I. Introduction

International petroleum projects involve the commitment of significant capital for a very long duration. These projects are exposed to acute risks (geological, commercial and political). The potential foreign investor makes a risk/reward assessment of the project’s fiscal and regulatory regime and then makes an informed decision on whether to commit his capital in the potential host country or go elsewhere. If he decides to go ahead, he then expects the fiscal and legal conditions to remain relatively stable. When the exploration risk has been successfully overcome, the production begins and the investment acquires a hostage status. Any government-imposed regulation that is likely to upset the financial returns in a significant way—and governments have an infinite variety of ways to do this—will have an impact on the economics of the project. Hence, stability of the fiscal and regulatory regime in the host state is probably the key issue for stabilization concerns. Despite the weakening of the dogma of intangibility of contracts, most foreign investors, for the protection of their interests, rely on contractual clauses aimed at maintaining the integrity of their contracts and precluding any modification thereto except with their mutual consent. Foreign investors use stabilization clauses to achieve this purpose.

Other clauses, such as renegotiation and adaptation clauses, recognize the mutability of the contract and allow changes in the contract. Contrary to stabilization clauses which record the host state’s undertaking to freeze the legal situation in the host country at the time of concluding the contract, renegotiation clauses aim to protect the foreign private party by making the contract flexible and dynamic throughout its duration in order to adapt to changes in circumstances and more particularly to re-establish the contractual equilibrium of the transaction. The latter clauses are put under the generic category of contractual protection clauses. This is mainly because when the parties agree on the manner their contract should evolve in order to adapt to changes in circumstances and more particularly to re-establish the financial equilibrium of the contract, they diminish the risk of disputes and as a consequence they reduce the danger of unilateral state intervention.¹

The renegotiation or adjustment of the contract to changed circumstances can be initiated either where the contract contains a renegotiation or adjustment clause, or

where the applicable law or other contractual terms provide an appropriate starting point for the renegotiation of the contract. This article focuses on the law and practice with respect to renegotiation of international petroleum agreements. It discusses the reasons governments and companies have for insisting on and accommodating renegotiation clauses. It provides a survey of legal issues which are relevant to renegotiation. Here, two scenarios need to be distinguished. The first scenario deals with the question of renegotiation of contracts which do not contain a renegotiation clause. The second scenario concerns the renegotiation of contracts that contain special provisions dealing with renegotiation or adjustment problems. Certain questions arise here for consideration: How do the major legal systems deal with the issue of renegotiation? Is it in the interest of investors to include renegotiation clauses that would allow for sometimes significant changes of long term agreements? What if the renegotiations initiated by such clause fail? How will the ensuing dispute be resolved? These issues and other related matters will be discussed in this article, followed by an examination of the contribution of the international arbitral practice relating to the petroleum industry to the concept of renegotiation.

II. The Renegotiability of International Petroleum Agreements: Stability v. Flexibility

The need for stability in international petroleum agreements is considerable. International petroleum companies want to be assured that a number of aspects of their investment are stabilized. Such aspects include, inter alia, the fiscal regime, the regulatory regime and export and import regulations. Such assurances are not only needed for the investor to ensure that he will realize the expected benefits of the project, but also to convince other sponsors of the project (e.g., banks, export financing institutions, long-term purchasers of production, international and national development finance institutions) that the project will generate enough revenue to pay off their loans and meet their supply requirements. International oil companies know that there are a variety of ways by which host governments can control foreign-based enterprises through local laws and their judicial systems. Therefore, stabilization clauses are often inserted in investment agreements to restrict the legislative power of the state to unilaterally amend or abrogate the agreement. Such clauses are still in application in many investment agreements, and very often in international petroleum

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3 A. Kolo & T. Waelde, Renegotiation and Contract Adaptation in International Investment Projects, 1 J. World Inv. & Trade 5, 7 (2000); Waelde & Ndi, supra note 2, at 228.

agreements.\(^5\) Hence, one may ask why we should have a renegotiation clause. Is it not more stable not to have one? In order to answer this question, a number of considerations have to be taken into account. These are addressed in the remainder of this section.

### A. Stabilization Clauses

Stabilization guarantees obtained from a government or public agency through stabilization clauses do not always provide the foreign petroleum company with an adequate protection, since the effectiveness of such clauses may be doubtful as such clauses come into conflict with the sovereignty of the host state,\(^1\) and the state, as guardian of the public interest and legislator, may use its powers to modify to its advantage the carefully negotiated contractual equilibrium. This risk becomes particularly acute in the case of the new generation of petroleum and natural resources agreements due to the blend of public and private law characterizing their legal regulation.\(^7\) The supremacy of a subsequent legislative rule over previously negotiated contractual commitment undermines the legal effect of such clauses.\(^8\) Some commentators stress that the state, when entering into a long-term contract with a foreign investor, does not waive its sovereign prerogative to terminate such a contract, and that the exercise by the state of its sovereign powers, even when exercised in a manner that constitutes a breach of contract, does not amount to per se an illegal act creating international state responsibility.\(^9\) Nationalizations of petroleum resources, including the famous

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3. “It has been held that the new generation agreements [used in the international petroleum industry], as opposed to the old-style concessions, are public law contracts since they are regulatory in substance, their regulatory components being predominant vis-à-vis the contractual elements.” Bernardini, supra note 2, at 167–68; Bernardini, supra note 6, at 411, 412; A. Maniruzzaman, The New Generation of Energy and Natural Resources Development Agreements: Some Reflections, 11 JENRL 207 (1993).
5. Wallace, supra note 4, at 976; J. Westberg & B. Marchais, General Principles Governing Foreign Investment as Articulated in Recent International Tribunal Awards and Writings of Publishers, 7 ICSID REV. 453, 476–77 (1992). Nonetheless, it must be emphasized that this should not be understood to mean that contractual limitations on the state’s right to nationalize are not jurisdictionally possible. Such exercise is in fact possible. However, it would involve a particularly serious undertaking which would have to be expressly stipulated for, and it should cover only a relatively limited period. This was the view of AMINOIL on the question of stabilization clauses, see AMINOIL, 21 I.L.M. 1023 (1982) Yet, there is a school of thought which supports the view that the breach of a state contract by the contracting state of itself can create international responsibility, see S. Schwelbe, On Whether the Breach by a State of a Contract with an Alien is a Breach of International Law, in INTERNATIONAL LAW AT THE TIME OF ITS CODIFICATION: ESSAYS IN HONOUR OF ROBERTO AGO 401–15 (1987); D. O’Connell, INTERNATIONAL LAW 993 (1970). But see J. Brownlie, Principles of Public International Law 522–27 (2003). Brownlie suggests that there is little evidence for the latter position and as far as the government was acting in good faith, it is difficult to treat such action as illegal on the international plane.
1982 AMINOIL award, were considered a legitimate exercise of sovereign power unfeathered by the presence of a contractual stabilization clause embodied in the petroleum agreement. The protection against unilateral revocation or modification of the contract by the state through stabilization clauses is far from a satisfactory solution.\(^{10}\) Hence, an investor should not rely solely on the protection of clauses the efficacy of which is doubtful.\(^{11}\)

### B. Renegotiation Clauses

It should be realized that the protection of the legitimate expectations of a foreign investor in a manner that stabilizes the contractual relationship through the mechanism of stabilization clauses represents only half of the reality. This is especially true in an industry as volatile as oil and gas. One has to acknowledge that the international petroleum industry involves contracts of a very long duration covering up to and over ten years of exploration and over twenty years of initial production phases, with the commitment of significant capital for exploration, and particularly production, and the assumption of considerable risk, in particular with regard to exploration.\(^{12}\) Investments made in the field of petroleum are usually based on assumptions about the rate of return, geology of the area, labour cost, the cost of complying with national and international environmental protection standards, taxation rates and other financial charges to the host country. Investors in this industry, as in any industry, make a risk/reward assessment of the project’s fiscal and regulatory regime and then draw a conclusion on whether to commit their capital in the potential host country or go elsewhere. Yet these assumptions and assessments are uncertain and highly speculative.\(^{13}\) Such long-term contracts are exposed for a long time to future events, the impact of which on the contract is often hard to predict. No petroleum agreement exists in a separate environment totally isolated from the changes taking place in the real petroleum world, which has witnessed considerable revolution during the last thirty years. The find may turn out to be marginal, or the price of the mineral

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\(^{10}\) Although the legal value of stabilization clauses remains suspect, one has to mention that such clauses may play a role in the calculating of compensation. It has been suggested that compensation will be higher if a stabilization clause is present in the contract. See Waelde & Ndi, supra note 2, at 266.

\(^{11}\) Yet, it should be noted that some bilateral investment treaties (BITs) contain clauses providing additional protection to investors beyond the traditional international law standards. Such clauses are often referred to as “umbrella clauses” as they put contractual commitments under the BIT’s protective umbrella and hence a violation of such a contract is a violation of the BIT. Although such clauses include compliance with investment contracts, or other undertakings by the state, they cannot cure the inherent instability of an industry as volatile as the petroleum industry. On the contrary there can be an accumulation of frustration leading to a drastic disagreement between the parties. See FedEx v Republic of Venezuela, 37 I.L.M. 1391 (1998); SGS Société Générale de Surveillance S.A. v. Republic of the Philippines, Decision on Jurisdiction, January 29, 2004, available at <www.worldbank.org/icid/cases/SGSvPhil-final.pdf>; contrast with SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan, Decision on Jurisdiction, 18 ICSID Rev. 307 (2003). The latter case arrived at a different result when interpreting the umbrella clause. For an analysis of the umbrella clause see T. Waelde, Is the Treatment of the “Umbrella” or “Pacta sunt Servanda” Clause in the SGS v. Pakistan Jurisdictional Decision (2003) Correct? A Case Comment, 1 OGEL 27 (No. 5, 2003), at <www.gasandoil.com/ogel>; C. Schreuer, Travelling the BIT Route of Waiting Periods, Umbrella Clauses and Forks in the Road, 5 J. World Inv. & Trade 231, 251–55 (2004).

\(^{12}\) Kolo & Waelde, supra note 3, at 29.

\(^{13}\) N. Fabri, Stability of Contractual Relations in Long-Term Transnational Agreements, 1987 AMPLAY 563, 565.
Renegotiation of International Petroleum Agreements

may fall due to over-supply or mild weather which may have an impact on the economics of the project and put pressure on the parties to revise the agreement. On the other hand, the find may turn out to be more than expected or the price of the commodity may increase dramatically and the field starts making windfall profits. Under such circumstances, the host country may feel that it is not greatly benefiting from the exploitation of its non-renewable natural resources, and so demand adjustment of the terms of the agreement.

Whenever there is a significant change in the assumptions underlying the original contract and such fundamental change affects both or one party’s original expectations of profit/return from the project, pressure will be put on the parties to revise the agreement. In such cases there is much to be said for a renegotiation clause. It has been stated that “it is idle to freeze the position of the parties for long periods to conditions that become so out of date. Either parties will include renegotiation provisions in their contracts or they will act as if they were there.”

It is considered that renegotiation has been a feature of the natural resources industry. Experience shows that host countries will renegotiate investment contracts even though the agreement and the governing law do not provide a basis for such renegotiation. Requests or, in some cases, demands for renegotiating existing agreements are often accompanied by express or implied threats, including governmental intervention, expropriation, slow down in performance, or the complete repudiation or cancellation of contracts. Existing legal doctrines have not proven adequate as a basis for dealing with the pressure for renegotiation. Host states often have asked for renegotiation of the financial terms of their agreements. Several countries managed to renegotiate their contracts with the international oil companies in the 1950s and further renegotiations were conducted with the efforts of the Organisation of Petroleum Exporting Countries (OPEC) in the 1960s. The OPEC renegotiations in the 1970s resulted in a full ownership of most of the oil companies operating in its member states. Host government-initiated renegotiation of state contracts is by no means a developing countries issue. Reference here could be made to the North Sea oil renegotiations of the mid-1970s in

14 Kolo & Waelde, supra note 3, at 21.
15 D. Vagts, Coercion and Foreign Investment Rearrangements, 72 AJIL 17, 22 (1978).
16 Kolo & Waelde, supra note 3, at 29.
20 See generally Note, From Concession to Participation: Restructuring the Middle East Oil Industry, 48 NYULR, 774, 785–816 (1973).
the United Kingdom. Assuming that long-term agreements in most cases will be subject to pressure for change, there is much to be said for a renegotiation clause to ensure the continuation of the contractual relationship.

C. ENVIRONMENTAL CONCERNS

Government, pressure groups, or international agreements may impose new environmental standards on the industry. The major concern of the foreign investor is with the uncertainty and surprise aspect of such environmental regulations. No one can deny that there is a legitimate need to adapt the environmental regulations to the new national and international environmental standards. Yet environmental law, both national and international, is very prone to post-investment regulatory surprise, open-ended and very responsive to public opinion pressure groups, easily mobilized by NGOs hungry for a suitable target. Compliance with new standards and regulations may require the foreign company to spend huge amounts of money, thereby adding to the cost of the project. Such unexpected changes may have a drastic impact on the economics of the project. Salvaging the project may require the parties coming together and revising their agreement so as to address those concerns. In such cases renegotiation can provide a measure of flexibility for adapting the contract and reduce the chances of confrontation and deadlock.

D. BENEFITS OF RENEGOTIATION

When a state enters into a long-term agreement with an international oil company to explore and exploit its natural resources, the extent, quality and the future prices of the resources are often unknown to the host state at the time of the conclusion of the contract. Therefore, it is sometimes considered that it is in the interest of the host state to have the contract modelled on a flexible and amendable approach to accommodate the circumstances of both the domestic and international political and economic situations. The major concern of the foreign investor is not with the renegotiation clause per se, but rather with the fear that flexibility created by the insertion of a renegotiation clause could be used by the state to alter key investment conditions to its advantage.

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22 Peter, supra n. 18, at 240; Z. Mikdashi, The International Politics of Natural Resources 154 (1976).

23 “It would seem unreasonable for a company to argue that a stabilization clause should be relied upon to prevent a government from following the examples of developed countries standards and the consensus guidelines of international agencies in bringing its safety and offshore pollution up to date,” see Waelde & Nih., supra note 2, at 286.


25 Mikdashi, supra note 22, at 157.

26 Peter, supra note 18, at 240.
Comparing the mechanism of the renegotiation clauses which allows for flexibility with that of the stabilization clauses which aims at establishing a fixed legal situation reveals the continuous conflict between host states and international companies over the stability and flexibility of long-term investment agreements. For, as Asante rightly observed:

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 demands of host governments for a more flexible contractual regime on the other.27

In fact, the use of a renegotiation mechanism in a foreign investment agreement has several attractions and may contribute to the transactional stability sought by the foreign party.28 In the light of the fact that the effectiveness of stabilisation clauses may be doubtful, renegotiation clauses in contrast may offer protection against unilateral revocation or modification by the state. Under a renegotiation clause a state binds itself to renegotiate the agreement in case of supervening circumstances instead of revoking or altering the terms of the agreement by unilateral action. Hence, the aim of such clauses is to protect the company not by freezing the contractual regulation, but conversely by making the agreement flexible and amendable throughout its duration, in case the economic circumstances of the agreement change by a “sovereign act.”29 It is often said that legal constructions are of little significance since they cannot contain the pressure for contractual change. This view overlooks the fact that appropriate legal provisions may indeed not necessarily prevent contractual change from occurring, but can nevertheless be valuable in terms of bargaining positions if their violation bears judicial, economic or political consequences.30 The lack of success in negotiations may lead an arbitral tribunal to intervene and restore the contractual equilibrium, if so provided by the parties or in the absence of the arbitrator’s power to that effect, to determine the destiny of the contract.31 The renegotiation clauses also have the advantage of satisfying the state’s desire to preserve its sovereign prerogatives. Such clauses do not infringe upon the host country’s sovereign prerogatives like the stabilization clauses, but open the way to the renegotiation of certain

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27 S. Asante, Stability of Contractual Relations in the Transnational Investment Process, 28 ICLQ 401, 404 (1979) (cited in N. Horn, Standard Clauses on Contract Adaptation in International Commerce, in ADAPTATION AND RENEGOTIATION OF CONTRACTS IN INTERNATIONAL TRADE AND FINANCE (N. Horn ed., 1985)). However, one might suggest that if, as authors mostly from developing countries have pointed out, the host state is entitled by virtue of its sovereign legislative power to change unilaterally the conditions of an agreement, why should host states have a renegotiation clause. Is it not more in the interests of host states not to have one? In fact, renegotiation clauses have advantages for both parties and both are advised to use this technique. Following the recommendations of the Group of Eminent Persons (U.N. Doc. ST/ESA 16 (1974)) a number of commentators have advocated such provisions. For a discussion of reasons advocated for the inclusion of such clauses by host countries see Waelde (1978), supra note 3, at 267–68. For a recent discussion of the drawbacks of renegotiation clauses see J. Gotanda, International Commercial Arbitration: Renegotiation and Adaptation Clauses in Investment Contracts, Revisited, 36 Vand. J. Transnat’l L. 1461 (2003).


30 W. Peter, Arbitration and Renegotiation Clauses, 3 J. Int’l Arb. (1986), n.3.

31 Bernardini, supra note 6, at 415.
terms of the agreement at specified times or on the happening of specified events. In addition, while a stabilization clause aims at restricting the legislative power of the host state to apply new laws and regulations to the detriment of the private party, a renegotiation clause is more in the nature of a private law arrangement between two private parties. As such, a renegotiation clause may give rise to a duty to compensate the private party for the prejudice suffered by reason of any new laws or regulations affecting contractual terms. Hence, one should say that such renegotiation in fact works both ways.

Another situation where a renegotiation clause may be helpful is where the parties, by virtue of their differing cultures, understand and perceive the basis of a business transaction in fundamentally different ways. The Asian business style, for instance, is completely different from that of the West. In the Asian context, business executives seek to avoid conflict wherever possible, and seek to keep the relationship alive in times of adversity. To them, the essence of the business deal is the relationship between the parties. Businessmen from such a culture assume that long-term relationships include an implicit principle which provides that parties in time of changes should meet and decide together how to cope with the new circumstances and adjust their relationship accordingly. In contrast, Westerners—in particular Anglo-Saxons—often view "the transaction as set in the concrete of a lengthy and detailed contract, without the possibility of modification."

The nature of long-term agreements requires cooperation of the parties. When we have an agreement concluded between parties belonging to different cultures as illustrated above, it is wise to acknowledge and anticipate the differences that may occur between them and try to bridge the gaps by finding a middle ground to satisfy both parties. It has been suggested that a renegotiation clause should do this job as it stands in the middle between total contractual rigidity and complete relational flexibility. Thus, a renegotiation clause may play a facilitative role in stabilizing long-term agreements such as international petroleum agreements, whose nature creates a high risk of instability.

### III. Renegotiation Without a Renegotiation Clause

In the absence of special mechanisms for dealing with a change in the commercial equilibrium in the contract, a renegotiation or adjustment of the contract to changed circumstances can only be taken into consideration where other contractual terms or the

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32 Id. at 418.
33 Id. at 418.
34 Salacuse, supra note 17, at 1514.
36 J. Salacuse, Ten Ways that Culture Affects Negotiation: Some Survey Results, 14 NEG. J. 221, 222 (1998). It is interesting to note that the use of stabilization clauses is rare in Japan. See Wallace, supra note 4, at 972; Wizelle & Nih, supra note 2, at 221.
37 Salacuse, supra note 17, at 1515; see also P. Lansing & W. Marlene, Doing Business in Japan: The Importance of Unwritten Law, 17 INT’L LAWYER 674, 654 (1983).
38 Salacuse, supra note 17, at 1515.
39 Sornarajah, supra note 28, at 55; Salacuse, supra note 17, at 1515.
applicable law provide an appropriate starting point. This section will look at these two grounds to see whether and under what circumstances a party to an international petroleum agreement may find a starting point to trigger renegotiation of contracts that do not provide explicitly for such renegotiation. Each of these grounds raises different problems, and each demands different solutions.

A. Applicable Law Considerations

The question of the law applicable to the contract is of crucial importance to the sensitive issue of contract change. It determines the conditions under which and to what extent a party is entitled to change the contract. The applicable law also determines the legal consequences of failed negotiations or if failed negotiations are attributed to the conduct of one of the parties. The purpose of this section is to see whether and under what circumstances a party to an international petroleum agreement may find a starting point to trigger renegotiation of contracts that do not provide explicitly for such renegotiation.

As is well known, the parties can choose the law they deem appropriate to govern their agreement. If a national law is chosen, arbitrators apply that law, although questions concerning the taking of foreign private property and compensation might fall under the rules of international law relating to state responsibility for property of aliens. Parties may also choose international law to govern their agreement. Besides this, there are occasions where the parties agree on a combined solution as when they choose international law, national law, and general principles of law, and sometimes also with reference to the practices in the international petroleum industry. Such cases pose great

40 N. Horn, Changes in Circumstances and the Revision of Contracts in Some European Laws and International Law, in \textit{Adaptation and Renegotiation of Contracts in International Trade and Finance} 29 (N. Horn ed., 1985); Peter, supra note 18, at 240; Berger, supra note 29, at 1347, 1350. It should be noted that parties can always agree to renegotiate their agreement, even in the absence of a renegotiation clause.

41 Such issues are sometimes specified by the parties in the renegotiation clause. See Peter, supra note 18, 130.

42 According to the principle of party autonomy, the parties can choose the law they deem appropriate to govern their agreement. This principle is universally known and widely accepted. See J. LEW, APPLICABLE LAW IN INTERNATIONAL COMMERCIAL ARBITRATION 75 (1978); G. DELAUME, TRANSNATIONAL CONTRACTS: APPLICABLE LAW AND SETTLEMENT OR DISPUTES, SUPPL. 1, 2–3 (1988); K. BÖCKSTIEGEL, ARBITRATION AND STATE ENTERPRISES: A SURVEY ON THE NATIONAL AND INTERNATIONAL STATE OF LAW AND PRACTICE 28 (1984); W. CRAIG \textit{et al.}, INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION: 301 (1999); KEEFERS \& HUNTER, supra note 5, at 94–95. See also Texaco Overseas Petroleum Company/California Asiatic Oil Company and Government of the Libyan Arab Republic (\textit{TOPCO}) 17 I.L.M. 3, 11 (1978); Serbian Loans, 1929 P.C.I.J. (ser. A) No. 20/21, at 42. But see A. Tang, The Law Applicable to a Transnational Economic Development Contract, 21 J.W.T.L. 95, 113 (1987).

43 The host country’s national law may also be applicable, though subject to international law, if the agreement provided for arbitration under the International Centre for the Settlement of Investment Disputes (ICSID) (§ 24).

44 However, there is some controversy as to whether public international law rules and principles alone can govern all aspects of the contractual relationship between a government and a foreign company. See W. FREIDMANN, \textit{Some Impacts of Social Organisation of International Law} 90 A.I.L. 475, 484 (1956); P. Lafave, Contracts between a State or a State Agency and Foreign Company, 13 I.C.L.Q. 987 (1964); K. BÖCKSTIEGEL, The Legal Rules Applicable in International Commercial Arbitration Involving States or State-Controlled Enterprises, in \textit{INTERNATIONAL ARBITRATION: 60 YEARS OF ICC}: A LOOK AT THE FUTURE 117 [ICC ed., 1984]; El-Khoshni & Reid, supra note 6, at 268.

45 When the parties fail to agree on a particular system of law as the governing law, a typical solution is to compromise on a combination of various systems. On the difficulties caused by such formulas see G. DELAUME, \textit{The Myth of the Lex Mercatoria and State Contracts}, in \textit{LEX MERCATORIA AND ARBITRATION: A DISCUSSION OF THE NEW LAW} 111, 116 (T. Carboneau ed., 1998). See also K. BÖCKSTIEGEL, States in the International Arbitral Process, 2 ARB. INT’L (1986).
difficulty for the arbitrators at the stage of identifying the legal rules to be applied.\footnote{Delaume, \textit{supra} note 45. It should be noted that in the field of international commercial arbitration the question of the law applicable is rarely a primary issue. Arbitrators rely on contract interpretation and trade usages. Nonetheless, this is not the case in state contracts. The question of the law applicable to state contracts is one of the most disputed issues. See Peter, \textit{supra} note 18, at 129–203.} In such circumstances, the arbitral tribunal will normally see how the various legal systems chosen and commercial usages deal with the dispute and then apply concepts and principles which are common to those various systems.\footnote{Kolo & Waelde, \textit{supra} note 3, at 33.} When those legal systems come to divergent results, arbitrators have a tendency to give less weight to solutions which are not generally shared and highlight and apply the common principles.\footnote{“Arbitrators have a natural tendency to select those principles which are international and are seen as a reflection of an international consensus, while they are likely to disregard principles of national law which are inconsistent with generally recognised principles of international law. This preference reflects the natural preference of international arbitral tribunals for internationally recognised principles.” Kolo & Waelde, \textit{supra} note 3, at 33. But see the new pattern established in CME Czech Republic B.V. v Czech Republic, Partial Award, September 13, 2001, under the UNICITRAL Rules, available at <\!\!\!\!\!/www.mfcr.cz/static/Arbitraz/eu/PartialAward.pdf>. See also N. Rubins, \textit{Judicial Review of Investment Arbitration Awards, in Investment Law and Arbitration: Past Issues, Current Practice, Future Prospects} 359, 382–83 (T. Weiler ed., 2004).} For our purpose, this section will look at two main areas. First, it will examine the response of the major legal systems to the question of the renegotiability of long-term international commercial agreements concluded with a state or state entity. This will help to identify the content of the generally recognized legal principles, frequently referred to in international petroleum agreements and to delineate the areas of differences between the major legal systems. The second point relates to how the problem of renegotiation is dealt with under international law.

1. Major Legal Systems


The traditional position of English common law is that contracts are absolute.\footnote{S. Woolman, \textit{Contract} 195 (1994).} Parties must perform the contract however burdensome it may have become and however much the circumstances may have changed.\footnote{R. Goode, \textit{Commercial Law} 140 (1995).} In addition, under the common law there is no duty on the parties to renegotiate the contract terms, nor does the court have power to modify the contract to reflect the changed circumstances.\footnote{Peter, \textit{supra} note 18, at 186; Goode, \textit{supra} note 50, at 140.}

However, in a number of cases the courts have recognized relief from contractual liability under the concept of “frustration.” “A contract is said to be frustrated when a supervening event occurs which so fundamentally affects the performance of the contract that in the eyes of the law the contract comes to an end and both parties are discharged from any duty to perform.” Frustation of the contract may be brought about when the...
performance of a contract becomes physically or legally impossible, or when the performance is possible but only in a very different manner from that originally contemplated, without fault of either party. Mere hardship is not a sufficient ground under English law to forgive performance. Nonetheless, the English courts construe the doctrine of frustration quite narrowly and English judges are reluctant to apply it. As one commentator has noted, “the English doctrine of frustration as currently applied is too strict and narrow to produce that degree of adjustment which the commercial community would regard as fair.” The courts, however, in the vast majority of cases do recognize contractual provisions which will provide the flexibility necessary to enable the parties to adapt their contract to changing circumstances.

The U.S. practice takes a more liberal approach to the question of excuse in cases of changes in surrounding circumstances than its English counterpart. This approach is referred to as “commercial impracticability” and is embodied in section 2–615 of the Uniform Commercial Code and in section 268(2) of the Restatement (Second) of Contracts. Under the doctrine of impracticability, relief from contractual performance may follow from excessively burdened performance such as severe shortage of raw materials or unforeseen shutdowns of major sources of supply and also in such cases parties can request renegotiation. While U.S. law recognizes such a narrow ground for escape from unexpectedly onerous contractual undertakings, courts have some times adjusted contractual terms when the change was unexpected at the time of the conclusion of the agreement and if holding the party to continued operation of the contract would lead the project or contractor into bankruptcy. In addition, U.S. law—as reflected in some court opinions—recognizes renegotiability of long-term agreements in cases of extreme unexpected onerous events.

55 Goodie, supra note 50, at 143.
56 “The narrowness of the doctrine of frustration does not act as a barrier to the parties themselves inserting into their contracts a range of clauses which will enable them to adapt their contract to meet changing conditions. A wide range of devices is available to contracting parties to enable them to adjust or suspend the contract in the light of unforeseen events.” E. McKendrick, The Regulation of Long-term Contracts in English Law, in Good Faith and Fault in Contract Law 305, 322, 332 (J. Beaton & D. Friedmann ed., 1995); see also Prof. Roy Goode who observed that under English law “the general principle is that the parties are free to stipulate those events that are to be considered as frustrating the contract, or as entitling one party or the other to an adjustment of the terms, and if the parties fail to do so the law will not intervene”: Goodie, supra note 50, at 140; Atiyah, supra note 52, at 244; Horn, supra note 40, at 21, 29.
60 Kolo & Waelde, supra note 3, at 35.
b. **Civil Law Systems: Germany and France**

German law is based on the principle of sanctity of contracts. Nonetheless, German law provides grounds for relief from contract performance in cases of impossibility without fault on either side. In addition, German courts have formulated a general doctrine on contract revision when there is a collapse of the foundation of the transaction, that is, the doctrine of "*Wegfall der Geschäftsgrundlage.*" This doctrine provides that the contract may be adapted or terminated in cases of "uncontrollable change in the circumstances surrounding the contract that leads to a fundamental disequilibrium in the contract and puts an undue burden on the party who had not anticipated and accepted that risk in the contract."\(^{61}\) A mere change in risk or onerousness of the contract does not justify in and of itself the changing of freely negotiated deals by the courts.\(^{62}\) The legal consequence of the collapse of the foundation of the contract is that the parties are obligated to negotiate on adaptation in good faith, and in *certain* cases, and not always, the court can adapt the contract.\(^{63}\)

The principle of sanctity of contracts is strictly upheld by French law. Excuse from performance of contractual obligations is restricted only to cases of impossibility, mainly by reason of force majeure, unless there is a contractual clause to the contrary. Force majeure in the traditional sense is an unforeseeable and irresistible event which makes the performance of the contract impossible.\(^{64}\) In addition to demonstrating that performance was rendered impossible, one must show that the occurrence of the event was not a result of either party’s fault. Mere change of circumstance is not sufficient grounds for relief from contract performance. Nonetheless, this strict position has been made more bearable by the requirements of good faith and equity encompassed in Articles 1134\(^{65}\) and 1135\(^{66}\) of the French Civil Code.\(^{67}\)

In addition, the French Conseil d’Etat has developed the doctrine of "*imprévision*" in connection with contracts concluded with governments or public bodies (administrative contracts).\(^{68}\) This principle allows the courts to adapt a contract in the event that the economic equilibrium of the contracts is seriously affected by unforeseen change of

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\(^{61}\) The basis of this doctrine is the concept of good faith which serves as the basis of German contract law as spelled out in art. 242 of the German Civil Code. See Horn, *supra* note 40, at 18–19; Peter, *supra* note 18, at 186; Goode, *supra* note 50, at 191.

\(^{62}\) R. Kunth, *Contract Adjustment*, in *ENERGY LAW* 86, 201 (IBA, Section on Energy and Natural Resources ed., New York, 1986). It is interesting to note that the doctrine of "*Wegfall der Geschäftsgrundlage*" is rarely argued in published international arbitral awards, see Nassar, *supra* note 53, at 198.

\(^{63}\) Horn, *supra* note 40, at 23–34. See also R. Horn, *The Procedures of Contract Adaptation and Renegotiation*, in id. at 173.


\(^{65}\) Art. 1134 provides that "Agreements legally make take the place of law for those who made them … They must be executed in good faith."

\(^{66}\) Art. 1135 reads: "Agreements oblige not only for what is expressed therein, but also for all the consequences which equity, usage or the law gives to an obligation according to its nature."

\(^{67}\) See Nassar, *supra* note 53, at 196–98. The use of commercial arbitration and adaptation clauses has also contributed to the making of this strict position more bearable. See Horn, *supra* note 40, 18.

\(^{68}\) See the leading *Gas Bordeaux* case, Conseil d’Etat, March 30, 1961, S. 1916.3.17.
circumstances. The doctrine of imprévision allows the termination of the contract only if the event affecting the economic equilibrium is final and irremediable. It should be noted that the doctrine of imprévision is of some significance for international petroleum agreements, as such contracts are very likely to be entered into with states and/or state enterprises. In addition, this concept (as will be shown later) has inspired corresponding provisions in the Civil Codes of many Arab countries.

c. Other Civil Law Systems

The Swiss doctrine of impossibility permits excusing contractual obligations in case of impossibility, unless there is a contractual clause to the contrary. The event causing impossibility must be unforeseen, unavoidable and without fault on either side. Nonetheless, the harshness of this rule is tempered by the requirement of good faith encompassed in Article 2 of the Swiss Civil Code. Accordingly, Swiss courts have rescinded or adjusted contracts where the commercial equilibrium of the contract has been disturbed by fundamental change of circumstances.

Italian and Greek Civil Codes contain provisions to the effect that contracts may be adapted or terminated when the commercial equilibrium of a contract has been profoundly disturbed by the occurrence of exceedingly onerous and unforeseeable circumstances.

Most other civil law systems such as the Scandinavian and Russian laws allow escape from contractual obligations which have become excessively onerous under the circumstances of extraordinary and unforeseeable occurrences that profoundly affect the equilibrium of the transaction.

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69 The arbitral tribunal in Libyan American Oil Co. (LIAMCO) v. Government of the Libyan Arab Republic observed that “This doctrine empowers the Courts to revise those provisions of a contract as might become excessive and exorbitant due to the advent of extraordinary circumstances,” 20 I.L.M. 1, 73 (1981).

70 The court has a duty to take steps in order to help towards the survival of the contract and, in particular, to suggest to the parties an agreement on new bases and it may decide in favour of termination only if the attempt to reach agreement has failed. See A.F.M. Maniruzzaman, State Contracts with Aliens: The Question of Unilateral Change by the State in Contemporary International Law, 9 J. Int’l Arb. No. 4 141–172 (1992); Horn, supra note 40, at 18.

71 Art. 2 of the Swiss Civil Code provides: “A manifest abuse of right is not protected by Law.” A leading commentator has summarised the Swiss position as follows: “the principle of pacta sunt servanda is limited by the greater principle of good faith. It is therefore contrary to good faith to insist upon the obligations imposed on the debtor if circumstances have changed to a point where, in exchange for his performance, he will receive either no reciprocal performance or one which is totally inappropriate,” A. VON THUR & A. EISER, ALLGEMEINER TEIL DES SCHWEIZERISCHEN OBBLIGATIONENRECHTS vol. II 170–72 (1974); cited in Peter, supra note 18, at 193.

72 See arts. 1467 and 1468 of the Italian Civil Code. See also art. 388 of the Greek Civil Code; Peter, supra note 18, at 194; Horn, supra note 40, at 20.

d. Arab law

The position of the laws of the Arab countries is of great significance to international petroleum agreements since several of the major oil-producing countries are Arab. Since the law of the Arab and Islamic countries have been influenced by Islamic law, considering the position of such law is appropriate (see below).

When many Arab countries gained their independence following the Second World War, the Egyptian Civil Code of 1949, which was based on the French legal traditions, was adopted in its entirety in other Arab countries. The Egyptian Civil Code has established a doctrine of changed circumstances under restrictive conditions. For an event to qualify for a change of circumstances, it must be exceptional and unforeseeable and render the performance of the contract onerous in such a way that the debtor is threatened with exorbitant losses. If these conditions are met the court is empowered to adapt the obligations to a reasonable limit taking into account the interests of both parties, but not to terminate the contract. Nonetheless, the Code recognizes a special category of public contracts called “contracts administratifs” which requires special treatment. In all Arab states (including Saudi Arabia) the public and administrative law French legal traditions became an integral part of the various domestic legal systems. Consequently, in all Arab countries a distinction is made between (1) the category of private contracts which are exclusively subject to the rules contained in the Civil and Commercial Codes; and (2) the category of public contracts which are to a certain extent governed by a special set of public law rules corresponding to the needs emerging from their particular nature and objectives. It is important to emphasize here that Articles 668–673 of the Egyptian Civil Code, which was adopted almost in its entirety in the other Arab countries, formally recognizes a special category of contracts that require different treatment from ordinary contracts and are more accessible to renegotiation and termination by the government. The relevant implication of the latter provisions of the Egyptian Civil Code, from an administrative law point of view, is that the state always has an inherent and inalienable right to intervene in pursuing public interest considerations by imposing general regulations of an extracontractual nature. This different treatment is limited to the regulation of the relationship between the public utility concessionaire and consumers. Hence, the Egyptian Civil Code left out of its scope the regulation of the relationship between the administration and the concessionaire. Nonetheless, according to the established case law of both the Egyptian Conseil d’État and the ordinary courts, the exercise of the abovementioned

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77 Namely: Syria, Iraq, Libya, Kuwait, Qatar, Algeria, the Sudan, Yemen, and the United Arab Emirates.
78 Art. 147(2) of the Egyptian Civil Code of 1949.
80 The latter rules are embodied in arts. 668–673 of the Civil Code under the heading of Concessions of Public Utility.
81 El-Khosheri & Riad, supra note 6, at 260.
public power is not limited to the concessions of public utility mentioned in the Civil Code, but extends to all other contracts which share the same nature of being concluded by a state and/or a state agency in pursuing a public interest. The point to be made here is that the study of the case law as well as the legal literature related to the proper characterization of natural resources development agreements under the Egyptian model applicable in other Arab countries clearly indicates that these agreements necessarily fall within the category of public contracts.

e. Islamic law

Under Islamic law (Sharia) every lawful contract must be observed. This principle is supported by the following verse from the Holy Quran: “Oh you who believe, observe covenants.”

The leading commentators are agreed that the above words apply to all contracts. Nonetheless, Islamic law recognizes a very restricted concept for excuse from contractual performance. For an event to excuse performance it must be unforeseeable at the time of concluding the contract, fundamental in character and render the performance of the contract onerous. In addition, the event must be beyond the party’s control and must affect the substance of the contract. Furthermore, the event also must be threatening the party with excessive loss exceeding the benefits expected from the continuation of the contract. In such cases the judge is empowered to adapt the parties’ obligations taking into account the interests of both parties. The judge can also terminate the contract if he considers that its termination is in the interest of both parties, provided that just compensation is paid to the other party.

However, contracts relating to the exploitation of natural resources belong to a special category under the Islamic law of contract. There seems to be a consensus in current

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83 T. Badawi, Administrative Law 251 (1983), cited in Reid, supra note 82, at 72 n.16.
85 Almeida Sura, ch. 5, verse 1.
86 Id. This verse is from Surah 6:135, which states: “O you who believe, observe covenants.”
87 Al-Tabari, Tafsir VI, 33 (905–12); Al-Qurtubi, Al-jami’ li Ahkam Al-Qurania VI, 33 (1935).
88 A study prepared by the Permanent Committee for Research and Iftaa’ [Giving Islamic Verdicts]. This study was conducted pursuant to the decision of Lajnat Kibar Al-Olama’ [The Body of Most Knowledgeable Islamic Scholars], i.e., the highest Islamic authority in Saudi Arabia, in the seventh circulation (1981), at 72. This study was not published.
89 Id.
90 A. Alsaeedan, The Law Governing Oil Concession Agreements and the Permanent Sovereignty of States Over Their Natural Resources: With Special Reference to Islamic Shari’ah Law 245 (1997).
91 This was the view of the Congress of Islamic Fiqh of the Assembly of Islamic World in its decision No. 7, 8th circulation (1978), at the holy city of Makkah, Saudi Arabia.
Islamic opinion that under Islamic law, the ownership of natural resources belongs to the Islamic community and the Sovereign grants concessions on behalf of the Islamic community in whom the ultimate right of property is vested. Contracts relating to the exploitation of such resources fall under the category of contracts called “iqta’ al-mawat” (allotting of undeveloped land). In such an Iqta, the leader of the Muslim community (Imam) grants permission to one or more persons to explore a specified area and to take out whatever minerals he may discover. It is stated that the Islamic contract of Iqta enters necessarily in the category of public contracts and hence is more accessible to renegotiation and termination by the government than normal commercial contracts. In addition, the Imam has the right to terminate agreements entered into with other parties ahead of time if he finds that its terms are harmful to the interest of the Islamic community, provided that an adequate prior notification is sent to the other party informing them of his intention to terminate the agreement. The other party is of course entitled, under Islamic law, to compensation for its loss. Finally, the adjustment of contracts in cases of changed circumstances under Islamic law has to be done through renegotiation, and when a party refuses to participate in the renegotiation of the contract, the disadvantaged party can then withdraw from the agreement.

95 W. EL-MALIK, MINERAL INVESTMENT UNDER THE SHARI’A LAW 54 (1993); S. TORGUÉLAN, LEGAL STATUS OF OIL CONCESSIONS IN THE MIDDLE EAST 109 (1972). This is the view of the Hanbali and Maliki Schools, see generally MOHAMMED RIAD, Ibn QuSama vol V 523–24 (Almughini ed., 1948) (in Arabic). Yet there are other Islamic Law Schools which disagree with this view: The Hufati and Shafi Schools adopt the view that minerals ownership follows land ownership, subject to the payment of taxes (zakat). This position would be similar to that in the Anglo-Saxon common law, see M. BUTTER, THE ISLAMIC SHARI’A LAW AND PETROLEUM DEVELOPMENTS IN THE COUNTRIES OF NORTH AFRICA AND THE ARABIAN GULF, I TRANSNATIONAL DISPUTE MANAGEMENT (No. 2, 2004), available at <www.transnational-dispute-management.com/276>. This was the legal opinion of the learned Sheikh Mohammad Abu Zahra in the Arbitration between Aramco and Saudi Arabia, Aramco’s First Memorial, at 351–52. Yet, some of the provisions and clauses of modern oil concessions could possibly be found in breach of some of the principles of the Islamic law of contract regarding interest on investment under the Sharia. Nonetheless, it is important to note that the answers given by Islamic law to such problems have been given before the commercial and economic evolution had reached today’s stage. They are not unalterable and do not constitute an exception to the universal rule that “the law must change over time.” Indeed, Sharia is not static and rigid and it is only bound by the Qur’an, Sunna, Iqma and Qivas. A suggestion following this line was initiated by Prof. I. Shihata in his article on the question of riba I. Shihata, Some Observations on the Question of Riba and the Challenges Facing Banking, 7 CEPMLP ON-LINE JOURNAL, art. 7. See also Z. ALQURASHI, ARBITRATION UNDER THE ISLAMIC SHARI’A, I OGLE (No. 2, 2003), at <www.gasandoil.com/ogle/276>. The term “Iqta’” is the noun of the verb “gata” meaning to cut. A concession was named Iqta’ because by conferring an exclusive right upon an individual concerning a certain plot of land, the Muslim community was cut off from the benefits of the land in question. See TORGUÉLAN, supra note 93, at 109. For discussion on the main characteristics of Iqta’ see EL-MALIK, supra note 93, at 71–74; M. KARIM, Oil, Islamism and the International Petroleum Industry: Legal, Economic, Political and Cultural Issues (L.L.M dissertation, University of Dundee, 2001); A. YAMANI, Islamic Law and Contemporary Issues, in GOD AND MAN IN CONTEMPORARY ISLAMIC THOUGHT: PROCEEDINGS OF THE PHILOSOPHY SYMPOSIUM HELD AT THE AMERICAN UNIVERSITY OF BEIRUT, FEBRUARY 5–10, 1976, 69 (C. Malic ed., 1972); EL-KHOSEYER & RIAD, supra note 6, at 262–63; A. El-KHOSEYER, LE RÉGIME JURIDIQUE CRÉÉ PAR LES ACCORDS DE PARTICIPATION DANS DOMAINE PétROLE, 147 RECUEIL DES COURS 219, 342–43 (1975); RIAD, supra note 82, at 38. 96 A. YAMANI, Islamic Law and Contemporary Issues, in GOD AND MAN IN CONTEMPORARY ISLAMIC THOUGHT: PROCEEDINGS OF THE PHILOSOPHY SYMPOSIUM HELD AT THE AMERICAN UNIVERSITY OF BEIRUT, FEBRUARY 5–10, 1976, 69 (C. Malic ed., 1972); EL-KHOSEYER & RIAD, supra note 6, at 262–63; A. El-KHOSEYER, LE RÉGIME JURIDIQUE CRÉÉ PAR LES ACCORDS DE PARTICIPATION DANS DOMAINE PétROLE, 147 RECUEIL DES COURS 219, 342–43 (1975); RIAD, supra note 82, at 38. 97 A. YAMANI, Islamic Law and Contemporary Issues, in GOD AND MAN IN CONTEMPORARY ISLAMIC THOUGHT: PROCEEDINGS OF THE PHILOSOPHY SYMPOSIUM HELD AT THE AMERICAN UNIVERSITY OF BEIRUT, FEBRUARY 5–10, 1976, 69 (C. Malic ed., 1972); EL-KHOSEYER & RIAD, supra note 6, at 262–63; A. El-KHOSEYER, LE RÉGIME JURIDIQUE CRÉÉ PAR LES ACCORDS DE PARTICIPATION DANS DOMAINE PétROLE, 147 RECUEIL DES COURS 219, 342–43 (1975); RIAD, supra note 82, at 38. 98 A. YAMANI, Islamic Law and Contemporary Issues, in GOD AND MAN IN CONTEMPORARY ISLAMIC THOUGHT: PROCEEDINGS OF THE PHILOSOPHY SYMPOSIUM HELD AT THE AMERICAN UNIVERSITY OF BEIRUT, FEBRUARY 5–10, 1976, 69 (C. Malic ed., 1972); EL-KHOSEYER & RIAD, supra note 6, at 262–63; A. El-KHOSEYER, LE RÉGIME JURIDIQUE CRÉÉ PAR LES ACCORDS DE PARTICIPATION DANS DOMAINE PétROLE, 147 RECUEIL DES COURS 219, 342–43 (1975); RIAD, supra note 82, at 38.
To sum up: the examination of the major representative legal systems of the world shows that, in the sphere of both private and public law contracts, the principle of *pacta sunt servanda*, or strict sanctity of contract, is widely accepted. However, under no legal system has the latter principle been found to be absolute. In all legal systems contracts lose their legal validity when the core purpose of the contract no longer exists. Nevertheless, legal systems differ where the contract can still be executed, while the continued execution of the contract has become very onerous to one party due to a drastic change in circumstances underlying the original deal. English law tends to uphold the validity of the agreement and English judges are reluctant to interfere with the negotiated terms. In contrast, the U.S. practice is more far-reaching than its English counterpart. U.S. practice, as reflected in some court opinions, does recognize renegotiability of long-term contracts in cases of extreme onerousness to one party. This concept is more strongly supported in all countries with a civil law tradition and under Islamic law as well, the more so in contracts entered into with governments and having public law elements.

2. **International Law**

The existence in international law of the doctrine of *rebus sic stantibus*/change of circumstance has been widely accepted in modern times. This principle applies irrespective of the inclusion of a change of circumstances clause in the agreement itself.

The rule of fundamental change of circumstances has found its way into the Vienna Convention on the Law of Treaties of 1969 under Article 62. The legal effect of a fundamental change of circumstances under the treaty is that the disadvantaged party can request withdrawal or renegotiation of his treaty obligations. Nonetheless, the latter article is carefully worded and has a very limited application in exceptional cases. This is mainly to discourage the over-use of the principle and thus to avoid uncertainties as to the sanctity

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102 Kolo & Waelde, *supra* note 3, at 37.


104 See Kolo & Waelde, *supra* note 3, at 47.


106 Art. 62 reads as follows: “Fundamental Change of Circumstances 1. A fundamental change of circumstances which has occurred with regard to those existing at the time of the conclusion of a treaty, and which was not foreseen by the parties, may not be invoked as a ground for terminating or withdrawing from the treaty unless: (a) the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and (b) the effect of the change is radically to transform the extent of obligations still to be performed under the treaty. 2. A fundamental change of circumstances may not be invoked as a ground for terminating or withdrawing from a treaty: (a) if the treaty establishes a boundary; or (b) if the fundamental change is the result of a breach by the party invoking it either of an obligation under the treaty or of any other international obligation owed to any other party to the treaty. 3. If, under the foregoing paragraphs, a party may invoke a fundamental change of circumstances as a ground for terminating or withdrawing from a treaty it may also invoke the change as a ground for suspending the operation of the treaty.” The whole Convention is available at <www.un.org/law/ilc/texts/treaties.htm>.

107 This is of course subject to a procedure prescribed by art. 65, *see generally* G. Haraszti, *Treaties and Fundamental Change of Circumstances*, 146 Recueil des Cours 1 (1974).
of international agreements provided for under Article 26 of the same treaty. This understanding is reflected in the International Court of Justice (ICJ) judgment in the recent Gabcikovo-Nagymaros Project case, in which the ICJ observed that “a fundamental change of circumstances must have been unforeseen; the existence of circumstance at the time of the Treaty’s conclusion must have constituted an essential basis of the parties to be bound by the Treaty.” The tribunal added that “the negative and conditional wording of Article 62 of the Vienna Convention on the Law of Treaties is a clear indication, moreover, that the ability of Treaty relations requires that the plea of fundamental change of circumstances be applied only in exceptional circumstances.”

The Vienna Convention is applicable only to inter-state treaties. Nonetheless, it has been stated that “article 62 is a strong argument for the existence of a general legal principle which might also be relevant to transnational contract with or between private parties.” In addition, it is often argued that an obligation is created to renegotiate international investment contracts where the contractual equilibrium that existed at the time the contract was made has been altered by a fundamental change of circumstances. This view is based on various United Nations General Assembly Resolutions supported by developing countries. The United Nations Economic and Social Council (ECOSOC) Draft Code of Conduct on Transnational Corporations has also provided that transnational corporations should engage in renegotiation with governments even without a relevant clause in circumstances marked by duress, or clear inequity between the parties, or where the conditions upon which the contract was based have fundamentally changed. This concept was also endorsed by the members of OPEC, who supported the legitimacy of the renegotiation of concession agreements and made it the core of their Declaratory Statement of Petroleum Policy of 1968 which inaugurated the changes in the relationship between the host countries and oil companies that took place in the ensuing ten years.

In this regard, there is no consensus on the existence of the duty to renegotiate transnational agreements. Developing countries argue that in agreements concluded between developing countries and the District of Gex, 1932 P.C.I.J. (ser. A/B) No. 46. See also Free Zone of Upper Savoy and the District of Gex, 1932 P.C.I.J. (ser. A/B) No. 46.

108 Horn, supra note 40, at 25.
110 Fisheries Jurisdiction, supra note 109, at 53 ¶ 104.
111 Art. 1 of the Treaty provides: “The present Convention applies to treaties between States.”
112 Horn, supra note 44, at 25.
114 See G.A. Res. 1803 (XVII) of December 14, 1962, Permanent Sovereignty over Natural Resources; see also G.A. Res. 3281 (XXIX) of December 12, 1974, the Charter on Economic Rights and Duties of States (CERDS).
115 It should be noted that the Code stated that renegotiation in such situations should be undertaken only if this is provided for in the law applicable to the contract. See art 5 of the ECOSOC Code of Conduct on Transnational Corporations 1979.
116 Declaratory Statement of Petroleum Policy in Member Countries, Res. No. XVI. 90 of the Sixteenth OPEC Conference, reprinted in 7 I.L.M. 1183 (1968). In addition, still other international documents have recommended the inclusion of renegotiation clause in long term agreements such as the UN Group of Eminent Persons Report of 1974 and the General Counsel of the World Bank.
states and foreign investors for the exploitation of natural resources the concept of sanctity of contracts is overridden by the principle of permanent sovereignty over natural resources and by the fact that such agreements are major instruments of public concern on which the country’s socio-economic development depends. On the other hand, Western countries insist on sanctity of contracts and the protection of foreign investment. However, it must be emphasized that the “insistence of developed countries on the sanctity of contracts did at no point explicitly or implicitly reject the application of contract law concepts such as ‘change of circumstance,’ but it rejected the developing countries’ claim to a right to unilaterally change, revoke or coerce the renegotiation of a contract on the grounds of sovereignty and new economic policy alone.” Given all of the above, it is not clear whether there is a duty to renegotiate investment agreements entered into with governments under international law where there has been a genuine fundamental change of circumstances.

B. Force Majeure and Hardship Clauses

One of the most difficult renegotiations is that occurring when one party insists on renegotiating the terms of a valid contract that contains no express provision authorizing renegotiation. In such situations the party insisting on renegotiation frequently relies on either a force majeure clause included in the agreement or the hardship concept of international contract law.\(^\text{119}\)

Force majeure and hardship clauses are used to reduce the damage that may result to one of the parties because the contract is to be performed in changed circumstances.\(^\text{120}\) Our purpose here is to see to what extent these clauses may be used by the party insisting on renegotiation to trigger the renegotiation process. A brief survey of the function of these clauses is appropriate.

A force majeure clause in the traditional sense is used to provide for events not foreseen by the parties, unavoidable and outside of their control.\(^\text{125}\) Such clauses relate only to an event of a fundamental character which constitutes permanent or temporary obstruction and is thus recognized as grounds for excuse from having to fulfill the contract.\(^\text{122}\)

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\(^{118}\) Kolo & Waelde, supra note 3, at 40.

\(^{119}\) Berger, supra note 29, at 1350; A. Doudko, Hardship in Contract: the Approach of the UNIDROIT Principles and Legal Developments in Russia, 5 Uniform L.R. 483, 507–08 (2000), where the author observes that there is a tendency beginning to emerge to treat hardship as a general rule of law, cited in Berger, supra note 29.

\(^{120}\) Sornarajah (1988), supra note 113, at 113.

\(^{125}\) M. Blessing, Mandatory Rules of Law versus Party Autonomy in International Arbitration, 14 J. Int’l Arb. 23 (1997); Peter, supra note 18, at 235.

\(^{122}\) K. Böckstiegel, Hardship, Force Majeure and Special Risk Clauses in International Contracts, in Adaptation and Renegotiation of Contracts in International Trade and Finance 159–60 (N. Horn ed., 1985); Horn, supra note 40, at 131.
Force majeure provisions currently used in international petroleum agreements fall into two major categories. The first category of such clauses incorporate into the agreement the concept of force majeure accepted in a given system of law—whether or not the governing law of the agreement. Such clauses must be looked at in the context of contractual liability established by the law applicable to the contract. The second category, instead of defining the concept of force majeure by reference to a given system of law, stipulates in the agreement the type of events which, in the opinion of parties, would constitute a valid excuse.

A force majeure clause would usually provide for the termination of the contract if the performance of the contract becomes impossible or too onerous on one of the parties, and as such “it does not seek to re-establish the equilibrium of the contract.” Hence, this type of clause is not within the scope of our discussion on renegotiation of contracts. Yet, it is said that force majeure clauses in international business transactions usually have a wider meaning. A study of a significant number of force majeure clauses by a group of international lawyers led by Professor Marcel Fontaine revealed that most force majeure clauses used in such contracts have less strict conditions for occurrence of force majeure than in the concept of force majeure stricto sensu. It also found that such clauses provide for the suspension and not the termination of the contract. Finally and perhaps most importantly, it found that such clauses usually contain a duty to make best efforts to overcome the force majeure event eventually by subsequent renegotiation.

Force majeure clauses in current use in international petroleum agreements show that while termination of contracts is not excluded, it is intended to take place only in exceptional circumstances as where the parties become convinced that the venture may not be pursued because of the expiration of a more or less prolonged period of time without being able to reach an agreement. Such clauses frequently define what constitutes a force majeure event, and the ways and means of mitigating its impact in order to save the relationship. They can also contain an obligation on the parties to negotiate

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123 Blinn et al., supra note 19, at 287.
124 An example of such clauses would be a clause in an agreement entered into by Brazil. This clause reads as follows: “26.1. In accordance with the provisions of Article 1058 of the Brazilian Code, neither Party shall be liable for losses resulting from a fortuitous event or force majeure,” cited in Blinn et al., supra note 19, at 287.
125 See Horn, supra note 40, at 131.
126 See T. Carbonneau, Rendering Arbitral Awards with Reasons: The Elaboration of a Common Law of International Transactions, 23 Colum. J. Transnat’l L. 579, 594 (1985). It should be noted that the discussion in this section will be confined to the second category of such clauses. The first category was examined above when dealing with the adaptation concepts provided by the applicable law.
127 McKendrick, supra note 56, at 185–86, 189–90.
128 El Chiati, supra note 1, at 105; see also Berger, supra note 29, at 1352; Sornarajah, supra note 28, at 53.
131 Fontaine, supra note 130, cited in Peter, supra note 18, at 235–36.
132 Blinn et al., supra note 19, at 292.
133 Id.; Bartels, supra note 2, at 32.
and to search for ways to overcome the situation resulting from intervention by “acts of god.”

Harshness clauses have not yet found their way into international agreements that deal with exploration and exploitation of oil. Yet, such clauses are frequently used in natural gas sales contracts and other international long-term contracts in general, therefore a discussion of them may prove useful.

A hardship clause is used in situations where the contract performance has not become impossible but extremely burdensome, as when the contract performance has reached the “limit of sacrifice.” Professor Clive Schmitthoff defined the circumstances in which a hardship exists. He observed that for an event to be considered as a hardship event it has to have three elements: (1) it must have arisen beyond the control of the

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134 See Delaume, supra note 129, at 256; Fontaine, supra note 130; Berger, supra note 29, at 1352; Sornarajah, supra note 28, at 119–20. It has also been suggested that “in this event so-called force majeure clauses are in fact renegotiation clauses”, see Peter, supra note 18, at 235 n.103 and 249. A 1982 liquefied natural gas sales agreement involving a Canadian petroleum company and Japanese buyers provides a good illustration of such a clause: Article XIII: Force Majeure

13.1: Excuse for Non-Performance. In the event that any party to this Agreement is rendered unable, wholly or in part, by Force Majeure to carry out its obligations under this Agreement, such party shall give notice by telex or telegraph to the other parties to this Agreement in the English language setting forth the full particulars of such Force Majeure and the estimated duration thereof as soon as possible after the occurrence of said Force Majeure. Upon the giving of such notice the obligations of such party, insofar as they are affected by such Force Majeure, shall be suspended, except for the obligations to make payments hereunder, during the continuance of any inability so caused, but for no longer period, and such cause shall so far as possible be remedied with reasonable dispatch. The party claiming Force Majeure shall exercise reasonable efforts to mitigate the effects of such Force Majeure on the performance of its obligations under this Agreement (emphasis added).

13.2: Meaning of Force Majeure. The term ‘Force Majeure’ as employed herein shall mean any event beyond the reasonable control of the parties hereto, including without limitation, acts of God, forces of nature, perils of the sea, shipwrecks; collisions; stranding; bursting of boilers; acts of the public enemy; wars; blockades; civil wars; insurrections; strikes; lockouts or differences with workmen; riots; disorders; quarantines; epidemics; landslides; lightning; earthquakes; atmospheric disturbance; typhoons; tornados; fires; storms or storm warnings; floods; subsidence or washouts; soil erosion; arrests; restraints of government or judicial body (including Canadian or Japanese, federal, provincial, prefecture or local) including restraints in the form of orders, rules or regulations; strikes or differences with employees; serious accidental damage; and without limitation by enumeration, any other cause or causes (whether of the kind enumerated or otherwise) not reasonably within the control of the party claiming Force Majeure. It is understood and agreed that the settlement of strikes or differences with employees shall be entirely within the discretion of the party having the difficulty. Notwithstanding the foregoing, both Buyers and Seller shall make reasonable efforts so that the supply of LNG shall not be interrupted due to strike, lockout or other industrial disturbance.

13.5: Subject to Arbitration. In the event of a dispute between the parties hereto as to the validity of a claim of Force Majeure, the dispute shall be resolved in accordance with the provisions of Article XVIII. The party asserting the claim of Force Majeure shall have the burden of proving that the circumstances constitute valid grounds of Force Majeure under this Article XIII and that such party has exercised reasonable efforts to remedy the cause of any alleged Force Majeure condition.

13.6: Extended Force Majeure. If an event of Force Majeure occurs and appears likely to continue for a period in excess of thirty (30) Days, the parties shall immediately consult for the purpose of determining what action should be taken to mitigate the effects thereof. (cited in Blunn et al., supra note 19, at 287).

136 Blunn et al., supra note 19, at 287.

137 C. Schmitthoff, Handelrecht and Intervention Clauses, 1980 J. Bus. L. 82, 84.

138 Peter, supra note 18, at 237.

139 Berger, supra note 29, at 1352.
parties; (2) it must be of fundamental character; (3) it must be entirely uncontemplated and unforeseeable.\footnote{140}

Hardship clauses are not dissimilar to force majeure clauses except that they do not contemplate situations which bring the contract to an end.\footnote{141} Hardship clauses have as their aim the renegotiation of some of the contractual terms in order to adapt the contractual balance, which may have been upset by the new circumstances.\footnote{142} Therefore, it is said that hardship clauses are a “specific type of renegotiation clause, which only apply in situations similar to force majeure.”\footnote{143} To take just one example, the hardship clause of a contract for the sale of natural gas provides as follows:

Hardship: when entering into this Agreement the parties contemplate that the effects and/or consequences of this Agreement will not result in economic conditions which are a substantial hardship to any of them; provided that they will act in accordance with sound marketing and efficient operating practices. They therefore agree on the following:

(a) Substantial hardship shall mean if at any time or from time to time during the term of this Agreement without default of the party concerned there is the occurrence of an intervening event or change of circumstances beyond said party’s control when acting as a reasonable and prudent operator such that the consequences and effects of which are fundamentally different from what was contemplated by the parties at the time of entering into this Agreement (such as, without limitation, the economic consequences and effects of a novel economically available source of energy), which consequences and effects place said party in the situation that then and for the foreseeable future all annual cost (including, without limitation, depreciation and interest) associated with or related to the processed gas which is the subject of this Agreement exceed the annual proceeds derived from the sale of said gas. Notwithstanding the effect of other relieving or adjusting provisions of this Agreement the party claiming that it is placed in such position as aforesaid may by notice request the other for a meeting to determine if said occurrence has happened and if so to agree upon what, if any, adjustment in the price then in force under this Agreement and/or other terms and conditions thereof is justified in the circumstances in fairness to the parties to alleviate said consequences and effects of said occurrence. Price control by the Government of the state of the relevant Buyer(s) affecting the price of natural gas in the market shall not be considered to constitute substantial hardship.\footnote{144}

As indicated earlier, international petroleum agreements are often concluded between states, state agencies or enterprises and international oil companies. This reality poses a particularly delicate aspect to the question dealt with in this section. Can such state agencies or enterprises, being entities with legal personality and able to trade and enter into contracts of private law, rely on force majeure or hardship events caused by the host state’s interference with contract performance (such as new legislation) to escape their contractual obligations with the oil company or to achieve a renegotiation of the contract? A number of famous cases have dealt with this issue. An illustration is provided

\footnote{140} Schmitthoff, \textit{supra} note 137, at 82, 85.
\footnote{143} Peter, \textit{supra} note 18, at 237; see also El Chiati, \textit{supra} note 1, at 102–10.
\footnote{144} \textit{Cited in Blinn et al.}, \textit{supra} note 19, at 297.
by the decision of the House of Lords in *C. Czarnikow v. Rolimpex*. This dispute involved a sugar supply contract between the Polish state enterprise Rolimpex and a private contractual partner. The Polish state enterprise did not honour its sugar supply obligation due to a ban placed by the Polish government on the export of sugar. The House of Lords decided in favour of Rolimpex and accepted the existence of force majeure, being an entity sufficiently different from the Polish state. This decision has been widely criticized in the West. It has been suggested that recognizing the separate legal personality of such entities at all times would put all contracts with state-controlled enterprises at risk.

It has to be said that the principle of the separation between state and state enterprise is generally respected. Hence, the state enterprise can in principle claim to be excused from having to fulfil its contractual obligations by claiming force majeure due to acts of public authority by its own state. Yet this principle serves only as a starting point. There are occasions where the defence of the principle of separation is not accepted, as where there is decisive evidence that the state enterprise is not independent from its government or where the contract itself expressly contemplates the effect of government action. Professor Karl-Heinz Böckstiegel observed:

> the starting point will have to be the principle that the separation between the state enterprise and the state is respected and that therefore normally acts of public authority by the state have to be accepted as an excusing case of force majeure ... If the contract itself stipulates that the state enterprise is to be considered responsible for certain acts of state, no force majeure can be claimed if such an act of state then actually occurs.

Thus, although the defence of force majeure caused by state interference has been rejected in a number of arbitral awards and court decisions, the final result depends on the surrounding circumstances of each case and the specific contractual undertaking made in the contract. This highlights the serious need for taking precautions against adverse changes in the socio-economic circumstances during the drafting of contracts with state-controlled enterprises. If they do not take such precautions, force majeure or hardship clauses "may not serve as a substitute for their negligence at the drafting stage and will not serve as a pretext for diluting the *pacta sunt servanda* principle."
Hence, the inclusion of force majeure and hardship clauses in international petroleum contracts may promote contractual flexibility and provide the parties with an opportunity to salvage much of the monies and efforts already spent on a particular venture. Such clauses may, in theory, provide a starting point for the renegotiation of the contract in cases of changed circumstances. Nonetheless, the idea behind such clauses should not be forgotten and parties should always bear in mind that the principle of sanctity of contract remains the general rule and priority is given to fulfilling contractual promises. Such clauses are inserted into contracts to accommodate unforeseeable fundamental changes in the circumstances surrounding the contract. Accordingly, a force majeure event does not merely occur because of a change of the economic equilibrium of the contract, but rather where the interference of “acts of God” render execution of the contract impossible, either temporarily or permanently. Also, a hardship clause is used in situations where contract performance becomes extremely burdensome. Beneath these levels, parties to international petroleum agreements should not expect to obtain relief from courts against bad bargains or simply because they turned out to be onerous, unless they have agreed on something more specific, i.e. a specific contractual provision providing for the renegotiation of the contract, assuming that this is permitted under the applicable law. Thus, as one commentator has noted:

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 argument for a variation of the contract.153

This approach derives support from international arbitral practice as well.154 International arbitrators are extremely reticent when it comes to varying contracts without a specific contractual basis.155 An illustration is provided by the arbitral award in the dispute concerning an energy supply contract between the Indonesian electricity state corporation and a foreign private party.156 The contract entitled the foreign company to build power plants in Indonesia and sell the power to the Indonesian state electricity corporation, PLN. In the wake of the economic crises which befell Indonesia in 1998, PLN failed to purchase the energy supplied. The private partner called for arbitration relying on a clause in the contract. One of the requests of the Indonesian corporation was for the tribunal to rewrite the content of the contract on the basis of force majeure. The tribunal rejected the defendant’s request and made this interesting statement:

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

154 Gooch, supra note 80, at 143.
155 Berger, supra note 29, at 1353.
156 Himpurna, supra note 149, at 11.
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.157

This kind of reasoning is based on the presumption that transnational commerce is a field where parties are most likely to be aware of the risks of changing circumstances.158 Arbitrators presume that parties engaged in such contracts are knowledgeable about their transactions and aware of the risks that such transactions may pose.159 They generally interpret party silence about possible future contingencies as a concise decision to assume the risk of such eventualities. This principle has been widely emphasized by international tribunals over the past decades and serves as a standard for risk distribution within the contract.160 Thus, the change of the commercial equilibrium of the contract that is below the limits illustrated above is to be born by the parties.

IV. Renegotiation With a Renegotiation Clause

In an attempt to balance the imperatives of contractual stability with the need for flexibility in long-term agreements, some contracts may contain a definite clause that obligates the parties to renegotiate specified terms affected by changes in circumstances or unforeseen events, such as those concerning governmental regulations, commodity prices etc. The use of such clauses is becoming common in recent times.161

In the 1970s and 1980s, it was thought that the use of stabilization clauses was becoming obsolete.162 As foreign investment is being portrayed as the solution to economic problems, governments (particularly those earlier characterized by strict investment control or outright denial of entry) in their attempts to attract foreign investment are offering “competitive” terms in contracts and foreign investment legislation.163 In the 1990s and the beginning of the 2000s, stabilization clauses are being used by such governments “as a tool in their highly motivated and competitive attempts to demonstrate a commitment to stability in their respective legislative and tax regimes.”164 Nonetheless,
modern practice in the area of stabilization clauses has moved from traditional freezing clauses and developed a hybrid contractual mechanism combining stabilization with renegotiation provisions. This approach is of particular relevance to agreements relating to natural resources exploration and exploitation. This modern practice is not reflected at all in the extensive international law literature due to the fact that the theoretical analyses relating to the petroleum industry were mostly written in the context of the arbitrations of the past which reflects the practice of the past. Therefore, it may be worthwhile to list some of these clauses together with traditional renegotiation clause in an attempt to understand the features of such stipulations and the problems they may produce.

A Petroleum Production Sharing Agreement concluded on November 10, 1995 between the State Oil Company of the Azerbaijan Republic and a consortium of international oil companies contained the following article:

The rights and interests accruing to Contractor (or its assignees) under this Agreement and its Subcontractors under this Agreement shall not be amended, modified or reduced without the prior consent of Contractor. In the event that any Government Authority invokes any present or future law, treaty, intergovernmental agreement, decree or administrative order which contravenes the provisions of this Agreement adversely or positively affects the rights or interests of Contractor hereunder, including, but not limited to, any changes in tax legislation, regulations, or administrative practice, or jurisdictional changes pertaining to the Contract Area, the terms of this Agreement shall be adjusted to re-establish the economic equilibrium of the Parties, and if the rights or interests of Contractor have been adversely affected, then the State entity shall indemnify the Contractor (and its assigns) for any disbenefit, deterioration in economic circumstances, loss or damages that ensue therefrom.

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 included the following clause:

Article 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.

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165 “Modern stabilization clauses provide that if any governmental action adversely affects the economics of the project, then the terms of the agreement will be readjusted to maintain the company in the same financial position as when the contract was signed”, R. Bishop, et al., Strategic Options Available when Catastrophe Strikes the Major International Energy Projects, 36 Tex. Int’l L.J. 635, 641 (2001); see also Waelde & Ndi, supra note 2, at 219, 266, 267. Yet some agreements did have a renegotiation clause stricto sensu, e.g., the Ok Tedi Papua New Guinea Concession Agreement of 1976 contained the following clause: “The parties may from time to time by agreement add, substitute for, cancel or vary all or any of the provisions of this agreement,” cited in Nassar, supra note 53, at 175. Similarly, the traditional stabilization clause has not completely disappeared. The latest Production Sharing Agreement Model 2003 of the Sultanate of Oman contains a traditional stabilization clause: Art. 25(1) provides “The mutual written consent of the Government and the Company shall be required to annul, amend or modify the provisions of this Agreement.” This agreement is obtained by the author from the Ministry of Oil and Gas of Oman and is not yet published.

166 Bernardini, supra note 6, at 416.

167 Waelde & Ndi, supra note 2, at 219.
The Production Sharing Contract of August 19, 1992 between the Vietnam National Oil and Gas Corporation of the Socialist Republic of Vietnam, Lasmo Vietnam Ltd and C. Itoh Energy Development Co., Ltd for Offshore Block 04-2 contained the following clause:

Article 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.168

The Model Exploration and Production Sharing Agreement of the State of Qatar of 1994, contained the following clause:

Article 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 31.169

Similarly, the Model Production Sharing Agreement of March 20, 1997 for Petroleum Exploration and Production of Turkmenistan contained the following clause:

Article 16–6: Where present or future laws or regulations of Turkmenistan or any requirements imposed on Contractor or its subcontractors by any Turkmen authorities contain any provisions not expressly provided for under this Agreement and the implementation of which adversely affects Contractor’s net economic benefits hereunder, the Parties shall introduce the necessary amendments to this Agreement to ensure that Contractor obtains the economic results anticipated under the terms and conditions of this Agreements.

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:

Article 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.

168 Cited in Berger, supra note 29, at 1360.
169 Barrows, Basic Oil Laws and Concession Contracts, Middle East, Supp. 124, 1 (1995), cited in Bernardini, supra note 6, at 416.
The above listed clauses are far from exhaustive. Nonetheless, they may be sufficient to uncover some of the major features of this type of clauses currently in use in the international petroleum industry.

The shared characteristic between these clauses is that unlike the traditional stabilization clauses, which aim at protecting the foreign investor by restricting the legislative power of the host state to amend or abrogate the agreement, the renegotiation clauses aim at protecting the foreign investor by making the contract modelled on a flexible and amendable approach in case legislative power were to be used by the state to the detriment of the foreign investor. Hence, such clauses do not infringe on the state’s legislative powers, which remain intact, but open the door for the renegotiation of the contract upon the happening of specified events. Therefore, such clauses constitute a private law agreement according to which the parties undertake to renegotiate their agreement when certain conditions are met. The degree of protection that such a clause may offer is another question and will be answered when dealing with the issue of the problems that such clauses may exhibit.

A. Effects and Potential Problems

Under the above discussed clauses the parties agree to come together to renegotiate in their agreement when certain conditions are met. Thus these clauses are not of automatic application. This raises many questions the answers to which are crucial to the efficacy and enforcement of such clauses. The first question relates to the conditions that have to be met to trigger the renegotiation of a contract. In other words, what is the definition of a particular event that will trigger renegotiation? Each clause has its own definition as to the events that will trigger the renegotiation process. The next issue, once the parties are engaged in a renegotiation process, is what are the parties’ obligations during the renegotiation process? This question leads us to the question of whether a state can breach the contract by failing to renegotiate (or even by refusing to agree to the other party’s proposal during the renegotiation). On the other hand, each clause has its obligation as to the result to be achieved by such renegotiation. As the effectiveness of such clauses and their ability to protect the legitimate expectations of the foreign investor depends primarily on these two key issues, each of these two issues raises different problems and therefore they demand further examination.

1. Triggering Events for Renegotiation

The importance of this issue stems from the fact that the ability of a renegotiation clause to function depends primarily on it. See Carter, supra note 161, at 188, who states that “in order for a renegotiation clause to be valid, it must contain a clear statement of the circumstances in which renegotiation is to occur.” See also Nassar, supra note 53, at 176–77.
Therefore, it is stated that such prerequisites should be clearly defined in the clause. Nonetheless, such prerequisites do not have a set formula that can be adopted in such clauses. Each of the clauses cited earlier has its own conditions and criteria that have to be met before a renegotiation phase can commence.

In the clauses cited above, one finds different triggers. Article 9 of the AMINOIL Supplementary Agreement required a review of the parties’ rights and obligations upon the occurrence of “an increase in benefits to Governments in the Middle East and such increase should come generally to be received by them.” Hence, the parties have to make estimates as to whether such development has indeed occurred. Assuming that such development has occurred, the company does not thereby recognize its obligation to negotiate; the existence of other conditions is required, i.e. such change must have become general in the Middle East. This would require an empirical study to determine whether such development has become general in the Middle East. That would be very difficult to obtain in an industry where such provisions remain confidential.

Other clauses contain general formulations. Article 16–6 of the Turkmenistan Model Agreement is exemplary. It links the trigger of renegotiation to the imposition of laws or regulations the implementation of which adversely affects the contractor’s economic benefits. Of course, the difficulty relates to the exact meaning of the triggering event. How could one estimate an adverse effect on the contractor’s economic benefits? Such an open-ended criterion is open to extensive interpretation and may give rise to fears of instability and frequent conflicts. This is not to say that a precise mathematical formula is required. Some of the clauses cited above were specifically worded, very precise and linked the trigger to an increase of customs or taxes. However, although the latter type of triggers has the advantage of being precise, such clauses are applicable only to certain aspects of the contractual relationship.

Other clauses, such as the Ghana/Shell clause mentioned above, attempted to formulate a general clause with a specific trigger. This clause requires for the initiation of the renegotiation process a “change 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.” Under these conditions this renegotiation clause takes a legal form close to that of a hardship clause. The purpose of renegotiation clauses, as mentioned above, is to make the contract flexible and dynamic throughout its duration. Hardship clauses as discussed earlier provide for a starting point for renegotiation in rare cases and under strict

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171 Horn, supra note 40, at 129.
172 Berger, supra note 29, at 1361–62.
173 This is one of the challenges of drafting renegotiation clause and has yet to be tested in the courts.
175 Id.
176 See the clause above.
177 Therefore in the literature, a hardship clause has often been put under the generic term of adaptation clauses. See, e.g., El Chiati, supra note 1, at 99; Peter, supra note 18, at 240.
conditions. Hence, the purpose of having a renegotiation clause is not realized by using such a clause. Experience shows that arbitrators interpret revision clauses very narrowly and thus such formulations have little chance to trigger renegotiation.

From the above, it may be concluded that the criterion that has to be met before an event can trigger renegotiation is of great importance and thus has to be carefully worded. General and imprecise criteria would cast doubt on the efficacy and enforceability of such clauses. However, this is no easy task. The nature of renegotiation clauses makes them difficult to formulate. It is not easy to formulate a clause that is general in style and at the same time defines precisely the triggering event.

Determining whether a triggering event has occurred may create a conflict among the parties, particularly if the clause incorporates vaguely worded triggers. The arbitral tribunal is competent to issue a decision on such problems since it amounts to a legal question arising under the contract. Thus, as one commentator has noted, “express contractual language will not totally eliminate risk?there is virtually nothing that can accomplish this.”

2. Extent of Contract Change by Virtue of Renegotiation Clause

Renegotiation clauses often contain a guideline as to the extent of contract change. The importance of this issue stems from the fact that it will determine the result to be achieved by the renegotiation process.

The Vietnam Production Sharing Agreement provides a good example of an objective standard on the question of the extent of contract change. It requires the parties to consult each other and “make the necessary change to ensure that the contractor is restored to the same economics which would have prevailed if the new law and/or regulation or amendment had not been introduced.” Similar patterns can be found in the Turkmenistan Production Sharing Agreement cited above. The extent of contract change in the renegotiation clause can be limited by appropriate restriction such as the passage of a limited number of years before any renegotiation phase can take place or if the clause excludes a particular result such as the exclusion of any retroactive result. Finally, the extent of contract change can extend to the indemnity of the contractor for any disbenefit, loss or damages ensuing from the introduction of new laws or amendment of current regulations.

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178 See above.
179 See case, cited in NASSAR, supra note 53, at 178. See also Berger, supra note 29, at 1363, who rightly observes “clauses to other general risks below the hardship and force majeure threshold generally will not be considered.”
180 It has been stated that perhaps for this reason “negotiators on both the government and the company side do not focus in most cases on including a general renegotiation clause in agreements.” See Kolo & Waelde, supra note 3, at 47.
181 PETER, supra note 30.
182 FOX, supra note 58, at 217, cited in Berger, supra note 29, at n.50.
184 See art. 47(b) of the petroleum agreement concluded between Ghana and Shell, cited above.
3. The Duty to Renegotiate

When a problem arises between the parties and the conditions for applying the renegotiation clause are realized, the parties have to renegotiate a potential solution for their problem. At this stage a number of problems may arise. What if one of the parties refuses to enter into renegotiation? What if the parties fail to agree on the revision of the agreement? This section will examine these questions.

The insertion of a renegotiation clause in the agreement requires the parties to renegotiate their agreement once the conditions for applying the renegotiation clause are realized. If a party refuses to enter into renegotiation it is in breach of contract and the violation of this duty could entail legal sanctions. Nonetheless, a party’s duty to renegotiate is not fulfilled by merely entering into renegotiations with the other party. There are obligations imposed on both parties during the renegotiation process. The clauses discussed earlier say very little about this issue. Nonetheless, one should not expect very clear rules. One of the widely recognized rules as to the obligations of the parties is the “no profit no loss rule.” According to this rule, “the original equilibrium of the contract should be maintained and therefore neither party should be allowed to profit or forced to suffer a loss as a result of the renegotiation.” Another rule is that parties should be serious throughout the renegotiation process, with an aim to resolving their disputes. The seriousness of the parties may not be fulfilled by merely exhibiting a willingness to listen to each other’s demands, but they must understand such demands and be flexible enough to surrender some of their demands for the benefit of reaching a compromise. Thirdly, it should be born in mind that the purpose of these clauses is limited to adapting the contract to the changed circumstances and not restructuring the entire contract unless this is clearly expressed in the clause. Fourthly, timing plays a role in determining the extent to which a party has satisfied his duty to negotiate. Nonetheless, it should be noted that the preceding considerations are mere starting points for determining what is required of the parties during the renegotiation process in general terms. The parties’ obligations must necessarily be judged in accordance with the wording of each renegotiation clause, the nature of the contract and the combined effect of its provisions and the nature of risks intended to be covered by the parties.

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186 Horn, *supra* note 40, at 28.


188 Berger, *supra* note 29, at 1365.


4. Failed Renegotiations

When the parties enter into renegotiations, it is possible that they do not reach agreement. A number of questions arise here. Does the inclusion of a renegotiation clause into the agreement imply an obligation to reach an agreement? If the parties cannot agree on an amendment of their agreement, will the contract stay as it is, will it be terminated and on what terms, or will it be adopted by a third party?

National and international law does not explicitly recognize a duty to reach an agreement and hence the fact that an agreement has not been reached is irrelevant to the liability issue. According to unanimous international opinion, the duty in such clauses is one of best efforts to reach an agreement. Accordingly, parties must do their best to pursue successful negotiation in good faith, but they are not required to reach an agreement. Hence, the duty to renegotiate could still be fulfilled even if the parties do not reach an agreement. Nonetheless, the party’s refusal to agree should be based on “normal commercial judgment.” Thus, as one commentator has noted, this type of clauses results in “process-oriented instead of success-oriented contractual obligations of both parties.”

If the renegotiations were conducted in good faith and both parties have observed their obligations during the renegotiation process and the renegotiation fails, the logical consequence of failed renegotiations is that the contract will stay as it is. Parties are required by virtue of the principle of *pacta sunt servanda* to fulfil their obligations as originally agreed. If the host state refuses to fulfil its contractual commitments, the state would be in breach of contract and the damages due for this breach would be calculated on the basis of the original contract terms.

V. Contribution of International Petroleum Arbitral Practice to the Concept of Renegotiation

A number of international petroleum arbitrations have dealt with the question of renegotiation. Although the arbitral practice concerning renegotiation is not plentiful, its holdings are consistent and conclusive. This section, in line with the pattern followed so far, will examine how the concept of renegotiation has been articulated by the international arbitral practice relating to the petroleum industry.

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191 Bishop, supra note 185, at 26; Peter, supra note 18, at 247; Bernardini, supra note 6, at 419; Salacuse, supra note 17, at 1513; Nassar, supra note 53, at 182; Schmitthoff, supra note 137, at 82, 87; AMINOIL, supra note 174, at 1014; Wintershall, supra note 189; Railway Traffic Between Lithuania and Poland, 1931 P.C.I.J. (ser. A/B) No. 42, at 116; North Sea Continental Shelf, 1969 I.C.J. 47.

192 Berger, supra note 29, at 1368.

193 Kröll, supra note 76.

194 Kolo & Waelde, supra note 3, at 44; Bishop, supra note 185, at 24; see also Wintershall, supra note 189, at 795, discussed below.

195 Berger, supra note 29, at 1368.

196 Kröll, supra note 76.
The first petroleum arbitration that dealt with the question at hand was the AMINOIL case. Following the 1973 war in the Middle East, oil prices increased dramatically and with it the oil companies’ profits increased. In 1974, three Arab states met in Abu Dhabi and devised a formula to restrict these profits, which became known as the “Abu Dhabi formula.” One month later, OPEC announced that, in accordance with the Abu Dhabi formula, the average government take from the operating oil companies would be set at U.S.$ 10.12 per barrel on the market crude, with effect from January 1, 1975. AMINOIL, as a marginal oil producer, feared that it would be driven out of business by strict application of this decision and hence asked for negotiations with the government. Negotiations took place but the parties failed to reach an agreement on AMINOIL’s take out of its investment in Kuwait. Finally, the government acted unilaterally and terminated the concession agreement entered into with AMINOIL and offered the payment of compensation. The dispute was referred to arbitration. One of the issues dealt with by the arbitral tribunal was clause 9 of the Supplemental Agreement of 1961 cited above which provided for consultation between the government and the company in cases of increase in benefits to governments in the Middle East. When considering this clause the arbitral tribunal drew a number of conclusions with respect to the duty to negotiate, adaptation standards and the enforceability of such clauses.

The tribunal started by examining the content of the renegotiation clause. The tribunal found that clause 9 contains three constituents. First, it institutes a procedure for consultation, which is more a matter of negotiation. Secondly, it gives rise to the right to ask for the initiation and pursuit of negotiation. Lastly, it provides details of the agreement to be reached which “had to have some noteworthy characteristics; the agreement has to introduce, in favour of the government, changes in the previous provisions of the concession, and yet remain ‘equitable to the parties’, i.e., to AMINOIL also,” see AMINOIL, supra note 174, at 1002–04, ¶ 15–24.

Although the tribunal was explicit on the issue that an obligation to negotiate does not imply an obligation to conclude an agreement, such obligation can involve precise requirements which a party ought to observe to satisfy his duty to negotiate. After examining the long negotiations between the parties the tribunal defined “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” as the following: (1) sustained up-keep of the negotiations over a period appropriate to the circumstances; (2) awareness of the interests of the other party; and (3) a preserving quest for an acceptable compromise. In addition, the tribunal dealt with the question of failed negotiations. Failed negotiations can be regarded as a breach of contract and thus entail legal responsibility if such failure can be attributed to one of the parties.

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197 AMINOIL, supra note 174, at 976.
198 The tribunal found that clause 9 contains three constituents. First, it institutes a procedure for consultation, which is more a matter of negotiation. Secondly, it gives rise to the right to ask for the initiation and pursuit of negotiation. Lastly, it provides details of the agreement to be reached which “had to have some noteworthy characteristics; the agreement has to introduce, in favour of the government, changes in the previous provisions of the concession, and yet remain ‘equitable to the parties’, i.e., to AMINOIL also,” see AMINOIL, supra note 174, at 1002–04, ¶ 15–24.
199 Id. at 1004, ¶ 24.
200 Id. at 1014, ¶ 70.
201 Id. at 1004, ¶ 24.
The tribunal when interpreting clause 9 addressed also the issue of the object of renegotiation which has a direct connection with the standards to be followed by the tribunal when adjusting the contract in the event that renegotiations fail or reach a deadlock. The tribunal observed that the object of renegotiation “is a matter of concluding an agreement which had to have some noteworthy characteristics; the agreement has to introduce, in favour of the government, changes in the previous provisions of the concession, and yet remain ‘equitable to the parties’, i.e., to AMINOIL also.” The tribunal then added that this does not mean that the parties’ original contract was not equitable to parties at the time when the contract was concluded but, rather, “this original equilibrium will be modified in favour of another equilibrium deemed equally equitable.” Hence, the rule is that the contract change that has to be introduced by the tribunal should attempt to re-establish a new equilibrium instead of the original one that has been lost as a result of a change in the circumstances.

Another point mentioned by the AMINOIL tribunal was concerning the issue of the way in which the contract can be modified. The tribunal pointed out that “a study of the remaining clauses of the contract, as also of its juridical setting must determine” such process. Hence, the parties’ original agreement should be one of the considerations that arbitrators take into account when re-establishing the new equilibrium.

The second case involving the renegotiation of an international petroleum agreement was Wintershall A.G. and others v. Government of Qatar. This case involved an Exploration and Production Sharing Agreement (EPSA) entered into in 1976 (in substitution for an earlier concession agreement), between the Government of Qatar and Wintershall and four other companies. The government of Qatar by this agreement granted the Wintershall consortium the exclusive right to explore for, drill for and produce petroleum in a defined area offshore of Qatar (the contract area).

The contract was to last for thirty years starting from 1973. Wintershall was required by the EPSA to relinquish 50 per cent of the contract area after five years, but could continue to exploit the remaining 50 per cent. After eight years, the Wintershall consortium was required to relinquish an additional 20 per cent of the contract leaving them with only 30 per cent. If neither crude oil in commercial quantities nor economically-utilizable natural gas were discovered within eight years, Qatar was entitled to terminate the EPSA. The EPSA provided further that if non-associated natural gas was discovered in the contract area, the Wintershall consortium was entitled to produce it pursuant to further contractual arrangements to be mutually agreed by the parties. In addition, under the EPSA if the government should decide that utilization of the non-associated natural gas was not economical, the Wintershall consortium was entitled to produce it on its own under the “go it alone” option specified in the third paragraph of Article XV.
The Wintershall consortium failed to discover crude oil in commercial quantities, although because of a boundary dispute with Bahrain, the ruler of Qatar instructed the consortium not to drill in Structure (A) area, which was regarded as the area most likely to contain crude oil. As contemplated by the EPSA, the Wintershall consortium relinquished 50 per cent of the contract area.

In 1980, the Wintershall consortium advised Qatar that they had discovered non-associated gas in substantial quantities in the remaining 50 per cent of the contract area and that they considered its utilization to be economical. The parties reviewed several projects for the utilization of non-associated natural gas in the contract area as well as from an adjacent area where the petroleum rights were held by the Qatar General Petroleum Corporation (QGPC), a wholly-owned corporation of the Government of Qatar. No agreement was ever reached for projects in either of these areas. In 1985, the Government of Qatar terminated the EPSA. Negotiations continued for another year, but no agreement was reached. The Wintershall consortium invoked arbitration, alleging that Qatar had breached the EPSA and had in effect expropriated the consortium’s contractual rights and economic interests under the EPSA by both (1) denying permission to explore the Structure (A) area, and (2) by failing to agree on further contractual arrangements for the use of the non-associated natural gas.

The tribunal decided that there had been no breach by the government of the EPSA and no expropriation of the consortium’s contractual rights and economic interests under the EPSA. As to proposals by the claimants relating to the joint development of the adjacent area, the tribunal found that the claimants’ rights under the EPSA did not include any rights relating to developing areas beyond the contract area. The tribunal found that there was no legal duty on the part of the government to unitize the area and to accept proposals from the claimants relating to the utilization of that area. The tribunal found also that proposals by the claimants relating to the joint development of the adjacent area were no more than offers by the claimants and their acceptance was not required by the respondent.206

With respect to non-associated natural gas in the contract area, the tribunal, after a thorough examination of the evidence submitted to it, including the technical and economic evidence, found that the respondent had never agreed that the utilization of non-associated natural gas was economical. The tribunal held that even if the respondent had agreed or was deemed to have agreed as to the economic utilizability of the natural gas, the parties had never agreed to a utilization plan nor entered into further contractual arrangements for the utilization of such gas.207 In addition, the tribunal found that the

206 Id. at 815.

207 The conditions for an agreed joint venture under art. XV(3) provide that “Should Government and Contractor mutually agree that the utilization of non-associated Natural Gas is economical they shall thereafter participate in the construction and installation of facilities for utilizing such gas pursuant to an agreed Utilization plan. It is hereby agreed that it is the intention of the Parties to enter into further contractual arrangements for the utilization of such gas, including mutually acceptable provisions regarding division of costs, revenues and duration, with a view to achieving economic results on a basis equivalent to those provided herein concerning crude oil.” See Wintershall, supra note 189, at 813–14.
failure of the respondent to agree that the claimant’s finding of natural gas was economically utilizable could not prevent the claimants from exercising the “go it alone” option provided in the last paragraph of Article XV. On these bases, the tribunal held that the relinquishment period would be extended eight years from the date of the award for exercising the “go it alone” option to develop the natural gas in the contract area. As to the Structure (A) area, the tribunal held that the relinquishment would not begin to run until claimants were permitted to develop that area. The tribunal’s decision on this matter is important because it shows that due regard was given to the parties’ original agreement as one of the considerations that arbitrators take into account when re-establishing the new equilibrium. The point of this exposition is that the tribunal gave full effect to the terms of the original agreement by extending the contractual period for the claimants to exercise the “go it alone” option and by holding that the relinquishment period for the Structure (A) area would not begin to run until the claimants were permitted to develop that area. The tribunal decision on this issue is in line with that of AMINOIL when the AMINOIL tribunal pointed out that “a study of the remaining clauses of the contract, as also of its juridical setting must determine” the way in which the contract can be modified.208

As to the duty to negotiate in good faith, the tribunal was clear and made interesting remarks. The tribunal dealt with the question of whether the respondent’s acceptance of further contractual arrangements for the development of the natural gas found in the contract area was required by the duty to negotiate in good faith under the EPSA. After a thorough examination of all the evidence by the claimants’ principal legal witness and by the respondent’s counsel, the tribunal accepted that such a duty existed. Accepting that there was such a duty, the tribunal found that the failure of the respondent to agree on further contractual arrangements for the use of the non-associated natural gas was not a violation of any duty to negotiate in good faith.209 The tribunal added that “such a duty does not include an obligation on the part of the respondent to reach agreement with respect to the proposals made by the claimants.”210 This last phrase is particularly important because it makes clear that the tribunal was not making a general finding that a duty to negotiate in good faith does not, under any circumstances, imply a duty to reach agreement.211 In the view of the tribunal, there was no such a duty on the government to reach agreement with respect to “proposals made by the claimants.” This observation is qualified by later language in the award when the tribunal expressly found that “the refusal by the respondent to accept proposals by the claimants was made in good faith and was justified under normal commercial practice.”212 In addition, the tribunal found that the only proposal by the claimants relating solely to the petroleum in the contract area was “reasonably rejected by the respondent on technical grounds.”213 The above reasoning

209 Wintershall, supra note 189, at 814.
210 Id.
211 Bishop, supra note 185, at 20.
212 Wintershall, supra note 189, at 815.
213 Id. at 816.
for finding no violation of the duty to negotiate in good faith by the respondent raises an
important question. What would the finding of the tribunal have been if the claimant had
made a technically sound proposal dealing solely with the contract area? Would not the
tribunal have found the respondent in breach of his duty to negotiate in good faith?
Relying on the basic reasons for the tribunal’s decision set forth above, one should say
that if a technically sound proposal had been made by the claimants relating solely to the
contract area and whose financial and other terms fell within the range of normal com-
mercial practice, the tribunal would have found that the respondent was in breach of his
duty to negotiate and hence would have obligated the respondent to accept the claimant’s
proposal.214

In Mobil Oil Iran, Inc. v. Government of the Islamic Republic of Iran215 Chamber Three
of the Iran–United States Claims Tribunal addressed the issue at hand. In this case, Mobil
Oil and other consortium members entered into a Sale and Purchase Agreement (SPA)
in 1973, which replaced and terminated the Consortium Agreement of 1954. Mobil and
the other consortium members claimed that the National Iranian Oil Company (NIOC)
and Iran repudiated the SPA and expropriated the consortium members’ contract rights
by a letter addressed to them by the Chairman of the Board and Managing Director of
NIOC in March 10, 1979. Iran and NIOC argued that force majeure conditions per-
sisted over a long time period, which frustrated the agreement by changed circumstances,
thereby resulting in the full termination of the contract. The tribunal rejected the asser-
tions that the SPA was terminated by way of frustration, repudiation or expropriation.
Instead, it found that the parties agreed in March 1979 not to revive the agreement, and
to negotiate in view of formally terminating it and settling the issues arising from termi-
nation. Such an agreement was subject to three main conditions, spelled out in the
exchange of letters of March 10 and 23, 1979: that NIOC would treat the consortium
member companies as its prime consumers under equal terms and conditions; that
NIOC would take over all contracts and obligations entered into by Oil Services Com-
pany of Iran (OSCO) and Iranian Oil Services Ltd. (IROS); and that any claims of either
party would be settled through negotiations.216 As of that time, the SPA was suspended
by force majeure.

Having decided that the parties mutually agreed to terminate the SPA and negotiate
the issue arising from its termination, which negotiation was interrupted and never com-
pleted due to the Iranian revolution, the tribunal concluded it had to determine what the
parties could have legitimately expected from good faith negotiations. In doing so, the
tribunal made interesting remarks as to the guidelines to be followed by the arbitral tri-
bunal when arbitral interference becomes inevitable to resolve the parties’ disagreement
where negotiations fail or when such negotiations reach a deadlock. Specifically, the tri-

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214 See Bishop, supra note 185, at 21.
215 Mobil Oil Iran Inc. v. Government of the Islamic Republic of Iran, award No. 311–74/76/81/150–3, 16
216 Id. at 54.
into account when establishing the equitable remodelling of contractual undertakings. The tribunal had this to say:

The tribunal has to take into account all the relevant factual and legal circumstances of the case. Of primary concern, obviously, are the duties and obligations of both parties under the SPA and all related agreements. The agreement must be construed, not only pursuant to its initial terms, but also as to the manner in which it was performed and de facto or de jure amended during its life, up to the time it was suspended by force majeure. Each party’s record in performing the agreement so defined during the same period constitutes a second set of determinative circumstance. Finally, all circumstances affecting the exercise of such rights and the performance of such obligations, as they could be observed or foreseen at the time [the negotiation started] are also relevant.

The above statement shows how due regard was given to the parties’ original agreement. The panel in this case added some other considerations that had to be taken into account such as the manner in which the parties’ agreement was performed, each party’s record in performing the agreement and all circumstances affecting the exercise of the parties’ rights and the performance of their obligations. All these considerations were used to assess the legitimate expectations of the parties, which in turn helped the tribunal to establish equilibrium between the parties’ interests.

The same tribunal observed that the same rule did not apply to proposals and concessions that either party might have made during the negotiation process. Despite the irrelevance of such proposals and concessions to the question of establishing the equitable remodelling of contractual undertaking, they could play a role in revealing and determining the contractual context of the parties’ relationship. The role that the parties’ position could play was defined by the same tribunal when it stated the following:

It is well settled that a Tribunal, which must decide a case subsequent to the failure of the parties to arrive at a settlement by way of negotiations, need not take into account the proposals and concessions that either party might have made in the course of such negotiations. The reason for this rule is obvious: such proposals and concessions have no purpose other than to allow an agreement to be attained and may well be very far from what each party legitimately considered to be its rights. Since such proposals were rejected, they have lost all validity and have become meaningless. The Tribunal does not see any reason to depart from such a sound rule in the present case. Since the Tribunal, however, must assess the legitimate expectations of the parties in the negotiations initiated pursuant to the March 1979 agreement, it would be difficult indeed to consider issues which the parties had not raised in the negotiations. The fact that a party refrained from raising a specific issue in the negotiations is a strong assumption, indeed, that this party did not expect to obtain anything on such issue.

The international petroleum arbitrations discussed above show that the existence of a duty to negotiate does not imply an obligation to conclude a new agreement. Nonetheless, such duty is not devoid of content, and when it exists, many considerations could be relevant. The duty to negotiate has to be exercised in good faith.

\[\text{Id. at 54–55, ¶ 161.}\]

\[\text{Id. at 55, ¶ 162. For a discussion of the question of pre-contractual liability and renegotiation see M. Omalu, Legal Implications of Precontractual Agreements in the Energy and Natural Resources Industries, 2 CEPMLP Online Journal, art. 10 (1997), available at <www.dundee.ac.uk/cepmlp/journal/html/vol2/article2-10.html>.}\]

\[\text{Id. at 54, ¶ 161. AMINOIL, supra note 174, at 1014, ¶ 70.}\]
required by this duty to enter into serious negotiations with a view to reaching an agreement. The parties are required by this duty to engage in sustained period of negotiations appropriate to the circumstances.\textsuperscript{220} Each party is not only required to engage in the negotiation process, but it must understand the interest of the other party and be flexible enough to surrender some of their demands in an attempt to reach a reasonable compromise.\textsuperscript{221} On the other hand, the preceding discussion of the cases provided basic guidelines as to the rules that arbitrators should take into account when resolving the parties’ disagreement in cases of failed negotiations.

VI. Conclusion

The examination of the major representative legal systems of the world shows that the generally recognized principle of \textit{pacta sunt servanda} or sanctity of contracts is widely accepted. However, under public international law as well as under the majority of national laws, this principle was not found to be absolute. Yet only in exceptional circumstances and under strict conditions may changes in the contractual environment lead to an adaptation of the contract or excuse of non-performance. These circumstances and their consequences depend on the law applicable to the contract. It was also set out how the inclusion of force majeure and hardship clauses in international petroleum agreements can promote contractual flexibility and how they can at times provide a starting point for renegotiation. Yet beneath the limit of unforeseeable fundamental change in the contractual basis, parties to international petroleum agreements should not expect to obtain relief from courts against bad bargains or simply because they simply turned out to be onerous. Neither the hardship nor the force majeure clause can offer adequate protection against every unfavourable change in the contractual equilibrium. Unless parties have agreed on something more specific, such as a renegotiation clause, the \textit{pacta sunt servanda} principle cannot be set aside. The discussion in this article has revealed how the use of renegotiation clauses can contribute to contract stability in international petroleum agreements, whose nature is of high risk of instability. Such provisions recognize the need for such agreements to adapt to change in circumstances. They lessen the possibility of disputes, avoid confrontation and reduce the risk of unilateral action by the state. On the other hand, it must be kept in mind that host states are not the only beneficiary from the inclusion in the contract of such provisions. True, renegotiation clauses are more likely to be invoked by host states but they are also available for the investors as well who may want to change the agreement in times of recession and depressed prices. In addition, such clauses may cause the state to refrain from taking unilateral action. Hence, parties to international petroleum agreements are well advised to include such clauses in their agreements. When drafting such clauses, parties are required to pay especial attention to a number of considerations. First, the triggering event and the procedure to be followed

\textsuperscript{220} AMINOil, \textit{ supra} note 174, at 1014, ¶ 70.

\textsuperscript{221} Id.
by the parties have to be carefully formulated. Secondly, the extent of the contract change by virtue of the renegotiation clause has to be clearly defined.

The validity of such clauses is not in question. As El Chiati pointed out "they are a manifestation of the autonomy of the will of the parties and as such are binding on the parties as long as they do not violate the public order."222 Yet there are relatively few precedents on such clauses and the efficacy of them will be tested by future judgments. Growing case law may reduce the uncertainty attributed to such clauses.

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222 El Chiati, supra note 1, at 110.