Force majeure and hardship

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INTRODUCTION

A basic and universally accepted principle ofcontract lawis “ pacta sunt servanda.” This principle means that each party to an agreement is responsible for its non-execution, even if the cause of the failure is beyond his power and was not or could not be foreseen at the time of signing the agreement. The principle reflects natural justice and economic requirements because it binds a person to their promises and protects the interests of the other party. Since effective economic activity is not possible without reliable promises, the importance of this principle has to be emphasized.

On the other hand, practice has demonstrated that on many occasions application of this principle may lead to the opposite of its aim. That is to say, the situation existing at the conclusion of the contract may subsequently have changed so completely that the parties, acting as reasonable persons, would not have made the contract, or would have made it differently, had they known what was going to happen. This situation is unlikely to arise with short-term contracts, which often exhibit a simple structure where non-performances are exchanged for money. In international trade, however, many contracts are of a more complicated structure, and even if they are not long term contracts, they frequently exist over a substantive period. International trade transactions generally imply a greater element of uncertainty because they are subject to political and economic influences in foreign countries.

Different legal concepts deal with this problem of changed circumstances and provide for the discharge of the duty to perform of one or both parties when a contract has become unexpectedly onerous or impossible to perform.

The classic concept of force majeure is primarily directed at settling the problems resulting from non-performance, either by suspension or by termination. Concepts like imprévision or hardship are mainly directed at the adaptation of the contract.

Although all legal systems take notice of the situation of changed circumstances, the conditions under which they allow the defence of force majeure vary. Furthermore, the adaptation of the contract is not universally accepted. Attempts have been made to tackle these problems on an international level. In particular, the United Nations Convention on Contracts for the International Sale of Goods (CISG) addresses the issue of changed circumstances. It avoids reference to the existing concepts because it has developed a system of its own. This concept, however, is generally not regarded as being able to solve the problem entirely. Parties to international sales transactions, therefore, frequently include special clauses in their contracts dealing with matters of hardship and force majeure.

This paper aims to give some idea of the concepts of hardship and force majeure in the context of international sales transactions. First, the concepts will be discussed on a theoretical basis. The different approaches to the situation of changed circumstances in the major legal systems will then be discussed. Article 79 of the CISG will be introduced, interpreted, and its scope determined. It will then be possible to ascertain if, to what extent, and what kind of clauses dealing with the matter of changed circumstances, should be inserted into international sales contracts. Force majeure and hardship clauses will then be discussed in more detail. Finally, the use of standard forms of contract, with special regard to the UNIDROIT Principles of

International Commercial Contracts, will be considered, and a recommendation as to force majeure and hardship clauses will be made.

FORCE MAJEURE AND HARDSHIP – THE CONCEPTS IN GENERAL

The two major legal concepts dealing with the problem of changed circumstances are those of force majeure and hardship. In order to understand the interpretation and discussion of Article 79 of the CISG and the deliberations on force majeure and hardship clauses in international sales contracts, the two concepts first have to be considered on a general and theoretical basis.

1. Force majeure

The concept of force majeure, providing for the discharge of one or both parties when a contract has become impossible to perform, “ has evolved progressively in international trade practice by assuming many original and autonomous features distinct from similar legal concepts.” The approach of municipal legal systems to situations of force majeure varies from country to country. Despite these circumstances, certain general characteristics of the conception of force majeure can be determined.

The roots of the classic concept lie in the Code Napoleon, from which the words force majeure (an irresistible compulsion or coercion) are taken. An English court’s interpretation of the words held that they have a more extensive meaning than “ act of God” or “ vis major.” “ Act of God” is defined as an event happening independently of human volition, which human foresight and care could not reasonably anticipate or avoid. According to the judgment, the words force majeure could cover the

dislocation of a business due to a universal coal strike or accidents to machinery, but would not cover bad weather, football matches, or a funeral. In Brauer & Co. v. James Clark it was held that a party could not rely on force majeure simply because the price it was required to pay for the goods was considerably in excess of the price at which it had contracted to sell them.

In more general terms, it can be said that force majeure occurs when the performance of a contract is impossible due to unforeseeable events beyond the control of the parties. The following is a possible definition of force majeure:

Force majeure occurs when the law recognizes that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which the performance is called for would render it impossible. I promised to do this but I cannot due to some irresistible unforeseeable and uncontrollable event.

A similar definition is contained in Article 7. 1. 7 of the UNIDROIT Principles of International Commercial Contracts where, under the headline of " Force majeure," it is stated that a party's non-performance is excused if that party proves that the non-performance was due to an impediment beyond its control, and that it could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome the impediment or its consequences.

The aim of the classic concept of force majeure, as is reflected in Article 7. 1. 7 of the UNIDROIT Principles, is to settle the problems resulting from non-performance either by suspension or termination.

2. Hardship

The concept of hardship is usually discussed in the context of hardship clauses, which are frequently introduced into contracts in international trade. The term “ hardship,” however, has also been used in legislation, e. g., in the Australian National Security (Landlord and Tenant) Regulations and the Landlord and Tenant (Amendment) Act 1948-1964. With respect to those rules, courts had to interpret the term “ hardship” and determine its scope. Thus, it was held that hardship, as used in the National Security Regulations, may be regarded as the subjective effect of a detrimental nature upon the person concerned. In another decision interpreting the Landlord and Tenant Act, hardship was said to include any matter of appreciable detriment whether financial, personal or otherwise.

The circumstances in which hardship generally exists (as usually set out in hardship clauses) normally incorporate three elements. First, the circumstances must have arisen beyond the control of either party; self-induced hardship is irrelevant. Second, they must be of fundamental character. Third, they must be entirely uncontemplated and unforeseeable.

A clear descriptive definition of hardship is contained in the UNIDROIT Principles. It reads as follows (Article 6. 2. 2):

There is hardship where the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of a party’s performance has increased or because the value of the performance a party receives has diminished, and

1. the events occur or become known to the disadvantaged party after the conclusion of the contract;
2. the events could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract;
3. the events are beyond the control of the disadvantaged party; and
4. the risk of the events was not assumed by the disadvantaged party."

The concept of hardship intends to solve problems of such fundamentally altered circumstances by adapting the contract to the new situation.

3. Differences between the two concepts

The concepts of hardship and force majeure seem to be related to each other, particularly since they share some features: they both cater to situations of changed circumstances. The difference between the two concepts is most aptly described in such a way: 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 . . . the party concerned has become impossible, at least temporarily. Moreover, there seems to be a functional difference between the two concepts. Hardship constitutes a reason for a change in the contractual program of the parties. The aim of the parties remains to implement the contract. Force majeure, however, is situated in the context of non-performance, and deals with the suspension or termination of the contract.

DIFFERENT APPROACHES OF DOMESTIC LEGAL SYSTEMS

The approach of municipal legal systems to the problem of changed circumstances varies from country to country. Although all these concepts

are related to each other, since they share important features, the distinction between them is extremely important in drafting choice of law clauses in international contracts. Furthermore, it is important to have knowledge about the law that will apply when a force majeure or hardship clause is left out of a contract, and no unified international rules are applicable. Moreover, in order to have relevance and serve a purpose, force majeure and hardship clauses should differ from the doctrine that would be applicable to the problem of changing circumstances, if such clauses were left out of the contract. Thus, the scope of those doctrines has to be determined.

The illustration and comparison of force majeure and hardship will also give a deeper insight into the structure and functioning of these concepts in general. For this purpose English, American, French, German and South African law and their approaches to the situation of changed circumstances will now be analyzed.

1. England

“ Consistent with the common law approach to strict liability for breach, the traditional common law rule was that conditions rendering performance impossible, that occurred after the execution of a contract, did not excuse performance.” The reason for this was stated inParadine v. Janewhere the King’s Bench held that:

“ When the party by his own contract creates a duty or charge upon himself, he is bound to make it good, if he may, notwithstanding any accident by inevitable necessity, because he might have provided against it by the contract.”

Such a rigid interpretation prevailed in the United Kingdom until 1863. InTaylor v. Caldwell the court changed its traditional opinion: the strict rule should only apply when the contract is positive and absolute, and not subject to any condition either express or implied. The court held that in contracts where performance depends on the continued existence of a given person or thing, “ a condition is implied that the impossibility of performance arising from the perishing of the person or thing shall excuse the performance.” With this theory of implied condition, the doctrine of impossibility was introduced into English law.

The concept of frustration, which developed from the doctrine of impossibility, is based on the sole interpretation of the intent of the parties. If stemming from an act of God, “ the performance of a contract is to take place under circumstances which are totally different from what the parties envisaged, and therefore, the agreement is frustrated.” The concept originates from the famousCoronation cases. For instance, in one such case, an apartment was rented for one day because it afforded a privileged view of the Coronation parade of Edward VII. When the parade was cancelled due to the King’s illness, the landlord sued for the rent. The court, however, decided the contract was frustrated because its execution was fundamentally and essentially different from what the parties had intended.

According to the doctrine of frustration, the concept dealing with situations of changed circumstances in English law today, a contract can be frustrated by impossibility, physical, e. g., destruction of the subject-matter, or for legal reasons, e. g., illegality, or by the occurrence of a radical change in circumstances, so that the foundation of the contract has been vitiated. If

the contract were to retain its validity under such changed circumstances, it would amount to a new and different contract. The doctrine, by covering situations which do not amount to the impossibility of the performance is thus wider than the concept of force majeure. When a contract is frustrated, a judge cannot amend or adjust it to the new situation. Frustration simply discharges the contract. Although the prerequisites of frustration are rather similar to those required by the concept of hardship, the former is final, by disallowing the adaptation of the contract, directed at another aim.

2. United States

Also based on the doctrine of impossibility and its further developments, the United States' doctrines regarding changed circumstances are carefully defined in both the U. S. Restatement (Second) of Contracts and the Uniform Commercial Code. Section 261 of the Restatement (Second) is entitled " Discharge by Supervening Impracticability" and reads as follows:

" Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event, the non-occurrence of which was a basic assumption in which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary."

The Uniform Commercial Code, in Section 2-615, entitled " Excuse by failure of presupposed conditions" also employs the term " Impracticable." In both statutes this term encompasses " impossible." The relevant paragraph of U. C. C. Section 2-615 reads:

“ Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance: (a) Delay in delivery or non-delivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not in breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was the basic assumption on which the contract was made or by compliance in good faith with any foreign or domestic governmental regulation or order whether or not it later proves to be invalid.”

U. C. C. Section 2-615 Paragraph (b) contains an allocation requirement in the event only part of a seller’s capacity to perform is affected. Paragraph (c) states a notice requirement. According to its wording, U. C. C. Section 2-615 only excuses the seller from the delivery of the goods contracted for. The general belief, however, is that this provision is to be considered equally applicable to buyers.

The concept of commercial impracticability, which discharges a party’s duty although the event has not made performance absolutely impossible, has been adopted in order to call attention to the commercial character of the context in which the excuse defence is used. Courts, however, have been reluctant to accept anything short of impossibility as an excuse for performance. The United States’ approach to situations of changed circumstances is broader than that of the classical concept of force majeure. The United States’ approach does not allow the adaptation of the contract and because of the court’s way of treating “ impracticability,” it is not as far-reaching as the concept of hardship.

3. France

Under French law, the line is drawn between the impossibility of the performance on the one hand, i. e., force majeure, and, on the other hand, circumstances which destabilize the contract where economic conditions are such that fundamental and far-reaching changes occur. The latter is called the doctrine of imprévision.

In France, the principle pacta sunt servanda (as incorporated in Article 1134 of the French Civil Code) prevails over the principlerebus sic stantibus. If the contract does not contain any provision regarding events of changing circumstances, then, the performance of the contract will be enforced without any changes to the contract. A judge is not supposed to appraise the economic situation of the parties or to rule in equity against the wording of a contract. In principle, the only excuse for non-performance of the contract is force majeure. The doctrine of imprévision has not been adopted by French courts.

Article 1142 of the French Civil Code stipulates that any obligation to do, or not to do, is dissolved by damages whenever the debtor does not execute the obligation. Article 1148, however, specifies that damages are not due in the case of force majeure. While courts have applied those Articles strictly, some change and more flexibility is noticeable in recent case law. Although courts do not apply the doctrine of imprévision, they have not explicitly rejected it.

The application of Article 1148 requires four conditions to be fulfilled simultaneously:

1. the event is “ irresistible” (this clearly distinguishes the force majeure from imprévision):
2. the event must be unforeseeable:
3. the event is to be an outside one: The failure of suppliers or subcontractors or associates is no excuse for the contractor:
4. the debtor is not at fault: The event should be unavoidable and absolutely beyond the control of the debtor.

“ Article 1148, in recognizing that a contract can be discharged due to force majeure, is not mandatory law. Parties are free to give their definition to force majeure events and the judge has to respect such definition.”

As the roots of the classical concept of force majeure lie in the Code Napoléon, this concept and the present approach to the problem of changed circumstances in France, correspond widely. A greater degree of flexibility in the latter has only been noted recently. The doctrine of imprévision is the counterpart of the concept of hardship. The former, however, is not part of French law.

4. Germany

The German approach to the problem is rather flexible. Under German law, the rulepacta sunt servandais certainly not adhered to anymore in the strictest sense. This is not surprising in a country where, after World War I, the value of the items on the menu in a restaurant could change between the placing of the order and the arrival of the bill.

As a general rule, section 275 of the Bürgerliches Gesetzbuch discharges the debtor of his obligation if, after the conclusion of the contract, its

performance was rendered impossible for reasons other than negligence, his own fault, or the negligence of his employees. The impossibility of performance (“ Unmöglichkeit”) can be of a physical or legal nature. The performance may still be possible at a later time without unreasonable damage to the other party.

As a consequence of World War I, some judges and legal scholars began advocating the doctrine of Unmöglichkeit for application to economic impossibility. According to such experts, the debtor cannot be forced to comply with efforts or sacrifices which are beyond what parties reasonably envisaged in good faith. This doctrine is called “ Opfergrenze.”

“ The doctrine of Opfergrenzeis a suitable stepping stone to the famous German doctrine of the Wegfall der Geschäftsgrundlage. According to the latter doctrine, every contract has a basic aim, emanating from a basic intention of the parties, which cannot be achieved or realised in the absence of an existing environment, e. g. the prevailing economic and social order, the value of the currency, normal political conditions, etc. This definition of the Geschäftsgrundlage bears close resemblance to therebus sic stantibus doctrine in international public law treaties.”

A line should be drawn between the so-called “ erg *ä* nzende Vertragsauslegung” (an interpretation of the contract which fills gaps) and the Geschäftsgrundlagenlehre. According to the former, which requires a gap in the contract, the function of the judge is to complete the contract, whereby he should give an interpretation of what the parties actually would have wanted if a given event had been contemplated. According to

theGeschäftsgrundlagenlehre, the judge is not only allowed to complete a contract, but depending on the object of the contract, the judge can also change its terms or terminate it.

There is a little difference – and if so, not an essential difference – between the reasoning in the classical force majeure concept and the German reasoning in the Unmöglichkeit. Furthermore, the doctrine of the Wegfall der Geschäftsgrundlage, aiming at an adaptation of the contract, is very similar to the concept of hardship.

5. South Africa

Until 1919, there was a general assumption that . . . no difference between South African law and English law on the effect of supervening impossibility. The English approach was adopted in a number of cases until the case ofPeters, Flamman and Co v. Kokstad Municipality was decided. According to this case, " if a person is prevented from performing his contract byvis majororcasus fortuitus. . . he is discharged from liability."

In applying the principle that supervening impossibility discharges the contract, impossibility must be given the same meaning as when initial impossibility is under consideration, i. e., the impossibility must be absolute (as opposed to probable and relative) and it must not be the fault of either party. Most important is the fact that, ifvis majororcasus fortuitushas made it uneconomical for a party to carry out its obligations, it does not mean that it has become impossible. Additionally, sincePeters, Flamman and Co. there is no room in South African law for the English doctrine of frustration.

The decision in the recent case of Kok v. Osborne and Another, however, could be a first step toward recognition of the concept of commercial impossibility in South African law. The plaintiff in this case (Mrs. Kok) entered into a contract of sale as the buyer . . . wrongly assumed that the seller had already been paid by a third person. The court held that the contract between the litigants hinged on the assumption that the defendant indeed had been paid, which in fact did not happen, and that the contract failed due to supervening impossibility of performance. In this case, the court’s opintion was that South African law recognises commercial impracticability as a form of supervening impossibility as does the English.

This decision, however, has been heavily criticised by commentators for different reasons. As a result, the doctrine of frustration under the English law is not a recognised part of South African law. Moreover, it is properly stated that supervening impossibility is not applicable in the present case. For these reasons, it is not likely that the case of Kok v. Osborne and Anotherconstitutes the starting point for a change in the South African approach to the problem of changing circumstances.

Thus, one can conclude that the South African approach corresponds with the concept of force majeure. Situations of hardship do not discharge a party of its liability.

ARTICLE 79 CISG

Article 79 is the provision of the CISG, that deals with situations of changed circumstances. More precisely, it deals with the circumstances in which the buyer or seller may be excused from performance of his contractual

obligations because of an extraneous event that is judged sufficiently important to warrant the excuse. This is a situation which is referred to as frustration, force majeure or Wegfall der Geschäftsgrundlagein different legal systems.

In subsequent chapters the legislative history of Article 79 and its significance for international trade will be outlined. Its contents, scope of application, and legal effect will also be analysed and evaluated.

A. The significance of the CISG for international sales transactions

Never before has the increase in international commerce been as significant as it has been during recent decades. Many difficulties occur in the context of an international sale of goods as a consequence of the considerable differences in the national rules governing the law of sales. Thus, the expanding volume of international sales requires a common understanding of the legal rights and duties among partners to an international transaction.

The CISG is understood as a modern uniform substitute for the wide array of foreign legal systems. It is based on the Uniform Law for the International Sale of Goods (ULIS) and the Uniform Law on the Formation of Contracts for the International Sale of Goods (ULF), drafted by the " Rome Institute." These two Conventions had a rather limited success; only nine countries have become members. The United Nations Commission on International Trade Law (UNCITRAL), therefore, in a further attempt to unify the law governing the international sale of goods, prepared the Draft Convention on Contract for the International Sale of Goods. This was finalised at a diplomatic conference in Vienna in 1980 and entered into force in 1988.

Nations are now ratifying or acceding to this Convention at a pace comparable to that of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards when it was promulgated. The latter is said to be the most successful instance of international legislation in the history of commercial law. The CISG harmonised interests and ideas of different legal systems and of countries on different levels of economic development. Thus, a text that is suited for implementation in civil law countries and common law countries and for economies that are developed and those which are developing.

According to Article 1, the Convention applies to international contracts for the sale of goods (if the parties have not rejected its application in their contract – Article 6) when the States where the parties have their places of business, are in different contracting states, or the rules of private international law lead to the application of the law of a Contracting State. As more than fifty countries have already enacted the Convention, among them major trading nations like the United States, Germany, France, or China, the Convention can apply to a large number of transactions. This number will continue to increase with the accession of further countries to the CISG. Only ten years after entering into force, the Convention can already be considered a success. Its significance for international sales transactions will increase in future years.

B. Legislative history of Article 79

1. The role of legislative history

As previously discussed, the CISG was created to free international commerce from a babel of diverse domestic legal systems. The ultimate goal of the Convention is the uniform application of the uniform rules.

The Convention will often be applied by tribunals (judges or arbitrators) who are only intimately familiar with their own domestic law. These tribunals will be subject to a natural tendency to read the international rules in the light of the legal ideas of those specific systems. In order to control the damage, there will be long-range correctives through international critique of questionable interpretations; to this end measures have been taken for the collection and publication of caselaw produced under the Convention, e. g., CLOUT (Case Law On UNCITRAL Texts). These measures, however, take time to become effective. Fortunately, there need not be a delay in using the legislative history, which sets out the evolution of the uniform law, to counteract the tendency to view the Convention through the lenses of domestic law. The Convention’s legislative history provides an international reference point in applying the uniform international law, and its record clarifies the purpose and intent of the Convention’s words.

2. The evolution of Article 79

Article 79 is a revised version of the exemption clause in ULIS (Article 74). Its development, as a part of the CISG, went through three stages: (1) The UNCITRAL Working Group (1970-1977); (2) Review by the full Commission (1977-1978); (3) The Diplomatic Conference (1980).

Article 74 ULIS was criticised during the discussions of the Working Group. The clause was thought to make it too easy for the promisor to excuse his non-performance of the contract. Grounds for relief were not only physical or legal impossibility, or circumstances which fundamentally altered the character of the performance owed, but the provision could also apply to situations where performance had unexpectedly been made more difficult. Several members of the Working Group were, therefore, in favour of restricting the grounds for relief and making them more objective. The Working Group set up a drafting party, but it could not agree on a revised wording. It submitted a draft which was provisionally adopted by the drafting party (Alternative A) and an alternative proposal of the Norwegian observer (Alternative B).

Following a study by the British delegate, the Working Group adopted a version which largely followed Alternative A. This based the promisor's liability on fault, but transferred the basic concept of the " impediment" taken from Alternative B into the first paragraph. The version was adopted as Article 50 in the 1976 Geneva Draft.

In reformulating the grounds for exemption in Article 51 of the 1977 Vienna Draft, the former Article 50, the requirement of the promisor not being at fault was abandoned and replaced by an objective test of the " impediment beyond control." The 1978 New York Draft adopted Article 51 of the Vienna Draft relatively unchanged as Article 65.

At the Vienna Conference, the Norwegian delegation proposed that paragraph (3) be supplemented by stating that if a temporary impediment

ceased and the circumstances had radically changed to such an extent that it would clearly be unreasonable to continue to hold the promisor to his obligation, he should be released from that obligation. It was, however, argued that such an extension would introduce the théorie de l’imprévision into the Convention, and the proposal was therefore rejected. There was, nevertheless, agreement that the limitation in paragraph (3) should be deleted, i. e., that an exemption was “ only” for the period during which the impediment existed.

Contents of Article 79 CISG

The meaning and purpose of the different provisions of Article 79 will now be considered in more detail.

1. The general rule – paragraph (1)

Paragraph (1) sets out the conditions under which a party is not l