Chapter XXII. Hardship clauses

SUMMARY

Hardship is a term that is used in the Guide to describe a change in economic, financial, legal, or technological factors which causes serious adverse economic consequences to a contracting party, thereby rendering more difficult the performance of his contractual obligations. A hardship clause usually defines hardship, and provides for renegotiation to adapt the contract to the new situation created by the hardship (paragraph 1). Hardship clauses are to be distinguished from exemption clauses (paragraph 2).

A hardship clause may be considered to have the advantage that renegotiation under it might avert a disruptive failure of performance by the party affected by the changed circumstances. The clause may also facilitate renegotiation by providing a framework within which it may be conducted (paragraph 3).

A hardship clause has, however, several disadvantages which may outweigh the advantages described above. The possibility of renegotiation makes the contract to some degree unstable, the definition of hardship tends to be imprecise and vague, and the inclusion of the clause may induce the advancement of spurious claims that hardship exists to avoid the performance of obligations (paragraph 4). Furthermore, the purchaser may in particular be disadvantaged because the contractor will potentially have more opportunities to invoke the clause than the purchaser (paragraph 5). The Guide deals with other clauses which may be included in the contract and which may apply when a change of circumstances causes serious adverse economic consequences to a party. The purchaser may wish to consider whether the inclusion of those clauses renders a hardship
clause unnecessary (paragraph 6).

If, despite its disadvantages, the parties wish to include a hardship clause in the contract, it is advisable to draft it so as to reduce the uncertainty it might create as to the obligations of the parties. It may be acceptable for the clause to define hardship, and in addition to include a list of events on one or more of which alone a party can rely to invoke the clause (paragraphs 7 and 12). A restrictive definition of hardship may be adopted under which all required elements must be satisfied before hardship is deemed to occur (paragraphs 8 to 11).

The parties may wish to consider the inclusion of other limitations to invoking a hardship clause, since those limitations may reduce the instability introduced into the contract by the clause (paragraph 13). The parties may wish to decide whether, in the event of hardship occurring, they are to be obligated only to participate in renegotiations with a view to adapting the contract, or are to be obligated to adapt the contract after renegotiations (paragraph 14).

The parties may wish to provide procedures for facilitating renegotiation (paragraphs 15 to 17). The contract may also determine the point of time at which a failure to agree on adaptation after renegotiations may be deemed to occur (paragraph 18).

The parties may wish to facilitate the implementation of a hardship clause by providing guidelines to assist them in reaching a fair adaptation of the contract (paragraph 19). Since the circumstances which had changed and created the hardship may change once more and approximate to their previous condition, thus alleviating the hardship, the contract may provide how the contract is to be readapted if circumstances return to their previous condition (paragraph 20).

The parties may wish to determine the status of the contractual obligations of the parties during renegotiations. Where the parties are obligated only to participate in renegotiations, they may provide that the performance of the obligations of the parties which are alleged to be affected by the hardship is to continue in accordance with the original terms of the contract during the renegotiations (paragraph 21). Where the parties are obligated to adapt the contract after renegotiations, they may provide that the performance of the obligations is to continue both during renegotiations and, if the parties fail to agree on adaptation, during the ensuing dispute settlement proceedings. Alternatively, they may provide that the party invoking the hardship clause is entitled to interrupt the performance of the obligations (paragraph 22).

Where the contract obligates the parties to adapt the contract after renegotiations, it is advisable for the contract to provide for the consequences of a failure to agree on adaptation (paragraph 23).

A. General remarks

1. The term "hardship" as used in the Guide means a change in economic, financial, legal or technological factors that causes serious adverse economic consequences to a contracting party, thereby rendering more difficult the performance of his contractual obligations. A typical hardship clause has two main aspects. Firstly, it would define hardship and, secondly, it would provide for renegotiation to adapt the contract to the new situation created by the hardship. The legal effect of hardship clauses may vary under different legal systems. While they are recognized under some legal systems, they are unknown in others; in still other legal systems their validity has not been tested in legal proceedings.

2. Hardship clauses are to be distinguished from exemption clauses (see chapter XXI, "Exemption clauses"). A hardship clause as conceived in the Guide would apply when a change of circumstances makes the performance of a party’s obligations more onerous, but does not prevent that performance. An exemption clause as conceived in this Guide would apply only when a change of circumstances prevents performance. Thus, a hardship clause may apply where, after the
contract is entered into, administrative regulations relating to environmental protection applicable to the construction change so as to introduce more stringent requirements which greatly increase the cost of construction. An exemption clause may apply where the regulations change so as to prevent further construction. The legal consequences resulting from the application of each type of clause as conceived in the Guide would also differ. A hardship clause would provide that, if hardship occurs, the contract is to be renegotiated (see previous paragraph). An exemption clause would provide that, if a failure to perform an obligation occurs as a result of exempting impediments, certain remedies, in particular the recovery of damages, are not available to the aggrieved party against the party who failed to perform.

3. The inclusion of a hardship clause may be considered to have the advantage that if a change of circumstances results in serious adverse economic consequences to a party, renegotiation of the contract under the clause might avert a disruptive failure of performance by the party affected by the changed circumstances. Although there is nothing to prevent parties from renegotiating even in the absence of a hardship clause, the clause may facilitate renegotiation by providing a framework within which the renegotiations may be conducted. Thus, the clause may include provisions which help to achieve an equitable outcome from the renegotiations (see paragraph 19, below) and may regulate the rights and obligations of the parties during renegotiations (see paragraphs 15 to 17 and 21 and 22, below).

4. A hardship clause has, however, considerable disadvantages which may outweigh the advantages mentioned above. The possibility of renegotiating the contract under a hardship clause makes the contract to some degree unstable. Furthermore, because of the nature of hardship, its definition tends to be imprecise and vague. Further, disadvantages of a hardship clause are that the renegotiation may result in interruptions in the performance of obligations under the contract, and that the clause may induce the advancement of spurious claims that hardship exists as an excuse for avoiding the performance of obligations. In addition, where a hardship clause obligates the parties to adapt the contract after renegotiations (see paragraph 14, below), and the parties fail to reach agreement on the adaptation, there may be difficulties in securing an adaptation through dispute settlement proceedings (see paragraph 23, below).

5. A hardship clause may have particular disadvantages for a purchaser. While the purchaser has usually to perform only a single principal obligation (i.e., to pay the price), the contractor has to perform a number of obligations in the course of constructing the works. The contractor, therefore, will potentially have more opportunities to invoke the hardship clause than the purchaser. Accordingly, before agreeing to the inclusion of a hardship clause in the contract, the purchaser should carefully consider the possible adverse effects to him of that clause.

6. The Guide discusses other clauses which may be included in the contract and which may apply when circumstances change after the contract is entered into causing serious adverse economic consequences to a party. Of these other clauses, those having an objective closest to that of a hardship clause are index clauses and currency clauses. An index clause provides for the revision of the price when the cost of goods or services to be supplied by the contractor changes, and a currency clause provides for a revision of the price when there is a change in the exchange rate of the currency in which the price is to be paid in relation to a reference currency (see chapter VII, “Price and payment conditions”, paragraphs 49 to 55, 58 and 59). These clauses deal with changes which are predictable and can be clearly identified in advance. Hence, the clauses can specify the modifications which are to be made to contract terms as a result of those changes, and the contract need not, as under a hardship clause, provide for renegotiation, with its attendant uncertainty of outcome. Where, as a result of changed circumstances, the purchaser wishes to alter the scope of the construction, he may do so within certain limits under a variation clause (see chapter XXIII, “Variation clauses”, paragraphs 5 to 18). Where the changed circumstances make it advisable for the purchaser to suspend construction, he may do so under a clause providing for suspension (see chapter XXIV, “Suspension of construction”, paragraphs 3 and 4). Where the change is so drastic that the project ceases to be viable, the purchaser may, under a termination clause, terminate for convenience (see chapter XXV, “Termination of contract”, paragraphs 17 and 18). The purchaser may therefore wish to consider whether the inclusion of the clauses mentioned above renders a hardship clause unnecessary. The discussion of hardship clauses in the Guide is not to be regarded as an indication that their inclusion in contracts is desirable.

B. Approach to drafting hardship clause

7. If, despite its disadvantages, the parties wish to include a hardship clause in the contract, it is advisable to draft it so as to reduce the uncertainty it might create as to the obligations of the parties. The use of open-ended and vague criteria
(e.g., "changed circumstances", "upsetting the initial equilibrium of the contract", and "causing serious economic consequences") to determine the application of the clause is to be avoided. Providing a list of hardship events which is not exhaustive will also lead to uncertainty. An acceptable approach might be to set forth in the clause a definition of when hardship may be said to occur (see sub-section 1, below), together with an exhaustive list of the events on one or more of which a party can rely to invoke the clause (see sub-section 2, below). Under this approach, the clause can be invoked only if an event specified in the list occurs which results in the hardship defined in the clause.

1. **Definition of hardship**

8. The parties may find it advisable to adopt a restrictive definition of hardship under which all the following elements must be satisfied before hardship can be deemed to occur: (a) a change of the circumstances which existed at the time the contract was entered into; (b) the change being unavoidable and one which the party invoking the clause could not reasonably be expected to have taken into account; and (c) the change resulting in serious adverse economic consequences to that party.

(a) **Changed circumstances**

9. The scope of the hardship clause may be made more clear if, instead of merely requiring a "change of circumstances", the parties were to require that the changes occur in particular areas. For example, the parties may provide that the change must relate to specific economic, financial, legal, or technological circumstances.

(b) **Nature of change**

10. The parties may wish to provide that the change of circumstances must have been beyond the control of the party invoking the hardship clause and that he could not reasonably be expected to have taken the change of circumstances into account at the time the contract was entered into or to have avoided or overcome the change of circumstances or its consequences.

(c) **Serious adverse economic consequences**

11. The parties may wish to define what adverse economic consequences to the party invoking the hardship clause are to be regarded as serious. The purpose of that definition would be to seek to prevent a party from invoking a hardship clause upon the occurrence of adverse economic consequences the risk of which he must fairly be regarded as having assumed at the time he entered into the contract. One approach may be to use a general term to quantify the required degree of seriousness, e.g., that the change of circumstances must have caused "a substantial financial burden" or "undue prejudice" to the party invoking the clause. A preferable approach may be to quantify the seriousness in a more specific manner, e.g., by providing that the change of circumstances must result in cost increases which exceed a specified percentage of the price.

2. **Exhaustive list of events**

12. The parties may wish to provide that a party may invoke the hardship clause only if he establishes that one or more of the events enumerated in an exhaustive list has occurred and has resulted in hardship to him as defined in the clause. Illustrative examples of events which might be included in a list are a severe reduction in the size of the purchaser's anticipated market for the output of the works, or an increase in the cost of raw materials needed to produce the output of the works which results in a severe reduction in its profitability. Similar events may occur causing hardship to the contractor.

3. **Other possible limitations**

13. The parties may wish to consider the inclusion of a provision that the hardship clause cannot be invoked by a party in respect of an obligation imposed on him if, at the time the hardship occurs, he has already failed to perform that obligation. The application of the clause may also be restricted by providing that it cannot be invoked for a certain period of time after the date the parties entered into the contract. Furthermore, the parties may place a limit on the number of times that a party may invoke the clause, or agree that the clause may be invoked only a specified number of times during a specified time period. Such limitations may reduce the instability which a hardship clause introduces into
C. Renegotiation

14. The hardship clause may provide for the renegotiation of the contract if hardship occurs. The parties may wish to decide whether the contract should obligate them only to participate in renegotiations with a view to adapting the contract, or should obligate them to adapt the contract after renegotiations. The parties may at the time of entering into the contract, or subsequently, agree upon a conciliator who could assist them in an independent and impartial manner in their attempt to adapt the contract (see chapter XXIX, “Settlement of disputes”, paragraphs 12 to 15). If the contract obligates the parties to adapt the contract after renegotiations, it may be desirable to provide that, upon a failure by the parties to reach agreement on adaptation, the contract is to be adapted by a court, arbitral tribunal or referee (see paragraph 23, below).

1. Procedure for renegotiation

   (a) Notification

15. The contract may provide that a party may invoke the hardship clause only by notification in writing to the other party. It may be provided that the notification must be made within a specified period of time after the occurrence of the change of circumstances relied upon as constituting hardship, must set forth sufficient detail concerning the change of circumstances and its consequences to enable the other party to evaluate the effects of the change, and must indicate the nature of the adaptation sought by the party invoking the clause.

16. The party notified may be obligated to respond in writing within a specified period of time of the notification. It may be provided that, if he considers that the grounds set out in the notification are not sufficient to justify renegotiations, he must set forth in the response the reasons for that conclusion. If he is willing to participate in renegotiations, he may be obligated to indicate the nature of an adaptation of the contract which he considers to be appropriate.

17. The parties may wish to provide that, if the party entitled to invoke the hardship clause fails to give the required notification within the specified period, he loses his right to invoke the clause. This approach may reduce belated claims of hardship made with a view to avoiding the performance of obligations which have become onerous. Alternatively, the parties may provide that a party who fails to give the required notification in time remains entitled to invoke the clause, but is liable to compensate the other party for losses resulting from the delay in notification.

   (b) Time-limit for renegotiation

18. It is advisable for the contract to determine the point of time at which a failure, to agree on adaptation of the contract after renegotiations may be deemed to occur. The contract may provide that a failure occurs if no agreement is reached within a specified time period after notification of a hardship situation.

   (c) Guidelines for renegotiation

19. The parties may wish to facilitate the implementation of a hardship clause by providing guidelines to assist them in reaching a fair adaptation of the contract. They may, for example, provide that the original terms of the contract are to be modified only to the extent required to rectify the imbalance in the contract created by the hardship event. Other guidelines which may be provided include the following: that the principle of good faith should apply in determining the required adaptation; that adaptation should seek to ensure full performance of contractual obligations to the extent possible; that there should be no undue prejudice to either party arising from the adaptation; and that the adaptation should seek to maintain the pre-existing balance of interests between the parties.

20. The circumstances which changed and created the hardship may change once more and approximate to, their previous condition, thereby alleviating the hardship. The contract may provide that the likely duration of the change
of circumstances is to be taken into account when adapting the contract, and that the adaptation should, to the extent possible, indicate how the contract is to be re-adapted if circumstances return to their previous condition.

(d) Status of obligations during renegotiation

21. The parties may wish to determine the status of the contractual obligations of the parties during renegotiations. Where the parties are obligated only to participate in renegotiations with a view to adapting the contract, they may wish to provide that the performance of the obligations of the parties which are alleged to be affected by the hardship is to continue in accordance with the original terms of the contract during the renegotiations. If the parties after renegotiations agree on an adaptation, the terms of the adaptation could make allowance for losses caused to the party affected by the hardship by reason of the continued performance of the obligations during renegotiations.

22. Where the parties are obligated to adapt the contract after renegotiations (see paragraph 14, above), one of two approaches may be adopted. The contract may provide that the performance of the obligations of the parties which are alleged to be affected by the hardship is to continue both during the renegotiations and, if the parties fail to agree on adaptation, during the ensuing dispute settlement proceedings, unless the court, arbitral tribunal or referee settling the dispute decides otherwise. The terms of the adaptation could make allowance for losses caused to the party affected by the hardship by reason of the continued performance of the obligations. Providing that performance is to continue may reduce the making of spurious claims of hardship by a party who wishes to avoid the performance of certain obligations. An alternative approach is for the contract to provide that the party invoking the hardship clause is entitled to interrupt the performance of the obligations alleged to be affected by the hardship. The terms of the adaptation could settle in what manner, if at all, those obligations are to be performed subsequent to the adaptation. If it is decided in dispute settlement proceedings that the party invoking the hardship clause had no right to invoke the clause, it may be provided that the other party is entitled to be compensated for losses caused to him by the interruption. Providing for the interruption of the performance of obligations might make it easier to adapt the contract, as continued performance may result in prejudice to the party affected by the hardship, and it may be difficult to remedy the prejudice by adaptation.

2. Failure to fulfil obligation to adapt

23. Where the contract obligates the parties to adapt the contract after renegotiations (see paragraph 14, above), it is advisable for the contract to provide for the consequences of a failure to agree on adaptation. The contract may provide that the party invoking the hardship clause is entitled to institute judicial or arbitral proceedings for the adaptation of the contract, or may provide that a referee is to decide whether and in what way the contract is to be adapted. These methods of resolving the dispute between the parties are dealt with in chapter XXIX, “Settlement of disputes”. The parties should be aware that some legal systems do not permit adaptation in judicial or arbitral proceedings.

Referring Principles:

IV.6.8 - (Re-) Negotiation agreement / clause (pactum de negotiando)

VIII.1 - Definition