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THE PANAMA CANAL EXPANSION: ADAPTATION OF CONTRACTS

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I. INTRODUCTION

The Expansion of the Panama Canal is the biggest engineer project of the twenty-first century. In the project of expansion that initiated in 2009 and finalized in 2016, there were difficulties (notwithstanding the detailed construction contract tailored for the specifics of the Canal) of supervening events had produced the renegotiations and current arbitrations that in total are quantified in billions of dollars.

Using this mega-project as a contractual experience has shown that the adaptation of contracts due to supervening events remains one of the most controversial topics in international contracts because the rendezvous between the legal principles *pacta sunt servanda* and *rebus sic stantibus*[1] produced the conflict in the correspondent assumption of risk for these occurrences.

This article will address the background of the history of the construction of the Panama Canal, its expansion's impact for the world trade, the resolution of dispute mechanism adapted to the needs of the Panama Canal, the disputes regarding the Expansion, comparing it with different previous awards and judgments to determine which of the principles mentioned above is the trend in the international contracts resolution of disputes.

II. BACKGROUND INFORMATION

A. History of the construction of the Panama Canal

The twenty-first century has Elon Musk; the nineteenth Century had Ferdinand De Lesseps. The French visionary, considered the creator of the Suez Canal in Egypt, had in mind a Canal in Central America that could expedite travel from west to east. After convincing the investors, the *Compagnie Universelle du Canal Interocéanique de Panama* started working in 1880 with a projected cost of US$120 million. However, due to problems of administration (wrong use of the shareholders' investments) and a huge

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[1] *Pacta sunt servanda* is the legal principle which indicates that contracts are the law between the parties and should be executed according to what the parties agreed to. On the other side, *rebus sic stantibus* is the legal principle that indicates that when an unforeseeable event makes the contract excessively onerous for one party, the disadvantaged party has the right to terminate the contract, and sometimes ask for renegotiations.

propagation of malaria and yellow fever (due to the environmental condition of the place), the French Canal failed.

Watching with precaution the construction of the French Canal, there was the United States which also had in mind the construction of a Canal in Central America to be able to get a more efficient way to transport the products from the West coast to the East coast and vice versa. At this time, a French businessman called Phillipe Bunau-Varilla began discussions with businessmen and authorities from Washington. The conversations in Washington about changing the place to build the canal from Nicaragua to Panama was still in debate. Then, the American Congress decided that the place where the Canal was going to be built was Panama, instead of Nicaragua.

The American government paid US$40 million to acquire the shares of the French company to build the Canal, but the Colombian authorities did not want to have the Americans building the Canal without any consideration in return. However, after certain failed negotiations with the Colombian authorities, the American government refused to keep negotiating with them. At this moment, in Panama, which was part of Colombia, there was an independence movement. Philippe Bunau-Varilla saw the perfect opportunity for the independence of Panama from Colombia in order to allow the Americans to build the Canal without the approval of the Colombians.

Panama gained independence on November 3, 1903. Three days later the United States became the first nation to recognize Panama as an independent nation. In exchange for his work, Phillipe Bunau-Varilla requested to be appointed by the provisional government of Panama as Ministry Plenipotentiary. He was then appointed on November 6, 1903. On November 18, 1903, in an act that was criticized by President Manual Amador Guerrero and the Panamanian authorities, Bunau-Varilla signed the Hay-Bunau-Varilla treaty with the American Secretary of State, John Hay. This treaty recognized the Panama Canal building site and its surroundings as property of the United States, gave the New Panama Canal Company (an American entity) a monopoly on construction, and provided Panama US$10 million and an annual payment of US$250,000.

Subsequently, the New Panama Canal Company started the work where the French left it. The US company had the required technology to build this project, but its biggest obstacle was in a petite insect which produced a lethal disease - yellow fever. In response, the brilliant Dr. Gorgas discovered the way to eliminate the reproduction of the mosquito. With this problem solved, the construction was unstoppable. The Panama Canal was inaugurated on August 15, 1914. Unfortunately, because of the start of the World War I, this event did not have the media impact that it meant to have.

B. Change from American to Panamanian administration

During the decades of the sixties and seventies, there was a trend in the international community regarding the decolonization of the small countries from the powerful countries, and Panama was not the exception. After January 9, 1964 incidents[2], the

[2] In the incidents of January 9, 1964, a group of Panamanian school students went to the Balboa High School in the Canal Zone to raise the Panamanian flag jointly with the American. However, the act provoked tensions and fights that resulted in the Panamanian flag being torn. Then, the students were chased by the American

international community pressured the United States to give the Canal Zone back to Panama. This movement produced the Torrijos-Carter Treaty in 1977, where the United States agreed to give Panama the Canal Zone and the administration of the Panama Canal on December 31, 1999.

After control passed to Panamanian administration, the Constitution of Panama was modified to add Title XIV to address the Panama Canal territory and to create the *Autoridad del Canal de Panamá* (ACP, Panama Canal Administration).

Between 2000 and 2006, the previous *Panamax* size[3] was not enough for the requirements of world trade. At this time, some of the Panama Canal's clients started using other routes, like the Suez Canal, to be able to transport bigger ships. In light of these facts, the Panama Canal Administration considered a possible expansion and the creation of the Third set of Locks. The expansion was approved by a national referendum on October 22, 2006.

III. THE EXPANSION

A. The bidding process

The most important part of the Expansion[4] was the design and construction of the Third Set of Locks, which will be the focus in this article. The creation of the third set of locks had four bidders. On August 11, 2009, Grupo Unidos por el Canal (GUPC or the Contractor) won the bid. This consortium was composed of the following companies: Sacyr (Spain), Salini Impregilo (Italy), Jan de Nul (Belgium), and Constructora Urbana (Panama). Its proposal was the more economical, offering the price of US$3.11billion, which was below the price offered by the ACP of US$3.48 billion. Also, it had the highest

police which were armed with guns. Several Panamanian groups joined the fight, which resulted in 21 Panamanians and 4 Americans dead.

[3] *Panamax and New Panamax*, MARINE CONNECTOR, http://maritime-connector.com/wiki/panamax/ (last visited Mar. 25, 2019) (Panamax are the mid-sized cargo ships that are capable of passing through the lock chambers of the Panama Canal, which are 1,050 ft (320.04 m) in length, 110 ft (33.53 m) in width, and 41.2 ft (12.56 m) in depth).

[4] *International Financial Institutions Visit the Panama Canal Expansion*, CANAL DE PANAMÁ, https://micanaldepanama.com/expansion/2016/03/international-financial-institutions-visit-the-panama-canal-expansion/#prettyPhoto (last visited Mar. 25, 2019) (in 2008, the cost for the total Expansion of the Panama Canal was projected as US$5.25 billion. ACP invested US$2.95 billion from its operations and the rest US$2.30 billion was financed by five institutions, as wit: Japan Bank for International Cooperation (JBIC) – US$800 million, European Investment Bank (EIB) – US$500 million, Inter-American Development Bank (IDB) – US$400 million, International Financing Corporation (IFC) – US$300 million, Development Bank of Latin America (CAF) – US$300 million. These loans were approved without any collateral in behalf of the Panama Canal Administration, they were approved based on the trust and the positive credit rate of the Panama Canal. This funding, agreed to 20 years with a ten-year grace period, stipulating that creditors will not intervene in the management or operation of the Canal and will not affect the Canal´s contributions to the National Treasury, as established by Law 28 of 2006 which approved the Expansion Program).

score in the technical evaluation.[5] Work started on August 25, 2009 with a projected end date in October, 2014.

B. The Contract

The Contract for the design and construction of the Third Set of Locks ("the Contract") was based on the Yellow Book template of the *Féderation Internationale des Ingénierus-Conseils* (FIDIC[6], the International Federation of Consulting Engineers). FIDIC is an international organization founded in Belgium in 1913. Since 1957, when its first standard form called the Red Book was released, it has been the pre-eminent international organization in offering standard forms of contracts in the international construction market.[7]

The Conditions of Contract for Plant and Design-Build for Electrical and Mechanical Works and for Building and Engineering Works Designed by the Contractor,[8] also called Yellow Book, is the standard form used by a contractor to create a contract with the employer's requirements for the works.[9] The payment mechanism provided in the Yellow Book is regulated in sub-clause 4.1., "[W]here the Contractor accepts a fitness-for-purpose obligation for the design of the works, as well as for materials and workmanship. The payment mechanism for the Yellow Book is lump sum fixed price,[10] with provision for progress payments on the basis of Engineer certification." The Yellow Book is an

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[5] The consortium earned 4.088,5 points in the technical proposal (over a total of 5.500) and obtaining a total of 8.088,5 total points. Contract Officer's Report on the evaluation process of the Technical Proposals, July 2009 https://micanaldepanama.com/ampliacion/documentos/ (last visited Mar. 25, 2019). *See also* Francisco L. Hernández González, *La Problemática del Restablecimiento del Equilibrio Económico en la Contratación Pública Internacional: La Crisis de la Ampliación del Canal de Panamá*, 194, REVISTA DE ADMINISTRACIÓN PÚBLICA Revista 475, 481 (2014).

[6] Aisha Nadar, *The Contract: The Foundation of Construction Projects in the Guide to Construction Arbitration*, GLOBAL ARBITRATION REV 7, 15 (2017) (there are also another international professional associations that offer standard forms, such as: the Institution of Civil Engineers; the Institute of Chemical Engineers; the Joint Contracts Tribunal; the Engineering Advancement Association of Japan; the Civil Engineering Contractors Association; the AIA; and the Design Build Institute of America (DBIA)).

[7] Ellis Baker and Anthony Lavers, *Introduction to the FIDIC Suite of Contracts in The Guide to Construction Arbitration*, GLOBAL ARBITRATION REV 38, 50 (2017).

[8] While the Red Book standard form is used when the design is made by the Employer.

[9] Irene Nuviala Lapieza, *The Expansion of the Panama Canal and its Ruling International Contract: A Mega-Project Sailing in Troubled Waters?* 33 REVISTA ELECTRÓNICA DE ESTUDIOS INTERNACIONALES 1, 13 (2017).

[10] *See* Nadar, *supra* note 6, at 11 ("Fixed-price or lump sum contracts are contracts where the contractor is paid a pre-agreed sum of money when he or she has successfully performed all of his or her obligations under the contract. The contract sum is determined and specified in the contract agreement. Payment is made in pre-determined stages and the contractor assumes the risk for both performance and price.").

efficient industry standard, which allows parties to create a contract with certainty and predictability. Based on the principle of autonomy of the parties, they can amend this contract and tailor it according to the needs of the specific circumstances. As FIDIC implements international contracts, they provide for arbitration as the mechanism for the resolution of disputes.[11] Thus, to understand the issue of adaptation in case of hardship, this article will analyze the interaction between clause 13 (Right to Vary), clause 19 (*Force Majeure* clause), clause 17 (Risk Allocation), sub-clause 4.12 (unforeseeable physical conditions), and clause 20 (Resolution of Disputes clause).

1. Right to Vary

The Adjustment Clause in the Panama Canal Contract is contained in clause 13, with the name of Variations and Adjustments.[12] The Right to Vary starts with the employer's representative, who may initiate the variation[13] with or without[14] first request of the Contractor. The Contractor will be bound by it unless it gives notice to the employer's representative. After receiving this notice, the employer's representative shall cancel, confirm, or modify the instruction.[15]

The variation procedure provides that if the employer's representative sends a proposal prior to a variation, the Contractor shall respond as soon as practicable by accepting it or submitting comments, recommendations, or changes to the proposal (including suggestions for adjustment of the Contract price). Then, the employer's representative shall respond by either approving, disapproving, or giving comments. It is

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[11] Jane Jenkins & Kim Rosenberg, *Engineering and Construction Arbitration*, in ARBITRATION IN ENGLAND, WITH CHAPTERS ON SCOTLAND AND IRELAND162-163 (Julian D. M. Lew, Harris Bor , et al. eds., [X ed.] 2013)..).

[12] WOLFGANG PETER, ARBITRATION AND RENEGOTIATION OF INTERNATIONAL INVESTMENT AGREEMENTS 231 (X et al. eds,. X ed. 1986) (This is an example of clauses where the parties between themselves have formulas to be able to adapt the Price of the contract if it is required by the circumstances without requesting a tribunal to modify the contract. As was recognized by one scholar. "The parties may continually transform or operationally adapt their relationship to new circumstances and technical difficulties without any legal or contractual modification.").

[13] *See* Jenkins, *supra* note 11, at 166. (variations or change of orders are changes of the scope of works ordered by the owner or agreed with the contractor).

[14] *See* PETER, *supra* note 12, at 234 (If the Employer's Representative confirms and modifies the variation without the consent of the Contractor. It will work as a unilateral adaptation clause, which is used in the FIDIC contracts for purposes of efficiency in long term constructions contracts. "Under the FIDIC Civil Engineering Contract, the engineer is allowed to change or "vary" the works. Even if the FIDIC clause allows changes, the engineer's power to change the works is not unlimited. Accordingly, the engineer, acting as the employer's agent, can "avoid the need for renegotiations with the contractor each time a change becomes necessary or desirable."").".".

[15] Variation Orders, MICANAL DE PANAMA (last visited March 31, 2019) (available at https://micanaldepanama.com/expansion/documents/variations/) (on March 31, 2019, the contract has 197 Variation Orders).

important to highlight the fact that, while awaiting a response, the Contractor shall not delay any work that is not subject to the proposal. Once a variation is confirmed by the employer's representative or through an agreement, such a variation enters into force.

The Contract also provides for the payment due to additional costs in a daywork basis. The Contractor must send a quote to the employer's representative with the cost to perform and basic salaries of personnel.[16] After the work, it must send invoices of the expenses to the employer's representative (who shall include them in the next Interim Payment). Additionally, the Contract provides for adjustments due to changes in legislation. The Contractor will not be entitled to variations if it, while exercising Prudent Industry Practices,[17] ought to have reasonably foreseen such increases in cost or time.

Also, the Contract provides for an adjustment related to changes in prices of specified materials. It indicates that the Contract price shall be increased or decreased during the course of the Contract following the adjustment price changes of reinforcing steel, lock gate, and diesel fuel.[18] This price adjustment contains a ceiling called the Maximum Adjustment Quantity.[19]

2. Force Majeure

Clause 19 defines *force majeure* as an exceptional event or circumstance: (a) which is beyond a Party's control; (b) which such Party could not reasonably have provided against before entering into the Contract; (c) which, having arisen, such a Party could not reasonably have avoided or overcome; and (d) which is not substantially attributable to the other Party. Some events characterized as *force majeure*, if they fulfill the elements, are the following: war, hostilities, rebellion, terrorism, and natural catastrophes such as earthquake and hurricane. It also includes the munitions of war, explosive materials, except as attributable to the Contractor's use of such munitions, explosives, radiation or radio-activity, which will be at the risk of the Contractor because it could reasonably be avoided

[16] Wilfredo Jordan, Eduardo Mendoza, *Demand Made to Finish Canal Expansion* La Prensa, (Jan. 4, 2016), https://www.prensa.com/in_english/Canal_21_4385021455.html (On November 2012, DAB recognized US$17.7 million due to the increase of the cost of the workforce. Originally, GUPC requested US$31.4 million.).

[17] In sub-clause 1.1.5.25, the Contract defines **"**Prudent Industry Practices" as means using the standards, practices, methods and procedures, complying with Laws and exercising the degree of prudence and foresight which would be expected from a properly skilled and experienced international market leading EPC contractor in the international civil engineering and infrastructure sector.

[18] The adjustment indexes present in the Contract for this materials are: (a) Reinforcing Steel: "Platts Steel Markets Daily", "Reinforcing Bar", "Ex-Works, US SE", "Close/Midpoint" Price, in US $ per short ton; (b) Lock Gate, Valve, and Bulkhead Structural Steel Plate and Shapes: "Platts Steel Markets Daily", "Plate", "Ex-Works, US SE", Close/Midpoint" Price, in US $ per short ton; and (c) Diesel Fuel: "Platts Latin American Wire", "Gulf Diesel (No. 2 Oil)", Closing Price, in US $ per US gallon.

[19] The sub-clause 1.1.5.18 of the Panama Canal Contract provides that **"**Maximum Adjustment Quantity" means in respect of each Specified Material the maximum adjustment quantity as stated in the Price Adjustment Timetable.

or overcome with the right use and the principle that self-induced *force majeure* is not valid.

If as a consequence of the event, a party will be prevented from performing its obligations, temporarily or permanently, notification has to be given to the other party within 14 days after the party became aware or should have become aware, of the circumstance constituting *force majeure*. The consequence of the *force majeure* is the excuse of performance of the obligations as long as the events prevent it from being performed. Also, with due regard to the dispute resolution mechanism, the Contractor may request an extension of time for such delay caused by the *force majeure*, and it can request the costs incurred due to the event. If the *force majeure* substantially affects the work for 120 days or multiple periods which total more than 200 days, either party may request the termination of the Contract with payment due for the work that has been carried out.

For instance, this clause was applied in 2012 when in the province of Colon, protests and riots occurred due to the disagreement of the population when the government imposed a law affecting the free zone of the province. GUPC made a claim to the DAB in the amount of US$16.4 million and the DAB recognized US$6.2 million in favor of GUPC.

Additionally, in a case involving the strikes of the union called Suntracs from April 23, 2014 to May 7, 2014, GUPC claimed the amount of US$28.6 million and the DAB recognized US$11.2 million. [20]

3. Risk allocation

Clause 17 establishes that the events that caused *force majeure* are in the burden of the ACP.[21] According to this clause, the risk passes from the Contractor to the ACP until the Taking-Over Certificate is delivered. If any loss or damage happens to the works and goods while the Contractor is responsible for their care, not caused by *force majeure*, the Contractor shall rectify the loss or damage at its own risk and cost, so that the works, goods, and Contractor's documents be according to the requirements of the Contract.

This clause was applied in August 2015[22] when cracks appeared in the chamber of Cocoli locks, a highly publicized event. According to the administrator of the Panama

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[20] Wilfredo Jordan, *La DAB falla a favor de GUPC, aunque el monto es menos de lo que pedía a la ACP*, La Prensa,(Dic.31,2015) https://www.prensa.com/economia/Junta-favor-GUPC-reconoce-ACP_0_4381811899.html

[21] *See* Jenkins, *supra* note 11, at 164. "It is important to check the risk allocation for both time and costs for each neutral event, i.e. weather delays. It is not uncommon for construction contracts to allocate the risk of delays arising out of neutral events to the owner, but the risk of additional costs arising out of these events to the contractor. For example, under the JCT Standard Form of Building Contract, 2005 ed., the contractor is entitled to an extension of time for inclement weather conditions as a 'Relevant Event', but not compensation for any additional costs arising from that event."

[22]Michele Labrut, *Repairs to Panama Canal cracks to be completed in January 2016*, SeaTrade Maritime News (Dec. 2, 2015) http://www.seatrade-maritime.com/news/americas/repairs-to-panama-canal-cracks-to-be-completed-in-january-2016.html?highlight=Imd1cGMi, (last visited March 25, 2019).

Canal, Jorge Luis Quijano, the cost for the repairs was US$40 million, and it was a problem with the designer of locks.[23] The Contractor was responsible for the repairs of the locks and reinforced the sills with steel in the three chambers of both locks Agua Clara (Atlantic) and Cocoli (Pacific).

Interestingly, this Contract does not have a hardship clause (explained and discussed below) subject to maintaining the economic equilibrium of the parties. The Contract provides for an adjustment clause and a *force majeure* clause, but in the sub-clause 17.6 of risk allocation it expressly provides that neither party shall be liable to the other party for loss of use of any works, loss of profit, loss of any contract, or for any indirect or consequential loss or damage which may be suffered by the other party in connection with the Contract. . . . Therefore, in this Contract there is a limitation of liability, and it rejects the principle of restoring the economic equilibrium according to the risk allocation of the Contract.

ICC case no. 18,806 (decided in 2016, seated in London, between Konoike Construction Co. Limited (claimant) v. The Ministry of Works of Tanzania et al. (respondents) involving the design and construction of the upgrade of the Dodoma-Manyoni Road) regarded the allocation of risks where the contract was based in the FIDIC Yellow Book design and build contract.[24] On November 15, 2002, the Tanzania Ministry of Works invited tenders for the project.[25] On 2003, Konoike won the bid.[26]

In the arbitration, Konoike had several delays and disruption claims where the unforeseeability and risk allocation of these risks were discussed.

In a claim based on cement shortage, the claimant alleged that there was a national shortage of cement in Tanzania in the second half of November and December 2007 caused by the introduction of import tariffs by Tanzania.[27] On the other hand, Respondent argued that the shortage of cement was the claimant's risk.[28] Tanzania indicated that the event was not unforeseeable and that claimant could have avoided or overcome the event by paying higher market prices or sourcing cement from abroad.[29] Based on a Tanzanian case decided in 1983, respondent indicated that the shortage of building materials in Tanzania was a

[23]Wilfredo Jordan, *GUPC ha cobrado $4,235 millones* , La Prensa, (Jan. 25, 2015), https://impresa.prensa.com/panorama/GUPC-cobrado-millones_0_4377312227.html (last visited Mar. 25, 2019)

[24] Konoike Construction Co. Limited v. The Ministry of Works of Tanzania et al. ICC case no. 18806, 24 (2016).

[25] *Id.*

[26] *Id.* at 23.

[27] *Id.* at 127.

[28] Konoike Construction Co. Limited v. The Ministry of Works of Tanzania et al. ICC case no. 18806, 128 (2016).

[29] *Id.*

notorious fact.[30] Claimant submitted that the conditions from 1986 have changed due to a liberalization of the economy, easing of import restrictions, and opening of two cement plants increased the availability of cement in Tanzania.[31] In this claim, the tribunal concluded that it was an inability from the cement manufacturer due to problems with a clinker machine.[32] Therefore, the tribunal indicated that where at least a substantial cause of the cement shortage arose from the manufacturer's plant break down. Moreover, the tribunal was not able to conclude if Tanzanian government had any effect in the shortage of cement.[33]

4. Unforeseeable Physical Conditions

Sub-clause 4.12 of the Contract expresses and numbers different site conditions or unforeseeable physical conditions that are the burden of the employer. Unforeseeable is defined in sub-clause 1.1.6.42 as "not reasonably foreseeable by a Contractor exercising Prudent Industry Practices by the date established for submission of Tenders." Additionally, "the physical conditions mean natural physical conditions, including sub-surface and hydro-geologic conditions but excluding climatic conditions and man-made and other physical obstructions and pollutants." If the Contractor finds: (1) unforeseeable and different physical conditions from those described by the Employer in the descriptive documents, such as the geotechnical interpretative report and the topographical data; and (2) the circumstance is included in the list of circumstances provided in the clause, then the Contractor shall send the information to the employer's representative, describing the material changes and demonstrating that the condition was unforeseeable.

The Contractor has an obligation to keep performing the works provided in the Contract while the claims are being resolved. Moreover, the clause has a provision limiting the scope of the unforeseeable circumstances to those numbered in the clause. This clause expresses the conditions that are the burden of the Employer. Therefore, the issue arises when an unforeseeable circumstance causes the fundamental alteration of the equilibrium of the contract by an excessive increase in the onerousness of the contract. Can the tribunal modify the terms of the contract based on hardship?

[30] *Id.*

[31] *Id.* at 129.

[32] *Id.*

[33] *Id.* at 130.

5. Resolution of disputes

Clause 20 provides for three tiers in which the claims will be resolved. First, the claim is submitted to the employer's representative, who will analyze the merits of the claim. Second, in the case that the Contractor does not agree with the decision of the employer's representative, the claim must be filed before the Dispute Adjudication Board (DAB), which will render a binding decision on the parties. Finally, if during the period of 28 days after the notification of the decision, a party disagrees with the decision, the third tier will apply - the final resolution by arbitration.

a. Renegotiations through the employer's representative

The Contractor has a term of 28 days from when it knew or ought to have known about the event or circumstance to notify the employer's representative. In the case that the event has continuing effect, the Contractor must report this situation on a monthly basis and will have 28 days after the ending of the effect to present the final claim. The employer's representative is a specialized engineering professional with duties to include supervising the execution of the works by the Contractor to make certain that the works have been done according to the employer's requirements. The employer's representative is an agent of the ACP appointed to approve or disapprove internally the claims presented by the Contractor. In this regard, "it is precisely as the name implies, the representative of the employer for the purposes of the contract."[34]

Hence, the Engineer is not a party to the construction contract. The Engineer's contractual relation is with the Employer; through this contract it acquires supervisory obligations to the Employer.[35] In the FIDIC terms, the Contractor must first address the

[34] Scott Stiegler, *Parties to a Construction Contract*, The Guide to Construction Arbitration, 18, 23 (2017) (Stavros Brekoulakis and David Brynmor Thomas eds.) "The role of the Employer's Representative, while it is position held by an individual, is usually developed in a team which has been related to the project from the tender process to the development of the works."

[35] Sigvard Jarvin, Yves Derains and Jean-Jacques Arnaldez. ICC case No. 4416, Collection of ICC Arbitral Awards 1986-1990, 460-464 (Kluwer International 1994)., 1985. Reported by Sigvard Jarvin. (In a case which involved a European construction company acting as claimant and an African state corporation acting as respondent. In 1975, the parties agreed for a contract for the construction of public utilities, in this contract they provided for an independent engineer appointed by the owner. Later, in 1977 the independent engineer appointed by the owner was removed by the employer, with no replacement. The employer indicated that its own staff will handle the matter by itself. The contractor rejected this decision, but the owner did not appoint a replacement. The contract provided for the clause 52 (5) of the FIDIC conditions which requested that if the contractor may consider it entitled for additional payment it should send to the engineer the new accounts in a monthly manner. The question before the arbitral tribunal was whether because the owner did not appoint an independent engineer, the contractor may file the claim directly in arbitration. The tribunal indicated that: "A strict interpretation of the contract was excluded because of the deviations from the contract which the parties themselves, explicitly or implicitly, had undertaken." The tribunal also indicated that the role of the engineer can be performed by an employer's agent or employee. The tribunal is not going to consider the professional capability and integrity of the appointed engineer. However, the tribunal indicated that the own staff of the respondent did not have this institutional role and this provoked an *ex parte* procedural frustration provoked by the respondent, and this factor authorizes the respondent to file the claim directly by arbitration.).

complaint to the employer's representative.[36] For this position, the ACP appointed Mr. Jorge de La Guardia.[37] The employer's representative must request proof from the Contractor of the existence and impact of the event in question and will have 42 days to render a decision. If the Contractor disagrees with the decision, the next step is the resolution of the dispute by the Dispute Adjudicatory Board (DAB).

b. Dispute Adjudication Board (DAB)

The Dispute Adjudication Board is an alternative dispute resolution mechanism designed for construction projects where the members reach a decision that may become binding for the parties. In this regard, the DABs are tailored for big construction projects because they allow the parties to continue the works while the DAB is making the resolution of the dispute in an expeditious and efficient way. This continuance of performance is supported by the text of sub-clause 20.4 of the Contract, which establishes that "at all times unless the Contract has already been abandoned, repudiated or the Contract has been terminated or the Contractor's right to complete the Contract has been terminated, the Contractor shall continue to proceed with the Works in accordance with the Contract." This continuance of performance coupled with the absence of strict formalisms, like in the litigation or in arbitration, allow the mega-projects to obtain efficient justice in a period when it is still useful instead of entering long and complex procedures that lose the economic value for the parties.[38]

In the Contract, the parties agreed to a Board formed of three members - each party appointed one, and these two appointed the chair. In the standard Yellow Book resolution mechanism, the DAB is appointed as *ad hoc*[39] for every difference that the parties have

[36] *Id.* at 454, 454-459. ICC case No. 4589, 1984. (In this case involving a European contractor and an Middle East employer, the contractor indicated that several delays which overruns the cost of the construction of an hotel due to the fault of the employer in getting the custom documentation for the materials. The contractor submitted a claim for extension of time and additional payments to the engineer, who in 1982 rejected the claims. In January 1983 the contractor submitted a claim for arbitration in ICC Court of Arbitration Secretariat in Paris. On 16 May, 1983 the contractor terminated the contract with effective date 30 May 1983. On August 1983 it amended its claim adding totaling amounts in excess of the original claim. The employer indicated that according to the contract, the contractor had to submit this claim first to the engineer, regardless that the contract was terminated. M.M. Soumrani acting as sole arbitrator answered the question why should a termination of the construction contract make the engineer *functus officio?* The sole arbitrator indicated "that the contract relating to the project, the construction contract, may be repudiated by the Contractor without necessarily affecting the Engineer's authority to perform surviving duties and exercise remaining rights laid down in the FIDIC conditions. As long as the appointment of the Engineer is notified to the contractor, disputes must first be referred to him, and he must be prepared to examine new disputes after the termination of the construction contract until the Employer decides to replace him or otherwise.").

[37] *See* Nuviala Lapieza, *supra* note 9, at 15.

[38] Agenor Correa Pulice, *La Naturaleza Jurídica y Misión de los Disputes Boards*, Revista Métodos Alternos de Solución de Conflictos en Panamá, 65, 65 (2016).

[39] *See* Baker, *supra* note 7, at 41.

during the project However, the parties modified this provision and agreed to appoint permanent members of the DAB,[40] to be able to obtain a more active and present role of the DAB during the advances of the project. The members of the permanent DAB are Mr. Pierre Genton (appointed by GUPC), Mr. Robert Smith (appointed by ACP), and Mr. Peter H.J. Chapman (the chairman selected by the parties).[41]

The DAB shall be deemed not to be acting as arbitrators.[42] Both parties shall make available to the DAB all the necessary information.[43] After the DAB has all the required information, it has to render a decision within 84 days, which shall be reasoned under sub-clause 20.4.[44] The DAB is not obliged to render a decision until it has been paid in full (divided in the equivalent proportion by each party). According to the text of the Contract, the decision of the DAB is binding unless and until it is revised by the parties in an amicable settlement or in an arbitral award.[45] The parties have a period of 28 days after the decision has been rendered to notify the other party of its dissatisfaction with the decision. In absence of this notification, the decision of the DAB will be final, binding, and enforceable.[46]

The following is an example of the DAB's decisions on December 31, 2014. GUPC asked for damages of US$463 million and requested a 265 day extension. GUPC claimed that the mixture of basalt, which is the main element of the concrete offered by the ACP, was not of the same characteristics that were necessary for its use. When it proposed a different mixture, the ACP approved it after an initial rejection. According to GUPC this costed "overruns" for adjusting its cement processing plant and seeking alternative sources of basalt.[47] The permanent DAB rendered a decision awarding GUPC US$233 million plus interest and 176 additional days to complete the project. However, regarding this dispute,

[40] *See* Nuviala, *supra* note 9, at 25.

[41] *Id.* at 30.

[42] Sub-clause 20.4 of Conditions of Contract. https://micanaldepanama.com/expansion/documents/third-set-of-locks-contract/

[43] *Id.*

[44] *Id.*

[45] *Id.*

[46] *Id.*

[47] Ryan Mellske, *Grupo Unidos por el Canal v. Autoridad del Canal de Panamá, Dispute Adjudication Board Decision, 31 December 2014*, A contribution by the ITA Board of Reporters, 1 (Kluwer Law International 2015).

on March 17, 2015, the ACP filed a claim[48] before the next tier in the dispute resolution of the Contract - arbitration seated in Miami and administered by the ICC.[49]

c. Arbitration[50]

The last and ultimate instance to resolve any dispute in this mega-project is arbitration. Sub-clause 20.6 of the Contract contains the arbitration agreement. This clause establishes: "(**i**) Unless settled amicably, any dispute in respect of which the DAB's decision (if any) has not become final and binding shall be finally settled by international arbitration in law (within the meaning of Panamanian law)."[51]

The wording "any dispute*"* in this sub-clause is defined in sub-clause 20.4 and establishes that "If a dispute (of any kind whatsoever) arises between the Parties in connection with, or arising out of, the Contract or the execution of the Works, including any dispute as to any certificate, determination, instruction, opinion or valuation of the employer's representative. . . ." The language "if a dispute (of any kind whatsoever)" related to the contract, *prima facie* will appear as a broad concept in which everything

[48] According to the Independent Financial Statement of 2015 of the ACP produced by Ernst & Young. The ACP paid the US$233 million as the DAB decided, and then the ACP presented this claim to recover this amount. This supports the fact that the DAB's decisions are binding until they are reversed by the arbitral tribunal. In this same arbitral process, GUPC is claiming a total of US$807,472,000 from the ACP. Independent Auditors' Report of Financial Statements to the Board of Directors of the Panama Canal (Sept. 30, 2015), https://www.pancanal.com/eng/general/fin-statements/FY-2015.pdf.

[49] After the notification of the no conforming letter. Sub-clause 20.5 of the Contract provides that the parties shall attempt to settle the dispute amicably before the commencement of arbitration. However, the Contract created there a presumption that the parties agree that after 56 days of the notification of the letter the arbitration may be commenced, even if the parties have made no attempt at amicable settlement. In practical matters, it has to be seen that in the first tier the parties already tried to negotiate, and they went to the DAB, it means that the renegotiations did not have a successful outcome. Therefore, this clause is only a wait of 56 days to be able to start the arbitration.

[50] In the different ICC arbitrations between GUPC and ACP the legal team of GUPC included White & Case LLP (N.Y.C., United States), BonelliErede (Italy), Seyfarth Shaw (D.C., United States) and Alemán, Cordero, Galindo & Lee (Panama). The legal team of the ACP included Vinson & Elkins LLP (USA, with a consulting contract for US$15.3 million), Mayer Brown LLP (United States, with a consulting contract for US$99.5 million), Galindo, Arias & López (Panama), Manus McMullan QC and Peter Land from Atkin Chambers (United Kingdom) and Karla Arias and Carlos Arrue Montenegro from the ACP's legal department. Tom Jones, *Panama Canal consortium ordered to pay*. LATIN LAWYER (Jan. 3, 2019), https://www.vonwobeserysierra.com/images/PDF_news/2019/LL---Panama-Canal-consortium-ordered-to-pay-3-01-2019.pdf; *Manus McMullan QC and Peter Land in win for the Panama Canal Authority* (Dec. 17, 2018), https://www.atkinchambers.com/manus-mcmullan-qc-and-peter-land-in-win-for-the-panama-canal-authority/(; (*Informe Trimestral XLIX Avance de los Contratos del Programa de Ampliación* (December 31, 2018) https://micanaldepanama.com/ampliacion/wp-content/uploads/2019/01/20181231.pdf., https://micanaldepanama.com/ampliacion/documentos/informes-no-auditados/

[51] Sub-clause 20.6 of Conditions of Contracts.

related to the contract shall be submitted to arbitration. However, this was not the holding in a case decided in 2017 by the High Court of Justice in England involving a dispute related to the main Contract, where GUPC filed an application to stay the court proceedings in London under §9 of the English Arbitration Act of 1996. [52]

In this case, ACP (claimant) and the members of GUPC (defendant) agreed to new guarantees for the repayment of the advance payments that the ACP made to GUPC in 2015. These new guarantees, called APG (advance payment guarantee) and JAPG (joint advance payment guarantee), had an exclusive jurisdiction clause in favor of English courts and a choice of law clause for English law.[53]

The main issue was to determine if GUPC was liable for the repayment of the advance payments to ACP under the main Contract. The defendants argued Panamanian law was the applicable law because the issue was subject to arbitration under the main Contract and the arbitration clauses had Panamanian law as the applicable law.[54] The court denied the stay of proceedings due to the parties' agreement in the APGs.[55] In this regard, the court agreed with the defendants that the repayment issue subjected to arbitration was the most substantial issue arising under the APGs.[56] However, the court applied the theory "the substance of the controversy,"[57] which indicated that the issue was whether the defendants were liable to ACP under the English law APGs (within the exclusive jurisdiction clause). Therefore, the court found that was not a matter that the parties agreed to arbitrate.[58]

This is an example of how the parties may choose another forum or different applicable laws to regulate and resolve the contract disputes that are related to the main contract. In this case, even though the main Contract contains a broad arbitration agreement and the dispute was related to it, the court based its decision on the agreement of the parties

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[52] *Autoridad del Canal de Panamá v. Sacyr, S.A., Salini-Impregilo S.P.A., Jan De Nul, N.V., Constructora Urbana S.A., Sofidra S.A.*, [2017] EWHC 2228 (Comm).

[53] ACP motion for summary judgment indicated that because of APG and JAPG, the members of GUPC were principally responsible and that the advance repayments were upon demand. The court rejected this motion.

[54] [2017] EWHC 2228.

[55] "There is no reason to take a different approach here. To hold otherwise and impose a mandatory stay would run contrary to the substantive provisions of the contract, by which ACP is entitled to enforce the security without enforcing any other security or the principal indebtedness itself."[2017] EWHC 2228.

[56] [2017] EWHC 2228.

[57] "The essential nature of the claim here is that it is brought under guarantees (the APGs), which are subject to English law and jurisdiction. The substance of the controversy between the parties is the claim under the APGs, and that is the "matter" for the purposes of s. 9(1). The issue of the liability of the principal debtor to repay the advance payments (i.e. the GUPC Repayment Issue) is necessarily bound up with the nature of the instrument as a guarantee, but it is not the, or a, "matter" for these purposes in itself." [2017] EWHC 2228.

[58] [2017] EWHC 2228.

when they choose English law as the applicable law for the APGs.[59] This is because the choice of forum and choice of law clauses as the arbitration agreements are products of the principle of autonomy of the parties.

The arbitration agreement also indicates that (**ii**) "The dispute shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce".

As of September 30, 2018, the claims of GUPC amount to US$5.68 billion. In the development of the Expansion of the Panama Canal there have been five arbitrations administered by ICC (including the jointed ones). The cases that are still in dispute are the second, third and fourth.

The first case, *Pacific entrance Cofferdam Arbitration* (ICC 19962/ASM), involved a dispute over the Pacific Entrance Cofferdam. The arbitrators were Bernard Hanotiau (President/Belgium), Bernardo Cremades (Spain) and Robert Gaitskill QC (UK).[60] The arbitration commenced in December 2013, and the final hearing was in January 2017.[61] The decision was communicated on July 31, 2017. The amount claimed by GUPC was US$194 million.[62] The tribunal ruled in favor of ACP and ordered GUPC to pay US$23 million in legal costs.[63]

The second case, *Concrete Arbitration* (ICC 20910/ASM merged with ICC 20911/ASM), involves a dispute concerning the concrete and aggregates, on-site laboratories and Pacific foundation.[64] The arbitrators were Pierre-Yves Gunter (President/Switzerland), Claus von Wobeser (Mexico) and Robert Gaitskill (UK).[65] The amount claimed by GUPC was US$807 million. The arbitration commenced in March 2015.[66] Hearings on the merits were held January 2019 and February 2019.[67] Before this arbitration, the DAB ordered the ACP to pay US$233 million plus interest to GUPC. In the arbitration, GUPC requested U$347 million more, while ACP claimed to recover the paid US$244 million paid and additional US$264 million.

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[59] [2017] EWHC 2228.

[60] *See* Tom Jones *supra* note 50.

[61] ACP's Audited Financial Statements, Tax Year 2018 at 71, https://micanaldepanama.com/nosotros/sobre-la-acp/rendicion-de-cuentas/presupuestos-y-proyectos/estados-financieros-auditados/ (last visited on May 25, 2019).

[62] *Id.*

[63] *Id.*

[64] *Id.*

[65] *See* Tom Jones *supra* note 50.

[66] *See* ACP's Audited Financial Statements *supra* note 61, at 71.

[67] *Id.*

Also, the ACP claimed delay damages for US$54 million due to the 182 day delay.[68] This tribunal faced an Emergency Application filed by GUPC.[69] GUPC requested that the tribunal issue an order directing ACP to agree to a revised timetable to defer any repayment obligation after the conclusion of the arbitration, anticipated to last until 2022 (the letters of credit were valid until December 2018).[70] Basically, GUPC requested the tribunal prohibit the ACP from taking any action that could affect the *status quo* of the parties until the disputes were settled.[71] The arbitral tribunal in the Procedural Order No. 1, made on a *prima facie* basis, denied the claim.[72]

The third case, *Locks Arbitration* (ICC 22465/ASM/JPA), involves a dispute about the lock gates and adjustment of labor costs.[73] According to the Project Report of the ACP "a mutual agreement by them is still pending to designate the President of the Arbitral Tribunal to constitute such Arbitral Tribunal." The amount requested by GUPC is US$506 million.[74] Arbitration commenced on December 8, 2016. It is in an early stage.[75] Also, it is important to point out that the arbitrations 22465/ASM//JPA and the 22966/JPA were jointed in this case.[76]

The fourth case is *Disruption, Unforeseeable physical conditions and other claims Arbitration* (ICC 22466/ASM//JPA). It is in an early stage. The amount requested by GUPC is US$4.34 billion.[77] The ICC 22466/ASM//JPA was consolidated with the case ICC 22967/JPA and filed in July 2017.[78] This case was not decided in the 84 days that the DAB had to render the decision (sub-clause 20.4) and GUPC filed the notice of arbitration.[79] According to the administration of the Panama Canal, the amount that GUPC

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[68] *Id.*

[69] [2017] EWHC 2228

[70] *Id.*

[71] *Id.*

[72] *Id.*

[73] *See* ACP's Audited Financial Statements *supra* note 61, at 71.

[74] *Id.* at 72.

[75] *Id.* at 71

[76] *Id.* at 72.

[77] *Id.*

[78] *Id.*

[79] GUPC incumple pasos para hacer reclamos (Oct. 25, 2017), https://impresa.prensa.com/panorama/GUPC-incumple-proceso-reclamo_0_4879012207.html (last visited Mar. 25, 2019).

is requesting will be enough to build a fourth set of locks.[80] The contract price for the third set of locks was US$3.11 billion.

The fifth case was *Advance payments or Guarantee Arbitration*. The arbitrators were Gabrielle Kauffman-Kohler (President/Switzerland), Guido Tawill (Argentina) and Stephan Furst QC (UK).[81] GUPC requested declarations that repayments of the advance payments were not due or payable under Panamanian law and the relevant agreements.[82] There were US$548 million in advance payments secured by Letters of Credit with the applicable law being Panamanian law.[83] This matter was going to consider much of the same points of the Emergency Arbitration.[84] The proceedings commenced in January 2017, and the decision was rendered on December 12, 2018.[85]

The ACP argued that GUPC did not follow the dispute resolution mechanism by addressing this dispute directly to arbitration.[86] The tribunal held that GUPC would have to pay the ACP the initial advances, which amount to US$547 million (secured by three letters of credit, subjected to Panamanian law and issued by two Panamanian institutions).[87]

GUPC will have to pay the ACP the additional advances of US$299 million secured by corporate guarantees subjected to English law, producing a total of US$847 million.[88] The ACP became entitled to collect the Guarantee issued by UniCredit AG (London) for the interests of the advance payments in the amount of US$13 million.[89] The tribunal also held that the ACP was not authorized to withhold amounts payable to GUPC related to maintenance services. GUPC must reimburse ACP US$395,000 in concept of costs and

[80] Jorge Luis Quijano: 'GUPC ha hecho reclamos muy superiores', (Jan. 13, 2016) https://www.prensa.com/politica/Quijano-GUPC-hecho-reclamos-superiores_0_4390811059.html (last visited Mar. 25, 2019).

[81] *See* Tom Jones *supra* note 50.

[82] [2017] EWHC 2228.

[83] *Id.*

[84] *Id.*

[85] *See* Tom Jones *supra* note 50.

[86] [2017] EWHC 2228

[87] Canal de Panamá hace efectivas Cartas de Crédito que garantizaban el repago de los Adelantos Iniciales por USD547.9 millones (Dec. 17, 2018), https://micanaldepanama.com/canal-de-panama-hace-efectivas-cartas-de-credito-que-garantizaban-el-repago-de-los-adelantos-iniciales-por-usd547-9-millones/ (last visited Mar. 25, 2019).

[88] *Id.*

[89] *Id.*

expenses of the tribunal members and the International Court of Arbitration of ICC.[90] Finally, GUPC must pay ACP US$5 million as contribution of the legal costs and expenses.[91]

The arbitration clause also indicates that (**iii**) "as an addition to the Rules the parties agreed that the arbitration shall be conducted according to the International Bar Association Rules on the Taking of Evidence in International Commercial Arbitration"[92] known as the "IBA Rules."

On this point, the document of the IBA Rules is an effort of the international community to get uniformity, predictability, and guidance to the tribunal in how to deal with situations of evidence, which can be problematic because of the many differences between civil and common law in taking on evidence.[93] Initially, the IBA Rules are not binding, but they may be binding by virtue of the parties' agreement,[94] as in the Panama Canal Contract.

Moreover, according to (**iv**), the dispute shall be settled by three arbitrators who shall all be licensed lawyers appointed in accordance with the Rules; (**v**) the arbitration shall be decided in law (within the meaning of Panamanian law) and shall be conducted in the language for communications defined in sub-Clause 1.4,[95] i.e. English. Also, the clause provides in (**vi**) the venue of the arbitration shall be Miami, Florida, United States of America.[96] In this part, the terms "venue" and "seat" are used indistinctly. The selection of the seat of arbitration is of fundamental importance in dealing with matters of setting aside arbitral awards or annulling arbitration agreements.[97]

A prime example can be found in the case *Grupo Unidos por el Canal, S.A. v. Autoridad del Canal de Panama*, where GUPC (claimant) filed a motion to vacate an arbitral award rendered by the arbitral tribunal seated in Miami. This arbitral award was issued in the Arbitration No.1, the Pacific entrance Cofferdam Arbitration. GUPC claimed for overruns of almost US$200 million on the Pacific side of the project, due to significant time delays and cost overruns, related to the design and construction of a cofferdam, which

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[90] Panama Canal new lock construction consortium ordered to repay $848m (Dec. 14, 2018), http://www.seatrade-maritime.com/news/americas/panama-canal-new-lock-construction-consortium-ordered-to-repay-848m.html (last visited Mar. 25, 2019).

[91] *Id.*

[92] Sub-clause 20.6 of Conditions of Contracts. *See supra* note 51.

[93] Gary Born, *International Commercial Arbitration 202* (2d ed. 2014).

[94] Article 1.1. of IBA Rules on the Taking of Evidence in International Commercial Arbitration (2010).

[95] Sub-clause 20.6 of Conditions of Contracts. *See supra* note 51.

[96] *Id.*

[97] *See* BORN, *supra* note 93, at 93.

would allow a dry work area, and a diversion of the nearby Cocoli River.[98] GUPC based its motion on 9 U.S.C.§10(a)(3), arguing that the arbitral tribunal majority refused to consider relevant and necessary evidence as a result of ACP's repeated failure to produce pertinent documentation and witnesses.[99] The arbitral tribunal held in favor of the ACP. Also, the arbitral tribunal ordered GUPC to reimburse ACP US$22 million in legal and administrative costs.[100]

The court rejected the motion to vacate the award and confirmed the arbitral award.[101] The court reasoned that the motion to vacate was time-barred because it has passed the term of three months, after the filing or delivering of the award, to serve the adverse party.[102] The court indicated that the ACP was an instrument of a foreign state, therefore, the Foreign Sovereignty Immunity Act (FSIA) applied. §1608 (b)(1) of the FSIA act provides that the service must be made according to the special arrangement between the plaintiff and the agency.[103] The ACP indicated that there was no special arrangement and that the notice by email and courier to the ACP's counsel was not a valid service.[104] GUPC argued that according to the terms of the contract the communication regarding the arbitration proceeding had to be sent to the ACP's counsel.[105] The court held that this motion to vacate was not part of the arbitration and that the agreement to communicate to the ACP's counsel was narrowed only to the procedure of the arbitration.[106] GUPC also argued that three months was not enough to be able to review the award, draft the motion to vacate, obtain the translations of the documents, and attempt to serve ACP via letters rogatory.[107] Because of these reasons they did not have any choice other than to send the service by special arrangement.[108] The court indicated that it may be true, but GUPC did

[98] Grupo Unidos por el Canal, S.A. v. Autoridad del Canal de Panama, 17-23996-CV, 2018 WL 4111216, at *1 (S.D. Fla. Aug. 29, 2018)

[99] *Id.*

[100] *Id.*

[101] *Id.*

[102] *Id.*

[103] *Id.*

[104] *Id.*

[105] *Id.*

[106] *Id.*

[107] *Id.*

[108] *Id.*

not attempt any proper way of serving the ACP, according to §1608(b) of the FSIA.[109] Therefore, the court held that the motion to vacate was time-barred.[110]

Finally, the clause indicates in **(vii)** the arbitration agreement and the arbitration shall be governed by the United States Federal Arbitration Act, 9 U.S.C. §§ 1 et seq. In the present element, the parties expressly decided which law was going to be the law applicable to the arbitration agreement. The parties agreed to the Federal Arbitration Act (FAA). The *lex arbitri* is also the FAA, which is pro-arbitration in virtue of the *Federal Policy Favoring Arbitration* of the Supreme Court of the United States.[111]

IV. THE DISPUTES

On January 1, 2014, when the project had advanced 71% and the construction of the lock was at 64%,[112] the problems and their impact[113] became public. They started being discussed when the Contractor sent a note to the ACP indicating that it was going to suspend the work because the ACP did not recognize extra costs of US$1.65 billion, which was near 50% of the original cost of the project. GUPC argued that these overruns were caused by breach of contract caused by the ACP.[114]

GUPC indicated that the ACP had failed to maintain and restore the financial equilibrium of the contract produced by the unforeseeable events that occurred in the

[109] *Id.*

[110] *Id.*

[111] Southland Corp. v. Keating, 465 U.S. 1 (1984); Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52 (1995); Shearson/Am. Exp., Inc. v. McMahon, 482 U.S. 220 (1987); Moses H. Cone Meml. Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983); Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213 (1985); Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985); Epic Sys. Corp. v. Lewis, 138 S. Ct. 1612 (2018).

[112] Consorcio emplaza a la ACP (Jan. 2, 2014), https://impresa.prensa.com/panorama/Consorcio-emplaza-ACP_0_3835866376.html (last visited Mar. 25, 2019).

[113] The ACP started analyzing to enforce the guarantee of US$600 million endorsed by Zurich American Company to continue the project with a new contractor. However, to do this would produce extra costs of €2 billion and would delay the project until 2018, which will produce detrimental situations to both parties. At the date of the note, the ACP had pay US$2.04 billion of the total of US$3.11 billion of the project, US$784 million in anticipated payments which GUPC had only payback US$52 million and recognized extra costs of US$176 million (US$156 due to increase in the price of gas and steel and US$20 million because of needs of the workers). *See* HERNÁNDEZ, *supra* note 5, at 483.

[114] *See* HERNÁNDEZ, *supra* note 5, at 482- 484. The ACP indicated that it was not going to accept pressures from GUPC, and if GUPC had any claim against the ACP in this regard the contract provided for the order of the instances to be able to resolve these issues. Indeed, GUPC stopped the works on February 7, 2014 and after with long failed renegotiations, rejection of different proposals and the intervention of officials from Panama, Spain and Italy on February 20th, 2014 the parties made a preagreement that was ratified by the Board of the ACP and a new date for the termination of the project was extended to December 2015.

project. The parties resolved this dispute through renegotiations and a variation order where the ACP paid advance payments to GUPC to be able to advance with the project.[115]

The parties had other disputes before finishing the project, which was inaugurated in 2016. However, even though the Panama Canal Expansion was finished, arbitral procedures with a higher value than the projected cost are currently being litigated. In this regard, the parties currently have an arbitration seated in Miami where the dispute is over Unforeseeable Physical Conditions. GUPC is requesting US$4.34 billion. Due to the confidentiality of this arbitration and its early stage, we do not have the exact prayer for relief and arguments of each party; however this allows us to make a deeper and more creative analysis of the consequence of unforeseeable events that fundamentally alter the economic equilibrium of the Contract.

This article will address two issues: First, whether a tribunal, without express conferral of powers, can adapt or modify the terms that the parties agreed to; Second, if the arbitral tribunal considers that it has jurisdiction, can the tribunal adapt the terms of the Contract in order to restore the altered equilibrium of the contract due to unforeseeable circumstances that the parties did not include in the contract?

V. MAY THE ARBITRAL TRIBUNAL MODIFY THE TERMS OF THE CONTRACT?

The arbitral tribunal derives its jurisdiction from the parties' arbitration agreement. Thus, the tribunal's jurisdiction depends on what the parties agreed to. The arbitral tribunal, based on the principle of *kompetenz-kompetenz,* is the one who will interpret the arbitration agreement, the contract, and will rule about its own jurisdiction.[116]

A. Arbitration agreement

Through the arbitration agreement, the parties decide to resolve certain contractual or not contractual disputes by arbitration. Therefore, the tribunal should first analyze the text of the arbitration agreement to determine if the parties agreed to grant the tribunal jurisdiction to adapt or modify the contract.

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[115] *See* [2017] EWHC 2228, supra note 52. These negotiations produced a Memorandum of Understanding (MOU) between the parties where through the Variation Order (VO) 90, the ACP as advance payment for Specified Expenditures (APSE) injected cash to the project to be repaid at the end of 2015. The MOU entered into effect by the VO 108 and became part of the Contract on August 1st, 2014. This variation order also modified the period of repayment of the Other Existing Advances (OEA) including APSS and APLG which by sub-clause 14.2J of the Contract established that the repayment could be deferred until 31 December 2015 upon certain conditions being met; and December 31, 2018 upon certain conditions being met, including the provision of letters of credit with a December 31, 2018 expiry date and issued by Panamanian financial institutions of a specific financial standing, which included a Guarantee Arbitration Agreement in favor of Panamanian law and ICC arbitration in Miami.

[116] CARLOS ARRUE MONTENEGRO, *Precisiones Conceptuales y Practicas sobre el Efecto Negativo de la Regla Competencia-Competencia*, REVISTA MÉTODOS ALTERNOS DE SOLUCIÓN DE CONFLICTOS EN PANAMÁ, 41, 42 (2016).

1. Express conferral of power.

In the case that the arbitration agreement grants the arbitral tribunal with express conferral of power to adapt the contract, then the tribunal will have the authority to apply the *lex causae* (the law applicable to the merits of the case) to modify the terms of the agreement. Initially, because in some legal systems adaptation of a contract due to economic imbalance is such an extraordinary measure, if the parties' intent is that a third party (or even a court) should modify (for example the price of the contract), they should expressly provide for such power.[117]

2. In absence of express conferral of power, Supplementary contract interpretation may be applicable

As in the arbitration agreement of the Panama Canal Contract, where there is no express conferral of power to the arbitral tribunal to adapt or modify the contract, the debate of interpretation starts. Clause 20 provides that the arbitral tribunal has jurisdiction (after the decision of the DAB and the possibility of an amicable settlement): "If a dispute (of any kind whatsoever) arises between the Parties in connection with, or arising out of, the Contract or the execution of the Works. . . ." The term "any dispute" may include the conflict in matters of interpretation of the contract and the arbitration agreement. Therefore, if the text of the clause is ambiguous the tribunal has the authority to interpret the contract and the intent of the parties at the moment of its conclusion.

The theory of compliance with the parties' intent is called the supplementary contract interpretation. Conceptually, it is not a review of the terms of the contract or the creation of them for unforeseeable circumstances that may cause economic imbalance but the recognition and deciphering of pre-existing contractual terms.[118] The arbitral tribunal may conclude that the issue of possible adaptation is a dispute between the parties and should be decided. Additionally, one scholar had established that functionally the tribunals can adapt the contract by interpretation of them because "the distinction between interpreting and creating the law is a fiction."[119]

In this regard, based on the principle that *Arbiter non substituit*, arbitrators do not make contracts.[120] The arbitrators should take into consideration the law applicable to the

[117] BRUNO OPPETIT, THE ADAPTATION OF INTERNATIONAL CONTRACTS TO CHANGING CIRCUMSTANCES: THE HARDSHIP CLAUSE, 808 (1974).

[118] Lisa Beisteiner, *The Arbitration Agreement and Arbitrability, The (Perceived) Power of the Arbitrator to Revise a Contract – The Austrian Perspective*, AUSTRIAN YEARBOOK ON INTERNATIONAL ARBITRATION 80 (2014).

[119] *Id.* at 80.

[120] *Id*. at 77.

arbitration agreement, the *lex arbitri*, and the *lex causae* to determine if they can adapt the contract.[121]

a. Applicable laws to the arbitration

i. The law applicable to the arbitration agreement

When the parties agree to arbitration agreements, they may subject it to a law different from the law applicable to the substantive contract. Hence, the tribunal should take it into consideration to supplement the arbitration agreement if the law applicable to it allows the adaptation of the contract. If the parties agree to a law that is pro-arbitration, by which the wording of the arbitration agreement should be interpreted, then the tribunal may understand the parties' intent as giving it the power to modify or adapt the contract without exceeding the scope of the arbitration agreement. Due to the fact that the arbitration agreement may be supplemented by the law applicable to it, if the parties agreed to a law which interprets the arbitration agreement in a pro-arbitration way, they should expressly reject the power of the arbitral tribunal to modify the contract due to unforeseeable circumstances.

The applicable law to the arbitration agreement will determine the scope of the arbitrator's authority to interpret the arbitration agreement. Hence, in the case that the law applicable to it requests for express conferral of power to adapt the contract and the parties did not grant the tribunal with such a power, the tribunal should interpret this intent as a rejection of adaptation at the moment of the conclusion of the contract.

In the case of the arbitration agreement of the Panama Canal, the applicable law is the FAA, which according to the Supreme Court of the United States has a Federal Policy Favoring Arbitration[122] in favor of the recognition and enforcement of the arbitration agreements. In this regard, the substantive provision of the FAA is §2 which recognizes the enforceability of the arbitration agreements before the courts.[123] Also, the FAA contains a very broad notion of arbitrability[124] which may give the tribunal broader powers than those expressly mentioned in the arbitration agreement.[125]

When the parties agree to a law applicable to the arbitration agreement the tribunal has a better notion of the intent of the parties on how to deal with different disputes about

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[121] *Id*. at 77, 79.

[122] THOMAS E. CARBONNEAU, ARBITRATION LAW AND PRACTICE 166 (7th ed. 2015).

[123] Arthur Andersen LLP v. Carlisle, 556 U.S. 624, 630 (2009).

[124] *See* Carbonneau, supra note 122, at 34.

[125] At this moment we are only dealing with the matter if the tribunal has jurisdiction to adapt the contract, the dispute if it should or not will be discussed later based on the agreement of the parties and the *lex causae* (applicable law to the merits of the dispute).

the scope of the arbitration agreement. However, parties do not always determine the law applicable to the agreement. In this case, the tribunal must interpret the intent of the parties to establish the most reasonable law to apply to the arbitration agreement. In this regard, part of the doctrine indicates that there is a presumption that the applicable law to the substantive contract should be the one applied to the arbitration agreement.[126]

A point to take into consideration in this discussion is that the separability doctrine only applies to situations where the validity of the arbitration agreement is questioned or disputed,[127] it does not mean that the arbitration agreement has a different applicable law when the parties were silenced on this topic.

The other side argues that the default law applicable to the arbitration agreement must be the law of the seat. This position is mostly based on the presumption that the doctrine has been interpreted in Art. V(1)(a) of the New York Convention, which indicates that the recognition and enforcement of the arbitral award may be refused if the arbitration agreement is invalid under the agreed applicable law, or in the absence of such a choice, is invalid under the law where the award was made (the seat of the arbitration).[128]

The debate of the law applicable to the arbitration agreement was the main issue in the renowned case decided in 2012 by the Court of Appeal of England and Wales, Sulamerica CIA Nacional de Seguros SA v. Enesa Engeharia SA.[129] This case was based on risk insurance policies for the construction of hydroelectric plants in Brazil. The policies provided the law of Brazil as applicable law to the substantive contract, and the escalation clause provided for the seat of the arbitration in London, United Kingdom. The tribunal applied a three-prong test to determine which was the most adequate law applicable to the arbitration agreement.

This three-prong test indicated that first the tribunal should look for the explicit choice of law in the arbitration agreement - in the Sulamerica case there was no explicit choice of law. Second, the tribunal should look for the implicit choice of law according to the intent of the parties at the moment of the conclusion of the contract. Finally, if there is no explicit or implicit choice of law, the tribunal should look for the law with the closest and most real connection to the parties' agreement. In this stage, the purpose and the importance of the choice of the seat of the arbitration should be balanced against the importance of the choice of law of the substantive contract. For this purpose, the tribunal should also take into consideration factors like the place of performance of the contract, where the negotiations were held, and where it was concluded.[130]

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[126] Nigel Blackaby, Martin Hunter, Alan Redfern and Constantine Partasides QC. *Redfern and Hunter on International Commercial Arbitration* 158 (6th ed. 2015) quoting Julian Lew.

[127] Art. 16 (1) UNCITRAL Model Law on International Commercial Arbitration 1985 with amendments as adopted in 2006.

[128] *See* Blackaby, *supra* note 126, at 159.

[129] Sulamerica CIA Nacional de Seguros SA v. Enesa Engeharia SA [2012] EWCA (Civ) 638.(Eng.).

[130] In the Sulamerica case the court held that the applicable law to the arbitration agreement was the English Arbitration Act of 1996, because the law of the main contract which was the law of Brazil will give the respondent the power of discretion to go to arbitration or not, and this will make the arbitration agreement

Once, the tribunal has determined the law applicable to the arbitration agreement, it can determine whether the parties, through the selection of this law, have conferred the tribunal the power to adapt the contract. In this regard, because the arbitration agreement is the door for the tribunal's jurisdiction, establishing its scope and starting the arbitral proceedings, the law applicable to the arbitration agreement has to be analyzed jointly with the *lex arbitri*.

ii. Lex arbitri

The *lex arbitri* determines the general rules of procedure that the arbitrators must follow during the arbitration. Principally, this law will fill the gap when the arbitration rules selected by the parties do not deal with a specific situation. Also, the *lex arbitri* will deal with the cooperation of the national courts of the country of the arbitration, and this law will address the grounds on which a court can set aside the arbitration award.

When the arbitration rules selected by the parties do not address the matter of possible adaptation of the contract, as in the case of the ICC Rules, the *lex arbitri* may fill the gap. When the *lex arbitri* is different from the law applicable to the arbitration agreement, the tribunal must consider both of them in order to determine if the contract can be adapted. If the parties selected the law of the seat as applicable to the arbitration agreement, then the tribunal should analyze if this law is applied with a pro-arbitration view. In the case of the Panama Canal Contract, the parties agreed to the FAA as the law applicable for the arbitration agreement and as the *lex arbitri*, when they agreed that the seat of the arbitration would be Miami, United States.

The FAA does not address matter of adaptation of contracts by the arbitral tribunal, however, as has been described above, the American courts usually follow the federal policy favoring arbitration confirmed by the Supreme Court. Therefore, the American legal system grants the necessary entrustment for the arbitrators to rule about their own jurisdiction without the court intervening (except in the case of a manifest disregard of the law).[131]

Similar to other arbitration instruments (such as the UNCITRAL Model Law of 1985), the FAA also does not address the power of the arbitral tribunal to modify contracts. According to scholars in the *travaux préparatoires* of the Model Law, the topic of

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dependent of the will of one party and will affect the validity of the arbitration agreement and the arbitration process. *See* Herbert, Smith and Freehills, *Law of the Seat or the Law of the Main Contract for the Arbitration Agreement?*, HERBERT SMITH FREEHILLS: ARBITRATION NOTES (May 18, 2012) https://hsfnotes.com/arbitration/2012/05/18/the-law-of-the-arbitration-agreement-which-law-applies-and-why-does-it-matter/.

[131] Hall St. Associates, L.L.C. v. Mattel, Inc., 552 U.S. 576 (2008); United Paperworkers Int'l Union v. Misco, Inc., 484 U.S. 29, 38 (1987). "An arbitrator's result may be wrong; it may appear unsupported; it may appear poorly reasoned; it may appear foolish. Yet, it may not be subject to court interference." Delta Air Lines v. Air Line Pilots Ass'n, Int'l, 861 F.2d 665, 670 (11th Cir. 1988)). "It is only when an arbitrator strays from interpretation and application of the agreement and effectively dispenses his own brand of industrial justice that his decision may be unenforceable." White Springs Agric. Chems., Inc. v. Glawson Invs. Corp., 660 F.3d 1277, 1281 (11th Cir. 2011) (quoting Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 559 U.S. 662, 671 (2010)).

adaptation and modification of the contracts was left outside for two reasons. First, it is related to the substantive laws, and it would be inappropriate to regulate this matter in a procedural instrument.[132] Second, as a practical matter, the countries regulate the matter of adaptation in diverse ways, therefore, the Model Law did not render any uniform solution between the different national systems.[133]

The other key element, which allows the tribunal to determine if the parties granted the power to adapt the contract or not (in case of economic imbalance), is whether the contract contains a hardship clause.[134] A hardship clause will include provisions for hardship and remedies under the applicable law.

B. Hardship

In the *lex mercatoria* and in the different national systems, there is a consensus about the definition of hardship. Hardship is generally considered the situation where the equilibrium of the contract is fundamentally altered due to an external and unforeseeable event that causes an unjust sacrifice or burden for one of the parties.[135] The parties can define and regulate hardship in their contract (providing for the causes of hardship) and the remedy. Whether the parties included this clause helps the tribunal to determine if the parties agreed or envisioned adaptation as an eventual remedy. Therefore, in order to guide the arbitral tribunal to determine the intent of the parties, three aspects should be analyzed. First, if the contract provides for a hardship clause. Second, if there is no hardship clause in the contract. Third, the approach of hardship of the applicable law.

1. If the contract provides for a hardship clause

A hardship clause is defined as a contract provision where the parties agree that in case of a fundamental alteration of the equilibrium of the contract caused by an unforeseeable event which makes the performance of the contract excessively onerous, but not impossible, the disadvantaged party has the right to request renegotiations. As scholars

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[132] Howard M. Holtzmann and Joseph E. Neuhaus, A Guide To The Uncitral Model Law on International Commercial Arbitration. Legislative History and Commentary 1117 (1989). Nevertheless, there are some countries that had regulated the power of the arbitrators to adapt the contract, such as: the Art. 1020 of the Dutch Code of Civil Procedure which provides for arbitrators to modify the legal relationship between the parties, if the parties authorize them. Similarly, §1 of the Swedish Arbitration Act arbitrator may also fill gaps in contracts due to newly established facts. *See* Beisteiner, *supra* note 118, at 107.

[133] *See* Holtzmann, *supra* note 132, at 1117.

[134] Philippe Fouchard, Emmanuel Gaillard, Berthold Goldman. International Commercial Arbitration 25 (1999).

[135] *See* Oppetit, *supra* note 117, at 794.

established, "they organize the review of the contract when changed circumstances have deeply altered the economy of the operation."[136]

Certain contracts and applicable laws indicate that hardship gives the tribunal or the court the jurisdiction to adapt the contract in order to restore its equilibrium. The elements of hardship clauses are similar to *force majeure* clauses. The difference is that *force majeure* deals with situations of absolute or objective impossibility, while hardship deals with subjective or economic impossibility where the performance is still possible but will exceed the limits of sacrifice for the corporation to perform. Also, hardship clauses lead to renegotiation, while *force majeure* leads to exoneration of liability in case of non-performance.[137] Depending on the remedy that the parties agreed to in the text of the hardship clause the tribunal may be able to adapt the contract.

Due to the fact that hardship clauses lead to renegotiation by the parties, some authors[138] had concluded that if the parties do not reach an agreement after the renegotiations a party may request the tribunal adapt the contract to be able to do what the parties failed to - restore the equilibrium of the contract.[139] Therefore, if there is a provision in the contract referring to hardship, a tribunal may be convinced the original intent of the parties was for a tribunal to adapt the terms of the contract if the parties could not do so themselves.

As has been described above, the Panama Canal Contract does not contain a hardship clause. Rather, it has a variation and adjustment clause where the cost of certain materials, wages, and other circumstances may change during time and the parties agreed to certain indexes and formulas to be able to deal with them. However, adjustment clauses, where the parties take into consideration the cause of the events, are not the same as hardship clauses, which address events that are unforeseeable. In this regard, the adjustments clauses and the hardship clauses may be complementary when events change the circumstances in which the formula or index was agreed upon.[140]

The hardship clauses have two elements. First, the hypothesis of the event. Second, the consequence in the contractual relationship. [141]

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[136] Marcel Fontaine and Filip de Ly. Drafting International Contracts 455 (2009).

[137] Harold Ullman, *Enforcement of Hardship Clauses in the French and American Legal Systems*, 19 California Western International Law Journal 81, 81-84 (1988).

[138] Ugo Draetta, Ralph B. Lake and Ved P. Nanda, Breach and Adaptation of International Contracts, An Introduction to Lex Mercatoria 177 (1992).

[139] Art. 6.2.3. of the UNIDROIT Principles provide that in case of hardship, the disadvantaged party may request renegotiations and in the case the parties did not get to an agreement, the tribunal may adapt the contract if reasonable.

[140] *See* Fontaine, *supra* note 136, at 458.

[141] *Id.*, at 460.

a. The hypothesis

i. Unforeseen or unforeseeable

The parties usually describe the event that may cause hardship as unforeseen or unforeseeable. Unforeseeable means that the parties (or a reasonable person in their position) would be unable to foresee the event and its consequences. Unforeseen is a lower threshold that does not address whether the parties were able to foresee the event, but only focuses on if the parties in fact foresaw the event.[142] As an example, the ICC Hardship Clause 2003 provides as hypothesis, "a) the continued performance of its contractual duties has become excessively onerous due to an event beyond its reasonable control which it could not reasonably have been expected to have taken into account at the time of the conclusion of the contract; and that b) it could not reasonably have avoided or overcome the event or its consequences."

ii. Alteration of the equilibrium of the contract

In the description of the hypothesis the parties also address the consequence of the unforeseeable or unforeseen event in the contract with consequences such as: the event eliminated the fairness or equity of the deal, or the event altered the equilibrium of the contract. First, the tribunal should look for the wording of the hardship clause to determine if it provides for an economic threshold that the parties agreed to.

If the parties did not agree to a specific threshold, then the tribunal may look to the negotiations of the parties to determine which thresholds the parties discussed in their negotiations. In absence of the agreement of the parties, the threshold must be addressed in a case-by-case basis, considering a totality of the circumstances. For example, if the parties did not agree to an economic threshold, but agreed that the hardship clause would be triggered if the event made the contract more onerous, then the tribunal should look for a lower threshold than excessively onerous. However, the common standard in the industry is that the simple loss of the profit for the disadvantaged party cannot amount to hardship.[143]

In absence of the agreement by the parties, scholars have different positions concerning what is a fundamental alteration of the equilibrium of the contract. If the impact of an event is analyzed with an objective standard, some authors proposed a 100% increase in the cost[144] for contracts where the parties had not allocated the risks. When, the tribunal is determining the threshold in international contracts, due regard has to be given to the

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[142] *See* Draetta, *supra* note 138, at 195.

[143] "A party is also not entitled to use the hardship exemption only because the contract turned out to be less profitable than expected at the time of conclusion of the contract." Daniel Girsberger, *Fundamental Alteration of the Contractual Equilibrium under Hardship Exemption*, 19 Jurisprudence Review 121, 123 (2012). *See* Christoph Brunner, *Force Majeure and Hardship under General Contract Principles: Exemption for Nonperformance in International Arbitration*, 437 (2008).

[144] *See* Brunner, *supra* note 143, at 430.

fact that the threshold of 50% was removed from the UNIDROIT Principles for being considered too low by the international scholars according to its *travaux préparatoires*.[145]

Another criteria that the tribunal may take into account is the possibility of the financial ruin of the obligor. However, the tribunal must analyze the totality of circumstances for the parties, their negotiations, and the representations in the contract, because tribunals cannot start becoming the salvation for companies with solvency problems.[146]

These economic thresholds are considered applicable to short term contracts, such as the majority of sale of goods. Professor Brunner argued that, in theory, the same standards apply to long term contracts.[147]

In this regard, when the contractor delivers the work for a fixed or lump sum price, it assumes the risk of cost increases, but not of excessive cost increases.[148] Once again, there is no definition of the difference between an excessive and a normal cost increase. Is it an objective standard or a subjective standard? It should be a reasonable subjective standard with due regard to the circumstances of each case and without any unreasonable detachment of the objective standard.

However, if the parties did allocate specific risks and the economic disequilibrium is because of one of these risks, there is no place for the hardship exemption.[149] For example, in the Panama Canal Contract sub-clause 17.6 of risk allocation it expressly provides that "neither party shall be liable to the other party for loss of use of any works, loss of profit, loss of any contract or for any indirect or consequential loss or damage which may be suffered by the other party in connection with the contract." Therefore, according to the Contract each party is responsible for its own financial situation and in the case of an unforeseeable event that make the contract more onerous a tribunal may not adapt the contract because of the risk allocation.

The terms in the Contract provide for any loss of profit or for any consequential damage deriving from the Contract. However, may the tribunal think differently if it was an unforeseeable event that caused a fundamental alteration of the equilibrium of the contract rendering the performance excessively onerous?[150] The tribunal must interpret the

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[145] UNIDROIT 2003, Study L – Doc. 85.(Memorandum prepared by the Secretariat) [interactive]. Rome, 2003: 15 [accessed 2012-02-09]. <http://www.unidroit.org/english/documents/2003/study50/s-50-085-e.pdf>.

[146] *See* Brunner, *supra* note 143, at 437.

[147] *Id.* at 439.

[148] *Id.* at 440.

[149] According to the art. 6.2.2. of the UNIDROIT Principles 2016, in order for hardship to occur, the risk should not be taken by the disadvantaged party.

[150] According to the Project Progress Report of the ACP at December 31, 2018. For Arbitration No. 4, Disruption, Unforeseeable Physical Conditions and other Claims, the Parties jointly selected the President of the Arbitral Tribunal and set the date for the jurisdiction hearing for April 2019. *See* PROJECT PROGRESS

risk allocation of the parties. In absence of a hardship clause, may the tribunal find hardship under the applicable law to the contract? What would be the remedy in that case? These are questions that we will address below in the section regarding when the parties do not have a hardship clause.

b. The remedy in the hardship clause

If the parties agreed to a hardship clause and the elements of the hypothesis were triggered, what happens now? In the example of the ICC Hardship Clause 2003, it provides for renegotiation or termination as a consequence for hardship.[151]

It has to be noted, that the parties may provide for any remedy in their hardship clause. Usually the parties agree to first attempt to renegotiation. In case of failed renegotiation, the question of adaptation or termination of the contract will arise.

i. Renegotiations

If one party believes an event will produce hardship if it performs or continue performance of the contract, it may request for renegotiations to address the issue with the other party and protect the economic equilibrium of the contract. It is important to remember that hardship exemption only deals with new situations which have not been performed. If the party has performed already, hardship is not applicable as an exemption. If the renegotiations failed, the obligor remains responsible to perform its obligation. If the obligor requests the tribunal to adapt the contract and the tribunal does not grant adaptation, the obligor still remains responsible to perform, which is different from the *force majeure* (where the obligor is exempted from performance because the obligation is impossible to perform, temporarily or permanently).

Which criteria or standard applies to the renegotiations of the parties? The standard for renegotiations is good faith.[152] Therefore, due attention must be paid to the points of each party in order to render a common determination. The renegotiation is a duty of *moyens* and not of result.[153] In other words, the parties have an obligation to listen and analyze the arguments and reasons of the other party but do not have an obligation to accept

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REPORT AS OF DECEMBER 31st, 2018, https://micanaldepanama.com/expansion/documents/project-progress-report/ (last visited Mar. 25, 2019).

[151] The ICC Hardship Clause provides "the parties are bound, within a reasonable time of the invocation of this Clause, to negotiate alternative contractual terms which reasonably allow for the consequences of the event. Where paragraph 2 of this Clause applies, but where alternative contractual terms which reasonably allow for the consequences of the event are not agreed by the other party to the contract as provided in that paragraph, the party invoking this Clause is entitled to termination of the contract.".

[152] In this regard, good faith involves the diligent will to complete the renegotiations within the party's contractual obligations.

[153] *See* Fontaine, *supra* note 136, at 481.

the offer of new terms. If a party disagrees that the disadvantaged party is in a hardship situation it must inform the disadvantaged party in a reasoned and clear way.[154]

The fastest and most efficient way to adapt the contract is between the parties because they know better than anyone the circumstances of their business. However, if the parties cannot make an agreement but have provided for adaptation, then the next step is to request a tribunal to adapt the contract.[155]

ii. Adaptation

If the parties provided for adaptation in the hardship clause, the decision will be taken by the third party to determine, according to the rest of the clauses, the adaptation of the contract to restore the equilibrium of the contract.[156] In this regard, some clauses provide for the condition of the failing of the agreement of the parties in the renegotiations.[157]

When the hardship clause provides for adaptation it is related to the arbitration agreement. Therefore, even if the arbitration agreement does not address the power of the arbitral tribunal to adapt the contract, if the hardship clause provides for adaptation as a remedy for the hardship, most likely the parties had the intent at the moment of the conclusion of the contract that the tribunal should adapt the contract.[158]

iii. Termination

Another consequence of the hardship clause may be the termination of the contract. Depending on the structure of the hardship clause, if the parties do not enter successful renegotiations the tribunal may terminate the contract, adapt it, or maintain the original text of the contract.

In long-term construction contracts, there are performance bonds if the contract is terminated that the employer would cash and use as payment for another contractor to

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[154] *See* Brunner, *supra* note 143, at 486.

[155] It is our view that in the case that the parties only agree for renegotiation and not for adaptation, the tribunal does not have this extraordinary power of adapting the contract, thus creating a new right for the parties who only agreed for renegotiations.

[156] As an example of the mission of the arbitral tribunal in the hardship clause regarding the adaptation of the contract: "The arbitrators shall determine ... what adjustment, if any, in the said price or in the other terms and conditions should be made for the purposes of paragraph (a) […]." *See* Fontaine, *supra* note 136, at 484.

[157] *See* Fontaine, *supra* note 136, at 484.

[158] *See* Fontaine, *supra* note 136, at 488. Nevertheless, it has been shown that international arbitral tribunals are prudent. Arbitrators have a preference for enforcing contractual provisions *(pacta sunt servanda)*, as they often consider that in international trade, professional operators are able, when they wish, to provide for change of circumstances by appropriate clauses.

finish the project. However, it is in the best interest of both parties to renegotiate first because a termination in that regard would not benefit anyone. In other words it was a lose-lose situation.

The parties in international contracts usually agree regarding the consequences of the termination of the contract because they desire predictability and to limit the discretion of the tribunal. Thus, if the parties agreed to a hardship clause with adaptation as a remedy, in the arbitral tribunal's analysis of the clause the tribunal most likely will conclude that the parties' intent at the moment of the conclusion of the contract was to grant jurisdiction and power to the tribunal to modify the terms of the contract. However, even if the tribunal acknowledges its power to adapt the contract, the arbitral tribunals are reluctant to modify the terms of the agreement due to the uncertainty that it may cause in the international business community, which agree to international contracts to get as much predictability and certainty as possible. Therefore, there is an interaction inside the contract between the hardship clause and the arbitration agreement derived from the intent of the parties, which grants the arbitrators the power to adapt the contract.

At this point, it is important to ask, what happens when the contract does not provide for a hardship clause? What weight should the tribunal give regarding the *lex causae* and its interaction with the arbitration agreement? What is the interaction between the *lex causae* and the text of the contract, in absence of a hardship clause?

2. If the contract does not provide for a hardship clause

The next debate centers upon when the parties did not agree to a hardship clause in their contract, but they agreed to an applicable law that contains a provision for hardship. In this regard, if the arbitration agreement does not prohibit the adaptation of the contract and the *lex causae* provides for the remedy of adaptation in cases of hardship, the arbitral tribunal will derive its power to grant adaptation from the law applicable to the merits of the dispute. Therefore, when the parties agree to the law applicable to the contract, it is a manifestation of the parties' intent to provide the provisions of the *lex causae* to be part of the contract, as long as it does not contradict the derogations of the non-mandatory rules of the *lex causae* agreed by the parties in the contract.

Thus, if the tribunal determines that it has jurisdiction and power. At that moment, the tribunal will analyze the merits of the dispute. The facts should be applied to the rules of the applicable law, and application must be rendered to consider if there is hardship and the consequence.

3. Hardship and its consequences in different national laws

As has been stated above, when the Model Law did not address the adaptation of the contract because of the different perspectives of the national legal systems. Different national laws contain different provisions similar to hardship, which cause different outcomes. Panamanian Civil Code establishes the Termination of the contract for excessively onerous (*terminación del contrato por excesiva onerosidad*). In American law it is called impracticability. In Italy it is called *Onerosità o difficoltà dell'esecuzione and*

eccessiva onerosità sopravvenuta. In France and Belgium it is called *imprévision*. Therefore, the causes and consequences of hardship will depend on the applicable law to the contract that the parties agreed to.

a. Panama[159]

In the Panama Canal Contract the applicable law is Panamanian law, therefore, the contract relationship is governed by the Civil Code of Panama. This civil code provides in its art. 1161-A to 1161-C, the termination of the contract for excessively onerous.

Art. 1161-A addresses the bilateral contracts of continued performance, where in the arise of an extraordinary and unforeseeable event the obligation of one of the parties become excessively onerous, the disadvantaged party has a right to request the termination of the contract. However, if the event is part of the normal developments of that type of contract there is no right of termination by the disadvantaged party. The party against a request for termination that has been addressed may propose to amend the terms of the contract to restore the equilibrium of the contract.

This article requires that the event was extraordinary and unforeseeable for the parties, making the contract excessively onerous, and that the event was not part of the normal development of the contract (i.e. construction contract). Therefore, this last element applies the usages of the industry applicable to the contract and provides for a presumption for the level of experience and professionalism of the parties according to the type of contract. Thus, the parties are responsible for addressing the allocation of risks to be able to shield themselves in cases of unforeseeable circumstances because the law is not going to give the disadvantaged party a remedy to restore the equilibrium of the contract if the parties did not agree.

As can be deduced from this article, the Civil Code of Panama is conservative regarding unforeseeable circumstances that make the contract excessively onerous, only granting the disadvantaged party the right to terminate the contract, not giving to this party a right to request for renegotiations to resolve the disequilibrium of the contract. Thus, the principle of *pacta sunt servanda* in Panamanian law has a primary position and does not provide for adaptation in cases of hardship. According to the Civil Code, the renegotiations are at the discretion of the requested party in response to the termination proposed by the disadvantaged party. In practice, termination is the most extreme remedy because it ends the performance of the contract. However, usually the parties try to renegotiate to be able to solve the dispute.

[159] One of the members of the consortium Grupo Unidos por el Canal is Constructora Urbana, S.A. from Panama, www.gupc.com.pa (last visited Mar. 25, 2019).

Therefore, because in the Panama Canal Contract the parties did not agree to a hardship clause and the applicable law is Panamanian law, there is no place for a request to the tribunal to adapt the Contract.[160]

In the Panama Canal Contract the causes of termination by the Employer and by the Contractor and the consequences of termination are regulated in the art. 15. The Employer reserved a right to terminate the Contract at their convenience[161] with the duty to notify the Contractor 28 days beforehand. After that time the termination is effective. In this regard, the consequences of the termination by the Employer include paying the Contractor for all the work done and proved to the employer representative according to the value at termination.

In the case that the Contractor required the termination of the Contract due to the causes enumerated in sub-clause 16.2,[162] it can be interpreted that if the Contractor made a request to the tribunal for the termination of the Contract, then the tribunal should apply the consequences of the terminations according to sub-clauses 16.4 and 19.6, which require the payment at termination. These consequences indicate that the employer's representative shall determine the value of the work done and issue a Payment Certificate, which shall include the amount payable for any work for which a price is stated in the Contract, the materials that the Contractor acquired or was going to acquire in which the Contractor is liable for its delivery, for any cost caused in expectation to terminate the work, the removal of the equipment of the Contractor, and the cost of reparation of the Contractor at the date of termination. Thus, if the Contractor had requested termination of the Contract by the arbitral tribunal the consequences should be those agreed to by the parties in concept of termination.

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[160] In the case Gaming & Services Panama, S.A. v. Ministerio de Economia y Finanzas (MEF), decided by the Supreme Court of Panama in 2006. The court established that because the parties did not agree a clause to maintain the contractual equilibrium, there was no obligation of the parties to maintain the economical equilibrium of the contract.

[161] "The termination for convenience clauses have the purpose to enable an owner . . . unilaterally to terminate a contractual relationship at any time it deems its interests not to be served by the contract." *See* DRAETTA ET AL., *supra* note at 138, at 211.

[162] Sub-clause 16.2. of the Conditions of the Contract establishes: The Contractor shall be entitled to terminate the Contract if: (a) the Employer's Representative fails, within 104 days after receiving a Statement and supporting documents, to issue the relevant Payment Certificate; (b) the Contractor does not receive the amount due under an Interim Payment Certificate, for undisputed items, within 90 days after the expiry of the time stated in sub-Clause 14.7 [Payment] within which payment is to be made (except for deductions in accordance with sub-Clause 2.5 [Employer's Claims]); (c) the Employer substantially fails to perform his obligations under the Contract;(d) the Employer fails to comply with sub-Clause 1.6 [Contract Agreement]; (e) a prolonged suspension affects the whole of the Works as described in sub-Clause 8.11 [Prolonged Suspension]; or (f) the Employer becomes bankrupt or insolvent, goes into liquidation, has a receiving or administration order made against him, compounds with his creditors, or carries on business under a receiver, trustee or manager for the benefit of his creditors, or if any act is done or event occurs which (under applicable Laws) has a similar effect to any of these acts or events. In any of these events or circumstances, the Contractor may, upon giving 14 days' notice to the Employer, terminate the Contract. However, in the case of sub-paragraph (e) or (f) of this sub-Clause 16.2, the Contractor may by notice terminate the Contract immediately. The Contractor's election to terminate the Contract shall not prejudice any other rights of the Contractor, under the Contract or otherwise.

b. United States

The contracts based on civil law are usually not as detailed as contracts based on common law.[163] This is because the civil codes are seen as supplementing the contract between the parties, therefore, by selecting an applicable law, it becomes part of the contract. On the other hand, contracts based in common law do not have the same level of supplementation as statutes or jurisprudence.[164] For this reason, the principle of *pacta sunt servanda*[165] has been the main rule in the American legal system because "certainty and finality are important objectives of contract law given the role that contracts play in the global commercial environment."[166]

i. Changes of circumstances in Construction Contracts

This plain interpretation of the wording of the contracts was applied in the *Olympus Corp. v. U.S.* On March 10, 1987, Olympus Corp. entered into a fixed-price construction contract with the United States to pave the plant yards at the Stratford Army Engine Plant in Connecticut.[167] The contract included a standard Differing Site Conditions clause.[168] On April 18, the works started. One month later, Textron Lycoming, an independent government contractor that operated the plant, accidentally cut open an underground oil

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[163] AXEL-VÖLKMAR JAEGER & GOTZ-SEBASTIAN HÖ, FIDIC-A GUIDE FOR PRACTITIONERS 106 (2010).

[164] *Id.*

[165] This principle has been also applied in the public contracts where the state will be protected in case the obligation of the contractor becomes more expensive. Therefore, the states will not pay other amount for an already contracted or performed obligation. City of Greenville v. Emerson, 740 S.W. 2d 10 (Tex. App. 1987) in RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS BY SAMUEL WILLISTON VOLUME 3 at 683, (4th ed. 2008). The court established that: "the contract sought to be enforced by appellees would require the City to pay additional sums of money for services already rendered and benefits already paid. In effect, it would constitute in Greenville entering into a second contract with appellees to pay them additional benefits above what they received under a prior valid existing contract for no additional consideration."

[166] Jennifer Camero, *Mission Impracticable: The Impossibility of Commercial Impracticability*, 13 U.N.H. L. REV. 1, 27 (2015).

[167] Olympus Corp. v. U.S., 98 F.3d 1314 (Fed. Cir. 1996).

[168] Which is similar to Sub-Clause 4.12 of the FIDIC Yellow Book and the Panama Canal Contract. *See* VÖLKMAR JAEGER, *supra* note 163, at 186-189. In the Olympus case, the text of the clause was: "(a) The Contractor [Olympus] shall promptly, and before the conditions are disturbed, give a written notice to the Contracting Officer of (1) subsurface or latent physical conditions at the site which differ materially from those indicated in this contract, or (2) unknown physical conditions at the site, of an unusual nature, which differ materially from those ordinarily encountered and generally recognized as inherent in the work of the character provided for in the contract. (b) The Contracting Officer shall investigate the site conditions promptly after receiving the notice. If the conditions do materially so differ and cause an increase or decrease in the Contractor's cost of, or the time required for, performing any part of the work under this contract, whether or not changed as a result of the conditions, an equitable adjustment shall be made under this clause and the contract modified in writing accordingly."

pipe, which prevented Olympus from paving the plant yard.[169] After this, the employees of Textron went to a strike, which prevented Olympus from accessing the place for nearly two months.[170] When the strike ended Olympus helped the contractor clean the polluted soil, then resumed paving the yard on August 2.[171]

Olympus timely notified the contracting officer of both the contamination and strike delays and requested an equitable adjustment to the contract of a 69-day time extension and a price modification for additional costs of US$107,988.79.[172] The officer granted the time extension but only granted the increase of the price of US$5,358.00 (only adjusting for the contamination delay).[173] Olympus rejected this proposal and submitted a claim to the officer requesting both additional costs and a final decision. The officer rejected these requests in the final decision.[174]

Thereafter, Olympus filed a claim in the United States Court of Federal Claims, which dismissed the claims and granted the government summary judgment.[175] The court held that the Differing Site Conditions Clause only applied for the conditions existing at the time of the conclusion of the contract.[176] Therefore, was not applicable to events that occurred after the conclusion of the agreement such as the soil contamination and the strike of the Textron employees.[177] The court also indicated the Olympus assumed the risk of unexpected costs such as those associated with labor unrest.[178] Olympus appealed.[179]

The appeal only focused on a *de novo* interpretation of the public contract as a matter of law.[180] Olympus argued that the Differing Site Conditions did not expressly limited its scope to only situations at the moment of the conclusion of the contract.[181]

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[169] Olympus 98 F.3d at 1314, 1315.

[170] *Id.*

[171] *Id.*

[172] *Id.*

[173] *Id.*

[174] Olympus 98 F.3d at 1314, 1315-1316.

[175] Olympus 98 F.3d at 1314, 1316.

[176] *Id.*

[177] *Id.*

[178] *Id.*

[179] *Id.*

[180] *Id.*

[181] *Id.*

Olympus indicated that this approach will validate the subjective intent[182] of the government and that this clause shifted the risk of all unanticipated adverse site conditions to the government.[183]

The court indicated that the Differing Site Conditions clause has been used in public contracts for over half a century with the purpose of shifting the risk of adverse subsurface or latent physical conditions from the contractor, who normally bears such risk under a fixed-price contract, to the government. The court, citing *United States v. Spearin*, indicated that: "Where one agrees to do, for a fixed sum, a thing possible to be performed, he will not be excused or become entitled to additional compensation, because unforeseen difficulties are encountered."[184]

Also, the court pointed out that the purpose of this clause is to prevent the bidders from increasing the price of the bids because of the previous inspections of the physical conditions; therefore the government takes the risk of the unforeseeable event at the moment of the conclusion of the contract. Moreover, the court stated that: "Although we interpret public contracts according to their "ordinary and commonly accepted meaning,"[185] we also do so from the vantage point of a "'reasonable and prudent' contractor."[186] Such a contractor would have been familiar with the long-standing limitation on a Differing Site Conditions clause to conditions existing when the contract was executed. Moreover, we are bound by precedent. Therefore, consistent with our precedent, we hold that the Court of Federal Claims did not err in interpreting the Differing Site Conditions clause to apply only to conditions existing at the time of contracting." Finally, the court affirmed the ruling of the trial court.[187]

This case shows the approach used for the interpretation of contracts in American law, where the courts do not exercise a paternalistic interpretation of the plain wording of the contract. The court did not find any ambiguity in the clause and applied it only to the unanticipated circumstances that existed at the moment of the conclusion of the contract, which reaffirms that the purpose of contracts is to provide certainty and predictability.[188] To the Olympus argument of the subjective intent, the court indicated that a reasonable and prudent contractor should have known the meaning and the scope of the Differing Site

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[182] The subjective intent is what a party knew or understood internally without expressing it to the other party.

[183] Olympus 98 F.3d at 1314, 1316.

[184] United States v. Spearin, 248 U.S. 132, 136 (1918).

[185] Brunswick Corp. *v.* United States, 951 F.2d 334, 336 (Fed.Cir.1991).

[186] P.J. Maffei Bldg. Wrecking Corp. v. United States, 732 F.2d 913, 917 (Fed. Cir. 1984).

[187] The scholars Axel-Völkmar Jaeger and Götz-Sebastian Hök indicated that this case cannot be considered a rule of law, because due consideration has to be taken to the text of the clause and the merits of the case. Probably, the clause was going to be applied different in a civil law tribunal, where the text of the contract is superseded by the intent of the parties. *See* VÖLKMAR JAEGER, *supra* note 163, at 186-189.

[188] Brunswick Corp. v. United States, 951 F.2d 334, 336 (Fed.Cir.1991).

Clause, and therefore applied the reasonable person test according to the circumstances of the plaintiff.[189]

Also, this case pointed out the fact that when a party, i.e. contractor, signed a lump-sum price contract, as in the Panama Canal Contract, the differing site clause or unforeseeable physical conditions clause shift the risk from the contractor to the employer.[190] Therefore, if the contract provides for the circumstances that may trigger this clause, it means that any other unforeseeable circumstances will be the contractor's risk.[191]

Years later, in 2013, in *Extreme Coatings, Inc. v. U.S.*, where the contractor who was awarded a contract to perform partial recoating of downstream side of spillway radial gates at the dam sued United States pursuant to the Contract Disputes Act after its certified claim for equitable adjustment was denied by the contracting officer.[192] United States filed a motion to dismiss based on Rule 12 (b)(6).[193] The court denied this motion to dismiss.[194] Then, the court based on the case *Randa/Madison Joint Venture III v. Dahlberg* pointed out the elements for the type I and type II of Differing Site Conditions clauses.[195]

The type I of differing site conditions is defined as: "subsurface or latent physical conditions at the site which differ materially from those indicated in this contract."[196] The court indicated the four elements that must be met for this clause to apply:

> First, the contractor must prove that a reasonable contractor reading the contract documents as a whole would interpret them as making a representation as to the site conditions. Second, the contractor must prove that the actual site conditions were not reasonably foreseeable to the contractor, with the information available to the particular contractor outside the contract documents, i.e., that the contractor "reasonably relied" on the representations. Third, the contractor must prove that the particular contractor in fact relied on the contract representation. Fourth, the contractor must prove that

[189] *Id.*

[190] *Id.*

[191] *Id.*

[192] *Extreme Coatings, Inc. v. U.S.*, 109 Fed. Cl. 450 (Fed. Cl. 2013).

[193] *Id.*

[194] *Id.*

[195] *Id.*; *Randa/Madison Joint Venture III v. Dahlberg*, 239 F.3d 1264, 1269 (Fed. Cir. 2001).

[196] *Id.*

the conditions differed materially from those represented and that the contractor suffered damages as a result.[197]

The type II of differing site conditions is defined as: "unknown physical conditions at the site, of an unusual nature, which differ materially from those ordinarily encountered and generally recognized as inhering in work of the character provided for in the contract."[198]

According to the court, for this clause to be applicable the following elements must be met: "First, plaintiff must show that it did not know about the physical condition. Second, plaintiff must show that it could not have anticipated the condition from inspection or general inspection or general experience. Third, plaintiff must show that the condition varied from the norm in similar contracting work."[199]

Analyzing the four elements required by Type I and the three elements by Type II, the court indicated that the temporal limitation (analyzed in the Olympus case) was not found explicitly in the test, and that it should be added to the tests according to the circumstances of the case.[200] In this regard, the court indicated that this temporal limitation may have variations or exceptions which preclude its application or requirement as a heightened pleading standard.[201] As an example, the court indicated that in some cases the moment of the origin of the event has been analyzed at the time of the issuance of the notice to proceed.[202]

Thus, the court indicated that the difference between the elements required by the Type I and Type II of differing site conditions, the temporal limitation "is not a bedrock hurdle at the notice pleading level."[203]

Another important aspect of this case, is that in neither the type I or type II one of their elements is the financial situation of one party or that the measure will be taken to restore equilibrium of the contract. Therefore, the elements of these clauses only refer to the characteristic of the event and not the situation of a particular party as in hardship occurrences, where the equilibrium of the contract is altered.

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[197] Extreme Coatings Inc., 109 Fed. Cl. at 450. (citing *Randa/Madison Joint Venture III v. Dahlberg*, 239 F.3d 1264, 1269 (Fed. Cir. 2001); *See* Int'l Tech. Corp. v. Winter, 523 F.3d 1341, 1348-49 (Fed. Cir. 2013).

[198] *Id.*

[199] *Id.*

[200] *Id.*

[201] *Id.*

[202] Extreme Coatings Inc., 109 Fed. Cl. at 450 (citing Hoffman v. United States, 340 F.2d 645, 648-51 (Ct. Cl. 1964).

[203] *Id.*

On December 7, 2018, in *W.M. Schultz Constr., Inc. v. Vermont Agency of Transportation*, the Supreme Court of Vermont affirmed a judgment where the plaintiff requested an equitable adjustment due to differing-site conditions.[204]

The contract to replace four bridges destroyed by Tropical Storm Irene[205] was agreed to in 2013. The first three bridges were built without problems.[206] This dispute was concerning the fourth bridge.[207] According to the plaintiff, the assumed rock elevation of 802.5 feet from the bottom of the bridge footing as shown on VTrans' plans was in fact drastically irregular and much lower in some areas than shown.[208]

Schultz argued that the uneven elevation forced them to change the specific means and methods from a sandbag style cofferdam to a steel-sheet pile cofferdam. This change would substantially increase costs beyond the original estimate.[209]

The contractor submitted the claim to the chief engineer, who denied the claim.[210] The contractor appealed to the Transportation Board, which is a specialized body in construction contracts. The Transportation Board found that the contractor's reliance on the conditions present in the contract was reasonable and ruled in its favor, indicating that due to the additional costs the contractor was entitled to US$589,782.09 as damages.[211] VTrans appealed this decision.[212]

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[204] W.M. Schultz Constr., Inc. v. Vermont Agency of Transportation, 203 A.3d 1205 (Vt. 2018); The text of the different-site conditions clause was: 104.08 Differing Site Conditions (a) During the progress of the work, if subsurface or latent physical conditions are encountered at the site differing materially from those specified in the Contract or if unknown physical conditions of an unusual nature, differing materially from those ordinarily encountered and generally recognized as inherent in the work provided for in the Contract, are encountered at the site, the party discovering such conditions shall promptly notify the other party in writing of the specific differing conditions before they are disturbed and before the affected work is performed. (b) Upon written notification, the Engineer will investigate to determine if the conditions materially differ and will cause an increase or decrease in the cost or time required for the performance of any work under the Contract. The Contractor will be notified of the Engineer's determination, whether or not an adjustment of the Contract is warranted. If an adjustment is warranted, the Contract will be modified in writing accordingly. Any adjustment made will exclude loss of anticipated profits. (c) No Contract adjustment that results in a benefit to the Contractor will be allowed unless the Contractor has provided the required written notice. (d) No Contract adjustment will be allowed under this clause for any effects caused on unchanged work.

[205] *Id.*

[206] *Id.*

[207] *Id.*

[208] *Id.*

[209] *W.M. Schultz Constr*, 203 A.3d at 1205.

[210] *Id.*

[211] *W.M. Schultz Constr*, 203 A.3d at 1205.

[212] *Id.*

VTrans argued that the Board did not take into consideration the decision of the agency regarding the claim.[213] The court indicated that the Board, took into consideration the decision of the agency, but the Board does not owe deference to the agency's decisions. It was not obligated to discuss, explain, or refute the Chief Engineer's analysis of the claim.[214]

This analysis by the court confirms that the decisions of the agent appointed by the employer or owner of the project are not considered a starting point for the discussion as a judgment in a trial court where the tribunal has to reversed or affirmed.[215] The decision of the engineer will only serve as evidence for the tribunal.[216]

Then, the court indicated that because the contract interpretation is a matter of law, it was a *de novo* review, with due consideration to the decision rendered by the Board as an experienced institution.[217] The court applied the *Stuyvesant* test, where the contractor must prove by a preponderance of evidence that:

> (1) the conditions indicated in the contract differ materially from those it encounters during performance;
>
> (2) [t]he conditions actually encountered [were] reasonably unforeseeable based on all the information available to the contractor at the time of bidding;
>
> (3) it reasonably relied upon its interpretation of the contract and contract-related documents; and
>
> (4) it was damaged as a result of the material variation between the expected and encountered conditions.[218]

In relation to the first element, the court indicated that is "based on how a reasonable contractor would interpret the contract documents as a whole."[219] A "contractor does not need to show that its 'interpretation of the contract is the only reasonable one, but it does

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[213] *Id.*

[214] *Id.*

[215] *Id.*

[216] *W.M. Schultz Constr*, 203 A.3d at 1205.

[217] *Id.*

[218] *Id; Stuyvesant Dredging Co. v. United States*; 834 F.2d 1576, 1581 (Fed. Cir. 1987).

[219] *Int'l Tech. Corp*., 523 F.3d at 1349.

bear the burden of showing that its construction is at least a reasonable reading.'"[220] In this regard, the court indicated that:

> Viewing the contract materials here as a whole—including multiple plan sheets depicting ledge at 802.5 feet and the 1974 bridge information—a reasonable contractor would not view the use of the word "approximate" to convey that the ledge elevation could vary wildly from what was represented. We are similarly unpersuaded that the various design contingencies in the instant case conveyed that the ledge was not as it was represented to be in multiple plan sheets. These caveats—including a statement that elevation could vary and the inclusion of a method of payment for excavation up to fifteen feet below the design—must be considered through the lens of "known information" provided to prospective bidders and in light of the contract materials as a whole.[221]

The court noted that VTrans did not provide for any witness or expert declaring that the interpretation of the contractor was unreasonable. Therefore, the court made an interpretation of the contract as a whole and not individual terms (such as approximate, argued by VTrans as a ground for exemption of certainty of the information provided to the contractor).

Regarding the second and third element, because the Board was the fact-finder, the findings were not going to be disturbed unless they were clearly erroneous. The Board relied in the testimony of Mr. Waite, who designed the cofferdam for Schultz, which even though was a witness, the board relied on his statement as an experienced engineer. The court indicated that regardless of being considered a witness or an expert, "it was fair to rely on his testimony with respect to these elements here."

With respect to the fourth element, which addresses the damages. The court indicated that Schultz suffered damage from the variation between the expected and the encountered conditions. Thus, the court indicated that the Board found that:

> Schultz reasonably relied on the ledge elevations in the bid documents in designing and pricing its cofferdam. Because the ledge was much deeper than anticipated, Schultz was required to construct a different, more time-consuming, and more expensive cofferdam. In the words of subdivision (b), the differing site conditions "caused an increase . . . in the cost or time required for the performance of any work under the Contract".[222]

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[220] United Constructors, LLC v. United States, 95 Fed. Cl. 26, 37 (2010) (alteration omitted) (*quoting P.J. Maffei Bldg. Wrecking Corp.*, 732 F.2d at 917).

[221] *W.M. Schultz Constr*, 203 A.3d at 1205, 1219.

[222] *Id*. at 1223.

This case applies a similar test to one applied in *Extreme Coatings*, for the different conditions clause to be applicable it requires four elements: (1) that the conditions encountered during performance materially deviate from the conditions indicated in the contract, (2) that these conditions were reasonably unforeseeable for the contractor taking into consideration the information available at the moment of the bidding, (3) the contractor reasonably relied in the description of the conditions provided in the contract, (4) the contractor suffered damages from the unforeseeable change. Also, this case pointed out that even if the contractor suffered damages, it is obliged to continue the performance of the project. Therefore, the courts are not going to deviate from what the parties agreed to even in the occurrence of unforeseeable changes. If these unforeseeable changes occur, then the contractor will be responsible.

ii. Changes of circumstances due to Impracticability

Taking this *pacta sunt servanda* as the Star of Bethlehem, the American legal system also provides for the situation in which the obligation became excessively onerous due to unforeseeable circumstances with the denomination of impracticability. The § 261 Restatement (Second) of Contracts defines impracticability as:

> § 261. Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.

The current theory of impracticability does not focus on the implied terms of the parties but on whether justice requires departure from the general rule that the obligor bears the risk of increased difficulty or performance in light of extraordinary circumstances.[223] Professor E. Allan Farnsworth indicated that for impracticability to apply, four elements must be met: "(1) the event must rendered the performance as agreed, impracticable; (2) the nonoccurrence of the event must have been a basic assumption on which the contract was made; (3) the event was not the fault of the disadvantaged party; and (4) the party must not have assumed a greater obligation than the law imposes."[224]

The first element addresses the economic imbalance of the performance, where a party is not obliged to exceed the limit of sacrifice, when the performance will be extremely burdensome. The second element addresses that the event was unforeseeable for the parties and did not take it into account at the moment of the conclusion of the contract. The third

[223] EDWARD ALLAN FARNSWORTH, CONTRACTS 625 (4th ed., Aspen Publishers 2004).

[224] *Id.*

element indicates that no party may benefit from a circumstance that itself caused. Finally, that the party did not assume the risk in the contract, implicitly or explicitly.

According to the §261 Restatement (Second) of Contracts the main remedy is discharge of the obligation for the disadvantaged party, which is related to the termination of the contract. On this note, it is important to mention that especially in long-term contracts, in the event of hardship, the parties have an obligation of good faith to try to renegotiate the terms of the contract.[225] However, the supplement of the principle of good faith in the common law is not the rule but an exception.[226] This is based on the notion that the courts or tribunals do not rewrite contracts and will not intervene in the essential terms agreed to by the parties.

However, in chapter 11, which deals with impracticability, section §272 of the Restatement (Second) of Contracts provides that if any remedy will not avoid injustice, the court may grant relief on such terms as justice requires including protection of the parties' reliance interests. Therefore, in the interpretation of this provision, it grants the courts and tribunals the power to adapt the terms of the contracts,[227] but as an extraordinary measure when no other remedy will prevent injustice. This section will be specially applied in the case of long-term contracts where the parties cannot get modification of the agreement, but will be the best solution taking into consideration the circumstances of each case.

There is an exception, which has been criticized,[228] when a court uses an index clause to modify the terms of the contract due to the excess burden that the clause was going to cause one of the parties. In *Aluminum Co. of Am. v. Essex Group, Inc.*,[229] a decision held in the Federal Court of Pennsylvania in 1980. The parties entered into a supply contract in 1967 until 1983, with an option to extent, where ALCOA was going to convert alumina supplied by Essex into molten aluminium, and then Essex would take ownership of this material for further processing.[230] This contract contained an indexing formula, in which the non-labour costs were going to be escalated in accordance with the Wholesale

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[225] Mkt. St. Associates Ltd. Partn. v. Frey, 941 F.2d 588, 595 (7th Cir. 1991).The court indicated that: the concept of the duty of good faith like the concept of fiduciary duty is a stab at approximating the terms the parties would have negotiated had they foreseen the circumstances that have given rise to their dispute… "The parties to a contract are embarked on a cooperative venture, and a minimum of cooperativeness in the event unforeseen problems arise at the performance stage is required even if not an explicit duty of the contract." Citing AMPAT/Midwest, Inc. v. Illinois Tool Works, Inc, 896 F. 2d. 1035 (7th Cir. 1990). *see also* CHRISTINA KUNZ, CAROL CHOMSKY, JENNIFER MARTIN, & ELIZABETH SCHILTZ, CONTRACTS, A CONTEMPORARY APPROACH 635 (3rd. ed., West Academic 2018).

[226] "Common law judges are more reluctant to rely on the term of good faith. They will therefore be happy to find express terms as to the duty of co-operation by the Employer. FIDIC has obviously included a spirit of good faith in the Contract to the extent which was necessary to ensure that the progress of the Works will not be adversely interfered with." Völkmar Jaeger, see *supra* note 163, at 181.

[227] *See* Farnsworth, *supra* note 223, at 647.

[228] *See* Camero, *supra* note 166, at 25-27.

[229] Aluminum Co. of Am. V. Essex Group, Inc., 499 F. Supp. 53 (W.D. Pa. 1980).

[230] *Id*. at 56.

Price Index for Industrial Commodities.[231] Changes in the price of oil caused an increased cost of the electricity which was used for the molten aluminium, which was going to represent a loss for the seller of US$60 million during the life of the contract.[232] ALCOA requested for the contract to be excused because the agreed index was not according to the unforeseeable new circumstances.[233] The tribunal decided to adapt the index in order to reflect the new economic conditions.

c. Italy[234]

In the Italian law the concept for hardship is present in the art. 1664 of the Civil Code with the title *Onerosità o difficoltà dell'esecuzione* and in the art. 1467 with the title *eccessiva onerosità sopravvenuta*.

i. Onerosità o difficoltà dell'esecuzione

The art. 1664 of the Italian Civil Code applies specially to construction contracts. The first paragraph of this article provides that if unforeseeable circumstances cause an increase or decrease to the cost of materials or labor that accounts for more than 10% of the total agreed price, the contractor or client can request a revision of the price. The revision can be granted only for that difference which exceeds the tenth.

In order for this first paragraph to be applicable, the following requirements must be met. First, the event needs to be unforeseeable[235] (but not necessarily extraordinary), which only requires that the parties were not able to foresee the event, but the event does not need to be unimaginable. The unforeseeable threshold takes into consideration the presumption of sophistication and expertise of the parties, indicating that if the parties were able to foresee the event, this provision is not applicable.[236] Second, because the economic prices in construction projects are high, the suggested threshold of 100% will not be applicable. To solve this problem Italian law requires an increase or a decrease of more

[231] *Id.*

[232] *Id.* at 69.

[233] *Id.* at 81.

[234] Another member of the consortium Grupo Unidos por el Canal is Salini Impregilo from Milan, Italy. Additionally, the 16 sluice gates (8 on the Pacific and 8 on the Atlantic) were fabricated by a subcontractor of GUPC, the Italian company Cimolai. The sluice gates have maximum dimensions of 60 m x 10 m x 33 m (comparable to a 10 storey building) and weighing approximately 4,300 t. Gates on New Panama Canal (2016), https://www.cimolai.com/portfolio/gates-on-new-panama-canal/.

[235] Cassazione civile. Sez Unite, sentenza n. 12076 del 9 novembre 1992. Available at: https://www.brocardi.it/massimario/7233.html

[236] Cassazione civile. Sec. II, sentenza n. 1494 del 21 gennaio 2011.

than 10% in the cost[237] of the project to be able to request a revision or renegotiations of the contract price. It also indicates that the revision can be granted, which is interpreted to mean that the modification of the contract price may be resolved by a court or tribunal, but this modification is limited to the increase or decrease over the 10%. For example, if the contractor faces overruns that increase the price of the costs by 25%, the court may adapt the contract and increase the price by 15% (the amount over 10%). Therefore, if the parties intend to protect themselves from increases of less than 10% they should include a hardship clause to deal with this situation.[238]

The second paragraph of this article provides that if in the course of the work difficulties of execution arise due to geological, water and similar causes, not foreseen by the parties, which gives the contractor the right to fair compensation if performance is considerably more expensive. This provision applies due to physical conditions that were different from those considered and known by the parties at the moment of the conclusion of the contract. These conditions may also be affected by acts of man. This provision has a lower threshold, only requiring that the parties did not actually foresee it, even though they were capable of foreseeing it. Equally important, it also focuses on the increase in the cost of the performance, by indicating that it has to be considerably more expensive, where the threshold of more than 10% is taken into consideration by the tribunal. This produces a right for the contractor to request fair compensation for the overruns they had to pay to keep the works of the project. Thus, the request for adaptation of the price is first made to the employer. If the parties do not agree, then the contractor has a default right to require that the tribunal adapt the price of the contract to reflect the increase in the costs.

The provisions of this article are not mandatory for the parties, and they may depart from it.[239] This consequence may be the invariability of the fee, related to an increase of costs for unforeseeable circumstances.[240] The derogation from this provision does not need to be express in the contract, it can be implied. The court or tribunal may use the legal tools for the interpretation of contracts and the circumstances of negotiations between the parties to establish this intent.[241]

ii. Eccessiva Onerosità Sopravvenuta

Article 1467, which addresses the *eccessiva onerosità sopravvenuta*, is extremely similar to art. 1161-A of the Civil Code of Panama. According to the Italian law, "courts and arbitrators do not have the power to adapt contracts in cases of hardship being such

[237] Cassazione civile, Sez. II, sentenza n. 4514 del 14 Iuglio 1980.

[238] Brocardi. *Onerosità o difficoltà dell'esecuzione.* Available at: https://www.brocardi.it/codice-civile/libro-quarto/titolo-iii/capo-vii/art1664.html

[239] Cassazione civile, Sez. II, sentenza n. 4514 del 14 Iuglio 1980.

[240] Cassazione civile, Sez. I, sentenza n. 11469 del 21 dicembre 1996.

[241] Cassazione civile 5267/2018. Section I, Ordinanza n. 5267 del 6 marzo 2018.

possibility only granted to the advantaged party."[242] The *Corte di Cassazione* in 2000 in the case of *Pamedil v. Bruno, Giur It*, the court ruled:

> [T]he only party entitled to solicit the equitable modification of the contract's conditions is the one sued by means of the termination claim for excessive onerousness, since it has to be excluded that a request of reduction *ad aequitatem* can be opposed to a request of performance of the contract [i.e., the equitable modification of the contract cannot be asked by the party affected by hardship when it is sued in order to justify its breach of contract].*[243]*

According to Professor Christoph Brunner, the ICC Hardship Clause 2003, which does not provide for adaptation, was based on the Italian Rule. In this regard, in the Italian Rule there is no adaptation of the contract and the disadvantaged party may only request termination if the other party does not provide an alternative.[244]

The *Corte di Cassazione* has indicated that when the requested party makes only one offer, instead of approving the termination of the contract requested by the disadvantaged party,[245] the Court can only analyze if that proposal is equitable. However, when the parties have proposed alternative proposals for the consideration of the court, it can decide and adapt the contract.[246]

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[242] PIETRO FERRARIO, THE ADAPTATION OF LONG-TERM GAS SALE AGREEMENTS BY ARBITRATORS 114 (Wolters Kluwer 2017).

[243] Original text: "Nei contratti a prestazioni corrispettive, la parte che ha titolo per sollecitare l'equa rettifica delle condizioni del negozio è quella convenuta in giudizio per la risoluzione del negozio medesimo per eccessiva onerosità; mentre è escluso che una richiesta di riduzione ad equità si possa contrapporre ad una domanda di adempimento."

[244] *See* Brunner, *supra* note 143, at 497-98.

[245] *Annoni v. Salvia*, I 1985 Giur It, 362, *Corte di Cassazione* n. 275 13 January 1984 (if the event was part of the normal development of contract the party cannot request for termination. In this regard, it has to be noted that, according to part of the doctrine, beyond the normal risk there is another area (so called 'anomalous risk') in which the performance cannot still be considered as excessive onerous and, consequently, the termination cannot be claimed).

[246] Moscatiello v. Cerbo, Rep. Foro. It. Corte di Cassazione 'Contratto in genere', n. 359 (n. 5922 25 May 1991). Available at: https://lib.unibocconi.it

d. France and Belgium[247]

i. France

In the French legal system, the principle of *pacta sunt servanda*[248] is king, but hardship now seems as the New Kid on the Block because of the reforms to the French Civil Code. Now hardship is contemplated in art. 1195 of the French Civil Code. Until 2016, the only concept similar to hardship in the French law was the *imprévision*,[249] which only dealt with extreme change in economic circumstances due to unforeseeable circumstances in administrative contracts (i.e. contracts with the French government). In case of changes in the economic circumstances the contract could be adapted in order to maintain the long-term relationship, the service, and the works for the community.[250] While in private law, in the past, if the parties did not expressly provide for adaptation of the contract due to hardship, adaptation could not be requested and the tribunal did not have the power to adapt it.

Before the change of legislation, French jurisprudence reacted to the change in economic circumstances in the private contracts, indicating that in case of economic disequilibrium for unforeseeable circumstances the parties have a duty of good faith, and included in this principle there is a duty to renegotiate in good faith to address the new circumstances.

In the case Electricité de France v. Societé Shell Française, decided in 1976 by the *Cour d´appel de Paris*, the parties agreed to an indexation clause and a hardship clause that provided:

> If the price of fuel sustains vis-a-vis its initial value a rise or fall of more than 6 francs-a-ton; the parties should come together to examine the modifications to be brought to the contract; should they fail to agree, E.D.F. shall have the right to rescind the contract in the

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[247] *Inauguration Panama locks*, JAN DE NUL GROUP (June 26, 2006), https://www.jandenul.com/en/pressroom/press-releases/inauguration-panama-locks (one of the companies that was part of the consortium Grupo Unidos por el Canal was the Belgian: Jan De Nul NV which helped in the construction of 2 lock complexes, one on the Atlantic and one on the Pacific Ocean side).

[248] C. CIV. art. 1134.1 (Fr.).

[249] LUKAS KLEE, INTERNATIONAL CONSTRUCTION CONTRACT LAW 37 (2015) ("'[T]héorie de l'imprévision', i.e. the situation (obstacle), which was not foreseeable and is now complicating the realization and, therefore, is providing the contractor with the right to claim increased costs and/or to terminate the contract. This theory is typical of administrative law and imposes on the public authority the obligation to help the contractor if the equilibrium of the contract is shaken").

[250] Panamanian Compound Text, art. 21, Law 22 of 2006 of Public Procurement Law (also contents an equilibrium provision in contracts with the government, but because the Panama Canal has its own rule of contracting, the Law 22 of 2006 is not applicable.)

case of an increase in price and Shell shall have the same right in the case of a decrease in price.

Due to the economic situation, the price fell below the agreed floor between the parties, they renegotiated in good faith without any outcome. The Tribunal de commerce indicated that it could not intervene in the autonomy of the parties and it could not modify, and therefore, invented a new indexation clause. In this regard, the *Cour d´appeal de Paris* proposed the parties renegotiate again for 6 months with an observer to get an agreement. If the parties could not reach an agreement in that time, then the tribunal would try to revise the contract, but the tribunal could not act by changing any of the foundations of the contract.

This principle of *imprévision* from French jurisprudence, which applies to public contracts, has been interpreted to state that the courts can only act by the autonomy of the parties, but the courts could not modify or adapt private contracts.[251] This course of thought was maintained in the following French jurisprudence.

In Sociéte d'Exploitation de Chauffage (SEC) vs Soffimat, judgment rendered on June 29, 2010 by the *Cour de Cassation*, the issue was a long-term contract where Soffimat had to maintenance two motors of a central production of SEC, and in 2008 the price of the raw materials and metal increased more than triple from 1998 due to unforeseeable circumstances. Soffimat proposed renegotiations, but SEC rejected then and sued in court for performance according to the original terms of the deal. The trial court and the appeal court rendered their decisions in favor of the plaintiff. The *Cour de Cassation* reversed the judgments of the lower courts and held that because the economic equilibrium of the contract was fundamentally altered, while the parties agreed to different conditions at the moment of the conclusion of the contract, SEC had a duty of good faith to renegotiate with Soffimat.[252]

In the ICC case No. 9994 rendered in 2001,[253] where the applicable law was French law, a French company (claimant) had a long-term contract to supply raw materials to an American company (respondent) that was allowed to make, use, and sell products from these materials. The parties discussed the possibility of adding a provision to the *force majeure* clause regarding a possible economic disequilibrium of the contract based on an increase in the processing of the placentae due to any cause not within its control. This proposal was rejected by the respondent. The government agency imposed new regulations over the placentae where the raw materials are derived, which increased excessively the cost for the claimant, who then requested renegotiations. However, the respondent refused and terminated the contract. The claimant sued the respondent, arguing that the termination of the contract was illegal based on art. 1134.2 of the French Civil Code. The claimant

[251] *See* Ullman, *supra* note 137, at 81-84.

[252] *Cour de cassation, civile, Chambre commerciale*, LEGIFRANCE (June 29, 2010), .https://www.legifrance.gouv.fr/affichJuriJudi.do?idTexte=JURITEXT000022430481. .*See also* Ferrario, *supra* note 242, at 47.

[253] UNILEX UNIDROIT PRINCIPLES, http://www.unilex.info/case.cfm?pid=2&do=case&id=1062&step=FullText (last visited Mar. 25, 2019).

argued that the parties had a duty to renegotiate in good faith due to the fundamental alteration of the equilibrium of the contract.

Even though the *force majeure* did not provide for economic imbalance based on the increase in the processing of the placentae, the arbitral tribunal indicated that the parties did not expect that the governmental agency would require these new processes for the placentae that increased its price. Also, the tribunal, based on the applicable law, held that the parties had a duty to renegotiate that cannot be eliminated by a contractual provision. Furthermore, the tribunal indicated that the parties had a duty to renegotiate, but this does not mean that the claimant had the right to impose a new price that the respondent would be obligated to accept.

In the French jurisprudence, the courts established that in cases of hardship, there was a duty of good faith to renegotiate between the contracting parties. This jurisprudence evolved and became *loi de la République* in 2016 when reforms were made to the Napoleonic Code of 1804.

With this reform, France decided to follow the elements and consequences of hardship present in the UNIDROIT Principles, indicating in art. 1195 that in cases of unforeseeable circumstances that make the contract excessively onerous, the parties have a duty to renegotiate. If the disadvantaged party accepted the risk of the event under the contract, it does not have the right to request for renegotiations or adaptation.

During the renegotiations, the disadvantaged party had to keep performing its obligation. If renegotiations do not produce any outcome, either party may request the tribunal terminate or adapt the contract. Thus, the remedy of adaptation is now available in French law and can be granted without an express authorization of the tribunal to adapt the contract. It is no longer an extraordinary remedy. The requirements to request adaptation are: (1) hardship, and (2) the parties held renegotiations.

Therefore, this change of perspective from one of the most conservative law systems, where the principle *pacta sunt servanda* was applied as the golden rule, now has innovated its approach to allow adaptation in cases of hardship.

ii. Belgium

Belgium follows the principle of *pacta sunt servanda* in private contracts. It provides for *imprévision* only in cases of administrative law. Therefore, the Belgium courts do not adapt the contracts without an express conferral of power.

In the case of unforeseeable events that make the contract excessively onerous, the remedy is renegotiation in good faith to deal with the new situation, but the courts do not intervene in the autonomy of the parties or their agreements. In this regard, probably the most renowned case dealing with situations of hardship is the *Scafom* case,[254] decided in the *Cour d´Cassation* of Belgium in 2009. The court, applying the Convention of International Sale of Goods (CISG), found hardship and that art. 79 of the CISG has a gap for the remedy in cases of hardship that needs to be filled by the mechanism of art. 7 (2) of

[254] CISG CASE PRESENTATION, .http://cisgw3.law.pace.edu/cases/090619b1.html (last visited Mar. 25, 2019); *See also* Ferrario, *supra* note 242, at 98.

the CISG, which means that the gaps of the Convention needs to be filled by its international principles. These principles guide the uniform application of the UNIDROIT Principles, which in art. 6.2.3. provide for renegotiation as the remedy in cases of hardship.

In this case, Scafom International (Dutch buyer) vs. Lorraine Tubes (French seller),[255] the parties had an agreement for supplying steel tubes. Years later, due to unforeseen market fluctuations, the price of the steel tubes increased approximately 70%. The seller proposed renegotiations, but the buyer refused and expressed that the seller had to perform according to the original agreement. The seller refused to perform, and the buyer sued for breach of contract. The trial court indicated that the CISG only deals with situation of *force majeure* and not hardship, and therefore, could not adapt the contract. Ultimately, the court increased the price of the contract by half after the proceedings.

The buyer appealed, and the court of appeals indicated that CISG had a gap regarding hardship that need to be filled by the rules of private international law. The court determined that the applicable law was French law, sent the parties for renegotiations, and granted the seller 450,000 euros as damages because the proposal of the seller was reasonable.

Then, the *Cour de Cassation* indicated that the applicable law was the CISG, which deals with situations of hardship in art. 79 and has a gap for the remedy that needed to be filled by the UNIDROIT Principles, sending the parties to renegotiations.

e. Spain [256]

Contrary to other civil codes, such as the Panamanian Civil Code and the Italian Civil code, Spain does not have an express provision in its civil code addressing the grounds or consequences of excessive onerousness. During the years 1940 to 1990 the application of the principle of *rebus sic stantibus* in Spain was not common. However, an evolution in the case law that addressed this principle occurred from 1991 to 2012.[257]

In the ICC case No. 8873 decided in 1997,[258] involving a French consortium (plaintiff) and Algerian entity (respondent) for the construction of a road in Algeria. The applicable law to the dispute was Spanish law. The plaintiff was delayed in finishing the project, and the respondent requested liquidated damages for the delay. The plaintiff brought this arbitration requesting the following: first, compensation for the overruns it

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[255] *Id*.

[256] The leader of the consortium Grupo Unidos por el Canal was the corporation named Sacyr from Spain. gupc.com.pa (last visited Mar. 25, 2019).

[257] Henríquez Salido et. al, *La cláusula rebus sic stantibus en la jurisprudencia actual*, *66 REVISTA DE LLENGUA I DRET, JOURNAL OF LANGUAGE AND LAW* 189, 196 (2016).

[258] Sigvard Jarvin, Yves Derains and Jean-Jacques Arnaldez. Collection of ICC Arbitral Awards 1996- 2000. Kluwer International (1994) at 500, 500-509. ICC case No. 8873, 1997. Reported by Domenique Hascher. *See also* Frederick R. Fucci, *Hardship and Changed Circumstances as Grounds for Adjustment or Non-Performance of Contracts Practical Considerations in International Infrastructure Investment and Finance*, https://files.arnoldporter.com/hardship_excuse_article.pdf.

suffered during the project, based on hardship; second, that it suffered *force majeure* that produced the delay in the project due to insecurity in Algeria, difficulties of transit in the national roads, difficulty in the supply of asphalt, other climate events that impacted the works, defective use of the road, and violation by the respondent in its obligation to assist and to cooperate.

In the first issue, the plaintiff argued that the trade usages in the international contracts were applicable to the dispute, in addition to the applicable law. The arbitral tribunal determined that based on the ICC Rules the arbitral tribunal must take into consideration the stipulations of the contract and the usages of commerce. The tribunal indicated that the usages of a certain industry in the international commerce are considered applicable without an express reference, because it is obligatory as a consequence of an usage repeated and widespread. But it had to take it into consideration with caution to avoid adding terms to the contract that the parties did not reasonably consider applicable.

The plaintiff argued that the UNIDROIT Principles of International Contracts were applicable as trade usage. The tribunal indicated that in the international practice the obligation to restore the equilibrium of the contract (first by renegotiations and then, the possibility to request adaptation, as provided by art. 6.2.3.(4), of the UNIDROIT Principles) constituted an exceptional principle that has not been accepted in the frame of the hardship clauses, which need to provide the causes and the consequences of the hardship. Therefore, the considerations of hardship of the UNIDROIT Principles cannot be considered as trade usage.

The plaintiff also argued under the trade usage conditions of FIDIC and ENAA the costs paid by the contractor in consequence of a situation of *force majeure* should be reimbursed by the employer. However, the tribunal also rejected this argument indicating that FIDIC and ENAA have specified different procedures in the case of *force majeure* situations and these separate regulations cannot be applied by default and out of context, because they require the negotiations of several complementary elements.

About the issue of the contractor's responsibility in the delays, the tribunal found the *force majeure* that the parties agreed to only provided the elements of unavoidability and no control of the parties. The *force majeure* clause provided that the affected party shall give notice and details of the *force majeure* circumstances in writing to the other party as promptly as possible after its occurrence. The tribunal indicated that this notification provision has to be taken into consideration with flexibility because that would mean that no communication, except in a specific manner, could be taken into account. The respondent argued that the risk of the events was a burden of the plaintiff because it was already delayed in the fulfillment of its obligation to finish the project. This argument was based on art. 1096 (3) of the Spanish Civil Code, which indicates that if the debtor is delayed in its obligation (in this situation of giving notice to the employer) it bears the risk. The plaintiff argued that this provision only applied to obligations to give something. In this issue, the tribunal indicated that there was no proof that this provision applied to construction contracts and that its application would not be justified.

In an interesting approach to the specificity of international contracts, the tribunal established that through the contract the parties showed their implicit intent to exclude the application of dispositive rules of the national applicable law which do not correspondent to the international practice, as art. 1096 (3) of the Spanish Civil Code. Therefore, the circumstances of *force majeure* that arose after the project had to be done could be taken

into consideration. The tribunal found two situations to be considered *force majeure* that justified the delay of the delivery of the project: the closing of the roads and the problem with the supply of the asphalt, with justified delays of 15 days and 20 days respectively, which reduced the liquidated damages for the delayed of the project.

In this case, the plaintiff not only requested a reduction of the liquidated damages due to the justified delays (arguing hardship or *rebus sic stantibus*), but also requested reimbursement of the overruns expended as consequences of the *force majeure* events. As mentioned above, the tribunal rejected art. 6.2.3. of UNIDROIT Principles addressing the remedies of hardship as applicable as trade usages. The tribunal also indicated that because this principle was not in the contract or in the Spanish law, hardship was not applicable in the case.

However, the tribunal did recognize that *rebus sic stantibus* due to external circumstances that affected the equilibrium of the contract, was present in the Spanish law. Citing judgments of the Supreme Court of Spain that indicated a judge may restore the equilibrium of the contract if the following elements were met: (1) an extraordinary alteration of the economic circumstances different from the moment of the conclusion of the contract and the moment of performance, (2) an extraordinary disproportion of the obligation of the parties that destroyed the preexistent equilibrium, (3) that the situations were unforeseeable. Nevertheless, the tribunal indicated that the circumstances alleged by the plaintiff did not meet these requirements, and *rebus sic stantibus* was not applicable to grant plaintiff the reimbursement of the overruns.

In the twenty-first century, the Spanish case law perspective about hardship changed mostly due to the economic crisis in 2008.[259] In this regard, in lack of a provision in the Spanish Civil Code the courts adapted to the economic circumstances of the moment by recognizing adaptation as a remedy to preserve the contracts between the parties where unforeseeable circumstances affected the economic essence of the contract.

The landmark case where the Supreme Court of Spain ("Tribunal Supremo") addressed and recognized the principle of hardship was the *Promedios* case (STS 2823/2014).[260] A publicity company called Promedios Exclusivas de Publicidad, SL (plaintiff) had a contract with the transportation company of the city of Valencia, Empresa Municipal de Transportes de Valencia (respondent). In 2006 the parties concluded a contract where Promedios had to pay Empresa for the space of publicity with a minimum amount of 178,350 euros per month upgradeable up to 5%.

In 2009 plaintiff informed respondent of its offer to temporally pay 70% of the previous canon due to the unforeseeable change in circumstances in the investment in the advertisement market, which in 2007 decreased by 21.74% and by 2009 decreased 33.3%. Promedios had to close that line of business to save the other areas of business of the company.

Promedios sued Empresa in the trial court requesting adaptation of the contract due to the economic crisis. The trial court ruled in favor of Promedios and adapted the contract

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[259] Félix Benito Osma, *La excesiva onerosidad de las prestaciones en la contratación mercantil, Estudios sobre el futuro Código Mercantil: libro homenaje al professor Rafael Illescas* 1223, 1228 (2015).

[260] S.T.S., June 30, 2014 (Spain), http://www.poderjudicial.es/search/doAction?action=contentpdf&databasematch=TS&reference=7128082&links=&optimize=20140718&publicinterface=true.

where from November 2008, the monthly payment was going to be 70% of the income of Promedios or 70,000 euros per month. Empresa appealed and the court of appeals reversed the judgment, ruling that Promedios had to pay Empresa for damages. The case went to cassation to the Supreme Court.

The Supreme Court ruled in favor of Empresa, reversing the judgment of the court of appeals and affirmed the judgment of the trial court, which applied hardship to adapt the contract. In this regard, the Supreme Court indicated that the Spanish jurisprudence established that the equitable notion of the principle of *rebus sic stantibus* must be changed to an objective notion that does not contradict with the principle of *pacta sunt servanda* and the stability of the conditions of the contract. The new concept of *rebus sic stantibus* will have an objective notion based on principles of the Spanish codified system, such as equilibrium of the contracts (art. 1289 of the Spanish Civil Code) and good faith (art. 1258 of the Spanish Civil Code).

Regarding the consequence or the remedy in case of hardship, the court established that based on the principle of conservation of contracts, the hardship may produce an adaptation of the agreement to restore the equilibrium of the contract and not necessarily the termination of the contract.

The court indicated a three-prong test to be able to determine if the objective basis of the contract was destroyed by the change of circumstances. The three elements of the test are cause, purpose of the contract, and risk allocation. First, the event must cause the impact of the new event, in consideration of the conditions that the parties had at the moment of the conclusion of the contract. Second, there must be an alteration in the purpose of the contract. For this element the court indicated that two factors must be met: (a) The main economic purpose of the contract, expressly provided or derived from the essence of it, is frustrated or becomes unattainable; and (b) the equivalence of the contract, between the consideration of the parties, disappears, destroying the basis of *quid pro quo* of the agreement. Finally, the risk allocation agreed to by the parties must be part of the consideration of the tribunal. If the parties did not agree to a specific risk allocation, then the event cannot be a hardship if it is part of the normal risks of the type of contract.

Thus, the Supreme Court ruled that in cases of hardship, the parties may require the tribunal to adapt the contract if renegotiation by the parties did not produce any outcome. By jurisprudence, the hardship is a default provision in contracts that are governed by the Spanish law.

VI. CONCLUSION

Once upon a time, a philosopher said: "*the only thing that is constant is change*." The history of the Panama Canal is the perfect example of this statement. Since its construction, the people who wanted to be involved in this project have faced the hardest challenges and the most unexpected changes. From the genius of De Lesseps negotiating with the Colombians and the failure of his Canal *a niveau*, passing through the American desire to connect the world through a Canal and the concurrent independence of a country. The subsequent change of command from the experienced American administration to the hands of the fervent and entrepreneurial Panamanians, to the Panamanian project of

expansion. As in the construction of the Canal, the expansion also had dreams, extreme difficulties and unforeseeable changes.

When the parties are involved in international business, the freedom of contract grants the chance to negotiate and choose their rights and obligations in the occurrence of material changes. In this choice, there is a presumption that the parties involved in international business are sophisticated and at least reasonable. Thus, the freedom of contract grants a right, but also a duty to be coherent in the choice of the agreement by selecting the text of the contract and the applicable law. Therefore, by these choices the parties agree and are bound by their consequences.

If the parties intend to maintain the equilibrium of the contract in cases of certain changes, having due regard to the economic situations of both parties, they should include a hardship clause with the correct remedy. When the tribunals determine if there is hardship for one party, they have to analyze on a case-by-case basis, with due regard to the economic circumstances of both parties.

If the parties try to include all the situations that may happen, the contracts would be infinite. It is true that the parties cannot foresee all the changes that may occur. This is the reason why the selection of the applicable law is fundamental, because it will supplement what the parties did not take into account. In this regard, because of the variety of approaches that different legal systems have in interpreting the contracts, the level of supplementation of the agreements with the applicable law, and the different ways that the legal systems deal with the consequences of economic disequilibrium due to unforeseen or unforeseeable changes, the parties must choose carefully when selecting an applicable law that best suits their will on how to deal with subsequent changes. The only usage in cases of economic impossibility is the duty of good faith, that is more a duty to be ethical and a reasonable businessperson, which has been recognized in the international business community as the obligation that each party has to listen to the arguments and the position of the disadvantaged party to reach a joint solution. In the duty of good faith, the parties are not obligated to reach a solution. The reason why the international parties make contracts is to have certainty and predictability in the constantly changing world.

In cases of failed renegotiations, there is no international usage on the remedy of adaptation in cases of hardship. Finally, because the parties come from different legal systems, it is fundamental to select the remedy in cases of hardship in the contract and to select the applicable law for the contract to ensure a remedy in cases of failed renegotiations.