Renegotiating International Business Transactions: The Continuing Struggle of Life Against Form*

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"One turns from the contemplation of the work of contract as from the experience of Greek tragedy. Life struggling against form. . ." Karl N. Llewellyn

I. Introduction

Experienced lawyers and executives know that the challenge of international business negotiations is not just "getting to yes,"[1] but also staying there. Despite lengthy negotiations, skilled drafting, and strict enforcement mechanisms, parties to solemnly signed and sealed international contracts often find themselves returning to the bargaining table later on to renegotiate their agreements.

The last half century witnessed numerous examples of renegotiation in international business and finance: the renegotiation of mineral and petroleum agreements in the 1960s and 1970s, often in the face of threatened host country nationalizations and expropriations[2]; the loan reschedulings of the 1980s following the debt crisis in many developing countries[3]; and most recently the restructuring of project agreements and financings required by the Asian financial crisis of the late 1990s.[4] The pattern will certainly continue in the future.

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1. ROGER FISHER ET AL., GETTING TO YES: NEGOTIATING AGREEMENT WITHOUT GIVING IN (Bruce Patton ed., 2d ed. 1991).

2. For an excellent summary of major renegotiation cases in the petroleum and minerals industry, see Abba Kolo & Thomas W. Walde, *Renegotiation and Contract Adaptation in International Investment Projects*, 1 J. WORLD INV. 5 (2000). *See also* Detlev F. Vagts, *Coercion and Foreign Investment Rearrangements*, 72 AM. J. INT'L L. 17, 36 (1978).

3. *See, e.g.*, VINOF K. AGGARWAL, DEBT GAMES: STRATEGIC INTERACTION IN INTERNATIONAL DEBT RESCHEDULING (1996).

4. *See, e.g.*, Rosa M. Lastra, *Central Banks as Lenders of Last Resort: Lessons From the Asian Contagion*, 7 J. FIN. REG. & COMP. 234, 242 (1999).

For example, the entry of China into the World Trade Organization will prompt the renegotiation of countless international business contracts made during that country's previous trade and investment regime.[5]

The renegotiation of business deals is a constant and common phenomenon of the international business environment.[6] In today's business world, executives, lawyers, and government officials through renegotiation seem to be seeking continually to either alleviate a bargain that has become onerous or to retain a good deal that the other side wants to change. The examples are so numerous that renegotiation of a previous deal seems to be as basic to modern business life as negotiating a new deal for the first time. In the current period of heightened uncertainty, renegotiation may become even more pronounced as companies attempt to negotiate contracts that provide stability on one hand, yet give the parties the flexibility to face the unknown on the other.

The purpose of this article is to examine the phenomenon of renegotiation of international business transactions, to explore its nature and causes, and to offer useful advice on how best to conduct the renegotiation process.

II. Defining Renegotiation

Discussions of renegotiation apply the term to three fundamentally different situations, and it is, therefore, important to distinguish them at the outset. Each raises different problems, and each demands different solutions. The three situations are: (1) post-deal renegotiations, (2) intra-deal renegotiations, and (3) extra-deal renegotiations.[7]

A. Post-Deal Renegotiations

Post-deal renegotiation refers to the situation in which negotiations take place at the expiration of a contract when the two parties, though legally free to go their separate ways, nonetheless try to renew their relationship.[8] For example, a project company has built an electrical generating station in an emerging market country and has made a twenty-year electricity supply contract with that country's state public utility corporation. At the end of twenty years, when local law considers their legal relationship at an end, the project company and the public utility corporation begin discussions on a second long-term electricity supply contract, thereby renegotiating their original relationship. While this second negotiation process, a post-deal renegotiation, may seem at first glance to resemble the negotiation of their original contract, it also has some notable differences that influence renegotiation strategies, tactics, and outcomes.

B. Intra-Deal Renegotiations

A second type of renegotiation occurs when the agreement itself provides that during its life, at specified times or on the happening of specified events, the parties may renegotiate

5. *See, e.g.*, Daniel Walfish, *China—Free Trades Beware: Renegotiating Contracts After China Enters WTO Can Be Tricky*, China Online News, June 13, 2000.

6. *See generally* Jeswald W. Salacuse, Making Global Deals—What Every Executive Should Know About Negotiating Abroad 147–63 (1991).

7. *See id.* at 151–55.

8. This process is also sometimes referred to as "contract renewal."

or review certain provisions. For example, the twenty-year electricity supply contract mentioned above might include a provision calling for the renegotiation of the agreement's pricing terms in the event of dramatic changes in fuel costs. Or, in an agreement between a manufacturer and a sales company for the marketing of specific products, the contract may stipulate that if the manufacturer develops new products it will agree to renegotiate its original deal with respect to the marketing of the new products.[9] Here renegotiation is anticipated as a legitimate activity in which both parties, while still bound to each other in a valid contract, are to engage in good faith. It is an intra-deal renegotiation because it takes places within the legal framework established in the original contract.

C. Extra-Deal Renegotiations

The most difficult, stressful, and emotional renegotiations are those undertaken in apparent violation of the contract or at least in the absence of a specific clause authorizing a renegotiation. These negotiations take place "extra-deal," for they occur outside the framework of the existing agreement. Forced renegotiation of mineral concession contracts of the 1960s and 1970s, negotiations to reschedule loans following the Third World debt crisis of the early 1980s, and the restructuring of infrastructure and financial agreements in the wake of the Asian financial crisis of the late 1990s all fit within the category of extra-deal renegotiations. In each case, one of the participants was seeking relief from a legally binding obligation without any basis for renegotiation in the agreement itself. For example, in the illustration given above, if the state public utility company, without justification in the contract, had insisted on negotiations to reduce the price it was committed to pay for electricity under the contract, such discussions would be categorized as extra-deal renegotiations because they would be taking place outside of the legal framework of the original contract.

D. Summary

All three types of renegotiation are a constant and ever-present fact of international business life. Yet three important factors distinguish them from negotiations in first instance: (1) increased mutual knowledge, (2) increased transactional understanding, and (3) increased mutual linkage. First, as a result of working together during their first agreement, the parties know much more about each other than when they first negotiated the agreement. Second, many of the questions that they had about their contemplated transaction during their initial negotiation have now been answered. And third, as a result of their investment in the transaction during their first agreement, it may not be more costly to abandon renegotiations than it would have been to have walked away from their initial negotiations.

At the same time, each of these three types of renegotiation differs among themselves with respect to the dynamics between the parties, as well as the strategies and tactics they may employ. The remainder of this article explores these three renegotiation processes in detail, and devotes particular attention to extra-deal renegotiations because they are a constant risk for an international transaction and can have serious implications for transaction parties and financing institutions. To illustrate the problems and dynamics of this kind of renegotiation, the article will examine in some detail a specific case of extra-deal renegotiation—the renegotiation of the Dabhol Power Project in India.

9. *See, e.g.*, Howtek, Inc. v. Relisys, 958 F. Supp. 46 (D.N.H. 1997).

III. Post-Deal Renegotiations

A. Distinguishing Factors

Although post-deal renegotiations take place when the original transaction has reached or is approaching its end, several factors distinguish it from a negotiation in the first instance, factors that may significantly affect the renegotiation process. First, by virtue of local law, customs of the particular business concerned or the parties' express or implied contractual commitments to one another, the parties may have a legal obligation to negotiate in good faith with one another despite the fact that their original contract has terminated. Consequently, their ability to refuse to engage in post-deal renegotiations may be limited. The existence and precise nature of such a duty will depend on the law governing the contract.

English common law has traditionally recognized a broad, unrestrained freedom of negotiation, which permits a party to begin or end negotiation at any time for any reason.[10] The rationale for this rule is that to limit the freedom to negotiate might discourage persons from making transactions in the first place. Although the common law has traditionally upheld the freedom to negotiate in commercial matters,[11] the law in certain other countries has taken a less liberal approach to permissible behavior in business negotiations.[12] In such jurisdictions, once the parties have commenced negotiations, they may have an obligation to negotiate in good faith.

In the case of post-deal renegotiations, by reason of an express provision in the original contract itself, the prevailing practices and customs of the business concerned, or the conduct of the parties toward one another, the parties at the termination of their first contract may have an obligation to negotiate in good faith a renewal of their relationship. In contrast, parties seeking to negotiate a transaction in first instance would have no such obligation and could abandon negotiations at any time.

The precise content of the obligation to negotiate in good faith will vary from country to country. It may include a duty not to negotiate with a third person until post-deal negotiations with a party in the original transaction have failed. It may also impose an obligation not to terminate renegotiations without reasonable cause and without having persevered for a reasonable length of time.[13] Failure by a party to fulfill its obligation to renegotiate in good faith may result in liability in damages.

Even if the applicable law imposes no legal obligation to renegotiate in good faith, the original contract, as well as economic factors, may constrain the renegotiation process in ways not present in the original negotiations. For example, the twenty-year electricity supply contract mentioned above might provide that if the project company and the public utility company fail to successfully negotiate a second twenty-year supply contract at the end of the first agreement, the public utility company will be obligated to purchase the project company's electrical generating facility in accordance with a pricing formula specified in the original agreement.

10. *See* E. Allan Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 Colum. L. Rev. 217, 221–22 (1987).

11. *See id.*

12. *See generally* Saul Litvinoff, *Good Faith*, 71 Tul. L. Rev. 1645, 1659–62 (1997).

13. *See* Farnsworth, *supra* note 10, at 269–85 (discussing the meaning of fair dealing in negotiations and offering instances of unfair dealing).

In addition to the factors arising out of contract law, numerous other elements may influence post-deal renegotiations. First, the parties in a post-deal renegotiation have a shared experience of working together and knowledge of each other's goals, methods, intentions, capabilities, and reliability. Obviously, the nature of their earlier experience together will significantly affect their renegotiation. For example, the problems of cross-cultural communication that may have complicated their first negotiation will probably be far less important in the second negotiation, since the parties, through working together, have learned much about each other's cultures. Second, many of the original questions about their venture, such as its risks and opportunities, have likely been answered. This information will shape bargaining positions in the renegotiation.

Finally, the willingness of the participants to reach an agreement will be influenced by their tangible and intangible investments in their first relationship and the extent to which they can use those investments advantageously in their second contract. For example, the project company in the illustration above will have built the generating facility, organized itself, and trained its employees to provide electricity over the long term to a single specific purchaser, the state public utility. All other things being equal, the project company may prefer to enter into a new contract with the utility, rather than to make an agreement with another purchaser, since the latter course of action would entail significant new risks and costs. Similarly, the public utility relying on the project for a major portion of its supply may wish to avoid the costs of finding another supplier or creating its own electrical generating capacity.

In any negotiation, a party's behavior at the negotiating table is influenced by its evaluation of available alternatives to the deal it is negotiating. Rational negotiators will not ordinarily agree to a transaction that is inferior to its best alternative to an agreement at the negotiating table.[14] In a post-deal renegotiation, each party's evaluation of its alternatives to a renegotiated deal will be heavily influenced by the history of its relationship with the other party during their first contract.

In general, the success of post-deal renegotiations will depend on the nature of the relationship that has developed between the parties during the original contract. If that relationship is strong and productive, the atmosphere at the bargaining table will be that of two partners trying to solve a common problem. If the relationship is weak and problematic, the prevailing mood will be that of two cautious adversaries who know each other only too well.[15]

B. Some Principles to Guide Post-Deal Renegotiations

The factors discussed above give rise to the following principles, which lawyers, executives, and government officials should consider in structuring and conducting the process of post-deal renegotiations.

1. *Provide for Post-Deal Renegotiations in the Original Contract*

In transactions where the desirability or likelihood of post-deal renegotiations is high, the parties should specify in their original contract the process and rules that they will

14. *See* Fisher et al., *supra* note 1, at 99–102 (discussing the concept of BATNA, i.e., Best Alternative to a Negotiated Agreement).

15. *See generally* Jeswald W. Salacuse, *After The Contract, What? Negotiating to Work Successfully with a Foreign Partner*, 2 Can. Int'l Law. 195–200 (1997).

follow in conducting a post-deal renegotiation. For example, among other factors, the contract should state how soon before the end of the contract that renegotiations are to begin, how long the renegotiations are to continue before either party may legally abandon them, where the renegotiations are to take place, and the nature of the information that each side is to provide the other. Recognizing that post-deal renegotiations may become problematic, parties might also want the contract to authorize the use of mediators or other third-party helpers in the process.[16]

2. *Review Individually and Jointly of the History of the Relationship During the Original Contract*

As part of its preparation, each party to a post-deal renegotiation should carefully and thoroughly review the history of the experience of working together during the first contract. An understanding of the problems encountered during that period will enable each side to shape proposals to remedy the situation during a contemplated second agreement. To make that review an opportunity for creative problem-solving rather than mutual acrimony over past mistakes, the parties should structure a joint review of past experience, perhaps with the help of a neutral facilitator, at the beginning of the post-deal renegotiation process. For example, as a first step in the renegotiation process, the parties might agree to give a review team consisting of executives from each participating company the task of preparing a mutually acceptable history of the transactions to be considered by the negotiators as they begin their work on a new agreement. Inevitably, during the course of post-deal renegotiations, each side will refer to past events. The renegotiation will proceed more smoothly and efficiently if at the beginning of the process the parties have a common understanding of their history together, rather than if they engage in a continuing debate about the existence and significance of past events throughout the renegotiation.

3. *Understand Thoroughly the Alternatives to the Deal*

Negotiation scholars stress the importance for negotiators to know their alternatives to the deal that they are trying to negotiate and to estimate their counterparts' alternatives.[17] Generally, the better a negotiator's alternatives are away from the negotiating table, the stronger the negotiator position is at the bargaining table.[18] In a post-deal renegotiation, these two tasks are often complicated by the fact that the parties may have conducted their business in such a way during the first contract that few realistic alternatives to a second contract seem possible. For example, the project company that owns a generating facility may feel that it has few other options than to enter into a second contract with the state public utility. Or, the public utility company in a country that has a severe energy shortage may see no realistic alternatives to making a second electricity power purchase agreement with the project company. Rather than to accept the inevitability of a second contract, each side, long before the termination of the first contract, should carefully examine all options and even seek to develop possible new alternatives before entering into post-deal renegotiations with the other side.

16. *See* Jeswald W. Salacuse, *Direct Negotiation and Mediation in International Financial and Business Conflicts*, *in* NON-JUDICIAL DISPUTE SETTLEMENT IN INTERNATIONAL FINANCIAL TRANSACTIONS 53–72 (Norbert Horn & Joseph J. Norton eds., 2000). *See generally* CHRISTIAN BUHRING-UHLE, ARBITRATION AND MEDIATION IN INTERNATIONAL BUSINESS (Dr. Julian Lew ed., 1996).

17. *See* FISHER ET AL., *supra* note 1, at 99–102.

18. *See, e.g.*, David Lax & James Sebenius, *The Power of Alternatives or the Limits To Negotiation*, *in* NEGOTIATION THEORY AND PRACTICE 97–113 (J. Breslin & J. Rubin eds., 1991).

For example, the state public utility corporation, perhaps several years in advance of the end of the first contract, should contact other potential project companies to determine their interest in developing electrical generation plants in the country.

IV. Intra-Deal Renegotiations

A. Balancing Contractual Stability and Flexibility

Increasingly, international business transactions cover long time periods (usually many years), include several parties, deal with highly complex technical and financial matters, and involve large sums of money. As a result, a goal sought by all sides in the negotiation process is contractual stability, which is the assurance that the terms of their agreement will be respected in the future. At the same time, the parties know that during the long time period covered by their agreement many unforeseen political, economic, regulatory, and technical circumstances may arise and drastically change the balance of benefits from what the parties contemplated at the time they originally signed their agreement. Consequently, one can argue that a certain degree of flexibility is a second imperative that the negotiating process should seek. To provide for that flexibility, mechanisms could be included in the contract to allow the parties to adjust their relationship to such changes in circumstances.

One approach to balancing the imperatives of stability and flexibility in transaction agreements is for the contract itself to authorize the parties to renegotiate key elements of their relationship upon the happening of specified events or circumstances. The inclusion in the contract of some type of intra-deal renegotiation clause would appear to be a wise basis for establishing a long-term business relationship. Although commentators have advocated specific renegotiation or revision clauses in long-term international business agreements, these provisions have traditionally been rarely used.[19] Indeed, prevailing contracting practice among western firms and lawyers is just the opposite. Their preferred approach is to try to anticipate all possible future contingencies and to provide for them in the contract document, while seeking to foreclose any possibility for renegotiating its terms at a later date.

The traditional reluctance to use renegotiation clauses stems from a variety of factors, which are both legal and practical. First is the concern among lawyers that renegotiation clauses are merely "agreement[s] to agree" and, therefore, may be invalid and unenforceable under the law of many countries.[20] Judicial precedent on the validity of renegotiation clauses is sparse, so guidance in this area seems to come almost exclusively from judicial doctrine with respect to contract renewal and preliminary agreements.[21] Unlike the English common law, which has tended to dismiss agreements to negotiate as unenforceable, the contemporary approach in many American jurisdictions is to hold that agreements to negotiate in good faith are not unenforceable as a matter of law.[22] According to one recent case from a U.S. Federal District Court, "the critical inquiry in evaluating the enforceability of an express or implied agreement to negotiate in good faith is whether the standard against

19. *See* Martin Bartels, Contractual Adaptation and Conflict Resolution 65 (James E. Silva trans., 1985). *See also* Kolo & Walde, *supra* note 2, at 43.

20. *See, e.g.*, J. W. Carter, *The Renegotiation of Contracts*, 13 J. Cont. L. 185, 188 (1998).

21. *See generally* Farnsworth, *supra* note 10.

22. *See* Howtek, Inc. v. Relisys, 958 F. Supp. 46 (D.N.H. 1997); *see also* Channel Home Ctr. v. Grossman, 795 F.2d 291, 299 (3d Cir. 1986).

which the parties' good-faith negotiations are to be measured is sufficiently certain to comport with the applicable body of contract law."[23] It would seem that a specific renegotiation clause in an existing contract with definite terms as to how the parties are to conduct the renegotiation process would easily meet this standard of enforceability. The required certainty would be further satisfied by specifying the precise events that give rise to the obligation to renegotiate and by specifically providing for the timing, locale, and conditions of the renegotiation process, among other factors.

Practical considerations have also led western lawyers and executives to view renegotiation clauses with suspicion, on grounds that they increase uncertainty and risk in business transactions and offend western concepts of the sanctity of contract.[24] Their presence in a contract also creates a risk that one of the parties will use a renegotiation clause as a lever to force changes in provisions that, strictly speaking, are not open to revision. Moreover, the challenges of drafting these provisions and the heightened risks to contractual stability by renegotiation provisions that have yet to be tested in the courts are additional factors that have deterred lawyers from using them in long-term business contracts.[25]

Despite these potential pitfalls, the inclusion of a renegotiation clause may actually contribute to transactional stability in certain situations. First, in cases in which significant changes in circumstances may result in severe unexpected financial hardship, a renegotiation clause may permit the parties to avoid default, with the attendant risk of litigation and extra-deal renegotiations. At the outset, it may be wiser for the parties to recognize the risk of changed circumstances and create within the contract a process to deal with them rather than to try to predict all eventualities and leave the matter up to the courts or arbitrators when those predictions prove to be flawed.

A second situation in which a renegotiation clause may be helpful occurs in cases in which the parties, by virtue of their differing cultures, understand and perceive the basis of a business transaction in fundamentally different ways. For example, western notions of business transactions as being founded upon law and contract often clash with conceptions in other cultures that hold that business dealings are fundamentally based on the relationship between the parties involved.[26] In many Asian countries, in particular, business executives consider the essence of a business deal to be the relationship between the parties, rather than the written contract, which can only describe that relationship imperfectly and incompletely.[27] Often persons from those cultures assume that any long-term business relationship includes an implicit, fundamental principle: in times of change, parties in a business relationship should meet to decide together how to cope with that change and adjust their relationship accordingly.

23. *See Howtek*, 958 F. Supp. at 48.

24. *See* William A. Stoever, Renegotiations in International Business Transactions 27 (1981).

25. *See, e.g.*, Nagla Nassar, Sanctity of Contracts Revisited 205–30 (1995); *see also* J. W. Carter, *supra* note 20, at 189; *see also* K. M. Sharma, *From "Sanctity" to "Fairness": An Uneasy Transition in the Law of Contracts*, 18 N.Y.L. Sch. J. Int'l & Comp. L. 95, 132–42 (1999).

26. *See* Philip J. McConnaughay, *Rethinking the Role of Law and Contracts in East-West Commercial Relations*, 41 Va. J. Int'l L. 427 (2001); *see also* Jeswald W. Salacuse, *Ten Ways That Culture Affects Negotiation*, 14 Neg. J. 221, 225–27 (1998); *see also* Lucian Pye, Chinese Negotiating Style (1982).

27. *See* Salacuse, *supra* note 26, at 225–27 (surveying over 300 executives and lawyers from twelve nationalities and finding significant differences among nationalities on whether they viewed the goal of a negotiation as creating a contract or creating a relationship). Whereas 74 percent of the Spanish respondents viewed the goal of a negotiation as concluding a contract (instead of creating a relationship), 66 percent of the Indians claimed that a relationship, rather than a contract, was their negotiating goal. *See id.*

In long-term business transactions between a western and Asian firm, the western party may view the transaction as set in the concrete of a lengthy and detailed contract without the possibility of modification, while the eastern party may see the transaction as floating on the fluid personal and social relationships between the parties, relationships that contain an implicit commitment to renegotiate the terms of the transaction in the event of unseen happenings. In long-term transactions, such as a joint venture project between eastern and western companies whose success depends on close and continuing cooperation, it may be wise to recognize this difference of view at the time of negotiation and attempt to find some middle ground.

A renegotiation clause may represent such middle ground between total contractual rigidity on one hand and complete relational flexibility on the other. Thus, rather than dismiss the possibility of renegotiation and then be forced at a later time to review the entire contract, transaction participants who want to enable their business relationship to weather difficult seas should recognize the possibility of renegotiation at the outset of their dealings with one another and set down a clear framework within which to conduct that process. Through a renegotiation clause the parties recognize the possibility of redoing their deal, but control the renegotiation process. An intra-deal renegotiation clause, then, may give stability to an arrangement whose long-term nature creates a high risk of instability.

B. Approaches to Intra-Deal Renegotiation

In recent times, the use of renegotiation clauses seems to have become somewhat more frequent as a means of dealing with the problem of unpredictable future changes in circumstances in long-term agreements.[28] A review of possible approaches to intra-deal renegotiation clauses may be useful to executives, lawyers, and government officials involved in international business and financial transactions.

1. *The Implicit Minor Renegotiation Clause*

Persons responsible for transaction implementation know that, despite some lawyers' claims to the contrary, project agreements, no matter how detailed, are not a kind of automatic, comprehensive instruction booklet that the parties follow blindly. Time and again, executives involved in the actual implementation of international transactions have given the author the same message: "Once the contract is signed, we put it in the drawer. After that what matters most is the relationship between us and our partner, and we are negotiating that relationship all the time." At best, such contracts are frameworks within which the parties constantly negotiate their relationship.[29] What this view means in practice is that certain matters in the transaction, usually but not always of a minor nature, are subject

28. *See* Carter, *supra* note 20, at 189.

29. Sixty years ago, Karl Llewellyn made the same point when he wrote:

> To sum up, the major importance of a legal contract is to provide a frame-work for well-nigh every type of group organization and for well-nigh every type of passing or permanent relation between individuals and groups, up to and including states—a frame-work highly adjustable, a frame-work which almost never accurately indicates real working relations, but which affords a rough indication around which such relations vary, an occasional guide in cases of doubt, and a norm of final appeal when the relations cease in fact to work.

Karl N. Llewellyn, *What Price Contract? An Essay in Perspective*, 40 Yale L.J. 704, 736–37 (1931).

to renegotiation by the parties as part of the on-going relationship, despite the fact that their contract contains no specific renegotiation clause.[30] One can therefore argue that an implicit minor renegotiation clause is part of the transaction agreement. For example, if the electrical supply agreement in the example above provides that the project is to commence delivery of electricity on June 1, 2002, but it later becomes apparent that a four-day national religious holiday falls on that date making it difficult for the public utility to accept delivery, the parties would renegotiate a more appropriate time for delivery.

2. *Review Clauses*

Long-term contracts, particularly in the oil and mineral industries, sometimes commit the parties to meet to review the operation of their agreement from time to time.[31] Thus, one mining agreement provided that the parties were to meet together every seven years "with a view to considering in good faith whether this Agreement is continuing to operate fairly to each of them and with a view further to discussing in good faith any problems arising from the practical operation of this agreement."[32] Although the words "negotiation" or "renegotiation" are not used in the clause, one reasonable interpretation is that it carries an implicit obligation for the parties to negotiate solutions to problems in good faith.

3. *Automatic Adjustment Clauses*

Transaction agreements often contain certain terms, such as those concerning prices or interests rates, subject to automatic change by reference to specified indices, such as a cost of living index or the London Interbank Offered Rate (LIBOR).[33] For example, in the electricity supply contract discussed above, the price to be paid for the electricity by the public utility might be tied to variations in fuel costs or the local cost of living index. While the aim of such a provision is to provide for flexibility without the risks inherent in renegotiation, negotiations may still be necessary during the life of the contract in order to apply the index in unanticipated situations or in the event that the index itself disappears or becomes inappropriate.[34]

4. *Open-Term Provisions*

Because of the difficulties and risks inherent in trying to negotiate arrangements to take place far in the future, some transaction agreements specifically provide that certain matters will be negotiated at a later time, perhaps years after the contract has been signed and the transaction implemented. For example, the electricity project company mentioned above might agree to negotiate appropriate senior management training schemes after it has constructed the facility and begun to hire local managers. This type of provision might be called an "open-term" clause because the matter in question has been left open for negotiation at a later time.[35]

In a strict sense, the subsequent negotiation of the open term is not really a *renegotiation* of anything, since the parties have not yet agreed to anything with respect to the open term.

30. *See* Kolo & Walde, *supra* note 2, at 45.
31. *See id.* at 43.
32. W. Peter, Arbitration and Renegotiation of International Investment Agreements 79 (1995).
33. *See* Kolo & Walde, *supra* note 2, at 44.
34. *Id.*
35. *See* Farnsworth, *supra* note 10, at 250 (discussing what he calls "agreements with open terms").

In a broader sense, however, the negotiation of the open term at a later time will have the effect of modifying the overall relationship between the parties. Moreover, it is not inconceivable that one or both of the parties could use the opportunity of negotiating the open term as an occasion to seek concessions or changes in other terms through the common negotiating device of linking issues. For example, the project company might offer a particularly attractive management training program if the government would agree to certain desired regulatory changes.

5. *Renegotiation Clauses*

In an effort to balance the imperatives of contractual stability with the need for flexibility in long-term arrangements, some agreements may contain a definite clause that obligates the parties to renegotiate specified terms affected by changes in circumstances or unforeseen developments, such as those concerning construction costs, governmental regulations, commodity prices, or product specifications. For example, in a contract for the exploration of petroleum, the Government of Qatar and an oil company had agreed that they would negotiate future arrangements for the use of natural gas not associated with oil discoveries if commercial quantities of such non-associated gas were later found in the contract area.[36] In addition, as Kolo and Walde point out, renegotiation clauses in investment contracts often accompany stabilization clauses by which a host country promises that any changes in laws or regulations will not adversely affect the foreign investment project. The effect of the two clauses is to obligate the host government and the project company to enter into negotiations to restore the financial equilibrium, which the new laws and regulations may have destroyed.[37]

An intra-deal renegotiation clause obligates the parties only to negotiate, not to agree. If the parties have negotiated in good faith pursuant to the clause but fail to reach agreement, that failure cannot justify liability on the part of one of the parties. In the Qatar case mentioned above, the oil company ultimately did find commercial quantities of non-associated natural gas and did enter into negotiations with the Government of Qatar concerning its use. When the two sides failed to reach agreement, the oil company brought an arbitral proceeding against the government on the grounds that by failing to agree to a renegotiation of their agreement with respect to natural gas the Qatar government had breached its contract with the oil company. The arbitral tribunal rejected this argument on the grounds that the duty to negotiate in good faith does not include an obligation to accept proposals made by the other side and that the Qatar government's refusal to accept those proposals was based on reasonable commercial judgments.[38]

In order to bring finality to the process of intra-deal renegotiation, parties sometimes include a contract adaptation clause in long-term project agreements. A contract adaptation clause stipulates that on the happening of certain specified events the parties will first seek to negotiate a solution and, failing that, refer their problem to a third party for either a recommendation or a binding decision, depending on the desire of the parties to the contract.[39] Certain institutions, such as the International Chamber of Commerce and the World

36. Wintershall, A.G., v. Qatar, 28 I.L.M. 795 (Ad Hoc Arbitral Tribunal 1989). Jeremy Carver & Kamal Hossain, *An Arbitration Case Study: The Dispute That Never Was*, 5 ICSID 311 (1990).

37. *See* Kolo & Walde, *supra* note 2, at 44-45.

38. Wintershall v. Government of Qatar, 28 I.L.M. at 814.

39. *See* Int'l Chamber of Commerce, Adaptation of Contracts (1978); *see* Bartels, *supra* note 19; *see also* Adaptation and Renegotiation of Contracts in International Trade and Finance (Norbert Horn ed., 1985).

Bank's International Centre for the Settlement of Investment Disputes, have developed rules and facilities to help carry out the contract adaptation process.[40]

V. Extra-Deal Renegotiation

A. The Context of Extra-Deal Renegotiations

In an extra-deal renegotiation, one party is insisting on renegotiating terms of a valid contract, which contain no express provision authorizing renegotiation. Unlike negotiations for the original transaction, which are generally fueled by both sides' hopes for future benefits, extra-deal negotiations begin with both parties' shattered expectations. One side has failed to achieve the benefits expected from the transaction, and the other is being asked to give up something for which it bargained hard and which it hoped to enjoy for a long time. Whereas both parties to the negotiation of a proposed new venture participate willingly, if not eagerly, one party always participates reluctantly, if not downright unwillingly, in an extra-deal renegotiation.

Beyond mere disappointed expectations, extra-deal renegotiations, by their very nature, can create bad feeling and mistrust. One side believes it is being asked to give up something to which it has a legal and moral right. It views the other side as having gone back on its word, as having acted in bad faith by reneging on the deal. Indeed, the reluctant party may even feel that it is being coerced into participating in extra-deal renegotiations since a refusal to do so would result in losing the investment it has already made in the transaction. Thus, it is very difficult for the parties to see extra-deal renegotiations as anything more than a process where one side wins and the other side loses. Whereas the negotiation of any transaction in the first instance is usually about the degree to which each side will share in expected benefits, an extra-deal renegotiation is often about allocating a loss. At the same time, because the parties are bound together in a legal and economic relationship, it is usually much harder for one or both of them to walk away from a troubled transaction than it is for two unconnected parties to walk away from negotiating a prospective business transaction in the first instance.

In most countries, the law does not oblige a party to enter into renegotiations, no matter how much conditions have changed or how heavy the costs incurred by the other side since the contract was originally concluded.[41] Indeed, the common law of England at one time viewed renegotiated contracts under certain conditions as invalid since they lacked consideration in those cases in which, as a result of the renegotiation, a party was promising to do no more than it was already obligated to do.[42] In general, unless some legal doctrine

40. *See* Int'l Chamber of Commerce, Adaptation of Contracts (1978); *see also* Mezger, *The ICC Rules for the Adaptation of Contracts*, *in* Adaptation and Renegotiation of Contracts in International Trade, *supra* note 39.

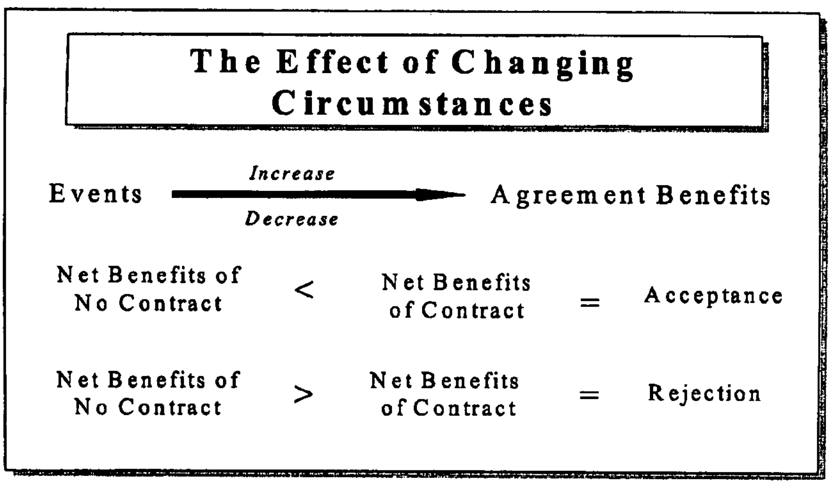
41. *See* Carter, *supra* note 20, at 185, stating ". . . the so-called classical law of contract does not include a doctrine of renegotiation. This can be expressed by saying that there are no legal principles which can be invoked by one party to require the other to renegotiate a contract."

42. *See* Stilk v. Myrick, 2 Camp 317, 6 Esp 29 (1809). Recent cases have held that the concern in enforcing renegotiated contracts should not be lack of consideration but presence of duress. Williams v. Roffey Bros. & Nicholls (Contractors) Ltd., 1 QB 1 (Eng. C.A. 1991). *See* S. M. Waddams, *Commentary on 'The Renegotiation of Contracts'*, 13 J. Contract L. 204 (1999).

such as frustration is applicable to excuse performance, the party being asked to renegotiate an existing agreement has a legal right to refuse to renegotiate and to insist on performance in accordance with the letter of the contract. On the other hand, requests or, in some cases, demands for renegotiation of an existing agreement are often accompanied by express or implied threats, including governmental intervention, expropriation, slow down in performance, or the complete repudiation or cancellation of the contract itself.

In response, of course, the other party usually has a legal remedy in the courts or in arbitration to enforce its contract and will often threaten to assert it. However, its willingness to pursue a legal remedy to its conclusion, rather than renegotiate, will usually depend on its evaluation of that remedy in relation to the results its expects from renegotiation. To the extent that the net benefits (i.e., benefits minus costs) from renegotiation exceed the expected net benefits from litigation, arbitration, or other legal remedy, the rational party will ordinarily engage in the requested renegotiation. But if, either before or during the renegotiation, a party judges that the net benefits to be derived from litigation will exceed the net benefits to be gained in any renegotiation, that party will normally pursue its legal remedies. On its side, the party requesting the renegotiation will be making its own cost/benefit analysis of the relative merits of contract repudiation and its probable fate in arbitration or litigation. As long as it judges that the net benefits of repudiating the contract are less than the net benefits of respecting it, the contractual relationship will continue. But when it judges the respective net benefits to be the opposite, the result will be a demand for renegotiation with the threat of eventual repudiation in the background. Figure 1 seeks to capture this dynamic.

A party's reluctance to agree to an extra-deal renegotiation may be due not only to the impact of renegotiation on the contract in question but on other contracts and business relationships as well. The side being asked to relinquish a contractual right may feel the



need to show other parties with which it has relationships that it cannot be taken advantage of. Yielding to a demand for the extra-deal renegotiation of one contract may encourage other parties to ask for renegotiation of their agreements as well. Renegotiation of one transaction with one particular party may set precedent for other renegotiations with other parties. This concern for the potential ripple effect from extra-deal renegotiations clearly contributed to the reluctance of international commercial banks to yield to demands by individual developing countries for a revision of loan terms. Concessions to Mexico would inevitably lead Argentina to demand equal treatment in its own extra-deal renegotiations.[43]

In considering the problem of renegotiation, this section of the article first examines the causes of renegotiation, then focuses on the renegotiation of a particular international business transaction, the case of Enron's Dabhol Project in India, and finally proposes a few principles to assist parties in conducting extra-deal renegotiations of international business and financial agreements.

B. The Causes of Extra-Deal Renegotiation

The causes of extra-deal renegotiations in international transactions are numerous. Nonetheless, most factors contributing to the need for extra-deal renegotiations would seem to fall into two basic categories: (1) the parties' imperfect contract with respect to their underlying transaction, and (2) changed circumstances after they have signed their agreement.

1. *The Parties' Imperfect Contract*

The goal of any written contract is to express the full meaning and extent of the parties' understanding and agreement concerning the transaction in which they are about to enter. Despite lawyers' belief in their abilities to capture that understanding in lengthy and detailed contracts, in practice, a written contract, particularly in long-term arrangements, can only achieve that goal imperfectly, largely for three reasons. First, the parties to long-term agreements are incapable of predicting all of the events and conditions that may affect their transactions in the future. Second, the transaction costs of making contracts limit the resources that the parties are willing to devote to the contracting process, and thus restrict the ability of the parties to arrive at a contract that perfectly reflects their common understanding of the underlying transaction. Therefore, an ideal contract for a long-term transaction is impossible to achieve because it would require perfect foresight and limitless resources for negotiating and drafting the contract.[44] Moreover, even if the parties had the requisite foresight and resources to draft a perfect contract reflecting their understanding in all its present and future dimensions, a court, arbitral panel, or other enforcement body might be unable to apply that contract accurately and inexpensively.

Third, in international transactions, the problem of accurately negotiating and articulating the parties' intent with respect to a long-term arrangement is particularly difficult

43. *See* Alfred Mudge, *Sovereign Debt Restructure: A Perspective of Counsel to Agent Banks, Bank Advisory Groups, and Servicing Banks, in* A Dance Along the Precipice: The Political and Economic Dimensions of the International Debt Problem 105, 106 (William N. Eskridge, Jr. ed., 1985).

44. *See* Eric L. Talley, *Contract Renegotiation, Mechanism Design, and the Liquidated Damages Rule*, 46 Stan. L. Rev. 1195, 1206 (1994); *see also* Marshall E. Tracht, *Renegotiation and Secured Credit: Explaining The Equity of Redemption*, 52 Vand. L. Rev. 599, 623–24 (1999).

because of the parties' differing cultures, business practices, ideologies, political systems, and laws—all factors that often impede a true common understanding between them and inhibit the development of a working relationship.[45] One encounters this problem particularly in long-term business and financial arrangements. For example, although the parties to alliances, joint ventures, and mergers usually announce them with great fanfare at the start, they often become disappointed within a short time, and in many cases terminate them earlier than expected. Various studies have found that between 33 percent and 70 percent of international alliances surveyed eventually broke up and that business executives generally consider joint ventures to be notoriously unstable.[46]

Once the contract has been signed and the parties begin to work together, numerous conflicts caused by a lack of common understanding can arise to threaten the very existence of the transaction. Here are a few examples drawn from experience around the world:

- A small emerging-market company in a joint venture with a large U.S. multinational corporation feels that it is much weaker than its partner, and is therefore afraid that it will be taken advantage of. Consequently, in all dealings with the U.S. company it is extremely guarded and slow to reach agreement, an attitude that is hampering the development of the venture.
- A U.S. firm has created a pharmaceutical company in Russia with a local partner and wants to confine the venture to narrow and specific areas; however, its Russian partner wants to expand into activities unrelated to the U.S. company's competence, like the production of television programs. Disagreement over this question is causing tension in the relationship.
- A European company and Chinese enterprise have established a joint venture that has clear mutual benefits, but both parties are very cautious about sharing information. The Chinese partner withholds information about customer problems with products and requests for new product features. In response, the Europeans have slowed the transfer of technology badly needed by the venture. The two sides are also in conflict over advertising expenses. The Europeans want to spend heavily on advertising, while the Chinese oppose these expenditures as unnecessary.
- A U.S. pharmaceutical firm with a long tradition of strong presidents and top-down management, has acquired a Swedish firm with a management style that entails getting the whole management groups' approval before making big decisions, rather than handing down orders—*alla aer I baten*, "getting everybody in the boat," according to the Swedes. The difference in style is causing severe internal conflict and the possible loss of talented managers and scientists.

None of these problems can be solved by contractual provisions alone. None can be settled by invoking arbitration or other dispute settlement clauses. The best means of solving these problems is for the parties to these transactions to sit down together and refine their relationship through renegotiation of their underlying transaction.

45. *See generally* Salacuse, *supra* note 6.
46. *See* Benjamin Gomes-Casseres, The Alliance Revolution: The New Shape of Business Rivalry 52 (1996).

2. *Changed Circumstances*

Changes in circumstances since the time of the original contract are a second major cause for post-deal renegotiations. A sudden fall in commodity prices, the outbreak of civil war, or the imposition of currency controls are examples of changes in circumstances that have forced the parties back to the negotiating table. As Professor Raymond Vernon argued over three decades ago with reference to mineral investment projects, a bargain once struck will inevitably become obsolete for one of the parties and issues once agreed upon will be reopened at a later time. Project agreements, in Vernon's words, are "obsolescing bargains."[47]

Generally speaking, changes in circumstances can either increase or decrease the costs and benefits of the agreement to the parties. As Figure 1 shows, when a change in circumstances means that the cost of respecting a contract for one of the parties is greater than the cost of abandoning it, the result is usually rejection of the deal or a demand for its renegotiation. The notion of costs and benefits are not limited to purely economic calculations. Political and social costs and benefits must also be accounted for. For example, in one case involving a long-term investment project in Egypt in 1974, the Egyptian government signed the agreement because it perceived the economic benefits of the project, a resort complex to be built near the Giza Pyramids, to exceed its potential costs. But when public and international opposition became strong and persistent, the government cancelled the project because it perceived the political costs to outweigh the benefits to be derived from its construction.[48]

A traditional theme in international business circles is the lament over the unstable contract, the profitable agreement for one side that the other side refuses to respect. Although hard data on the subject is lacking, anecdotal evidence suggests that contractual instability is more prevalent in international business than in the domestic setting. Certainly one can say that international business transactions involve special factors not present in domestic deals and that these factors heighten the risk of contractual instability. First, because the international environment itself is so unstable, international business dealings seem particularly susceptible to sudden changes such as currency devaluation, coups, wars, and radical shifts in governments and governmental policies.

Second, mechanisms for enforcing agreements are often less sure or more costly in the international arena than in the domestic setting. If one side in an international transaction does not have effective access to the courts or arbitral tribunals to enforce a contract or to seize assets, the other party to a contract that it judges burdensome may feel it has little to lose in rejecting the contract or demanding its renegotiation. Thus, this factor has the effect of reducing the costs to be incurred by not fulfilling its contractual obligations.

Third, foreign governments are often important participants in international transactions. They often reserve to themselves, either explicitly or implicitly, the power to repudiate an agreement on grounds of protecting national sovereignty and public welfare.

Finally, the world's diverse cultures and legal systems attach differing meanings and degrees of binding force to a signed contract and recognize varying causes to justify avoidance of onerous contractual burdens.[49] For example, a Spanish company in a long-term transaction

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47. Raymond Vernon, Sovereignty at Bay: The Multinational Spread of U.S. Enterprises 46 (1971).

48. *See* Int'l Comm. Arb., Award in the Arbitration of S.P.P. (Middle East) Limited, Southern Pacific Properties limited, and the Arab Republic of Egypt, the Egyptian General Company for Tourism and Hotels, 22 I.L.M. 752 (1983).

49. *See* Jeswald W. Salacuse, *Renegotiations in International Business*, 4 Neg. J. 347, 347–54 (1988).

with an Indian firm may view their signed contract as the essence of the deal and the source of the rules governing their relationship in its entirety. The Indian partner, however, may see the deal as a partnership that is subject to reasonable changes over time, a partnership in which one party ought not to take advantage of purely fortuitous circumstances like radical and unexpected movement in exchange rates or the price of raw materials.[50]

C. A Case of Extra-Deal Renegotiation: Enron's Dabhol Project in India

One may gain an understanding of the dynamics at work in extra-deal renegotiation by examining a specific case, the renegotiations involved in Enron's Dabhol Electricity Power Project in India,[51] an incident that received significant media attention in 1995–1996.[52]

1. *Background*

India, the largest democracy in the world, had a population exceeding 920 million people in 1995, which was increasing at an annual rate of 2.3 percent. A poor country with per capita income of $370 a year, it also had a growing middle class of 250 million people located primarily in the cities. The former jewel in the crown of the British Empire, India gained its independence in 1947, and is a federation consisting of twenty-six states and six union territories. It has a strong central government whose 600-member Parliament is elected every five years. Following the British parliamentary model, the political party with the majority in Parliament forms the executive government and that party's leader becomes the Indian Prime Minister. Each of India's states has its own legislature and an executive consisting of a Chief Minister and cabinet of state ministers chosen from the elected members of the state assembly. State elections are held every five years but not necessarily at the same time as central government elections.[53]

From its independence in 1947, until the early 1990s, India had based its economic policies on self-sufficiency, import substitution, and state control of basic industry and infrastructure. Historically, the country had been wary of foreign investment and its policies in that area had been extremely restrictive, particularly under Prime Minister Indira Gandhi in the 1970s. With broad popular support, Gandhi had forced Coca-Cola, IBM, and other multinational firms out of India, thereby driving away foreign investment for a generation.[54]

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50. *See* Salacuse, *supra* note 26, at 225–27, in which the author's survey of over 300 executives and lawyers found that whereas 74 percent of the Spanish respondents viewed the goal of a negotiation as concluding a contract (instead of creating a relationship), 60 percent of the Indians claimed that a relationship, rather than a contract, was their negotiating goal.

51. For background, see Richard P. Teisch & William A. Stoever, *Enron in India: Lessons From a Renegotiation*, 35 Mid-Atlantic J. Bus. 51–62 (1999); *see also* Harvard Business School, Enron: Development Corporation: The Dabhol Power Project in Maharashtra, India (A) (HBS Case no. 9–596–099, Mar. 25, 1997) [hereinafter Harvard Study (A)]; *see also* Harvard Business School, Enron Development Corporation: The Dabhol Power Project in Maharashtra, India (B) (HBS Case no. 9–596–100, Dec. 16, 1996) [hereinafter Harvard Study (B)]; *see also* Harvard Business School, Enron Development Corporation: The Dabhol Power project in Maharashtra, India (C) (HBS Case no. 9–596–101, Dec. 16, 1996) [hereinafter Harvard Study (C)].

52. *See, e.g.*, John F. Burns, *Indian Politics Derail a Big Power Project*, N.Y. Times, July 5, 1995, at D1; Mark Nicholson, *Survey—Maharashtra 1996: U-Turn that Saved the Project*, Fin. Times, July 11, 1996, at 3; *The Mugging of Enron*, Euromoney, Oct. 1995, at 33; Gary McWilliams & Sharon Moshavi, *Enron: Maybe Megadeals mean Megarisk*, Bus. Week, Jan. 22, 1996, at 62; Rajiv Rao, *Enron's Power Outage in India*, Fortune, Oct. 2, 1995, at 35–36.

53. *See* Burns, *supra* note 52, at D1.

54. *See id.*

After that, much of India's trade was with the Soviet Union, whose collapse had severe consequences for the Indian economy.[55]

India's economic policy of self-sufficiency, state control of basic industry and infrastructure, and restriction on foreign investment was probably no more apparent than in its electric power sector. The generation and distribution of electricity was the exclusive domain of the central and state governments, and political factors, rather than market forces, were primary considerations in the operation of the Indian electrical power system. The Indian Energy Supply Act of 1948[56] had initiated this monopoly, establishing state electricity boards to develop the power sector at the state level and the Central Electricity Authority to set policy at the national level. Under this regime, total electricity generating capacity amounted to approximately 81,000 megawatts in 1995, of which state agencies accounted for 65 percent, the national government 31 percent, and private enterprise a mere 4 percent.[57]

As India entered the 1990s, the country's demand for electrical power greatly exceeded its ability to supply it. During 1993–1994, demand for electricity exceeded supply by 22.5 billion-kilowatt hours.[58] As a result, the country experienced serious power outages, with significant negative impact on industrial production. Furthermore, many rural areas received little electricity, while some 95,000 Indian villages had none at all. Experts predicted that the situation would only grow worse in the years ahead. One source estimated that India would need to create an additional generating capacity of 62,000 megawatts by 2005 at an estimated cost of $165 billion.[59] The U.S. Energy Department estimated that by the same year India would need a staggering 140,000 megawatts of additional capacity.[60] The Indian government identified the country's lack of power resources as a fundamental obstacle to economic development.[61]

Neither the Indian central government nor the various state electricity boards had the necessary capital to develop the capacity to meet the nation's growing demand for electricity. Indeed, most state electricity boards were insolvent or nearly so due to the inefficiency of their operations. Power losses from their distribution grids were as much as 40 percent. Electricity was stolen from the system and in many cases pricing for certain privileged groups, such as farmers, resulted in it being sold for less than the cost of production. The entire system of electricity generation and distribution was beset by high costs, entrenched subsidies, and bloated employment rolls. The state electricity boards were selling electricity for as much as 50 percent below cost and the agricultural sector was paying as little as 20 percent of the rates charged to industrial users. As a result, the accumulated losses of the public power sector amounted to $6.4 billion in 1996.

One of the consequences of the subsidies and method of operation was the existence of entrenched constituencies opposed to reform of the power sector and especially privatization. Attempts to raise electricity rates in the state of Haryana resulted in riots and several deaths. At the same time, growing public demand for increased electricity and the resolution of a power deficit that was increasingly seen as a crisis became an important political issue in the

54. *See* Vishvjeet Kanwarpal, *Power Shift*, INDEPENDENT ENERGY, July/Aug. 1996.

56. *See* HARVARD STUDY (A), *supra* note 51, at 6.

57. *See Survey: Business in Asia – Underpowered*, ECONOMIST, Mar. 9, 1996, at 6.

58. HARVARD STUDY (A), *supra* note 51.

59. RAWI SARATHY, ENRON: SUPPLYING ELECTRIC POWER IN INDIA, Case 16.4 (7th ed. 1997).

60. Teisch & Stoever, *supra* note 51, at 53.

61. INT'L PRIVATE POWER QUARTERLY, 3d Quart., 1996, at 140.

country. In 1991, the Congress Party narrowly won an election victory with promises to address the problem.[62] The Prime Minister P. V. Rao, an advocate of market reforms, appointed as his finance minister Manmohan Singh, who began a series of reforms, similar to those being adopted elsewhere in developing countries that sought to transform the economy from one based on state control to one based on market forces.[63] A central focus of this package of reforms was the encouragement of private and foreign investment in India.

To address the entrenched problems of the power sector, the new Indian government secured the adoption of the Electricity Laws Act of 1991,[64] which represented an historic shift in policy. This legislation allowed private sector companies with 100 percent foreign ownership to build, own, and operate power plants, mandated a minimum rate of return of 16 percent on equity, allowed foreign investors to repatriate profits entirely, permitted new projects to have a debt-to-equity ratio of four to one, outlined procedures by which private and foreign-owned projects could sell electricity to state electricity boards, and specified how electrical tariff rates should be set.

Despite these substantial reforms, foreign power companies did not immediately rush to India to develop new projects.[65] The Indian government therefore took the initiative in May 1992 of sending its Power Secretary, S. Rajgopal, to the United States in an effort to attract American companies to invest in the Indian power sector. One company that responded positively to Mr. Rajgopal's overtures was Enron Corporation, based in Houston, Texas.

2. *Negotiating the Dabhol Project*

Enron Corporation was a diversified energy company that earned net income of $453 million on revenues of approximately $9 billion in 1995. Facing the problem of slow growth in the U.S. energy market, it had made a strategic decision to focus heavily on the demand for power in foreign countries, a demand that was expected to grow to 560,000 megawatts. In order to pursue this strategy, it created Enron Development Corporation, a wholly owned subsidiary, to exploit the growing worldwide demand for energy, particularly in high growth emerging market countries.[66] The visit to Enron by the Indian Power Secretary in May of 1992, persuaded the company's leadership that India offered the kind of opportunities that fit Enron's worldwide strategy. The following month, on June 15, 1992, a team of Enron executives arrived in Delhi, the capital of India, to continue discussions with central government officials and to explore concrete opportunities for power projects.[67]

Under the guidance of central government officials, the Enron team identified the state of Maharashtra as the most advantageous site from which to begin to serve the Indian electricity market. With a population of nearly seventy-nine million people, Maharashtra was India's third largest state and the home of its commercial capital, Bombay (later to be Mumbai). Moreover, as the country's most important industrial state, Maharashtra had the highest gross national product per capita in India. At the time of the Enron visit, the

62. *See* Teisch & Stoever, *supra* note 51, at 54.

63. *See* Jeswald W. Salacuse, *From Developing Countries to Emerging Markets: A New Role For Law in the Third World*, 33 INT'L LAW. 875–90 (1999).

64. *See* Teisch & Stoever, *supra* note 51, at 52.

65. *See id.*

66. *See* SARATHY, *supra* note 59.

67. For a chronology of events leading up to the agreement on the Dabhol Project, see Government of Maharashtra, *Report of the Cabinet Sub-Committee to Review the Dabhol Power Project, available at* http://www.hrw.org/reports/1999/enron/enron-b-htm.

Congress Party, which controlled the central government and had been the dominant force in Indian politics since before the country's independence, also controlled the Maharashtra state government.

In discussions with officials of the Maharashtra state government and the Maharashtra State Electricity Board, Enron proposed the construction of a 2015 megawatt power plant at a cost of nearly $3 billion, which would make it the largest foreign investment project ever undertaken in India. A plant of that size would require a large reliable source of fuel. Enron believed that liquefied natural gas would be the most cost efficient fuel and that a dependable source of natural gas lay across the Indian Ocean in the Arabian Peninsula 1,200 miles away, specifically in the country of Qatar, with which Enron had already entered into a joint venture for liquefied natural gas development. In view of the substantial time and capital needed to develop facilities to liquefy, handle and ship natural gas, Enron proposed to divide the electricity project into two phases: a first phase of 695 megawatts to use locally produced fuel and a second phase of 1,320 to use imported liquefied natural gas. Dividing the project into two phases also permitted Enron to test India's credibility and for India to determine Enron's ability to deliver a reliable source of electricity. Enron decided that the best location for its power plant was the town of Dabhol, located on the Indian Ocean approximately 120 miles south of Bombay.

An essential requirement for the financial success of the proposed Dabhol project was the existence of a credible, long-term purchaser of the electricity it would generate. A commitment from such a buyer was necessary to enable the project company to secure its needed long-term debt financing and to assure the equity investors an adequate return on their investment. For the Dabhol Project to become a reality, it was therefore necessary for the Maharashtra State Electricity Board, the only potential buyer in the state, to enter into a long-term power purchase agreement with the Dabhol Power Company. On June 20, 1992, just three days after the Enron team's arrival in Bombay and only five days after entering the country for the first time, Enron and the MSEB signed a Memorandum of Understanding outlining the project as described above and proposing a power purchase agreement, which stipulated that the price to be charged by the Dabhol Power Company would be no more than 2.40 rupees (7.3 cents) per kilowatt hour.

Over the course of the next year, Enron, the Maharashtra State Electricity Board, and various concerned Indian central and state government departments negotiated the precise arrangements under which the proposed Dabhol Power Project would come into existence and sell electricity in Maharashtra.

The negotiation encountered three major problems. First, the World Bank, which served as a consultant to the central government, wrote a report claiming that the Dabhol project was too big and would create excess capacity for years to come. It also asserted that the proposed project was too expensive when compared to electricity generated by more traditional fuels such as coal. In response, Enron, stressing the environmental benefits of the Dabhol project and the long-term power needs of India, undertook a lobbying campaign in key departments of the Indian government and succeeded in countering the negative effects of the Bank's Report.[68]

The second and more difficult problem concerned the project's expected rate of return. Enron projected a rate of return to equity holders of 26.52 percent, which the government

68. *See id; see also* Milind Palnitkar & K. S. Nayar, *Enron Decision: Shockwaves*, INDIA ABROAD, Aug. 11, 1995, at 24.

of Maharashtra as well as the central government's Foreign Investment Promotion Board considered too high. The Indian side felt that 20 percent was much more reasonable. Enron insisted that given the risks involved and prevailing market expectations for similar projects, the projected rate of return on the Dabhol project was reasonable and that even 30 percent would be appropriate. Although the negotiations nearly collapsed over the issue, the two sides finally agreed on a rate of return of 25.22 percent, although various government officials considered the agreed upon rate of return as also too high. Other difficult issues concerned the project's capital costs, the government guarantees, and the pricing escalation factor in the power purchase agreement, and the provisions on monetary exchange rate fluctuations.

The third problem that surfaced during the negotiations was a growing negative view of the project among certain segments of the Indian public. Opponents of the project strongly criticized its high rate of return, the high electricity tariff that Indians would ultimately have to bear, and the government's failure to engage in competitive bidding, as had been standard practice with other power plants constructed in the country. Accusations were made that Indian officials had been bribed to approve the project. Public demonstrations against the project took place, and at one point a bomb exploded in the hotel in which the Enron team was staying.[69] Despite these manifestations of public opposition, negotiations continued.

To undertake the project, Enron, with two American minority partners, General Electric and Bechtel, each of which held 10 percent of the equity, formed the Dabhol Power Company in April 1993. On December 8, 1993, some twenty months after the Indian Power Secretary's first contact with Enron, the Dabhol Power Company and the Maharashtra State Electricity Board signed the Power Purchase Agreement, formally launching the Dabhol Project, the biggest foreign investment project ever undertaken in India. The basic provisions of the Power Purchase Agreement were as follows:

- The Dabhol Power Company agreed to design, finance and build within thirty-three months an electrical generating plant with a base load capacity of 625 megawatts and additional peak load capacity of seventy megawatts. Failure to provide commercial service within thirty-three months of the deadline would result in penalty payments by the Company to the MSEB of $14,000 per day. Moreover, if the Company failed to reach baseload capacity of 625 MW within one year after the beginning of commercial service it would be required to pay $100 for each kilowatt below the required 625 MW requirement.
- The Maharashtra State Electricity Board and the Government of the State of Maharashtra agreed to provide the land and the necessary infrastructure, including roads to the site, communications, and transmission lines from the power plant to the MSEB grid.
- The Maharashtra State Electricity Board agreed to purchase what amounted to at least 90 percent of the Dabhol plant's output. It was obligated to pay for electricity from the Dabhol Power Company under a complex payment formula for an initial period of twenty years. The formula consisted of two parts: (1) a capacity payment determined by the baseload and peak capacities, regardless of the amount of power actually used by the MSEB; and (2) an energy payment based on the actual amount of power produced. The result of the formula was that the estimated cost of power to the MSEB

69. *See* SARATHY, *supra* note 59.

would be 7.05 cents per kilowatt-hour at the commencement of commercial operations. The tariff was indexed to Indian inflation rates and was expected to rise to 11.34 cents per kilowatt-hour by 2015.

- Although the MSEB's payments were to be made in rupees, it also had the responsibility of bearing any changes in the dollar-rupee exchange rate over time.
- The Maharashtra state government guaranteed the MSEB payment obligations to the Dabhol Power Company, and the central government issued a counter guarantee.
- Although the Power Purchase Agreement was governed by Indian Law, the parties agreed to settle any disputes arising under the agreement by binding arbitration in London under UNCITRAL Arbitration Rules.
- At the end of twenty years, MSEB had the option to extend the Power Purchase Agreement for an additional five or ten years at its option. If it chose not to renew the Agreement, the MSEB would be required to purchase the plant at 50 percent of its then depreciated replacement value.

Enron then moved rapidly to finance and implement the project. In addition to the equity contribution of $279 million[70] from the project partners, it ultimately secured loan commitments of $643 million from banks and lending agencies.[71]

3. *The Forces for Changing the Deal*

Public opposition to the Dabhol Power Project grew as construction activity proceeded. Activists and organizations filed lawsuits in the Bombay High Court, challenging the legality of the project and the processes by which it was negotiated.[72] Although the courts dismissed the complaints, political opposition continued to mount. Specifically, the opposition alliance of the Bharatiya Janata Party (BJP) and the Shiv Sena took up the issue on the floor of the Maharashtra State Assembly. As they prepared for state election scheduled for March of 1995, they made opposition to the Dabhol Project a centerpiece in their campaign. Emphasizing Hindu nationalism and warning against the dangers of American economic and cultural imperialism, BJP-Shiv Sena politicians encouraged public opposition to the project in their campaign rhetoric. They charged that Enron was offering India nothing that India could not do for itself, that the power tariff was exorbitant and would hurt the poor, that Enron's rate of return was exploitative, and that the whole negotiation process had been tainted by corruption.[73] According to one observer of the campaign, the Dabhol Project became "a national icon . . . rallying economic nationalists suspicious of the post-liberalization arrival of foreign investment."[74]

70. Enron Power Corporation, which had the responsibility for construction management, operations, maintenance and fuel management, contributed $233 million; Bechtel Enterprises, a construction contractor on the project, contributed equity of $28 million; and General Electric, also a construction contractor, also had an equity interest of $28 million.

71. The loan commitment were as follows: A bank syndicate led by Bank of America and ABN Amro: $150 million; Overseas Private Investment Corporation: $100 million; Industrial Development Bank of India and other Indian financial institutions, rupee loans equivalent to $96 million; United States Export-Import Bank of the United States, $298 million. ENRON, PRESS RELEASE: DABHOL PROJECT ACHIEVES FINANCIAL CLOSE; RESUMES CONSTRUCTION, *available at* http://www.enron.com/india/Newsroom/Press_Release02.htm (Dec. 10, 1996).

72. *See e.g.*, Ramdas Nayak v. Union of India, 1995 AIR 225.

73. *See* Burns, *supra* note 52, at D1.

74. *See* Nicholson, *supra* note 52, at 3.

In the State Assembly elections of March 1995, the BJP-Shiv Sena alliance won a majority of seats and thereby ousted from government the incumbent Congress Party, which most observers had expected would continue to hold power. In May, the new government appointed a cabinet sub-committee, chaired by the deputy Chief Minister, Shri Gopinath Munde, to investigate the Dabhol Project. The committee submitted a report in July recommending that the State repudiate Phase I of the project and cancel Phase II. The Report based its recommendation on several grounds, including the absence of transparency in the negotiation process, the lack of competitive bidding procedure, the relaxation by the previous government of certain regulations relating to the project, the great expense of the project, the high electricity tariff rate and its continuing escalation, the obligation of the Maharashtra State Electricity Board to pay for electricity whether or not it was actually used, the World Bank Report's objections to the project, and the failure of the project negotiations to address environmental concerns.[75]

On the basis of this report, the state government, under its new Chief Minister, Manohar Joshi, and the Maharashtra State Electricity Board formally cancelled the Power Purchase Agreement with the Dabhol Power Company.[76] Chief Minister Joshi stated: "This decision is not against the United States; but against the Dabhol project. . . The deal is against the interests of Maharashtra. Accepting this deal would indicate an absolute lack of self-respect and would amount to betraying the trust of the people."[77] At this point in its development, the Dabhol Project had incurred sunk costs of approximately $300 million and each day of delay on construction was estimated to cost an additional $250,000.

In response, the Dabhol Power Company and the project sponsors invoked their legal rights under the Power Purchase Agreement by instituting arbitration in London against the Maharashtra State Electricity Board and the Maharashtra state government, claiming damages in excess of $300 million. The State of Maharashtra reacted by bringing suit in the Bombay High Court to invalidate the arbitration clause and the guarantee of MSEB payments on the grounds that both had been secured through illegal means. The U.S. government issued a statement critical of the contract repudiation and asserted that it would have negative consequences for foreign investment in India. Foreign investors considering India became demonstrably more cautious and expressed their concern over the incident. The Indian press appeared to be divided over the wisdom of Maharashtra State's action. In the face of this growing controversy, the Deputy Chief Minister Munde, who had chaired the Dabhol Project review committee stated: "Our decision is firm. We do not wish to renegotiate."[78]

4. *Renegotiating the Dabhol Project*

While pursuing its legal remedies in arbitration, Enron made it clear to the Maharashtra State authorities that it would be willing to renegotiate the Dabhol Project. In the fall of 1995, discussions took place between Enron executives and Maharashtra officials and political leaders. These decisions culminated in a meeting between Chief Minister Joshi and

75. *See Report of the Cabinet Sub-Committee to Review the Dabhol Power Project, reprinted in* Human Rights Watch Report, The Enron Corporation: Corporate Complicity in Human Rights Violations, Appendix B, (Jan. 1999), *available at* http://www.hrw.org/reports/1999/enron/; *see also* HARVARD STUDY B, *supra* note 51, at 2–3.

76. Marcus W. Brauchli, *Enron Project Scrapped by Indian State,* WALL ST. J., Aug. 4, 1995, A3; Rao, *supra* note 52.

77. *See* Rao, *supra* note 52.

78. HARVARD STUDY (B), *supra* note 51, at 5.

the chief executive officers of Enron Corporation and its subsidiary, Enron Development Corporation, intending to find a way of reviving the Dabhol Project. Shortly thereafter, Chief Minister Joshi announced that Maharashtra State would undertake a review of the project and promised to reopen negotiations in November. To carry out the review and renegotiation, he appointed a panel consisting of the President of the MSEB, the Power Secretary of Maharashtra State, and four other academic and industry experts, in contrast to the first review panel, which had consisted of government ministers.[79]

During a period of two weeks, the Review Panel not only met with Enron to discuss proposals for restructuring the Dabhol Project, but it also listened to principal critics of the project. The key issues in the discussions with Enron concerned the electricity tariff, capital costs, payment terms, and the environment.[80] Finally, on November 19, 1995, the Panel submitted a proposal to the Maharashtra state government embodying the renegotiated terms of the Dabhol project, to which the Panel and Enron had agreed. Enron agreed to suspend its arbitration proceedings in London until December 10, 1995. Ultimately, on January 8, 1996, after some delay, the Maharashtra government agreed to accept the Panel's proposal for renegotiated terms.[81] These terms eventually became the basis for amending the Power Purchase Agreement between the Dabhol Power Company, the State of Maharashtra and the MSEB, which took place on February 23, 1996. Ultimately, in July, after much debate, the Indian Central Government, which had also undergone a recent election that led to a new governing coalition, approved the amended Power Purchase Agreement and extended the central government's counter guarantee of Maharashtra's obligations, thereby removing the final barrier to the revived project. In August of 1996, Enron agreed to abandon its arbitration proceeding in London, and Maharashtra state agreed to drop its case in the Mumbai High Court.

Despite the renegotiation and government approvals, Enron was not able to resume construction immediately. While the conflict and renegotiation between Enron and the government was evolving, various labor unions, public interest groups, and activists brought some twenty-four suits in the Indian courts to stop the project. Even though the Maharashtra government had approved the terms of the renegotiated agreement, the courts ruled that until these suits were resolved construction on the project would remain suspended. Eventually, the Indian courts held against the plaintiffs in all of these cases, but it was not until December of 1996, that the last suit was dismissed and construction resumed on the Dabhol Project.[82]

5. *The Terms of the Renegotiated Deal*

The renegotiation resulted in a modification of all of the principal terms of the Power Purchase Agreement. A summary of the changes is as follows.

a. Equity Participation

Although the project company originally had only three U.S. shareholders (Enron, 80 percent; Bechtel, 10 percent, and General Electric, 10 percent), the renegotiated deal pro-

79. Harvard Study (C), *supra* note 51, at 1.

80. Shekhar Hattangadi, *Enron, Indian State Revive Power Project*, Wall St. J., Nov. 22, 1995, at A4.

81. *See* McWilliams & Moshavi, *supra* note 52, at 62.

82. Enron, Press Release: Court Rules in Favor of Dabhol Power, Dabhol Construction to Resume, *available* at http://www.enron.com/corp/pressroom/releases/1996/141dabhol.html (Dec. 2, 1996); Enron, Press Release: Dabhol Project Achieves Financial Close; Resumes Construction, *available at* http://www.enron.com/corp/pressroom/releases/1996/144dabhol.html (Dec. 10, 1996).

vided for the introduction of the Maharashtra State Electricity Board as a 30 percent shareholder with a proportionate reduction in Enron's interest. Thus, the new equity structure was Enron, 50 percent; MSEB, 30 percent; Bechtel, 10 percent; and General Electric, 10 percent. The introduction of an Indian partner seemed a way of meeting public suspicion over foreign investment.

b. Output Capacity

Although the World Bank's Report had criticized the original proposed power plant as being too large, the renegotiated terms provided for a plant of even greater output capacity. The capacity of Phase I was increased from 695 megawatts to 826 megawatts and total capacity after the completion of Phase II under the renegotiated agreement was increased to 2,450 MW, as compared to 2,015 in the original proposal.

c. Capital Costs

To respond to the criticism that the project was too expensive, the renegotiation reduced the capital costs from $2.85 billion to $2.5 billion. The Panel achieved this result by removing the regassification plant from the Dabhol project and treating it as a separate project, for which the power plant would pay a fixed charge. This change transformed a portion of capital costs to an ongoing variable cost that would be included in the new power tariff.[83] A portion of the reduction in capital costs can also be attributed to the worldwide fall in the price of generation equipment.

d. Power Tariff

The politics of Maharashtra demanded a reduction in the power tariff to be paid by the MSEB. Accordingly, the Panel, with the agreement of Enron, recommended a reduction in the power tariff from approximately 7.03 cents per kWh, subject to a 4 percent annual escalation on fixed charges, to 6.03, subject to fuel price and exchange rate fluctuations. These tariffs would be in effect until Phase II became operational, at which time the tariff would become 5.08 cents per kWh, subject to fuel price and exchange rate fluctuations for twenty years, but with no escalation.

e. Fuel

The original proposal had called for distillate oil to be used in Phase I and liquefied natural gas in Phase II. The renegotiated terms provided in Phase I for the use of naphtha, a fuel that was produced locally, thus sparing India foreign exchange costs of importing oil for the project.

f. Environment

The original power purchase agreement contained no provisions with respect to environmental protection. The renegotiated terms stated that Enron and the Dabhol Power Company would pay for monthly air and water surveys, would plant trees, manage effluent discharged into the sea as to protect marine law, and would employ one person from any family displaced due to the construction of the plant.[84]

83. Later, the Central Electricity Authority and the Ministry of Power, both agencies of the Indian Central government, persuaded the state to put the regassification facility back into the project without any changes in the renegotiated power purchase agreement. This further development resulted in a real capital cost increase but a small tariff reduction since the lower rate no longer included amortization of the LNG facility. *See BJP Collapse Muddies Enron/Dabhol Waters*, POWER ASIA, June 10, 1996.

84. HARVARD STUDY (C), *supra* note 51, at 4.

g. Other Terms

Various other terms were introduced into the renegotiated agreement. For example, Enron and the Dabhol Power Company agreed to use local suppliers and supplies to the extent possible and to employ a bidding procedure in purchasing power equipment. Moreover, Enron agreed to bear costs of approximately $175 million caused by the State's cancellation of the contract so long as construction was renewed by February 1, 1996. Although Maharashtra State failed to meet this deadline, Enron later also agreed to waive the daily interest charges of $250,000 that had been accruing as a result of work stoppage, thereby saving Maharashtra state approximately an additional $10 million.[85]

6. *The Aftermath*

Both Enron and the State of Maharashtra claimed the renegotiation as a victory. The Maharashtra government pointed to the reduction in the power tariff and reduced capital costs as major concessions favoring the state.[86] On the other hand, the enlarged project capacity was clearly a renegotiated term favorable to Enron, and a significant portion of the capital cost reduction resulted from favorable market developments with respect to generating equipment, not a transfer of value from Enron to the State of Maharashtra.

Despite government statements of satisfaction with the renegotiation, significant public opposition to the project continued. Although the Indian courts eventually dismissed all the numerous lawsuits against the project, public protests and demonstrations at the project site persisted. The measures taken by the Maharashtra state government and the police to deal with these protests have prompted concerns with respect to human rights violations.[87] Nonetheless, in May 1999, the Dabhol Power Project was completed and began commercial operation. In that same month, Enron secured financing of $1.87 billion for Phase II of the Project,[88] which was scheduled for completion at the end of 2001.[89]

VI. The Lessons of Dabhol and Some Principles to Guide Extra-Deal Project Renegotiations

Since the risk of extra-deal project renegotiations is always present in any project, participants planning international projects need to ask two basic questions:

1) How can the likelihood of extra-deal renegotiations be reduced? and
2) When renegotiations actually occur, how should the parties conduct them to make the process as productive and fair as possible?

In answering these questions, project participants need to distinguish actions they should take, before and after the transaction has broken down and one party is demanding renegotiation or threatening to reject the deal entirely. Thus, in the case of the Dabhol Project,

85. *Legal Hurdles Dropped as Dabhol Project Gets Set*, Power Asia, Aug. 4, 1996.

86. *India. Power Struggle*, Economist, Jan. 13, 1996, at 37; Gary McWilliams & Sharon Moshavi, *More Power To India*, Bus. Week, Jan. 22, 1996, at 62.

87. *See Report of the Cabinet Subcomittee to Review the Dabhol Power Project*, *supra* note 75.

88. Enron, Press Release: Financing Complete, Construction Commences on Second Phase of Dabhol Power Project, *available at* http://www.enron.com (May 6, 1996).

89. Enron International, Our Presence in India, *available at* http://www.ei.enron.com/presence/projects/india.

one needs to consider the actions that Enron might have taken to avoid the conflict and renegotiation that actually took place, as well as the actions that it took when faced with the cancellation of the Power Purchase Agreement.

A. Principles to Follow Before Deal Break-Down

1. *Work to Create a Business Relationship Between the Parties and Recognize That a Signed Contract Does Not Necessarily Create an International Business Relationship*

For a long-term transaction to be stable and productive for both sides, it must be founded on a business relationship, a complex set of interactions characterized by cooperation, and a minimal degree of trust. A relationship also implies a connection between the parties. It is the existence of a solid business relationship between the parties to a transaction that allows them to face unforeseen circumstances and hardships in a productive and creative manner. A contract, no matter how detailed and lengthy, does not create a business relationship. Just as a map is not a country, but only an imperfect description thereof, a contract is not a business relationship, but only an imperfect sketch of what the relationship should be. A contract may be a necessary condition for a business relationship in some, but not all countries; however, it is never a sufficient condition for a business relationship in any country. A business negotiator, while necessarily concerned about contractual provisions, should also be concerned that a solid foundation for a business relationship is in place. Accordingly, a project negotiator should also ask a variety of non-legal and non-contractual questions during the contracting process: How well do the parties know one another? What mechanisms are in place to foster communications between the two sides after the contract is signed? To what extent, are there genuine business links and connections between the parties to the project? Is the deal balanced and advantageous for both sides?

One may argue that these issues are management problems or personnel questions, matters that have nothing to do with law or the lawyer's work in negotiating and structuring international transactions. On the other hand, if the lawyer's fundamental task is to help the client establish the best possible basis for an international transaction, not just to draft a contract, then these issues should be of concern from the very start of negotiations. Rather than to see his or her basic objective in an international business negotiation as merely securing an advantageous contract for the client, an international lawyer should also strive for the goal of negotiating a basis for the client to work productively with a foreign partner and to help the parties find an overriding mutuality of purpose. Throughout the negotiation of any international business transaction, lawyers and executives must keep asking themselves a basic question: After the contract, what?

While a contract may seem the essence of a business relationship in North America, other cultures give it far less importance. Indeed, different cultures may tend to view the very purpose of a negotiation differently. For North Americans, the goal of a business negotiation, first and foremost, is usually to arrive at a signed contract between the parties. They consider a signed contract as a definitive set of rights and duties that strictly bind the two sides, an attitude succinctly summed up in the statement "a deal is a deal."

Japanese and other Asian cultures, on the other hand, often consider that the real goal of a negotiation is not a signed contract, but the creation of a relationship between the two sides. Although the written contract expresses the relationship, the essence of the deal is the relationship itself. For Americans, signing a contract is closing a deal; for many Asians, signing a contract might more appropriately be called opening a relationship.

Regardless of culture, in most countries whenever one party fails to respect its contractual obligations to another party, the existence of a good relationship between the parties is more likely to facilitate a negotiated resolution of their dispute than if no such relationship exists. This is because the aggrieved party views the relationship with the offending party as more valuable than the individual claim arising out of the failure to honor the contractual provision. Thus, banks are willing to renegotiate loans with delinquent debtors when the prospect of continuing business is likely.

In reviewing the Dabhol Project case, one may conclude that although a detailed contract governed the project, no real business relationship appears to have existed at all between Enron, on the one hand, and the Maharashtra State Electricity Board and the various concerned Indian government departments on the other. Specifically, at the time the Power Purchase Agreement was signed, there was no real connection between Enron and India itself. No Indian party was to participate in any meaningful way in the development and management of the Dabhol Power Company. The Indian public had little knowledge of Enron or of the proposed Dabhol Project, which was negotiated largely in secrecy. The only role for any Indian entity was to buy electricity according to the Power Purchase Agreement. The negotiation of the contract had been contentious, and Enron appeared to have little appreciation for the concerns of the Indian public about foreign investment in general and the manner in which the Dabhol Power Project was being negotiated and developed in particular. Finally, given the size and importance of the Dabhol Project, Enron and India seemed to know relatively little about one another. Thus, after nearly eighteen months of negotiation, Enron emerged with a contract but no real business relationship. It had no real connection to any Indian party, and had established no basis for cooperation and trust with the Maharashtra State Electricity Board, the Maharashtra state government, or the Indian public. Indeed, the situation was quite the contrary. Before ground had been broken for the project, important segments of the Indian public were either suspicious of or downright hostile toward Enron.

Had Enron thought in terms of relationship building, in addition to contract negotiation, and taken actions accordingly, it might have avoided the cancellation of the contract. For example, the involvement of the Maharashtra State Electricity Board as a partner in the project from the very start of the project might have been a crucial first step in building an effective business relationship between Enron and India. Moreover, given India's historical ambivalence toward foreign investment, it was essential that a deal of the magnitude of the Dabhol Project be and *appear* balanced and fair to both sides. The Project's high rate of return and high power tariff raised important questions in the minds of the Indian public, concerns that Enron should have addressed.

2. *Building a Relationship Takes Time; So Don't Rush Negotiations and Use Negotiation Preliminaries Fully*

Project negotiators who are concerned to lay the foundation for a business relationship as well as to conclude a contract know that sufficient time is required to achieve this goal. In the case of the Dabhol Project, the speed with which Enron and the Maharashtra State Electricity Board achieved a contract not only hindered the development of a relationship, but the project's opponents viewed that speed as a defect in the negotiation process. Opponents and the Indian press criticized the original Enron transaction as having been done in "unseemly haste," and the Maharashtra state government based one of its grounds for canceling the Power Purchase Agreement on flawed "fast track procedures," which had circumvented established practice for developing power projects in the past. In particular, the Cabinet sub-committee pointed to the fact that the Memorandum of Understanding had been signed less than three days after the Enron team's arrival in Bombay.[90]

While speed of negotiation may appeal to American negotiators as "efficient" and a recognition of the fact that "time is money,"[91] for other cultures a quick negotiation of a complicated project transaction may imply overreaching by one of the parties, insufficient consideration of the public interest, or even corruption. Thus, negotiations done in haste may be subject to challenge later on.

The difference in view between American and other negotiators concerning desirability of fast negotiations may explain why Asians tend to give more time to negotiation preliminaries, while Americans want to rush through this first phase in deal making. Asians consider negotiation preliminaries, whereby the parties seek to get to know one another thoroughly as a crucial foundation for a good business relationship. For negotiators who are concerned primarily in achieving a contract and are less cognizant of the need to lay a foundation for a relationship, negotiation preliminaries may seem less important when the goal is merely a contract.[92]

As a general rule, North American executives and lawyers generally want to dispense with the preliminaries and to get down to cases. Consequently, they have a tendency to rush through prenegotiation and to view it as not really important to building a strong deal. Enron clearly followed the typical North American pattern, for it secured a memorandum of understanding on establishing the largest foreign investment project ever undertaken in India just five days after the Enron team had entered the country for the first time.

Asians tend to devote more time and attention to the preliminary phase of deal making than do Americans. Most Asians view the preliminaries as an essential foundation to any business relationship; consequently they recognize the need to conduct them with care before actually making a decision to undertake substantive negotiations of a deal. No Japanese power development firm would have pushed to conclude a memorandum of understanding on a power purchase agreement within five days of arriving in India.

While Enron seems to have taken pride in the speed with which it concluded the memorandum of understanding and the Power Purchase Agreement, one may ask whether a greater investment of time in the negotiation process would have in the end proved cost-effective by avoiding the costs and delays of renegotiation later on.

3. *Consider Providing for Renegotiation in Appropriate Transactions*

If the risk of change and uncertainty is constant in international business, how should dealmakers cope with it? The traditional method is to write detailed contracts that seek to foresee all possible eventualities. Most modern contracts deny the possibility of change.

90. *See Report of the Cabinet Subcommittee to Review the Dabhol Power Project*, *supra* note 75.

91. In a 1997 interview in BusinessWeek, Rebecca Mark, chairman and CEO of Enron International, reflected this attitude with regard to the process leading up to the Dabhol Project: "We were extremely concerned with time, because time is money for us. People thought we were pushy and aggressive. But think of the massive bureaucracy we had to move. How do you move a bureaucracy that has done things one way its entire collective life? You have to be pushy and aggressive." *Enron's Rebecca Mark: 'You Have To Be Pushy and Aggressive'*, Bus. Week, Feb. 24, 1997, at 56, *available at* http://www.businessweek/1997/08/b351586.htm.

92. *See* Jeswald W. Salacuse, Making Deals in Asia: Private Investments Abroad—Problems and Solutions in International Business in 1995, 23–31 (1995).

Therefore, they rarely provide for adjustments to meet changing circumstances. This assumption of contractual stability has proven false time and time again.

As suggested above, rather than to view a long-term transaction as frozen in the detailed provisions of a lengthy contract, it may be more realistic and wiser to think of an international deal as a *continuing negotiation* between the parties to the transactions as they seek to adjust their relationship to the rapidly changing international environment in which they must work together. Accordingly, another approach to the problem of contractual instability is to provide in the contract that at specified times or on the happening of specified events, the parties may renegotiate or at least review certain of the contract's provisions. In this approach, the parties deal with the problem of renegotiation before, rather than after, they sign their contract. Both sides recognize at the outset that the risk of changed circumstances is high in any long-term relationship and that at sometime in the future either side may seek to renegotiate or adjust the contract accordingly. Rather than dismiss the possibility of renegotiation and then be forced to review the entire contract at a later time in an atmosphere of hostility between the partners, it may be better to recognize the possibility of renegotiation at the outset and set down a clear framework within which to conduct the process. Although commentators[93] have urged this approach in long-term business relationships, it is rarely used. Perhaps the new era of global finance and business requires a re-examination of renegotiation provisions.

Other than through the use of *force majeure* clauses, most contracts implicitly deny the possibility of change and therefore make no provision whatsoever to meet changing circumstance. This assumption of contractual stability has proven false time and again. For example, most mineral development agreements assume they will continue unchanged for a period of up to ninety-nine years, yet they rarely remain unmodified for more than a few years.[94] The traditional approach in international business has been to assume and insist on the stability of international agreements and only grudgingly and bitterly agree to renegotiations in the face of changing circumstances.

4. *Consider a Role for Mediation or Conciliation in the Deal*

A third party can often help the two sides with their negotiations and renegotiations. Third parties, whether called mediators, conciliators, advisors, or something else, can assist in building and preserving business relations and in resolving disputes without resorting to arbitration or adjudication. Consequently, persons planning and negotiating international business and financial transactions should consider the possibility of building into their deals a role for some form of mediation. For example, the contract might provide that before either party can invoke arbitration to settle their dispute, they must use the services of a mediator or conciliator in trying to negotiate a settlement of their conflict.

B. Renegotiation Principles After Deal Break-Down

When one side has demanded renegotiation of the basic contract governing their relationship, how should one or both of the parties proceed?

93. See e.g., Stoever, *supra* note 24, at 27.

94. *See* David N. Smith & Lewis L. T. Wells, Negotiating Third-World Mineral Agreements 18 (1975).

1. *Don't Become Hostile, Belligerent, or Moralistic in Response to Demands for Renegotiation*

Demands for renegotiation of the contract by one party to a project contract are often met with hostility, belligerency, or moralistic objections by the other side. Such arguments are hardly ever effective in persuading the other side to end its insistence on renegotiation. The party asking for renegotiation almost always is able to assert equally moralistic arguments justifying the need to renegotiate the contract. Like the Maharashtra state government, a party resisting a contract will usually offer a variety of legal and moral arguments for its action: the contract is exploitative, the negotiators were corrupt, one side used duress, the other side was ignorant of all the underlying factors, and the basic circumstances of the deal have changed in a fundamental way.

While respect for agreements is indeed a norm in virtually all societies and may even rise to the level of a universal principle of law, most cultures also provide relief, in varying degrees, from the binding force of a contract in a variety of circumstances. "A deal is a deal" (*pacta sunt servanda*) is certainly an expression of a fundamental rule of human relations, but so is the statement "things have changed" (*rebus sic stantibus*). While a request for extra-deal renegotiations may provoke bad feelings in one party, an outright refusal to renegotiate may also create ill will on the other side since it will be seen as an attempt to force adherence to a bargain that has become unreasonable. Thus, throughout the crisis provoked by the Maharashtra state government's cancellation of the Power Purchase Agreement, Enron consistently and quite wisely made known its willingness to renegotiate the Power Purchase Agreement, a posture that ultimately led to a satisfactory resolution of the conflict. While it did begin to pursue its legal remedy in arbitration immediately, it did not become belligerent or hostile toward the Maharashtra government.[95]

2. *Understand that the Other Side May Believe It has a Legitimate Basis for Renegotiating the Contract*

How can renegotiation be justified in the face of a detailed contract that contains no specific provision authorizing it? One may argue that in many transactions, particularly between parties from different cultures, there are in effect two agreements, the legal contract which sets out enforceable rights and duties and their "foundation relationship," which reflects their fundamental understanding in all its dimensions, legal and non-legal. As indicated earlier in this article, the author has been led to this conclusion from statements made consistently by international business executives that once the contract is signed "it is put into the files and what matters for purposes of the transaction is the relationship between the parties." An important, implied aspect of this relationship is an understanding, given the impossibility of predicting all future contingencies that if problems develop in the future the two sides will engage in negotiations to maximize the joint gains in their relationship. At the same time, the legal contract grants the parties the right to invoke certain enforcement mechanisms, such as litigation or arbitration, if specified legal obligations have not been performed by the other side. The aggrieved party will only pursue them fully, however, if it judges the benefits of a legal remedy to be greater than its costs, one of which is the loss of any relationship with the other side. But a party usually cannot accurately make that calculation unless it has engaged in some form of renegotiation first. One can argue that one of the purposes of the delays inherent in pursuing legal remedies

95. *See* Teisch & Stoever, *supra* note 51, at 62.

such as a lawsuit or arbitration is to give the parties an opportunity to negotiate an efficient solution to their conflict.[96] Thus, although Enron began arbitration in London immediately after the Maharashtra government's cancellation of the power purchase agreement, it also immediately communicated to the government its willingness to renegotiate. The delay inherent in the arbitration process allowed the renegotiation to take place, and Enron eventually abandoned its arbitration because it judged the value of the renegotiated agreement to be worth much more than any damages it might receive in arbitration.

3. *Evaluate the Worth of the Claim for Breach of Contract Against the Value of a Continuing Relationship With the Other Side*

The extent of a party's willingness to renegotiate a project agreement will usually be in direct proportion to the value it attaches to its potential future relationship with the other side, particularly if it judges the potential relationship with the other side to be worth more than the claim for breach of contract. For example, one of the factors that encouraged Enron to renegotiate with the Maharashtra government after it had cancelled the contract was the prospect of long-term relationships in India involving many energy projects over many years in the future. Enron clearly evaluated that relationship to be worth much more than winning an arbitral award in a case that would certainly be a long protracted struggle. Even if it won an award for $300 million, that victory would not only drastically reduce its business prospects in the economically important State of Maharashtra, but also in all of India as well.

4. *Look For Ways to Create Value in the Renegotiation*

Because of differences in culture and/or personality, persons appear to approach deal making with one of two basic attitudes: that a negotiation is either a process in which both can gain (win/win) or a struggle in which, of necessity, one side wins and the other side loses (win/lose). Win/win negotiators see deal making as a collaborative and problem-solving process; win/lose negotiators see it as confrontational. In a reflection of this dichotomy, negotiation scholars have concluded that these approaches represented two basic paradigms of the negotiation process: (1) distributive bargaining (i.e., win/lose) and (2) integrative bargaining or problem solving (i.e., win/win).[97] In the former situation, the parties see their goals as incompatible, while in the latter they consider themselves to have compatible goals.

In an extra-deal renegotiation, the general tendency of the party who feels it has been forced into renegotiation is to fight a rear guard action, to raise recriminations, to see the process as the worst kind of win/lose activity in which anything gained by the one side is an automatic loss to the other party. The challenge for both sides in a renegotiation is to create a win/win process, an atmosphere of problem-solving, joint gains negotiation. Even if a party feels forced into an extra-deal renegotiation, it should approach the process as an opportunity to create value, to make the pie bigger.[98] Thus, in the renegotiations between

96. *See* Tracht, *supra* note 44, at 622, who argues that a well-crafted security arrangement should encourage lenders and borrowers to renegotiate their loans if renegotiation is efficient.

97. *See, e.g.*, Terrence Hoppman, *Two Paradigms of Negotiation: Bargaining and Problem Solving*, 542 ANNALS AM. ACAD. POL. & SOC. SCI. 24–47 (1995); ROY LEWICKI ET AL., NEGOTIATION—READINGS, EXERCISES AND CASES (1993); Jeswald W. Salacuse, *Intercultural Negotiation in International Business*, 8 GROUP DECISION & NEG. 217, 225 (1999).

98. *See* Howard Raiffa, *Post-Settlement Settlement*, *in* NEGOTIATION THEORY AND PRACTICE 323–26 (Breslin & Rubin eds., 1991).

Enron and the Maharashtra state government over the Dabhol Project, while Maharashtra state gained a reduced power tariff and project that was no longer exclusively foreign, Enron secured certain additional benefits including a large power plant, increased capital from a new joint venture partner, and an influential local partner who now had an interest in the success of the project.

5. *Make Sure the Parties Fully Understand the Alternatives to Succeeding in the Renegotiation—Especially the Costs*

Negotiation scholars[99] have identified the importance of each side understanding its Best Alternative to a Negotiated Agreement (BATNA) and of estimating the other side's BATNA. Recognizing the costs and benefits of a BATNA, for example pursuing a claim in arbitration or being sued in a court, may encourage both sides to work harder at resolving their problems at the negotiating table. In the case of the Dabhol Project, at the time the Maharashtra government cancelled the Power Purchase Agreement, it probably assumed that its action would entail relatively little cost. Moreover, it seemed to have assumed that other investors would be willing to step into the shoes vacated by Enron or that it would be able to find indigenous means of solving India's power shortage. When it fully understood that its alternatives to dealing with Enron were potentially very costly, it looked more favorably on renegotiation than it had at the time it cancelled the contract as a result to the Cabinet sub-committee's report. Once it fully understood the costs that it might entail in an international commercial arbitration and the difficulty it would encounter in attracting other investors, it became considerably more open to agreeing to renegotiation and to arriving at a satisfactory conclusion to the conflict.

6. *Make Sure to Involve Either Directly or Indirectly All Necessary Parties in the Renegotiation*

In any renegotiation, a variety of parties may need to be involved, either directly or indirectly, even though they are not themselves insisting a renegotiation. It is therefore important to determine who those parties are and how they should be connected to the renegotiation process. For example the Enron-Maharashtra renegotiation, the Indian central government was such a party since it had counter guaranteed the Maharashtra government's payments under power purchase agreement and would have to approve the terms of any renegotiated contract. Whether such parties should be at the negotiating table is another question. It may be preferable to conduct discussions with them separately.

7. *The Right Process for the Renegotiation Is Important*

It is important for both sides to think hard about the appropriate process for launching and conducting extra-deal renegotiations. Renegotiations often emerge out of crisis characterized by severe conflict among the parties, threats, and high emotion. An appropriate process for the renegotiation may help to mollify the parties and reduce the negative consequences of the crisis on their subsequent discussions. An inappropriate process, on the other hand, may serve to heighten those negative consequences and impede the renegotiations. Thus, in the case of the Dabhol Project, the government of the State of Maharashtra, having repudiated the original contract while declaring that renegotiations were out of the question, needed to find a process later on that would allow renegotiations to take place while preserving its dignity and prestige. The use of committee of experts, rather than face-

99. *See* FISHER, *supra* note 1.

to-face renegotiations between the government and Enron to start the process, served this purpose. The committee, in effect, conducted the renegotiations, which the government had the discretion to approve or disapprove. Moreover, it status as a committee of independent experts, rather than of politicians, tended to give its recommendations a legitimacy needed to persuade the public that Indian interests had been protected.

In some cases, the way in which a renegotiation is framed may influence its success. For example, rather than use the label "renegotiation", a term that conjures up negative implications of fundamental changes in the sanctity of contract, the parties in some cases can cast the renegotiation as an effort to clarify ambiguities in the existing agreement, rather than to change basic principles. This approach, at least formally, respects the sanctity of contract and thereby may avoid some of the friction and hostility engendered by demanding outright extra-deal renegotiations. For example, a host country government finding that a foreign investment project exempted from "all taxes and duties" is placing increasing demands on public services may seek to require the project to pay user fees for certain governmental services on the grounds that they are not taxes or duties. Another approach is to request review or reinterpretation of key terms in the contract in light of changes in circumstances, while still preserving the principles in the original agreement. For example, even if the host government had specifically agreed that the investment project would be exempt from user fees, requiring it to pay additional costs incurred by the government to supply power to the project during an energy crisis might be a principled way for redefining the scope of the exemption without altering the fundamental principles agreed by the parties. Waiver is yet another way of framing a renegotiation, an approach that respects the sanctity of the agreement yet enables the burdened party to obtain the relief it seeks. For example, during the energy crisis mentioned above, the government might seek a temporary waiver of certain of its obligations until the crisis ends.

8. *Consider a Role for a Mediator in the Renegotiation Process*

Mediation is basically a "voluntary, non-binding process in which a third person tries to help the parties reach a negotiated settlement."[100] Although mediators are not used frequently in resolving international business disputes, they may play a useful role in assisting the parties to achieve agreement during a renegotiation. A mediator can help in any or all of the following three functions: (1) helping design and manage the renegotiation process so that the parties will have the maximum opportunities to create value through their interaction; (2) assisting with the communications between the two sides in a way that will facilitate positive results from their renegotiation; and (3) suggesting substantive solutions to the problems that the parties are encountering during the course of their extra-deal renegotiation.

VII. Conclusion

Renegotiation, whether post-deal, intra-deal, or extra-deal, is a constant fact of international business life. As a result, international executives and their lawyers need to under-

100. For a similar, but more elaborate, definition of mediation, *see* JACOB BERCOVITCH & JEFFREY Z. RUBIN, MEDIATION IN INTERNATIONAL RELATIONS: MULTIPLE APPROACHES TO CONFLICT MANAGEMENT 7 (1992). *See also* Jeswald W. Salacuse, *Direct Negotiation and Mediation in International Financial and Business Conflicts*, *in* NON-JUDICIAL DISPUTE SETTLEMENT IN INTERNATIONAL FINANCIAL TRANSACTIONS 53–72 (Norbert Horn & Joseph J. Norton eds., 2000).

stand this phenomenon and devise strategies and mechanism to deal with it productively. For many persons, renegotiation is an aberration, for others it is a somewhat disreputable practice. It provokes images of disappointed expectations, of broken promises, of bargains made but not kept. From the viewpoint of an international company or financial institution facing demands for an unwanted renegotiation, such a reaction is normal and understandable. But from the vantage of international business life in general, renegotiation can be seen as playing as constructive role. Seventy years ago, Karl Llewellyn made a thoughtful inquiry into the role of contract in the social order and concluded: "One turns from the contemplation of the work of contract as from the experience of Greek tragedy. Life struggling against form. . ."[101] In the realm of modern international business transactions, the struggle of life against form continues. The case of the Dabhol Power Project was essentially a struggle between the political life of India and the form of the Power Purchase Agreement. As that case demonstrates, the role of renegotiation in the social order of modern international business is to mediate the struggle between life and form, to allow life and form adjust to one another over the long term at least cost.

101. *See* Llewellyn, *supra* note 29, at 751.