

31st Annual ITA Workshop and Annual Meeting

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„Expect the Unexpected: Adjudicating Changed Circumstances in Commercial and Treaty Arbitration“

Keynote:

Changed Circumstances and Commercial Arbitration

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- I. Introduction
- II. Long-term contracts: planning for the uncertain future
- III. The eternal dilemma: *pacta sunt servanda* versus *rebus sic stantibus*
- IV. Force Majeure and Hardship distinguished
- V. Hardship
 - a) Concepts in domestic laws
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 - c) Contract adaptation by arbitrators: three crucial questions
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- VII. Hardship as a Force Majeure Event under Art. 79 CISG
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Examples

- a substantial devaluation of the contract currency
- extreme price volatility for the supply of goods to be procured by the seller on a secondary market and to be delivered to the buyer over a period of time for a fixed price
- a regional (like in South East Asia in 1997) or a global (2008/09) financial crisis causing extreme economic burdens for a party to a contract
- a long-term gas or LNG supply contract concluded 25 years ago in which the gas price formula is linked to the oil price index, and the much lower current gas prices on the spot markets make the contract unprofitable for the buyer
- civil riots, other hostilities or natural catastrophes that prevent the performance of construction works at a site in a distant country (road or other infrastructure projects)
- state embargoes or sanctions that have an impact on the parties' obligations in long-term delivery contracts

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The eternal dilemma

Pacta sunt servanda = stability of contractual undertakings

The eternal dilemma

Pacta sunt servanda = stability of contractual undertakings

Rebus sic stantibus = flexible reaction to changed circumstances

The eternal dilemma

Pacta sunt servanda = stability of contractual undertakings



Rebus sic stantibus = flexible reaction to changed circumstances

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Force Majeure & Hardship distinguished

Force Majeure → performance impossible

Force Majeure & Hardship distinguished

Force Majeure → performance impossible

Hardship → performance possible (but excessively onerous)

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Germany: Sec. 313 Civil Code

- (1) If circumstances, which became the basis of a contract, have significantly changed since the contract was entered into and if the parties would not have entered into the contract or would have entered into it with different contents if they had foreseen this change, adaptation of the contract may be demanded to the extent that, taking account of all the circumstances of the specific case, in particular the contractual or statutory distribution of risks, one of the parties cannot reasonably be expected to uphold the contract without alteration.
- (2) It is equivalent to a change of circumstances if material conceptions that have become the basis of the contract are found to be incorrect.
- (3) If adaptation of the contract is not possible or one party cannot reasonably be expected to accept it, the disadvantaged party may withdraw from the contract. In the case of a contract with continuing obligations, the right to terminate takes the place of the right to withdraw.

France: Art. 1195 Civil Code

If a change of circumstances that was unforeseeable at the time of the conclusion of the contract renders performance excessively onerous for a party who had not accepted the risk of such a change, that party may ask the other contracting party to renegotiate the contract. The first party must continue to perform his obligations during renegotiation.

In the case of refusal or the failure of renegotiations, the parties may agree to terminate the contract from the date and on the conditions which they determine, or by a common agreement ask the court to set about its adaptation. In the absence of an agreement within a reasonable time, the court may, on the request of a party, revise the contract or put an end to it, from a date and subject to such conditions as it shall determine.

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Art. 6.2.1 UPIICC - Contract to be Observed

Where the performance of a contract becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligations subject to the following provisions on hardship.

Art. 6.2.3 UPICC – Definition of Hardship

There is hardship where the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of a party's performance has increased or because the value of the performance a party receives has diminished, and

- a. the events occur or become known to the disadvantaged party after the conclusion of the contract;
- b. the events could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract;
- c. the events are beyond the control of the disadvantaged party; and
- d. the risk of the events was not assumed by the disadvantaged party.

Art. 6.2.4 UPICC – Effects of Hardship

1. In case of hardship the disadvantaged party is entitled to request renegotiations. The request shall be made without undue delay and shall indicate the grounds on which it is based.
2. The request for renegotiation does not itself entitle the disadvantaged party to withhold performance.
3. Upon failure to reach agreement within a reasonable time either party may resort to the court.
4. If the court finds hardship it may, if reasonable,
 - a. terminate the contract at a date and on terms to be fixed; or
 - b. adapt the contract with a view to restoring its equilibrium.**

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Contract adaptation by arbitrators:

Three crucial questions

1. procedural authority?

Contract adaptation by arbitrators:

Three crucial questions

1. procedural authority?

"It is artificial and in many respects deplorable that a distinction should be drawn between the two varieties of arbitration: the one aiming at the settlement of a legal dispute, the other at the regulation of a contractual relationship. In both cases the same technique is resorted to, the same result is aimed at, and the application of the same rules is desirable."

René David, 1985

Contract adaptation by arbitrators:

Three crucial questions

1. procedural authority?
2. substantive legitimacy?

Contract adaptation by arbitrators:

Three crucial questions

1. procedural authority?
2. substantive legitimacy?
3. adaptation standards?

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France: Art. 1148 Civil Code

There is no occasion for any damages where a debtor was prevented from transferring or from doing that to which he was bound, or did what was forbidden to him, by reason of force majeure or of a fortuitous event.

France: Art. 1218 Civil Code

In contractual matters, there is force majeure where an event beyond the control of the debtor, which could not reasonably have been foreseen at the time of the conclusion of the contract and whose effects could not be avoided by appropriate measures, prevents performance of his obligation by the debtor.

If the prevention is temporary, performance of the obligation is suspended unless the delay which results justifies termination of the contract. If the prevention is permanent, the contract is terminated by operation of law and the parties are discharged from their obligations under the conditions provided by articles 1351 and 1351-1.

Three different approaches

1. Impossibility
2. Frustration
3. Impracticability

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Art. 7.1.7 UPICC

- (1) Non-performance by a party is excused if that party proves that the non-performance was due to an impediment beyond its control and that it could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.
- (2) When the impediment is only temporary, the excuse shall have effect for such period as is reasonable having regard to the effect of the impediment on the performance of the contract.
- (3) The party who fails to perform must give notice to the other party of the impediment and its effect on its ability to perform. If the notice is not received by the other party within a reasonable time after the party who fails to perform knew or ought to have known of the impediment, it is liable for damages resulting from such non-receipt.
- (4) Nothing in this article prevents a party from exercising a right to terminate the contract or to withhold performance or request interest on money due

Four basic requirements

1. Externality

Four basic requirements

1. Externality
2. Unavoidability

Four basic requirements

1. Externality
2. Unavoidability
3. Unforeseeability

Four basic requirements

1. Externality
2. Unavoidability
3. Unforeseeability
4. Causal nexus

Four basic requirements

1. Externality
 2. Unavoidability
 3. Unforeseeability
 4. Causal nexus
- + notification of other party

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ICC Award No. 4462
First Award on Force Majeure
International Legal Materials 1990, 565 et seq

National Oil Corporation (NOC) (Claimant)

v

Sun Oil Company (Sun Oil) (Respondent)

31 May 1985

Art. 22 (1) EPSA

Any failure or delay on the part of a Party in the performance of its obligations or duties hereunder shall be excused **to the extent attributable** to force majeure.

Force majeure shall include, without limitation: Acts of God, insurrection, riots, war, and any **unforeseen** circumstances and acts **beyond the control** of such Party.

Libyan Law

Circumstances must be

- a) **beyond the control** of the parties,
- b) **unforeseeable** at the time the agreement, out of which the parties' duties to perform arise, is entered into, and
- c) render the performance of the obligation of the non-performing party absolutely **impossible**.

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Art. 79 (1) CISG

A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.

CISG Advisory Council Opinion No 7:

“genuinely unexpected and radically changed circumstances in truly exceptional cases.”

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Thank you very much!

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