Hardship and Force Majeure

The first and paramount task of international commercial contracts is organizing the relationship between the parties in an optimal manner. This means that contracts must determine the rights and duties of the parties so that the transaction works smoothly and its costs can be minimized. A second important task is providing remedies for cases of breach of contract. Requirements as to the rules for such contracts, as well as to the contracts themselves, have to be assessed in light of these aims.

An approach that focuses on the distribution of the obligations on the one hand, and the nonperformance on the other hand, is a rather static one. It may suffice if short term contracts are at stake with a rather easy structure where non-money performances are exchanged against money. In international trade which is the subject of the Principles, many contracts are of a more complicated structure, and even if they are not long term contracts they exist frequently over a substantive period.

A contract is not only a momentary picture of the reality as it is to according to that very contract, but it also initiates and covers processes which develop in the future. Depending on the subject of the contract these processes may extend over a period of several years and in certain cases even over a legally unlimited period. Insofar as the contract has to reflect the developing reality the Unidroit Principles have to address these problems.

Two concepts will be presented here, showing how the Principles tries to cope with them. Hardship, which is mainly directed at the adaptation of the contract, will be analyzed first and more in detail. The second concept, namely force majeure, is primarily di-

1. HARDSHIP
1.1 Stability and Flexibility of Contracts

A basic and it seems universally accepted principle of contract law is "pacta servanda sunt." It reflects natural justice and economic requirements because it binds a person to its promises and protects the interests of the promisee. Since effective economic activity is not possible without reliable promises, the importance of this principle has to be underlined.

On the other hand, practice has demonstrated that on many occasions this principle may lead to the opposite of its aim. That is to say that the promisor cannot be held to his promise because circumstances have changed so fundamentally that a hardship has occurred to him. However, on the other hand, the promisor cannot reasonably expect that the benefits from the advantages of the change should be without any compensation.

The problem of hardship and adaptation of a contract to changed circumstances as a legal consequence thereof is by far less elaborated, established and acknowledged than the principle "pacta servanda sunt." Certainly, some legal systems exist in which the adaptation has found its expression in legislation, and others in which this principle is widely accepted by case law and legal literature. On the other hand, it cannot yet be said that this principle has reached a breakthrough on the international level. In particular it has not found its expression in CISG, though attempts were made to introduce such a provision. The preparation of such a rule in practice and theory and the awareness of the problem had not yet reached that level which would have made possible such a solution.

Also in the UNCITRAL Guide to Construction Contracts, which is by far less ambitious, a cautious position has been taken as to the desirability of hardship clauses because of political differences concerning this issue, mainly between developed and developing countries.

The problem of hardship in our century seems to have come up in waves. It is not necessarily bound to political, economic and social developments of a macro character, and can also affect individual contracts only under normal circumstances. But in fact hardship is discussed and legal solutions are considered mainly in periods of crises. Under such circumstances the problem gains mass character which leads to cases. Legal literature grows up and the public interest develops.

In Germany, the waves of great importance for adaptation problems are connected with the periods after each of the world wars, whereby post World War I Inflation played a particular role. Later a new wave of the adaptation discussion was connected with the oil crisis in the seventies. A new wave may now be expected, connected with the collapse of the socialist system.

The ongoing revolutionary events, for the time being mainly in Eastern Europe, make clear how badly we need rules on hardship. It is an advantage that the Unidroit Principles could undertake to solve this problem. The group that prepared the rules was not bound by instructions of governments with their mostly conservative attitude towards new legal inventions. Governments have an inate tendency to maintain their own legal regulations and even to expand the sphere of application of own legal concepts, not always with a critical examination of the justification. The combined knowledge of different facets of legal theory and practice in the group could be used in order to elaborate rules which fit international contractual practice. The disadvantage of this approach is obviously that the result will probably not obtain the high authority of a convention.

An international commercial contract is not singly a set of obligations where legal sanctions come into play only if one party fails. It is like a domestic contract and, more specifically, a process. It is directed at a certain goal, which is the execution of the performances of both parties. The contract and the rules behind it establish a program to achieve this aim. This program may contain several means for that purpose, in order to react to factual events which may occur even after performance in the case of defective performance. But in some cases it may even be necessary to change the program itself. Of course, it is not always easy and not even necessary to make a distinction between originally foreseen reactions and change in the program. But if change in the original obligations of the parties which are binding shall be made, this can only be done if there exists a legal program for that, in other words a meta-program, a program of a higher level, and this is basically connected with the problem of hardship, but not limited to it. Regulations and clauses on hardship do not directly change the primary obligations of the parties, but create obligations, a program, to achieve such alterations.
1.2. Reasons for Adaptation in Unidroit Principles

The reasons for the necessity of changing the programming and for adaptation may be different. Therefore the problem appears under different aspects in several parts of the Principles.

One example of these reasons is the gaps in the contract. The first group of these gaps covers such problems which the parties have intentionally left open. The Principles deals with them particularly under Article 2.13 (Contract with terms deliberately left open). A second group relates to cases where the parties simply did not anticipate certain questions. Of course this does not relate to gaps which may be easily filled by the applicable law, but to gaps that necessarily require party agreement be a suitable one. For this problem, the Principles offer mainly rules on Interpretation (Chapter 4, in particular Article 4.7 (Supplying on omitted term)), but also in the chapter on performance (Article 5.2 (Implied obligations), Article 5.3 (Cooperation between parties), Article 5.5 (Determination of kind of duty involved), Article 5.7 (Price determination), such prescriptions are to be found. Lastly, it shall be mentioned that the Principles also foresee a possibility to avoid avoidance by adaption of the contract (Article 3.9 (Gross disparity), Article 3.13 (Adaption of contract)).

A second reason for adaptation may take place in connection with breaches. In this case already the legal consequences which be-

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long to the original program contain elements of change of that program, of adaptation, that is to say alternatives. With the Principles this holds true in particular for Article 7.1.5 (Additional period for performance) and for Article 7.2.3 (Repair and replacement of defective performance). But often the parties in their contracts foresee additional possibilities of adaptation in case of breach, such as where long lasting force majeure occurs. The Principles have been left to the parties.

The same is true for adaptation in cases where one party has changed its mind without a showing. This is the so-called variation of modification (Unidroit Principles Article 1.4) of contracts. But one important kind of adaptation of the contract (with termination as a final consequence) is hardship.

1.3. The Hardship Clause

The Principles have dedicated a whole section (Article 6.2) with three articles to hardship. The term "hardship" identifies specific circumstances and therefore most exactly describes what is meant. In German it is similar, but without expressly addressing the increased burden, the phenomenon is described by "Wegfall der Geschäftsgrundlage." In French the term "imprévision" is used which indicates one of the prerequisites for establishing a hardship case-and not even the most characteristic one, since the same prerequisite relates to force majeure as well. Another term which is frequently used in this context is "adaptation." This is one of the legal consequences of hardship and obviously the most important one. On the other hand adaptation-as we have seen-is not limited to hardship so that also this term is not precise enough.

The section on hardship Starts with Article 6.2.1 stressing that a party for whom its performance becomes more onerous generally is nevertheless bound to perform. This seems to be more or less self evident, and is similarly mentioned in Article 1.4. It is only repeated here in order to make clear that the Principles also take the principle "pacta servanda sunt" as a basis, and that the possibility of adaptation is of an extraordinary character.

Articles 6.2.2 and 6.2.3 deal with the definition of hardship and the effects of hardship respectively. This splitting up is intended to achieve greater clarity. The content of the rules is similar to that of the Principles of European Contract Law, which deal with the problem in one article (2.117).

The definition of hardship has the form of a general description and not of an enumeration. In its first part it makes clear that hardship, in the narrower sense, is basically a fundamental change of the equilibrium of the contract. In the following, it is explained in two different ways, either the costs of the disadvantaged party increase or the value of what it has to receive decreases. The latter variant includes the cases in which the performance the disadvantaged party is entitled to receive has lost its value for that party since the aim of that performance can no more be achieved. cases of this kind in Eastern European countries nowadays unfortunately occur rather frequently. The factory for which certain machines, plants, etc. have been produced has stopped its production. The fundamental character of the change is that it must be decisive change. The definition gives no figures. In my view as a rule an alteration of at least 50% (increase of costs,
decrease of value) should be required.

This means that the Principles have taken the objective approach, that is to say, hardship exists if these objective criteria are observed, and it is not necessary that the parties themselves in a subjective manner have made the maintenance of certain conditions a basis of their relationship. This problem plays a role in the German discussion.\(^\text{10}\)

The crucial point clearly is the definition of "fundamental" change. This formula by no means should lead to the result that normal economic risks can be shifted to the other party. This would undermine the foundations of a market economy. But on the other hand the consequences of events which lie far beyond the normal path of economic development, as turbulent as it is, and hit one Party or the other only by chance, regardless of the distribution of economic consequences.

But the occurrence of some such events forms a hardship case only if certain additional criteria are fulfilled. They resemble the presuppositions of force majeure (Article 7.1.6(1)). In fact they should only partly do so. These criteria are: first, that the respective events occurred or became known to the disadvantaged Party after the conclusion of the contract; second, that they could not reasonably have been taken into account by that party at that time; and third, that they were beyond the control of that party. It seems that in most cases the second criterion will cover the Problems envisaged by the first one. By eliminating the first criterion the clause could be brought in greater harmony with the rule on force majeure. Finally, there is a fourth criterion which deliberately differs from force majeure. It excludes cases in which the disadvantaged party has assumed the risk relating to those events which have caused the hardship. (This is of course also possible in force majeure cases, but a presumption if it exists at all, runs in the opposite direction.) The taking of the risk can be made not only expressly, but also be derived from the nature of the contract (prospective transactions) or be otherwise implied. If the parties have a certain adaptation clause, such as, an indexation clause for the prices, it may be concluded that price increases not covered by that clause must be born by the disadvantaged party.

The effects of hardship have both a procedural and a substantive law aspect. The procedural aspect starts with renegotiation and may lead to a court decision. The latter seems to be a problem in some jurisdictions since it includes to a certain degree the imposition of conditions by the judiciary. This is true even if the court only terminates the contract, since it has to fix the respective terms at the same time. A tendency in this direction, problematical enough if practiced in national law, causes even more concern in international trade, where the party autonomy is of particular importance. The judge usually has to decide what the law is and not to make decisions for the parties or anybody else. Nevertheless the working group has proposed to put this burden on the shoulders of the judge in these exceptional cases and by adding certain substantive rules which give a certain legal basis for this constructive legal decision-making which is also practiced in some other cases where it is less obvious (price decisions according to Article 5.7).

These rules are contained in Article 6.2.3(4) according to which the court may either terminate the contract, whereby he has to determine the date and the terms-in other words, no further guidance could be given. But the contract may only be terminated if this is reasonable. Otherwise the court must adapt the contract. Insofar the original equilibrium of the contract is given as a yardstick for adaptation.

2. FORCE MAJEURE

The concepts of hardship and force majeure seem to be related to each other, particularly since they share some features. This Impression is intensified by the fact that, as Marcel Fontaine has rightly pointed out, contractual hardship clauses on the one hand and force majeure clauses on the other hand have developed a certain parallelism.\(^\text{11}\) The difference between the two concepts is mostly described in such a way that hardship is at stake where the performance of the disadvantaged party has become much more burdensome, but not impossible, while force majeure means that the performance of the party concerned has become impossible, at least temporarily. But moreover there seems to be a functional difference between the two concepts, at least as they are used in the Principles.

Hardship is a reason for a change in the contractual program of the parties and has a deeper influence on the implementation of the contract than normal variants which come up in this process, however hardship is nevertheless...
related to the fulfillment of the contract. The aim of the parties remains to implement the contract. But force majeure in the context of the Principles like elsewhere in the context of nonperformance.

The three main aspects of nonperformance in a broad sense which also appear in PICC are the facts of the breach (in PICC failure to perform an obligation including defective performance and late performance-Article 7.1.1), the responsibility of the non-performing party and the legal consequences of the breach (inter alia termination and damages).

Force majeure relates to the question of responsibility. Two concepts are used which I will call here shortly the fault principle and the exemption principle, the first being more or less characteristic of the continental law, the second of the common law. While according to the fault principle a party is only liable if it has committed a fault, according to the exemption principle the party which has committed a breach is held to be liable, unless it can establish reasons for exemption. In general, this would lead to opposite the burden of proof, but, in certain cases, also under the fault principle, the party in breach has to prove its innocence. As far as the practical is concerned it is well known that the two principles do not greatly differ. This is partially due to the fact that a party can best prove its lack of fault, if it can establish exemptions. The CISG, the most important international document in contract law, uses the exemption principle. Interpretations which try to make clear that the fault principle is implemented in the CISG do not correspond to reality. The Principles rely on that principle too. It seems to approach the real problems in a more direct manner, corresponding to the situations in which these problems occur. One of the most important reasons for exemption is force majeure which is described in Article 79 of CISG, though not denominated as such. In Article 7.1.6 of the Principles the function of force majeure as an exemption has been enlarged compared with CISG. In both cases the respective article starts with a paragraph saying that a party is not liable for a failure to perform (CISG) or that a party's nonperformance is excused if the said circumstances occur. But in CISG this seemingly far reaching effect very soon is reduced to claims for damages only. All other claims are allowed, so that one might even ask whether penalties are allowed, which in my view would be absurd. But performance in general can be claimed in spite of the existence of exemptions which has led to a vivid discussion. The Principles use quite the opposite approach. It sticks to the principle that the excuse is general, but makes in paragraph 4 important exceptions in determining certain claims which shall not be affected by force majeure, namely the right to terminate the contract or withhold delivery or request interest on money due. That means that in case of force majeure, performance cannot be claimed, including, of course, damages and penalties.

3. RECENT EXPERIENCE IN GERMANY

As already indicated a new wave of hardship and force majeure cases is to be expected and has already started in connection with the decisive changes in Eastern Europe. They were particularly radical and quick to appear in the former GDR, and therefore the importance of the problems dealt with under the first two articles 1. and 2. shall be illustrated by experience gathered in this context. First some remarks concerning the relations of the former East German (foreign trade) enterprises with their partners in other former CMEA countries. Much litigation has already arisen, related to hardship and force majeure. The competent court for cases where the German party is defendant is still the Berlin Arbitration Court which is identical with the former Court of Arbitration with the Chamber of Foreign Trade. This competence is clean as to cases submitted before October 3, 1990, but in most cases is also clean for cases filed later, but arising out of contracts made before that date, since regularly the GCD are expressly agreed upon providing for this competence.

The GCD as the applicable rules of material law deal only with force majeure (called insuperable force), but not with hardship. In the national legislation, which was to be applied subsidiary to the

GCD, such rules were missing with the exception of the International Commercial Contracts Act (ICCA) of the former GDR and to a lesser degree of the Civil Code of Hungary. In Order to find a solution under these circumstances it does not seem to be impossible to use the rules of the GCD concerning force majeure at least partly for hardship as well, or even to make use of the rules of the Principles draft in order to fill out lacunae which the rules of the GCD, drafted for a different aim, doubtlessly leave. The Principles serve as an expression of international commercial practice. The cases mentioned so far predominantly have been resolved by settlement. But in the legal discussions leading to such settlements the rules of the Principles have played a certain role. The decision in the case 126/90 (not yet published), the draft rules of PICC on hardship have been cited as an additional argument for justifying hardship and determining its
consequences.

Difficulties relating to hardship have also come up in the relations between former GDR enterprises and their Partners in the former FRG or in other countries or between former GDR enterprises whether connected with external relations or not. The Problem is either that, in case of former GDR imports, the goods are no longer needed, or that, in case of exports, the seller is no longer able to deliver the goods for the agreed price, since the subsidies have disappeared. These subsidies were mainly marked by a special rate of exchange for foreign trade, but which in order to hide the sinking real value of the Mark of the GDR was not labelled as such. The denomination of this Instrument was direction coefficient (Richtungskoeffizient), whereby the word "direction" meant that the coefficient depended on the direction of the trade, in other words on the currency on the other side of the equation. At the end the coefficient, which was kept top secret, was in relation to the Deutschmark 4.4. That means the export earnings were multiplied by 4.4, if they were converted into Mark of the GDR, though the official rate of exchange was 1:1. The same was true for import payments. After the threefold union (currency, economy and social union, starting July 1, 1990), many of the costs, especially wages, had to be paid in the relation 1:1 and soon increased. Others sank, but not to such an extent. So for many old contracts it was no longer possible to fulfill them in a normal way.

These problems are covered by some court and arbitration decisions. The court decisions are mainly made by courts of the first instance, are sometimes appealed and partly, like the arbitration decisions, remain unpublished.

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The general tendency is that the courts, as well as the arbitrators, seem reluctant to apply the concepts of hardship and force majeure in the context of the restructuring the economic system in the former GDR. The applicability of the concept of hardship (Wegfall der Geschäftsgrundlage) is generally accepted, but the factual preconditions for it to be applied in a particular case are rather severe.

As for hardship, one decision of the second instance (Kammergericht) has partly denied and partly accepted this argument. The court had to decide on a contract between a former foreign trade enterprise of the GDR and its domestic Partner for an import. The latter had partly refused to pay the price for a machine delivered to it. The legal basis for the litigation was a special regulation for the relations between the so called peoples' owned enterprises of the GDR, the Contract Law. Since this law in the court's view did not contain a rule for the Problems of adaptation, it felt that § 242 of the BGB contained a principle of legal ethics which had to be applied also to contracts which have been concluded before the reintroduction of the BGB in Eastern Germany and normally are not governed by the BGB. Section 242 BGB in German law is taken as a basis for decisions on hardship. Nevertheless the adaptation of the price was not conceded as far as it was influenced by the direction coefficient. The reason for this was that the price had fallen at a time when the contractual price according to the GDR regulations was still valid. On the other hand, a part of the price was to be financed by state subsidies which were cancelled. To that extent, the court accepted, that § 242 had to be applied with the consequence of a price adaptation. This meant that each Party had to bear 50% of the loss caused by the cancellation of the subsidies. The defendant had only to pay 50% of that part of the price. In another case the Landgericht Berlin awarded the payment of costs which could be looked at on a consequence of a contract adaptation in a hardship case according to the Contract Law of the GDR applicable to the case. In a comparable manner it was decided in 94.0.53/91.

The Landgericht Bochum in the case 15.0.83/91 held § 295 of the ICCA-the Paragraph on so-called changed circumstances generally applicable to a case where deliveries from former Eastern to

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former Western Germany were not made in 1990, but found that the presuppositions were not fulfilled in the given case, in particular since the procedure for adaptation as foreseen in § 295 (first offer for a reasonable adaptation, then termination) was not observed.

In a further case (94.0.53/91) the Landgericht Berlin ruled that a party had to pay for a delivery already received, but which it wanted to cancel for hardship. The result is not objectionable since in general hardship cannot be invoked in relation to a performance already made. But the court states quite generally: "Since the Unification Co[ntr]act contains no different rule, we must begin with the principle that the risk of sale remains with the defendant as buyer, despite the decisive political and economic changes on the territory of the former GDR. . . ." In my view it would go much too far to take this as a general rule.
In case 99.0.278/90, which also had to be decided according to the ICCA, the Landgericht Berlin took note of § 295, but refused to apply it with a very general and in my view unacceptable reasoning. The court referred to a provision of the State Contract (Art. 13 al. 2) according to which the grown foreign economic relations of the GDR, in particular existing contractual obligations in relation to the CMEA countries, should enjoy protection of confidence (Vertrauensschutz). This was clearly directed at relations on the state level (international law). But the court drew the conclusion that generally all existing foreign trade contracts (that means on the enterprise level) are to be observed, not only in relation to parties of the former CMEA countries, but in relation to all parties. This would in fact mean that § 295 ICCA could never be applied in cases for which it was drafted.

The Berlin arbitration court, in three rather similar cases, had to decide on claims for the price for goods for which the demand had disappeared with the buyer and his client. The applicable law was that of the GDR, and in particular the ICCA. The arbitration court felt in all these cases, and I take as example SG 234/90, that the prerequisites of § 295 ICCA were not fulfilled. This provision requires the interpreting court to take into account the circumstances which formed the Basis for the parties at the time the contract was made and which have changed later-as the court interpreted it-and were not foreseeable at the time of the making of the contract and beyond the control of the parties. In this case the lack of foreseeability was denied. The contract was made at the end of February 1990 and, as the arbitration court interpreted the facts, confirmed at the end of June. At that time at the latest the fundamental alterations were foreseeable. Furthermore the defendant had not observed the procedure for the adaptation according to § 295.

In this context it should be noted that the law which determines

the opening balance sheet of former GDR enterprises in Deutschmark foresees the possibility of newly fixing prices if the prices had been subject to price regulations and the contracts are to be fulfilled after the threefold Union and such price regulations no longer exist. A new determination is also possible if the original Balance between performance and counterperformance has changed considerably and that amounts for at least one party to an unacceptable disadvantage (§ 32 of that law).

As for the concept of force majeure, the Landgericht Bochum stated in the case already mentioned that the German unification and the preceding currency union alone cannot be dealt with as force majeure (in this case in the Sense of § 293 ICCA). This seems to be true. In the given case, though the court did not find that the facts constituted force majeure, it did not entirely exclude this possibility.

The Landgericht Berlin acted very rigidly in a case where a foreign trade enterprise had to deliver goods to Portugal, but was not able to do so since the direction coefficient had been cancelled. The court applied the United Nations Sales Convention (CISG) because the decisive date required application of the law of the GDR. But it did not see reasons for an exemption according to Article 79 of the CISG, mainly using the argument of the protection of confidence already described, and ruled that the defendant had to deliver according to the contract.

It goes without saying that in Germany many adaptation problems connected with the restructuring, particularly in contractual matters, are solved by corresponding legal regulations.

One problem intensively discussed is how to behave against credits granted by GDR banks to former GDR enterprises and often forced on them. Though voices have been raised that socialist credits cannot be repaid, since the planned economy has been abolished, the leading view holds that in these cases it is not generally possible to rely on hardship, that is to say § 242 BGB (insofar as it is applicable).

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1. In a comparative analysis of 8 EEC countries based on national reports, Tallon stated that hardship, in his terminology "imprévision," was accepted in one form or another everywhere except in France (but there in administrative law) and Belgium. See Rodies (ed.), Les modifications du contrat aux cours de son exécution en raison de circonstances nouvelles 186 et seq. (1986). As for the former CMEA countries another comparative analysis also based on national reports of nine countries leads to the opposite result. Legal rules were missing everywhere except in the GDR, Hungary and to a certain degree Czechoslovakia. The Law of Contracts of the Member States of the CMEA and of the SFRY 192 (1986).

corresponding discussion p. 381 et seq.


4 As to adaptation, mainly based in the peculiarities of the individual contract; see Brand & Maskow, Der internationale Anlagenvertrag 312 (1989).


8 As for the notion see also Fontaine, Droit des contrats internationaux. Analyse et rédaction de clauses 251 (1989).


10 See, e.g., Larenz, loc. cit., p. 320 et seq.

11 See Fontaine, loc. cit., p. 238.

12 See Nicholas "Prerequisites and extent of liability for breach of contract under the U.N. Convention," in Einheitliches Kaufrecht und nationales Obligationenrecht 286 et seq. (Schlechtriem ed., 1987.)

13 See, e.g., the different views of Tallon in Commentary on the International Sales Law. The 1980 Vienna Sales Convention 589 et seq. (Bianca & Bonell 1987); Stoll in v. Caemmerer/Schlechtriem, Kommentar zum Einheitlichen UN-Kaufrecht 672 et seq. (1990); Maskow in.


18 Kammergericht, Zeitschrift für Wirtschaftsrecht 17 (1991). In principle confirmed by the Supreme Court (Bundesgerichtshof), but referred back to the former instance for determining the exact amounts of economic disadvantages of both parties. See the report in Wirtschaftsrecht 475 (1992), the comment will be published in Wirtschaftsrecht no. 12 (1992).


21 Gesetz über die Eröffnungsbilanz in Deutscher Mark und die Kapitalneufestsetzung, Gesetzblatt (GDR) I no. 64, p. 1909 (part of the Unification Co[ntr]act, later modified).


Referring Principles:

VI.3 - Force majeure

VIII.1 - Definition