Renegotiating International Project Agreements

Jeswald W. Salacuse*
Renegotiating International Project Agreements

Jeswald W. Salacuse

Abstract

The Essay examines the phenomenon of renegotiation of international project agreements, explores its nature and causes, and offers useful advice on how best to conduct the renegotiation process.
RENEGOTIATING INTERNATIONAL PROJECT AGREEMENTS

Jeswald W. Salacuse*

INTRODUCTION

Experienced lawyers and executives know that the challenge of international project 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 project contracts often find themselves returning to the bargaining table later on to "re-negotiate" their agreements.

The last half century has witnessed numerous examples of renegotiation in international business: 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. 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

---

* Jeswald W. Salacuse (J.D., Harvard University; A.B., Hamilton College; Diplome, University of Paris) is the Henry Braker Professor of Law at the Fletcher School of Law and Diplomacy, Tufts University. His e-mail address is jeswald.salacuse@tufts.edu.


6. See generally JESWALD W. SALACUSE, MAKING GLOBAL DEALS—WHAT EVERY EXECU-
In today’s business world, executives, lawyers, and government officials through renegotiation seem to be seeking continually either to alleviate a bargain that has become onerous or to hold on to 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 is negotiating a new deal for the first time. In the new economy, which is characterized by rapid change, renegotiation may become even more pronounced as companies try to find ways to negotiate contracts that provide stability, on the one hand, yet give the parties the flexibility to face the unknown, on the other.

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

I. DEFINING RENEGOTIATION

Discussion 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 sides, though legally free to go their own 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, as will be seen, 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 or review certain of its 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 for the original transaction.

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. All three differ significantly from the situation in which two parties come together to negotiate a deal in first instance. At the same time, each of these three types of renegotiation differ among themselves with respect to the dynamics between the parties, as well as the strategies and tactics they may employ. The remainder of this Essay will explore these three renegotiation processes in detail. It will devote particular attention to extra-deal renegotiations because they are a constant risk for an international project and can have serious implications for project sponsors and financing institutions. To illustrate the problems and dynamics of this kind of renegotiation, this Essay will examine in some detail a specific case of extra-deal project renegotiation—the renegotiation of the Dabhol Power Project in India.

II. POST-DEAL NEGOTIATIONS

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 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. The rationale for this rule is that to limit the freedom to negotiate might discourage persons from undertaking to make transactions in the first place. Although the common law has traditionally upheld the freedom to negotiate in commercial matters, the law in certain other countries has taken a less liberal approach to permissible behavior in business negotiations. 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 negotiations 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. Failure by a party to fulfill its obligations 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 electri-

---

11. See id.
13. See Farnsworth, supra note 10, at 269-85 (discussing the meaning of fair dealing in negotiations and offering instances of unfair dealing).
cal generating facility in accordance with a pricing formula specified in the original agreement.

In addition to the factors arising out of law and contract, numerous other elements may influence post-deal renegotiations. First, the parties in a post-deal renegotiation have a shared experience of working together and a 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, since the parties, through working together, have learned much about each other’s cultures. Second, many of the original questions about their venture—its risks and opportunities—have been answered and that 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 having come to rely 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 trying to negotiate. Rational negotiators will not ordinarily agree to a transaction that is inferior to its best alternative to an agreement at the negotiating table.\textsuperscript{14} In a post-deal renegotiation, each party’s evaluation of its alternatives to a renegotiation

\textsuperscript{14}. See \textit{Fisher et al., supra} note 1, at 99-102 (discussing the concept of BATNA, Best Alternative to a Negotiated Agreement).
ated 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 that 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 project situations in which 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 follow in conducting a post-deal renegotiation. For example, 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, among other matters. Recognizing that post-deal renegotiations may become problematic, the contract might also authorize the use of mediators or other third-party helpers in the process.16

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

As part of its preparation, each party to a post-deal renegotiation should review carefully and thoroughly 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 project 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 process may proceed more smoothly and efficiently if, at the beginning of the process, the parties have a common understanding of their history together, rather than 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 of negotiators knowing their alternatives to the deal that they are trying to negotiate and estimating their counterparts' alternatives. Generally, the better a negotiator's alternatives away from the negotiating table, the stronger the negotiator's position at the bargaining table. 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

17. See Fisher et al., supra note 1, at 99-102.
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 accepting the inevitability of a second contract, each side, long before the termination of the first contract, should carefully examine all options and seek to develop possible alternatives before entering into post-deal renegotiations. For example, the state public utility corporation, 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.

III. INTRA-DEAL RENEGOTIATIONS

A. Balancing Contractual Stability and Flexibility

Due to the nature of projects themselves, project agreements 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, all sides in the negotiation process seek contractual stability. 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 to drastically change the balance of benefits from the project that the parties contemplated at the time that they signed the project agreement. Consequently, one can argue that a certain degree of flexibility is a second imperative that the project contracting 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 project 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 tradi-
tionally been rarely used. 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 of renegotiating its terms at a later date.

The traditional reluctance to use renegotiation clauses stems from a variety of factors, both legal and practical. First is the concern among lawyers that renegotiation clauses are merely "agreements to agree" and, therefore, may be invalid and unenforceable under the law of many countries. Judicial precedent on the validity of renegotiation clauses is sparse, so guidance in this area comes almost exclusively from judicial doctrine with respect to contract renewal and preliminary agreements. 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. 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 which the parties' good-faith negotiations are to be measured is sufficiently certain to comport with the applicable body of contract law." 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 others.

Practical considerations have led western lawyers and executives to view renegotiation clauses with suspicion on the grounds

19. M. BARTELS, CONTRACTUAL ADAPTATION AND CONFLICT RESOLUTION 65 (James E. Silva trans., 1985); see also Kolo & Walde, supra note 2, at 45.
21. See generally Farnsworth, supra note 10.
that they increase uncertainty and risk in business transactions and offend western concepts of the sanctity of the contract. 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 challenge 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.

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, the parties should 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. 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 re-


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 ac-
cordingly.

In long-term business transactions between a western and
an 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 fluid personal and social relationships
between the parties that contain an implicit commitment to re-
negotiate the terms of the transaction in the event of unforeseen
happenings. In a long-term transaction, 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 the one hand, and com-
plete relational flexibility, on the other. Thus, rather than dis-
miss the possibility of renegotiation and then be forced at a later
time to review the entire contract, project partners 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 should set down a clear
framework within which to conduct that process. Through a re-
negotiation clause, the parties recognize the possibility of re-
doing their deal, but control the renegotiation process. An in-
tra-deal renegotiation clause, then, may give stability to an ar-
rangement 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

²⁷. See Ten Ways, supra note 26, at 222 (surveying over 300 executives and lawyers
from 12 nationalities and finding significant differences among nationalities on
whether they viewed goal of negotiation as creating contract or creating relationship).
Whereas 74% of the Spanish respondents viewed the goal of a negotiation as conclud-
ing a contract (instead of creating a relationship), 67% of the Indians claimed that a
relationship, rather than a contract, was their negotiating goal. Id.
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 project contracting.

1. The Implicit Minor Renegotiation Clause

Persons responsible for project 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 projects 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 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 project 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 pub-

29. See Karl N. Llewellyn, What Price Contract? An Essay in Perspective, 40 YALE L. J. 704, 736-37 (1931). 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 framework 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 framework highly adjustable, a framework 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.

Id.

30. See Kolo & Walde, supra note 2, at 45.
lic 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.\(^3\) 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."\(^2\) 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

Project 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").\(^3\) 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 to 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.\(^4\)

4. Open-Term Provisions

Because of the difficulties and risks inherent in trying to negotiate arrangements to take place far in the future, some project agreements specifically provide that certain matters will be

\(^3\) See id. at 43.
\(^2\) W. Peter, Arbitration and Renegotiation in International Investment Agreements 79 (1995).
\(^3\) See Kolo & Walde, supra note 2, at 44.
\(^4\) Id.
negotiated at a later time, perhaps years after the contract has been signed and the project established. 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.\textsuperscript{35}

In a strict sense, of course, 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. In a broader sense, however, the negotiation of the open term at a later time will have the effect of modifying the over-all 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 project 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.\textsuperscript{36} In addition, as Kolo and Walde point out, renegotiation clauses in investment contracts often accompany stabilization clauses, by which a host country

\textsuperscript{35} See Farnsworth, \textit{supra} note 10, at 250 (discussing what he calls "agreements with open terms").

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 that such new laws and regulations may have destroyed.\footnote{37. Kolo & Walde, supra note 2, at 44-45.}

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 found commercial quantities of non-associated natural gas and entered 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. The oil company claimed 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.\footnote{38. Wintershall v. Government of Qatar, 28 I.L.M. at 814.}

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.\footnote{39. See Int'l Chamber of Commerce, Adaptation of Contracts; Bartels, supra note 19; Adaptation and Renegotiation of Contracts in International Trade (Norbert Horn ed., 1985).}

Certain institutions, such as the International Chamber of Commerce and the World Bank's Centre for the Settlement of Investment Disputes, have developed rules and facilities to help carry out the contract adaptation process.\footnote{40. See Int'l Chamber of Commerce, Adoption Rules, Pub. 326 (1978); Mezger,
IV. EXTRA-DEAL RENEGOTIATION

A. The Context of Extra-Deal Renegotiations

In an extra-deal renegotiation, one party insists on renegotiating the terms of a valid contract that contains 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, while the other is being asked to give up something for which it bargained hard and which it hoped to enjoy for a long time. And 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 feelings 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 its 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 in which one side wins and the other side loses. Whereas the negotiation of any transaction in 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 first instance.

In most countries, the law does not oblige a party to enter into renegotiations, no matter how 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 some renegotiated contracts as invalid since they lacked consideration in those cases in which as a result of the negotiation a party was promising to do no more than it was already obligated to do. 42 In general, unless some legal doctrine, 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 of enforcing 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 it 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, for whatever reason, it

41. 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." Id.

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

In considering the problem of renegotiation, this section of the Essay first will examine the causes of renegotiation, then will focus on a particular project renegotiation, the case of Enron’s Dabhol Project in India, and finally will propose a few principles to assist parties in conducting extra-deal renegotiations of international project agreements.

\section*{B. The Causes of Extra-Deal Renegotiation}

The causes of extra-deal renegotiations in international project transactions are numerous, perhaps too numerous to be catalogued here. Nonetheless, most factors contributing to the need for extra-deal renegotiations 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.

\subsection*{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 restrict the ability of the parties to arrive at a contract that perfectly reflects their common understanding of the underlying transaction. Thus, 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.\footnote{\textit{E. L. Talley, \textit{Contract Renegotiation, Mechanism Design, and the Liquidated Dam-}}
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 not 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 because of the parties' differing cultures, business practices, ideologies, political systems, and laws—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% and 70% 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 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 pro-

---

45. See generally Making Global Deals, supra note 6.
grams. 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 group's approval before making a big decisions—*alla aet 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 could have been 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.

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 circumstance 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. In one case involving a long-term investment project in Egypt in 1974, the Egyptian government signed an agreement because it perceived the economic benefits of the project, a resort complex to be built near the Giza Pyramids, as exceeding 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 may have little to lose in rejecting the contract that it judges burdensome or in 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 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. For example, a Spanish company in a long-term transaction 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.

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, an incident that received significant media attention in 1995-1996.


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%. A poor country with a per capita income of US$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 with a 600 member Parliament that 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 Indian state 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.\(^5\)

From its independence in 1947 until the early 1990s, India based its economic policies on self-sufficiency, import substitution, and state control of basic industry and infrastructure. Historically, the country was wary of foreign investment and its policies in that area were 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.\(^4\) After that, much of India’s trade was with the Soviet Union, whose collapse had severe consequences for the Indian economy.\(^5\)

India’s economic policies of self-sufficiency, state control of basic industry and infrastructure, and restriction on foreign investment were 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 consid-

---

53. See Burns, *supra* note 52, at D1.
54. See id.
operations in the operation of the Indian electrical power system. The Indian Energy Supply Act of 1948\textsuperscript{56} 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 ("MW") in 1995, of which state agencies accounted for 65%; the national government, 31%; and private enterprise, a mere 4%.\textsuperscript{57}

As India entered the 1990s, the country's demand for electrical power greatly exceeded its ability to supply it. In 1993-1994, for example, demand for electricity exceeded supply by 22.5 billion kilowatt hours ("kWh").\textsuperscript{58} As a result, the country was experiencing serious power outages with significant negative impact on industrial production. Furthermore, many rural areas received little electricity and 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 62,000MW by 2005 at an estimated cost of US$165 billion.\textsuperscript{59} The U.S. Energy Department estimated that by the same year India would need a staggering 140,000MW of additional capacity.\textsuperscript{60} The Indian government identified the country's lack of power resources as a fundamental obstacle to economic development.\textsuperscript{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%. 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

\textsuperscript{56} See Harvard Study (A), supra note 51, at 6.
\textsuperscript{58} Harvard Study (A), supra note 51, at 6.
\textsuperscript{60} Teisch & Stoever, supra note 51, at 53.
\textsuperscript{61} Int'l Private Power Quarterly, 3d Quart., 1996, at 140.
selling electricity for as much as 50% below cost and the agricultural sector was paying as little as 20% of the rates charged to industrial users. As a result, the accumulated losses of the public power sector amounted to US$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, for example, 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 viewed as a crisis became an important political issue in the 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% foreign ownership to build, own, and operate power plants, mandated a minimum rate of return of 16% on equity, allowed foreign investors to repatriate profits entirely, permitted new projects to have a debt-to-equity ratio of 4:1, 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.\[^{65}\] In May of 1992, the Indian government therefore took the initiative of sending its Power Secretary, S. Rajgopal, to the United States.

---

62. See Teisch & Stoever, supra note 51, at 54.
64. See Teisch & Stoever, supra note 51, at 52.
65. See id.
in an effort to attract U.S. 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 is a diversified energy company that earned a net income of US$453 million on revenues of approximately US$9 billion in 1995. Facing the problem of slow growth in the U.S. energy market, it made a strategic decision to focus heavily on the demand for power in foreign countries, a demand that was expected to grow to 560,000MW. 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 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 79 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 Congress Party, which controlled the Central Government and was 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 (or "MSEB"),

66. See Harvard Study (A), supra note 51, at 6.
Enron proposed the construction of a 2015MW power plant at a cost of nearly US$3 billion, which would make it the largest foreign investment project ever undertaken in India. A plant of that size requires a large reliable source of fuel. Enron believed that liquefied natural gas would be the most cost efficient fuel. A dependable source of natural gas lay across the Indian Ocean in the Arabian peninsula 1200 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 695MW using locally produced fuel and a second phase of 1320MW using 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 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 Project 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 Project would be no more than 2.40 rupees (7.3 U.S. cents) per kWh.

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 World 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%, which the Government of Maharashtra as well as the central government's Foreign Investment Promotion Board considered too high. The Indian side felt that 20% 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% would be appropriate. Although the negotiations nearly collapsed over the issue, the two sides finally agreed on a rate of return of 25.22%, although various government officials still considered the agreed upon rate of return as too high. Other difficult issues concerned the project's capital costs, the government guarantees, 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. However, despite these manifestations of public opposition, negotiations continued.

To undertake the project, Enron, with two U.S. minority partners, General Electric and Bechtel, each of which held 10% 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 625MW and additional peak load capacity of 70MW. Failure to provide commercial service within thirty-three months of the deadline would result in penalty payments by the Company to the MSEB of US$14,000 per day. Moreover, if the Company failed to reach baseload capacity of 625MW within one year after the beginning of commercial service it would be required to pay US$100 for each kilowatt below the required 625MW 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% 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 would be 7.05 U.S. cents per kWh at the commencement of commercial operations.

---

69. See Harvard Study (A), supra note 51, at 6.
The tariff was indexed to Indian inflation rates and was expected to rise to 11.34 U.S. cents per kWh 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 Indian Law governed the Power Purchase Agreement, the parties agreed to settle any disputes arising under the agreement by binding arbitration in London.
- 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% of its then depreciated replacement value.

Enron then moved rapidly to finance and implement the project. In addition to the equity contribution of US$279 million from the project partners, it ultimately secured loan commitments of US$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 Shiva Sena took up the

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


issue on the floor of the Maharashtra State Assembly. As they prepared for state election scheduled for March 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 Shena 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. According to one observer of the campaign, the Dabhol Project became "a national icon . . . rallying economic nationalists suspicious of the post-liberalisation arrival of foreign investment."

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.

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 Agree-

73. See Burns, supra note 52, at D1.
74. See Nicholson, supra note 52, at 3.
ment with the Dabhol Power Company. 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 US$300 million and each day of delay on construction was estimated to cost an additional US$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 Electricity Board and the Maharashtra State government, claiming damages in excess of US$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, which culminated in a meeting between Chief Minister Joshi and the chief executive officers of

77. See Rao, supra note 52.
78. HARVARD STUDY (B), supra note 51, at 5.
the Enron Corporation and its subsidiary, the Enron Development Corporation, intended 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. Ultimately, on January 8, 1996, after some delay, the Maharashtra government agreed to accept the Panel proposal for renegotiated terms,81 which eventually became the basis for amending the Power Purchase Agreement between the Dabhol Power Company, the State of Maharashtra, and the MSEB, an event that 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 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

79. Harvard Study (C), supra note 51, at 1.
81. See McWilliams & Moshavi, supra note 52, at 62.
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 have to remain suspended. Eventually, the Indian courts held against the plaintiffs in all of these cases, but it was not until December 1996 that the last suit was dismissed and construction resumed on the Dabhol Project.  

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%; Bechtel, 10%; and General Electric, 10%), the renegotiated deal provided for the introduction of the Maharashtra State Electricity Board as a 30% shareholder with a proportionate reduction in Enron's interest. Thus the new equity structure was Enron, 50%; MSEB, 30%; Bechtel, 10%; and General Electric, 10%. 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 695MW to 826MW and total capacity after the completion of Phase II under the renegotiated agreement was increased to 2450MW, as compared to 2105MW 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 US$2.85 billion to US$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. A portion of the reduction in capital costs can also be attributed to the worldwide fall in the price of generation equipment.

83. See *BJP Collapse Muddies Enron/Dabhol Waters*, *Power Asia*, June 10, 1996. 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. *Id.*

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 U.S. cents per kWh, subject to a 4% annual escalation on fixed charges, to 6.03, subject to fuel price and exchange rate fluctuations, until Phase II became operational, at which time the tariff would become 5.08 U.S. 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.\(^{84}\)

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 US$175 million caused by the State’s cancellation of the contract provided that the 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 US$250,000 that had been accruing as a result of work stoppage, thereby saving Maharashtra state an additional approximately US$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 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 result 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

---

84. Harvard Study (C), supra note 51, at 4.
85. Legal Hurdles Dropped as Dabhol Project Gets Set, Power Asia, Aug. 4, 1996.
violations. Nonetheless, in May 1999, the Dabhol Power Project was completed and began commercial operation. In that same month, Enron secured financing of US$1.87 billion for Phase II of the Project, which is scheduled for completion at the end of 2001.

D. 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?

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, one needs to consider the actions that Enron might have taken to have avoided 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.

1. Principles to Follow Before Deal Break-Down

a. 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 rela-

87. See supra note 75.
tionship 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 see his or her basic objective in an international business negotiation as merely securing an advantageous contract for the client, an international lawyer ought also to 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 project negotiations, international business lawyers must keep asking themselves a basic first 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 binds 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 concludes 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 rela-
tionship. It had no real connection to any Indian party, and had established no basis for cooperation and trust with either 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 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 to be, 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 that Enron should have sought to address.

b. Building a Relationship Takes Time, So Don’t Rush Negotiations and Use Negotiation Preliminaries Fully

Project negotiators who wish to lay the foundation for a business relationship as well as to conclude a contract know that sufficient time is required to achieve these goals. In the case of the Dabhol Project, the speed with which Enron and the Maharashtra State electricity Board achieved a contract not only did not permit the parties to develop 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 ground for canceling the Power Purchase Agreement on flawed "fast track procedures" that 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.\textsuperscript{90}

While speed of negotiation may appeal to American negotiators as "efficient" and a recognition of the fact that "time is money,"\textsuperscript{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, a crucial foundation for a good business relationship. For negotiators who are concerned primarily with 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.\textsuperscript{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.

\textsuperscript{90} See Report of the Cabinet Subcommittee to Review the Dabhol Power Project, supra note 75.

\textsuperscript{91} Enron's Rebecca Mark: "You Have To Be Pushy and Aggressive," Bus. Week (Feb. 24, 1997), available at http://www.businessweek.com/1997/08/b351586.htm. 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."

\textit{Id.}

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.

c. Consider Providing for Renegotiation in Appropriate Transactions

If the risk of change and uncertainty is constant in international business, how should deal-makers 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. They therefore 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 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 99 years, yet they rarely remain unmodified for more than a few years. 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.

d. 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.

2. Renegotiation Principles After Deal Break-Down

When one side has demanded renegotiation of the basic

---

93. See, e.g., STOEVER, supra note 24, at 27.
contract governing their relationship, how should one or both of the parties proceed?

a. 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

95. See Teisch & Stoever, supra note 51, at 62.
b. 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 that sets out enforceable rights and duties and their "foundation relationship" that reflects their fundamental understanding in all its dimensions, legal and non-legal. As indicated earlier in this Essay, 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, 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.

96. See Tracht, supra note 44, at 622 (arguing that well-crafted security arrangement should encourage lender and borrower to renegotiate their loan if renegotiation is efficient).
c. 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 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 US$300 million, that victory would not only drastically reduce its business prospects in the economically important state of Maharashtra, but probably in all of India as well.

d. Look for Ways to Create Value in the Renegotiation

Because of differences in culture or personality, or both, 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 chal-
lenge for both sides in a renegotiation is to create a win/win
process, an atmosphere of problem-solving, joint gains negoti-
ation. Even if a party feels forced into an extra-deal renegoti-
ation, it should approach the process as an opportunity to create
value, to make the pie bigger. Thus in the renegotiations be-
tween 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.

e. Make Sure the Parties Fully Understand the Alternatives to
Succeeding in the Renegotiation—Especially Their Costs

Negotiation scholars 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 ex-
ample 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 indige-
nous means of solving India's power shortage. When it fully un-
derstood that its alternatives to dealing with Enron were poten-
tially very costly, it looked more favorably on renegotiation than
it had at the time it cancelled the contract as a result to the Cabi-
et 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 inves-

98. See Howard Raiffa, Post-Settlement Settlement, in Negotiation Theory and Prac-
tors, it became considerably more open to agreeing to renegotiation and to arriving at a satisfactory conclusion to the conflict.

f. 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.

g. 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 a committee of experts, rather than face-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, its 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.

h. 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

100. See Jacob Bercovitch & Jeffrey Z. Rubin, Mediation in International Relations: Multiple Approaches to Conflict Management 7 (1992) (offering similar, but more elaborate, definition of mediation); see also Direct Negotiation and Mediation, supra note 16, at 53-72.
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.

CONCLUSION

Renegotiation, whether post-deal, intra-deal, or extra-deal, is a constant fact of international business life. As a result, project developers, financing institutions, and their lawyers need to understand this phenomenon and devise strategies and mechanisms to deal with it productively. For many persons, renegotiation is an aberration; for others, a somewhat disreputable practice. It provokes images of disappointed expectations, of broken promises, of bargains made but not kept. From the vantage point of the individual project company 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 a constructive role. Sixty 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, . . . .”\textsuperscript{101} In the realm of modern project contracting, 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 to adjust to one another over the long term at the least cost.

\textsuperscript{101} See Llewellyn, \textit{supra} note 29, at 751.