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Expect the Unexpected: A Report from the 31st Annual ITA Workshop on Adjudicating Changed Circumstances in Commercial and Treaty Arbitration

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Reflecting on fallout from economic and geopolitical turmoil since the financial crisis of 2008, the 31st Annual ITA Workshop and Annual Meeting, held in Dallas on June 19-21, 2019, focused on how to adjudicate changed circumstances in international arbitration.

Keynote speakers and panelists engaged in lively debates on how domestic and international legal principles on changed circumstances have evolved in response to major events, such as the imposition of tariffs and sanctions, political upheaval, sustained swings in commodity prices, coercive pressures from rent-seeking state actors, and the particular challenges associated with long-term contracts in light of such changes. Co-chairs Dean Céline Lévesque (University of Ottawa), Tomasz Sikora (Exxon Mobil), and Gaëtan Verhoosel (Three Crowns) led the two-day Workshop, which featured a stellar faculty of practitioners, academics, and in-house counsel from around the world, including keynote speakers Yas Banifatemi (Shearman & Sterling) and Professor Klaus Peter Berger (University of Cologne), as well as a lively debate with active audience participation.

Among other examples, the Workshop drew on the transformation of the natural gas economy. Before 2009, natural gas prices were strongly correlated with oil prices. But this changed with the fracking boom in the United States and elsewhere, which led to a shift in the economics of producing, selling, and purchasing natural gas. Moreover, the boom in natural gas production, its commoditization, and increased global trade in LNG (liquefied natural gas) also affected the prices of other energy sources—chief among them lignite or brown coal. Massive swings in currency exchange rates due to sanctions (*e.g.*, on the Russian Federation and Iran) or monetary crises (*e.g.*, in Argentina and Turkey) also proved troublesome for contracting parties located or invested in affected markets. Geopolitical developments—from the Arab Spring, to Brexit, to China's Belt and Road Initiative—likewise led to disputes over the continued enforceability of previous contractual arrangements.

Faced with these and many other developments bearing on long-term transnational contracts and investments, the international arbitration community has routinely been

tasked with considering the extent to which changed circumstances should affect bargains reached before such circumstances were, or could have been, foreseen.

This question poses a classic dilemma for legal systems, pitting the ancient Roman legal doctrine of *pacta sunt servanda* (sanctity of contracts, or stability of contractual relations) against that of *clausula rebus sic stantibus* (recognizing the need for change in light of evolved conditions). Put simply, should legal certainty prevail even if continued performance of the contract on its original terms would no longer be fair vis-à-vis the circumstances present at the time of the contract's formation? There was broad agreement among Workshop panelists that the answer lies in striking a balance between the two doctrines—a balance that must be based on the particular circumstances of a given case. A decade of tremendous volatility appears to have bolstered awareness—both at the contract formation stage and in arbitral disputes—that the governing law must address changed circumstances in some manner.

Professor Klaus Peter Berger, in his keynote address, examined developments in substantive law as well as international arbitral practice. He discerned a trend away from formalistic insistence on the sanctity of contracts and toward a more pragmatic approach that has as its primary objective the maintenance of the "contractual equilibrium", which takes into account not only the terms of the contract but also the parties' assumptions when the contract was formed. In other words, if circumstances change to such an extent as to disturb this equilibrium, the applicable law should provide mechanisms for recourse.

Force majeure and hardship exceptions,[1)] whether as contractual provisions or as operative legal doctrines found in domestic law or international contract principles, are such mechanisms. While the former is generally limited to circumstances that render performance impossible, the latter tends to be more permissive in scope—performance may be technically possible yet onerous. Civil law countries once resisted the inclusion of hardship provisions in their codified contract law. As Professor Berger pointed out, however, Germany was among the first to reevaluate its stance, or as he put it, Germany allowed "what [was] thrown out through the door [to] reenter through a window". Although the German Civil Code of 1900 had failed to recognize changed circumstances as an exception to legal certainty, the hyperinflation of the early 1920s gave rise to a codified right to terminate a contract in particular circumstances, which is now contained in Civil Code Section 313. More recently, in 2016, French Civil Code Section 1195 came to recognize a similar, albeit narrower, right when changes in circumstances have rendered performance "excessively onerous". Other jurisdictions, among them Italy and the Netherlands, have similar provisions. The same principle is reflected in the UNIDROIT Principles of International Commercial Contracts (Articles 6.2.1 and 6.2.3).

From these and other developments, Professor Berger discerned a trend that, while arguably running the risk of undermining legal certainty, may give better effect to the parties' commercial intent, particularly in long-term contracts of ten years or more requiring large front-loaded investments that are only recoupable over the life of the contract.

Professor Berger proposed that, in tackling changed circumstances, tribunals should adopt a three-step analytical framework:

1. Tribunals should verify that the *lex arbitri* provides procedural authority for adapting a contract to changed circumstances. This authority, according to Professor Berger, may be derived from either an explicit statutory warrant, such as the gap-filling provisions in Swedish and Dutch law, or as a function of plenary arbitral powers granted to tribunals in jurisdictions such as Germany.
2. Tribunals should confirm that they have explicit substantive authority to adapt the contract—either in the contract itself or in the contract's governing law. If not, tribunals must ask whether the governing law provides an implied duty of good faith that could support adapting the contract. According to Professor Berger, an implied duty of good faith provides a tribunal with sufficient authority to adapt a contract in light of changed circumstances under the *clausula.* Because such a duty is recognized broadly, with at least one notable exception, Professor Berger's rationale would lead to widespread acceptance of a duty to renegotiate,[2)] as well as recognition of arbitral tribunals' authority to adapt contracts in light of changed circumstances.
3. Finally, what standard should govern the adaption of a contract? Drawing on several ICC awards, Professor Berger argued that the governing standard should consist of reestablishing the parties' contractual equilibrium. He acknowledged that hardship and force majeure may introduce uncertainty into commercial relationships, but emphasized that principles of good faith and reasonableness "can promote commercial predictability and efficiency, provided that their application remains within the confines of the parties' initial bargain".

Beyond doctrinal considerations, the ITA Workshop presented a host of perspectives on changed circumstances in commercial and investment arbitration across the globe. For example, Laura Sinisterra (Debevoise & Plimpton) explained how arbitral tribunals have recognized, at least in principle, Ecuador's right under established contracts to effect significant increases in oil-revenue percentages payable to the government. Considering changed circumstances from yet another angle, a panel, comprised of current and former government officials and moderated by Dean Lévesque, considered states' efforts to protect their right to regulate. In negotiating recent multilateral agreements, such as the TPP and CETA, governments were reported to have worked toward that objective by maximizing the specificity of investor protections.

In an ideal world, parties could foresee all future eventualities at the contract formation stage and tailor their contracts accordingly. Short of such clairvoyance, conference participants generally agreed that a modicum of contractual flexibility is arguably unavoidable. Recognizing this alone, of course, would be only an initial step in defining the legal doctrines addressing changed circumstances; ultimately, their application by arbitral tribunals will be determinative.

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References

↑1 For a recent analysis of ICC awards addressing the interplay of force majeure contract clauses and domestic law, please refer to Klaus Peter Berger, *Force Majeure Clauses and Their Relationship With the Applicable Law, General Principles of Law and Trade Usages*, in Hardship and Force Majeure in International Commercial Contracts 137 (Fabio Bortolotti & Dorothy Ufot eds., 2018).

↑2 *See* Klaus Peter Berger, *Renegotiation and Adaption of Int'l Investment Contracts: The Role of Contract Drafters and Arbitrators*, 36 Vand. J. Transnat'l L. 1347, 1357 (2003) (asserting that "there are good reasons to assume the existence of such a transnational legal principle").

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