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CHANGED CIRCUMSTANCES:

**PRACTICAL INSIGHTS FROM SEASONED ARBITRATION COUNSEL AND
ARBITRATORS**

Aníbal Martín Sabater, *Moderator*

Julie Bédard, *Panelist*

Paula Hodges, QC, *Panelist*

Philippe Pinsolle, *Panelist*

Eduardo Zuleta, *Panelist*

Panel from the 31st Annual ITA Workshop and Annual Meeting, held in Plano, Texas on June 19-21, 2019.

In this panel a set of seasoned practitioners addressed the challenges that arbitration counsel typically face when arguing the doctrines and mechanisms of changed circumstances in arbitration; the challenges that arbitrators typically face when resolving claims based on these doctrines and mechanisms; and the contract negotiation/drafting strategies that can avoid or mitigate those challenges.

ANÍBAL SABATER: Good morning ladies and gentlemen. It is my honor to moderate this panel. We are going to be talking about practical insights into changed circumstances. If you read the Tribune or the New York Times, you know there are in essence two types of change: Change we can believe in, or fake change. We are going to address both. As Professor Klaus Peter Berger was saying earlier, legal theories on change have abounded at least since medieval times. What happens when a supervening legal change or change in market renders performance of a contract illegal? Or impossible? Maybe not illegal or impossible, but at least deprives me of the bargained for exchange, the profit that I was expecting to obtain? These are issues that have been around for centuries and continue to be around. It is one of our goals today to give you some comments on how to these are issues addressed in practice by leading arbitration practitioners.

I am flanked here today by four highly experience arbitration lawyers. They frequently act as counsel or arbitrator in complex big-ticket cases. To my left is Philippe Pinsolle. Philippe is based in Geneva and he is a partner with Quinn Emanuel Urquhart & Sullivan, LLP. He is the head of Global Arbitration for Continental Europe.



Next is Paula Hodges, who is the Global Head of International Arbitration at Herbert Smith Freehills. She is a partner with the firm based in London. She is a QC and recently became the president of the London Court of International Arbitration (LCIA). To my further left, Julie Bédard. She is based in New York, partner with Skadden Arps, Slate, Meagher & Flom LLP, and she is the head of the firm's International Litigation and Arbitration Group for the Americas. To my farthest left is Eduardo Zuleta. After a very long and distinguished period with bigger law firms, Eduardo, a few years ago, established Zuleta Abogados from where he operates. Most of you know him as a very distinguished lawyer and arbitrator in cases around the world with a special emphasis on Latin America.

We would like to start the presentation talking about changed circumstances. This is an issue usually addressed both in the law and in the contract, and not always consistently. We thought it would be a good idea to start by evaluating, in a quick round robin, how are changed circumstances addressed in the laws of the jurisdictions our panelist come from? Then we will talk about contract theories and how those two interact.

Starting with the law, Paula, what does the laws of England and Wales ("English law"), have to say about changed circumstances in its legal system?

PAULA HODGES, QC: English law is, of course, very popular for cross border transactions for the purpose of achieving commercial certainty. The wording of contracts in English law definitely takes precedence when it comes to interpretation. Subjective intentions of the parties before the contract is signed or indeed performance afterwards are irrelevant. We do look at the objective factual matrix, in other words, the information available to both parties before the contract is signed. Once the contract is signed, the words definitely take precedence. Nevertheless, we are not completely heartless. We do have certain principles that have developed over the centuries to assist where there are exceptional unexpected circumstances. However, there is no principle of change circumstances as such.

Now, one of these concepts is frustration. It certainly applies where performance has become impossible or illegal. I think Professor Berger said that it is a type of hardship principle. I would take issue with that. It is much more than hardship. You



cannot invoke frustration just because it has become more difficult or more expensive to perform. It does have to be impossible.

*Taylor v. Caldwell*¹ is an 1863 case that brought this concept to English law in a substantive way. It related to a contract to use a music hall for various very fancy concerts and fetes. Extravagant entertainment was planned, including a forty-piece military band, *al fresco* entertainments, minstrels, fireworks, a ballet, a wizard, Grecian statues, tightrope performers, rifle galleries and air gun shooting, and Chinese and Parisian games, boats on the lake and aquatic sports, whatever all that entails. Sadly, the music hall burned down a week before all of this started. Of course, this was not covered in the contract, and there was no insurance, so the court case developed. One of our great Law Lords, who was Mr. Justice Blackburn at the time, decided that it would be impossible to go ahead because there was no music hall. He actually relied on both Roman law principles, and certain principles in the French civil code to say that when the existence of a particular thing is essential to a contract and if that thing is destroyed through no fault of the parties, then the obligations fall away. So, this was the birth of frustration.

Over the years, the law on frustration has developed and it has become quite clear that it must be interpreted narrowly. It is not applicable just when property prices fall, for example. A more recent attempt to use the law of frustration relates to that certain scenario we are experiencing in the UK at the moment called Brexit. Believe it or not, one party tried to get out of a lease to rent some very expensive property in London because it was going to move its headquarters to Amsterdam instead. It quoted the law of frustration due to Brexit.² Needless to say, that has been thrown out by the High Court. We will see if there are any more attempts coming up.

Estoppel is another favorite that pops up. If a party has made an unequivocal representation that it is not going to rely on strict contractual performance by the other side, and the counterparty then relies on that to change its position so that it would be unfair to go back to strict performance, then estoppel allows the party that

¹ *Taylor & Anor v. Caldwell & Anor*, [1863] EWHC QB J1.

² *Canary Wharf (BP4) T1 Ltd v. European Medicines Agency*, [2019] EWHC 335 (Ch).



has relied on the representation not to perform its side of the bargain. You will not be surprised to hear another famous judge of ours, Lord Denning, really put some legs on this principle back in the 1940s in the *High Trees* case³ which came just at the end of World War II.

In this case a landlord, during the war, had said to his tenants: “Don’t worry about paying rent. Everyone’s in a hard situation.” Then, once the war was over, he tried to collect payment of the rent retrospectively. Lord Denning, well he was Mr. Justice Denning at that time, said No. You, landlord, are estopped from now insisting on collecting the rent due.

Those are just two concepts we have under English law. But there is not a hardship principle as such, and certainly not one that would allow you to get out of a bad bargain.

ANÍBAL SABATER: Thank you very much Paula. Julie could claim title to competently talk about New York law or the laws of Canadian Provinces, but she agreed today to focus on New York law. Julie, what does New York law say about changed circumstances?

JULIE BÉDARD: Thank you Aníbal. I will make one preliminary comment, which I think might resonate with the practitioners and arbitrators in the room. Although it does make a lot of sense for us to start with the analysis of the applicable laws before we turn to discussing the clauses in international agreements, it is interesting to note that the law we are looking at, whether it is in England or in New York, and I suspect other places in the world, we find ourselves in a slightly disappointed. When we try to look at those laws and the case law to inform our decisions or our arguments in international arbitration controversies we are having to use Chinese and Persian games cases, or Brexit analogies, as opposed to much relevant, or at least, closer fact patterns to the controversies we handle on a regular basis for our clients; such as long term oil concession agreements. Those controversies are not, in fact, routinely found in the judicial cases, at least not in some of the common law jurisdictions I deal with. That creates a disconnect. Perhaps less of an emphasis on judicial cases, and

³ Central London Property Trust Ltd v. High Trees House Ltd, [1947] (K.B.) 130.



of course, as one might expect further emphasis in the increased importance of the law that we are developing in international commercial and investment arbitration cases.

Be that as it may, I think we still like to be grounded into some principles of domestic law, even if as the name might suggest, they are very domestic in their nature and factual circumstances, but they do provide legal guidance.

With respect to New York, you will not hear anything that is dramatically different from the English approach. Nevertheless, it is interesting to go through some of these cases with the understanding that there is, generally, overlap. This would be very true as a general principle. The common law jurisdictions, by and large, have been historically, less inviting of arguments about changed circumstances. You do not have anything like the divide between administrative and private law contracts, anything like the variety of concepts such as *imprévision* or changed circumstances. The analysis is done on a case-by-case basis, and it is done with great reluctance if the parties did not speak to the matter in their contract. The default mechanism under the law will provide very little recourse for the parties. Not quite nothing as we will see in some of the examples that we will go through. But it is limited.

If you consider a situation where a party signs a contract, for either the lease or the sale of a property, for example, if the person who signs this instrument dies, there is New York case law that suggests the estate is not, in fact, bound by the contract to proceed and close with the transaction. This might be analogized to some international arbitration situations or perhaps bankruptcy and insolvency, but I leave it to you.

With respect to the importance of the agreement, whenever the parties actually speak to and have in their contemplation some of these eventualities, New York courts will be extremely focused on these provisions. In fact, if the parties speak to this, they are likely to provide something more than the words on the page. So, if the agreement provides for a certain type of compensation in the event, a certain event will occur, then this will be strictly enforced.

If you sign a lease and this lease is frustrated because your competitor leased the property next door and would be your next-door neighbor; your lease is less valuable,



and you are less interested in it; New York courts have no patience for that kind of claim. They will not rule that this constitutes frustration of the contract.

Frustration is being recognized in certain situations, and I think this is close enough to a business context that we might recognize it in international controversies. The situation is such that you have a usage of entrance money for payment of certain restoration costs. That was the basis upon which the restoration agreement was actually entered into; so, the assumption of regular payment was going into the agreement. There is a 2009 case that actually recognizes that this might be entertained as a reason for frustration.⁴ Again, a very specific set of circumstances where the assumption for entering into the contract was communicated to the other side and built into the way the contract came about.

If frustration is tough to get, impossibility and impracticability are harder. We will not dwell on this as there are sophisticated lawyers in the room, we all know impossibility when we see it. Impracticability is a little different. I have been surprised to see some very isolated cases of recognition of the doctrine and circumstances that were perhaps a bit of a close call. In a case as recent as 2017, a premise is destroyed by fire.⁵ This is a resort facility that was destroyed. It was rebuilt and even if the facility was rebuilt, it was found that there was, in fact, no obligation to a lease to the perspective lessee. So, there had been a contract to lease the property and the performance was excused. Frankly this would not, at first blush, meet the impossibility requirements. Perhaps there is a little bit more patience, to call it that, on the part of the New York courts here to excuse the performance when the lessor refused to give the premises and the resort to the perspective lessee.

This is very much in line, I think, with what we might see in some of the international cases. You are merrily talking about an increase in costs of performance, that is not going to cut it for New York law impossibility purposes. This might get close to replacement in case of total loss. So, these are very significant

⁴ *D & A Structural Contrs. Inc. v Unger*, 2009 NY Slip Op 52026(U), 25 Misc 3d 1211(A) (Sup. Ct. Nassau Cty, Aug. 20, 2009).

⁵ *Leisure Time v. Villa Roma*, 2017 NY Slip Op 27055, 52 N.Y.S.3d 621 (Sup. Ct. Queens Cty, Feb. 22, 2017).



financial consequences, but nevertheless would not meet the threshold.

With respect to force majeure, I like this example. It will resonate with some of us. In this particular case, there was a dispute that arose between the defendant and an aircraft manufacturer that prevented the timely delivery of the aircraft. The existence of the dispute was used to argue that the delayed performance should be excused. I suppose you can try anything. That was, in fact, denied by the court.

Perhaps more interestingly and relevantly, when you think about the liability insurance crisis in the mid-80s and the inability of some to maintain proper insurance coverage after their policies expired. This was found not to constitute force majeure. Thus, the difficulty for a party to get or continue insurance coverage required under contract, if the impossibility, as a matter of fact, might arise or become costly to get the coverage, this is not something that the New York courts would recognize as force majeure. If you lease a stadium out and the season is cancelled due to a lockout by the players, that too will not constitute force majeure unless it is specified by the clause.

So, I will leave it at that, in terms of description of New York cases and I probably would sum up the case law situation in New York as one that is overly on the side or greatly on the side of caution in giving much room for a party argue that it is excused from performance. But there are some cases that can be used for that purpose.

ANÍBAL SABATER: Thank you, Julie. Philippe, we sometimes have the impression that civil law jurisdictions are completely at odds with common law ones on the issue of changed circumstances, that they are much more lenient when it comes to allowing for changes in the contract. Is that the case? How are things in France?

PHILIPPE PINSOLLE: That is not necessarily the case. It is as wrong as saying a civil law jurisdiction will not enforce a contract as written. Because, for example, if you take French law, it is simply forbidden to interpret the contract if it is clear. The supreme court will always enforce this. The notion that you look into the subjective intention of the parties arises only if the contract is not clear. The supreme court is very attentive to this.

If I move now into hardship and force majeure, thanks to the work of my friend



Professor Klaus Peter Berger, I can be faster, especially on force majeure, because essentially, in 2016 the definition of force majeure was reformed but the regime is quite straight forward and in keeping with international standards in that respect. More interesting, perhaps, is the evolution or the tentative evolution on hardship. We come from a situation where hardship, as Professor Berger said, was simply denied in commercial contracts. Administrative contracts were the very narrow space where it applied. But, in commercial cases, the rule was very clear dating to 1876 that in no case courts are entitled, however equitable that may seem, to take into consideration change in circumstances to modify the parties' agreement and replace contractual clauses freely accepted by the parties by new clauses. That was the very clear principle. There is no way you can modify the contract.

When we reformed the law on obligations in 2016, there were some discussions as to whether or not we should introduce a hardship principle. Very important professors in France were actually divided. Judges were consulted and judges were not at all divided. They were totally against it. They said, "It's not our role to rewrite contracts. We will not do it. Do whatever you want, we will not do it." The result of that is a provision which is very convoluted and in my view is unlikely to give rise to many changes. If I just read the trigger, it says, "if a change of circumstances that was not foreseeable at the time of conclusion of the contract, results in the performance of the contract being excessively onerous by a party that did not accept the corresponding risks, then that party can ask for renegotiation and ultimately go to a court which can revise or terminate the contract." If you look at it, the trigger threshold is extremely high, because it has to be unforeseeable, it has to result in excessive onerousness in the promise of the contract, and the corresponding risk must not have been accepted by the party, whatever the corresponding risk is. How do you articulate that with notion of unforeseeability is entirely unclear to me? So, the threshold is very high. Then, the remedy is just a discretion. The court can revise, they are not obliged to. Most likely the courts will say: "I'm not going to revise." As a consequence, that provision is not applied in any significant transaction that I have seen; it is simply excluded.

As a result, this provision which applies for contracts between private parties



since the first of October 2016, has produced very few cases so far and only cases of first instance. So, I cannot tell you where the case law is because in most cases, it was rejected. However, it was accepted in one case which is not exactly high priority, so it does not mean anything. I cannot tell you what the future lies and what it will be in terms of this provision. My suspicion is that French case law will remain faithful to the original principle of *imprévision*, like it or not. In general, the contract will not be changed. That is my prediction. Thank you.

ANÍBAL SABATER: Thank you very much Philippe. Eduardo, we have been talking about national theories or domestic theories on changed circumstances, but there is a whole body of arguably transnational law out there that may also have a bearing on changed circumstances. You have the UNIDROIT Principles of International Commercial Contracts (UPICC). You have the United Nations Convention on Contracts for the International Sale of Goods (CISG). You have published arbitral awards. Do you think nowadays we can talk about transnational principles of hardship, force majeure, and if so what would those be?

EDUARDO ZULETA: Arbitrators, to some extent, have been forced to adapt or to create rules for situations where changes of circumstances are alleged for a variety of reasons. First, normally the parties and their counsel are not as thorough and as clear in their drafting. Normally you would find clauses that have been drafted at the very last minute when the businesspeople want to close the deal, get rid of the lawyers, not necessarily in that order, but that is what they want. Thus, we have more and more situations where either the parties have not agreed on applicable law, or, even worse, they have drafted a contract under a system or legal tradition, they draft a contract fitted for certain applicable law, basically common law. For example, they draft an M&A contract under New York law, and then, at the very last minute, they decide to apply Peruvian law, or they decide to apply Paraguayan law. Here we have a contract, which is drafted under one set of circumstances, one set of clauses, and the governing law may say totally the opposite or may not have appropriate provisions or may have inapplicable provisions.

The other types of clauses that you will find are clauses with references to general



principles of law. The contract will be governed by law 'x' but with regard or considering general universal principles and contracts.

You also have vague clauses. Clauses that provide for a change of circumstances in a very general manner, or where the triggering event is not clear, or where the triggering event is tied to a change in the local law or things to that sort. Or back-to-back contracts with different or contradictory provisions; different change of circumstance clauses. As an arbitrator you have to, one way or another, decide on them together, because one contract impacts, of course, the other.

That is the first problem to get into a really transnational approach. The second set of problems is the different approaches the several laws take to this situation. You will find laws where there is a specific provision for changed circumstances. Most of the civil laws in Latin American countries do include a specific provision for hardship or for force majeure for change of circumstances or economic equilibrium. There are, however, a number of legislations where there is no specific provision and there is a development of the changed circumstances based on the principles of good faith or use of process. So, you have different rules that you have to apply.

The third problem that you will find, to try to find something that is common, is that courts put a number of different things under the principle of *rebus sic stantibus*. For example, force majeure, frustration, the theory of *imprévision* from French law, and they mix them all together. They could mean, under the decision of the courts, basically anything.

Now, what the tribunals have done is, number one, try to find common ground in the different sets of legislation. Number two, find international legal principles derived from, sometimes the Vienna Convention on the Law of Treaties that expressly refers to change of circumstances. The principles contain issues such as force majeure and changed of circumstances.

A general review of the awards leads to the conclusion that tribunals, even though they have not built a general understanding or general transnational rules on change of circumstances, there are certain common grounds that tribunals have accepted that I would say are not debated today. The two main principles of *pacta sunt servanda*, sanctity of contracts, and that the issue of change of circumstances is a



matter of allocation of risks. To the extent that the parties have allocated the risks, the tribunal would have to respect that. Those are two general common principles contained in the decisions that I have reviewed.

Third, *rebus sic stantibus* is an exception to the rule. It is generally the rule of restricted application. A common thing that one could see is that the arbitrators have to respect the contract terms, even when the applicable law provides for a different solution. If you have a change of circumstances clause, and the applicable law provides for a different solution, then you would have to apply the contract except in the unlikely event that the solution has the nature of involving public police or the international applicable law.

The fourth principle is that hardship clauses should be interpreted strictly. A clause referring to a specific change of circumstances should be understood to mean only those changes that the parties agreed to and other kinds of changes would not be included in the contract. In other words, there will be not implied changed of circumstances clause.

The fifth and final consideration is that there seems to be a general consensus as to what are the requirements for the change of circumstances, particularly in hardship, to apply. This is, number one, that the triggering event must have occurred after the conclusion of the contract. That is one of the key reasons, of course. The second is that the event must be unforeseeable. Both circumstances should apply. It should be beyond the control of the disadvantaged party and must result, and this is the most difficult one, in a fundamental change in the equilibrium of a contract. That is a difficult factor, because it is an economic concept. It is not a legal concept. What is a substantial change in the condition of the contracts? What is a change in the economic equilibrium of a contract? What is economic excessive onerousness?

To conclude, I would say that there is not a general transnational rule for applying change of circumstances, but you can find in the awards certain general common grounds that are not being discussed today. Regardless of the applicable law, the general rule that the contract terms prevail and that it is normally difficult to find change of circumstances is pervasive. Contractual clauses that try to regulate hardship lack something that, to me, is relevant which is an economic formula for the



adjustment. Normally you will see general definitions of what a substantive change is—substantive change means any substantive change that is substantive—however, those clauses do not have an economic formula and you do not have a clear way to get back to the equilibrium of the contract.

ANÍBAL SABATER: Thank you very much Eduardo. Paula, building on something that Eduardo was just alluding to, how do you build changed circumstances provisions into your contract? A client comes to your firm and says, well we are doing business in Venezuela or in Russia, it is a volatile legal and economic environment. The transaction may suddenly be voided or impossible to perform because of sanctions or because of a market change. What type of protections can you build into the contracts to account for that type of situation?

PAULA HODGES QC: Leaving aside force majeure provisions, material adverse change provisions, and other types of boilerplate clauses that we often see, and which are normally drafted in very general terms, there are certain industries that do try to cater for market changes. Obviously in the gas industry, we have price review clauses, which sometimes have an economic formula and then there is a big argument about whether it should apply. In the upstream oil and gas business, if an oil field straddles two licensees, because oil fields do not always fit nicely into the grid that the state carves up, you have a unitization agreement and the parties on both sides will look at the initial seismic data (giving an indication of where the oil is located) and decide the percentage interests that should be allocated to each side. Of course, until they have more precise information about where the oil is, it may not be the right split. As a result, you often see a redetermination clause, which can be triggered once or twice during the life of the agreement, when there is more information available. Then you get into wonderful principles like the “Indonesian Saturation Equation” which I grappled with last year. Even though the contract will go into huge amounts of detail about when a redetermination clause is triggered and what the results are, needless to say, particularly if there is going to be a big swing one way or another, the redetermination process can spawn into a big technical dispute.

One other example I wanted to raise, focusing in on changed circumstances, was



a case I was involved in fifteen years ago. The UK changed the power industry from a national grid to bilateral contracts. One of our clients had actually come to us in advance. They knew reform was on the cards. How can we deal with it? A clause was put in to deal with changed circumstances, which was specific to a degree, but you still had to include some generic language because you did not know where it would end up. I do not think anyone expected quite the seismic shift from the grid to bilateral contracts that occurred, and the clause did not quite work.

When it came to the arbitration, both sides put in extremely different interpretations for the tribunal at very different ends of the spectrum. I remember clearly after day two of the hearing, the tribunal called a halt to the proceedings and said that they had been considering the situation and given that the governing law was English law, they did not have the ability to take out a blue pencil and rewrite the contract. They would have no choice but to accept the interpretation of one or the other of the parties. Given the extreme nature of the interpretations put forward, one or the other party would be very disappointed. All I can say is that the case settled at about 4 AM in the morning because neither side could risk having the extreme results proposed by the other. I think it is very difficult to put in a change of circumstance clause that actually works in advance of knowing the type of change likely to happen.

ANÍBAL SABATER: Thank you very much, Paula. Two of the most frequently invoked clauses in arbitration involving changed circumstance are renegotiation clauses and stabilization clauses. Philippe, first, and Julie next, what are they about? How do they work in practice? More importantly, how do they make appearances in arbitration cases?

PHILIPPE PINSOLE: Two comments. One first on stabilization, and then on rebalancing clauses. If we discuss stabilization clauses *per se*, they are in theory the best way to avoid any change because you say I operate in a stabilized environment and any future change does not apply to me. We have various degrees of these. You can freeze the applicable law at a given point in time, including that is between private parties, and then you can go further. You can provide that not only the law is frozen,



but any change in the law is frozen, and generally this new tax law, custom law, etc., does not apply to the contract. It can apply to the rest of the world, but it does not apply to the contract. That is the second step.

The first step is a contract where you create a comprehensive regime that applies only to your company in a given country and that is completely divorced from that state of common regime. Of course, that can only work if you have this comprehensive regime and an arbitration agreement, which sort of makes the whole contract. It puts it outside the local legal environment. This happens only if you deal with a sovereign, the state itself, and you have to have some sort of negotiating power, some leverage to obtain this type of agreement.

Until the end of the 90s, the World Bank was very much in favor of those types of arrangements because they give predictability. So, do they occur frequently? The answer would be yes, in certain countries and in certain types of deals. You find them very often in Africa, especially French speaking Africa, in major oil and gas deals. I have arbitrated some of them including very significant cases. One case is US\$77 billion, which was a significant case, pure stabilization clause. These clauses exist. They are reserved, or they are limited to certain circumstances and they are very different from clauses from where you allocate the risk of change. For example, you can have a clause that says: “if the tax law changes, it is not my problem, it is yours.” When you discuss with the local national oil company, that is not strictly speaking a stabilization clause. You just allocated the tax risk to the national oil company.

I wanted to ask a few questions on rebalancing clauses. Not so much on the validity or the compatibility of the local law, or even the trigger, which is very often litigated, but rather, if the parties agree that you should restore the original bargain. My question to you is, what is the original bargain in practice? We find very little guidance on this. How do you do that? What do you mean by that? Do you consider the original bargain in absolute terms? For example, in the gas price review the buyer may have a certain margin built in the price, and do you restore that margin fifteen years or thirty years later in absolute terms? Or is it a proportion? Do you look at the risk allocation? If the change itself affects the risk allocation, how do you remedy that? Maybe it is impossible to restore the agreed risk allocation, because the market



has changed. Do you consider the expectations of the parties when entering into the contract? For me the answer is yes, but what type of expectations? The expected rate of return from the project? It may be that the economics have changed so much the initial rate of return means nothing, even if it was a threshold for an investment decision. But it is something which in practice can no longer be restored? Are you completely changing the formula? Are you changing the parameters of the contract? How far are you prepared to go?

I give you two examples derived from real life. One is a contract for exchange of electricity. One party will exchange what we call base electricity, which is produced during the day for example by a gas turbine system or nuclear electricity, against what is called peak electricity which can be produced by hydroelectric power. Okay, you have a long-term contract with an exchange ratio. The market has completely changed. The ratio does not mean anything. One party gets, let us say, a windfall. How do you rebalance that, if at all, knowing the market will change again in the future? Do you rebalance the formula? Or do you just neutralize the effect of the windfall, assuming you can? That is one aspect.

Another possible example is an old concession type contract entered into at a certain point in time with the expectation that the oil barrel will be between twenty and thirty dollars. Then, there is an increase in taxes which needs to be rebalanced, but at the same time, the barrel has increased to a hundred dollars a barrel, which makes the contract more interesting for the investor, including the new tax. Do you rebalance that or not? Even with the new tax they are making far more money than they expected at the beginning. These types of issues are very concrete issues that we find in the cases.

I do not pretend that I know the answer to my questions, but I do know that Julie will tell you what the principles are that govern the solution.

JULIE BÉDARD: Passing on the buck. Thank you, Philippe. When I noted earlier the disappointment we might have with the domestic cases, I highlighted the importance of the international jurisprudence in this area. Maybe what I should have said, before talking about the importance of the cases, is the overarching critical necessity for us as lawyers, and with our clients, to think through what we draft in the contracts. The



decisions in international arbitration are very focused on what the contracts have to say. This all stems from the default legal regimes being either not supportive of the notion of reviewing and revising contracts or having to some degree of uncertainty about how this is supposed to unfold.

In either situation, whether it is a common law or a civil law backdrop to your contract, there is great value in providing for these situations and thinking them through in the agreement. Many of us do this, or many of our clients are extremely focused on this. The more our clients have long term investments—the more they are putting in money into a project early, and they are putting hundreds of millions, possibly billions of dollars, into a project with the expectation that the return will flow through only over an extended period of time—the more they have to think about how the contract will work over time, over these extended periods of time. What is interesting, and I think Philippe quite correctly focused us on this, is the windfall situation that Philippe alluded to earlier. Although there is a decent amount of intellectual energy on both sides being invested in drafting the contract in such a way that the economic equilibrium might be preserved, I will give you only two cases as an example showing the importance of the words on the page. *Duke Energy*,⁶ this is a case that is known to many with Yves Fortier, sharing the pen with Guido Tawil and Pedro Nikken, in the context of a stabilization clause. The case involves laws enacted in Peru. Peru is really looking to attract investments, so Peru is making a big case of providing this legal stability upfront. Those legal guarantees are incorporated into the actual investment agreements. Then you have a situation where the tax authorities disagree with the legal guarantees that were provided up front. There is a potential loss to the investor. In that situation, the tribunal found that the purported application of the tax laws was in breach of the stabilization clause in the agreement.

There is a decent amount of emphasis put on how much you consider the expectations and intent of the parties. I think reasonable people can disagree in

⁶ *Duke Energy International Peru Investments No. 1 Ltd. v. Republic of Peru*, ICSID Case No. ARB/03/28, Award, (Aug. 18, 2008).



different jurisdictions about what the default ultimately is with respect to whether you analyze the expectation—the intent of the parties—only when there is an ambiguity in the terms of the contract. I found in practice that this distinction matters less than one might think simply because we, as lawyers, argue both sides of this issue. The expectations and intent are always put before the tribunal, regardless of whether a party takes a position that it should not arise, because you have to address the other side's position that says it is in fact relevant and should be considered. Ultimately, tribunals do have all of this information in front of them. It is hardly debated. Most of the time, what we find is that tribunals much prefer, and this is quite understandable, they much prefer to find support in the expectations and intent, and the background and the history, and the negotiations of the agreements, to ultimately justify the interpretation they are giving to the agreement. The distinction between applying expectations and intent only where there is the ambiguity, although hardly debated, in practice is less important than one might think.

A quick word on *Burlington*,⁷ which is also a decision that many of us will look to in the context of product sharing contracts. Prices did rise in Ecuador as many will remember, which did create this purported windfall environment that Philippe alluded to, that then lead Ecuador to tax what it perceived to be were excess profits made by the companies. The contracts, however, did provide for several “tax modification clauses.” The parties, having put their minds to the matter of potential changes in the tax laws, lead to a “correction factor” being included in the agreement. The tribunal found that the tax modification clauses were stabilization clauses. The purpose of which was, of course, to avoid tax increases or decreases, this actually went both ways. We tend to forget the other side of the coin. The award, under the pen of Gabrielle Kaufmann-Kohler, also considered that a decrease could alter the economic foundation. Ultimately the conclusion was that the application of “a correction factor is mandatory when a tax affects the economy of the product sharing

⁷ *Burlington Resources Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability (Dec. 14, 2012).



contracts for these laws.”⁸ Otherwise stated, “the correction factor must restore the economy of the production sharing contract to its pre-tax modification level.”⁹

Two comments here. One is the notion that it is not always easy to go back to the pretax or pre-unforeseen event situation and restore the equilibrium between the parties. Two, and this is a comment that Gabrielle Kaufmann-Kohler made in a speech that she gave a few years ago at the IBA Arbitration Day in Buenos Aires, Argentina. Gabrielle Kaufmann-Kohler does purport to read and look into the intentions of the parties almost always. She is far from persuaded that if there is lack of ambiguity she should be prevented from looking at the expectations and intents. Here, the particular historical situation between the parties also was important.

ANÍBAL SABATER: Thank you very much, Julie. In the hopefully five minutes that we have left, Eduardo, I think we have been taking for granted perhaps a critical distinction, at least in civil law jurisdictions, and that is the distinction between a contract that involves only private parties and a contract that also involves the government. Civil contracts v. administrative contracts. What differences are you seeing in the way changed circumstances get addressed in those different types of contracts? Consequently, in the arbitrations stemming from them.

EDUARDO ZULETA: Yes, two or three things. First, un-stabilization or the theory that some courts have adopted is that the stabilization clause is an indemnity clause but not a clause to freeze the law. In other words, if the law changes, the changes apply to the contract, the state or the state entity, and the private party. The changes apply to the contract, but the state entity has to indemnify and restore the economic equilibrium of the contract.

Second, the difficulty is: what is an administrative contract? Certain jurisdictions define an administrative contract as any contract signed by state entity. Others define an administrative contract by the content of the contract, etc. That is the second difficulty.

The third difficulty is that generally, in administrative contracts, there is this

⁸ *Id.* at 334.

⁹ *Id.*



concept, this definition of collaboration contracts where the private party is considered to be a collaborator to the administration, to the state entity or the state, and that results in a number of things. First, the criteria to define change of circumstances is different. Second, the criteria to adjust the contract in the case of changed circumstances is different. Under this theory of collaboration, you even see cases where the courts have said that the restoration of the equilibrium should be to the point of no loss, meaning, no gain for the private party. Simply no loss and that is it. That has, of course, a number of economic implications. The third difference is the issue of defining the circumstances that are considered change of circumstances in this so-called administrative contract.

Normally there are four sets of different circumstances. The first one is the so-called administrative, which is the sovereign act. This is the situation in which the state takes a general measure, not a measure into the contract, but a general measure that has a direct or indirect impact in the contract and then the state has to re-adjust price and restore the economic equilibrium in the country.

The second one is the so-called private, which is the act of the state that affects directly the contract. This is the situation in which the state has the authority either to interrupt the contract unilaterally or even to terminate or to suspend the contract unilaterally. Then there is a change there in which the economic equilibrium should be restored.

The third one is something called unforeseen circumstances, which in both in a number of legislations, particularly in Latin America and Spain is called *caso fortuito*. This is the situation in which there are external circumstances that arise in the development of the contract, like, excessive rain or that kind of natural or technical things, that give the right to the private party to adjust the contract if it is an administrative or state contract.

Of course, last, but not least, the very well-known theory of *imprévision* which you find in basically all civil law statutes.

There is a difference there in the grounds, number one, and in the approach to the way of restoring the economic equilibrium of the country, number two. Under these theories of collaboration, the private party may end up in a situation where



there is no gain, no loss, just a collaboration with the state, which is, of course, not an ideal situation.

ANÍBAL SABATER: Excellent! Thank you very much. Thank you to our panelists!

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INSTITUTE FOR TRANSNATIONAL ARBITRATION OF THE CENTER FOR AMERICAN AND INTERNATIONAL LAW

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