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Renegotiation and Adaptation of International Investment Contracts

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Renegotiation and Adaptation of International Investment Contracts: The Role of Contract Drafters and Arbitrators

*Klaus Peter Berger**

“Renegotiation should . . . be acknowledged as an integral feature of the foreign investment process.”¹

TABLE OF CONTENTS

I.	INTRODUCTION	1348
II.	CONTRACT WITHOUT RENEGOTIATION CLAUSE	1350
	A. <i>Force Majeure Clauses and the Hardship Concept</i>	1350
	B. <i>Inherent Obligation to Renegotiate?</i>	1356
III.	CONTRACT WITH RENEGOTIATION CLAUSE	1357
	A. <i>Examples from Legal Practice</i>	1358
	1. The AMINOIL Clause	1358
	2. The Ok Tedi Clause	1359
	3. The Ghana/Shell Clause	1359
	4. The Lasmo Clause	1359
	5. The Qatar Clause	1360
	B. <i>Similarities and Differences</i>	1360
	C. <i>Definition of “Trigger Events”</i>	1362
	D. <i>The Parties’ Obligations in Reaching Agreement</i>	1363
	1. General Obligations During Negotiations	1363
	2. Duty to Negotiate or Duty to Agree?	1367
	E. <i>Claims for Damages</i>	1368
	F. <i>Procedural Enforceability</i>	1370
	1. The Significance of Arbitration	1370
	2. Differences about Contractual Adaptation as “Legal Disputes”?	1371
	a. Non-doubtful Cases	1371

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1. Samuel B. Asante, *Stability of Contractual Relations in the Transnational Investment Process*, 28 Int'l & Comp. L.Q. 401, 413 (1979).

	b.	Doubtful Cases.....	1372
3.		The Traditional "Dispute Oriented" Understanding of Arbitration.....	1373
4.		Arbitration as a Means of Contract Adjustment	1375
	a.	Procedural Law.....	1375
	b.	Contract Law: Sanctity of Contracts vs. Fairness.....	1377
IV.		SUMMARY	1378

I. INTRODUCTION

In modern-day international investment practice, especially in connection with the exploitation of natural resources, Production Sharing Agreements have come to take over the role of the classic concession agreement.² Like their predecessors, these contracts are particularly vulnerable to disturbances in the commercial balance agreed to, or assumed by, the parties at the conclusion of the contract.³ This vulnerability has three primary causes.

First, these are classic examples of long term contracts. In the petroleum industry, the commitment of significant capital for exploration, particularly in development, and the assumption of considerable risk, particularly in exploration, require contracts covering up to and over ten years of exploration, and over twenty years of an initial production phase.⁴ The long duration of these contracts makes them particularly susceptible to political or economic influences which are unforeseeable at the time of contract conclusion,

2. Production Sharing Agreements (PSA) as a special form of service contract were first used in 1967 in Indonesia. See KASSAN HOSSAIN, *LAW AND POLICY IN PETROLEUM DEVELOPMENT* 138 (1979); RAYMOND F. MIKESELL, *PETROLEUM COMPANY OPERATIONS & AGREEMENTS* 59 (1984). See generally Ernest E. Smith & John Dzienkowski, *A Fifty-Year Perspective on World Petroleum Arrangements*, 24 *TEX. INT'L L.J.* 13, 37 (1989); Irina Paliashvili, *The Concept of Production Sharing*, available at http://www.rulg.com/documents/The_Concept_of_Production_Sharing.htm (last visited Sept. 3, 2003) (explaining that production sharing agreements are "a special form of subsoil use relations based on civil-legal contractual principles for relations between a state and an investor with respect to prospecting, exploration and extraction of mineral resources"). PETER FISCHER, *DIE INTERNATIONALE KONZESSION* 177 (1974); A.F.M. MANIRUZZAMAN, *The New Generation of Energy and Natural Resource Development Agreements: Some Reflections*, 1993 *J. OF ENERGY & NAT. RES. L.* 207, 213.

3. *Kuwait v. American Independent Oil Company*, 1982 *I.L.M.* 976, 1003 (Final Award, Mar. 24, 1982) (stating that "a freely concluded agreement establishes as a matter of principle an equilibrium of interests between the parties").

4. Abba Kolo & Thomas W. Wälde, *Renegotiation and Contract Adaptation in International Investment Projects*, 2000 *J. WORLD INVESTMENT* 5, 21 (2000). See generally STEWART MACAULYAY ET AL., *CONTRACTS: LAW IN ACTION* (1992); FRITZ NICKLISCH, *DER KOMPLEXE LANGZEITVERTRAG* (1987).

but which from the investor's point of view have a negative effect on the economic equilibrium of the contract.

Second, the investor will initially incur significant costs in setting the exploration strategy in motion (sunk costs), which will only be recovered over the duration of the contract. The investor therefore unavoidably depends on the contract actually being carried out for the length of time and on the basis of the framework initially negotiated with the host country.

Third, many host countries make use of the investor's "prisoner's dilemma," pressing for changes to the originally negotiated equilibrium in their favor once the venture has begun, i.e. once the investor has a large amount of sunk costs at stake. In particular, this is likely where exploration plans have proven to be more profitable than originally expected. These negative changes in the investment climate occur through amendments to the relevant laws, tax increases or a more or less forced renegotiation of the contract (obsolescing bargaining):⁵

As soon as a commercially valuable mineral is developed, the psychology of the government is altered. The company may begin to enjoy a high return on its investment. The government...may begin to feel that the resource is virtually being given away. The stage is set for renegotiation, as the original risks are forgotten. Usually the old terms are modified and the parties adopt new terms that are more favourable to the government than those agreed to under conditions of relative uncertainty.⁶

In addition to these conscious and controlled influences such changes can also result from deterioration in the general economic or political circumstances in the host country not foreseen at the time of concluding the contract. For the investor, both scenarios are equally problematic: profit and profitability estimates based on the contractual equilibrium will not be met and the economic success of the project is jeopardized.

5. Cf. RAYMOND VERNON, SOVEREIGNTY AT BAY 46 (1971); ERICH SCHANZE, INVESTITIONSVERTRÄGE IM INTERNATIONALEN WIRTSCHAFTSRECHT 46 (1986); Kolo & Wälde, *supra* note 4, at 23; Klaus Peter Berger, *The New Multilateral Investment Guarantee Agency Globalizing the Investment Insurance Approach Towards Development*, 15 SYR. J. INT'L L. & COM. 13, 52 (1988).

6. DAVID N. SMITH & LOUIS T. WELLS, NEGOTIATING THIRD-WORLD MINERAL AGREEMENTS 19 (1975); *see also* Happ, 2002 RECHT DER ENERGIE 39, 40.

Especially in the oil and gas sector disputes can arise because of the long duration of the project. The passage of time can lead to the initial risks of the project being forgotten and the contractual framework appearing unbalanced once the project begins to experience success. The initial risks of the investor, who had to bear significant costs at the start, are forgotten by the host country and the investor's profits appear unfairly high.

Kolo & Wälde, *supra* note 4, at 30.

This article will examine ways to protect the investor against these sorts of risks and uncertainties. Two scenarios need to be distinguished.⁷ In the first scenario discussed *infra* in Section II, the contract contains no specific adjustment or renegotiation clause. In the second scenario, discussed *infra* in Section III, the parties have included special provisions in their contract to deal with these cases.

II. CONTRACT WITHOUT RENEGOTIATION CLAUSE

If the parties have not included special mechanisms for dealing with a change in the commercial equilibrium in their contract, a renegotiation or adjustment of the contract to changed circumstances can be considered only where other contractual terms or the applicable law provide an appropriate starting point.⁸

A. Force Majeure Clauses and the Hardship Concept

In cases where there is no express renegotiation clause, investors frequently rely on either a force majeure clause included in the contract or the hardship concept of international contract law.⁹ For example, the Lasmo Group Production Sharing Contract of August 19, 1992 between "Vietnam National Oil and Gas Corporation of the Socialist Republic of Vietnam, Lasmo Vietnam Ltd. & C. Itoh Energy Development Co., Ltd for Offshore Block 04-2" contains the following force majeure clause:

17.7 Force Majeure

The obligations of each of the Parties hereunder, other than the obligation to make payments of money, shall be suspended during a period of Force Majeure and the term of the relevant period or phase of this Agreement shall be extended for a time equivalent to the period of Force Majeure situation. In the event of Force Majeure the Party affected thereby shall give notice thereof to the other Party as soon as reasonably practical stating the starting date and the extent of such suspension of obligations and the cause thereof. A Party whose obligations have been suspended as aforesaid shall resume the

7. WOLFGANG PETER, ARBITRATION AND RENEGOTIATION OF INTERNATIONAL INVESTMENT AGREEMENTS 322 (1995); *see also* Asante, *supra* note 1, at 418 ("Although . . . some investment agreements have adopted the mechanism of expressly providing for review or renegotiation, this trend is by no means general").

8. *See* Norbert Horn, *Changes in Circumstances and the Revision of Contracts in some European Laws and in International Laws*, in ADAPTATION AND RENEGOTIATION OF CONTRACTS IN INTERNATIONAL TRADE AND FINANCE 15, 29 (Norbert Horn ed., 1985); PETER, *supra* note 7, at 240.

9. Regarding the latter compare Alexei G. Doudko, *Hardship in Contract: The Approach of the UNIDROIT Principles and Legal Developments in Russia*, 2000 UNIFORM L. REV. 483, 507 (2000), with the truism, "The tendency to treat hardship as a general rule of law is only beginning to emerge."

performance of such obligations as soon as reasonably practical after the removal of the Force Majeure and shall notify the other Party accordingly.

The UNIDROIT Principles of International Commercial Contracts as a restatement of the currently accepted rules and principles of international contract law¹⁰ define hardship and its legal consequences as follows:

Article 6.2.2 - Definition of Hardship

There is hardship where the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of a party's performance has increased or because the value of the performance a party receives has diminished, and

- (a) the events occur or become known to the disadvantaged party after the conclusion of the contract;
- (b) the events could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract;
- (c) the events are beyond the control of the disadvantaged party; and
- (d) the risk of the events was not assumed by the disadvantaged party.

Article 6.2.3 - Effects of Hardship

- (1) In case of hardship the disadvantaged party is entitled to request renegotiations. The request shall be made without undue delay and shall indicate the grounds on which it is based.
- (2) The request for renegotiation does not in itself entitle the disadvantaged party to withhold performance.
- (3) Upon failure to reach agreement within a reasonable time either party may resort to the court.
- (4) If the court finds hardship it may, if reasonable,
 - (a) terminate the contract at a date and on terms to be fixed; or
 - (b) adapt the contract with a view to restoring its equilibrium.¹¹

These examples show that force majeure clauses usually provide for an extension of the contractual performance period and the cancellation of the contract as a measure of last resort.¹² They serve primarily as precautions against the risks posed by economic,

10. See generally MICHAEL BONELL, AN INTERNATIONAL RESTATEMENT OF CONTRACT LAW 19 (2d ed. 1997).

11. International Institute for the Unification of Private Law (UNIDROIT), Principles of International Commercial Contracts 146-51 (1994), 34 I.L.M. 1067 (1995) [hereinafter UNIDROIT Principles].

12. See, e.g., FIDIC General Conditions of Contract for Construction of Building and Engineering Works Designed by the Employer, No. 19.5(a) and 19.6, Test Edition 1998, at 56.

political or social events¹³ unforeseeable at the time contracting, though without the aim of ensuring or re-establishing the commercial equilibrium of the contract. However, force majeure clauses can also contain an obligation on the parties to negotiate and to search for ways to overcome the situation resulting from intervention by "acts of god." Such a contract is particularly ill-suited for cancellation due to the complexity and financial obligations already incurred by the parties.¹⁴ The hardship concept, in comparison, aims directly at maintaining the commercial equilibrium of the contract in that it is triggered when the burden posed on one party has reached the "limit of sacrifice." As a legal consequence of hardship, the parties are obliged to renegotiate their contractual relationship.¹⁵ Thus, the hardship concept proves to be a special form of the same idea incorporated in renegotiation clauses: making contractual obligations more flexible in light of alterations to the commercial equilibrium.¹⁶

Although both the hardship concept and the force majeure clauses can, in theory, provide a starting point for the renegotiation of the contract in case of changed circumstances, this is rarely the case in practice. If the host country asserts a hardship or force majeure event which it brought about itself (legislation), it cannot rely on the clause even when the contract was not made with the state directly, but instead with a government corporation, as is common in natural resources exploration. These corporations are denied reliance on the contractual force majeure clause because, in a fashion similar to piercing the corporate veil, they are regarded as an integral component of the state, which is responsible for the change of conditions in the host country.¹⁷

13. A force majeure event is defined by Article 24 of the concession agreement between the Bougainville Copper Party Ltd. and the Administration of Papua and New Guinea as:

Acts of God, force majeure, floods, storms, tempests, washaways, earthquakes or other seismic disturbances, fires, acts of war (whether declared or undeclared), revolutions, acts of public enemies, riots, civil commotions, strikes, lockouts, stoppages, restraints of labour or other similar acts (whether partial or general), shortages of labour or essential materials, failure to secure contractors, delays of contractors or any other cause or causes whatsoever.

Reprinted in SCHANZE, *supra* note 5, at 242.

14. UNIDO Model Form of Semi-Turnkey Contract for the Construction of a Fertilizer Plant including Guidelines and Technical Annexes, art. 34, UNIDO/Pc.74/Rev. 1 dated Feb. 1, 1985, at 127. *See generally* PETER, *supra* note 7, at 235-39.

15. *See* BONELL, *supra* note 10, at 130.

16. PETER, *supra* note 7, at 242.

17. *Cf.* PETER, *supra* note 7, at 238-39; KARL-HEINZ BÖCKSTIEGEL, DER STAAT ALS VERTRAGSPARTNER AUSLANDISCHER PRIVATUNTERNEHMEN 328 (1971); Ekkehard Nolting, *Hoheitliche Eingriffe als Force Majeure bei internationalen Wirtschaftsverträgen mit Staatsunternehmen?*, 988 RECHT DER INTERNATIONALEN WIRTSCHAFT 511, 515.

If the investor asserts a hardship or force majeure event, they will likewise only rarely be able to achieve a renegotiation of the contract. Should the parties fail to reach an agreement upon renegotiation, their dispute must be decided before an international arbitral tribunal upon which the parties will have agreed in the contract. International arbitrators are, however, extremely reticent when it comes to varying contracts without a specific contractual basis.¹⁸ A good example of this reticence is demonstrated in the response of an arbitral tribunal in an ad hoc arbitration award with regard to an application by one party to have the tribunal rewrite the content of the contract on the basis of a force majeure clause:

It is not for the Arbitral Tribunal to question the motives or judgement of the Parties, but to assess their rights and obligations in light of their legally significant acts or omissions. *That is all; that is enough.* To go beyond this role would be to betray the legitimate expectations reflected in the Parties' agreement to arbitrate, and indeed to impair the international usefulness of the arbitral mechanism. . . .

The arbitrators cannot usurp the role of government officials or business leaders. They have no political authority, and no right to presume to impose their personal view of what might be an appropriate negotiated solution. Whatever the purity of their intent, arbitrators who acted in such a fashion would be derelict in their duties, and would create more mischief than good. The focus of the Arbitral Tribunal's inquiry has been to ascertain the rights and obligations of the parties to the particular contractual arrangements from which its authority is derived.¹⁹

Thus, the principle of sanctity of contracts (*pacta sunt servanda*) as the leading maxim of contract law generally has priority over changes in the surrounding economic conditions.²⁰ Hence, a case of

18. Cf. ICC AWARD NO. 1512 (1971), *reprinted in*, SIGVARD JARVIN & YVES DERAINS, COLLECTION OF ICC ARBITRAL AWARDS 1974-1985 3, 3-4 (1990); No. 2708 (1976), *reprinted in* 104 J. DU DROIT INT'L 943 (1977); No. 2216 (1974), *reprinted in* 102 J. DU DROIT INT'L 917 (1975); No. 2404 (1975), *reprinted in* 103 J. DU DROIT INT'L 995 (1976); No. 2478 (1974), *reprinted in* 102 J. DU DROIT INT'L 925 (1975); No. 2699 (1976), *reprinted in* 104 J. DU DROIT INT'L 945 (1977); Nos. 3099, 3100 (1979), *reprinted in* 8 Y.B. COM. ARB. 87, 87-92 (1982); No. 6281 (1989), *reprinted in* 116 J. DU DROIT INT'L 1114 (1989); No. 8486 (1996), *reprinted in* 125 J. DU DROIT INT'L 1047 (1998); No. 8873 (1997), *reprinted in* 125 J. DU DROIT INT'L 1017 (1998); JEAN FOUCHARD, L'ARBITRAGE COMMERCIAL INTERNATIONAL 438 (1965); NALGA NASSAR, SANCTITY OF CONTRACTS REVISITED 205 (1995); HANS VAN HOUTTE, TRANSNATIONAL RULES IN INTERNATIONAL COMMERCIAL ARBITRATION 105, 109 (Gaillard ed., 1993); UGO DRAETTA ET AL., BREACH AND ADAPTATION OF INTERNATIONAL CONTRACTS 200-02 (1992).

19. UNCITRAL Award of May 4, 1999, 25 Y.B. COM. ARB. 13, 61 (2000).

20. Cf. Norbert Horn, *Adaptation and Modification of Contracts in View of a Change of Circumstances*, in TEL AVIV UNIVERSITY STUDIES IN LAW 137 (1992).

In a contract, each party accepts a certain number of risks and cannot free itself from its obligations if a certain risk materializes. The mere fact that the risk falls heavily on one of the parties is, as yet, not a valid legal argument for a variation of the contract.

force majeure exists not merely because of a change in the economic balance of the parties' respective contractual duties, but rather only in the classic circumstance of interference of acts of god, war, strike, terrorist attacks, rebellion, embargo and natural or environmental disasters,²¹ unless the parties have agreed on other specific provisions.²² Also, performance of the contract will not constitute "hardship" just because the contract has become unprofitable for one party due to changes in the economic or technical setting.²³ Rather, only a breach of the commercial "limit of sacrifice" because of a fundamental change in the commercial balance of the contract will suffice.²⁴ In both cases, the change must have been unforeseeable at the time of concluding the contract:

Parties entering into international contracts cannot claim unawareness of the risks or macro-economic adversities. Their effects may be extreme, but are nonetheless within the contemplation of financiers who evaluate the reliability of borrowers on the strength of contractual undertakings; and as they are in the contemplation of insurers who assess their willingness to provide cover to investors who also rely on such undertakings.

Extreme instances test the very fabric of the myriad of contracts which are part of the foundation of international economic exchanges. It is precisely at the extremes that the test is meaningful. An international tribunal cannot disregard legitimate contractual expectations without risking harm to this fabric. Arbitrators have no more business sacrificing legal principle to perceived factual realism than a national court can disregard contractual entitlements because it has the impression that the debtor cannot factually meet its obligations.²⁵

Beneath this limit of unforeseeable fundamental change in the contractual basis, parties to international investment contracts can overcome the *pacta sunt servanda* principle only if the contract contains a renegotiation clause.²⁶ Only then are international arbitral

21. See Horn, *supra* note 8, at 132-34.

22. Cf. *id.* at 131 (noting that "special risk" clauses can denote specific risks to be treated as force majeure or hardship).

23. Cf. ICC PUBLICATION NO. 421, FORCE MAJEURE AND HARDSHIP S.22 (1985); UNIDROIT Principles, *supra* note 11, art. 6.2.1 (1994) ("Where the performance of a contract becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligation").

24. Marcel Fontaine, *Les Clauses de Hardship—Aménagement Conventionnel de l'Imprévision dans les Contrats à Long Terme*, 1976 DROIT ET PRATIQUE DU COMMERCE INTERNATIONAL 7. See Hans van Houtte, *UNIDROIT Principles of International Commercial Contracts and International Commercial Arbitration: Their Reciprocal Relevance*, in ICC PUBL. NR. 490/1, UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS: A NEW LEX MERCATORIA?, 181, 189 (1995); Clive M. Schmitthoff, *Hardship and Intervener Clauses*, 1980 J. BUS. L. 82, 84.

25. UNCITRAL Award of May 4, 1999, 25 Y.B. COM. ARB. 13, 64 (2000); ICC Award No. 2142 (1974), reprinted in 2 Y.B. COM. ARB. 132 (1976).

26. Wolfgang Harms, *Zur Anwendung von Revisionsklauseln in langfristigen Energielieferungsverträgen*, 1983 DER BETRIEB 322, 325; see also BAUR, Festschrift STEINDORFF 511, 512 (1985) ("By agreeing to the commercial clause the parties have

tribunals inclined to interfere with the content of the contract when economic conditions have changed, assuming that the applicable law permits it.

The basis of this approach is the presumption of professional competence of international businessmen, and the ensuing high level of responsibility for the contents and conduct of their legal relationships. This principle has been continuously emphasized by international arbitral tribunals over the past decades.²⁷ It serves as the standard for risk distribution within the contract. Based on this presumption, it is assumed that the parties themselves are responsible for taking precautions against adverse changes in the socioeconomic circumstances by agreeing on renegotiation clauses when concluding the contract. If they do not, force majeure clauses, or reliance on the hardship concept, may not serve as a substitute for their negligence at the drafting stage, and will not serve as a pretext for deluting the *pacta sunt servanda* principle.²⁸ Rather, the parties

made it clear that the 'fair distribution of performance and counter-performance' throughout the duration of the contract is more important to them than legal certainty").

27. Cf. ICC AWARD NO. 1990 (1974), reprinted in 101 J. DU DROIT INT'L 897 (1974); No. 1512 (1974), reprinted in 101 J. DU DROIT INT'L 905 (1974); No. 2291 (1975), reprinted in 103 J. DU DROIT INT'L 989 (1976); No. 2438 (1975), reprinted in 103 J. DU DROIT INT'L 969-971 (1976); No. 3130 (1980), reprinted in 108 J. DU DROIT INT'L 932 (1981); No. 3380 (1980), reprinted in 108 J. DU DROIT INT'L 927 (1981); No. 5364 (1988), reprinted in 118 J. DU DROIT INT'L 1059 (1991). See generally KLAUS PETER BERGER, *THE CREEPING CODIFICATION OF THE LEX MERCATORIA* 301 (1999).

28. See ICC AWARD NO. 1512, reprinted in JARVIN *supra* note 18, at 4.

As a general rule, one should be particularly reluctant to accept it [the doctrine *rebus sic stantibus*] when there is no gap or lacuna in the contract and when the intent of the parties has been clearly expressed. . . . Caution is especially called for, moreover, in international transactions where it is generally much less likely that the parties have been unaware of the risk of a remote contingency or unable to formulate it precisely.

Id.; see also ICC AWARD NO. 6281 (1989), reprinted in 15 Y.B. COM. ARB. 96, 98 (1990) (noting that "[o]therwise [i.e. in the case of an intervention in the contract], any business transaction would be exposed to uncertainty, or even be rendered impossible all together, whenever the mutual covenants are not performed at the time at which the contract is concluded"); Yves Derains note regarding ICC Award No. 2291 (1975), reprinted in JARVIN *supra* note 18, at 275-77; Yves Derains note regarding ICC Award No. 8486, 118 J. DU DROIT INT'L 1050 (1998); Thomas E. Carbonneau, *Rendering Arbitral Awards with Reasons: The Elaboration of a Common Law of International Transactions*, 23 COLUM. J. TRANSNAT'L L. 589, 593 (1985) (explaining that "Given the parties' [presumed] professional sophistication as international merchants, ICC arbitrators interpret party silence about possible future contingencies as a conscious decision to assume the risk of such eventualities"); Bernard G. Poznanski, *The Nature and Extent of an Arbitrator's Powers in International Commercial Arbitration*, 4 J. INT'L ARB. 71, 81 (1987) (suggesting that "Parties intending to contract can protect themselves [against the risk of changed circumstances] by fortuitous events clauses, and in the absence of such clauses, the contract is presumed to be speculative").

have to recognize that priority is given to fulfilling contractual promises. Thus, the risk of adverse changes to the economic balance of the contract below the last limit of sacrifice is to be borne by the parties.

There are exceptions to these principles; one example is Art. 17(1) of the Russian Act on Production Sharing contracts. According to this provision, the contract can also be varied without an agreement between the parties, where the requirements of the Russian Civil Code definition of a "significant change of circumstances" have been met.²⁹ This brings significant uncertainty into the contractual relationship.³⁰

B. *Inherent Obligation to Renegotiate?*

It is often argued that even without a specific contractual clause, international investment contracts include an inherent duty to renegotiate in light of changed circumstances.³¹ This view is based on various U.N. resolutions which founded the "New International Economic Order" (NIEO) in the 1960s.³² In international contract law, it derives from the principle of good faith and the duty of the parties to cooperate³³ based on it.³⁴ The U.N. Draft Code of Conduct for Transnational Corporations also contains a provision according to

29. Russian Act on Production Sharing Agreements, art. 17 (1995) *reprinted in* 35 I.L.M. 1251, 1270 (1996) ("The introduction of amendments to the agreement shall be allowed only by consent between the parties, as well as upon request of one of the parties in case of a significant change of circumstances as defined by the Civil Code of the Russian Federation").

30. *See id.*

31. *See* SUBRATA CHOWDHURY, THE PROCEEDINGS OF THE FIRST YUGOSLAV SEMINAR ON LEGAL ASPECTS OF THE NEW INTERNATIONAL ECONOMIC ORDER 25 (1986); M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 197 (1994).

32. *Declaration on Permanent Sovereignty over Natural Resources*, G.A. Res. 1803, U.N. GAOR, 17th Sess., Supp. No. 17, at 107, U.N. Doc. A/5217 (1962); *Charter of Economic Rights and Duties of States*, G.A. Res. 3281, U.N. GAOR, 29th Sess., Supp. No. 31, at 300, U.N. Doc A/9631 (1974). *See generally* JIMINEZ DE ARECHAGA, LEGAL ASPECTS OF THE NEW INTERNATIONAL ORDER (1980); T.W. Wälde, *in A Requiem for the "New International Economic Order": The Rise and Fall of Paradigm in International Economic Law and a Post-Mortem With Timeless Significance*, LIBER AMICORUM SEIDL-HOHENVELDERN 77, 774 (Hafner, et al., eds. 1998); Norbert Horn, *Normative Problems of a New International Economic World Order*, 16 J. WORLD TRADE L. 338 (1982).

33. *See generally* NASSAR, *supra* note 18, at 156-167; <http://www.tldb.de> (on the duty to cooperate as part of the *Lex Mercatoria*).

34. ICC AWARD NO. 6219 (1990), *reprinted in* SIGVARD JARVIN et al., COLLECTION OF ICC ARBITRAL AWARDS 1986-1990 428, 431 (1994); No. 2478 (1976), *reprinted in* 104 J. DU DROIT INT'L 942 (1977); No. 2291 (1975), *reprinted in* 103 J. DU DROIT INT'L 989 (1976); No. 2508 (1976), *reprinted in* 104 J. DU DROIT INT'L 939 (1977); Norbert Horn, *Neuverhandlungspflicht*, 181 ARCHIV FÜR DIE CIVILISTISCHE PRAXIS 255 (1981). *See generally infra* note 131 (discussing changed nature of international contract law).

which these corporations should engage in renegotiation even without a relevant contractual clause:

In the absence of contractual clauses providing for review or renegotiation, transnational corporations should respond positively to requests for review or renegotiation of contracts concluded with Governments or governmental agencies in circumstances marked by duress, or clear inequality between the parties, or where the conditions upon which such a contract was based have fundamentally changed, causing thereby unforeseen major distortions in the relations between the parties and thus rendering the contract unfair or oppressive to either of the parties. Aiming at ensuring fairness to all parties concerned, review or renegotiation in such situations should be undertaken in accordance with applicable legal principles and generally recognized legal practices.³⁵

The last section of the quoted provision makes it clear that such a duty to renegotiate can be taken into consideration only if the law applicable to the contract provides for it.³⁶ At the transnational level there is by no means agreement on the existence of such a duty to renegotiate, even in light of the changing understanding of a contract as a flexible framework for the "fair" and "reasonable" distribution of contractual rights and obligations.³⁷ However, there are good reasons to assume the existence of such a transnational legal principle.³⁸

III. CONTRACT WITH RENEGOTIATION CLAUSE

The necessity of agreeing on specific precautions for a subsequent alteration in the commercial balance in the contract itself is a consequence of the combined effects just described, of force majeure clauses or the hardship concept on one hand, and the principle *pacta sunt servanda* on the other. Since neither the classic force majeure clauses, nor the hardship concept, offer adequate protection against an unfavorable change in the commercial balance, investors have always tried to secure themselves against the risks of subsequent negative changes in the economic equilibrium assumed at the initial negotiation and conclusion of international contracts. Conversely, host countries use this sort of clause to participate in the investor's profit. Therefore, in the drafting practice of modern Production Sharing contracts, the parties always agree on

35. UN-ECOSOC 1979 Transnational Corporations: Codes of Conduct, Formulations by the Chairman, art. 5 *reprinted in* LEGAL PROBLEMS OF CODES OF CONDUCT FOR MULTINATIONAL ENTERPRISES 493, 494 (Norbert Horn ed., 1980).

36. PETER, *supra* note 7, at 201 ("In the absence of such provisions [on renegotiation] it seems more appropriate to speak about a *right to ask for contractual change* where the applicable law provides for such a right").

37. See *infra* note 130 and accompanying text.

38. Cf. BERGER, *supra* note 27, at 297.

precautions for an unfavorable alteration in the economic equilibrium of the contractual duties they assumed at the time of concluding the contract.

A. Examples from Legal Practice

Some examples from international investment contracts concluded in recent decades may illustrate the legal issues involved with these types of adjustment or renegotiation clauses.

1. The AMINOIL Clause

Probably one of the best known—even though, for reasons of special geo-political circumstances, unsuccessful—examples of such clauses is contained in the Supplementary Agreement of July 29, 1961 to the concession agreement between the state of Kuwait and the “*American Independent Oil Company*” (AMINOIL) of June 28, 1948. The clause was worded as follows:

Art. 9

If, as a result of changes in the terms of concessions now in existence or as a result of the terms of concessions granted hereafter, an increase in benefits to Governments in the Middle East should come generally to be received by them, the Company shall consult with the Ruler whether in the light of all relevant circumstances, including the conditions in which operations are carried out, and taking into account all payments made, any alterations in the terms of the agreements between the Ruler and the Company would be equitable to the parties.³⁹

In a “Confidential Letter” exchanged between the parties, it was recorded, amongst other details, that the term “benefits” in Article 9 of the Supplementary Agreement also included “arrangements not involving payments.”⁴⁰ With these words, the scope of the clause was extended significantly. After lengthy negotiations between the state and the U.S. concessionary, which took place against the background of the strengthened sovereignty of host countries in the last 1960s—initially in the Near and Middle East and later worldwide—as well as the rising oil prices in the years after 1973, the State of Kuwait declared the end of the contract through Decree No. 124 of September 19, 1977. At the same time, the decree nationalized corporation property. When a dispute arose between the parties as to the legality of these measures an international arbitral tribunal decided the

39. Cf. *Kuwait v. Am. Indep. Oil Co.*, Final Award, Mar. 24, 1982, 21 I.L.M. 976, 992, 1002 (1982); F.A. MANN, *The Aminol Arbitration*, in FURTHER STUDIES IN INTERNATIONAL LAW 252, 252-63 (1990); PETER, *supra* note 7, at 103 (noting that “. . . the Aminoil renegotiations were an excellent illustrative case of the general issues arising in connection with investment contracts”).

40. *Kuwait v. Am. Indep. Oil Co.*, 21 I.L.M. at 992.

reciprocal claims of the parties. The Ad Hoc Arbitration Agreement, which formed the basis of the procedure and subjected all "differences and disagreements" arising from the concession agreement to "transnational arbitration," provided that the jurisdiction of the arbitral tribunal was limited to deciding reciprocal payment or damages claims because the restoration of the legal relationship of the parties prior to Decree No. 124 as well as an adjustment to fit changed economic circumstances were out of the question.⁴¹

2. The Ok Tedi Clause

The "OK Tedi Papua New Guinea Concession Agreement" of 1976 contains the following brief and very general clause:

The parties may from time to time by agreement in writing add to, substitute for, cancel or vary all or any of the provisions of this Agreement.⁴²

3. The Ghana/Shell Clause

The Petroleum Production Agreement, concluded in 1974 between "The Government of Ghana and Shell Exploration and Production Company of Ghana Ltd.," contained the following clause:

Art. 47

(b) It is hereby agreed that if during the term of this Agreement there should occur such changes in the financial and economic circumstances relating to the petroleum industry, operating conditions in Ghana and marketing conditions generally as to materially affect the fundamental economic and financial basis of this Agreement, then the provisions of this Agreement may be reviewed or renegotiated with a view to making such adjustments and modifications as may be reasonable having regard to the Operator's capital employed and the risks incurred by him always provided that no such adjustments or modifications shall be made within 5 years after the commencement of production of petroleum in commercial quantities from the production area and that they shall have no retroactive effect.⁴³

4. The Lasmo Clause

The Lasmo Group Production Sharing Contract of August 19, 1992 between the "Vietnam National Oil and Gas Corporation of the Socialist Republic of Vietnam, Lasmo Vietnam Ltd. & C. Itoh Energy

41. *Id.* at 979.

42. "OK Tedi" Papua New Guinea Concession Agreement, *in* NASSAR, *supra* note 18, at 175.

43. On-Shore (Voltaian Basin) Petroleum Production Agreement, *in* Asante, *supra* note 1, at 417.

Development Co., Ltd for Offshore Block 04-2" contained the following clause:

Art. 17.8 Introduction of New Laws and Regulations

If after the Effective Date, new law(s) and/or regulation(s) are introduced in Vietnam adversely affecting CONTRACTOR'S interest, or any amendments to existing laws and/or regulations are made then the Parties shall meet and consult each other and shall make the necessary changes to this Agreement to ensure that CONTRACTOR is restored to the same economic conditions which would have prevailed if the new law and/or regulation or amendment had not been introduced.

In Article 11, the contract contains an arbitration agreement for "all disputes arising out of or in connection to the contract." In Article 17.9 the parties are granted the right to present all "questions, which are in substance of a technical nature" to an "independent expert of international reputation."

5. The Qatar Clause

The "Model Exploration and Production Sharing Agreement" of the Sheikdom of Qatar of 1994 contains amongst others the following clause:

Art. 34.12 Equilibrium of the Agreement

Whereas the financial position of the Contractor has been based, under the Agreement, on the laws and regulations in force at the Effective Date, it is agreed that, if any future law, decree or regulation affects Contractor's financial position, and in particular if the customs duties exceed . . . percent during the term of the Agreement, both Parties shall enter into negotiations, in good faith, in order to reach an equitable solution that maintains the economic equilibrium of this Agreement. Failing to reach agreement on such equitable solution, the matter may be referred by either Party to arbitration pursuant to Article 31.⁴⁴

B. Similarities and Differences

The special characteristics of the clauses presented above become clear when compared with classic stabilization clauses.⁴⁵ The latter are designed to protect the investor by "freezing" the legal situation in the host country at the time of concluding the contract (*clause de gel*). Unavoidably, they come into conflict with the sovereignty of the host country.⁴⁶ To avoid this, and because of the questionable legal validity of these clauses, the renegotiation clauses cited above aim to

44. Model Exploration and Production Sharing Agreement, in BERNARDINI, ICSID REV.-FILJ 411, 416 (1998).

45. See *id.* at 418; M. SORNARAJAH, THE SETTLEMENT OF FOREIGN INVESTMENT DISPUTES 54 (2000); Kolo & Wälde, *supra* note 4, at 43.

46. Cf. HANNO MERKT, INVESTITIONSSCHUTZ DURCH STABILISIERUNGSKLAUSELN 237 (1990).

protect the investor, not by establishing a fixed legal situation in advance, but conversely by making the contractual framework flexible and dynamic throughout the duration of the contract in case the host country changes the economic circumstances by “sovereign” acts. Comparing both approaches—freezing there, allowing for flexibility here⁴⁷—reveals the classic conflict of interests between host country and investor which has always characterized the law of international investment contracts:

A major source of conflict between host governments of developing countries and transnational corporations derives from the preoccupation of transnational corporations with stability and predictability in contractual relations on the one hand, and the persistent demands of host governments for a more flexible contractual regime on the other.⁴⁸

The more flexible contractual regime gained through the renegotiation clause leaves the host country’s sovereignty intact because it is a private law agreement on the renegotiation of the contract. To guarantee this flexibility, the contractual provisions must unavoidably be “open” in style. Therefore, they tend to exhibit significant uncertainty. This applies especially to the following key issues:

1. the definition of events triggering the duty to renegotiate (*trigger events*);
2. the exact content of the contractual obligations, in particular
 - the question of an obligation to negotiate as well as
 - the question of an obligation to reach a (particular?) result;
3. the legal consequences of failure to fulfil the contractual obligation to negotiate;
4. the enforceability of the obligation to negotiate before an international arbitral tribunal, in particular the authority of the tribunal to adapt the contract to the changed circumstances in lieu of the parties.

For investors, the answers to these questions are of essential importance to their risk planning. They determine the ease of use and efficiency of these clauses. Only when a certain amount of pressure is applied to the host country in regard to the ability of the clauses to function is it certain that the protection of the investor is not just on paper. Only then will the clause also fulfill its function in the realm of “conflict avoidance,” *i.e.* in the lead up to an argument over renegotiation and adaptation of the contract.

47. *Id.* at 253.

48. Asante, *supra* note 1, at 404.

C. Definition of "Trigger Events"

The ability of a renegotiation clause to function in practice is dependent, above all, on the prerequisites for initiating a consensual procedure being clearly defined in the clause.⁴⁹ The unavoidable openness of these clauses, however, is in direct contradiction to the necessity for concrete definitions. Hence, it is the nature of these clauses that they can never cover every conceivable case.⁵⁰

According to the duration and complexity of each contract, different approaches to determining the trigger to review can be found. Whereas some clauses, such as in the Ok Tedi contract, do not provide for any prerequisites to the consensus procedure,⁵¹ others provide for very general conditions. For example, Article 9 of the AMINOIL contract⁵² makes the obligation to renegotiate dependent on the existence of an "increase in benefits to Governments in the Middle East . . . generally to be received by them." Article 47(b) of the Ghana/Shell contract⁵³ requires "such changes in the financial and economic circumstances relating to the petroleum industry, operating conditions in Ghana and marketing conditions generally as to materially affect the fundamental economic and financial basis of this Agreement." The latter formulation in particular makes clear the issues involved with this sort of renegotiation clauses. The change in the commercial balance of the contract can barely be defined more concretely. Trigger events evade a detailed definition as they are complex, unforeseen, and influenced by naturally volatile economic determinants. These clauses can be qualified as "general review clauses." Other clauses, however, link the trigger of the procedure to the occurrence of one or more events defined more precisely in the clause, such as tax increases, price changes for raw materials, or in the event that a specific risk materializes (special risk clauses). From the perspective of contract control, the latter types of clauses have the advantage of determining more precisely the beginning of the adaptation procedure.⁵⁴ However, this comes at a cost: the disadvantage of having agreed to overcome the notion of sanctity of contract only for a specific, more or less strictly limited, type of risk.

49. Cf. Horn, *supra* note 8, at 129 (observing that "[t]he defining of a particular event which will trigger review is the most salient feature of a special review clause").

50. Cf. WILLIAM F. FOX, INTERNATIONAL COMMERCIAL AGREEMENTS 221 (3d ed. 1998) (arguing that "express contractual language will not totally eliminate risk- there is virtually nothing that can accomplish this").

51. See discussion *supra* note 42 and accompanying text.

52. See discussion *supra* note 39 and accompanying text.

53. See discussion *supra* note 43 and accompanying text.

54. Cf. Horn, *supra* note 8, at 129 (noting that "[i]n most cases, the parties are well advised to be quite specific as to the adaptation mechanism. . ."); Bernardini, *supra* note 44, at 419 ("The parties' obligations . . . should be precisely defined").

In view of the difficulties in formulating a general renegotiation clause that defines specifically when a change of circumstances and its impact is serious enough to trigger a renegotiation, many negotiators of modern investment agreements do not include such general clauses.⁵⁵ In that case an “analogous” application of these specific clauses to other general risks below the hardship and force majeure threshold generally will not be considered.⁵⁶ This follows from the presumption presented above in favor of the professional competence of the contracting parties in international commercial contract law. It is assumed that the parties would have included such a clause in the contract if they wanted one. An extension of the specific clause to other risks not regulated there would therefore be in contradiction of the parties’ presumed intentions.

D. *The Parties’ Obligations in Reaching Agreement*

Alongside determining the events triggering the renegotiation process, fixing or determining the contractual obligations of the parties in the context of that process is of decisive importance for the efficiency of a clause and its legal enforceability. Renegotiation clauses often contain only a broad guide to the standard to be applied to reaching an agreement. Often reference is made to “good faith,” “fairness and equity” or the goal of reconstructing the “contractual equilibrium as intended by and in the initial spirit of the contract.”⁵⁷ The Lasmò clause is more pronouncedly oriented to preserving the commercial *status quo ante* and requires that “necessary changes to this Agreement” be made “to ensure that CONTRACTOR is restored to the same economic conditions which would have prevailed if the new law and/or regulation or amendment had not been introduced.”⁵⁸

1. General Obligations During Negotiations

In themselves, these formulations say very little. The most one can infer from them is that in the first case the “*hic et nunc*” fair decision should typically be aimed for, whereas in the other two cases more consideration should be given to the original equilibrium expectations of the parties. In actuality, it must be assumed that,

55. Kolo & Wälde, *supra* note 4, at 47.

56. NASSAR, *supra* note 18, at 178; van Houtte, *supra* note 18, at 105, 110; ICC Award No. 2478 (1974), 3 Y.B. COM. ARB. 222 (1978) (contractual adjustment clause for currency fluctuations not applicable to collapse in commodity prices); No. 2216 (1974), reprinted in 102 J. DU DROIT INT’L 917 (1975); No. 2291 (1975), reprinted in 103 J. DU DROIT INT’L 989 (1976); No. 5953 (1989), reprinted in 117 J. DU DROIT INT’L 1056 (1990).

57. PETER, *supra* note 7, at 244; NASSAR, *supra* note 18, at 178.

58. Cf. *supra* part III.A.4.

unless there are indications to the contrary, the parties always (even after their contract has undergone an adaptation process) wish to preserve the equilibrium of their contractual obligations as expressed in the contract.⁵⁹ The idea that the performance obligations of the parties should be commercially equivalent is a general principle of international commercial contract law.⁶⁰ Therefore it also applies when not expressly included in the wording of the contract, as, for example, with the OK-Tedi clause.⁶¹

Independent of the formulation of each clause, a catalogue of more or less concrete party obligations can be derived from the inherent function of this type of clause which must be fulfilled in a renegotiation procedure. This catalogue is based on three basic considerations: first, despite their unavoidable uncertainty, these kinds of clauses are not empty shells. Rather, by agreeing to the clause, both parties are legally obliged to cooperate in the renegotiation procedure in an efficient manner, i.e. in a manner aimed at successfully negotiating a solution. This requires, above all, earnest efforts, flexibility (as a vital component of these clauses)⁶² and a willingness to consider the needs and interests of the other party. The arbitral tribunal in the AMINOIL arbitration interpreted the clauses according to their purpose and referred to the position taken by the International Court of Justice in its *Continental Shelf* decision⁶³ to summarize the content of the obligation as follows:

[Neither side has neglected] the general principles that ought to be observed in carrying out an obligation to negotiate, - that is to say, good faith as properly to be understood; sustained upkeep of the negotiations over a period appropriate to the circumstances; awareness of the

59. PETER, *supra* note 7, at 244; NASSAR, *supra* note 18, at 178.

60. See ICC AWARD NO. 2291 (1975), reprinted in JARVIN, *supra* note 18, at 274 ("toute transaction commerciale est fondée sur l'équilibre des prestations réciproques et ... nier ce principe reviendrait à faire du contrat commercial un contrat aléatoire, fondé sur la spéculation ou le hasard"); Ernst Steindorff, *Vorvertrag zur Vertragsänderung*, 1983 BETRIEBS-BERATER 1127 (referring to German law trade practices, i.e. 'Verkehrssitte' or 'Handelsbrauch'). See generally Gino Lörcher, *Die Anpassung langfristiger Verträge an veränderte Umstände*, in DER BETRIEB 1269 (1996).

61. See "OK Tedi" Papua New Guinea Concession Agreement, in NASSAR, *supra* note 18, at 175.

62. Cf. Horn, *supra* note 8, at 122 (correctly referring to "built-in contractual flexibility," introduced into the contractual framework by these clauses).

63. North Sea Continental Shelf (F.R.G. v. Den.), 1969 I.C.J. 4, 47 (Feb. 16).

Defining the content of the obligation to negotiate, the Permanent Court, in its Advisory Opinion in the case of *Railway Traffic between Lithuania and Poland*, said that the obligation was 'not only to enter into negotiations but also to pursue them as far as possible with a view to concluding agreements,' even if an obligation to negotiate did not imply an obligation to reach agreement.

Id.

interests of the other party; and a preserving quest for an acceptable compromise.⁶⁴

Second, the function of these clauses is limited to adapting the contract to the changed circumstances. They do not justify a restructuring of the entire contract unless this is clearly expressed in the clause. Third, in this sort of consensus procedure, the prohibition to cause damages to the other side and to exploit the other party's weakness to the detriment of that party is exceedingly important.⁶⁵ Both principles can be understood as a continuation into the consensus-finding phase of the general obligation to cooperate⁶⁶ in the performance of the contract, an obligation to which all parties to a long-term international contract are subject.⁶⁷ Renegotiation clauses should not result in a commercial advantage to one of the parties, but instead, function either to maintain or to restore the commercial balance of the contract to adjust to changed circumstances.

Accordingly, the obligations to which the parties to a renegotiation clause are subject can be defined as follows:

1. Keeping to the negotiation framework set out by the clause,
2. Respecting the remaining provisions of the contract,
3. Having regard to the prior contractual practice between the parties,
4. Making a serious effort to reach agreement,
5. Paying attention to the interests of the other side,
6. Producing information relevant to the adaptation,
7. Showing a sincere willingness to reach a compromise,
8. Maintaining flexibility in the conduct of negotiations,
9. Searching for reasonable and appropriate adjustment solutions,
10. Making concrete and reasonable suggestions for adjustment instead of mere general declarations of willingness,
11. Avoiding rushed adjustment suggestions,
12. Giving appropriate reasons for one's own adjustment suggestions,
13. Obtaining expert advice in difficult and complex consensus proceedings,
14. Responding promptly to adjustment offers from the other side,

64. See *Kuwait v. Am. Indep. Oil Co.*, Final Award, Mar. 24, 1982, 21 I.L.M. 976, 1014 (1982).

65. See ICC AWARD NO. 2291 (1975), reprinted in JARVIN, *supra* note 18, at 274.

66. See generally UNIDROIT Principles, *supra* note 11, art. 5.3; ICC Award No. 4761 (1987), reprinted in JARVIN, *supra* note 34, at 519; No. 5030 (1992), reprinted in 120 J. DU DROIT INT'L 1004, 1014 (1993) (note by Derains); BERGER, *supra* note 27, at 298.

67. See ICC AWARD NO. 2291 (1975), reprinted in JARVIN, *supra* note 18, at 277 (note by Derains); FRITZ NICKLISCH, PARTNERSCHAFTLICHE INFRASTRUKTURPROJEKTE 149, 157 (1996).

15. Making an effort to maintain the price-performance relationship taking into consideration the parameters regarded as relevant by the parties,
16. Avoiding an unfair advantage or detriment to the other side ("no profit – no loss" principle),
17. Prohibition on creating established facts during negotiations except in emergency situations (ban on "escalation" strategies),
18. Maintaining efforts to reach agreement over an appropriate length of time, and
19. Avoiding unnecessary delays in the consensus proceedings.⁶⁸

Within a given renegotiation process, none of these obligations have sole validity. Rather, they are starting points for determining what is required of the parties in each individual case by examining together the wording of the clause, the nature of the contract and the combined effect of its provisions, the consensus criteria set out in the clause, the purpose⁶⁹ the parties intended the clause to serve and the type of risks realized.⁷⁰ The various factors will be summing up subject to the principle of good faith and, in particular, the notions of fairness and reasonableness derived therefrom.⁷¹ Thus, a party will be subject to fewer requirements if the opposite side also makes no moves to support the negotiation process. This follows from the idea of cooperation as a distributor of legal duties, on which most of the above-mentioned obligations are based. The idea of an asymmetrical distribution of information also needs to be considered when summing up. Following this, the obligation of one party to make its own suggestions during the renegotiation process is proportionately smaller insofar as the other party is in a better position to make progress towards a solution due to technical conditions or the distribution of risks in the contract. Timing also has a role to play in determining the negotiation obligations of the parties. The obligation to provide concrete suggestions for a solution needs to be fulfilled to an increasingly higher standard the further the negotiations proceed.

68. See Horn, *supra* note 8, at 15, 28; Horn, *supra* note 34, at 255, 284; ANDREAS NASSAR, *supra* note 18, at 180; NELLE, NEUVERHANDLUNGSPFLICHTEN 272 (1994); JÜRGEN BAUR, VERTRAGLICHE ANPASSUNGSREGELN 120 (1983); PETER, *supra* note 7, at 246; Nicklisch, *supra* note 67, at 156; Steindorff, *supra* note 60, at 1130; Kolo & Wälde, *supra* note 4, at 57; UNCITRAL, LEGAL GUIDE ON DRAWING UP INTERNATIONAL CONTRACTS FOR THE CONSTRUCTION OF INDUSTRIAL WORKS 246 (1998); Kuwait v. Am. Indep. Oil Co., *supra* note 39, at 1014; Wintershall A.G. v. Gov't of Qatar, 28 ILM 798, 814 (1989); ICC AWARD NO. 2291 (1975), reprinted in JARVIN, *supra* note 18, at 277 (note by Derains); North Sea Continental Shelf, *supra* note 63, at 47.

69. These might include covering costs or increasing or protecting value. See BAUR, *supra* note 68, at 77.

70. See Kuwait v. Am. Indep. Oil Co., 21 I.L.M. at 1009 (¶¶ 49-70) (discussing the course of such a negotiation and its adjudication by an international arbitral tribunal); see also NASSAR, *supra* note 18, at 183.

71. HORN, *supra* note 8, at 28; PETER, *supra* note 7, at 206; NELLE, *supra* note 68, at 290; ICC AWARD NO. 2508 (1976), reprinted in JARVIN, *supra* note 18, at 292.

2. Duty to Negotiate or Duty to Agree?

If the negotiations fail to make progress, threaten to collapse, or have failed, the question arises whether the parties are obliged to reach an agreement. This is especially problematic because clauses aimed just at negotiation do not contain the same level of clearly defined performance terms as do “hard” contractual provisions, for example those on payment of a purchase price or delivery, or manufacture of the contractual object. In the interests of an efficiency-oriented interpretation of such clauses, German law provides that an obligation of the parties to reach agreement exists in this respect if the adjustment criteria and adjustment aim have been defined to sufficient clarity.⁷² Internationally, however, another point of view prevails. The result is based on the particular quality of renegotiation clauses. Contrary to “one-dimensional” contract clauses, these open clauses refer to several possible consensus options. Which one will be applicable in the end cannot be fixed in advance; instead, it depends on various circumstances, like the negotiation strengths of the parties and their respective commercial circumstances at the time of negotiation as well as the parties’ strategic aims and options. These circumstances are not fixed in advance, and cannot be evaluated in an objective legal sense. These considerations apply regardless of how strongly adaptation standards and aims have been clarified in the clause. According to unanimous international opinion, renegotiation clauses only contain an obligation on the parties to make the best possible effort to reach an agreement within the framework of the list presented above. They do not, however, require the parties to actually reach an agreement.⁷³ This has been repeatedly determined in particular in connection with adjusting Concession or Production Sharing Agreements⁷⁴ as well as in the context of international law.⁷⁵

72. See Horn, *supra* note 8, at 283; Norbert Horn, *Vertragsbindung unter veränderten Umständen*, 38 NEUE JURISTISCHE WOCHENSCHRIFT 1118, 1123 (1985); Steindorff, *supra* note 60, at 1128; STEFAN KRÖLL, ERGÄNZUNG UND ANPASSUNG VON VERTRÄGEN DURCH SCHIEDSGERICHTE 154 (1999); Lörcher, *supra* note 60, at 1270; German Federal Supreme Court, Apr. 8, 1968, VIII ZR 1 8/66, in WM 1968, 575; German Federal Supreme Court, Mar. 8, 1973, II ZR 134/71, in BETRIEBS-BERATER 1973, 723.

73. Schmitthoff, *supra* note 24, at 87; Fontaine, *supra* note 24, at 75; Durand-Barthez, D.P.C.I. 357, 371 (1984); NASSAR, *supra* note 18, at 180; PETER, *supra* note 7, at 247; Nicklisch, *supra* note 67, at 156; Bernardini, *supra* note 44, at 419; BAUR, *supra* note 68, at 120; NELLE, *supra* note 6, at 68; UGO DRAETTA ET AL., *supra* note 18, at 197.

74. *Kuwait v. Am. Indep. Oil Co.*, 21 I.L.M. at 1004 (“An obligation to negotiate is not an obligation to agree”); *Wintershall A.G. v. Gov’t of Qatar*, *supra* note 68, at 814, 841 (“it is clear that such a duty [to negotiate] does not include an obligation . . . to reach agreement . . . [nor is] the Government [is not] legally required to enter into such an agreement, however reasonable it may be”).

These types of clauses therefore do not establish any liability of the parties based on the failed success of the renegotiation process, rather they have an effect similar to "best efforts" clauses.⁷⁶ The duty to negotiate based on a renegotiation clause can therefore still be fulfilled even if the parties do not reach an agreement, e.g. because one party rejects the other side's proposals for reasons that are based on normal commercial judgment.⁷⁷ Any other view would fail. Because of their openness, these clauses can only set a generally determined goal (guaranteeing the commercial balance between the parties' contractual obligations) and provide for the procedure (negotiation) to be followed by both parties, but they can never set the actual manner in which this aim should be reached, e.g. by setting definite alternatives to be decided.⁷⁸ In that way, renegotiation clauses allocate authorisation for adjustment to *both parties together* with all the unpredictable elements necessarily involved. This means that these clauses result in process-oriented, instead of success-oriented, contractual obligations for both parties.⁷⁹

E. Claims for Damages

Party liability for damages arising from a breach of the contractual obligations derived from the clause only comes into consideration in exceptional cases.⁸⁰ Here too, the special legal nature of these clauses should be taken into account. Merely not reaching

75. Permanent Ct. of Int'l Justice *In re Ry. Traffic between Lithuania and Poland*, P.C.I.J., Series A/B, at 116 (noting that "an obligation to negotiate does not imply an obligation to reach an agreement"); *North Sea Continental Shelf Case*, *supra* note 63; NASSAR, *supra* note 18, at 180.

76. Cf. UNIDROIT Principles, *supra* note 11, art. 5.4(2) ("To the extent that an obligation of a party involves a duty of best efforts in the performance of an activity, that party is bound to make such efforts as would be made by a reasonable person of the same kind in the same circumstances").

77. See NASSAR, *supra* note 18, at 182; NELLE, *supra* note 68, at 17; Kolo & Wälde, *supra* note 4, at 73.

78. See BAUR, *supra* note 68, at 120.

79. See NELLE, *supra* note 68, at 278.

The aim of the renegotiation obligation is to achieve an exchange of suggestions for adjustment. However, just like the ultimate goal of reaching an agreement between the parties, this aim can only be served in a limited way by direct content provisions and additional indirect support, especially in the form of procedural regulations, is needed.

Id. Cf. CHRISTIAN BÜRHING-UHLE, *ARBITRATION AND MEDIATION IN INTERNATIONAL BUSINESS* 222 (1996) (elaborating generally on the negotiation process and its theoretical concept); HENRY BROWN & ARTHUR MARRIOT, *ADR PRINCIPLES AND PRACTICE* § 6-001 (2d ed. 1999).

80. See *supra* notes 3, 24 and accompanying text; see also *House of Lords in Walford v. Miles*, 2 A.C. 128, 128 (1992).

agreement will not in itself constitute a breach of obligation.⁸¹ Instead, this is assumed where the non-agreement is proven to be caused by a gross breach of obligation in bad faith by the other side. This could be the case, for example, where proceedings are unjustifiably delayed,⁸² when negotiations are intentionally obstructed⁸³ or where proposals by one side are obviously rejected for reasons other than normal business judgement. Only under these circumstances can it be assumed that a reasonable person in a comparable situation would have made greater efforts.⁸⁴

In such a situation, the problem arises as to how to prove that the behavior of the other party constituted the reason for the failure of the renegotiation.⁸⁵ Beyond this, problems will also exist when attempting to quantify the exact damage caused. If one were to grant the party a claim for damages for non-performance, the arbitral tribunal would have to compare the situation which has arisen with a possible successful negotiation outcome. In this way, the tribunal would be forced indirectly, i.e. via the calculation of damages, actively to structure the agreement. For this reason, such an approach is not practicable.⁸⁶ Therefore, only classic damages from delay and costs incurred in reliance on reaching an agreement are recoverable.⁸⁷ In order to avoid these difficulties in measuring damages in advance, the parties should include liquidated damage amounts in the clause.⁸⁸

It should be noted, independently of these practical problems, that even the failure of the consensus procedure where one party is at fault will not change the original contractual distribution of risk.⁸⁹ The contract remains in force, unless the parties have determined otherwise in the clause⁹⁰ or have clearly expressed via the adjustment

81. Cf. *Mobil Oil Iran, Inc. v. Iran*, 16 CTR 3, 47 (examining Iran U.S. Claims Tribunal).

82. Here, it is generally assumed that each party has the right to carefully consider its position. Unavoidable delays in negotiations which arise as a result of this must be accepted and do not lead to any liability for damages of the delaying party.

83. See PETER, *supra* note 7, at 247; NASSAR, *supra* note 18, at 182; BERNARDINI, *supra* note 44, at 421; NICKLISCH, *supra* note 67, at 159; BAUR, *supra* note 68, at 120; Durand-Barthez, *supra* note 73, at 72. See generally Dietrich Maskow, in DIE ANPASSUNG LANGFRITIGER VERTRÄGE IM INTERNATIONALEN WIRTSCHAFTSVERKEHR (Kotz & von Marschall eds., 1984).

84. Cf. *supra* note 76.

85. Cf. Durand-Barthez, *supra* note 73, at 357, 372.

86. See also Maskow, *supra* note 83, at 98; NELLE, *supra* note 68, at 328.

87. See Horn, *supra* note 34, at 255, 287; NELLE, *supra* note 68, at 328.

88. See Horn, *supra* note 34, at 255, 287. See generally Klaus Peter Berger, *Vertragsstrafen und Schadenspauschalierungen im Internationalen Wirtschaftsvertragsrecht*, 1999 RECHT DER INTERNATIONALEN WIRTSCHAFT 401, 406.

89. NICKLISCH, *supra* note 67, at 159.

90. See PETER, *supra* note 7, at 248; NASSAR, *supra* note 18, at 179. ICC Award No. 2478, 3 Y.B. COM. ARB. 222 (1978).

clauses that the validity of the contract is restricted to the circumstances as they existed at the time of concluding the contract.⁹¹ Finally, it is also conceivable that a party which does not accept an offer from the other side within the framework of the consensus structure is in breach of its general duty to minimize loss, and that would be to its detriment when calculating its claim for damages.⁹² In this way liability could also be assessed proportionately.⁹³

F. Procedural Enforceability

1. The Significance of Arbitration

Alongside the enforceability of renegotiation clauses in international investment contracts as a matter of substantive law, the procedural aspects of the renegotiation obligations manifested in them is of particular practical importance. International arbitration plays a decisive part in this. Nearly all Production Sharing contracts contain an arbitration clause. In some cases the contract contains no express link between the renegotiation clause and the arbitration clause.⁹⁴ In other cases, the arbitral tribunal is not just authorized to decide general disputes arising from the contract, but also it is expressly provided in the contract that the parties also have the right to call on the arbitral tribunal designated in the contract to decide on the adjustment of the contract on behalf of the parties if negotiations on adaptation foreseen in the contract have failed.⁹⁵ Typically, the contracts contain arbitration clauses which refer to the Rules of Arbitration of the International Chamber of Commerce (ICC)⁹⁶ or the UNCITRAL Arbitration Rules.⁹⁷ Frequently the contracts also contain arbitration agreements that refer to the arbitration mechanism for investment disputes of the World Bank (International

91. Cf. KRÖLL, *supra* note 72, at 154.

92. ICC Award No. 2478, 1978 Y.B. COM. ARB. 222; Note by Derains regarding Award No. 2291 in JARVIN & DERAIS, *supra* note 18, at 277.

93. See PETER, *supra* note 7, at 250 (referring to the unpublished ICC Award No. 4724); cf. NICKLISCH, *supra* note 67, at 150.

94. Cf. *supra* discussion in part III.A.4 of Lasmo Group Production Sharing Contract arts. 11 and 17.8.

95. See *supra* note 44 and accompanying text.

96. ICC RULES OF ARBITRATION, ICC Publication No. 808. See generally YVES DERAIS & ERIC A. SCHWARTZ, A GUIDE TO THE NEW ICC RULES OF ARBITRATION (1998); SCHÄFER, VERBIST & IMHOOS, DIE ICC SHIEDSGERICHTSORDNUNG IN DER PRAXIS (2000).

97. U.N. Commission on International Trade Law and Arbitration Rules of April 28, 1976. See generally JACMIJN J. VAN HOF, COMMENTARY ON THE UNCITRAL ARBITRATION RULES: THE APPLICATION BY THE IRAN-U.S. CLAIMS TRIBUNAL (1991); STEWART A. BAKER & MARK D. DAVIS, THE UNCITRAL ARBITRATION RULES IN PRACTICE (1992).

Centre for the Settlement of Investment Disputes, ICSID).⁹⁸ The ICSID System differs from the other “private” arbitration rules in that it is based on an international law convention⁹⁹ and can only be taken into consideration if the host country has ratified the convention and the parties have agreed on ICSID arbitration. The consent of the host country can also be declared in advance in a bilateral investment protection treaty (BIT), so that arbitration will be permissible even without an arbitration agreement between the host country and the investor.¹⁰⁰

2. Differences about Contractual Adaptation as “Legal Disputes”?

Despite these basic differences between “private” arbitration and the ICSID system, based on international law and largely isolated from national procedural law, the same question on the jurisdiction of the arbitral tribunal to adapt the contract arises in both areas. This question is whether a “dispute” or “legal dispute” exists in particular cases, as international arbitration laws e.g. Sec. 1029(1) German Arbitration Law just like Article 7(1) of the UNCITRAL Model Law on International Commercial Arbitration and Article 25(1) of the ICSID Convention seem to require for initiating an arbitration?¹⁰¹ In answering this question, two groups of cases need to be distinguished.

a. Non-doubtful Cases

In the first group of cases there is no doubt that a dispute exists as a prerequisite for initiating an arbitration. This applies, for example, if the parties are in dispute about the interpretation of the renegotiation clause. Hence, there can be a dispute between the parties as to whether the prerequisites for initiating the consensus procedure (trigger events) have been fulfilled, whether the conditions agreed to in the clause for an automatic adaptation (price

98. Cf. MOESHE HIRSCH, *THE ARBITRATION MECHANISM OF THE INTERNATIONAL CENTER FOR THE SETTLEMENT OF INVESTMENT DISPUTES* (1993); Georges Delaume, *Le Centre International pour le règlement des Différends relatifs aux Investissements (CIRDI)*, 109 J. DU DROIT INT'L 775 (1982); RICHARD HAPP, *SCIEDSVERFAHRN ZWISCHEN STAATEN UND INVESTOREN NACH ARTIKEL 26 ENERGIECHARTAVERTAG* (2000).

99. Convention on the settlement of investment disputes between states and nationals of other states (ICSID) of 18 March, 1965, reprinted in II INTERNATIONALER RECHTSVERKEHR IN ZIVIL- UND HANDELSACHEN, No. 720, at 34 (Arthur Bülow et al. eds. Supp. 1991).

100. See *Am. Mfg. & Trading, Inc. v. Repub. of Zaire*, I.L.M. 1544 (ICSID Award); Jan Paulsson, *Arbitration Without Privity*, 10 I.C.S.I.D. REV. FOREIGN INV. L.J. 232, 236-41 (1995); Happ, *supra* note 6, at 43 (regarding Article 26 of the Energy Charter).

101. Cf. BERNARDINI, *supra* note 44, at 421.

adjustment) have been met, or whether in the case of a failed agreement between the parties the conditions for a damages claim for breach of contract in terms of the renegotiation clause have been fulfilled.¹⁰² It is also possible for the host country to breach the contract during negotiations or even, as in the AMINOIL case, expropriate the investor. In all these cases a “dispute” or “legal dispute” clearly exists between the parties. The arbitral tribunal therefore is not called upon to make a creative legal decision but rather to decide the rights and obligations of the parties. The arbitral tribunal in the AMINOIL case therefore accurately confirmed its jurisdiction to decide the parties’ claims for damages:

[I]n the present case, the Tribunal thinks that it is not really a question of modifying or completing the contract of concession. The Tribunal is not expected to devise new provisions that will govern the contractual relations of the Parties for the future, but to liquidate the various consequences of their past conduct and of the contractual clauses that once bound them but are now at an end. Under this head, the Arbitration Agreement founding the competence of the Tribunal is widely drawn, and confers jurisdiction to investigate whether . . . a liability can be ascribed to Aminoil.¹⁰³

In these cases, therefore, the tribunal’s decision concerns a dispute between the parties in the sense of the national laws or Article 25(1) of the ICSID Convention.¹⁰⁴

b. Doubtful Cases

In the second group of cases, the parties do not want a decision from the tribunal on the interpretation of the renegotiation clause in order subsequently to enter the negotiation phase. Instead, the arbitral tribunal itself is called upon to undertake the adjustment for the parties at the request of one of them. There has always been a debate as to whether a “dispute” or “legal dispute” exists in these cases. The reason is found in the special nature of renegotiation

102. According to what has been said above, this will only rarely be the case. Cf. *Kuwait v. Am. Indep. Oil Co.*, 21 I.L.M. 976, 1003 (1982).

103. *Id.* at 1016.

104. Fritz Nicklisch, *Die Ausfüllung von Vertragslücken durch das Schiedsgericht*, 35 RECHT DER INTERNATIONALEN WIRTSCHAFT 15, 17 (1989); Maskow, *supra* note 83, at 97; PETER, *supra* note 7, at 254-322; BERNARDINI, *supra* note 44, at 420; KRÖLL, *supra* note 72, at 19; see also Georges Delaume, *ICSID Arbitration: Practical Considerations*, 1 J. INT’L ARB. 101, 116-17; Georges Delaume, *ICSID and the Transnational Financial Commentary on the ICSID Convention*, 11 I.C.S.I.D. REV. FOREIGN INV. L.J. 237, 242 (1986); Christoph Schreuer, *Commentary on the ICSID Convention*, 11 ICSID REV. FOREIGN INV. L. J. 318, 343 (1996); J. Barrigan Marcantonio, *ICSID as a Forum for the Renegotiation and Adaptation of Contracts*, in ADAPTATION AND RENEGOTIATION OF CONTRACTS IN INTERNATIONAL TRADE AND FINANCE 235, 238 (Norbert Horn ed. 1985); Klaus Peter Berger, *Power of Arbitrators to Fill Gaps and Revise Contracts to Make Sense*, FOUNDATIONS AND PERSPECTIVES OF INTERNATIONAL TRADE LAW 269, 274 (Ian Fletcher et al. eds., 2001).

clauses. Because the possible negotiation outcome is so open, a difference of opinion between the parties as to the way to adjust the contract is not suited to classical arbitral adjudication in the sense of a clear “yes or no” decision.¹⁰⁵ Rather, an agreement between the parties on changing individual contractual obligations or adapting them to the changed economic conditions should be replaced by a ruling by the arbitral tribunal. With regard to the openness of the possible decision, however, the arbitrators are no longer being called upon to make a legal decision but, rather, to shape the contractual relationship for the parties.

3. The Traditional “Dispute Oriented” Understanding of Arbitration

Even if in light of the currently dominant principle of a broad interpretation of international arbitration agreements, such decisions can be regarded as being covered by the parties’ intentions¹⁰⁶ and the applicable substantive law permits an adjustment by third parties, the question remains whether arbitral tribunals are procedurally authorized to make such decisions.¹⁰⁷ Some arbitration acts, such as the Dutch Act,¹⁰⁸ Bulgarian Act,¹⁰⁹ or the new Swedish Arbitration Act¹¹⁰ provide for such a jurisdiction of the arbitral tribunal where the parties have expressly authorized it to do so. Conversely, other arbitration acts and the ICSID Convention contain no such provisions.

105. See Detlev Vagts, in RUBIN & NELSON, INTERNATIONAL INVESTMENT DISPUTES: AVOIDANCE AND SETTLEMENT 29, 36 (1985).

106. Cf. INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION 143-44 (W. Laurence Craig et al. eds., 1990) (referring to the unpublished ICC Award No. 5754).

107. See KRÖLL, *supra* note 72, at 15; Robert Briner, *Special Considerations Which May Affect the Procedure (Interim Measures, Amiable Composition, Adaptation of Contracts, Agreed Settlements)*, in INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION CONGRESS SERIES NO. 7, PLANNING EFFICIENT ARBITRATION PROCEEDINGS: THE LAW APPLICABLE IN INTERNATIONAL ARBITRATION 362, 370-71 (Albert Jan van den Berg ed., 1996); KLAUS PETER BERGER, INTERNATIONAL ECONOMIC ARBITRATION 85 (1993).

108. Cf. Dutch Arbitration Act, art. 1020 para. 4 (d), *reprinted in* VAN DEN BERG, THE NETHERLANDS ARBITRATION ACT 1986 11 (1987): “By agreement . . . may also be subject to arbitration: . . . the supplementation or alteration of legal relations.” This also covers adjusting contracts to fit changed circumstances, VAN DEN BERG, *id.* at 116.

109. Cf. PIETER SANDERS, QUO VADIS ARBITRATION? 167 (1999) (“The international commercial arbitration resolves civil property disputes arising from foreign trade relations as well as disputes about filling of gaps in a contract or its adaptation to newly arisen circumstances”).

110. Article 1(2) of the Swedish Arbitration Act enables the parties to submit a dispute “over specific facts” or the filling of gaps in the contract to an arbitral tribunal, cf. Berger, *The Arbitration Agreement in the 1999 Swedish Arbitration Act and the 1998 German Arbitration Act, A Comparative Analysis*, 17 ARB. INT’L 389, 394 (2001).

Until now it has been recognized that a mere "conflict" or difference of opinion between the parties was not sufficient for an arbitration. "Dispute" turns out to be a narrower sub-category of "conflict."¹¹¹ An exact boundary between the two can scarcely be drawn, and the transition is fluid. The weakened formulation suggested during negotiations on the UNCITRAL Model Law, according to which the existence of a "difference" of opinion would suffice for an agreement to arbitrate,¹¹² was adopted neither by the UNCITRAL Working Group nor by the German legislator who adopted the Model Law in 1998.

This "dispute oriented" understanding of arbitration is also visible in older English decisions that had to deal with the question of whether a "dispute" existed between the parties that would justify assuming the validity of the arbitration agreement between the parties and hence the jurisdiction of the arbitral tribunal instead of the national courts.¹¹³ In fact, cases can be found in international arbitration where the defendant challenged the jurisdiction by arguing that no "dispute" between the parties existed.¹¹⁴

In the context of the ICSID system, it is also assumed that the arbitral tribunals are not authorized to adjust contracts, because in these cases the tribunal is not deciding the parties' rights and obligations.¹¹⁵ The official commentary of the World Bank (Report of the Executive Directors) on Article 25(1) ICSID Convention states in Paragraph 26 that:

The expression 'legal dispute' has been used to make clear that while conflicts of rights are within the jurisdiction of the Centre, mere conflicts of interest are not. The dispute must concern the existence or

111. BROWN & MARRIOTT, *supra* note 79, at 1-007.

112. GAOR, UN Commission on International Trade Law on International Contract Practices, ¶ II.1-3, art. 2, UN Doc.A/CN.9/WG.II/WP.37 (1982) *reprinted in* HOWARD M HOLTZMANN & JOSEPH E. NEUHAUS, A GUIDE TO THE UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION 278 (1989) ("to submit to arbitration all or certain differences").

113. *Nova (Jersey) Knit Ltd v. Kammgarn Spinnerei GmbH*, [1977] 1 LLOYD'S L.REP. 463, 467; *Ellerine Brothers (Pty) Ltd. and Another v. Klinger*, [1982] W.L.R. 1375, 1383; ADAM SAMUEL, JURISDICTIONAL PROBLEMS IN INTERNATIONAL COMMERCIAL ARBITRATION: A STUDY OF BELGIAN, DUTCH, ENGLISH, FRENCH, SWEDISH, SWISS, U.S. AND WEST GERMAN LAW 148 (1989); BERGER, *supra* note 107, at 80; BROWN & MARRIOTT, *supra* note 79, nos. 1-010; *cf. Halki Shipping Corp. v. Sopex Oils Ltd.*, 1 LLOYD'S L. REP. 465 (1998) (regarding the new British Arbitration Act).

114. ICC Award No. 4265, *reprinted in* 111 J. DU DROIT INT'L 922 (1984).

115. *Cf. Delaume*, *supra* note 104, at 117 ("disputes regarding conflicts of interest between the parties, such as those involving the desirability of renegotiating the entire agreement or certain of its term, would normally fall outside the scope of the Convention"). Marcantonio, *supra* note 104, at 237. *See also* BERNARDINI, *supra* note 44, at 424 (suggesting the delegation of this task to a neutral third party who will then make the decision outside of the ICSID Convention system).

scope of a legal right or obligation, or the nature or extent of the reparation to be made for breach of a legal obligation.¹¹⁶

The chairman of the “*Legal Committee*” responsible for the draft of the ICSID Convention was also of the opinion that differences of opinion of the parties on contractual adjustment could not be regarded as “disputes.”¹¹⁷

The opinion of those responsible for the Convention seems to suggest that a “legal dispute” in the sense of Article 25(1) ICSID Convention only exists if the plaintiff makes a legal claim.¹¹⁸ Therefore the adjustment of the contract by an ICSID arbitral tribunal requires that the plaintiff can make a genuine claim:

[T]he objective requirement of a legal dispute remains. The parties’ agreement cannot replace the limitation as contained in the Convention entirely. . . . Where the parties do not agree on the wish to revise the agreement, the claimant would have to present a convincing claim, couched in legal terms, that he has a right to *bona fide* negotiations and that the conditions for such renegotiations have been met.¹¹⁹

Frequently, however, the plaintiff will only be able to indicate the need for a contractual adjustment and the differences of opinion between the parties as to the “right” adjustment decision.

4. Arbitration as a Means of Contract Adjustment

A multitude of modern developments supports the assumption of a more extensive jurisdiction for arbitral tribunals, including the authorization to adjust and adapt contracts.

a. Procedural Law

Factors in support of this, at a procedural level, are the significantly greater arbitration-friendliness of national arbitration acts in recent years, increasingly equal treatment of adjudication by arbitral tribunals and by national courts, and the comprehensive

116. See also HIRSCH, *supra* note 98, at 58; HAPP, *supra* note 98, at 98. Report of the Executive Directors on the Convention on the Settlement of Investment Disputes, 1965 I.L.M. 524.

117. Cf. ICSID Doc. SID/LC/SR/4 of Dec. 21, 1964, at 3; Marcantonio, *supra* note 104, at 237.

118. Schreuer, *supra* note 104, at 339-40 (stating “the dispute will only qualify as legal if legal remedies such as restitution or damages are sought and if legal rights based on, for example, treaties or legislation are claimed”); see also Delaume, *supra* note 104, at 116-17; Marcantonio, *supra* note 104, at 237-38.

119. Schreuer, *supra* note 104, at 344; see also Nigel S. Rodley, *Some Aspects of the World Bank Convention on the Settlement of Investment Disputes*, CAN. Y.B. INT’L L. 43, 55-57 (1966).

recognition of party-autonomy as the leading maxim of arbitration.¹²⁰ Even under English law, which has traditionally rejected every interference with the contract by the arbitral tribunal,¹²¹ arbitrators today are authorized to undertake such legal creativity to quite a broad extent. Apart from the extremely arbitration-friendly attitude of the new English Arbitration Act 1996, this flows from, above all, the broad term “dispute,” which forms the basis of the new English law. As well as genuine legal disputes (*disputes*), it includes mere differences of opinion (*differences*)¹²² and hence permits the express transfer of the completion and adjustment jurisdiction to an arbitral tribunal. Even without an express transfer of jurisdiction under English law, in the case of contracts where performance has already begun, a so-called “implied term” can be assumed according to which the contract should be amended by a subsequent agreement. In the interests of an efficient winding-up of the contract, the arbitral tribunal should decide the interpretation of these implied contractual terms where such an open contract is combined with an arbitration agreement.¹²³

The broad understanding of the term “dispute” in international case law is a point in favor of extending the jurisdiction of the arbitral tribunal in ICSID arbitration, which is based on international law. According to the definition contained in the *Mavromatis* decision of the Permanent International Court of Justice, it will suffice for the assumption of a “dispute” that there is “a disagreement on a point of law or fact, a conflict of legal views or interests between two persons.”¹²⁴ This broad definition was later confirmed in a series of decisions by the International Court of Justice.¹²⁵ Even if the concept of “dispute” in Article 25(1) ICSID Convention is additionally qualified as a “legal dispute,” an extension of ICSID arbitration tribunals’ jurisdiction can be argued based on this international case

120. Cf. KRÖLL, *supra* note 72, at 63.

121. Cf. Schmitthoff, *supra* note 24, at 82.

122. Arbitration Act, 1996, art. 82(1) (Eng.) (“In this Part . . . ‘dispute’ includes any difference”).

123. Cf. Queensland Electricity Generating Bd. v. New Hope Collieries Pty., Ltd., 1 Lloyd’s Rep. 205, 210 (1989); Vosper Thornycroft, Ltd. v. Ministry of Defense, 1 Lloyd’s Rep. 58 (1976); F&G Sykes (Wessex), Ltd. v. Fine Fare, Ltd., 1 Lloyd’s Rep. 53, 58 (1967); KRÖLL, *supra* note 72, at 96, 160.

124. *Mavromatis Jerusalem Concessions* (Greek Repub. v. U.K.), 1925 P.C.I.J. (ser. A) No. 5, at 11 (Mar. 26).

125. Application for Revision and Interpretation of the Judgment of Feb. 24, 1982, in the Case Concerning the Continental Shelf (Tunisia v. Libyan Arab Jamahiriya), 1985 I.C.J. 192, 192 (Dec. 10); Applicability of the Obligation to Arbitrate under Section 21 of the United Nations Headquarters Agreement of June 26, 1947, 1988 I.C.J. 12, 28 (Apr. 26); Concerning East Timor (Portugal v. Australia), 1995 I.C.J. 90, 99 (June 30).

law in combination with the other procedural and material aspects mentioned here.¹²⁶

René David predicted this trend of extending the jurisdiction of international arbitrators decades ago under the heading “oneness of arbitration” (*unité de l'arbitrage*):

It is artificial and in many respects deplorable that a distinction should be drawn between the two varieties of arbitration: the one aiming at the settlement of a legal dispute, the other at the regulation of a contractual relationship. In both cases the same technique is resorted to, the same result is aimed at, and the application of the same rules is desirable.¹²⁷

b. Contract Law: Sanctity of Contracts vs. Fairness

For some years, modern international contract doctrine has been concerned with the formal rule of sanctity of contracts and the goal of ensuring fairness in contractual relations. Today, one can observe a trend to move away from a contractual model which is static and “complete” at the time of conclusion and thus unalterable¹²⁸ and towards a contractual understanding which is dynamic and therefore unavoidably accepts interference by the parties or by third parties that they have authorized.¹²⁹ Thus, the formal “all-or-nothing” rule of the principle of sanctity of contracts (*pacta sunt servanda*) is often replaced these days with a more flexible and pragmatic approach.¹³⁰ It attempts to guarantee that the rights and obligations set out in the contract with regard to the economic background remain “fair” and appropriate and consistent with the economic interests and rationality of the parties, not just at the time of concluding the contract but throughout its duration. This change in the paradigm of international contract law is made possible by the fact that, even in

126. See PETER, *supra* note 7, at 323 (referring to the system of the ICSID Convention as isolated from national law).

127. RENE DAVID, *ARBITRATION IN INTERNATIONAL TRADE* 409 (1985); cf. Kolo & Wälde, *supra* note 4, at 33; BERNARDINI, *supra* note 44, at 422.

128. Cf. M. Sornarajah, *Supremacy of the Renegotiation Clause in International Contracts*, *J. INT'L ARB.* 97, 104 (1988) (in the context of renegotiation of international contractual framework).

129. Cf. BERNARDINI, *supra* note 44, at 422; BERGER, *supra* note 27, at 284; Kolo & Wälde, *supra* note 4, at 8.

130. Cf. IAN R. MACNEIL, *THE NEW SOCIAL CONTRACT* 4-10 (1980); NASSAR, *supra* note 18, at 237; Asante, *supra* note 1, at 407 (“A blind insistence on the application of *pacta sunt servanda* to such transnational contracts betrays a lack of sophisticated appreciation of the nature and origin of such transactions, the inherent instability in such long-term arrangements, and the formidable difficulties posed by their administration”).

the common law, there is a growing reliance on behavior-linked standards like “good faith,” “fair dealing” or “reasonableness”.¹³¹

The current need for flexibility and co-operation, maintenance of relations and adjustment in the context of transnational contracts—whereby the contract is regarded as ‘not merely a meeting point for conflicting interests but also, to a certain extent, . . . a common project in which each party must . . . cooperate’—viewed against the legal maxims of good faith and fair dealing, *favor contractus* and adjustment to changed circumstances, form the ‘new spirit’ of contract law.¹³²

This idea of more flexible and dynamic contractual obligations has always been valid to a particularly high degree in Concession and Production Sharing contracts as prototypes of the long-term contract associated with significant uncertainties at the time of concluding the contract and subject to multiple economic influences throughout its duration.¹³³

Few contracts have been as ‘interactional’ as concession agreements. . . . In this respect, the concession contract is quite different from most agreements for the sale of goods, for example, where the transaction may be precisely defined and may be quickly concluded. Major uncertainties prevailing at the time a concession contract is negotiated generally make it necessary to re-examine the terms at a later time. In addition, the bargaining powers of the parties to the agreement are likely to change over time, creating tensions that generally lead to revisions. In fact, the need for change is so frequent and compelling that revision or updating are probably more apt terms to describe the process of evolution than is the frequently used term renegotiation.¹³⁴

IV. SUMMARY

Renegotiation, particularly of fiscal terms, has been a feature of the natural resources industry for the past twenty-five years.¹³⁵ However, adaptation of a Production Sharing agreement to changed economic circumstances can only be considered if the contract contains a renegotiation clause. This sort of clause is only effective if it has been combined with an arbitration agreement, and in this way

131. Cf. K.M. Sharma, *From “Sanctity” to “Fairness”: An Uneasy Transition in the Law of Contracts*, 18 N.Y.L. SCH. J. INT’L & COMP. L. (1999) (citing Ian R. Macneil, *Commentary, Restatement (Second) of Contracts and Presentation*, 60 VA. L. REV. 589, 593 (1974)).

132. Doudko, *supra* note 9, at 488 (in connection with the official commentary to Article 5.3 of the UNIDROIT Principles, *supra* note 11, which deals with the parties’ obligation to cooperate).

133. BÖCKSTIEGEL, *supra* note 17, at 335, 337 (“One cannot always rely on the state being bound by the contract as long as rigidly as might be possible between private partners”); see also Asante, *supra* note 1, at 407.

134. SMITH & WELLS, *supra* note 6, at 127.

135. Kolo & Wälde, *supra* note 4, at 29.

provides for a possible method of third party adjustment if the parties are unable to reach an agreement. However, this requires that the parties make clear that they wish to transfer to the tribunal this "creative competence" which goes beyond normal dispute adjudication,¹³⁶ as has been done, for example, in Article 34.12 of the Model Exploration and Production Sharing Agreement of Qatar.¹³⁷ The presence of a normal arbitration agreement in the contract will not suffice for this purpose.¹³⁸ Instead, an express allocation to the arbitral tribunal of the competence to adapt the contract is required.¹³⁹ In the AMINOIL decision already cited several times, the tribunal expressed this principle clearly:

[T]here can be no doubt that, speaking generally, a tribunal cannot substitute itself for the parties in order to . . . modify a contract unless that right is conferred upon it by law, or by the express consent of the parties . . . arbitral tribunals cannot allow themselves to forget that their powers are restricted. It is not open to doubt that an arbitral tribunal—constituted on the basis of a 'compromissory' clause contained in relevant agreements between the parties to the case . . . could not, by way of modifying or completing a contract, prescribe how a provision [for the determination of the economic equilibrium] must be applied. For that, the consent of both parties would be necessary.¹⁴⁰

The better the parties are able to establish a concrete nexus between the arbitral tribunal's creative competence and the areas of adaptation or adjustment set out by way of the open clause in the contract itself, the greater the guarantee of an effective allocation of jurisdiction to the arbitral tribunal for such cases.¹⁴¹ In individual cases, this type of express allocation of competence may not be possible due to the nature of the contract. If, however, the state has given its "anticipated" consent to arbitration with the investor in a bilateral investment treaty or other international treaty such as the Energy Charter Treaty,¹⁴² an arbitration agreement which could serve as a basis for allocating jurisdiction will have never existed. In these cases, one should think about providing for a solution to the conflict by way of Mediation/Conciliation or having the arbitrators decide as "*amiable compositeurs*" (*ex aequo et bono*). This freedom

136. KRÖLL, *supra* note 72, at 154; *see also* Kolo & Wälde, *supra* note 4, at 46.

137. *Cf. supra* note 44 and accompanying text.

138. BERNARDINI, *supra* note 44, at 411, 421 (noting that ". . . the reference to arbitration in case of failure by the parties to agree on the terms of the revision will not be sufficient to imply such a power [to adapt the contract]").

139. *Cf. U.N. Model law, supra* note 112, at ¶ 20; BERGER, *supra* note 88, at 82.

140. *See Kuwait v. Am. Indep. Oil Co.*, 21 I.L.M. 976, 1016 (1982); MANN, *supra* note 39, at 259.

141. *Cf. MARTIN HUNTER ET AL., THE FRESHFIELDS GUIDE TO ARBITRATION AND ADR* 45 (1993).

142. *Cf. supra* note 100 and accompanying text.

from the constraints of the applicable law is particularly suited to the adjustment of long-term contracts to changed circumstances.¹⁴³

All these measures serve, more than anything else, the purpose of avoiding contract adaptation by an arbitral tribunal altogether. Contract adaptation and renegotiation are consensual procedures. Legal arguments, positions, and principles mostly fade into the background here. Rather, these processes are a matter of genuine economic or even political considerations and estimations, which are closely woven together with the distribution of negotiating power between the parties and which may vary throughout the duration of the contract.¹⁴⁴ These sorts of complex processes are not compatible with the one-sided imposition of an adjustment by a neutral third party, regardless of its function or the legal framework in which it operates:

[N]o court or arbitrator in the world, at least in international business transactions, can render an award that could serve as the legal basis for a complex future cooperation against the will of one of the parties. There are definite limits to the powers of arbitrators to adapt a contract.¹⁴⁵

143. See BÖCKSTIEGEL *supra* note 33, at 335; BERGER, *supra* note 7, at 566; BERGER, *supra* note 4, at 282; Schreuer, *supra* note 104, at 344.

144. For example, on the investor's "prisoner's dilemma," see *supra* note 5 and accompanying text.

145. Horn, *supra* note 8, at 173, 182 (1994).