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

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

1. General Obligations During Negotiations

1. Duty to Negotiate or Duty to Agree?

D. The Parties’ Obligations in Reaching Agreement

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

1. General Obligations During Negotiations

In themselves, these formulations say very little. The most one can infer from them is that in the first case the “hic et nunc” fair decision should typically be aimed for, whereas in the other two cases more consideration should be given to the original equilibrium expectations of the parties. In actuality, it must be assumed that, unless there are indications to the contrary, the parties always (even after their contract has undergone an adaptation process) wish to preserve the equilibrium of their contractual obligations as expressed in the contract. The idea that the performance obligations of the parties should be commercially equivalent is a general principle of international commercial contract law. Therefore it also applies when not expressly included in the wording of the contract, as, for example, with the OK-Tedi clause.

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

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

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

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

1. Keeping to the negotiation framework set out by the clause,
2. Respecting the remaining provisions of the contract,
3. Having regard to the prior contractual practice between the parties,
4. Making a serious effort to reach agreement,
5. Paying attention to the interests of the other side,
6. Producing information relevant to the adaptation,
7. Showing a sincere willingness to reach a compromise,
8. Maintaining flexibility in the conduct of negotiations,
9. Searching for reasonable and appropriate adjustment solutions,
10. Making concrete and reasonable suggestions for adjustment instead of mere general declarations of willingness,
11. Avoiding rushed adjustment suggestions,
12. Giving appropriate reasons for one’s own adjustment suggestions,
13. Obtaining expert advice in difficult and complex consensus proceedings,
14. Responding promptly to adjustment offers from the other side,
15. Making an effort to maintain the price-performance relationship taking into consideration the parameters regarded as relevant by the parties,
16. Avoiding an unfair advantage or detriment to the other side (“no profit – no loss” principle),
17. Prohibition on creating established facts during negotiations except in emergency situations (ban on “escalation” strategies),

18. Maintaining efforts to reach agreement over an appropriate length of time, and

19. Avoiding unnecessary delays in the consensus proceedings.}

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

Page: 1367

2. Duty to Negotiate or Duty to Agree?

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

Page: 1368

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

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

58Cf. supra part III.A.4.

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

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

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

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

63North Sea Continental Shelf (F.R.G. v. Den.), 1969 I.C.J. 4. 47 (Feb. 16). Defining the content of the obligation to negotiate, the Permanent Court, in its Advisory Opinion in the case of Railway Traffic between Lithuania and Poland, said that the obligation was ‘not only to enter into negotiations but also to pursue them as far as possible with a view to concluding agreements,’ even if an obligation to negotiate did not imply an obligation to reach agreement. Id.


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

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

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

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

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

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

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

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

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

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

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

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

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

78See BAUR, supra note 68, at 120.

79See NELLE, supra note 68, at 278. The aim of the renegotiation obligation is to achieve an exchange of suggestions for adjustment. However, just like the ultimate goal of reaching an agreement between the parties, this aim can only be
served in a limited way by direct content provisions and additional indirect support, especially in the form of procedural regulations, is needed. *Id. Cf.* CHRISTIAN BÜRHING-UHLE, ARBITRATION AND MEDIATION IN INTERNATIONAL BUSINESS 222 (1996) (elaborating generally on the negotiation process and its theoretical concept); HENRY BROWN & ARTHUR MARRIOT, ADR PRINCIPLES AND PRACTICE § 6-001 (2d ed. 1999).

**Referring Principles:**

IV.6.8 - (Re-) Negotiation agreement / clause (<em>pactum de negotiando</em>)