AWARD MADE IN CASE NO. 1512, 1971

The failure by a Pakistani Bank to execute a guarantee in favour of an Indian Company was at the origin of the arbitration which gave rise to this award made by an arbitrator sitting in Geneva. The size of the award, more than 70 pages, itself preceded by two preliminary awards, have unfortunately forced us to limit the extracts to the questions which seemed of general particular interest.

[...]

2. Doctrine of frustration and the principle ‘Rebus sic stantibus’

The defendant (Bank) claimed that the armed conflict which opposed India and Pakistan in 1965 and the emergency legislation adopted in both countries on this occasion had created a situation which had freed it from, its obligation to pay the amount of the guarantee. It raised in this respect the English doctrine of ‘frustration’ which has a certain relationship without meaning the same thing, with force majeure, and according to which a contract becomes inoperative if the circumstances have brought about a radical modification of the obligations of the parties. It also claimed without making a clearly distinct ground from this, that the arbitrator should take account of the principle ‘Rebus sic stantibus’.

A. As to the English doctrine of frustration (recognized equally in India and Pakistan) the arbitrator pointed out that ‘when defining the circumstances which are regarded as a frustrating event, English law rejects the criteria of hardship, commercial inconvenience or material loss as such but insists that there must be such a radical change of circumstances... that the foundation of the contract has gone’. (Schmitthoff; op. cit. pp. 137, 138; cf. also by the same author, The Export Trade, 5th ed., p. 97).

The adaptation of this test (of the ‘fundamentally different situation’) admits or implies a large measure of judicial discretion (Schmitthoff p. 136). While exercising his power of judgment, the judge or arbitrator must take into account all relevant circumstances of fact, but also the rôle and legal consequences of the frustration of the contract, its nature as an exception to the fundamental principle of sanctity of contract, and also have regard to the necessities of international trade.

Further, while keeping in mind the strict conception which is traditional in the common law and in the business community, the arbitrator or the judge must remember that, as already referred to, this is ‘not simply a question whether there had been a radical change in the circumstances, but whether there has been a radical change in the obligation . . . ’ (Chitty no. 1266).

B. As to the application of the principle ‘Rebus sic stantibus’ the arbitrator rejected this plea:

‘The principle “Rebus sic stantibus” is universally considered as being of strict and narrow interpretation, as a dangerous
exception to the principle of sanctity of contracts. Whatever opinion or interpretation lawyers of different countries may have about the 'concept' of changed circumstances as an excuse for nonperformance, they will doubtless agree on the necessity to limit the application of the so-called 'doctrine rebus sic stantibus' (sometimes referred to as 'frustration', 'force majeure', 'Imprévision', and the like) to cases where compelling reasons justify it, having regard not only to the fundamental character of the changes, but also to the particular type of the contract involved, to the requirements of fairness and equity and to all circumstances of the case.

It should be obvious that none of the requirements which might justify the application of the 'doctrine' are fulfilled in this case. As a general rule, one should be particularly reluctant to accept it when there is no gap or lacuna in the contract and when the intent of the parties has been clearly expressed, as in the Bank Guarantee. Caution is especially called for, moreover, in international transactions where it is generally much less likely that the parties have been unaware of the risk of a remote contingency or unable to formulate it precisely'.

[...]

**Referring Principles:**

- I.2.3 - Presumption of professional competence and equality of parties
- VIII.1 - Definition