Sanctity of Contracts Revisited: A Study in the Theory and Practice of Long-Term International Commercial Transactions

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INTRODUCTION

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Chapter I. Competing Concepts of Contracts

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A. THE PRE-INDUSTRIALIZATION APPROACH

The Pre-Industrialization Approach

1. The Natural Law Theory
The earliest of these intellectual movements is the natural law theory dating back to the Middle Ages when legal jurisprudence was a branch of philosophy. Jus naturale was used to refer to the set of rules and principles predating society and positive law, when men lived in a state of nature. These rules could be discovered by man through introspection. Hugo Grotius and Samuel Pufendorf pioneered this school of thought, which was based upon the premise that contracts were naturally and inherently binding for two reasons. First, under this school of thought to overcome the severity of nature, man has to interact and cooperate with his fellow men. This meant that men have to trust and confide in one another, which in turn gives rise to the natural duty of maintaining veracity and fidelity (i.e., keeping one's promise). Second, in the state of nature, individuals have natural rights, the most fundamental of which are property rights, which are transferable. If the individual has a natural right to dispose of his property, there is no reason why he should be denied, if he so wishes, to dispose of less important rights, such as those transferred through contracts, whether proprietary or not.

The affinity between the disposition of property rights and contractual rights was echoed in a relatively recent international arbitration where the tribunal, in the course of defining the general principles of law, stated that:

These general principles are usually embodied in most recognized legal systems .... They thus form a compendium of legal precepts and maxims, universally accepted in theory and practice. Instances of such precepts are, inter alia, the principle of sanctity of property and contracts.

Placing property and contract principles on the same footing meant that contracts were to be sanctioned and respected in the same way private property was treated. The right to conclude contracts and the duty to respect them was regarded as a fundamental principle of general applicability. This understanding is entrenched in arbitral practice. For instance, in the LIAMCO Arbitration, it was held:

The right to conclude contracts is one of the primordial civil rights acknowledged since olden times. It was the essence of "commer-

cium" or "jus commercii" of the Roman "jus civile" whose scope was enlarged and extended by "jus gentium". Then it was always and constantly considered as security for economic transactions, and was even extended to the field of international relations.

Also, in the Sapphire Arbitration, in the course of determining the liability of the Iranian oil company, the arbitrator stated:

... it is a fundamental principle of law, which is constantly being proclaimed by international courts, that contractual', undertakings must be respected. The rule pacta sunt servanda is the basis of every contractual relationship.

Emphasizing the sanctity of contracts under the natural law approach did not necessarily mean for its proponents that the parties' autonomous will is to be left completely uninhibited. It is true that obligations are naturally or inherently binding, but only within the limits of natural law. Contracts were the by-products of the parties' will or intention, but that had to be determined objectively. Pufendorf specifically referred to the dangers of upholding cases of non-fulfillment of contractual obligations if no real loss has been sustained; that is, if the only damage suffered is the disappointment of expectations. The limitation of recoverable damage to that actually incurred is a recognition of the relativity of contractual obligations.

This understanding is particularly evident in the writings of Pufendorf, who cited with approval Cicero, On Duties, Book I (x), where it is stated that:

Occasions frequently happen with the result that it is not just to keep a promise: for it is proper to have recourse to the foundations of justice: in the first place, that of injuring a person, and secondly, that of being subservient to the public good. When these conditions are altered by circumstances, the moral obligation, not being invariably identical, is similarly altered. A promise, as a pactum, may happen to be made, the performance of which may be prejudicial' either to the party promising, or to the party to whom the promise is made .... Therefore, you are not to perform those promises which may be prejudicial to the party to whom you promised, nor if they may be more hurtful to you than they can be serviceable to him. It is inconsistent with our duty that the greater injury should be put before the less.
According to Pufendorf, this position is justifiable on the ground that natural law, in establishing the limits of agreements, requires individuals to advance the interest of others and not merely refrain from causing them harm.\textsuperscript{23} It seems that Pufendorf and the natural lawyers advocated altruism long before the welfare state came into being. Natural law, it is argued, does not uphold harshness and unfairness\textsuperscript{24} and, therefore, would not prejudice a party by obliging him to fulfill a commitment which is no longer apparent. This duty is one founded in law whether or not it is provided for by the expressed or presumed wills of the parties or positive law.\textsuperscript{25} Thus, it is admitted that, although the will creates the agreement, it is not the sole criterion for determining its limits and consequences. Laws and regulations also have a role in delimiting contractual undertakings.

Grotius is neither very clear nor direct on this point, but it would be difficult to argue that he would have envisaged the matter differently. He argues that fairness is a relevant factor in all contracts of exchange, while equality is one that pertains to the making and the subject of the contract.\textsuperscript{26} The natural lawyer's understanding of the supremacy of the individual will, thus, did not mean necessarily that contractual obligations created by this will were absolute. According to this school, creating a contract by will is one matter, and attributing all the consequences of the agreement to the parties' wills, is another. While the former issue was recognized as the exclusive domain of the parties' wills, the second was not, and could be largely influenced by legal rules. Therefore, the arguments of fairness, good faith and change of circumstances were generally recognized by the natural lawyer.

To conclude, it could be asserted that if the will theory, with its emphasis on the parties' autonomy, was promulgated by the natural law school, it was definitely not the natural lawyers who endowed it with its quality of absoluteness. This was, rather, the consequence of subsequent developments and intellectual trends, to be discussed hereafter.

\textbf{PART II-THE TIME ELEMENT: INFORMATION CHANGES AND THE LEGAL CONTEXT}

[...]
not expressly stated, a "...convention should be construed in good faith, that is to say, by taking into account the consequences of the commitments the parties may be considered as having reasonably and legitimately envisaged."\(^5\)
The vision and expectations of the parties do not go uncontrolled; rather, they operate within limits, i.e., the reasonableness and legitimacy of the parties' expectations. This is only the case, however, where there is no express covenant, the latter being the citadel of absolute sanctity regardless of how absurd, unfair or unrealistic it is. In essence, this is a discrete test, representing only a partial move towards relationalism with respect to non-regulated aspects of the contractual relationship.\(^5\)

Under a morality of individualism, good faith is used to enhance the principles of autonomy and sanctity.\(^7\) It is claimed that good faith, defined as a duty to keep one's promise, is part of natural law, for without it, the formation of communities and the promotion of exchange is not possible.\(^8\) In this respect, it has been stated:

> [The] foremost amongst [the characteristic rules and elements of the principle of good faith] is the rule *pacta sunt servanda* .... there is much authority in the jurisprudence of international tribunals\(^9\) for the proposition that... good faith is a legal principle that forms an integral part of the rule *pacta sunt servanda* .... That association of good faith with the keeping, and manner of performance of, treaties

It is evident that, under this conceptualization, the principle of good faith only arises in the context of the *pacta sunt servanda* principle. On the other hand, under a morality of sharing, good faith is used to promote the independent existence of the contractual relationship. Good faith is defined in reference to prevailing social and moral values. It is used to assure that contractual practices conform to those norms, and is the milieu for integrating contracts in its context. In such cases, good faith:

> ... must preside over the formation and the performance of contracts. The emphasis placed on contractual good faith is moreover one of the dominant tendencies revealed by the convergence of national laws on the matter .... Good faith expresses not only a state of mind, the knowledge or ignorance of a fact, but also "reference to customs, to an ethical rule of conduct" .... It thus expresses a required conduct which can be linked to the general principle of responsibility.\(^11\)

In other words, good faith provides a behavioral standard according to which contractual relationships should be conducted. The criterion adopted under this standard will be elaborated on hereafter.

**II. GOOD FAITH-BEHAVIORAL STANDARD HONESTY IN FACT v. REASONABLENESS**

The substantive content of the principle of good faith is inherently dependent on the behavioral standard which it is claimed to advance. The criterion determining the latter directly affects the features and scope of the former. Thus, much depends on the elements constituting the behavioral standard. To view a behavioral standard as limited to minimum requirements undermines the legal effectiveness of good faith, for it reduces its functions to a defined scope. A good faith principle characterized by good conscience and sincerity would require adherence and observance of pacts as a matter of trust and inner integrity, as well as outside social necessity. The freedom and equality of the members of the community require respect for an individual's choice to be bound, to maintain the common order and exchange which would otherwise be halted. To act honestly and in good faith is thus a basic behavioral standard. One is merely required to be honest in his dealings. This is a very individualistic conception of the role of good faith, which conforms to the will theory and the principle of autonomy. One is entitled to seek opportunities even if it entails being indifferent to the legitimate interests of others. This is acceptable as long as one is not deceptive. After all, contracting is a mechanism of allocating resources and risks, and it often protects specific interests at the expense of others: An honest man is not necessarily a caring one, ready to share his fortunes with others. The sharing of one's fortunes goes beyond honesty, which merely requires forbearance from cheating. This behavioral standard is the one referred to in legal doctrine as "honesty in fact," which is a standard very popular among common law countries. Under this standard:

> Honesty assures, first, that one will not mislead another as to the facts in order to profit by the other's misinformed decision. It assures also that engagements once made will be honored. Good faith as honesty may be viewed as a manifestation of the liberal belief in the objectivity
Inherent in this definition is a requirement of actual knowledge, for one cannot mislead his partner if he himself is ignorant of the fact. To cause ignorance is a clear case of dishonesty; to share ignorance is not.

Situations are not always that clearly cut, however. For example, what if one neither causes ignorance, nor shares it, but merely fails to inform one's partner of a particular fact. Consider the case of a long-term industrial cooperation contract where the investor conducts a feasibility study that reveals potential high levels of returns. During negotiations, the investor is neither asked about this information, nor requested to carry out any similar study. The other contracting partner— that is, the employer—does not agree to conditions to which he would not have otherwise consented. Did the investor, by not sharing the information—which he discovered through his own resources—commit a wrong? In other words, did the employer's ignorance, nor was he responsible for his distress. However, by not disposing of the knowledge he possessed, and as a result, of his partner's ignorance, he procured an advantage which otherwise would not have been attained. The classical conceptualization would find nothing wrong with this result, for, after all, the more calculating and foresighted should enjoy the fruits of his foresight and prudence.

Under a relational contextual approach, the fairness of such a result would be questioned. There, extra-contractual circumstances play a crucial role in evaluating the parties' conduct. The propriety of certain practices is determined in light of the surrounding circumstances. Not only is a *bona fide* actor required not to lie, he is also expected to act according to specific social standards. Without launching into an examination of the duty to inform—which will be the subject matter of the forthcoming section—one could assert that the behavioral standard required under the contextual approach is more rigorous than that of the honesty in fact approach. Under the contextual approach, where conduct is evaluated in light of the surrounding circumstances, something more than a refrain from lying is required. In the above hypothetical case, determining whether the investor fulfilled his duty of good faith depends more on the expected and accepted conduct given the circumstances, than on whether he lied in absolute terms. Even more important is the expected course of conduct of an average investor in similar situations. Factors such as the nature of the parties' relationship and their relative bargaining positions, as well as the resources available to each of them, are important considerations. In addition, consideration should be given to the reliance placed by the employer on the investor—who possessed the relevant research data—and whether any dependency relationship existed between the two partners. Also relevant to this inquiry is whether the investor was more capable of carrying out the research and/or was expected to do so. In other words, a contracting party, in proving that he acted in a *bona fide* manner, should demonstrate that, with due regard to all surrounding circumstances, his course of conduct was a reasonable one. This standard is more readily used for purposes of interpretation, where the test is that not only of an honest, but also a reasonable, man. Thus, contractual obligations should be defined:

"Reasonableness" is the other criterion against which good faith may be tested. Reasonable conduct is that which is rational and equitable under the circumstances, as well as suitable and appropriate given the underlying objective. Although it may be criticized for being loosely defined, it is certainly a more objective test than that of honesty in fact. Under a "reasonableness" standard, it is irrelevant whether or not a party has acted upon what he honestly believed. Rather, it is more important that one has put forth his best efforts, exercised due diligence in performing his contractual undertakings, upheld the common contractual goals, avoided abuse of rights acquired under the contract and facilitated the other party's performance. These duties are undoubtedly wider in scope, and entail more stringent implications than those articulated under the honesty in fact test. It is also clear that the "reasonableness" standard is based on what Professor Fried refers to as the "nonpromissory standards of justice." A tribunal's preference for either the honesty in fact or the reasonableness test reflects its view of contractual obligations. A tribunal viewing itself as a guardian of the autonomy principle will undoubtedly apply the "honesty in fact" test. On the other hand, a tribunal that...
views contracts as social instruments subject to prevailing notions of justice would foster the "reasonableness" standard. Which approach international arbitral practice supports is the concern of the forthcoming study of arbitral awards.

III. GOOD FAITH DUTIES-DEFINED

The focus of this section is to examine the various applications of the good faith principle, the conditions upon which they come into operation, their conformity to either one of the contractual conceptualizations and their theoretical premises. In this respect, the discussion will be limited to those decisions in which good faith duties arose in the context of international commercial disputes relating to LTICTs, and will not address cases arising within national legal systems.

A. THE DUTY TO INFORM

The duty to inform obligates a party to disclose information available to him but not to the other party. The crux of the issue is whether contracting parties are under an obligation to share their knowledge. A distinction should be drawn between two contractual stages—those arising before, and those arising after, the conclusion of the contract.

1. The Pre-Contractual Stage

(a) Failed Negotiations and Disclosure of Information

At the outset, liability for non-disclosure of information in cases of failed negotiations is excluded from the scope of this discussion. In attempting to conclude a deal, one of the negotiating parties may not be forthcoming, and may withhold information, thereby causing damage to the other party. Unless a contract is subsequently concluded, however, the matter is outside the realm of contract law. Consider, for instance, the process of negotiating an agro-processing industrial cooperation and management agreement. The contractor's (i.e., investor's) feasibility studies reveal that the merchanting and commodity trading of the questioned products is not promising, and is suffering a decline in demand. The client is informed of this fact after a lapse of time, during which substantial investments have been made in buildings, machinery and processing equipment. Such investments were made in an earnest belief that a deal would be concluded shortly. However, the negotiations fail, and the client sues to recover expenses incurred because of the contractor's failure to inform him promptly of the reality of the situation. Professor Fried has rightly stated that in situations of the sort:

> Promissory obligation is not the only basis for liability; principles of tort are sufficient to provide that people who give vague assurances that cause foreseeable harm to others should make compensation. Cases like [these] are seen to undermine the conception of contract as promise: If contract is really discrete and if it is really based in promise, then whenever there has been a promise in the picture (even only a potential promise) contractual principles must govern the whole relation. To state the argument is to reveal it as a non sequitur. It is a logical fallacy of which the classical exponents of contract as promise were themselves supremely guilty .... Modern critics of contractual freedom have taken the classics at their word. Justice often requires relief and adjustment in cases of accidents in and around the contracting process, and the critics have seen in this a refutation of the classics' major premise .... [T]he excessive rigidity of the classics played both them and the concept of contract as a promise false.

Contract law, whether defined in reference to the promise or viewed as a relationship, has no connection to the above hypothetical, which instead falls under the principles of restitution or negligence.

(b) Prior Negotiations and Disclosure of Information

Once a contract has been concluded, however, the story changes. Here, prior negotiations become relevant in determining the scope of the parties' contractual relationship. As a question of law, the parties' statements and conduct during prior negotiations can engender liability. Arbitrations involving claims for damages arising out of non-disclosure of information in the negotiation stage are rare, however, and the party alleging a wrong is usually held to strict standards. In this respect, international arbitral practice seems to be divided between two sets of reasoning—the contractual equilibrium approach and the misrepresentation approach.
In some cases, the issue has been approached in terms of contractual equilibrium. Contracts are rescinded where such equilibrium has been gravely affected by a party's failure to communicate information in the negotiation stage. A Dutch arbitration exemplifies this reasoning. In that case, the arbitrators:

... annulled a contract by which the total issued capital of a company was bought for a price exceeding five times the value of the shares as estimated by the accountant. The price was obviously based on the intention to run a casino on the premises rented by the company. The risks involved were, according to the arbitrators, not, or in any case not sufficiently, indicated by the sellers to the buyers. After a few months the casino had to be closed. The excessive price, in disproportion to the actual value of the shares, justified dissolution of the contract since the real purpose of the transaction could not be achieved.19

Under the above articulated reasoning, non-disclosure of information during pre-contractual negotiations, which affects the contractual equilibrium, is only actionable if the intended purpose of the transaction is frustrated. In the above case, neither party was cheated or mistaken by the other; hence, the doctrines of mistake and fraud were not applicable. Thus, under the classical conceptualization, the only remaining remedy was the doctrine of frustration.20 No adjustment of the contractual relationship was attempted to accommodate informational changes, as would have been the case under a relational approach. It is interesting to note that the tribunal did not address the questions of whether the buyer had indicated that running a profitable casino was his main reason for contracting, or whether he had relied on the seller's experience and knowledge in deciding to enter into the contract. It is implied-from the context of the case-that such reliance, even if not expressly stated, was presumed. Otherwise, the evaluation of shares at five times their par value would be unjustifiable.

(ii) The Misrepresentation Approach

Unlike the line of cases that have based their holdings on the interdependency of the contractual parties, and the reliance placed by one party on the other,21 this decision frees the duty to inform of such restrictions. Although relevant in cases of LTICTs involving joint ventures or industrial cooperation projects, reliance and trust-the foundation of fiduciary relationships-are less persuasive in other types of LTICTs.22 For, unless the contractual relationship produces an independent legal entity, such as a joint venture, there is no reason to assume that the parties' expectations and interests will always coincide. It is indisputable that in every long-term contractual relationship there are common interests, ensuing from the common contractual goal, which create a close bond between the parties. However, to assume that in all cases such ties are strong enough to merge the interests of the contracting parties into one inseparable unit, is contrary to commercial realities. It also imposes a paternalistic conceptualization of commercial relationships, which is totally alien to the business world. Requirement and franchising contracts typify the partial discrepancy that exists between the parties' legitimate interests. In such cases, implying a fiduciary relationship is not only difficult to justify, but is also impractical and unnecessarily limits the duty to inform. Thus, the nature and purposes of LTICTs only support the fiduciary relationship requirement in part. Instead, frankness and honesty are the criteria for the good faith duty in such LTICTs disputes, regardless of the existence of a fiduciary relationship, which, in its legal sense, is one of trust and confidence. It is sufficient-as was the case with the previously discussed decisions23 -that the proprietor of the information was aware that such information could influence the other party's contractual involvement. Whether or not he actually intentionally withheld the information is irrelevant. Mere lack of communication is sufficient; to require scienter would place a party in the position of proving the elements of a fraud claim. In other words, a party is under a duty to ensure that the other party's ignorance does not interfere with the contractual relationship to the extent that it adversely affects the party without knowledge.

Under the second category of judicial reasoning, more than mere failure to communicate information must be proven. Rather, to prove lack of good faith, a party must demonstrate an intention to conceal that caused damage. Under this approach, one cannot use the ignorance of his negotiating partner to secure a deal which might otherwise not have been attained. In a case involving an oil and gas concession-which was concluded after carrying out certain seismic work and the drilling of two exploratory wells-the host government claimed that when it signed the agreement, the gas concessionaire did not inform it that "no commercial quantities had been effectively discovered." It was held that:

The Arbitration Tribunal deems it unlikely that the Government would have entered into an Agreement which would lead to heavy immediate disbursements (US$2,514,315.46), and to even greater expenditure at a later date without first requesting information about the outcome of the tests which it obviously knew had been made.24
Although the case is principally an illustration of an instance of nondisclosure of information, the parties, as well as the arbitrators, dealt with the issue as one of misrepresentation. Misrepresentation is defined as any manifestation by words or other conduct which, under the circumstances, amounts to an assertion that does not accord with the facts, and which, if accepted, leads the mind to apprehend a condition other than, and different from, that which exists. Under the misrepresentation approach, then, nondisclosure of information in pre-contractual negotiations by a contracting party engenders liability only if it amounts to a false manifestation of a factual matter that was material to the contract and influential in its conclusion.

In fact, under international practice, not only are the parties under no duty to disclose information, but, in some instances, it is their responsibility to ask for information. The ICC award in case no. 3779 is exemplary. In a series of related sales of a certain type of powder, there arose a misunderstanding as to its solubility degree. The tribunal held:

The dialectics between the right of being informed, and the obligation of informing oneself is thus at the heart of the problem in the present dispute... A and B conclude a contract without informing themselves about the provisions of clearing that are applicable to their deal. Th[e] responsibility [of the buyer] presupposes a fault on his part... due to his own negligence as to the fact that [he] did not sufficiently ask for information about the goods.

Imposing a duty to seek, not to share or volunteer, information is very much in accordance with classical individualism, where individuals are not expected to volunteer information, but should not lie if asked to disclose information. This is the minimum standard of honesty in fact, where one is not expected to care for others or share his fortunes with them. His only obligation is not to cause his partner's ignorance for the purpose of increasing his profits or securing a contractual advantage. This reasoning is very discrete in nature, for it assumes the dominance of the autonomy principle. However, this understanding does not accurately represent the holdings in the ICC case no. 3779. For, although the parties were held to a duty to seek, not share, information, the arbitrators did not settle the dispute on the basis of the contract-that is, on the basis of the parties’ will. Instead, a fault standard was relied on to determine the issue of liability. The parties were held jointly liable for the miscommunication of information, and only restitution damages were awarded on the basis that:

Taking into consideration the respective faults, it is equitable to adjudicate an indemnification reduced by two fifths, the Respondent being responsible for 3/5 of the misunderstanding, the Claimant for 2/5. The compensation equals only the negative interest of the contract, that is to say the interest which the Claimant would have had when he had not concluded the invalidated contract. Its objective is to return the estate of the Claimant to the state it would have been in if the contract had not been concluded. The indemnification due to the Claimant can thus be fixed at 3/5 of $35,500 and $7,500, without taking into account the additional claim of $10,000 that does not correspond to the notion of negative interest of the contract.

The court, straight and simple, recognized that there was no concurrent will, and therefore based its decision on extra-contractual principles, that is, fault and restitution. There was no attempt to use the classical theory device of implied intent, which imputes contractual terms. Instead, there was a simple recognition that the issue in the case was outside the realm of the contractual promise, and could only be solved by referring to the context of the contractual relationship. Therefore, even though altruism and sharing are not yet the ideals of international practice, the classical conceptualization, based on the exclusivity and all-comprising nature of the promise principle, is no longer the dominant approach.

(iii) Contractual Equilibrium/Misrepresentation Approaches-Compared

Although the two approaches discussed above differ in substance and form, the pragmatic effects of either approach are the same. Whether the miscommunication or lack of information in prior negotiations is regarded as a misrepresentation or as affecting contractual equilibrium, the contract, in both instances, is irrelevant so far as remedies are concerned. Under both approaches, if a party proves his case, a contract is not adjusted to accommodate the changes generated by a change in information, but is instead deemed to have never existed. This solution is not a relational one, for it terminates the contractual relationship instead of recognizing the effects of its context and adapting the relationship to accommodate the changes. However, it is a startling move away from the dominance of the will theory and the principle of
**pacta sunt servanda.** The will, which—although not totally mistaken—is merely miscalculated, or misled, does not control the parties’ relationship and, consequently, their pact is not enforced.

2. **Post-Contractual Stage**

Are the same solutions adopted when changes in information (whether arising from a miscommunication, lack of, or newly acquired, information) occur after the contract has been concluded? At the outset, the answer is no. Here, the parties, being partners, have more entitlement vis-a-vis each other because a contractual relationship is already in existence at the time of the change in information. Stricto sensu, under the classical conceptualization, this should not be. Changes that occur after concluding the contract should not be allowed to produce any effects on the parties’ agreement. Benefits or disadvantages generated by such changes should be enjoyed by, or fall upon, the party who, because of the original contract, finds himself in a beneficial or disadvantageous position, respectively. A technological advance by one party that could facilitate the other party's performance is by no means common property. The proprietor, alone, enjoys its benefits, and the other party has only himself to blame for not contractually providing for such a contingency.

Under the classical approach, good faith requires one not to cheat, or intentionally create a disadvantageous situation for, his partner. In other words, a party to a contract must not act in bad faith, as was the case in *MINE v. Guinea*. This decision concerned a long-term agreement for the transport of bauxite and the assemblage of fleets of bulk carriers. The defendant, a state party, began negotiations with a third party, exercising its freight rights under article 9 of the agreement, without informing the other contracting party. Although, strictly speaking, Guinea was merely exercising its contractual rights, it was nonetheless held that by "... not tell[ing] MINE what it was doing ... Guinea’s conduct in secretly negotiating ... exhibits bad faith on its part, violating the principle of good faith." Guinea had knowingly withheld information from its contracting partner, thereby causing serious injury to their joint project. This was a clear case of dishonesty, and any minimum behavioral standard would denounce Guinea for its conduct. In this juncture, it is appropriate to ask whether a similar duty to inform would arise in situations where non-disclosure does not represent a fraudulent act. In other words, is the good faith duty to inform defined in terms of bad faith, or is it determined according to another standard?

On the basis of available international precedent, it is difficult to propose an unqualified general rule in this respect. With the exception of the duty to give reasonable notice of termination, delay or defects, other duties to inform are not well established. This is partly due to the scarcity of disputes relating to disclosure of information, and partly because of the diversity of related policy considerations. For example, a major concern which relates to most, if not all, LTICTs would be the costs and subsequent utility of the disclosed information. It is argued that obtaining information, like any other transaction, involves costs that are usually not included in the contract price unless expressly provided for by the parties. If this proposition is true, then there should not be an implied duty to inform. This holds true if a contract is defined in discrete terms, where contracting is merely a matter of immediate give and take.

The above argument does not lend itself to relational analysis, however. Under a relational approach, parties to a contract are partners in a joint project, and their undertakings do not necessarily have to be compensated by immediate gains; rather, the overall common good of their project is a sufficient return. However, the unity of the partners in commercial transactions should not be exaggerated, and, in many instances, their interests do not go hand in hand. Under such circumstances, the duty to inform could be implied, regardless of the costs involved, on the basis that it furthers the successful completion of the contractual undertakings. In other words, a duty to inform arises where the losses sustained from non-disclosure outweigh its benefits. This seems to be the unpronounced premise that underlies the *Wintershall/Qatar Arbitration* and the decision in *Guinomar v. MMA*. In the *Wintershall/Qatar Arbitration*, it was held that:

> [a]s far as the alleged transfer of ‘new information concerning valuable resources’ is concerned, this is surely a part of the implied duty to report. The costs involved would surely fall within the express recovery provisions of Art. XIII and Art. XIV of the EPSA.

In this decision, the costs of the duty to disclose information were regarded merely as part of the contractual duty to report.
and, as such, were compensated. Strictly speaking, these are two distinct obligations. However, under the circumstances of the case, the court resolved the costs defense by lumping the duty to disclose information with the duty to report. Holding otherwise would have been disadvantageous to both the respondent and the contractual relationship. It would have resulted in either the claimant being relieved from his duty to inform because the costs of informing were not compensated under the contract price, or the claimant being awarded extra damages for disclosed information. This decision is a conciliatory solution; it does not expressly reject the sanctity principle, but it severely undermines its premises.

Another, more serious, objection against imposing a duty to inform is that disclosure strips the information of most of its bargaining value or utility, and could render it useless. In the latter instance, since a duty to inform serves no purpose and generates more losses than gains, imposing it on the contracting parties would be unjustifiable, and even would run contrary to the wisdom of relationalism. As for cases where the bargaining utility of the information is merely decreased by disclosure, a requirement of confidentiality could be the correct solution. For instance, the disclosure of information to one’s partner may jeopardize the possibility of securing a bargaining advantage out of such information in another context. The tribunal in Guinomar v. MMA dealt with this contingency and stated:

> We emphasize that MMA has not been shown to have acted in bad faith or, without good faith. It might well have been more upright and straightforward for MMA to have approached Guinomar at the outset and on a confidential basis disclosed its determination to exit the aluminum business and seek to minimize the impact upon Guinomar and its partners of such a decision, but it is quite clear from

the evidence that MMA did not take the action it did for the purpose of circumventing its obligations under the Transportation Agreement.34

Thus, the risk that the disclosed information will lose some or all of its utility does not exonerate one from the duty to inform. The above citation from the Guinomar decision seems to do away with the bad faith requirement. Liability for breach of the duty to inform is imposed irrespective of bad faith or a desire to conceal on the part of the proprietor of the information. The majority holding in the Wintershall/Qatar Arbitration agrees with this proposition. The Government of Qatar was not found to have acted in bad faith for not disclosing information about ongoing boundary disputes. Nonetheless, because the omitted information affected Wintershall’s exploration activities, the government was held liable for breach of its duty to inform. To remedy the effects of nondisclosure, the contract was extended to give Wintershall a realistic chance to explore.35

3. Post- and Pre-Contractual Duty to Inform-Compared

To summarize, it could be asserted unhesitatingly that liability for non-disclosure of precontractual information only exists if the injured person proves that non-disclosure frustrated the contractual equilibrium of the agreement or resulted in a misrepresentation. On the other hand, with respect to information that becomes available after the conclusion of the contract, a duty to inform arises only if non-disclosure would impede or seriously affect the performance of the contract or an entitlement of one of the parties. This duty is subject to payment of the appropriate compensation and the requirement of confidentiality. This rule applies irrespective of the existence of bad faith—that is, an intention to conceal or cheat on the part of the proprietor of information. Liability is imposed on the defaulting party not because he acted in bad faith, but because he acted without due consideration to his partner’s interests. He has withheld information, thereby adversely affecting both the other party and the common project. In so holding, tribunals have weighed the interests of both parties, and then decided on the desirable course of conduct given the circumstances. This is essentially an objective test based on a required behavioral standard.

As reflected in the examined cases, the behavioral standard is measured by what is reasonable under the circumstances. This is yet another instance where good faith conduct is defined in reference to reasonableness, not bad faith or insincerity. Such a standard of conduct seems to apply to other instances of good faith duties as well. In fact, many of these duties overlap because they are based on similar premises and are defined by the same legal test. For example, in the Wintershall/Qatar Arbitration, the majority was of the opinion that failure to disclose information was also contrary to the required “... cooperation by the respondent in the discharge of its obligations with respect to the claimants’ rights under the EPSA option.”36 The definition of, and conditions upon which, the duty to cooperate rests, will be the core of the proceeding section.
II. THE DUTY TO NEGOTIATE-DEFINED

Whether a contract involves the exploitation of natural resources, the transfer of technology, the manufacturing of goods, the construction-or even the management-of a project, the effects of the time element are common to all long-term transactions. In LTICTs, the operations regulated by the parties' agreement are simply too complex to be all-encompassing and fixed at one point in time as envisaged by the classical theory. Discreteness is difficult to satisfy. There are too many considerations that cannot be finalized at the time of contracting because they depend on the occurrence of a future contingency, or because the parties-due to a lack of, or insufficient information-may be unable to make a final decision regarding some aspects of their relationship. Moreover, the passage of time might simply render the agreement incomplete. In other instances, a specific aspect of the contractual content is expected to develop over the course of time. Thus, regulating it by a conclusive, all-embracing and everlasting scheme is neither possible nor practical. In such cases, future review of the agreement is inevitable. Otherwise, the existence of the project would be at risk.

The difference between these instances and those of non-comprehensivity is that, while in the first, the parties, after concluding an agreement, complement its provisions, in the second, they merely review its provisions. In either case, the parties have to negotiate a potential solution for an existing problem. What if such negotiations fail, or if one of the parties refuses to participate in them? The parties, if concerned enough about the continuation of their relationship, may resort to a third party or a conciliation mechanism, e.g., that of the ICSID or the ICC, to bridge their differences. Alternatively, in cases where there is no space for conciliatory action, resort must be had to judicial or arbitral resolution to settle the dispute and attempt to salvage the disintegrating relationship.

Here, a preliminary question arises with respect to the authority of the arbitrators to complete the parties' agreement in case of failed negotiations. This question mainly pertains to the subject of the arbitrators' powers and autonomy, and is only indirectly related to the issue at hand. It will, thus, only be pursued to the extent necessary to understand the substantive issues involved. Does international law relating to commercial transactions vest arbitrators with the power to complete or revise contracts? The answer to this inquiry is threefold. First, one has to inquire whether the arbitration law allows such practice. A comparative analysis of national legal systems is beyond the scope of this book. However, in principle, the major legal systems, subject to different conditions, recognize such power. For example, in the US legal system, Sections 1-205 and 2-204 of the UCC and Section 204 of the Restatement (Second) of Contracts (1979) allow supplementing contractual terms upon the fulfillment of certain conditions. The common law rules applied on the other side of the Atlantic, provide for the same outcome. Commercial agreements in both the English and the American common law jurisdictions are governed by the maxim: certum est quod certum reddi potest. Only those agreements that are completely vague and ambiguous will not be upheld by the courts; otherwise, tribunals generally will be willing to work out the details of an agreement for the parties.

Among civil law jurisdictions, the Swiss Federal Code of Obligations is the only code that deals expressly with this problem. Article 2 of that code provides:

Where the parties have agreed on all the essential terms of a contract, the contract is presumed to be binding even though unessential terms have been left open. Where no agreement can be reached concerning the unessential terms left open, the court will decide them according to the nature of the transaction.

No corresponding provision exists in the German Civil Code. However, the combined reading of articles 155, 157 and 317 would allow for similar measures. Among the codified systems, it is the French practice that is most restrictive.
places stringent conditions on courts' ability to interfere with an agreement in order to supplement or revise it. The "definiteness" test is applied by courts to determine a contract's enforceability. Under this approach, a court's authority to supplement or revise a contract, is limited to instances in which a previously agreed upon variable factor or mathematical calculation is involved. Any gap-filling or revision that would not promote the parties' common will and contractual objective is not allowed.

In spite of this apparently strict view of the role of the judiciary in equitable adjustment, the French courts, in many cases, have supplied or reviewed contractual terms where the situation involved more than the mere application of a previously agreed upon formula. These cases primarily involved price revision clauses. The rationale underlying these decisions is that a court's determination of a payment due does not interfere with the autonomy of the parties' will and hence is not prohibited. This line of reasoning has made its way into some ICC awards concerned with defining the amiables compositeurs powers to review contractual provisions. In case no. 3327 of 1981, it was held that:

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... le Tribunal arbitral indique que ses pouvoirs d'amiables compositeurs ne l'autorisent pas à procéder à une révision du contrat. Par contre, il n'hésite pas, au nom de l'équité, à aménager les termes de paiement contractuellement prévus. Il ne s'agit sans doute pas d'une révision du contrat, mais cette décision ouvre néanmoins une brèche dans la jurisprudence arbitrale dominante, proclamant le caractère sacro-saint des contrats et rappelée supra.17

Reconciliatory as it may be, this reasoning leaves no doubt as to the arbitrator's authority to complete and review contracts.

The second question that arises in this respect is whether such authority extends to include all kinds of gaps and revisions, or is limited to a specific category. Here, the heart of the issue is the controversy concerning the supply and revision of minor and major terms. The problem is that, while there is a general consensus as to the arbitrator's authority with respect to minor terms, the same is not applicable when major terms are at issue. The absence or inadequacy of a major term affects the formation of the contract at its basis, rendering it either voidable or unenforceable. An arbitrator's role is not to make a contract for the parties; rather, his task is limited to supplementing or revising contracts to the extent necessary to further the business efficiency of the transaction. It is this kind of contract conceptualization that prompts the sort of reasoning advanced in the above-cited ICC award. To avoid any open contradiction with the discrete model-with its emphasis on sanctity-tribunals and arbitrators classify all terms-but for the offer and acceptance-as minor ones with respect to which judicial intervention is allowed. Evading the sanctity principle by means of classification is not discreet enough to disguise the diversion of legal practice from the classical model. If contractual price is not a major term, then what is considered a major term? In fact, an endless list of cases could be drawn from each major legal jurisdiction, where courts have supplied or reviewed contractual terms that were not necessarily minor in character. Even in France, where the law is most restrictive with respect to empowering judges or arbitrators to effectuate gap-filling or revision, the Cour de Cassation reviewed an indexation clause that was no longer in use and substituted it with a new one of its own choice.18

Arbitrators, are following suit, but are less overt. This is primarily a result of the contractual basis of the arbitrator's competence, which limits his powers to tasks expressly entrusted to him. Eroding the impracticability of this rule has been no formidable task, and its analysis is the third focal point of this discussion. Arbitrators, often under the cliché of interpretation, resort to trade usage to review or supply contractual terms. Where arbitration rules do not permit recourse to trade usage, tribunals invoke one general principle or the other to realize the same goal. The most famous of these are good faith, fair dealing and implied terms. Aware of their limited authority, arbitral tribunals have labored to establish their competence with respect to such issues. One of the more clearly defined and precisely worded awards dealing with an arbitrator's power to complete a contract is the AMINOIL decision. The tribunal, in the course of deciding the applicability of the OPEC resolution under a negotiation clause, held:

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...there can be no doubt that, speaking generally, a tribunal cannot substitute itself for the parties in order to make good a missing segment of their contractual relations-or to modify a contract-unless that right is conferred upon it by law, or by the express consent of the parties. The law does often give a tribunal this right, and precedents in many countries could be cited of cases in which, on the basis of the applicable law, courts have completed a contract. But arbitral tribunals cannot allow themselves to forget that their powers are restricted. It is not open to doubt that an arbitral tribunal could not, by way of modifying or completing a contract, prescribe how a provision such as the Abu Dhabi Formula must be applied. But in the present case, the Tribunal thinks that it is not really a question of modifying or completing the contract of concession. The Tribunal is not expected to devise new provisions that will govern the contractual relations of the Parties for the future, but to liquidate the various consequences of their past conduct, and of the contractual clauses that once bound them but are now at an end.19
Under this rationale, if the arbitrators are merely adjusting claims for damages, they can supply or review contractual terms if the calculation of damages so requires. This understanding is neither novel nor universally true. It is not novel because it has always been the case that the existence of a duty is only pleaded-or for this purpose, contested-when a party is claiming damages for a breach thereof. In addition, a party rarely requests the tribunal to supply or revise contractual terms in the context of specific performance. This is because resort is rarely made to specific performance as a contractual remedy. Parties pursuing arbitration, as opposed to conciliation, third party intervention or mediation, rarely have a future relationship to which to look forward. They are mainly interested in settling old accounts. The AMINOIL holding is also not universally correct because, in cases where there has been a possibility of resuming the parties’ relationship in the future, the above proposed distinction between settling old claims and regulating future contractual relations has not been observed by arbitrators. In a few cases, arbitral tribunals, under the rubric of interpretation, have supplied contractual terms to govern the future relationship between parties to a contract. The Wintershall/Qatar Arbitration is exemplary. The tribunal, though refusing to implement an agreement to agree on marketing and distribution, extended the original contract for a period of eight years to give meaning to the contractual option relating to natural gas use. Obviously, this meant that the parties had to remain in their contractual relationship for the extended period of time, and neither party contested the competence of the tribunal in so holding.

In short, there seems to be a general consensus among different national jurisdictions and arbitration practice that gap-filling and contractual revision are permissible as long as they do not amount to imposing a new contract on the parties. Once it is determined that arbitral tribunals have the authority to complete and review contractual agreements, it then becomes important to identify the standards they apply, and the content of the parties’ obligations, in either type of negotiation—that is, revision and gap-filling.

Chapter IX. Fair Dealing: Standards of Equitable Adjustment II. Rebus Sic Stantibus

The term "change of circumstances" is used here to refer collectively to a host of different doctrines, applied nationally and internationally, that deal with changes in the economic, legal and business realities underlying a contractual agreement. On the national level, these doctrines include the American doctrine of commercial impracticability, the German doctrine of wegfall der geschäftssgrundlage, unmöglichkeit, the French doctrines of force majeure and imprévision, the English doctrine of frustration and the Swiss doctrine of impossibility without fault. On the international level, reference can be made to the Vienna Convention of the Law of Treaties of 1969, where article 61 deals with impossibility of performance, and article 62 defines "fundamental change of circumstances" in terms of rebus sic stantibus. Also, a number of international organizations and institutions have attempted to define instances in which the setting aside of a contract is warranted. The UNCITRAL Legal Guide on Drawing Up International Contracts for Construction of Industrial Work is particularly noteworthy. It provides a very liberal definition of the circumstances under which contractual obligations can be excused, and, thus, reflects an understanding of the nature of LTICTs.

At the outset, it should be observed that national doctrines, when applied in the international arena, are modified to suit the needs of international transacting. It therefore, makes little sense to detail the different national practices. However, a brief outline of these doctrines is useful to help one understand the prevailing international definition of change of circumstances. Once national doctrines are defined, the analysis will proceed to examine the conceptual basis of change of circumstances. Finally, an international perspective of the application of this doctrine by arbitral tribunals will be offered.

II. COMPARATIVE PERSPECTIVE

The concept that a party's contractual obligations can be excused because of changes in surrounding circumstances takes a different form in each national legal system. Generally speaking, the common law countries, and those of Germanic legal traditions, tend to take a more liberal approach. With respect to the common law systems, the American practice is more far-reaching than its English counterpart. Section 2-615 of the UCC excuses contractual performance when presupposed conditions upon which the contract is based have not been met. Also, section 268 (2) of the Restatement (Second) of Contracts deals with the same contingency. The UCC has attracted more commentary and
litigation than the

Restatement. However, both provisions have departed from the old common law rule of impossibility and have adopted the new test of commercial impracticability. This test evolved from an "all-or-nothing remedy" to a "loss-sharing doctrine." Thus, excuse or partial relief is awarded if the occurrence of a certain contingency has made the performance of a commercial contract impracticable, i.e., unnecessarily burdensome, unprofitable or unfair to one of its parties. The rationale behind this rule is that no one in the business world is expected to work for free, and parties should not be encouraged to take advantage unjustifiably of the misfortunes of their partners; otherwise, the general stability of the institution of contracting would be threatened. It was, thus, thought far better to introduce the "flexible adjustment machinery" of UCC section 2-615 and Restatement section 268 (2), instead of the common law test of impossibility.

The common law practice on the other side of the Atlantic, though less liberal, is not substantially different from that of American courts. English courts have shown a willingness to imply in all contracts a condition to the effect that if the performance of a contract becomes physically or legally impossible, or if possible only in a very different manner from that originally contemplated, then the contract is dischargeable. The frustrating circumstances, however, must have arisen without the fault of either party. Frustration of the contract may be brought on by a variety of situations, including, for example, physical destruction of the subject matter of the contract, or subsequent legal changes, provided the contingency was not within the parties' contemplations. However, mere hardship is not sufficient under English common law to discharge, or even partially discharge, performance. Also, frustration affecting only part of the contract is subject to the normal conditions of frustration, and only arises in connection with severable contracts or where the supervening event is temporary.

The impossibility and foreseeability elements of the frustration doctrine make up the core of the French force majeure and Swiss impossibility doctrines. The French and Swiss laws of contract have much in common. In addition to drawing on parallel sources, they also provide for very similar solutions. The French and Swiss doctrines are based on only a few statutory provisions. Both systems enjoy a wealth of court practice from which the details of the doctrines of force majeure and impossibility are drawn. Finally, both permit excusing contractual obligations only in cases of impossibility, unless there is a contractual clause to the contrary. Mere hardship is not sufficient to excuse performance. In addition to demonstrating that performance was rendered impossible, one must show that the occurrence of a force majeure event was unforeseen and not a result of either party's fault. Also, the unforeseen event must have been unavoidable in the sense that the party seeking an excusal of performance could not have prevented it. The harshness of this rule is not as severe as it appears, for it is applied in light of the good faith and equity requirements encompassed in article 1134 of the French Civil Code. In arbitral awards, these requirements have been understood to necessitate "... refus[ing] a compensation [for non-performance] that would appear abusive in light of the change of circumstances." In fact, international tribunals, as will be detailed below, have awarded relief in cases where the facts far from demonstrated impossibility of performance. This also seems to be the position adopted by the national courts of both states. This brings the definition of force majeure or impossibility very near, if not identical, to that articulated in the doctrines of imprévision and wegfall der geschäftsgrundlage.

The doctrine of imprévision is a French one, developed by the Conseil d'Etat in connection with contracts involving public services. The doctrine of wegfall der geschäftsgrundlage is a German practice, providing relief for cases where the original economic basis of the contract has changed. The French doctrine is derived from state practice, based only indirectly on article 1134 of the French Civil Code. The German doctrine is also a judicial one, ensuing from court practice and "unmöglichkeit," as embodied in article 275 of the German Civil Code. The content of both doctrines is very similar insofar as they both allow a contract to be adjusted based on economic hardship. It was held that the doctrine of imprévision... empowers the courts to revise those provisions of a contract as might become excessive and exorbitant due to the advent of extraordinary circumstances...
geschäftsgrundlage, which is rarely argued in published international arbitral awards. However, it is agreed that it stands for the same proposition. A study of arbitral awards will demonstrate how international tribunals have amalgamated these different national doctrines into what is generally referred to as rebus sic stantibus, or "changed circumstances."

III. INTERNATIONAL PERSPECTIVE

Does international law and practice recognize the effects of changed circumstances on the performance of contracts? At the outset, it should be remembered that throughout the coming discussion, the terms "force majeure", "rebus sic stantibus", "frustration" and "changed circumstances" will be used interchangeably. As previously pointed out, international practice, particularly international commercial arbitration, does not attach to these terms the same definitions as those articulated in national jurisdictions. At the most, it can be claimed that a broad distinction is maintained between, on the one hand, absolute impossibility and, on the other hand, all the other above-stated doctrines that denote a change in the context in which the parties' agreement was concluded. It is not uncommon for a tribunal to describe a contract as being "... totally frustrated and thereby discharged by conditions of force majeure." Frustration by force majeure, rebus sic stantibus and changed circumstances are terms of frequent usage in international practice. In the forthcoming analysis, international practice under the law of treaties will be analyzed separately from that of commercial arbitration.

A. LAW OF TREATIES

Under the law of treaties, the question of changed circumstances is quite settled, and the Vienna Convention on the Law of Treaties of 1969, under articles 61 and 62, recognizes two instances where performance can be excused because of extraneous events. Article 61 deals with situations in which performance has become impossible because the object of the treaty is unavailable. The "unavailability of the object of a treaty" has been widely defined to include instances other than physical destruction. Accordingly, impossibility of performance has extended beyond cases of material impossibility to include those involving legal impossibility. In either case, the impossibility must be absolute; otherwise, performance is not excused, but merely suspended. Article 62 provides for instances where, due to a fundamental change in the circumstances in which a treaty was concluded, the parties' obligations have become radically transformed. Such a change warrants withdrawing, terminating or suspending a treaty, and, in some cases, it may also be a sufficient ground for the party disadvantaged by the change to request a revision of the original contract. There is a consensus among jurists that the doctrine of fundamental change of circumstances, kept within defined limits, embodies a general principle of law. The International Court of Justice has, on several occasions, examined the principle of fundamental change of circumstances, but has never outlined its exact scope and definition. In the Free Zones of Upper Savoy and the District of Gex, as well as the Fisheries Jurisdiction Case, the Court recognized the existence of the doctrine of rebus sic stantibus in principle, but held that it did not apply to the facts at hand.

B. COMMERCIAL ARBITRATION

1. Role and Scope of Rebus sic stantibus

International commercial practice, whether emanating from the Iran-U.S. Claims Tribunal or other arbitral tribunals, regards rebus sic stantibus as a general principle of law. On more than one occasion, it was held:

Under a variety of names, most, if not all, legal systems recognize force majeure as an excuse for contractual non-performance. Force majeure therefore can be considered a general principle of law. It follows that the right to invoke force majeure does not depend on, or arise out of, an express contractual provision. The parties to a contract may, however, agree that force majeure will have certain specific consequences for their contractual performance or with respect to termination of the contract. They also can decide that their contractual obligations, or some of them, will not be affected by force majeure. It is clear, however, that a limitation on the right to invoke force majeure as an excuse for non-performance cannot be presumed, but requires instead an express contractual provision to that effect.

The above assertion is limited, however. Tribunals have adopted a reservation that the rebus sic stantibus doctrine, though general in the sense that it is applicable regardless of a clause to the effect, still should be regarded as an exception to the sanctity rule. In the ICC award in case no. 1512, it was expressly stated:
The principle ‘rebus sic stantibus’ is universally considered as being of strict and narrow interpretation, as a dangerous exception to the principle of sanctity of contracts. Whatever opinion or interpretation lawyers of different countries may have about the ‘concept’ of changed circumstances as an excuse for non-performance, they will doubtless agree on the necessity to limit the application of the so-called ‘doctrine rebus sic stantibus’ (sometimes referred to as ‘frustration’, ‘force majeure’, ‘imprévision’, and the like) to cases where compelling reasons justify it.  

Acting accordingly, tribunals have required parties to plead and prove the condition of rebus sic stantibus. In QuesTech, Inc. v. Iran, it was held that: “... force majeure being an exception to the obligation to perform, a party that invokes it has the burden of proving that conditions of force majeure existed with regard to its various contractual obligations.” In Economy Forms Corporation v Iran, the tribunal awarded the claimant damages for breach of contract since the respondent “[did] not [contend] that its inability to take delivery was due to force majeure.” The same limitation is imposed by awards other than those of the Iran-U.S. Claims Tribunal. In Polish Foreign Trade Enterprise v French Company, it was stated:  

Defendant submitted as principal argument the fact that he had to stop the production of the goods in question for technical reasons involving the safety of the plant operation, invoking the necessity of this decision as an event of force majeure. However, except for his own statement, defendant failed to present to the arbitral tribunal any evidence concerning this subject. Consequently, the arbitral tribunal could not accept stoppage of production as an exception which would relieve defendant of the liability for non-performance.  

In addition to pleading and proving force majeure, a party invoking it must have notified his contractual partner of the existence of the disruptive event and his intention to terminate or suspend the contractual relationship because of it. The rationale underlying this requirement is to safeguard the parties from unpleasant surprises. Failure to comply with this requirement results in a denial of the right to invoke the force majeure doctrine, unless the other party becomes aware of the force majeure condition through other means. Knowledge is the most important factor; how it is acquired is not of great relevance. This rule applies unless the contract states otherwise. Thus, if a contractual clause requires notification of a force majeure condition, failure to comply with it may give rise to a claim for breach of contract, even if the other party knew, or ought to have known, of the disruptive event.  

Classifying the rebus sic stantibus as an exception to pacta sunt servanda has greatly affected its legal consequence. As was mentioned above, force majeure conditions have to be pleaded, proved, communicated to the other party and narrowly interpreted. Secondly, questions relating to force majeure are considered ones of fact, and, thus, their legal effects very much depend on the circumstances of each case. In this connection, tribunals have repeatedly stated:  

As force majeure arises out of and depends on factual circumstances, it will affect a contract as soon as the circumstances emerge which create the obstacle to performance. The factual effect of force majeure depends on the extent to which these circumstances, practically and objectively, render performance impossible. Consequently, the existence of force majeure does not depend on, or arise out of, an agreement between the parties as to the existence of such circumstances. Nor is the application of force majeure dependent on any special formal requirements, unless the contract in question so provides.  

Tribunals accepting the above definition of the scope and role of rebus sic stantibus are inclined to confine the application of the doctrine to its narrowest possible boundaries. This is particularly evident in tribunals’ allocations of losses ensuing from the occurrence of a force majeure. Even if performance is excused, arbitrators refrain, in general, from equitably allocating the ensuing losses. The rule is to let the loss lie where it falls, regardless of the equities of the situation. Basically, this is a discrete approach, whose conceptual basis will be examined shortly. On the other hand, awards articulating a more liberal approach tend to attach to rebus sic stantibus a broader scope, and are more inclined to adapt the parties’ relationship to the new status quo that resulted from the force majeure conditions. Thus, the loss does not have to lie where it falls, but is equitably allocated. Each of these approaches is the product of either the classical or modern contractual models. The content of each, therefore, is better understood if examined in relation to the conceptual basis of the rebus sic stantibus doctrine.

At this juncture, it should be mentioned that any excuse or suspension of contractual performance because of changed circumstances is, in principle, a departure from the strict application of the classical theory. Nonetheless, modern classical theorists do not adhere to such a strict model, which has been greatly modified to allow for more flexibility towards
modern needs of contracting. Thus; the dividing line between the classical and relational conceptualizations of contractual undertakings is no longer embodied in the recognition of the *rebus sic stantibus* doctrine. Rather, it is more related to the issue of legal consequences. What distinguishes classical from relational thinking is to what extent the *rebus sic stantibus* doctrine is allowed to produce its full effects on the contractual relationship. This issue will be addressed hereafter when examining the conceptual basis of *rebus sic stantibus*.

[...]

9 See generally Hill, C., Reformation to Industrial Revolution (Harmondsworth, 1969); Williams, R., Culture and Society 1780-1950 (Harmondsworth, 1963).
10 For a modern understanding of Natural Law, see Finnis, J., Natural Law and Natural Rights (Oxford, 1980).
11 The state of nature was defined as the condition of society in primitive time where men "... were governed solely by a rational and consistent obedience to the needs, impulses and promptings of their true nature." Black's Law Dictionary, supra n. 7, at 925.
15 Grotius, supra n. 13, Book I, ch. XII; Pufendorf, supra n. 14, Book III, ch. VI.
18 Ibid. at 101.
20 See supra n. 15.
22 Ibid. at 397 (emphasis added). The emphasized words show a balance of interest approach which will be discussed in the General Conclusion, infra.
23 Pufendorf, supra n. 14, ch. III, § 1 ("A man should advance the interest of another man").
24 Grotius, supra n. 13, Book II, ch. XII, § VIII ("The Law of nature enjoins that there is equality in contracts ...."); see also Pufendorf, supra n. 21.
25 Pufendorf, supra n. 14, Book III, ch. IV, § 3.
26 Grotius, supra n. 13, Book II, ch. XII, §§ VIII - XII and §§ XIV and XIX: talk about just price.
2 Unconscionability as a criterion for defining fairness will be mentioned in Chapter VIII. However, the rationale produced in the text equally applies to it. National codes have long recognized good faith as a general principle underlying all contractual obligations regardless of whether it is expressly stated. See, e.g., Articles 1134 and 1135 of the French Civil Code; Articles 157 and 242 of the German Civil Code; UCC 1-201.
3 The duty of good faith is traced back to the natural law school. It is argued that: "[t]he right or the just by nature became law by nature or natural law." Pound further alerted the reader to "[n]ote the way in which the ethical conception of a moral duty was taken over into the law as a duty of good faith in view of the nature of one's undertaking and thus became a legal duty." *Pound, R., Law and Morals* (Chapel Hill, 1924, reprinted Littleton, 1987), at 7, especially n. 14. Transferring
the ethical standard of justice into a legal duty of good faith is attributed to Cicero, De Officiis, Book I, at 7 and 20-23 and Book III, at 17 and 70.


The authority to complement the parties' agreement in the way proposed in the text is subject to much debate, see infra Chapter VIII.


Unger, R.M., Law in Modern Society (N.Y., 1976), at 76 et seq.

See, e.g., South-West Africa Voting Procedure, Advisory Opinion (1955) ICJ Rep. 67, Judge Klaestad, at 88, Judge Lauterpacht, at 118-9; Fisheries Jurisdiction Case (1974) ICJ Rep. 3, at 202 (this note is not in the original text, but is added by the current author).


Fried, supra n. 1, at 78; see also Iran-U.S. Case A/2 (1981-82) 1 Iran-U.S.C.T.R. 101, at 109 (after proving that good faith is part of international law, the tribunal stated: "It is obvious that if an international agreement were to be implemented on the basis of good faith, interpretation of such agreement should necessarily be made on the basis of good faith. The plain meaning of good faith in interpretation of agreements is application of the spirit of honesty and respect for law. To put it more precisely it has been stated that resort should not be made to concealment of reality, fraud and deceit in relations with the other contracting party" (emphasis added)).

ICC award in case no. 5505, Mozambique Buyer v. Netherlands Seller (1988) 13 Yb. Comm. Arb. 110, at 113 and 114; Ad hoc arbitration, Company Z v. State Organization (1983) 8 Yb. Comm. Arb. 94, at 116 (it was expressly stated that the principle of good faith is the basis of all contractual relations). An interesting case where good faith was applied to override a contractual term is the ICC award in case no. 1784, French Claimant Y v. Belgian Respondent X (1977) 2 Yb. Comm. Arb. 150, where the expiration of the contractual guarantee period was not imposed as being contrary to good faith. The tribunal stated: "Allowing such estoppel of the client and the licensee would be contrary to the requirement of good faith which should govern the determination of the parties' obligations and their fulfillment, particularly when the agreement involved is an international contract."


See Amoco International Finance Corporation v. Iran (1987 II) 15 Iran-U.S.C.T.R. 189, at 240 (a contractual clause stating that the parties agreement must be performed "... in accordance with the principles of mutual good will and good faith" was held to simply set "forth a principle of interpretation and implementation of the Khemco Agreement, which, as a long-term contract, implies a continuous cooperation between the parties and therefore must not be performed in a strict and formalistic way").


See supra ch. III.


The question of mistake as to an essential element was addressed on several occasions by the Iran-U.S. Claims Tribunal. See, e.g., Harnischfeger Corporation v. Ministry of Roads and Transportation (1985 I) 8 Iran-U.S.C.T.R. 119, at 133. It was held that, though an essential condition for the implementation of the parties' agreement was lacking, there was no mistake rendering the agreement null. However, the tribunal found that holding the respondents to such agreement would be contrary to good faith. See also FMC Corporation v. Iran (1987 I) 14 Iran-U.S.C.T.R. 111, at 141, where reliance on an erroneous telex was disputed as being contrary to the principle of good faith performance.

These are usually long-term distributorship or consultancy agreements. See, e.g., ICC award in case no. 5073, US
See, e.g., Agrostruct International, Inc. v. Iran State Cereals Organization (1989) 14 Yb. Comm. Arb. 111, at 114; Cf. ICSID case, Gaith R. Pharon v. Republic of Tunisia, in the unpublished pleadings of the parties it was argued that the misrepresentation and concealment of information by the defendant amounted to a breach of the good faith duty to inform. See claimant's memorial, § V, at 121 et seq. This duty was based on article 56 of the Tunisian Code des Obligations et des Contrats; article 1116 of the French Civil Code and precedents of the French Cour de Cassation. This case was settled and therefore the arbitral tribunal had no chance to decide the issue.  

See supra cases mentioned in nn. 19 and 20.  

ICC award in case no. 3572, Deutsche Schachtbau-und Tiefbohrgesellschaft v. Government of the State of R'as Al-Khaimah (1989) 14 Yb. Comm. Arb. 111, at 114; Cf. ICSID case, Gaith R. Pharon v. Republic of Tunisia, in the unpublished pleadings of the parties it was argued that the misrepresentation and concealment of information by the defendant amounted to a breach of the good faith duty to inform. See claimant's memorial, § V, at 121 et seq. This duty was based on article 56 of the Tunisian Code des Obligations et des Contrats; article 1116 of the French Civil Code and precedents of the French Cour de Cassation. This case was settled and therefore the arbitral tribunal had no chance to decide the issue.  

See supra cases mentioned in nn. 19 and 20.  


Swiss Seller v. Dutch Buyer, supra n. 19, at 130.  


The relevant provision of Art. 9 reads as follows: "The Government reserves for itself the right, insofar as this will not have unfavorable effects on the selling of bauxite, to have 50% of the burden to be exported loaded on ships flying the Guinean flag, other assimilated vessels, or ships chartered by the Government itself from the international charter market, and this, at the express condition that the prices in force in these instances be lower or equal to those which would be ascertained on the international charter market under conditions of chartering and international maritime relations similar to those prevailing in the period under consideration."  

See supra n. 28, at 87.  


The number of cases discussed in this section is the best evidence of the proposition made in the text.  

(1990) 15 Yb. Comm. Arb. 30. at 43 (where the court also added: "Insofar as the dealings between the parties did not fall within the provisions of the EPSA, any passing of information was a part of the process of informal collaboration and negotiation, which process is evident from the documents. It would be difficult to see a lack of 'lawful cause' in exchanges of information which may have taken place on this basis.").  

(1990) 15 Yb. Comm. Arb. 11, at 19-20 (emphasis added). Because of the information technology age, the confidentiality issue is being contractually dealt with in considerable detail. This is particularly so of LTICTs involving large investments and tough competition, e.g., petroleum concessions. Illustrative examples of such clauses are articles 34 and 41 of the 1991 Model Production Sharing Agreement between SONANGOL and International Companies which allow the host country to share the information developed by the investor and require prior written approval before release of information. For the text of these articles and other relevant examples, see Basic Oil Laws and Concession Contracts, South & Central Africa, suppl. 109 (Angola) (N.Y.: Barrows, 1992).  

Wintershall/Qatar Arbitration, supra n. 33. In his separate opinion, Prof. I. Brownlie, did not agree with the proposition of the majority and stated: 'The Government was not placed under a duty to inform the claimants about disputes. It is a matter for the appreciation of the Government whether to exercise the power to lay down operating limits within the Contract Area. In any event, the evidence shows that the Government made no effort to conceal the facts and, further,
that the material facts could have been discovered by means of a very simple process of inquiry and research." Ibid. at 51.

36Ibid. at 43.

5The term "duty to renegotiate" is used in lieu of the more frequently used term "duty to renegotiate" for reasons mentioned above in the text. See generally Gebrehana, T., Duty to Negotiate: An Element of International Law (Sweden: Unv. Uppsala, 1978) (discussing the issue from a public international law perspective); Peter, W., Arbitration and Renegotiation of International Investment Agreements (Dordrecht, 1986); Stoever, W., Renegotiations in International Business Transactions (Lexington, Mass., 1981); Sornarajah, "Supremacy of the Renegotiation Clause in International Contracts" (1988) 5 J. Int'l Arb. 97.


9UCC 1-205, which is too long to be reproduced here, deals with the role of trade usage and course of dealing in cases where a contract is silent on a specific matter. UCC 2-204, concerning the same issue, states: "When the parties to a bargain sufficiently defined to be a contract have not agreed with respect to a term which is essential to a determination of their rights and duties, a term which is reasonable in the circumstances is supplied by the court."


11Ibid. para. 260; cf. agreements to agree, supra ch. VIII, n. 48 and related text.


18Supra n. 16.

19AMINOIL Arbitration (1982) 21 I.L.M. 976, (1984) 9 Yb. Comm. Arb. 71, para. 74 of the original award; TACNA-Africa Question, 2 RIAA 925, at 928. But cf. Iran-United States Claims Tribunal, case A/1 (1982-83) 1 Iran-U.S.C.T.R. 189, at 206 (where it was held that: "The parties have requested the Tribunal to decide their dispute on the basis of the documents and arguments presented. They never demanded that the Tribunal fill the alleged gap or on the basis of that gap rewrite the contract for them.").


1No attempt will be made to cover all relevant literature; only selective reference will be made.


3UCC 2-615 provides: "Excuse by Failure of Presupposed Conditions. Except so far as the seller may have assumed a
greater obligation and the subject of the preceding section on substituted performance: (a) Delay in delivery or non-
delivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a 
contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-
occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any 
applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid. (b) Where the 
causes mentioned in paragraph (b) affect only a part of the seller's capacity to perform, he must allocate production and 
deliveries among his customers but may at his option include regular customers not then under contract as well as his 
own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable. (c) the seller 
must notify the buyer seasonably that there will be delay or non-delivery and when allocation is required under paragraph 
(b), of the estimated quota thus made available for the buyer."

§ 208 (1979) include provisions regulating instances of unconscionability. The

4The Restatement (Second) of Contracts, §§ 261-272 (1979), which are too long to be reproduced here, deal with the 
different instances of commercial impracticability and its effect on contract performance. Existing, temporary and partial 
impracticability (§§ 266, 269 and 270) are admitted as grounds for partial relief, suspension or extension of the contract. 
Also, the other provisions reflect a relational approach to contractual undertakings.

5American law on this topic is abundant. However, because of space limitations, not all works will be mentioned. 
See generally Birmingham, "Extending Good Faith: Does the U.C.C. Impose a Duty of Good Faith Negotiation Under 
Long-term Contracts" (1985) Wis. L. Rev. 527; Speidel, "Court-Imposed Price Adjustments under Long-term Supply 
Contracts" (1981) 76 U. L. Rev. 369; Spiegale, "The Turn of the Twentieth Century as the Dawn of Contract 

6Another doctrine used by American courts to revise the fairness of contracts is that of "unconscionability." Here courts 
may refuse enforcement of a contract which involves gross overall one-sidedness or gross one-sidedness of a term. "The 
basic test of unconscionability of contract is whether under circumstances existing at time of making of contract and in 
light of general commercial background and commercial needs of a particular trade or case, clauses involved are so 
onesided as to oppress or unfairly surprise one of the parties. Unconscionability is generally recognized to include an 
absence of meaningful choice on the part of one of the parties to a contract, together with contract terms which are 
unreasonably favorable to the other party." Black's Law Dictionary (5th ed., St. Paul, Minn., 1979), at 1367. UCC 2-302 
and Restatement (Second) of Contracts, §208 (1979) include provisions regulating instances of unconscionability. The 
Swiss Federal Code of Obligations also recognizes this doctrine under article 21, which states: "In the case of an evident 
disproportion in the relative considerations passing between the contracting party taking advantage of the distress, the 
inexperience or the improvidence of the other party, the prejudiced party may within one year rescind the contract and 
demand restitution of the consideration already given. The period of one year commences with the entering into the 
contract."

7Trakman, "Winner Take Some: Loss Sharing and Commercial Impracticability" (1985) 69 Minn. L. Rev. 47.

8In the United States, the observance and sanctity of contracts is regarded as a fundamental right and the United States 
Constitution states that: "No State shall... pass any ... law impairing the obligations of contract." U.S. Const. Art. I, § 10, cl. 
1. Does this constraint equally apply to court decisions? If it does, then adaptation would not be allowed. For further 
discussion of this issue, see Thompson, "The History of the Judicial Impairment 'Doctrine' and its lessons for Contract 

9Comment, "Contractual Flexibility in a Volatile Economy" (1978) 72 U. L. Rev. 1032, at 1053.

Kingdom" (1986) Jurid. Rev. 1; Gorman, "Commercial Hardship and the Discharge of Contractual Obligations Under 


12The English doctrine of frustration has been restrictively interpreted by some international arbitrations, see, e.g., ICC 

13French Civil Code, article 1148 states: "No damages arise when, as a result of an act of God or of a fortuitous event, the 
debtor was prevented from giving or doing that for which he had obligated himself, or did what was forbidden to him."

14The impossibility doctrine was derived from several provisions of the Swiss Federal Code of Obligations. The most 
influential and most frequently referred to are articles 97, 119 and 373, which respectively state: "97. The debtor who fails 
to perform his obligation or does not fulfill it properly is liable for damages, unless he proves that there is no fault on his 
part .... 119. An obligation is discharged to the extent of its performance becoming impossible by circumstances which the 
debtor cannot be made responsible. In the case of bilateral contracts the debtor so discharged is liable for any 
consideration previously received in accordance with the provisions governing unjustifiable enrichment and cannot claim
performance of the executory part of the contract. This provision does not apply to cases where, either by law or agreement, the risk passes to the creditor before the obligation is performed. ... 373. Where the exact price is fixed in advance, the contractor must complete the work for such price and may not increase the price even though he incurred more labour or expenses than anticipated. But where extraordinary circumstances which could not be foreseen, or which were excluded by the basis upon which both parties entered into the contract, prevent or unduly impede the completion, the court may at its discretion increase the price or rescind the contract. The party who ordered the work owes the full price even though the completion of the work caused less labour than anticipated."


17Article 1134 states: "Agreement legally made take the place of law for those who make them. They may be revoked only by mutual consent or for causes which the law authorizes. They must be executed in good faith." Article 1135 was also used as a control device under this article: "Agreements obligate 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."


20See awards mentioned supra n. 16.


24Article 275 states: "Impossibility for which one is not responsible (1) The debtor is relieved from his obligation to perform if the performance becomes impossible because of a circumstance, for which he is not responsible, occurring after the creation of the obligation. (2) The inability of the debtor to perform after the creation of the obligation is equivalent to subsequent impossibility of performance."


26See supra n. 22.


For a list of relevant cases and comments, see Oppenheim, supra n. 32, § 651, nn. 6-11; Brownlie, supra n. 32, at 620, nn. 85-88.

In many arbitrations, rebus sic stantibus was applied though there was no contractual clause to the effect, see, e.g., Reliance Group, Inc. v. Iran (1987 III) 16 Iran-U.S.C.T.R. 257, at 269; Ad hoc Tribunal (Washington, DC, 1991).


Referring Principles:

I.1.1 - Good faith and fair dealing in international trade
IV.1.2 - Sanctity of contracts
IV.6.7 - Duty to renegotiate
IV.6.9 - Duty to notify / to cooperate
VIII.1 - Definition