1. Introduction

There are various contractual arrangements through which a party (normally a foreign private party) makes an investment in the oil and gas fields. The most important category is represented by agreements in the field of petroleum exploration and production, be they in the form of concession agreements, production sharing contracts, service contracts or other types of contractual relations.

Two characteristics are common to these various agreements. Firstly, they are concluded by the investor with a State or a State entity, the latter being entrusted by the State with the task of administering in the public interest the country’s petroleum resources.\(^1\) The second characteristic is their duration. By its nature, an investment implies the establishment of a relation with the territory of the host State by far exceeding that of a normal commercial contract between private parties. The very nature of the activity to be deployed by the investor under this type of arrangements, characterized by the various phases of the petroleum operations (exploration, development, production, transport, storage and other downstream activities), demands a long-term duration (normally, averaging 20–30 years, or even more under the still surviving concession agreements).

In the presence of the mentioned characteristics the question has been raised whether the need to protect the private investment makes it advisable to include a stabilization clause in the contract in order to ‘freeze’ the parties’ rights and obligations in the name of the sanctity of contracts (\textit{pacta sunt servanda}) or whether an adaptation clause should be added providing for the renegotiation of the contractual conditions in the presence of a change of circumstances, in the name of the \textit{rebus sic stantibus} rule.\(^2\) In order to give an answer to these questions, a certain number of preliminary remarks are to be made.

Stabilization and adaptation clauses are the two ways to achieve the parties’ common objective to allocate between them the risk inherent in a long-term transaction. Obviously, there is a level of risk that experienced parties have to accept to bear also in this kind of transactions to ensure contractual stability. Accordingly, risk allocation clauses are triggered only in the presence of situations which the parties believe to exceed the level of acceptable risk in transactions of this nature. In the absence of a pre-determined level of such acceptable risk,

\(^{1}\) This is the task of the various entities established by States since the years ’50 to administer the country’s petroleum resources, such as the National Iranian Oil Company (NIOC), the Libyan Oil Company (LNOC), the Abu Dhabi National Oil Company (ADNOC), the Egyptian National Oil Company (EGPC), the Saudi Arabian PETROMIN, the Indonesian PERTAMINA and many others.

the conditions for triggering any such clauses will depend on the specificities of each contractual arrangement, the parties’ interest in concluding the same and their respective bargaining power. This explains why stabilization clauses may have different objects and why renegotiation clauses may be triggered by a variety of different events.

Stabilization and adaptation clauses may coexist in the same agreement, their objectives being different.

By a stabilization clause the State accepts that the exercise of its legislative and administrative powers will not have the effect of modifying the contractual conditions agreed with the investor to the latter’s detriment. As such, this clause reinforces the principle of the sanctity of contracts by protecting only the private party against actions of the State party. On the contrary, an adaptation clause operates in the presence of a change of circumstances beyond the control of the parties which causes a substantial modification of the economic equilibrium of the contract. It may be invoked by the party whose obligations have thus become more onerous, its objective being to protect the aggrieved party, be it the State (or the State entity) or the investor. Although, traditionally, attention has been rather paid to the investor’s protection, a significant number of renegotiations of petroleum agreements have been initiated by host States or State entities.

Another difference between the two situations is worth mentioning. Stabilization, to be a valid and enforceable undertaking, must be agreed by the State, only the latter having the power to guarantee the investor against the enforcement of its own laws or administrative acts. This means that the State entity signatory to the contract with the investor may not validly guarantee stabilization unless specifically empowered to that purpose by the State or unless the relevant undertaking is endorsed by the State.

On the contrary, adaptation may be triggered either by the parties’ agreement (through a renegotiation or a similar clause of their contract) or, in the parties’ silence, by the law governing the agreement. The question has been raised whether adaptation may be invoked by an aggrieved party even in case the agreement does not include provision for renegotiation and the applicable law is silent on this point. Two conflicting views have been expressed in this regard. One view asserts that any long-term contract requires adaptation in case of a change of circumstances, *rebus sic stantibus* being inherent in any such contract in application, also of good faith and fair dealing. The opposite view contends that the parties to such type of agreements are usually experienced professionals, well able to negotiate an adaptation clause if the latter is considered a necessary or desirable addition to their contract. Therefore, the absence of such a clause may only mean that the parties, in the

---

3 And within the State by the body empowered to engage the State in that regard.

4 *Rebus sic stantibus* has sometime been considered as a rule of the *lex mercatoria*: Mustill, *The New Lex Mercatoria: The First Twenty-five years, Liber Amicorum for Lord Wilbeforce* (1987) 176 (under 9). See also ICC Award No 2291 (1975), J Dr Int (1976) 989: ‘any commercial transaction is based on a balance between the reciprocal obligations and . . . to deny that principle would amount to deprive commercial contracts of all certainty, and to have them based on speculation or chance. Lex mercatoria contains a rule whereby the obligations should remain balanced from a financial point of view.’ Reference has also been made to good faith which would prevent a party from insisting on contract performance as originally agreed when such claim would be abusive: ICC Award No 3267 (1984) YB Com Arb (1987) 93; award of 6 July 1983, YB Com Arb (1984) 70.

5 ICC Award No 6281 (1989), YB Com Arb (1990) 98: ‘Otherwise, any business transaction would be exposed to uncertainty, or even be rendered impossible altogether, whenever the mutual covenants are not performed at the time at which the contract is concluded.’
exercise of their autonomy, have chosen to ensure the stability of their contractual relations rather than the adaptation of its terms in case of a change of circumstances.

2. Stabilization and adaptation in practice

Stabilization

Stabilization clauses aim at protecting the private investor by restricting the legislative or administrative power of the State, as sovereign in its country and legislator in its own legal system, to amend the contractual regulation or even to annul the agreement. Protecting the investor against what the French doctrine has aptly called aléa de la souveraineté serves also to dispel doubts regarding the possible characterization of these agreements as administrative contracts in view of the prevailing public interest pursued by the State (the exploitation of its natural resources for the country’s benefit).6

Stabilization may be ensured by providing that:

(i) The agreement takes precedence over any provisions enacted subsequent thereto by way of legislation or administrative regulation if the effect of such provisions is to the investor’s prejudice,7 a result that may be achieved only by conferring to the agreement of the force of law so that its provisions may not be modified by general legislation.8

(ii) Any modifications of the terms and conditions of the agreement may only be made by mutual written consent of the parties, the effectiveness of this kind of provision depending again upon the agreement having acquired the force of law.9 Or

(iii) The law applicable to the development agreement is the law of the host State in force at the time of the conclusion of the contract, thus excluding the applicability of any future laws and regulations (a provision referred to as freezing of the law).

Clauses of this kind aim at guaranteeing the stability of essential conditions of the agreement bearing upon the return on the private party’s investment, such as fiscal regime, labour legislation, companies’ and exchange control regulations. They may sometimes even provide for the State’s undertaking not to expropriate or nationalize the

---


8 This is the pattern followed in Egypt, Qatar and other Middle East countries as well as in countries of the former Soviet Union, as is the case of the Republic of Azerbaijan, where a petroleum agreement was made subject as to its effectiveness to ‘legislation giving this Agreement the full force of law’: Barrows, cit, Suppl 23.1 (1993).

9 See, eg, Production Sharing Contract between Pertamina and Agip SpA of 10 October 1968, art XVI.1.2.: “This Contract shall not be annulled, amended or modified in any respect except by the mutual consent in writing of the Parties hereto”, to be read in conjunction with the endorsement of the Contract by the Ministry of Mining on behalf of the Government. See also the concession agreement between the Ruler of Sharja and an oil company of 1975, providing (in art XXXIII) that the same may not be amended or annulled except by mutual consent and (in art XXXIV, lit G) that “This Agreement shall have the force of law”.

---
investment. No renegotiation of the investment agreement is produced by a stabilization clause since, as their name indicates, these clauses aim at preserving the contractual terms and conditions as originally agreed by the parties rather than modifying them in any respect (the clauses in question are sometimes significantly referred to also as *clauses d’intangibilité*). The effectiveness of such provisions may be doubted whenever they purport to limit the States’ inalienable prerogatives, as it would be the case of a stabilization clause providing for the prohibition of nationalization or expropriation. It is a principle of public international law that States may not renounce sovereign prerogatives, the exercise of which is instrumental to the pursuance of the country’s essential public objectives. A stabilization clause contradicting mandatory rules of international law (*jus cogens*) may not therefore produce its typical effects.\(^{10}\) The principle of permanent sovereignty of each State over its natural resources\(^ {11}\) assumes in this context a significant relevance. The qualification of the State’s sovereignty as *permanent* has led States to consider that the right to exploit the natural resources is inalienable so that it cannot be hindered or restricted by commitments conventionally undertaken *vis-à-vis* other States or private parties.\(^ {12}\) In case of breach by the State of the undertaking under a stabilization clause, an arbitral award may enjoin the State to refrain from applying the new laws and regulations to the private party,\(^ {13}\) or in a more realistic alternative, may condemn it to compensate the latter for the economic prejudice suffered because of the breach of such an undertaking.\(^ {14}\) Although in this context the State might raise before an international arbitrator the defence regarding the inalienable character of its sovereign rights in order to void the clause of its effects, the reliance created in the private party by the State’s promise is a sufficient strong argument to convince the international arbitrator that the foreign investor is entitled to compensation for any damage so caused, even if the breach by the State of its stabilization commitment might not be qualified as internationally unlawful.

### Adaptation

As an alternative to or in combination with a stabilization clause, the adaptation/renegotiation clause may offer both parties protection against the hardship caused to either of them by a change of those circumstances which were present at the time of the conclusion


\(^ {11}\) The most authoritative instrument affirming this principle is the Charter of Economic Rights and Duties of States, approved by Resolution No 3281 (XXIX) of 12 December 1974 of the United Nations General Assembly. See also UN General Assembly Resolutions No 1803 (XVII) of 14 December 1962 and No 3171 (XXVIII) of 17 December 1973 affirming the permanent sovereignty of each State over its national resources.

\(^ {12}\) See, in this context, OPEC Resolution XVI.90 of 24–25 June 1968 (Declaratory Statement of Petroleum Policy in Member Countries) which, after recalling in the preamble the UN General Assembly Resolutions on ‘the inalienable right of all countries to exercise permanent sovereignty over their natural resources in the interest of their natural development’ declares open to renegotiations the financial provisions of petroleum agreements resulting in excessively high net earnings ‘notwithstanding any guarantee of fiscal stability’.

\(^ {13}\) This was the kind of award issued by the sole arbitrator, Prof. René-Jean Dupuy, in the *Texaco Calasatic v Government of Libya* case on 19 January 1977, by ordering Libya the *restitutio in integrum* in favour of the company whose concessionary rights had been nationalized (YB Com Arb 1979, 177).

\(^ {14}\) A similar award was issued under an ICSID arbitration on 30 November 1979 in *AGIP SpA v People’s Republic of Congo Brazzaville* (ICSID Case No ARB/77/1), reprinted (in the English translation) in 1 ICSID Rep 306 et seq (1993). The same conclusion was reached by the Aminoil award of 24 March 1982 (referred to in n 26).
of the agreement. By undertaking to renegotiate in good faith the agreement in case of any such change the State (or the State entity) binds itself to conduct negotiations with the private investor instead of unilaterally altering the terms of the agreement. Two types of renegotiation clauses are recorded by the practice of petroleum agreements.

Doubts concerning the legal effectiveness of stabilization clauses (to which reference has been made before) and the State’s desire to preserve its sovereign prerogatives have brought about in the most recent phase a new approach providing that if future laws or regulations enacted by the host State should affect the foreign investor’s contractual position, negotiations shall be entered into in good faith in order to reach an equitable solution to maintain or restore the economic equilibrium of the agreement. A clause evidencing this approach may be found in the Model Exploration and Production Sharing Agreement of 1994 of Qatar (art 34.12, under the heading ‘Equilibrium of the Agreement’). Other agreements provide that, in addition to the renegotiation of their terms with the aim of restoring the economic equilibrium of the parties, the State entity shall indemnify the foreign party for any loss or damage ensuing from the change of circumstances. “An example of an economic stabilization clause may be found in a Petroleum Production Sharing Agreement concluded on 10 November 1995 between the State Oil Company of the Azerbaijan Republic and a consortium of oil companies.” The inventory of clauses reflecting the new approach in petroleum agreements, far from being exhaustive, is sufficient to reveal the basic features of the stipulations under consideration. These, with their variants, may be summarized as follows:

(i) The clause is alternative to a stabilization clause, the latter more and more rarely to be found in these agreements.

(ii) Contrary to a stabilization clause, which records the State’s undertaking not to apply new laws and regulations to the private party’s detriment, an economic stabilization clause is more in the nature of a private law arrangement between the parties.


16 Barrows, Middle East, Suppl 124, 1 (1995), reproduced in Annex 1. Also the Model Production Sharing Agreement of 20 March 1997 for Petroleum Exploration & Production of Turkmenistan contains a similar provision (in art 16-6): “Where present or future laws or regulations of Turkmenistan or any requirements imposed on Contractor or its subcontractors by any Turkmen authorities contain any provisions not expressly provided for under this Agreement and the implementation of which adversely affects Contractor’s net economic benefits hereunder, the Parties shall introduce the necessary amendments to this Agreement to ensure that Contractor obtains the economic results anticipated under the terms and conditions of this Agreement” (Barrows, Russia & NIS, Suppl 26, 75 (1997)). Similarly, the Model Contract for Oil & Gas adopted by the Republic of Kazakhstan by Decree 108 of 17 January 1997 provides (in s 28) that in case “[a]mendments and additions to legislation . . . cause a deterioration in the status of the Contract, paragraph 16 shall apply.” The latter provides that the parties shall meet “and, in case consensus is reached, introduce such amendments or alterations into the Contract, which are necessary to restore the economic interest of the parties to their status as of the moment of signing the Contract” (Barrows, Russia & NIS, Supp 25, 1 (1997)).

(iii) The clauses in question give rise to the State’s, or the State entity’s, undertaking to compensate the private party for the economic prejudice suffered by the reason of any new laws or regulations affecting specific contractual terms (eg in the field of taxation) or, more generally, the terms and conditions of the agreement.

(iv) They do not infringe upon the State’s sovereign prerogatives, which remain unfe
terred consonant to their nature, but open the way to the renegotiation of certain terms of the agreement.

(v) They may be agreed upon by the State entity as signatory to the petroleum agreement.

The renegotiation process described above is triggered by a pre-defined change of circumstances, the one caused by the issuance by the host State of new legislation negatively affecting the private investor’s interest, and is directed to protect only the latter’s interests (as any stabilization clause).

The other type of renegotiation clause is an adaptation clause of general application, leading to the renegotiation of the agreement upon initiative of either the State (or the State entity) or the investor. The clause is triggered by supervening events which are beyond the control of the parties and which negatively affect the contractual equilibrium to the detriment of either of them. A workable renegotiation clause of this kind presupposes the definition of

(a) the change of circumstances triggering the renegotiation;

(b) the effect of the change on the contract;

(c) the objective of the renegotiation;

(d) the procedure for the renegotiation;

(e) the solution in case of failure of the renegotiation process.

Triggering events, effect and objective of the renegotiation are often defined in general terms, sometimes for lack of care and some other times in order to leave greater flexibility to the negotiation process. Some adaptation clauses provide that rather than being implemented on occasion of a change of circumstances, a process of consultation between the parties is to take place at periodic intervals (eg every 3 years) to consider whether modifications to the agreement would be appropriate in the light of a change in the parties’ expectations.

**Change of circumstances triggering renegotiation**

This is the first element to be identified when drafting a renegotiation clause. To try to make an inventory of triggering events would be a fruitless exercise in view of the large variety of formulations to be found in adaptation clauses. A number of clauses include events which are not defined, such as ‘a substantial change in the circumstances existing on the date of the agreement’ or, more simply, ‘a change of circumstances’.

Some of the circumstances may be directly related to the agreement (such as an intervening imbalance in the economic equilibrium), while others are external to the
agreement (such as problems of balance of payments by the State). The reference to the principle of ‘change of circumstances’ as a ground for revising the parties’ rights and obligations under their contractual arrangements is contained in national legislations, international treaties and other important texts having a transnational dimension.

One of such texts is OPEC’s Resolution XVI.90 of 24–25 June 1968 which relies on the principle of changing circumstances to justify the acquisition by Member Governments of a reasonable participation in the ownership of the concession-holding companies. Another important text is the UNIDROIT Principles of International Commercial Contracts (2004) which (in ch 6, s 2) regulates ‘Hardship’. This is defined as the occurrence of events fundamentally altering the equilibrium of the contract (art 6.2.2) so as to entitle the aggrieved party to request renegotiations of the contract (art 6.2.3).

Among the international treaties making reference to the change of circumstance as triggering contract adaptation is one of the Algiers Agreements of 1981. The Agreement in question has established an arbitral mechanism to settle disputes arising from acts of nationalization, expropriation, contractual breaches and other measures having affected US nationals’ interests in Iran following the overthrowing of the Shah by the Khomeini revolution in 1979. Regarding the law applicable to the substance of the dispute, the Agreement prescribes (in art V) “the respect of the law... taking into account relevant usages of the trade, contract provisions and changed circumstances”.

Adaptation clauses are sometimes more precise in an attempt to circumscribe the event or events triggering renegotiations. A feature common to such clauses is that the event must not be within the control of the party invoking it to obtain some kind of relief, although this condition is not always spelled out clearly by the clause. Some clauses provide that contract changes shall have no retroactive effect.

**Effects of the change on the contract**

Adaptation clauses should apply only in exceptional circumstances. This requirement is defined in a variety of ways having all, as a common denominator, the conditions that the...

---

18 OPEC Resolution XVI.90 of 24–25 June 1968, cited in n 12, provides as follows in the part dealing with ‘Participation’: “Where provision for Governmental participation in the ownership of the concession-holding company under any of the present petroleum contracts has not been made, the Government may acquire a reasonable participation, on the grounds of the principle of changing circumstances. If such provision has actually been made but avoided by the operators concerned, the rate provided for shall serve as a minimum basis for the participation to be acquired”. OPEC policy regarding participation has produced, as most significant result, the acquisition by some Member Governments of 25% participation in existing concessions and the oil companies’ undertaking to allow, within ten years, for the acquisition of up to 51% participation (General Agreement on Participation, signed in New York on 20 December 1972).

19 ILM, 1981, 230 at 232. Among changes in circumstances taken into account by the Iran–US Claims Tribunal were sometime changes consequent on the Iranian Revolution (ie changes in the political and legal climate in the country). In the Questech case, Iran successfully invoked the radical political change in the country for a contract involving the sensitive area of national security (9 Iran–US CTR, 123, with dissenting opinion of Holtzmann). In other decisions, political and social changes brought about by the Iranian revolution have not been considered as ‘changed circumstances’ giving rise to relief (as in the Amoco International Finance and the Phillips Petroleum decisions).

20 Such as the clause referring to a novel economically available source of energy. An attempt to circumscribe the kind of changes triggering adaptation was made by the Supplemental Agreement of 1961 between Kuwait and Aminoil (see clause in Annex 3).

21 Unforeseeability of the event is another way of expressing this condition (ad hoc award of 6 July 1983, YB Com Arb 1984, 70). The consequence is that if the aggrieved party could have foreseen or has caused, or contributed to cause, the event it may not claim renegotiation of the contract to its benefit.

22 See clause in Annex 4.
change must be such as to cause a disproportionate prejudice or substantial detriment or substantial economic imbalance to the interests of one of the parties or to “materially affect the economic and financial basis of the agreement” or “the consequences and effects of which are fundamentally different to what was contemplated by the parties at the time of entering the agreement.” As to the immediate consequences of the change of circumstances on the contract, adaptation clauses normally provide that the aggrieved party may not suspend its performance, at least during the period of renegotiation.

**Objective of the renegotiation**

The extent to which the agreement may be changed is often independent of the triggering event and is to be determined on the basis of the specific wording of the clause. Such wording may be generic, adopting subjective standards (such as removing the unfairness or adopting an equitable revision) or such as to protect both parties by referring to an objective standard (as “restoring the original contractual equilibrium”)\(^23\) or only the private party (by making sure that it will obtain “the economic results anticipated under the terms and conditions of this Agreement”).\(^24\) In general, the meaning of an adaptation clause cannot possibly be to let only one contracting party feel the consequences of changed circumstances.\(^25\)

**Procedure for renegotiation**

Whenever all conditions are met for implementing the adaptation clause, a negotiation phase is open, normally for a specified period of time, in view of restoring the contractual equilibrium. This originates various problems:

(i) The parties’ obligation during this phase should be precisely defined. The engagement to use their best endeavours or to do their outmost to reach an agreement does not imply an obligation to conclude an agreement on the revised terms;\(^26\) failure to agree is not therefore a breach of contract for which either party might be held responsible.

(ii) The clause may leave open by its wording whether the objective of restoring the original equilibrium implies, in the parties’ common intent, that full compensation should be paid to the aggrieved party or that some consideration should also be given to the public party’s interest, particularly when the clause sets as a target the reaching of an equitable solution.

(iii) A common feature of any process of renegotiation is that the same should be conducted in good faith. Lack of good faith will be taken into consideration by a judge or an arbitrator called upon to settle the dispute resulting from the failure of the renegotiation process.

\(^{23}\) As in the case of the Qatar Model Exploration and Production Sharing Agreement of 1994: see n 16 and the text in Annex 1.

\(^{24}\) Model Production Sharing Agreement for Turkmenistan: see n 16.

\(^{25}\) Ad hoc award of 6 July 1983, YB Com Arb 1984, 70.

\(^{26}\) In the award of 24 March 1982, settling the dispute between the American Independent Oil Company (Aminoil) and the Government of the State of Kuwait, the Arbitral Tribunal considered the extent of the obligation to negotiate contemplated in art 9 of the Supplemental Agreement, concluding that ‘an obligation to negotiate is not an obligation to agree’ (the award is published in 24 ILM 976 (1982)). See the text of art 9 in Annex 3.
The solution in case of failure of the renegotiation process

The crucial issue concerns the aggrieved party’s position, and, more generally, the fate of the contract in case the parties fail to reach agreement on the adaptation of the contractual terms by the end of the time-limit normally set to the phase of direct negotiations. The parties’ disagreement may relate to:

(i) The existence of the conditions set by the contract for the renegotiation, namely whether a new law or regulation adversely affects the contractor’s rights or interests (Azerbaijan) or its financial position (Qatar) or its net economic benefits (Turkmenistan) or causes a deterioration of the status of the contract (Kazakhstan) or whether a substantial and unforeseeable change of circumstances has intervened altering the economic equilibrium of the contract.

(ii) The terms and conditions which should be made subject to revision and the extent of such revision in order to re-establish the economic equilibrium of the parties (Azerbaijan) or to reach an equitable solution that maintains the economic equilibrium of the agreement (Qatar) or to ensure that Contractor obtains the economic results anticipated (Turkmenistan).

The role of the international arbitrator in the contract adaptation

The parties’ disagreement regarding the conditions for the renegotiation will, in case of failure of the renegotiation process, give rise to a dispute which may be referred to arbitration according to the relevant clause of the agreement. The arbitrator shall determine whether and to what extent the events alleged by one of the parties meet the conditions set forth in the agreement for such renegotiation. Should the arbitrator determine that such conditions are not met, the agreement shall continue in full force and effect. Should the arbitrator’s decision be in the opposite direction, three alternative solutions will be open regarding the consequences to be drawn there from, depending also upon the parties’ claims before the arbitrator:

(i) The arbitrator may invite the parties to attempt to negotiate once again the terms of a revised agreement based on his (her) findings.

(ii) If such an attempt is unsuccessful, or in its absence, the arbitrator may determine that only the parties are entitled to proceed to the revision of the agreement, in which case he (she) may either declare that the latter is to continue or may declare its termination should it be found that the other party failed to act in good faith during the negotiation phase, in which case compensation may in addition be awarded to the aggrieved party.

---

(iii) The arbitrator may proceed to determine the manner in which the terms of the agreement should be revised in order to comply with the parties’ objective of restoring the contractual equilibrium and shall issue an award effectuating such a revision.

While solutions (i) and (ii) above are within the arbitrator’s normal adjudicative powers, solution (iii) poses delicate problems regarding the nature and extent of the arbitrator’s intervention, considering that an arbitrator normally lacks the power to rewrite the parties’ agreement.\(^{28}\) It should also be added that the trend evidenced by arbitral awards is rather in favour of a restrictive view of the arbitrator’s powers to adapt a contract, even a long-term one, in case of a change of circumstances.\(^{29}\) The arbitration clause should therefore expressly confer the power to adapt the agreement and determine the manner for its exercise as well as the limits of the arbitrator’s authority in that regard. This means that the simple reference to arbitration in case of failure by the parties to agree on the terms of the revision\(^{30}\) will not be sufficient to imply such a power, unless the same is specifically granted. The same conclusion will apply, for even stronger reasons, in the absence of such reference in the adaptation clause, the presence of an arbitration clause in the agreement\(^{31}\) not allowing per se to conclude that the arbitrator has the power to intervene to modify the agreement in lieu of the parties. It is worth noting that certain texts to which the parties may have made reference in their contract provide for the court’s power either to terminate the contract or to adapt it with a view to restoring its equilibrium, as in the case of the UNIDROIT Principles (art 6.2.3(4)). A reference of this kind is sufficient to confer to the arbitrator the power to adapt the contract. Other clauses specifically exclude the arbitrator’s intervention in the process of contract adaptation.\(^{32}\)

To determine the extent of its powers, the arbitrator shall look first to the law of the seat (\textit{lex arbitri}) to establish whether the latter prohibits the adaptation of contracts by an arbitrator.\(^{33}\) As a second step, the arbitrator will consider the \textit{lex contractus} in order to

\(^{28}\) See Mann, \textit{The Aminoil Arbitration}, 14 Brit YB Intl 213 (1984), at 218: “The interesting and important question which frequently arises in arbitration proceedings concerned with long-term contracts clearly embedded in a municipal system of law is whether an arbitrator has the power to impose the agreement which the parties were unable to reach.” The award in the Aminoil case decided that “an arbitral tribunal … could not, by way of modifying or completing the contract, prescribe how a provision such as the Abu Dhabi Formula must be applied. For that, the consent of both parties would be necessary.” (para 74 of the award cited in n 26). The same attitude was shown by the Paris Court of Appeal in the \textit{EDF v Shell Français} judgment of 28 September 1976, Rev Arb 1977, 341 et seq.

\(^{29}\) More than often arbitrators rely rather on \textit{pacta sunt servanda}. In the \textit{Sapphire v National Iranian Oil Company} award of 15 March 1963, for example, they expressly 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” (ILM 1967, 181). See also ICC Award No 1512 (1971), YB Com Arb 1976, 129; No 2321 (1974), J Dr Int 1974, 938; No 2404 (1975), J Dr Int 1976, 995; ICC Award No 8486 (1996), Aranaldez–Derains–Hasher, \textit{Collection of ICC arbitral awards}, IV, 323; award in \textit{Texaco Calasatic v Government of Libya}, cited in n 13.

\(^{30}\) As in the Qatar Model Exploration and Production Sharing Agreement of 1994, see n 16 and the text in Annex 1.

\(^{31}\) As is the case of the agreements (other than the one of Qatar) cited in nn 16 and 17, and in the text in Annex 2.

\(^{32}\) See clause in Annex 5.

\(^{33}\) National laws take different positions regarding the arbitrators’ power to adapt a contract. The Netherlands Arbitration Act of 1986 expressly allows the parties to empower an arbitrator to modify a contract or fill its gaps (art 1020(4)). The situation in other countries, such as Spain, Switzerland and France, is unclear: Craig, Park and Paulsson, \textit{International Chamber of Commerce Arbitration} 2000, 114–15.
establish if and to what extent he (she) is empowered to adapt a contract, the widespread view being that if the judge is so empowered the arbitrator is also empowered. Even in case such power is expressly conferred doubts have been raised regarding its adjudicatory nature. The distinction between the function of settling a dispute in an adjudicatory framework and that of filling a gap in the contract or determining an element thereof or adapting the same to changing circumstances in a contractual framework is well known to various civil-law systems, the distinction originating from Roman law. This distinction has a bearing on the efficacy of the arbitrator’s decision. The latter is certainly an award susceptible to enforcement (including under the New York Convention of 1958) if it settles a dispute by the exercise of an adjudicatory function. The same decision would add only an element to the parties’ contract, to be enforced through the State judiciary system as any other contractual provision unfulfilled by a party, in the case of a contractual determination.

The recognition of the different nature of the two types of intervention has led the International Chamber of Commerce to establish in 1978 Rules for the Regulation of Contractual Relations, providing for a procedure for the binding adjustment of contracts through the intervention of a third person. ICC itself has indicated that the adaptation procedure is clearly of a contractual nature and that in its view the decision of the third person is inserted into the contract and is binding on the parties as the contract, so that it may not be considered as equivalent to an award. The reference to this procedure is therefore to be accompanied by a parallel reference to arbitration as a means of settling disputes by a binding award rendered in a jurisdictional framework, since the two clauses do not serve the same purpose.

The issue whether contract adaptation falls within a jurisdictional function, and is therefore governed by the rule applicable to arbitration, is important in order to determine which means of recourse are available against the third person’s decision and whether the same may be enforced like an award. The distinction between the two types of the third person’s intervention rests on an investigation into the circumstances of the case, including the rules of the applicable legal system. The evolution is certainly in the direction of considering that the arbitrator’s role, particularly in contract of long duration, embraces more and more functions which do not strictly partake of a purely

---

36 In case of a determination of a contractual element Italian law refers to the intervention of an arbitratore, which has no adjudicatory powers but merely provides a contractual element that the parties have left undetermined.
37 Adaptation of Contracts, ICC Publication No 326 (1978), at 8. The rules in question were withdrawn by the ICC in 1994 because they had never been used in more than 15 years.
39 Peter, Arbitration and Renegotiation Clauses, cit, 29 et seq.; van den Berg, The New York Arbitration Convention of 1958 (1981), at 46: “decisions which are not considered as the result of arbitration proper in the country of origin must be deemed not to come within the purview of the New York Convention and cannot be enforced as a foreign arbitral award under it”. A different view is expressed by the present writer in the text.
adjudicatory nature but aim at regulating a contractual element with a view of securing the stability of the contract. The parties’ intent to confer this additional task on the arbitrator and the respect in the performance of such task of the essential requirements of any jurisdictional process, namely the right of the parties to be heard and the third person’s impartiality and independence, are all elements allowing for the conclusion that the activity of the arbitrator should receive a unitary consideration so that its decision is in any case, as to form, substance and effects, an award with all the resulting attributes, including its enforceability. After all, if the parties disagree on the terms of their contract adaptation the arbitrator may be well required to resolve the dispute arising from their conflicting position by exercising an adjudicatory function.

**The role of the ICSID arbitrator**

The issue however remains open whenever an ICSID (International Centre for Settlement of Investment Disputes) arbitrator is requested to perform the specific function to adapt the contractual terms and conditions to the changed circumstances. This is so because of the particular requirement, set by art 25(1) of the ICSID Convention for an ICSID arbitrator’s jurisdiction, that the dispute should be “legal”.

The term ‘legal dispute’ is not defined by the Convention. The report of the Executive Directors submitted to member governments on 18 March 1965 upon the formulation of the ICSID Convention states (in para 26) what was intended:

‘The expression “legal dispute” has been used to make clear that while conflicts of rights are within the jurisdiction of the Centre, mere conflicts of interest are not. The dispute might concern the existence or scope of a legal right or obligation, or the nature or extent of the reparation to be made for breach of a legal obligation.’

As noted by an authoritative commentator, formerly Senior Legal Adviser at ICSID:

‘Reference to the “legal” nature of a dispute limits the scope of the ICSID arbitration to a review of the respective rights and obligations of the parties as set forth in an... agreement, in light of the laws and regulations relevant to that agreement. Examples of “legal disputes” are those concerning non-performance... and the interpretation of the agreement... in contrast, disputes regarding conflicts of interests between the parties, such as those involving the desirability of renegotiating the entire agreement or certain of its terms, would normally fall outside of the scope of the Convention.’

Should the parties fail to agree about the occurrence of the conditions for a revision of the contractual terms as provided in their agreement, their disagreement will give rise to a dispute which will certainly be a legal one to the extent that it will concern the parties’ respective rights and obligations and, possibly, the interpretation of the relevant clause

---


41 ICSID Convention, art 25(1): “The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State.”

of the agreement. Likewise, a legal dispute will arise if, failing a consensual revision of the
terms of the agreements, one party claims that the latter should continue according to its
original terms and the other that it should be declared as terminated. Yet, whenever the
parties have failed to provide for a direct revision of the terms of their agreement without
fault, by either side, the arbitrator would have to intervene in order to perform a function
which, for the reasons outlined above, may hardly be characterized as the settlement of a
legal dispute and is therefore beyond the bounds of the ICSID Convention. Should the
latter be the agreed mechanism for the settlement of disputes arising under the agree-
ment, it would be therefore advisable to entrust the particular function of contract adap-
tation to a third person outside the sphere of application of the Convention. The ICSID
Convention will remain applicable in all other respects, thus permitting the parties to
avail themselves of this valuable and effective instrument of dispute settlement (and, fre-
quently, also of disputes avoidance) in the highly sensitive field of investment.44

Annex 1

Qatar, Model exploration and production sharing agreement of 1994
(art 34.12 ‘Equilibrium of the Agreement’)

“Whereas the financial position of the Contractor has been based, under the agreement,
on the laws and regulations in force at the Effective Date, it is agreed that, if any future
law, decree or regulation affects Contractor’s financial position, and in particular if the
customs duties exceed ... percent during the term of the Agreement, both Parties shall
enter into negotiations, in good faith, in order to reach an equitable solution that main-
tains the economic equilibrium of this Agreement. Failing to reach agreement on such
equitable solution, the matter may be referred by either Party to arbitration pursuant
to art 31”.

Annex 2

Petroleum production sharing agreement of 10 November 1995
between the State Oil Company of Azerbaijan and a Consortium of Oil
Companies

“The rights and interests accruing to Contractor (or its assignees) under this Agreement
and its Sub-contractors under this Agreement shall not be amended, modified or reduced
without the prior consent of Contractor. In the event that any Government authority
invokes any present or future law, treaty, intergovernmental agreement, decree or admin-
istrative order which contravenes the provisions of this Agreement or adversely or posi-
tively affects the rights or interests of Contractor hereunder, including, but not limited to,
any changes in tax legislation, regulations, or administrative practice, or jurisdictional
changes pertaining to the Contract Area, the terms of this Agreement shall be adjusted
to re-establish the economic equilibrium of the Parties, and if the rights or interests of

43 A request which may be accompanied by a damage claim should it be alleged that the reaching of an agreement on the revision
of the contractual terms was prevented by the other party’s bad faith behaviour.
Contractor have been adversely affected, then the State entity shall indemnify the Contractor (and its assignees) for any disbenefit, deterioration in economic circumstances, loss or damages that ensue therefrom. The State entity shall within the full limits of its authority use its reasonable lawful endeavours to ensure that the appropriate Governmental Authorities will take appropriate measures to resolve promptly in accordance with the foregoing principles any conflict or anomaly between any such treaty, intergovernmental agreement, law decree or administrative order and this Agreement”.

**Annex 3**

**Supplemental agreement of 1961 between the Government of Kuwait and American Independent Oil Company (art 9)**

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

**Annex 4**

**Petroleum production agreement between the Government of Ghana and Shell Exploration and Production Co of Ghana Ltd of 1974 (clause 47b)**

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

**Annex 5**

**Long-term crude oil supply contract (art V(12))**

“12. HARDSHIP. – If at any time during the term hereof either party shall by notice in writing to the other claim upon reasonable grounds stated in the notice that owing to changed circumstances including, but not limited to, changes in monetary values or discriminatory Governmental actions or regulations (such as differential customs duties unduly discriminating against the origin from which X are then supplying crude oil or petroleum products, as the case may be, to Y) the continued operation hereof is causing
undue hardship or inequity and shall require the other party to participate in a joint examination of the position with a view to determining whether revision or modification of the provisions hereof is required (and if so what revision or modification would be appropriate and equitable in the circumstances) then the parties shall (*but without reference to the arbitration*) participate in such joint examination accordingly” (italics added).