practical experience shows that also case management may have to be different and adapted if a state party is involved in the arbitration. Thus, the more complicated decision process in state administration may require that more time has to be given for the submission of memorials, statements of witnesses and experts and other procedural steps. The disclosure and submission of documents may become more complex in view of political or security concerns of the state. Small states in particular sometimes hesitate to invest the money for hiring a law firm which has experience in such international arbitral disputes. The government employees representing the state, in view of their lack of experience in international arbitration or in fear of political pressure, may be much more cautious and feel insecure if they have to take procedural decisions or agree to procedural steps suggested by the arbitral tribunal. I still recall from one of my earliest cases as an arbitrator that, first the parties agreed that the tribunal should make a proposal for an amicable settlement of the dispute, but then the state representatives felt they could not decide to agree to pay US\$20 million, but would rather receive an award requiring them to pay US\$40 million, because that was not a decision of theirs for which they could be blamed at home. My general recommendation for state parties would be that hiring an experienced

international law firm will mostly be a worthwhile investment and may considerably improve the state's chances in the arbitral procedure.

#### IV. SOME MAJOR ISSUES OF ARBITRATION PRACTICE

I cannot go into every detail of this topic. But at least let me shortly deal with three major issues of recent relevant arbitration practice in disputes between states and foreign private companies.

##### *(a) Submission by the State Party*

As in normal international commercial arbitration, very often the submission by the investor will be by an arbitration clause in the investment contract. However, where there is no investment contract or where such an investment contract does not contain an arbitration clause, there may still be submission to arbitration, if either a national law of the host state for the promotion of foreign investment provides for such a submission such as to ICSID, or if the BIT between the host state and the home state of the investor provides for such a submission. In such cases, though the investor has not expressly submitted to arbitration, by raising the claim before the arbitration machinery chosen in the national investment law or the BIT, a valid submission of both parties to arbitration has been recognised.

The submission to arbitration by the state party may often seem clear if it is contained in an investment contract concluded by the state party with the foreign investor, or in the BIT or in the national investment law. Nevertheless, in practical cases, it has occurred rather often that, once a dispute arises, the state party claims that it has not validly submitted to arbitration or at least to arbitration for the instant case. Sometimes it is claimed that the BIT has not been validly ratified, sometimes that the constitution or the law of the host state provides for certain conditions, such as authorisation by Parliament, and such conditions for submission to arbitration by a state party have not been fulfilled. If that occurs, the foreign investor will normally claim that these objections to jurisdiction by the host state should not be recognised under such rules as estoppel, good faith or the public international law principle that a state may not rely on its national law in defence to its obligations under public international law.

Very often, the arbitration of a foreign investment dispute will not involve the state itself, but an institution or enterprise which is owned or controlled by the state. This is particularly so in the many recent cases where states have outsourced some of their infrastructure and public utility activities to separate instruments or have implemented wide privatisation programmes transferring former state activities either first to privatisation agencies or directly to private enterprises. Their separate legal personality may particularly be relevant in our context with regard to the possibility to claim acts of state as *force majeure* for the state enterprise, the claim of immunity and the consequences of major national interest against performance of a contract.

*(b) Lifting the Corporate Veil of State Enterprises*

If an entity with separate legal personality from the state but controlled by the state is involved, that entity will often rely on its separate legal personality and object to the jurisdiction of the arbitral tribunal, if only the state has submitted to arbitration (such as by a BIT) but not the state entity itself. Or, vice versa, the state may raise a similar objection, if only the entity has submitted to arbitration (such as by a contract) but not the state itself. As a result the question often arises whether the arbitral tribunal has to respect that 'corporate veil' or whether there are circumstances under which that corporate veil may or must be lifted.

Lifting the corporate veil between subsidiary enterprises and controlling mother companies is, of course, not a question unknown in disputes between private parties. However, this question poses itself in a different and much more specific way between states and their corporations, because states may exercise their control not only by normal corporate means, but also by the other means available to them such as laws, decrees or other executive acts.

Therefore, though the possibility of disregarding the separation between a corporate entity and its owner or members is recognised in most national laws, when considering the problem in the context of arbitration and state enterprises, two basic qualifications make the simple transfer of national law solutions questionable. First of all we are dealing here with international commerce where at least two, if not more, national legal backgrounds, the usages of international commerce and perhaps also international law come in. Secondly, we are dealing with state enterprises and therefore with the question whether specific considerations may have to be taken into account if the state is behind the corporate veil and not private owners or members. The possibilities developed at the national level of disregarding the legal separation therefore need reconsideration and adaptation in view of several basic differences in our context.

When we try to draw conclusions from that level of national law, the primary impression is one of legal insecurity. Now, this is not a satisfactory state of affairs for international commerce and international arbitration, because the answer to a usually fundamental question of the contractual relationship, in a claim for contractual performance or damages, is uncertain in the calculation of the parties in performing their contract and in the evaluation of the arbitrators deciding a dispute. It would therefore facilitate international trade and international arbitration considerably if one could come to common denominators in this respect. It should especially be worth the effort to try to come to criteria that seem neutral and equally applicable to the variations of socialist and private economy systems existing in the world. If a state chooses to participate in international commerce by private or state enterprises, that should lead neither to discrimination nor to privileges for the state enterprise.

Starting from a presumption in favour of respecting the legal separation between the state and the state enterprise, I submit that exceptional cases can be identified where the lifting of the corporate veil may or must be considered possible and necessary.

First, the principles of estoppel and *venire contra factum proprium* are generally accepted both in public international law and as general principles of law based on the comparison of national legal systems throughout the world. They must be considered applicable if a state enterprise is granted or is allowed to say or claims that it has been granted authority to give certain assurances to the contractual partner on behalf of the state.

Secondly, one may find a functional identity with the state. A state enterprise must be considered to be so far identical with the state as it performs acts of public authority, because that is a function exclusively reserved in all countries through the world to the state itself. If therefore the state empowers a state enterprise to perform such functions, it must expect that contractual partners thereby identify that enterprise with the state and therefore consider the legal relationship to that extent as one between the private enterprise and the foreign state. In our context this may become especially relevant with regard to foreign investments, because in investment contracts between states and foreign investors we often find clauses dealing with such aspects of public authority as taxation, expropriation, exploitation licences and concessions, transfer authorisations, police requirements, etc. If contracts dealing with such matters are concluded by state enterprises with the permission of the state, then the invalidity or inapplicability of such clauses may not be claimed later on the basis of the legal separation between the state enterprise and the state.

The third exception is the evasion of obligations or the abuse of rights. It is a generally accepted principle in both national and international law that a state may not abuse legal forms and rights to evade its obligations. This principle has also been applied in national laws with the effect that the corporate veil was lifted. It may in appropriate cases be applied by international arbitrators. Whether it is applicable will, as before national courts, always depend on the specific circumstances of the case. Though the principle of applicability is beyond doubt, it seems difficult to describe appropriate cases in the abstract. There is, however, a further and more specific application of that principle which may also be considered in international arbitration with state enterprises. When a state makes use of its powers of control and of legislation to change the legal form of a state enterprise in order to evade the obligations of that state enterprise in a contract and an arbitration clause, this must be considered as an abuse of rights.

(c) *Responsibility for Acts of State*

In arbitrations between states and foreign investors, often a dispute arises regarding the relevance of acts of public authority of the host state for the performance of the contract. And a particularly disputed question is whether and under which circumstances state enterprises may excuse non-performance of contractual obligations by claiming that *force majeure* due to such acts of public authority by their own state prevented them from performing. Here again, the starting point will have to be the principle that the legal separation between the state enterprise and the state is respected and that therefore normally acts

of public authority by the state have to be accepted as an excusing case of *force majeure*.

On the other hand, it should be realised that this question does not lead to difficulties in all cases of state interference. If the contract itself stipulates that the state enterprise is to be considered responsible for certain acts of state, no *force majeure* can be claimed if such an act of state then actually occurs. To give a practical example, this principle applies if the contract expressly holds the exporting state enterprise responsible for getting the required export licence. The INCOTERMS of the International Chamber of Commerce also provide for such a responsibility of the exporting party, and therefore in cases where the contract contains a reference to FOB or CIF delivery, again the seller cannot claim *force majeure*. In addition, an act of state cannot be considered as *force majeure*, if it is shown that a party has formally applied or informally asked for the act preventing its performance; and sometimes a party may be held responsible for an act of state because available remedies against the act were not exhausted.

Only in cases when no such specific provisions or considerations are applicable, does the general question arise which rule should apply in view of the fact that it is after all a state enterprise claiming *force majeure* due to the act of some other organ of that same state.

Again, the basic approach must be that the state enterprise must be neither privileged nor discriminated against in comparison with a private enterprise. Since, for an arbitration tribunal, the question will mostly pose itself as a matter of proof and presumption, and taking further into account that the state party is in a much better position to provide details of proof on the background of acts of its own state, the following rules could be applied:

- (A) For acts of state in the form of administrative act, I suggest the following principles:
  - (1) Due to the presumption that a state will not have its executive organs act to the detriment of its own institutions, including state enterprises, administrative acts of state should in principle not be considered as *force majeure*.
  - (2) This presumption is not applied, however, if it can be seen *prima facie* or can be proved by the state enterprise that the administrative act was caused by general considerations not connected with this contract or this sort of contract.
  - (3) However, the primary presumption is applicable again, if the private party proves that in its specific case the general considerations did not apply.
  
- (B) For acts of state in the form of law, I suggest the following principles:
  - (1) If it is not a general law but a law for an individual case, the same rules apply as for administrative acts.
  - (2) A general law, due to its *per definitionem* general intention and applicability, will in principle have to be recognised as *force majeure*.

- (3) But that general applicability cannot apply, however, if the private enterprise submits at least prima facie evidence that it was in the interest of the state not to fulfil its contractual obligations which was the motivation of the law.

It should be noted that these principles, which I suggested some years ago in a similar manner,<sup>1</sup> on the one hand deserve more detailed reasoning than I can provide here, but on the other hand have been supported by several arbitral tribunals and the participants of an anniversary meeting of the ICC Court.

To illustrate these abstract principles, in practical examples they mean the following. If in a state trading country the state refuses an export or import licence, this is not normally a case of *force majeure* (rule A1). If the state party proves that general political considerations such as a food shortage for its population or a war in the designated delivery country have led to the refusal of the export licence, this is accepted as *force majeure* (rule A2). If a foreign investor cannot export its profits due from a state enterprise because the foreign exchange law has been changed by the legislative body, this is a case of *force majeure* (rule B2). If, however, he supplies evidence that the law was directed to stop payments to the foreign investors and keep the funds for other purposes of the respective state enterprises, the law is not accepted as a case of *force majeure* (rule B3). Similar considerations can be found in some of the ICSID claims of foreign investors against Argentina in the well known recent ICSID cases.

Of course, I do not suggest that the criteria I mentioned would solve every problem in relation to claims of *force majeure* by state enterprises or that the undisputed acceptance of these criteria can be expected by all private investors, state enterprises and arbitrators having to deal with that question. But it is suggested that these general presumptions could be of assistance in dealing with this issue in a way which is predictable and which takes into account the reasonable interests, procedural possibilities and access to eventual evidence of both sides concerned.

## V. CONCLUDING NOTE

In conclusion now, where are we in this dispute that used to be one between David and Goliath?

The traditional scenario of states as the only subjects of international law and the only ones having the capacity to raise international claims against other states in legal proceedings has gone. Private enterprises in international trade and investment no longer depend on the discretion of their home states in the context of diplomatic protection as to whether a claim should be raised against another state.

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<sup>1</sup> Karl-Heinz Böckstiegel, *Arbitration and State Enterprises: Survey of the National and International State of Law and Practice* (ICC and Kluwer, Paris, 1984).

Similar to the situation of private persons claiming international protection of human rights such as in the European Convention on Human Rights, private enterprises are today accepted as subjects and holders of individual procedural and substantive rights in international law.

In the context of international arbitration, this is particularly the case through the thousands of BITs and multilateral treaties such as the ICSID Convention, the Energy Charter Treaty, NAFTA and the law of the European Community. In addition to these instruments of public international law, thousands of contracts between states or state institutions on the one side and private enterprises on the other side provide for and are processed in normal commercial arbitration under the rules of the ICC, the LCIA, UNCITRAL and similar arbitral institutions.

However, in such arbitral proceedings between state parties and private enterprises, a number of specific procedural and substantive considerations have to be taken into account and I have tried to show, with regard to examples of the more diversified legal framework, the distinction between the state and state enterprises, and the responsibility for acts of state.

I think one can conclude that the traditional David-Goliath relationship between the two has been replaced, at least procedurally, by a level playing field.