The effect of a change of circumstances on the binding force of contracts

Comparative perspectives

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Comparative perspectives

Het effect van veranderde omstandigheden op de bindende werking van contracten: een rechtsvergelijkend perspectief
(met een samenvatting in het Nederlands)

El efecto de un cambio de circunstancias en la fuerza obligatoria del contrato. Perspectivas en derecho comparado.
(con resumen en español)

Proefschrift

ter verkrijging van de graad van doctor aan de Universiteit Utrecht op gezag van de rector magnificus, prof.dr. G.J. van der Zwaan, ingevolge het besluit van het college voor promoties in het openbaar te verdedigen op vrijdag 27 mei 2011 des middags te 12.45 uur

door
Rodrigo Andrés Momberg Uribe
geboren op 18 december 1972
te Osorno, Chile

Promotor: Prof.dr. E.H. Hondius

In loving memory of my mother, Nancy
Your light always shines on me

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While sitting just in front of my desk, with such a beautiful view of the Utrecht Dom, thinking that my stay and work in the Netherlands is becoming to an end makes me feel a complex mixture of sadness and satisfaction. Sadness because this wonderful stage of my life is closed, but satisfaction because is ending successfully.

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ABBREVIATIONS

AC	Appeal Cases
All ER	All England Reports
App.Cas.Law	Reports Appeal Cases
BGB	Bürgerliches Gesetzbuch
BW	Burgerlijk Wetboek
Bull.civ.	Bulletin des arrêts de la cour de cassation rendus en matière civile
Cám. Civil	Cámara Civil
CCiv. y Com.	Cámara Civil y Comercial
CNFed. Civ. y Com.	Cámara Nacional de Apelaciones en lo Civil y Comercial Federal
CA	Cour d'appel, Court of Appeal
CApel.	Corte de Apelaciones
Cass	Cassation; Cassazione
CE	Conseil d'Etat
CISG	United Nations Convention on Contracts for the International Sale of Goods
CNCiv.	Cámara Nacional de Apelaciones en lo Civil de la Capital Federal
CS	Corte Suprema (Argentina)
CNCom	Cámara Nacional de Apelaciones en lo Comercial de la Capital Federal
CNEsp., Civ. y Com.	Cámara de Apelaciones en lo Civil y Comercial
D	Recueil Dalloz
DCFR	Draft Common Frame of Reference
DP	Dalloz Periodique
Eng Rep	English Reports
F.	Federal Reporter
F. 2nd	Federal Reporter, 2nd Series
F.Supp.	Federal Supplement
F. Supp. 2d	Federal Supplement, 2nd Series

Abbreviations

Foro amm.	Il Foro Amministrativo
Foro it.	Il Foro Italiano
Giust. civ.	Giustizia Civile
Giust. civ. mass.	Giustizia Civile Massimario
ICC	International Chamber of Commerce
I.C.J Reports	International Court of Justice Reports
I.L.M.	International legal materials
JCP	Jurisclasseur périodique
JNCiv.	Juzgado Nacional de Primera Instancia en lo Civil
KB	King's Bench
L.R.C.P.	Law Reports Common Pleas Cases
L.R.Eq.	Law Reports Equity
Lloyd's Rep.	Lloyd's Law Reports
N.E.2d	North Eastern Reporter, 2nd Series
N.Y.S. 2d	New York Supplement, 2nd Series
N.W.2d	North Western Reporter, 2nd Series
P.	Pacific Reporter
P.2d	Pacific Reporter, 2nd Series
P.3d	Pacific Reporter, 3rd Series
PECL	Principles of European Contract Law
PICC	UNIDROIT Principles of international Commercial Contracts
Q.B.	Queen's Bench
Q.B.D.	Queen's Bench Division
RDC	Revue des Contrats
Riv. dir. comm.	Rivista del Diritto Commerciale e del Diritto Generale delle Obbligazioni
RTDCiv	Revue trimestrielle de droit civil
RDJ	Revista de Derecho y Jurisprudencia
SC Buenos Aires	Suprema Corte de Justicia (Buenos Aires)
S.E.2d	South Eastern Reporter, 2nd Series
S.W.2d	South Western Reporter, 2nd Series
S.W.3d	South Western Reporter, 3rd Series
UCC Rep. Serv. (CBC)	Uniform Commercial Code Reporting Service (Callaghan)
U.S.	United States Reports
WLR	Weekly Law Reports

PART I

INTRODUCTION AND HISTORICAL PERSPECTIVES

Chapter 1

Non haec in foedera veni.
It was not this that I promised to do.[1]

INTRODUCTORY REMARKS

1. The origin of this research

1.1. The same facts: the natural gas crisis

In 1995 Chile and Argentina signed an international economic agreement (*Protocolo de Integración Gasífera entre Chile y Argentina,* 1995), by which the trade in Argentinian gas to Chile was liberalized. Under this agreement, Argentina guaranteed the amount of gas needed to supply the necessities of the Chilean electricity-generation companies. Besides, the principle of 'non-discrimination' was established in the sense that Argentina was bound to meet Chilean requirements and its own domestic demand on an equal basis. In 2004, because of political and domestic economic circumstances, this agreement was not complied with by Argentina and the supply of natural gas to Chile was severely reduced. In 2005 the reduction reached a peak of 80%. As a consequence, a large number of electricity generation companies had to rely on other much more expensive sources (such as coal, fuel oil or diesel, the international price of which had increased at the same time as the gas restrictions) to produce electricity with the subsequent severe increase in generation costs.[2]

1 Lord Radcliffe in *Davis Contractors Ltd v. Fareham Urban District Council* [1956] A.C. 696 at 729. The quotation is taken from Virgil (Aen. iv. 338/9).

2 The increase in the cost of energy amounted to 230% to 400% for those companies which had to change their source from gas to fuel oil or diesel.
See http://www.economiaynegocios.cl/especiales/crisisdelgas_2005/01_la_crisis_afectados_00.htm.

1.2 …But two contradictory decisions

With the above-mentioned factual background, the outcome of two arbitral decisions was reported by the Chilean press on 2007 and 2008.[3] In both cases, the affected party (two electricity-generation companies) sought the termination or modification of contracts for the supply of energy, based, among other grounds, on the severe increase in its generation costs due to the unexpected and unforeseen change in the amount of gas supplied by Argentina. One of the juridical bases for the claims was the doctrine of a change of circumstances, known in Chile as *teoría de la imprevisión.*

The decision in the first case was delivered in April 2007.[4] There, the arbitrator accepted the claim for a revision of the contract price based on the occurrence of an unexpected and unforeseeable change of circumstances which affected the structure of the whole electricity market, leading to a serious imbalance in the economic equilibrium of the contract compared to the time when it was concluded.

The second decision, delivered by a different arbitrator in January 2008, took a completely different approach[5]. There, the arbitrator discarded the claim of the affected party who alleged that the Argentinian non-compliance with the international agreement which regulated the trade in gas was as a result of an unexpected and unforeseeable circumstance. On the contrary, the unforeseeable nature of the circumstances alleged by such a party was rejected. The arbitrator stated that the lack of natural gas as a source for the generation of electricity could not be avoided as a possibility for the affected party, considering its experience and sophistication and the magnitude of the investments involved in the agreement.

The contradiction between the outcomes of both decisions, on which the same events were qualified very differently by the arbitrators, as well as the conditions, the assessment of the (contractual or legal) distribution of risks and the remedies available in a case of changed circumstances, reflect the inconsistencies and doubts of Chilean private law concerning the subject-matter of this research.

Those contradictions can also be found in judicial decisions. In 2006, in a case related to a construction contract, the Court of Appeal of Santiago delivered a decision that expressly accepted the application of the doctrine of changed circumstances, stating that such a doctrine was not a danger to the principle of the sanctity of contracts as provided by article 1545 of the Chilean Civil Code,[6] but on the contrary, was an instrument to reinforce

3 Both decisions are examined in detail in Chapter five.
4 *Empresa Eléctrica Guacolda S.A. c/ Empresa Minera Mantos Blancos S.A.*, of 25.04.2007, unreported.
5 *Gas Atacama Generación S.A. c/ Empresa Eléctrica de Antofagasta S.A.*, 24.01.2008, unreported.
6 Article 1545 of the Chilean Civil Code states that '*Contracts lawfully entered into are a law for the contracting parties and cannot be invalidated except by mutual consent or for causes authorized by law.*' (Todo contrato legalmente celebrado es una ley para los contratantes, y no puede ser invalidado sino por su consentimiento mutuo o por causas legales). Author's own translation.

the expectations of the parties as they were at the time of contracting. The decision was considered by one commentator as a landmark judgment in the evolution of Chilean private law.[7]

This enthusiasm did not last. In a decision in September 2009, the Supreme Court expressly and firmly stated that article 1545 of the Chilean Civil Code excludes the possibility to apply the doctrine of a change of circumstances in the Chilean legal system, mainly because, in the absence of an express legal rule, the contract can only be modified or terminated by the parties' mutual agreement and not by the courts.[8]

This hesitancy of Chilean case law in recognizing the doctrine of a change of circumstances is considered by the author to be the result of a lack of a general regulation on the subject, which has led to an absolute prevalence of the *pacta sunt servanda* principle in Chilean private law. The scant legal doctrine on the subject has also collaborated in the undervaluation of the doctrine in legal practice, where lawyers, naturally concerned by the interests of their clients, are reluctant to invoke the doctrine as an action or defence due to its extremely questionable effectiveness in court.

This research, beyond its obvious academic purpose of improving legal knowledge and increasing understanding on the subject through the analysis, comparison and evaluation of the subject-matter in different legal systems, has the initial and main purpose to provide sufficient foundations and grounds for a legislative reform that expressly includes the general regulation of a change of circumstances in Chile. However, as mentioned below, the results of the research are equally applicable to any given legal system dealing with situations as those covered by the research and may therefore be useful not only to national or regional legislators but also to judges and parties involved in cases in which a supervening and unforeseen change of circumstances has severely altered the performance of the contract.[9]

2. *Pacta sunt servanda* and *Rebus sic stantibus*

The subject of a change of circumstances, hardship, *eccessiva onerosità*, *Wegfall der Geschäftsgrundlage* or *imprévision*, i.e. the situation where the performance of the contract has become excessively onerous or difficult for one of the parties due to unforeseen circumstances after the conclusion of the contract, is a polemic and controversial one. It is frequently introduced as a conflict between principles (*pacta sunt servanda* and *rebus sic stantibus*) or values (certainty and justice). Both under the civil and common law a large

7 *Guillermo Larraín Vial con Servicio de Vivienda y Urbanización de la Región Metropolitana*, Corte de Apelaciones de Santiago, 11.11.2006. See Alcalde Rodríguez (2007). However, others were not so enthusiastic, especially because of the evident flaws in the decision. For a detailed analysis see Chapter five.

8 *South Andes Capital S.A. c/ Empresa Portuaria Valparaíso*, Corte Suprema, 09.09.2009, rol 2651–08.

9 See Steyn (2007) stating at p. 4 that 'English judges, like their continental colleagues, regard comparative law as an essential tool in adjudication. Courts now are not only willing to consider comparative materials but expect practitioners to research and produce such materials.'

amount of scholarly writing has been produced, and judicial decisions (especially from the superior courts) are always subject to critical reviews and comments, maybe because the subject is placed at the very heart of contract law concerning the binding force of a promise and its relation with principles of justice, good faith and equity.

The old principle of the law of contract *pacta sunt servanda* provides a starting point for analysing the question. Traditionally, this principle implies the binding force of contractual obligations, except when they are physically impossible. In other words, once a person has assumed contractual liability he cannot escape from this liability on the ground that he has miscalculated the future. *Pacta sunt servanda* seems to be a principle which is accepted by all developed legal systems, in the sense that contractual obligations which are validly concluded must be fulfilled. In its pure formulation, intrinsically related with freedom of contract and the certainty of the law, *pacta sunt servanda* implies that the parties are bound by their agreement and are free to determine the content of their obligations, so 'equality in the values exchanged is immaterial. It is for the parties to make their bargain, not for the courts. The courts are merely concerned with the fairness of the bargaining process, the assumption being that the result of fair negotiations is likely to be substantially fair too.'[10] Thus, the classical view assumes that if the contracting process assures autonomous and informed decisions for the parties, then the results of that process will be socially acceptable: ensuring procedural justice in principle warrants the contract's substantive justice.[11]

Pacta sunt servanda is usually opposed to another principle, *rebus sic stantibus*, by which the binding force of an agreement is subject to the implied condition that the state of affairs present at the time of its conclusion remain the same. However, as extensively examined in Chapter II of this research, both principles have a common origin and were developed from moral considerations as a manifestation of the human will and therefore as part of every promise, not as opposites but as complements.

In addition, nowadays the principle of the sanctity of contracts has been the subject of a number of restrictions and qualifications, derived particularly from the necessity to protect weaker parties, the introduction of fairness and solidarity as countervailing values of autonomy and individualism, and a wide application of the principle of good faith to the whole contractual relationship. Thus, the principle of the conservation of the contract (*favor contractus*) seems to prevail in modern codifications and international bodies of rules, which provide for the revision of a contract if unexpected and extraordinary circumstances disturb the performance of the obligation of one of the parties, thereby making it much more onerous or burdensome.[12] Nevertheless, as this study intends to demonstrate, the issue of changed circumstances is far from being resolved. The comparative survey has

10 Zimmermann (1996), p. 577.
11 von Mehren (1991), p. 49.
12 The paradigmatic example is the German Civil Code (Bürgerliches Gesetzbuch – BGB), which after the reform of 2002 now expressly includes in §313 the doctrine of *Störung der Geschäftsgrundlag* (disturbance of the contractual basis). The New Dutch Civil Code (Burgerlijk Wetboek – BW) of 1992 (article 6:258),

revealed the reluctance of two major European jurisdictions (England & Wales and France) to recognize the doctrine of changed circumstances as an exception to the sanctity of contracts. The same can be said in Latin America with regard to Chilean private law. Additionally, with regard to international contract law it is highly debatable whether the doctrine is recognized in the Convention on Contracts for the International Sale of Goods (CISG); and the recent approach of the Draft Common Frame of Reference (DCFR) on the subject is much more restrictive than that of the Principles of European Private Law (PECL) and the UNIDROIT Principles of International Commercial Contracts (PICC).[13]

3. Scope of the research

It is necessary to clearly delimitate the scope of the research. The subject-matter of the study may be examined or analysed from a wide range of perspectives, including, for instance, law and economics, relational contract theory as well as traditional legal doctrines that are occasionally used in practice to deal with situations similar to a change of circumstances. The relation of this research with some of these approaches is explained on the following sections.

3.1. The concept of long-term contracts. The relational theory of contract

The subject of a change of circumstances is sometimes linked to situations that arise in the context of long-term contracts. It is assumed that in the case of long-term contracts the fact that the performance of the obligations by one or both parties takes place during an extended period of time gives rise to specific problems or difficulties related to the limited capacity of the parties (its so-called bounded rationality) to anticipate the relevant state of affairs that may affect the performance of the contract in the future.[14] In other words, 'the longer the period of time for which the contract is intended to subsist, the more difficult it is to allocate the risks of future events at the moment of entry into the contract.'[15] The idea is also linked to the unavoidable incompleteness of contracts.[16]

In this sense, it has been suggested that a modern codification should include two blocks of general contract law, distinguishing between short-term (or discrete) and long-term contracts.[17] Similarly, it has been stated that the characteristic of a long duration might

the UNIDROIT Principles of International Commercial Contracts (PICC) and the Principles of European Contract Law (PECL) are other examples.

13 Cfr. Basedow (2001), stating that the notion of freedom of contract remained the core idea for a European codification.

14 See Bell (1989), pp. 198-199.

15 McKendrick (1995), p. 307.

16 See Cenini et al., (2009).

17 Cfr. Grundmann (2010), stating at p. 49 that 'the model of long-term relationships has to become a second pillar in general contract law, and the latter can no longer be shaped exclusively on the model of exchange contracts'.

be treated as an independent variable in contract law that justifies the existence of special rules for long-term contracts.[18]

One of the legal theories that have tried to address the mentioned problems is the relational theory of contract, which finds its origins in the ideas developed by Ian Macneil.[19] Although there is no agreement about the concept of relational contract, at least three main characteristics thereof are usually stressed by legal doctrine. First, the relationship between the parties extends over time. Second, that prolonged duration implies that some parts or terms of the agreement cannot be properly defined or determined at the time of the conclusion of the contract. Third, most of the time the effects of the relationship are expanded to third persons who rely upon it, such as customers, suppliers, public bodies, banks and others.[20] In relational contracts, flexibility, cooperation and adjustment are essential to maintain the agreement in line with the inevitable changes that take place during the performance of the contract. A number of relational norms (in the sense of rules of behaviour to be followed by the parties) are derived from these features: contractual solidarity, preservation of the relationship and the harmonization of relational conflict.[21]

It seems clear that the relational theory of contract better matches long-term contracts. The duties of cooperation, good faith, and their consequences (shared gains and losses and the adjustment of the contract to changing surrounding conditions) are easier to elucidate in a complex and extended relationship.

However, the concepts of both long-term and relational contracts are rather elusive and unclear. Concerning the former, in principle by definition the period of performance should be the main parameter for its determination, but the extension of that period is far from clear. Thus, agreements for 15 or more years can clearly be considered to be long-term, but the situation is different for shorter periods, e.g. 3 years. Besides, a long-term relationship is not necessarily the same as a long-term contract. Long-term relationships may include a series of short-term contracts, deferred performance contracts, long-term contracts in a strict sense (contracts with a long performance time) and complex relationships (a framework of extralegal acts and specific contracts). In this sense, it has been stated that the notion of a long-term contract is rather sociological than juridical.[22] Taking into account these difficulties and the fact that a series of successive short-term contracts may be similar in practice to a long-term contract, it has been argued that the duration of the relationship rather than the duration of one or more contracts is the relevant feature to be taken into consideration.[23]

18 Eisenberg (1999), p. 814.
19 Macneil (1980).
20 See Speidel (1999), pp. 823-846.
21 Macneil (1980), pp. 31-69.
22 See Bell (1989), p. 195 ff.
23 McKendrick (1995), p. 307.

With regard to relational contracts, they are opposed to discrete transactions, i.e. those in which no relationship exists between the parties apart from a simple exchange of goods. However, the difficulty in or the absence of a clear definition of relational transactions or contracts has been pointed out by Eisenberg: '…it is impossible to locate, in the relational contracts literature, a definition that adequately distinguishes relational and non relational contracts in a legally operational way…' Eisenberg states that the proper definition of a relational contract is a contract that involves a relationship between the parties, and not merely an exchange. But when 'relational contracts are properly defined, however, and it is recognized that all or almost all contracts are relational, it is easy to see that relational contracts are not a special subcategory of contracts, and therefore should not and cannot be governed by a body of special contract-law rules'.[24] Due to these difficulties, legal doctrine has tended to associate relational contracts with long-term contracts; however, technically, they cannot be considered as equivalent in all cases.[25]

Without paying due regard to the above considerations, it seems that there is no valid reason to protect the debtor in the case of a long-term relationship and to deny such protection to the debtor in a discrete or short-term relationship. For example, there is no valid reason to deny protection to the affected party in the following case: after the conclusion of a sales contract with a fixed price, a serious earthquake affects the place where the utilities of the seller are situated. The obligations of the seller include the delivery of goods within thirty days after the contract date. The contract is silent with regard to the effect of a change of circumstances. The goods which are the subject of the contract have not been destroyed by the earthquake, but major ports and storage facilities have been severely damaged so there is no possibility to deliver the goods by sea, which was the seller's intended method of transportation. The only alternative is air transport, but its price (normally higher than maritime transportation) has increased by more than 200% after the earthquake. As a consequence, the costs for the seller have increased by more than 100%.

In sum, even when the problem of changed circumstances can be a normal occurrence in long-term relationships; based on the mentioned considerations the conclusions and results of this research are intended to be applicable not only to long-term or relational contracts, but to all cases in which supervening and unforeseen circumstances result in a severe burden to the pending performance of an obligation, either derived from a contract or an unilateral act.

3.2. Exclusion of related legal doctrines

The subject-matter of this research are doctrines that directly address the problem of the consequences of supervening and unexpected circumstances on the obligation of the parties, i.e. the effect of an external event rather than an internal flaw in the legal relationship or the construction of the hypothetical intention of the parties. This statement seems to

24 See Eisenberg (1999), p. 817.
25 See Goetz, Scott (1981), p. 1091.

be necessary since, on a practical level, occasionally some traditional legal concepts are used by the courts to deal with situations of changed circumstances. This choice may be explained by the relative weight that the principle of *pacta sunt servanda* has on the specific legal system. Another reason is that the use of traditional legal concepts does not technically imply an exception to that principle, since interference with the contract is mostly explained from an internal perspective, e.g. through defective or incomplete consent, as in the cases of mistake and constructive interpretation respectively.[26]

From a purely doctrinal and theoretical perspective, those traditional legal concepts can be clearly distinguished from the subject-matter of the research. To justify such a statement and the consequent exclusion of those doctrines from the present study, a brief overview of the conceptual differences between them and the subject of the research is provided in this section.

3.2.1. Impossibility, force majeure *and excessive onerousness*

The distinction or actual difference between excessive onerousness and impossibility or *force majeure* is difficult to draw beyond a conceptual definition: in the case of impossibility, performance is prevented by a factual or legal impediment that the debtor cannot overcome by any specific means or efforts. On the contrary, if the obstacle is not insurmountable, technically the situation is not a case of impossibility. There are diffuse limits between impossibility and changed circumstances: in the first case, the structure of the obligation is mutated, therefore turned into a different thing; in the second case, the obligation remains the same, but there is a serious disturbance in the economic equilibrium of the contract.

However, in practice, that distinction is not apparent in all cases. Both concepts deal with unexpected events or circumstances and in both there is a change of circumstances after the conclusion of the contract that severely affects the agreed performance of one of the parties.[27] The case of the destruction of the specific objects which are the subject of the contract and the death or incapacity of the designated person in the case of a service contract are maybe the only clear-cut cases. Borderline cases are usually present when the performance of the contract, even when this is not technically impossible, is so extremely onerous or difficult for the debtor that it is reasonable to release him from the performance which he agreed to.[28]

Thus, common law commentators have argued that *Taylor v Caldwell,*[29] where a music hall was destroyed by a fire just before its scheduled use (six days before the first concert), with no fault on the part of either party; is not strictly a case of impossibility, because the

26 See Hondius, Grigoleit (2010), forthcoming.
27 With regard to *initial* and *supervening* impossibility, only in the latter category is an overlap with the situation of a change of circumstances possible. On the contrary, cases of initial impossibility overlap more frequently with situations of mistake.
28 See DCFR Official comments, p. 711.
29 (1863) 3 Best & S. 826 (Q.B.). See Chapter six for the analysis of the case.

music hall could theoretically have been reconstructed. On the contrary, from a civil law perspective that statement seems to be unjustified and the case can be easily qualified as one of impossibility. Nevertheless, in practice, the determination becomes more an issue of degree rather than kind. Thus, in France, some cases that can be regarded as excessive onerousness have been resolved by the Courts on grounds of *force majeure*.[30]

The qualification of a situation as a case of impossibility or of changed circumstances may have important consequences for the contract or the legal relationship: in the case of impossibility, usually the debtor is released from its obligations with no further responsibility. This all-or-nothing approach may influence the court to determine the case under the rules on changed circumstances rather than under the rules on impossibility.

3.2.2. Mistake and excessive onerousness

Mistake and a change of circumstances have been regarded as sister doctrines, especially because they both deal with the allocation of the risks in the contract and with unanticipated or unforeseen circumstances that affect the obligation of one or both parties.[31]

Nevertheless, on a theoretical level they can be clearly distinguished. In the case of a change of circumstances, the parties have a correct representation of the reality at the time of concluding the contract, but supervening and unforeseen events severely affect the performance of their obligations as they agreed when concluding that contract. In the case of mistake, the representation by the parties of the reality which is present at the time of concluding the contract is incorrect and therefore they consent to the contract under an erroneous assumption. Then, a mistake concerns an erroneous representation by one or both parties about the present or existing circumstances at the time of concluding the contract. Consequently, a mistake deals with antecedent events and a change of circumstances with supervening events.

A clear distinction between the two doctrines can be made in relation to the parties' state of mind. In the case of a mistake, the parties have an affirmative belief in the existence of a certain state of affairs at the time of contracting, but that factual state of affairs does not exist or is essentially different. In the case of a change of circumstances, they do not need to *believe* that the event *will not* occur, i.e. the parties (or at least one of them) did not anticipate the occurrence of the disruptive event at the time of contracting.[32] Exceptionally, some borderline cases may be discerned, especially with events that develop before the conclusion of the contract and its performance, as in *Amalgamated Investment & Property Co Ltd v John Walker & Sons Ltd*[33] where the parties had concluded a contract for the sale of a warehouse to be redeveloped by the purchaser. The seller was aware of the intention

30 See Chapter three for further references.
31 See Kull (1991), stating at p. 1 that 'they represent aspects of the same phenomenon.'
32 See Treitel (2004), p. 9.
33 [1977] 1 W.L.R. 164. See Treitel (2004), pp. 7-12. In American law the situation seems to be different, see Kull (1991) p. 12.

of the purchaser. Before the contract was concluded, the competent public office decided to include the building as one of special architectural historic interest, but the actual listing as a building of historical interest only took place after the conclusion of the contract. As a consequence, the purchaser invoked both the doctrines of frustration and mistake as grounds of relief. Nevertheless, in English common law the case law has stated that mistake is a 'different juristic concept' from frustration, either concerning their conditions as well as their legal effects.[34]

In addition, in most cases a mistake is only regarded as a ground of invalidity if it concerns the subject-matter or other *objectively* relevant or essential element of the contract, but not in cases of erroneous assumptions concerning future developments or the mere expectations or motives of the mistaken party. Nevertheless, some civil law jurisdictions recognise the invalidity of a contract on the ground of a mistake concerning the motives of one of the parties for entering into the contract, but only where those motives were the main reason for that party entering into the agreement and that was (at least) known by the other party. This is for instance the case in France and in Chile (article 1454 of the Civil Code).

With regard to the legal effects, in civil law countries, a mistake is usually expressly regulated as a ground for the invalidity of contracts, being considered as one of the vices of consent (*vices de consentement*). It is explicitly regarded as a vice in the Civil Codes of Italy (articles 1427 to 1440, *Del vizi del consenso*), Chile (articles 1451 to 1455) and Argentina (article 1045). The French *Code Civil* includes mistake (*erreur*) as a ground for no valid consent (article 1109) and even no contract at all in the case of the so-called *erreur obstacle*. Similarly, the PECL, the PICC and the DCFR also include provisions on mistake in the chapter devoted to the validity of contracts.

On the contrary, in a case of changed circumstances, there is no defective consent and therefore the validity of the contract is not in question. Where expressly regulated, the provisions on a change of circumstances are placed in the sections on the general provisions of the law of contract or are related to the effects of contractual obligations.

3.2.3. Laesio enormis *and excessive onerousness*

The origin of the doctrine of *laesio enormis* can be traced back to the Roman law concept of 'just price', which was turned into a general principle of contract law by canon law in the Middle Ages. By this doctrine, a contract may be avoided if there is great disproportion in value between the reciprocal obligations of the parties. However, with the emergence of the market economy and the liberal laissez faire doctrine, the concept of just price lost its

34 See Treitel (2004), p. 12.

influence and therefore the doctrine of *laesio* was either not recognized or only allowed in specific cases by the Civil Codes of the 19th or the beginning of the 20th Century.[35]

This concept resembles changed circumstances because it also deals with a serious imbalance between the counter-obligations of the parties. However, the doctrine of *laesio enormis* refers to an initial imbalance which is present at the time of the conclusion of the contract, in contrast to the case of changed circumstances where the imbalance occurs after this conclusion. Additionally, by its very nature, the doctrine of *laesio* is only applicable to bilateral contracts, i.e. those with reciprocal obligations.

3.3. The role of the economic analysis of the law

In this research, there is no a special Chapter on the economic analysis of unforeseen circumstances. However, where pertinent, economic reasons or fundaments are included in the Chapters devoted to an analysis of the effects of changed circumstances, either to refute them or to support the position stated in the study.

It has been noted that the economic analysis of the law is based on the normative assumption that the law should aim mainly at welfare maximization which is sustained in another 'empirical' (but paradoxically not verified) assumption that individuals mostly rationally attempt to increase their own wealth.[36] However, the rational actor assumption as the economic model of choice has been contested as being unsatisfactory from the perspective of an actual psychology of choice, because the former fails to take into account the limits of cognition.[37] Because of those limitations, the model construed using the rational-actor assumption cannot be complete and may even sometimes lead to incorrect conclusions.

Applied to contract law, it has been stressed that economic efficiency is the principal purpose of contract law: 'If the purpose of the law of contracts is to effectuate the desires of the contracting parties, then the proper criterion for evaluating the rules of contract law is surely that of economic efficiency.'[38] Furthermore, in a case of changed circumstances, the aim should be to find the most efficient means of allocating risk and that question is resolved by deciding which of the parties is the superior risk bearer.[39] However, it has been argued that the efficiency criterion is of limited value because when a dispute arises, judgments are made ex post and the analysis of efficiency-relevant circumstances as they

35 The German BGB rejected the doctrine and the French Code Civil gave it limited recognition in the case of immoveable sales contracts (article 1674). See von Mehren (1974) and Thayer (1936).

36 Hesselink (2008), p. 20.

37 See Ulen (1989). For instance, statements such as the following can normally be found in the economic literature: 'In order to focus on the interaction between short-term contracting and relationship-specific investment, *I assume* that parties have perfect information and perfect foresight; that they are rational, and use their contracting possibilities efficiently; and that contracts are costless to enforce and complete...´ Crawford (1988), p. 485, emphasis added.

38 Posner, Rosenfield (1977), p. 89.

39 See Posner, Rosenfield (1977).

existed at the time of the conclusion of the contract is not feasible because of the infinite number of relevant factors that could have influenced the agreement and the will of the parties to determine the content and terms of the contract.[40] Therefore, the normative assumptions of efficiency analysis are questionable. It may be a valuable tool for an ex ante planning and an aid to inquiry, but not necessarily to ex post determinations, and even less so if it is used as the only criterion.

In the view of the author, the role of the economic analysis of law has been overestimated. This is not to say that such an analysis has to be discarded, on the contrary, it may be useful and it may provide important advice on the proposition and evaluation of legal rules and theories. The point is that economic considerations cannot be the *only* criterion or parameter by which legal rules and theories are measured or evaluated. Therefore, in this research the reader is not going to find a detailed examination of the subject from the law and economics perspective because the author does not share the basic assumption that efficiency (understood as the utilitarian idea that welfare maximisation is the main or exclusive purpose of the law) is *the* value or principle that contract law has to achieve, but only a desirable consequence after the principles or values of justice and solidarity have been accomplished by a system of contract law.[41]

3.4. The role of express clauses dealing with a change of circumstances

It has been stated that the legal regulation of a change of circumstances is not really necessary because the parties themselves mostly provide for a change of circumstances by means of express terms in the contract to cover the effect thereof. A related argument is that courts should not be allowed to intervene in a contract where the parties can protect themselves by the inclusion of force majeure or hardship clauses that can provide for mechanisms to adapt the contract to a change of circumstances.[42]

In contract practice, the so-called *force majeure* and *hardship clauses* seem to be the most employed devices to deal with a fundamental change of circumstances. On the theoretical level, those clauses are clearly distinguishable. Thus, a *force majeure* clause generally covers future events beyond the control of the parties that render the execution of the contract impossible, either temporarily or permanently. Consequently, in most cases, the effect provided by the clause is the suspension or termination of the contract. On the other hand, a hardship clause attempts to anticipate and deal with the situation where unforeseen circumstances fundamentally change the contractual equilibrium, rendering

40 See Halpern (1987), pp. 1159-1161, stressing that 'Such an [ex post] analysis seems to amount to little more than conjecture when used to determine how the parties would have handled the risk of the disruptive event had they been aware of it.'

41 Cfr. Speidel (1981), stressing at p. 396 that in contract law 'wealth maximization may be one of several values which should be considered'; and Hesselink (2009), stating at p. 29 that 'for those who reject [the economic model assumptions] law and economics scholarship is of little value when answering normative questions, including legal questions'.

42 McKendrick (1995), pp. 332-333, adding that a special regulation is only justified in cases of unequal bargaining power, e.g. employment and consumer contracts.

the performance of one of the parties excessively onerous or difficult.[43] Usually, they provide for a revision of the contract, either by the parties or by a third person.[44]
This research will not analyse in detail the situation where the parties specifically or generally deal with a change of circumstances in their contract. The main emphasis of the present study is on cases where such an agreement does not exist or on situations that fall outside the scope of the relevant clause. Therefore, subjects such as the concept, the taxonomy and the classification of, as well as the differences and similarities in hardship, force majeure or renegotiation clauses are not examined in this study.

The reasons for such an option are mainly fourfold. First, the assertion that the parties themselves regulate any changed circumstances in their contract can be contested. Thus, it has been argued that in long-term international business agreements specific renegotiation or revision clauses are rarely used.[45] A logical conclusion is that in the case of domestic transactions, involving much less sophisticated parties, the inclusion of hardship clauses is infrequent. Second, contractual practice does not observe a logical and consistent system of terms and in particular modern hardship clauses may be labelled as *force majeure* clauses, and the events themselves may make fine distinctions rather futile. Then, although the difference between hardship and *force majeure* may be clear at the theoretical level, in contract practice examples of circumstances giving rise to the application of hardship or *force majeure* clauses include certain events which do not correspond to the strict theory of the respective concept.[46] In this sense, the existence of a custom by which a hardship clause must be implied in international contracts has been contested because of the variety of such clauses with regard to their scope, application and remedies.[47] Third, empirical research shows that assumptions concerning the complexity and foresight of professional or business parties can be contested and therefore it is not always correct to presume their willingness to include detailed clauses dealing with a change of circumstances.[48] Finally, from an economic perspective it has been argued that since the nature of the post-contract disruptive events is extraordinary and the probability of their occurrence is remote, the transaction costs involved in the drafting of hardship clauses are higher than the cost of allocating the losses when (if) they occur.[49]

43 Böckstiegel (1985), pp. 159-160. In the same sense, Oppetit (1974), p. 794.
44 Rimke (1999), p. 229.
45 See Gotanda (2003), pp.1461-1473 and Salacuse (2001), adding on p. 1536 that '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 circumstances.' With regard to general hardship clauses containing a duty to renegotiate, it has been stressed that 'from an empirical viewpoint general hardship clauses of this kind are much rarer than one would assume from the theoretical literature in contract practice. In the 1980s we have studied 200 major mining contracts, and we did not find a single *general* hardship clause'; Schanze (1997) p. 159.
46 Fontaine (1976) p. 56. See also Rimke (1999), pp. 231-232.
47 van Houtte (1993), p. 109.
48 Kessedjian (2005), p. 421.
49 Cenini et al., (2009), adding that 'it is inefficient and often impractical to allocate the risk of unexpected contingency at the time the contract is made'. See also Halpern (1987) p. 1165, stressing that the parties do not always allocate risks efficiently.

Furthermore, attention has to be paid to the nature of the doctrine of changed circumstances: the events (or their consequences) are by definition unforeseeable, or, in other words, they are unpredictable. If they were foreseeable, the doctrine would simply not be applicable. Therefore, 'the uncertainties we are considering cannot be appraised rationally and would not occur naturally to the parties'.[50]

Then, an appropriate legal rule seems to be necessary for the ex-post allocation of losses, including the possibility of revising the agreement, because 'The legal default rule thus becomes the rule that operates in the vast majority of the cases.'[51] Thus, it can be sustained that an express legal regulation is highly necessary, even with the non-unanimous or not empirically-tested assumption that the parties themselves should and do provide for future contingencies in their contract. As the comparative study demonstrates, also the limits for the application and interpretation of express clauses on this subject imply the necessity of the existence of a legal rule dealing with the effects of changed circumstances.[52]

4. Terminology and concepts

Considering the different legal systems included in this research, four languages are involved: English, French, Italian and Spanish. As a consequence, problems with translation were indeed foreseeable. Nevertheless, the difficulties were not limited to the 'legal translation' of the concepts used by the different jurisdictions; there is also the fact that the *international* legal terminology in the subject is somewhat ambiguous or unclear.

Thus, even regarding the legal doctrines that address the subject-matter, there is no uniform legal designation that has been generally accepted. France and the Latin American jurisdictions share the concept of *imprévision* or *imprevisión*; Italy *eccessiva onerosità*; England & Wales *frustration* and the United States *impracticability*. In international contract law the most common terminology is *hardship;* however, during the last few years the expression *change of circumstances* has earned its place. The problem is not only one of designation, but it is also conceptual: frustration is not the same as *imprévision* and neither is a change of circumstances the same as *eccessiva onerosità*.[53]

The same problems are present concerning other relevant legal concepts which are frequently used in this book, such as *revision* or *termination*, which may have completely different meanings in the different jurisdictions covered. Therefore, in order to avoid ambiguities, a set of definitions of relevant legal concepts for the research is provided in

50 In this sense, Trimarchi (1991) p. 72.
51 *Ibid*.
52 See further the discussion on the limits to the application of the foreseeability test concerning a change of circumstances, the allocation of risks by the parties and the mandatory nature of the legal provisions dealing with the subject-matter of the research.
53 See Tallon (1998), p. 328 stressing that 'Whereas *force majeure* is now considered as an adequate way to designate the complete impossibility situation (even in the English language: see Article 7.1.7. UNIDROIT Principles), there is no generally admitted term in the various European legal systems for the hardship situation. This leads to much confusion.'

this section. An additional reason for establishing a set of definitions is the objective of developing neutral terminology for a comparative and international study of the subject, which can be used beyond the boundaries of mere national analysis.[54] Nevertheless, for reasons of style, in the comparative reports the 'local' expression is mostly preserved or indicated between brackets.

- Change of circumstances: The situation in which, due to supervening and reasonably unforeseeable events, the performance of the obligation has become excessively onerous for the debtor or the counter-performance he receives has severely diminished its value.
- Revision of contracts: The modification of the obligations of one or both parties, to the extent that the performance of the contract by the affected party is possible or bearable, with the aim being to restore their equilibrium when it has been severely disrupted by unexpected events.
- Termination: The situation in which a contract ceases to have effect before the period originally agreed by the parties; without regard to the entitlement of the parties to claim restitution where appropriate.
- Bilateral contract: A contract with reciprocal obligations for the parties.
- Unilateral contract: A contract where only one of the parties assumes an obligation to the benefit of the other.

5. Hypothesis and methodology

5.1. Hypothesis

As mentioned above, the origin of the study is the approach of Chilean private law with regard to the subject-matter of the research. However, starting from that point, a general hypothesis can be stated. A general hypothesis means in this context that it is not only applicable to the Chilean situation but also to jurisdictions in the same relative position; i.e. with no express general regulation on the subject or with remedies which are different from the revision of the contract.

The mentioned hypothesis is that in relation to the legal effects of a change of circumstances a duty to renegotiate must be imposed on the parties and, at the same time, such a request for a renegotiation by the affected party is a condition for later invoking the provisions on or the legal remedies for the subject. If both parties have acted in good faith but negotiations do not succeed within a reasonable period, either party may resort to the courts to request an adaptation of the contract to the new circumstances and the courts have wide powers and can either modify the contract or terminate it, whichever is the more suitable in the specific case. Additionally, it is supported that the best approach of a legal system to the subject is through an express legal regulation by means of a flexible but

54 See Hondius (2005) arguing that the development of an English neutral terminology in law is necessary to neutralize the natural linguistic advantages of the American law and legal theory on the Western World.

exceptional rule that contains the scope, conditions and effects of changed circumstances affecting the parties' obligations; as is generally the case with the issues of impossibility or *force majeure* in civil law systems.

In theory, a legal system may address the problem in different ways: holding the affected party to the original terms of the contract (either by granting specific performance or damages), granting relief to that party or giving the court the power to adjust the provisions of the contract to the new circumstances.[55] As mentioned above, traditionally the approach of the classical law of contract is to give almost absolute prevalence to the principle of the sanctity of contracts or *pacta sunt servanda*, by which contractual promises are binding in all circumstances. Therefore, the revision of the contract by the court or even by the parties was not a remedy which was traditionally provided by the Civil Codes of the 19th century or by the rules of common law. As stated before, even when nowadays the principle of the sanctity of contracts is subject to a number of exceptions and qualifications, changed circumstances is still a controversial and not unanimously resolved issue of the law of obligations. Thus, the primary aim of the research is to analyse the effects or consequences that the legal systems under review provide for the situation of a change of circumstances. The examination and comparison of such legal systems, as well as of model codes and international instruments will be used to check the validity of this hypothesis.

Additionally, a general comparative overview of the subject has the aim of providing a broad understanding of the conceptual framework on which cases of changed circumstances are addressed by the legal systems under review; that is, the (non-)existence of an express legal rule, the conditions for the applicability of the doctrine and the position of the case law and the legal doctrine on the subject. Therefore, the analysis is essentially a legal one: it is based on an examination of the legal rules, the case law and the legal doctrine of the relevant jurisdictions; however, occasional references are made to sociology or economics where this is necessary for a better understanding of the issue.

The research also tries to attain the general goal of the comparative method, which is to create new knowledge.[56] The author expects that such a general but ambitious objective has been attained in this book through the knowledge gained of Latin American jurisdictions by European readers and vice versa. Therefore, one of the purposes of the study is to provide an enhanced comprehension of the subject not only for the purpose of legal reform or harmonization, but also to serve as a useful tool for a better approach by the courts and practitioners when confronted with cases on this subject.

55 In the case of *force majeure*, i.e. the situation in which performance by one party has become absolutely impossible, the solution is usually to release the affected party from its obligation.

56 See Zweigert, Kötz (1998) stressing at p. 15 that 'The primary aim of comparative law, as of all sciences, is knowledge.'

5.2. Comparative method

In a broad sense, comparative law may itself be regarded as a method. However, nowadays comparative law is considered to be a discipline that can be used in a number of different methods. In this context, the research has been carried using the so-called *problem-solving* approach, which is part of the *functional* method. This method has been chosen because of the pragmatic nature of the hypothesis and the research questions which are related to how a specific problem is solved in different legal systems and not to how a legal doctrine or institution is addressed in other legal systems (the *functional-institutional* approach).[57]

In particular, the comparative survey of the selected legal systems is horizontal or successive so as to provide a general overview of the subject (Chapters three to seven). After such a general assessment, with regard to the effects of changed circumstances for the obligations of the parties, the comparison is vertical or simultaneous (Chapters eight and nine). By its very nature, the historical analysis has been drafted with regard to the legal history method, but there is also a comparative reference to the relevant jurisdictions. The historical analysis seems useful and necessary since the civil law systems share the common background of Roman and canon law. To some extent, this assertion is also applicable to the common law jurisidictions.[58]

5.3. Jurisdictions selected

The main purpose of the research determined the jurisdictions included therein. The selection of jurisdictions was made with three criteria:

a) The inclusion of legal systems both from the civil and common law traditions.
b) The inclusion of legal systems in which the subject-matter of the research is expressly addressed by a legal rule.
c) The inclusion of legal systems both from Latin America and Europe.

The above-mentioned criteria allow a broad and extensive analysis of the subject-matter of the research, because including representative jurisdictions from the two major legal families of the Western law tradition, i.e. civil and common law;[59] and, at the same time, jurisdictions which have no legal regulation of the subject and others that have dealt with the problem of changed circumstances through legislative measures.

Then, the selected jurisdictions may be classified in the following way:
– Civil law jurisdictions: Chile, Argentina, Italy and France.
– Common law jurisdictions: England & Wales and the United States.
– Legal systems with an express regulation on the subject: Argentina and Italy.

57 See in general, Örücü (2006).
58 For the influence of Roman law and continental legal doctrine on the common law, see Zimmermann, (1998).
59 von Mehren (1991) p. 43.

- Legal systems without an express regulation on the subject: Chile, France, England & Wales and the United States.[60]
- Latin American jurisdictions: Chile and Argentina.
- European jurisdictions: France, Italy and England & Wales.

Apart from the reasons stated above, there are particular reasons for including some of the mentioned legal systems. Thus, the French legal system is highly relevant because of its vast influence on the Latin American codifications of the 19th Century, especially with regard to the law of obligations.[61] In addition, and perhaps even more important was the influence of the liberal doctrine on which the *Code Civil* was founded, with the ideas of individual freedom, equality under the law, separation of powers and private property.[62]

The case of the Italian *Codice Civile* is also relevant because it represents a modern approach to the subject, as included in a Code almost 150 years younger than its French equivalent. Its influence on the 20th Century Latin American law reforms or recodifications is equivalent to the 19th Century French influence just referred to.[63] At the same time, it reflects a different economic and social philosophy which is more concerned with an adequate distribution of wealth and greater social justice. As a consequence, even when private property and freedom of contract are still general principles in the *Codice*, they were deprived of the excessive 19th Century individualistic liberal doctrine and regulated in order to comply with a more 'social' conception of private law.[64]

With regard to Chilean law, the reasons for including it are obvious and have been mentioned elsewhere in this Chapter. On the other hand, the analysis of Argentinian law serves as the counterpart of Chilean law, because despite of its common roots, it has developed a completely different approach to the subject than that followed by Chilean law, with abundant case law and doctrine devoted to the matter.

As stated before, English law was included as a representative of the common law tradition, in order to provide a wider comparative basis for the research. Finally, the choice to include American law was made after commencing the research, because of its particular approach and its especially interesting legal doctrine on the matter. In American law, impracticability is expressly regulated in article 2, Section 615 of the Uniform Commercial Code in relation to sales, and the influential but non-binding Restatement (2nd) of Contracts also includes impracticability in its §261 comment a.

In addition to national jurisdictions, the research also examines how modern model codes or restatements of international contract law deal with the situation of a change

60 In the case of the United States, the subject is not regulated by a general legal rule, but only for the case of sales in the U.C.C.
61 For a detailed examination of that influence on Chilean and Argentinian private law, see Chapter five.
62 Murillo (2001), p. 5.
63 See Lerner (2002).
64 See Cappelletti et al., (1967), pp. 215-228.

of circumstances. In a time when the harmonization of contract (or even private) law plays a major role in the academic legal debate and increasingly in political discussions, the analysis of such instruments cannot be avoided. Besides, most of them have the intention of being a manifestation of general principles of law or a model for national or international legislators, and have been drafted after an extensive comparative research into several jurisdictions, which makes them a valuable source of study.

Accordingly, the research includes the analysis of the United Nations Convention on Contracts for the International Sale of Goods (CISG), the UNIDROIT Principles of International Commercial Contracts (PICC), the Principles of European Contract Law (PECL) and the Draft Common Frame of Reference (DCFR). All of these instruments, except for the CISG, contain one or more express provisions that deal with the issue of a change of circumstances. With regard to the CISG, it is disputed in the legal doctrine whether its article 79 is also applicable to a change of circumstances, but its inclusion in the research is due to the fact that it is actually the applicable law in all but one (England & Wales) of the national jurisdictions analysed in the research.[65]

On the other hand, the exclusion of some jurisdictions that have relevant or interesting approaches to the subject was decided by practical considerations. Thus, the language limitations of the author were the main reasons for excluding German and Dutch law. Nevertheless, occasional references to such jurisdictions will be made when appropriate for a better understanding of particular points of the study.

6. Structure of the research

As noted above, the research includes both a comparative survey of the legal systems included as well as a historic study of the subject and an examination of the effects of a change of circumstances on the parties' obligations. The research has been structured as a mixture between a successive analysis of the jurisdictions examined and a simultaneous study of such jurisdictions with regard to the main subject of the research, i.e. general reports on the jurisdictions examined, followed by a more in-depth analysis, in separate chapters, of the subjects related to the consequences or effects of unexpected circumstances (renegotiation, adaptation, termination). The reason for this is that the reader will be made aware of the general development of the subject in the jurisdiction of his/her interest and/or will be given the opportunity to become acquainted with specifically one or more of the eventual effects of unexpected circumstances.
Thus, Part I of the research comprises the introduction (Chapter one) and the historical analysis (Chapter two). Part II is devoted to a comparative survey of the relevant legal systems: France (Chapter three), Italy (Chapter four), Chile and Argentina (Chapter five), England & Wales and the United States (Chapter six). After that, Part III deals with the examination of the CISG, the PECL, the Unidroit Principles and the DCFR (Chapter seven). Part IV examines the effects of a change of circumstances: renegotiation (Chapter

65 The Convention has been ratified by 76 countries (as of 7 July 2010).

eight), adaptation and termination (Chapter nine). Finally, in Part V, conclusions are made with regard to the research (Chapter ten).

Finally, it is worth mentioning that, concerning the national reports, the approach of the analysis cannot be the same. There are strong differences in the way the availability of the sources are presented for a foreign reporter. For instance, in some jurisdictions the case law reports include a minimum reference to the facts of the case, and great attention is given to the dictum of the decision. The analysis by the legal doctrine in each legal system is also different. Thus, in those jurisdictions with an express legal provision dealing with a change of circumstances, more attention is given to the conditions for the application of the provision than to the fundaments of the doctrine. On the contrary, in those legal systems where such a legal provision is not present, the analysis is mainly focused on how to support the existence or application of the doctrine through general principles of law. This research was completed in November 2010. Later developments could only be included in some instances.

Chapter 2

AN HISTORIC APPROACH TO *PACTA SUNT SERVANDA*, IMPOSSIBILITY AND *REBUS SIC STANTIBUS*

1. The origins of *pacta sunt servanda*

One can say with certainty that *pacta sunt servanda* (all pacts must be honoured) is an accepted principle in all major legal systems, and a cornerstone of contract law and contract legal theory. However, the following historical survey reveals that this was not always the situation, and more relevantly, that the original significance of the principle was different from the one given by classic contract law theory.

1.1. Roman law: No *pacta sunt servanda* principle

According to Gaius in his *Institutiones*, four types of legal acts could generate legal obligations *ex contractu*: *contractus re* (the delivery or transfer of a good), *contractus verbis* (the formal oral question and answer between the parties), *contractus litteris* (formal writing) and *contractus consensu* (the consent of the parties was sufficient to create the obligation). To sum up, in Rome an obligation could arise either from a formal arrangement between the parties or by virtue of the real act of handing over an object. The general rule was then *ex nudo pacto non oritur actio* or *nuda pactio obligationem non parit*. In this context, Roman law recognized only a *numerus clausus* of consensual contracts which were actionable: *emptio venditio* (sale) *locatio conduction* (lease), *societas* (partnership) and *mandatus* (mandate).[1]

Therefore, a mere *pactum* (agreement) outside the recognized situations was not actionable. Indeed, the original meaning of *pactum* was related to a formal redemption from liability for personal injury. Later the concept was extended to agreements not to sue and, finally, it was generalized by the praetors to provide a defence (*exceptio*) against any *actio* (action).[2] This was the Roman praetors' promise of *pacta conventa servabo* ('I will

1 G 3.89 and G 3.135, cited by Visser (1984), pp. 642-643.
2 Visser (1984), p. 644.

respect the agreement') which can be considered as the first expression of the *pacta sunt servanda* principle which, however, was never recognized as such in Roman law.[3]

However, in the *bonae fidei iudicia* the *exceptio pacti* was inherent and also in such *iudicia* the so-called *pacta ex continenti adiecta*, that is, agreements ancillary to any recognized contract *bonae fidei*, became indirectly enforceable, because it could determine the scope of the respective *actiones* modifying the original terms of the contract.[4] In addition, in some instances, the praetor (*pacta praetoria*) or the emperor (*pacta legitima*) could grant an action on the basis of an informal agreement.

In the end, a whole variety of agreements became legally recognized. Thus, on the one hand, there were contracts with a proper name (*transeunt in propium nomen*) and, on the other, innominate contracts (*contractus innominati*). However, the recognition of the latter was limited to synallagmatic relationships, with the requirement that one of the parties had already performed his side of the arrangement with the intention of obtaining a counter-performance. Additionally, the *condictio causa data causa non secuta*, which gave the alternative to demand a counter-performance or restoration, remained available to the performing party, in fact implying the right to cancel the contract at any time. Finally, some arrangements which did not qualify as contracts were also enforceable and also informal arrangements could be raised as an *exceptio* or regarded as *obligationes naturales*.[5]

In this context, the sanctity of contracts was never recognized as a general principle, and even the only passage of the Digest which can be related to the binding force of agreements is restricted to pacts to release a debtor or to grant an extension of the date of performance.[6] Roman contract law was largely casuistic and had no general theory of what a contract was or why it was enforceable.[7]

1.2. The glossators: the beginning of a rational and systematic scheme

The casuistic and sometimes contradictory bulk of Roman law was put into a rational and systematic scheme by the glossators. First, they took the term *pactum* from Ulpianus to comprise all agreements between two or more parties aiming to create obligations. Second, they classified them into *pacta nuda* (non-enforceable) and *pacta vestita* (enforceable). Enforceability being the main characteristic of the classification, contracts and most of the

3 Zimmermann (1996), p. 543, and Tabor (2008), p. 553.
4 Zimmermann (1996), p. 510.
5 See Zimmermann (1996), pp. 536-538.
6 Ulpianus D. 2.14.7.7: 'Pacts agreed on, where they are not concluded with malicious intent, not contrary to statutes, plebiscites, decrees of the senate, or imperial edicts, and there is no fraud on these, I will uphold'. Cited and translated by Visser (1984), p. 645. In the same sense, see Zimmermann (1996), p. 508-509.
7 Gordley (2006), p. 287.

pacta (including the *pacta praetoria* and *legitima*) were qualified as *pacta vestita*. Therefore in this system unenforceable agreements became an exception.[8]

1.3. From *nuda pactio obligationem non parit* to *pacta sunt servanda*

The systematization of Roman law by the glossators is the starting point for the rise of *pacta sunt servanda*. Commercial practice and canon law also supported the binding force of any kind of agreement.[9]

Thus, in the context of international lex Mercatoria and medieval French and Italian customary practice, consensual and informal agreements (*convenances*, derived from the Latin *conventio*) were enforceable.[10] As a consequence, 'by the end of the Middle Ages, every informal agreement had, for all practical purposes, become legally binding'.[11] The feudal concept of reliance on the simple promise of another also provided support for the acceptance of the new principle.[12] Customary Germanic law was also used as a source for the recognition of the binding force of informal agreements. Post-humanistic French contract theory was influenced by these ideas which were later recognized in article 1134 of the Code Civil.[13]

Canon law gave additional justification to the enforceability of all kinds of agreements. The foundations were moral and could be traced directly from the Gospels: God makes no distinction between an oath and a mere promise, and therefore a lie must be punished in the same way as perjury, that is, as a sin.[14] This idea was exposed in the *Decretum Gratiani* and later in the *Decretals* of Gregory IX (1234) through the incorporation of a decision by a church council held in the year A.D. 348 in Carthage. In such *Decretal*, under the heading '*De pactis*', the adage *pacta quantumcunque nuda servanda sunt* appears as a clear reference to the glossators' distinction between *pacta nuda* and *pacta vestita*. Therefore, 'in the course of the 14th century it became the prevailing opinion among canonists that all informal contractual agreements were directly enforceable by means of a *condictio ex canone*'.[15] Nevertheless, the jurisdiction of canon law was disputed, but canon lawyers and ecclesiastical courts played a major role in the acceptance and spreading of the ex *nudo pacto oritur actio* or, since then, the *pacta sunt servanda* principle.[16]

8 Zimmermann (1996), pp. 538-539.
9 Zimmermann (1996), p. 540.
10 Baldo de Ubaldis expressly stated that all agreements between merchants were actionable: 'Since good faith is required in these contracts which are most frequently concluded, and in these respects a bare pact does not differ from a stipulation…' (Gloss ad Dig. 13.5.1), cited and translated by Visser (1984), p. 647.
11 Zimmermann (1996), p. 540.
12 Visser (1984), p. 647.
13 Charles Dumuolin was the first French author to incorporate these ideas.
14 Visser (1984), p. 646.
15 Zimmermann (1996), p. 543.
16 Visser (1984), p. 647 and Zimmermann (1996), p. 544.

The late scholastics, following Thomas Aquinas (who was strongly influenced by Aristotle), divided Roman transactions into two categories, namely as acts of voluntary commutative justice (promises of exchange) and acts based on liberality (promises of gifts).[17] The enforceability of promises was based on grounds of commutative justice. Thus, Lessius and Molina argued that a promise gives a right to the promise to demand performance because of reasons of commutative justice, which is violated if the promisee is deprived of such a right (transferred by the promisor at the time of the promise).[18]

The natural law school gave final doctrinal support for the justification of *pacta sunt servanda* as the cornerstone of the law of contract. Thus, Hugo Grotius in his *De jure Belli ac Pacis* (1625), influenced by Molina and based on texts from the Digest and the work of Cicero *De Officiis*, stated that in terms of natural law all *pacta* are binding, extending the justification of such principle to the fact that even God 'would be acting against His nature, should He not keep His promises'.[19] Grotius provided major relevance to the binding force of promises, as one of the basic principles of natural law and 'he stated that this principle forms the source of the whole positive law.'[20] Pufendorf emphasised the binding force of promises as one of the inviolable principles of natural law. In the end, since *fides* is the foundation of justice, one conclusion was deduced: all promises must be binding under all circumstance.[21]

After Grotius, the Roman-Dutch law commentators agreed on the force of the *pacta sunt servanda* principle. Thus, Arnoldus Vinnius (1588-1657), Simon Groenewegen (1613-1652) and Johannes Voet (1647-1713) stated that the custom and the practice of the courts of their time followed the view of the canonists and therefore a *pactum nudum* was fully enforceable, giving rise not only to an *exceptio* but also to an *actio*. Based on this, it can be argued that the principle of the sanctity of contracts was of universal application in Roman-Dutch law and practice.[22]

The conceptions of the natural lawyers were adopted by Domat: 'agreements being formed, all that has been agreed to has the force of law for those who have agreed to it'.[23] Domat also supported this statement on Roman law: '*legem enim contractus dedit*'.[24] From Domat

17 Gordley (2006), p. 292.

18 Lessius stated that 'to promise is not merely to affirm that one will give or do something but beyond that to obligate oneself to another, and consequently to grant that person the right to require it', De iustitia et iure, lib. 2, cap. 18, dub. 8 no 52, cited and translated by Gordley (2006), p. 293. However, Cajetan, another scholastic author, stressed that 'the promisee could only claim that the promisor acted unjustly toward him if he had become worse off by changing his position on reliance of the promise.' Thus, there was no reason to enforce a promise when the promisee had no changed his position in reliance on such a promise. See Gordley (2006), p. 293.

19 De Jure Belli ac Pacis, 2.11.4.1, translated by Visser (1984), p. 649.

20 Visser (1984), p. 649.

21 Zimmermann (1996), pp. 544, 576-577.

22 The only exception to that view was Simon van Leeuwen, who argued that the principle '*ex nudo pacto non datur actio*' had been received in Dutch practice. See Visser (1984) pp. 652-654.

23 Domat, J., *Les loix civiles dans leur ordre naturel*, cited and translated by Laithier (2002), p. 105.

24 Dig. 50, 17, 23.

and via Pothier, this idea (among others) was introduced in the *Code Civil*:[25] 'Agreements lawfully entered into take the place of the law for those who have made them. They may be revoked only by mutual consent, or for causes authorized by law. They must be performed in good faith' (article 1134).[26]

The study of the historic development of the *pacta sunt servanda* principle demonstrates that its adoption can be considered as a consequence of the implementation of a contract system based on consensus. If no additional external acts are required to demonstrate the intention to be bound by a promise, the only means to protect good faith and reliance on the promise is to give legal force to the word of the promisor. However, as Zimmermann stated, once consensualism was established, the significance of *pacta sunt servanda* shifted slightly although, in my opinion, significantly: from 'all pacts are binding, regardless of whether they are clothed or naked' to 'contractual promises must under all circumstances be honoured'.[27]

2. Impossibility

Because of its close relationship with the doctrine of changed circumstances, before examining its historic development, a brief outline of the development of the doctrine of impossibility is necessary.

Although the doctrine of impossibility can be traced back to Roman law, again such law did not develop a general doctrine to this effect and therefore Roman jurists did not recognise a technical concept of impossibility.[28] However, different notions of the impossibility of performance were derived from the texts of the *Corpus Iuris Civilis*. In this sense, *impossibilitas* (through the adjective *impossibilis*) 'is used in legal texts to describe acts or events which cannot take place, either because they are contrary to nature…or contrary to law…*Difficultas*, on the other hand…(is used) merely to designate circumstances which prevent an individual debtor from making performance.'[29] Thus, the distinction between *impossibilitas* and *difficultas* can be considered to correspond, respectively, to objective impossibility and subjective impossibility.[30] In addition, the Digest contained the well-known maxim *Impossibilium nulla obligatio est*: there is no obligation to do the impossible.[31]

25 Zimmermann (1996), p. 566.
26 *Les conventions légalement formées tiennent lieu de loi à ceux qui les ont faites. Elles ne peuvent être révoquées que de leur consentement mutuel, ou pour les causes que la loi autorise. Elles doivent être exécutées de bonne foi.* Translation available at www.legifrance.gouv.fr.
27 Zimmermann (1996), pp. 576-577.
28 Feenstra (1974), p. 91.
29 *Ibid*., p. 78.
30 *Ibid*., pp. 79-80. However, the interpretation of the concepts of *impossibilitas* and *difficultas* as objective or subjective impossibility was disputed in medieval doctrine.
31 Dig. 50.17.185 cited by Feenstra (1974) 79.

It has also been stated that a number of Roman texts excused a party when performance was impossible at the time the contract was made, but this was limited to a contract of sale and *stipulatio*.[32] However, 'one cannot conclude that, in Roman law, a party was excused if his performance was or became impossible and he was not at fault in the ordinary sense'. Thus, initial impossibility had to be objective or absolute, beyond anyone's power.[33] Accordingly, in some cases of supervening impossibility, the debtor was liable if he failed to exercise the most careful diligence (*exactissima diligentia*)[34] and could not avoid liability merely because he was not at fault. In these cases, the debtor was liable unless he could prove *vis maior*.

It was the canonists, one again, who turned the concepts of impossibility and fault into terms of moral responsibility: one cannot be morally obliged to do the impossible. In addition, a person is morally responsible only when he could have acted otherwise and was at fault in doing so.[35] The contradiction of these statements with the limitations on civil responsibility in the Roman texts was never resolved in a satisfactory way. Thus, 'the 19th century jurists…inherited a body of law in disarray…In France, the textual problems changed with the enactment of the Code, although in a way that made principled solutions still more elusive'.[36]

Therefore, to avoid confusion, the drafters of the *Code Civil* rejected the distinction between degrees of fault. In this sense, article 1137 states that a person who has the obligation to watch over the preservation of a thing is responsible under the standard of *bon père de famille*, i.e., a prudent administrator or a reasonable person. The 19th century French doctrine interpreted this norm as setting a general standard of ordinary negligence for contractual responsibility. Accordingly, a party is only liable for non-performance only if he is at fault in the sense of ordinary negligence.[37]

However, articles 1147 and 1148 of the *Code Civil* contradict such a conclusion. They state that a person can only escape liability if he proves that the non-performance is the result of a *cause étrangère* (external cause), *force majeure* or a *cas fortuit*. Therefore, the non-performing party must prove the external and irresistible character of the event which prevented him from performing, which means that sometimes a party may be liable even if he is not at fault in the ordinary sense. In addition, following Pothier, *force majeure* and *cas fortuit* are equivalent to *vis maior*, an event which exonerates a person even in cases of a stricter standard of responsibility (*culpa levissima*).[38] In sum, 'the drafters established

32 Gordley (2006) pp. 336-337.
33 Dig. 45.1.137 cited by Gordley (2006), p. 337.
34 Dig. 44.7.1.4, cited by Gordley (2006), p. 337.
35 Gordley (2006), pp. 337-338.
36 *Ibid*., p. 339.
37 Gordley, von Mehren (2006), p. 499.
38 Pothier, cited by Gordley (2006), p. 340.

two contradictory general rules: one imposing liability for ordinary negligence, and the other for what had traditionally been called *culpa levissima*'.[39]
Nevertheless, the French commentators were aware of the contradiction, but the problem was ignored arguing that the standards of the cited articles were in practice always or nearly always the same: there is fault when there is no *cause étrangère*, *force majeure* or *cas fortuit*.[40]

A more satisfactory explanation was given by Demogue, who distinguished between obligations *de moyens* and obligations *de résultat*. The former involve a duty to use one's best efforts and then the debtor is liable for ordinary negligence; the latter require the achievement of a specific result and then the debtor is liable unless he can prove *cause étrangère*, *force majeure* or *cas fortuit*.[41] The subsequent problem is to qualify a contract within one of those (doctrinal) categories.

On the other hand, the English common law of impossibility is traditionally linked to *Paradine v. Jane*[42] when stating that the impossibility of performance was not an excuse until the rule in *Taylor v. Caldwell*[43] was established: 'in the absence of any express or implied warranty that the thing shall exist, the contract is not to be construed as a positive contract, but as subject to an implied condition that the parties shall be excused in case, before breach, performance becomes impossible from the perishing of the thing without default of the contractor'. To Gordley, this statement by Blackburn, J. 'conflated the traditional doctrine of impossibility with traditional formulation of the doctrine of changed circumstances: that the existence of certain circumstances may be an implied condition of a contract'.[44] Thus, no distinction was made between initial and supervening impossibility and neither was the situation of *vis maior* a subject for analysis.

3. Change of circumstances

3.1. The philosophical Roman roots and development as an implied condition

The doctrine of changed circumstances was developed by the medieval canon lawyers, based not on Roman law but on Roman philosophy. Cicero (106 BC-43 BC) was possibly the first author to raise the question of the legitimacy of refusing to perform a contract if the circumstances had sufficiently changed. To justify situations in which the course of time may turn something initially honourable into dishonourable conduct, he gave the example of a person who promises to return a sword to another, the former being excused

39 Gordley (2006, p. 340.
40 Aubry et Rau, Demolombe, Laurent, cited by Gordley (2006), p. 340.
41 See Gordley (2006) p. 341, Gordley, von Mehren (2006), p. 499.
42 Aleyn 26,82 Eng. Rep. 897 (KB 1647). For a further discussion of the case and its role as representing the original common law principle that impossibility is not an excuse, see Chapter six.
43 (1863) 3 Best & S. 826 (Q.B.). See Chapter six.
44 Gordley (2006), p. 344.

if the latter has become insane.[45] After Cicero, Seneca stated that 'all conditions must be the same as they were when I made the promise if you mean to hold me bound in honour to perform it.'[46]

The example of the sword given by Cicero was used by St. Augustine with no legal implications, but it received legal authority when it was included in the Gratian´s *Decretum* (22.2.14.2).[47] Later in the thirteenth century a gloss was added to explain that 'this condition is always understood: if matters remain in the same state'. The formulation of the condition was quoted from a text of the Digest, where the phrase was used in an entirely different context.[48] It was essentially this gloss which inspired later medieval authors.[49]

St. Thomas Aquinas developed the subject from a theological point of view, when discussing whether every lie would be a sin. He concluded that in the case of a *promissio* (which in this context does not exclusively designate promises which are legally binding) the promisor may be excused (i.e., not committing a sin) in two situations: when the promise is illegal or immoral, or 'if the circumstances relating to his person or the transaction should have changed'.[50] St. Thomas may also have been influenced by the ideas of Aristotle about equity in concluding that, similar to laws, promises are not binding in circumstances where the promisor would have intended to be bound.[51]

Until this point, the *clausula* concept was only present in canon law in connection with the taking of an oath, and in the work of St. Thomas to promises in general but without legal implications.[52] Bartolus seems to have been the first civilian author who introduced the idea of the *clausula* as an implied condition (*rebus sic habentibus*) in the civil law, but limited to the specific legal act of *renuntatio*.[53] This statement was extended by Baldus to all *promissiones* (in the sense of legally binding promises).[54] Baldus, following the doctrine of the tacit condition, stated that it was a 'rule that every promise is to be understood with the circumstances being the same.'[55] Jason de Mayno argued for an even wider application of the *clausula* as an implied condition not only to promises but also, inter alia, to legislation,

45 De officiis, cited by Thier (2010).
46 De beneficiis, 4, 35,3, cited and translated by Thier (2010).
47 See Feenstra (1974), p. 81.
48 Dig. 46.3.38, cited by Visser (1984). The origin of the idea of the implied condition is disputed. See Feenstra (1974), p. 82 and Visser (1984) p. 648.
49 Feenstra (1974), p. 82.
50 Summa Theologiae, Secunda Secundae, q. 110, art 3, ad quantum; translated by Visser (1984), p. 648.
51 Summa Theologiae, Secunda Secundae, q. 88, art. 10; q. 89, art. 9, cited by Gordley (2006), p. 348.
52 Feenstra (1974), p. 83.
53 Zimmermann (1996), p. 580. The source of the formula is the Accursian Gloss of the Dig. 12.4.8, in which the formula *rebus sic habentibus* is used, although in a different context. Later authors changed the formula to *rebuc sic stantibus*, but without any change to its meaning as an implied condition. See Feenstra (1974), p. 84.
54 Feenstra (1974), p. 84.
55 Cited by Thier (2010).

wills, contracts and oaths.[56] The work of Jason significantly influenced civilian authors in the 16th and 17th centuries.[57]

The conception of the *clausula* as an implied condition is in accordance with the medieval doctrine which based the binding force of a promise on the will of the parties. Therefore, the exceptions to such binding force must to also be found in the promise itself, in the form of an implied or tacit condition.

It has to be noted that because the basis of the *clausula* was the hypothetical will of the parties, this doctrine was a natural complement (and not an opposite) of the then developing principle of *pacta sunt servanda*. It is not odd that the *clausula* was promoted by the same authors who supported the binding force of all kinds of promises. The fundamental aspect was the same: the human will.[58]

3.2. Evolution towards a more objective standard

The growing relevance of principle *pacta sunt servanda* and its slowly but relevant change of meaning towards the absolute binding force of promises affected the fundaments of the *clausula* as an element of the contractual will of the parties. In this sense, Andreas Alciatus stated that not in every case was the *clausula* an implied condition in the will of the parties and, on the contrary, the agreed mutual promise might prevail over the interest of one single party.[59] Then, Alciatus introduced the exception of a *causa inconsiderata*: in the case of a non-considered and unexpected circumstance for both parties, the rule of the *clausula* will apply.[60] Therefore, 'the emergence of an unexpected event was dealt with by an objective concept which has its basis not in the covenant itself but in the limits of the parties' foresight'.[61]

Hugo Grotius also argued for a more restrictive and objective approach to the application of the *clausula*. As stated above, in the context of natural law, Grotius gave greater significance to the principle of *pacta sunt servanda*. Accordingly, Grotius dealt with the subject of the *clausula* in the chapter on the interpretation of promises.[62] He argued that the binding force of a promise (based on the will of the parties) could be restricted or limited in two cases: where the intention of the promisor was defective *ab initio* (*defectus voluntatis originarius*) or where a contradiction emerges between the declared will and a new and unexpected event after the promise has been made (*repugnantia casus emergentis cum voluntate*).[63] In the first case, Grotius rejected the notion of an implied condition

56 Visser (1984), p. 649.
57 Feenstra (1974), p. 84
58 See Zimmermann (1996), pp. 580-581.
59 Thier (2010).
60 Alciatus, cited by Their (2010).
61 Thier (2010).
62 Feenstra (1974), p. 88.
63 Grotius, cited by Visser (1984) p. 650.

si res maneant quo sunt loco (if things should remain as they are) as incorporated in the promisor's will as a general rule, with the only exception being that the continued existence of the state of affairs, when the promise was formulated, was the unique *ratio* (reasonable motive) for the promise in question.[64] Thus, 'Grotius set clear limits to the *clausula* concept as only the frustration of the specific expectations of the promisor could trigger the rescission of the contract'.[65]

With regard to the second case (*repugnantia casus emergentis cum voluntate*), Grotius stated that a degree of freedom was required to allow for circumstances which the promisor would have excluded if he were present.[66] However, he also discarded the idea of a tacit condition because the parties should have foreseen the possible change of circumstances at the time when the agreement was made.[67] Grotius introduced the idea that there have to be sufficient *indicia* (adequate indications) for the establishment of such intention.[68] He mentioned two types of *indicia* which contradict the original will: First, if the fulfilment of the promise could violate the (natural) law, for which he quoted the example of the sword mentioned above; and second, a situation which is relevant for this study: if the performance of the obligation appears to be excessively 'burdensome and unbearable, whether the condition of, human nature is considered in the abstract, or the person and matter under consideration are brought into comparison with the result of the act itself'.[69] Next, Grotius used three examples to illustrate this type of *indicia*: the case of lending a thing, which can be demanded before the agreed date if the lender is in 'great in need of it'; the case of the promise to provide military aid may be excused if the promisor 'needs his troops as long as he is in danger at home'; and finally, the situation of an exemption from taxes and tributes, which cannot be understood as covering also 'requirements imposed by extreme necessity'.[70]

These examples have been interpreted restrictively and it seems that Grotius only dealt with gratuitous or unilateral promises; but his ideas are interesting because they raised the possibility of escaping from liability if the agreement becomes extremely burdensome for the promisor. The concept of equity as a mean of corrective justice, borrowed from Aristotle, may have influenced his conclusions. In this sense, 'by focusing on the *ratio* of a promise as a reference point for a change of circumstances and its impact on the contract, Grotius developed (at least in principle) a more objective standard'.[71]

64 Visser (1984), p. 650.
65 Thier (2010).
66 Feenstra (1974), p. 89.
67 Grotius, *De jure Belli ac Pacis*, 2.16.26.1, cited by Visser (1984), p. 650.
68 Feenstra (1974), p. 89, states that in this subject Grotius followed the ideas of mediaeval canonists and civilians as well as authors of the Spanish scholastic school, the introduction of the requirement of the *indicia* being its innovation.
69 Grotius, *De jure Belli ac Pacis*, 2.16.27.1. Translation by Francis W. Kelsey, available at http://www.lonang.com/exlibris/grotius/gro-216.htm.
70 *Ibid.*
71 Thier (2010).

In the 17th century, the *clausula* doctrine was of great relevance, becoming part of the emerging doctrine of the *usus modernus pandectarum* as well as that of the natural lawyers.[72] In this context, Augustin Leyser argued for a broad application of the *clausula*.[73] His work is particularly interesting because of the elaboration of two ideas: Firstly, he argued (possibly for the first time) that if the promise contained multiple *rationes* then the contract should be modified in the case of changed circumstances: 'the promise is not dissolved, but modified in order to accommodate to the present time and condition'.[74] Secondly, his approach is clearly more objective since he required three conditions for the application of the *clausula*: a) the promise would not have been given if the new event would not have been present at the time of the conclusion of the agreement; b) the affected party must not be responsible for the change of circumstances; c) the parties could not have foreseen and prohibited the change of circumstances.[75] Thus, it has been argued that in the approach of Leyser 'the remedy for changed circumstances was no longer sought in the idea of a tacit condition. Instead it was considered to be crucial whether and to which extent the risk of a future change of circumstances could be located in the sphere of a contracting party.'[76]

3.3. The codification and the *clausula* doctrine

The acceptance of the *clausula* doctrine survived during the 18th century, though limited to essential changes of circumstances. Thus, the doctrine was incorporated by the early codifications of the 18th century. The *Codex Maximilianeus Bavaricus Civilis* of 1756 stated that contracts may be avoided in cases of changed circumstances if the change of circumstances was not due to the debtor, the possibility of a mutation was not easy to foresee, and the change of circumstances was not of trivial importance. If these conditions were fulfilled, the judge could terminate the contract or adapt it to the new situation.[77] In the same sense, the Prussian General Land Law of 1794 laid down the principle of *pacta sunt servanda*, but with an important qualification (§378 I 5): 'Apart from the case of factual impossibility, performance of a contract may not, as a rule, be refused on the ground of altered circumstances. If, however, an unforeseen change of circumstances makes it impossible to achieve the aim of both parties as expressed in the contract or inferable from the nature of the transaction, then each of them may resile from the unperformed contract'.[78] §380 I 5 added that 'If the alteration of circumstances frustrates the express or obvious purpose of one party alone, that party may withdraw from the contract on condition, if the alteration is a personal matter, of fully indemnifying the other party'.[79]

72 Zimmermann (1996), p. 581, states that the reason for such success was maybe the devastating wars of the time.

73 '*Omne pactum, omnis promissio, rebús sic stantibus, intelligenda est, ut Seneca, lib. 4 De Beneficiis c. 35 rem clarius explicat*', A. Leyser, *Meditationes at Pandectas*, Spec. XL, IV; cited by Zimmermann (1996), p. 581.

74 A. Leyser, *Meditationes at Pandectas*, Spec. 520, V, p. 847; cited and translated by Thier (2010).

75 Leyser, *Meditationes at Pandectas*, Spec. 520, 3, p. 843, Spec. 520, 4, p. 845, cited by Thier (2010).

76 Thier (2010).

77 Codex Maximilianeus Bavaricus Civilis, IV, c. 15 §12, cited by Gallo (1999) p. 286.

78 Translated by Lorenz (1995), p. 360.

79 Translated by Tony Weir, in Zweigert, Kötz (1998), p. 519.

A rule similar to the cited §378 I 5 was included in the Austrian General Civil Code, but limited to preliminary contracts.[80]

However, during the 19th century the doctrine of the *rebus sic stantibus* clause lost its importance. The influence of the contract theory of the Historic School which supported the absolute binding force of the contractual will and the doctrine of economic liberalism, with private autonomy, freedom of contract and certainty of law as its cornerstones fostered this change in legal thinking.[81]

As a consequence, the most important codifications of continental Europe, the German *Bürgerliches Gesetzbuch* (BGB), until the reform of 2002; and the French *Code Civil*, rejected the *clausula* doctrine and did not provide remedies in cases of unexpected circumstances.

Notwithstanding what has been stated above, in the 19th century the *clausula* doctrine found an important supporter in the German jurist Bernhard Windscheid through his theory of the 'doctrine of the contractual assumption' or 'tacit presupposition' (*Lehre von der Voraussetzung*).[82] Windscheid's theory stated that parties enter into contracts on the assumption 'that the intended legal consequence should only occur under certain circumstances'.[83] However, this assumption that a certain state of affairs will prevail was not elevated to the status of an express 'condition' of the transaction. Promises are not, strictly speaking, conditional, and the contract remains (formally) valid even if the assumption is falsified, but since this is not in accordance with the real intention of the parties, the contract, though valid and effective from a formal point of view, ceases to have any justification.[84] In this case, because the fulfilment of the parties' original expectations is the focus of Windscheid's theory, it is not fair and reasonable to insist on the fulfilment of a contractual promise, always provided, however, that the promisee was in a position to realise that the 'presupposition' had a determining influence on the will of the promisor.[85] The similarity of the presupposition with a true condition led Windscheid to designate the (tacit) assumption as an 'inchoate condition' (*unentwickelte Bedingung*) lying between a mere motive and a true condition.[86] The 'doctrine of the contractual assumption' was severely criticized, mainly on the ground that the 'assumption' was a kind of intermediate thing between a unilateral motive and a condition mutually agreed.[87] Both legal certainty

80 Thier (2010).
81 Zimmermann (1996), p. 579.
82 Thier (2010); Zweigert, Kötz (1998), p. 519; Lorenz (1995) p. 361. On this subject, the principal work by Windscheid was his monograph on 'Die Lehre des römischen Rechts von der Voraussetzung' (1850). See also *Lehrbuch des Pandektenrechts* (1865).
83 Cited by Zweigert, Kötz (1998), p. 519.
84 Zweigert, Kötz (1998), p. 519.
85 See Thier (2010).and Lorenz (1995), p. 361.
86 *Lehrbuch des Pandektenrechts* (1865) §§ 97 ff., cited by Zweigert, Kötz (1998), p. 519.
87 Zweigert, Kötz (1998), p. 519.

and the security of commercial dealings would be in great danger if one party were allowed to pass on his contractual risk to the other party.[88]

Although the first draft of the BGB included a provision which was in accordance with Windscheid's ideas, such a provision was excluded by the Second Commission on the ground that such a doctrine would endanger the security of commercial transactions and that the term 'presupposition' was not a useful legal concept which was clearly recognizable from the mere unilateral motives of a contracting party.[89]

Accordingly, the drafters of the BGB expressly refused to include a general *rebus sic stantibus* provision and instead 'intended that the Code provisions governing impossibility be construed narrowly and limited to cases in which the performance was literally 'impossible' rather than extremely onerous'.[90]

However, soon after the enactment of the BGB, the German courts started to develop a large body of case law to deal with unexpected circumstances, thereby allowing the termination or adaptation of the contract in cases of excessively onerous performance, mainly because of the serious events which affected Germany through the first half of the 20th century. The *Reichsgericht* first, and then the *Bundesgerichtshof* adopted different theories or grounds to justify their decisions, e.g. economic impossibility, Paul Oertmann's theory of the 'basis of the transaction' (*Geschäftsgrundlage*) and the principle of good faith (§242 BGB).[91] The long evolution of the doctrine and the case law led to the inclusion of a new provision on a change of fundamental circumstances (*Störung der Geschäftsgrundlage,* §313 BGB) in the context of the reform of the law of obligations in 2002 which modified the BGB. The new §313 BGB provides for, under strict conditions, the adjustment or termination of the contract if its performance has become burdensome for one of the parties or the contractual equilibrium has been severely disrupted.

In France, the 17th and 18th century legal practice and the commentators on local statutes and the case law of the *Parlements* admitted the resolution or adaptation of contracts of periodic performance and with an indefinite duration, which resulted mainly from feudal obligations, in cases of severe imbalances in the original contractual equilibrium.[92] The basis for such an acceptance was mainly the idea of equity in the parties' counter-obligations. However, the *clausula* doctrine was not included in the drafting of the French *Code Civil* and, on the contrary; a strong recognition of the *pacta sunt servanda* principle was laid down in article 1134. The rejection of a provision on this subject has been explained because of the absence of any doctrine of unforeseen circumstances in the

88 Lenel, O., '*Nochmals die Lehre von der Voraussetzung*' AcP 79 (1892) 49-107, cited by Lorenz (1995), p. 361.
89 Zweigert, Kötz (1998), p. 519 and Lorenz (1995), p. 362.
90 Gordley (2006), p. 348.
91 Further and comprehensive references to the evolution of German case law can be found in Rösler (2007), pp. 483-514, Lorenz (1995) and Zweigert, Kötz (1998).
92 Bruzin (1922), pp. 106-112, with detailed references to case law.

treatises of Jean Domat and Robert Pothier, works which were the main inspiration for the drafters of the *Code*.[93]

Accordingly, the case law of the *Cour de Cassation*, since the *Canal de Craponne* decision,[94] and traditional French contract law doctrine have provided absolute force to the principle of the sanctity of contracts, based on the cited article 1134 of the *Code Civil*, thereby rejecting the application of the so-called *théorie de l'imprévision*. However, recent case law and reform projects on the law of obligations in the Code Civil seem to accept the relevance of unexpected circumstances, but with very limited effects.[95]

The influence of the *Code Civil* in the 19th century codifications resulted in the inclusion of the *pacta sunt servanda* principle and the absence (and therefore the implied rejection) of the *clausula* doctrine or other objective theory with regard to unexpected circumstances in such codifications.

Thus, the Italian *Codice Civile* of 1865 was substantially based on the *Code*, because of the influence during the first half of the 19th century of the French *École de l'Exégèse* and also because the French model was compatible with the new unified Italy's needs. The principles of private property and freedom of contract were welcomed by the rising Italian *borghesia*, and the Roman law background of many of the provisions was familiar to legal scholars.[96] Therefore, in accordance with its model, the *Codice* of 1865 did not contain any provision which allowed the debtor to rely on a change of circumstances to terminate or adapt the contract when performance by one of the parties had become excessively burdensome. On the contrary, article 1640 (construction contracts) expressly rejects the revision of the contract price when there is an increase in the costs of materials or labour. In addition, article 1134 of the *Code Civil* was literally reproduced in article 1123 of the *Codice*, giving force of law to contracts validly agreed between the parties. Consequently, articles 1225 and 1226 only provide relief for the debtor in cases of impossibility caused by *force majeure* (*causa estranea, forza maggiore* or *caso fortuito*).[97]

However, by the end of the 19th century, Italian legal doctrine was vastly influenced by the German school of pandectists.[98] In this context, Windscheid's theory of tacit presupposition (translated into Italian as *presupposizione*) was accepted and developed by Italian doctrine, especially by those who were devoted to the study of the general doctrine of the *negozio giuridico* (i.e., the *Rechtsgeschäft*).[99] With this doctrinal background, a number of subjective (e.g. *clausula rebuc sic stantibus*, *presupposizione*) and objective (e.g.

93 Bruzin (1922), p. 105; and Gordley (2003), p. 39.
94 Cass. Civ., 6 March 1876, *D.P.* 1876, 1, 195, note Giboulot. See Chapter three.
95 For a detailed analysis, see Chapter three.
96 Cappelletti et al., (1967), p. 216.
97 The text of the *Codice Civile* of 1865 is available at http://books.google.nl/books?id=49h5kZnyiPcC&printsec=frontcover&hl=en#v=onepage&q=&f=false.
98 Zweigert, Kötz (1998), p. 105.
99 Macario (2010).

eccessiva onerositá of the performance, good faith) theories were developed to support the effect of unexpected circumstances on the binding force of contractual obligations.[100] Just as important as the reception of German legal doctrine were the calamitous effects on the performance and economy of contracts caused by some catastrophic events which affected Italy at the beginning of the 20th century, followed soon afterwards by both World Wars.[101] As a consequence, the *clausula* and its related doctrines also received a favourable reception in the Italian case law of the late 19th and early 20th centuries.[102]

Finally, the pressure to reform the *Codice* was compounded by the great economic and social changes which took place after Italy's unification, leading to a more social and less individualistic approach in the draft of the new *Codice*. In the law of contract, one of the innovations of the *Codice Civile* of 1942 was a new Section (articles 1467 to 1469) dedicated to the *risoluzione per eccessiva onerosità*, providing for the termination (*risoluzione*) or adaptation of the contract in cases of unexpected circumstances, provided that strict requirements were met.[103]

The same trend was present in Latin American jurisdictions. The French *Code Civil* was to a greater or lesser extent one of the main sources of the 19th century Latin American codifications. Possibly more relevant was the influence of the liberal doctrine which provided strong support for the ideas of individuality, private property and freedom of contract. Because of this, it is not surprising that such civil codes gave great relevance to the *pacta sunt servanda* principle and did not include provisions on unexpected circumstances except for cases of impossibility or force majeure.

However, again the severe economic circumstances and social changes of the 20th century and the reception of new legal theories such as the socialization of private law and solidarity in contract law led to the reform of the Codes and the inclusion of rules on the *théorie de l´imprévision* or excessive onerousness in such instruments.

Thus, the Civil Codes of Argentina and Paraguay were reformed in the 20th century to include a provision which was analogous to the rules of the Italian *Codice Civile*.[104] At the beginning of this century, the Civil Code of Brazil followed the same model with regard to this subject.[105]

The Peruvian Civil Code of 1984 contains a complete and innovative regulation of the subject, devoting six articles under the title of the 'excessive onerousness of the obligation'

100 For a detailed survey of the theories, see Traisci (2003), pp. 52-58.
101 Special war-time legislation was enacted to deal with the effects of such events on contracts: *Decreto Legislativo of 27.05.1915, no 739* and *Legge of 26.10.1940 no 1676*.
102 Philippe (1986), pp. 408-409; and Traisci (2003), pp. 52-58.
103 Further details in Chapter four.
104 Article 1198 of the Argentinian Civil Code (amended by Ley no 17.711 of 01.07.1968) and article 672 of the Paraguayan Civil Code of 1987. For further details on Argentinian law, see Chapter five.
105 Articles 478 to 480 of the Brazilian Civil Code of 2003.

(*excesiva onerosidad de la prestación*, articles 1440 to 1446). The rules are applicable to bilateral and aleatory contracts whose performance have become excessively onerous because of unforeseeable and extraordinary circumstances. The affected party is entitled to request the adaptation or termination of the contract and his claim (action) is subject to a brief prescription period (three months since the occurrence of the event which has given rise to the excessive onerousness).

Finally, the Colombian Commercial Code of 1971 also includes in its article 868 a provision on excessive onerousness which is applicable to commercial contracts with periodic or deferred performance. In addition, the Colombian legal doctrine has stated that such a provision is *vis-à-vis* applicable to civil contracts.

The main exception to this trend has been the Chilean Civil Code, whose Book IV on 'Obligations in General and Contracts' (*De las Obligaciones en General y de los Contratos*) remains without any significant amendments to its original draft. Based on the principle of *pacta sunt servanda*, expressly recognized in article 1545 of the Code in similar terms as article 1134 of the French *Code Civil*, the Supreme Court has historically rejected any revision of a validly concluded contract.[106]

4. Conclusions

Pacta sunt servanda and *clausula rebus sic stantibus* were not present as general principles in Roman law. Both ideas were developed from moral considerations by the canonists, and then received by the natural lawyers to be applied in the civil law sphere. Both doctrines were elaborated as manifestations of the human will and therefore as part of every promise, not as opposites but as complements. In addition, *pacta sunt servanda* was adopted as a consequence of the acceptance of consensualism in contract law, in that in the absence of formalities it was required that legal force be given to the mere word of the promisor; but the significance of the principle then evolved from this notion that all legally concluded agreements were valid to the concept of the absolute force of agreements in all circumstances

The rejection of the different doctrines of unexpected circumstances is a feature of the 19th century, as a natural consequence of the will theories and the liberal doctrine. In general, 19th century legal theory broke with the natural law theories, but its major feature was the use of the concept of will as the exclusive source of all the terms of the contract, without any consideration of other concepts, such as equity or the nature of the transaction as sources of the terms of the contract or means to limit the will of the parties.[107] However, such

106 However, a recent decision by the Court of Appeal of Santiago has admitted the application of the *théorie de l´imprévision* based mainly on the alteration of the basis of the transaction which caused a serious imbalance in the counter-obligations of the parties. *Guillermo Larraín Vial con Servicio de Vivienda y Urbanización de la Región Metropolitana*, Corte de Apelaciones de Santiago, 11.11.2006. For further details, see Chapter five.

107 Gordley, von Mehren (2006), p. 63.

rejection did not last for a prolonged period of time and throughout the 20th century the legal doctrine and the case law developed a number of theories to support the termination or adaptation of contracts in cases of supervening onerousness. This trend has been finally reflected in the provisions of several civil codes and international instruments or restatements. On the other hand, two of the major European jurisdictions, the English common law and the French, and one Latin American jurisdiction, Chile, still maintain a very restrictive approach to the subject.

The subsequent understanding of the principle of *pacta sunt servanda* as the binding force of promises in all circumstances only left room for the application of impossibility as an exception to such a principle. However, regardless of the approach to impossibility, it is not yet clear which contracts should or should not be enforced when performance becomes impossible after their conclusion. Neither is it clear what the role of fault is when there have been a lack of reasonable precautions to avoid the occurrence (or the consequences) of the event, because in some situations only if *vis maior* is present can the affected party be excused. The fact that the same questions can be raised with regard to changed circumstances reveals their evident relationship in the distribution of risks, implied terms and the achievement of the purposes of the parties.[108]

108 See Gordley (2006), pp. 344-346, 376-379.

PART II

COMPARATIVE SURVEY NATIONAL JURISDICTIONS

Chapter 3

FRENCH LAW

1. Introduction

Historically, French private law has been reluctant to recognize the effect of unexpected circumstances on the binding force of contracts: a party cannot claim relief from an obligation whose performance has become excessively burdensome due to an unforeseen change of circumstances. This situation is addressed in French law under the designation of *théorie de l'imprévision* or simply *imprévision*. In the case of *imprévision*, according to the French doctrine, the performance of the contract is still possible, but has become burdensome or even ruinous for one of the contracting parties because of the occurrence of an unforeseen event.[1] The problem is distinguished from *force majeure* or *cas fortuit*, where the performance has become absolutely impossible because of an unforeseeable event which is not imputable to the debtor who in this case is excused.[2] Both institutions also differ in their effects: in the case of *force majeure* the debtor is released from his obligation without further liability; in the case of *imprévision* the parties' duty to renegotiate and even the adaptation of the contract by the court should be the available remedies.[3]

The French notion of *imprévision* is mostly economic, in the sense that the relevant issue is the upheaval of the economic circumstances that leads to the severe imbalance between

1 Isabelle De Lamberterie (1989), p. 228.

2 Articles 1147 and 1148 Code Civil provide: [1147] A debtor shall be ordered to pay damages, if there is occasion, either by reason of the non-performance of the obligation, or by reason of delay in performing, whenever he does not prove that the non-performance comes from an external cause which may not be ascribed to him, although there is no bad faith on his part (Le débiteur est condamné, s'il y a lieu, au paiement de dommages et intérêts soit à raison de l'inexécution de l'obligation, soit à raison du retard dans l'exécution, toutes les fois qu'il ne justifie pas que l'inexécution provient d'une cause étrangère qui ne peut lui être imputée, encore qu'il n'y ait aucune mauvaise foi de sa part). [1148] There is no occasion for any damages where a debtor was prevented from transferring or from doing that to which he was bound, or did what was forbidden to him, by reason of force majeure or of a fortuitous event (Il n'y a lieu à aucuns dommages et intérêts lorsque, par suite d'une force majeure ou d'un cas fortuit, le débiteur a été empêché de donner ou de faire ce à quoi il était obligé, ou a fait ce qui lui était interdit). Translation available at www.legifrance.gouv.fr.

3 Fauvarque-Cosson (2004).

the counter-obligations and renders the performance excessively onerous for one of the parties. Therefore, the notion is linked to long-term contracts and in most cases the expectations of the parties or the purpose of the contract are not significant elements in the doctrinal analysis. The subject is therefore more restricted than in Germanic jurisdictions and does not include situations such as the doctrine of *frustration of purpose*.[4]

As stated in the following sections, traditional doctrine rejects the application of *imprévision* and the case law of the *Cour de cassation* has consistently refused to terminate or revise contracts on the basis of *imprévision*. However, modern French legal doctrine, as well as projects to reform the *Code Civil,* support the express admission of *imprévision* to a varying extent. In the same sense, recent case law has given limited recognition to the theory through the imposition of a duty to renegotiate in such a case. Nevertheless, in practice the judicial revision of contracts in situations where a change of circumstances has occurred is still not an available remedy for the affected party and the traditional approach is far from being discarded. These ideas will be developed in the sections below.

2. The provisions of the *Code Civil* and the traditional legal doctrine

As stated in the Chapter on the historic development of the doctrine of unexpected circumstances, in spite of the admission of the *clausula rebus sic stantibus* in legal doctrine and the case law of the *Parlements* in the 17th and 18th centuries, such a concept was not included in the draft *Code Civil* and, on the contrary, a strong recognition of the *pacta sunt servanda* principle was laid down in its article 1134: 'Agreements lawfully entered into take the place of the law for those who have made them. They may be revoked only by mutual consent, or for causes authorized by law. They must be performed in good faith'.[5] Thus, *contractual* obligations are imposed on the parties with the same force as a *legal* obligation is imposed on citizens.[6]

Accordingly, traditional French contract law doctrine has recognised the full force of the sanctity of contracts principle, based on article 1134 of the *Code Civil*: '*La règle pacta sunt servanda reste (…) un rempart inviolable (…)*'.[7] Thus, in the French legal tradition the contract must remain untouched so there can be no intervention by a judge, notwithstanding any

4 See Ancel (2006), adding that those subjects may be covered in French contract law by the notions of *cause* or *l´erreur sur les motifs*.

5 Article 1134: *Les conventions légalement formées tiennent lieu de loi à ceux qui les ont faites. Elles ne peuvent être révoquées que de leur consentement mutuel, ou pour les causes que la loi autorise. Elles doivent être exécutées de bonne foi*. Translation available at www.legifrance.gouv.fr.

6 The provision is based on Domat's treatise *Les lois civiles leur ordre naturel*, Livre I, sec. II, VII which stated that 'Les conventions étant formées, tout ce qui a été convenu tient lieu de loi à ceux qui les ont faites et elles ne peuvent ètre révoquées que de leur consentement commun', adding that for the contracting parties 'se font entr'eux une loy d'exécuter ce qu'ils promettent'; cited by Terré et al., (2002), p. 433.

7 J.P. Niboyet, La Révisión des Contrats par le Juge, Rapport Général, in *Rapports Préparatoires à la Semaine Internationale de Droit*, Societé de Législation Comparée, Sirey, 1938, at 1 et ss; cited by Mazeaud (2008), pp. 554-555.

circumstances which threaten its existence.[8] Based on the ideas of economic freedom and the certainty of the law, the drafters of the *Code Civil* gave prevalence to the principle of the security of transactions rather than values such as justice or equity in contracts.[9] In addition, because of the abuses of the *ancien régime*, any restriction on the powers of the courts was based on historical reasons: *Que Dieu nous garde de l'équité des parlements*.[10] Finally, it is said that the provision of article 1134 is grounded in the moral obligation to keep one's word and in the economic and social system which implies the principle of the security of transactions by which 'the interest of the society as a whole is that promises must be kept'.[11] Therefore, in its original draft, the *Code* only admitted *imprévision* in very limited or specific cases of leasing rural property (articles 1769 to 1773).

Hence, under article 1134 judges are restricted and bound by the *loi des parties* (as established in the contract) and only have the power to ensure its application. The negative attitude to the revision of contracts and, therefore, their adaptation to new circumstances would be consistent with the general philosophy of the *Code*, which only relieves the performance of the debtor in cases of *force majeure* (an absolute impossibility of performance without fault on the part of the debtor).[12] Thus, a judge interfering in a contract is considered to be a source of instability and arbitrariness, particularly if it is related to an economic evaluation of the counter-obligations or contractual equilibrium.

Consequently, traditional French legal doctrine rejected the application of the doctrine. More precisely, in general the legal doctrine of the first half of the 19th century ignored the subject because it was devoted to commenting, through the exegetic method, on the text of the articles of the *Code*. The opinion of authors later in the 19th century who referred to the subject was very unfavourable towards the application of *imprévision*. Thus, Demolombe and Laurent stated that such a doctrine was not compatible with the *pacta sunt servanda* principle of article 1134 and that agreements could not be avoided due to the occurrence of supervening circumstances unless their performance had become absolutely impossible (*force majeure*). In the same sense Aubry and Rau stated that the contract could only be terminated if the parties had expressly provided for a change of circumstances as a condition to terminate the contract. Only Larombière took a different but imprecise approach by which he confused the situation of unexpected circumstances with cases of force majeure.[13]

8 Mazeaud (2007), p. 770.
9 Ghestin (1990), pp. 116-117. Mazeaud et al., (1996), no 210. Carbonnier (2000), at p. 286 states that the problem of *imprévision* could not be ignored by the drafters of the Code Civil, being the solution in article 1134 which is deliberately negative.
10 Baudouin (1969), p. 154. Ghestin (1990), p. 117.
11 Mazeaud et al., (1996), p. 845.
12 Baudouin (1969), p.159, adding at p. 171 that '…under a formal interpretation of the present legislation of France…no really solid legislative ground can be found for the admission of a general authority for judicial revision'.
13 All Cited by Bruzin (1922), pp. 171-173.

On similar grounds, the majority of the legal doctrine of the first half of the 20th century was also against the admission of *imprévision*.[14] Thus, the ideas of the existence of an implicit *rebus sic stantibus* clause, an unjustified enrichment or an abuse of rights by the creditor to justify the intervention of the courts in cases of *imprévision* were consistently contested.[15] In the same sense, the arguments based on articles 1134 and 1135 Code Civil, which state that contracts have to be performed in good faith and in accordance with equity were rejected since it is stated that such articles are rules for the interpretation of ambiguous clauses or gaps in the contract: 'No article of the *Code Civil* authorizes a party to request the termination of the contract based on that performance of the contract has become more difficult than expected because of supervening events. Thus, paragraph 3 of article 1134 does not establish a special ground of termination. On the contrary, it specifies the scope of the parties' obligations. The parties must act in good faith, that is, with honesty and loyalty and the meaning of such paragraph is that the parties have to do not only what is expressed in the contract, but also what according to equity, the custom or the law belong to the nature of the obligation'[16]

Notwithstanding the juridical arguments, it has been stated that the *raison profonde* for the rejection of the revision of contracts by legal doctrine, and consequently by case law, is the risk of arbitrariness by the judge if he substitutes his own will for the free will of the parties.[17] Thus, the introduction of a general provision on *imprévision* was considered to be a threat to the stability of transactions and only the specific intervention of the legislator in particular cases could avoid or reduce the risks of the courts' arbitrariness.[18]

3. The traditional case law

The *Cour de Cassation* has consistently rejected the revision of contracts in cases of *imprévision*. The landmark case in this field is *l'arrêt Canal de Craponne*[19] in which the *Cour* laid down the foundations for its rejection of the possibility to judicially revise or adjust contracts: '*….dans aucun cas, il n'appartient aux tribunaux, quelque équitable que puisse apparaître leur décision, de prendre en considération le temps et les circonstances pour modifier les conventions des parties et substituer des clauses nouvelles à celles qui ont été librement acceptées par les contractants*'.[20] The facts of this case are as follows: by means of a contract dating from the sixteenth century, Sieur de Craponne had agreed to construct a canal for a certain sum of money. Since the water in this canal could also be used for irrigating the orchards of the community of Pélissane, its inhabitants had to pay a modest

14 Philippe (1986), p. 60.
15 See Mazeaud et al., (1996) pp. 859-860; Philippe (1986), p. 63-66; De Lamberterie (1989), pp. 229-231; Ghestin (1990), pp. 158-165.
16 Capitant, cited by Ghestin et al., (2001), p. 331. Author's own translation.
17 M. Planiol and G. Ripert, p. 553, cited by Philippe (1986), p. 61.
18 C.M. Popescu and R. Capitant, cited by Ghestin (1990), p. 172.
19 Cass. civ., 6 March 1876, *DP* 1876, 1, 195, note Giboulot.
20 '…in any case, it is not for the courts, however just their decision may seem to them, to take time and circumstances into account in order to modify contracts entered into by the parties and to replace those terms which have been freely agreed upon by the parties with new terms'. Author's own translation.

sum to maintain the canal. After three centuries, when the case came before the courts, the agreed sum had become insignificant and totally insufficient to cover the maintenance costs of the canal. The court at first instance and the Court of Appeal at Aix increased the sum to what was thought to be a reasonable amount. Their decisions were based on grounds of equity and with the aim of restoring the economic balance between the counter-obligations, but the *Cour* gave prevalence to the *pacta sunt servanda* principle as laid down in article 1134 of the Code.[21] Then, the binding force of contracts is given preference over any altered circumstances and therefore the *loi du contrat* is also compulsory as far as the courts are concerned. Thus, only the parties by their mutual agreement may adjust or modify the contract, because they are the only ones who are qualified to determine the terms of the contract which protect their mutual interest.[22]

Subsequent decisions confirmed the *Cour* criteria on the subject. The *Cour* retained its position that the judicial revision of contracts was to be rejected in cases of excessive onorousness even when the performance of the contract had been severely altered by the outcome of both World Wars. Thus, in cases relating to contracts for the lease of livestock[23] and for the delivery of coal at fixed price[24] the *Cour* refused to revise agreements on the ground of *imprévision*.

The termination, suspension or adaptation of the contract was refused in further cases. Thus, the massive political unrest of 1968 was not considered to be a case of *force majeure* and therefore an employer (a theatre) was not entitled to suspend payments to its employees.[25] In the same sense, modifications to a contract price were denied in cases where economic circumstances had changed since the conclusion of the contract. In a decision of 18 December 1972, the *Cour* stated once more that 'the courts cannot, based on equity or on any other grounds, modify the agreements lawfully concluded by the parties' and therefore it quashed a decision by the *Cour d'appel* of Paris which stated that in the case of new economic circumstances the price agreed upon in the contract should be increased so as to meet the parameters of a 'fair price' (*un juste prix*).[26] Accordingly,

21 See Capitant et al., (2000) pp.123-126; Zweigert, Kötz (1998), p. 526; De Lamberterie (1989), p. 228.

22 The Canal de Craponne decision was preceded by a series of cases in the first half of the nineteenth century. In those cases, the *Cour* had quashed certain decisions of lower courts which had granted the termination of insurance contracts which had become excessively onerous because of the Crimean War, on the grounds that they were not cases of force majeure leading to an absolute impossibility to perform (Civ. 9 Jan. 1856, *DP* 1856. 1. 33; 11 Mar. 1856, *DP* 1856. 1. 100). See Capitant et al., (2000) p. 127.

23 Civ. 6 June 1921, *D.* 1921.1.73, rapp. A Colin; 30 May 1922, *D.* 1922.69; cited in Capitant et al., (2000), p. 127.

24 Civ. 14 Nov. 1933, *Gaz. Pal.* 1934. 1 58, cited in Capitant et al., (2000) p. 127. In this case, the contract was dated 1845. The *Cour* unambiguously stated that, even after the passage of many years, there was no possibility to adjust the contract and that instead the price determined by the parties was valid in perpetuation.

25 Cass. Soc. 08 Mar. 1972, *D.S.* 1972. J. 340 cited in Gordley, von Mehren (2006).

26 Bull. Civ., IV. N. 339, p. 266; cited by Ghestin (1990) p. 127. See Terré et al., (2002), p. 462 for further references to case law.

the *Cour* also stated in several decisions that clear and precise commitments cannot be removed on grounds of equity (*au nom de l 'equité*).[27]

It has been stated that case law's consistent refusal to terminate or revise contracts in cases of *imprévision* is a deliberated option based on juridical and economic grounds. With regard to the juridical reasons, the rejection seems to be based on the aim of avoiding bad faith by contracting parties who only seek to escape from detrimental dealings and to prevent the danger of contractual instability as a method to ensure the principle of the security of transactions. On the other hand, the economic reasons would be grounded on the eventual risk that the admission of the effects of *imprévision* might generate: an unmanageable chain reaction of claims by parties who were in a similar situation. In this sense, it is considered that the courts are not in a position to evaluate the entire social and economic consequences of their decisions, and that the legislator is the only one who is qualified to intervene in cases where a large number of parties would be affected by a severe change of circumstances.[28] In other words, it would be extremely dangerous to leave the contract to the individual sense of equity or public interest of judges, thereby threatening the economic system and the security of transactions.[29]

However, the mentioned juridical and economic grounds can be considered to be a product of the interpretation of the case law by the legal doctrine more than express statements to be found in the decisions, because most of the time such foundations are absent (at least expressly) therefrom, and are grounded in the *letter* of the law (in this case, mainly article 1134) as an impediment to the recognition of *imprévision* and consequently to the granting of powers to the courts to intervene in the contract.

4. Legislative intervention

The general reluctance of the civil courts in France with regard to the revision or termination of contracts in cases of *imprévision* has led to repeated intervention by the legislator through the enactment of laws with temporary or indefinite force. Thus, notwithstanding the lack of a general statutory provision on *imprévision* in French Private Law, the legislative tendency is for increasing intervention to permit the adaptation of contracts in specific cases.[30]

The basis of this legislative policy is not clear. Some of these measures are the expression of a 'protective public policy'; i.e. the protection of individual interests and the correction of injustice, thereby re-establishing the balanced reciprocal obligations of the parties after they have been damaged by new circumstances (e.g. a housing crisis or currency

27 Cass. Civ., 15 Nov. 1933, *Gaz. Pal.* 1934.168; 2 Dec. 1947, *Gaz. Pal.* 1948.1.36; 16 Jan. 1961, *Bull. Civ.* I, no. 34, p. 27; Cass soc., 12 May 1965, *D.* 1965.652; Cass soc. 11 may 1994, *D.* 1995.626, note C. Pingelier; cited on Terré et al., (2002), p. 440.

28 See Capitant et al., (2000), pp. 128-129.

29 Mazeaud et al., (1996), p. 857.

30 Ghestin (1990), p. 301.

devaluation). However, some are instruments of an interventionist economic policy, by which the legislator seeks to introduce some order into contingent events through a genuine economic policy.[31]

Although a detailed analysis of such specific legislative interventions is outside the aim of this research, some of them deserve special attention. Thus, with regard to temporary legislation the *loi Failliot* of January 21, 1918 stated that courts may terminate contracts concluded before August 1, 1914 for the delivery of goods and, if the case required, to grant damages 'if performance by the contractor would cause hardship or loss greatly in excess of what could reasonably be expected at the time of the contract'.[32] After World War II the *loi* of April 22, 1949, provided that contracts concluded before September 2, 1939, could be terminated for similar reasons if an action was brought before July 1, 1949.

As stated above, in other cases the French legislator has introduced for specific contracts or situations 'permanent revision systems' which are not related to contingent or distressing socio-economic circumstances.[33] Thus, the *loi* of July 13, 1930, applicable to insurance contracts, authorizes modifications to the premium when the risks increase or decrease.[34] The *loi* of March 11, 1957, on literary and artistic property allows the author who has assigned his rights to request a revision of the terms of the assignment where the financial provisions are inadequate. In inheritance law, the *loi* no. 2006-728 of June 23, 2006 modified article 828 the Code Civil which provide that where the debtor of a balance has obtained time for payment and, as a result of economic circumstances, the value of the property in his share has increased or lessened by more than a quarter since the partition, the sums which remain due shall increase or lessen in the same proportion. However, the parties may exclude this provision by agreement.[35] The aim of the provision is to maintain the balance in the distribution of the estate. Similarly, in cases of divorce, articles 275 and 276-3 of the Code Civil as amended by the *loi* no. 2004-439 of May 26, 2004, give the right to the debtor of a compensatory benefit to request its judicial revision when there is a considerable change in his or her situation or in the means or needs of either party.

The *loi* of July 4, 1984, permits the judge to revise the terms and burdens imposed in certain gifts. Article 900-2 Code Civil provides that 'A beneficiary may apply for judicial revision of the conditions and charges encumbering the gifts or legacies which he has received, where, in consequence of a change of circumstances, performance of them has become for him extremely difficult, or seriously detrimental'.[36] In this case, the powers granted to the judge to modify the donation or the will are particularly broad.[37]

31 De Lamberterie (1989), pp. 233-234.
32 Translated by T. Weir in Zweigert, Kötz (1998), p. 527.
33 Fauvarque-Cosson (2004).
34 Article L113-4 of the *Code des assurances*, modified by the *loi* no. 89-1014 of 31 December, 1989.
35 The text is similar to the abrogated article 833-1 introduced by the *loi* of July 3, 1971.
36 Translation from http://www.legifrance.gouv.fr/.
37 Fauvarque-Cosson (2004); Ghestin (1990), p. 123.

Finally, the *loi* of July 9, 1991, modified article 1244 Code Civil and inserted a new article 1244-1, which states that 'taking into account the debtor's position and in consideration of the creditor's needs, a judge may, within a two-year limit, defer or spread out the payment of sums due. By a special judgment, setting out the grounds on which it is based, the judge may order that the sums corresponding to the deferred due dates carry interest at a reduced rate which may not be lower than the statutory rate or that the payments be appropriated first to the capital'.[38] By this *délai de grace*, the judge may intervene in the agreed performance of the contract by suspending the debtor's performance. The judge does not have the power to modify the quantum of the obligation, but he may adapt the stipulations of the parties with regard to the time of performance and the rate of interest agreed, based on the economic circumstances of the debtor and the creditor.[39] Article L313-12 of the *Code de la consommation* also provides that 'The performance of the debtor's obligation may, in particular, in the event of termination of employment, be suspended by order of the *juge d'instance* in accordance with the conditions provided for in articles 1244-1 to 1244-3 of the French civil code. The order may decide that, during the period of grace, the sums owing will not produce any interest at all.' According to paragraph two, the judge is entitled to determine the payment terms of the suspended performance, with a limit for the final payment of two years exceeding the original term of the loan.[40] Once again, the judge is entitled to intervene in the contract by modifying relevant aspects of the performance as well as the term for the execution of the debtor's obligation.

5. The different approach of French administrative law

After the *arrêt Gaz de Bourdeaux*, administrative French law elaborated an autonomous doctrine of *imprévision* which was different from the approach of private law.[41] The case concerned a contract concluded in 1904 by a gas company to supply gas and electricity to the city of Bordeaux at fixed rates over a period of thirty years. After the outbreak of the First World War, the price of coal rose considerably, and the company sought to have the rates increased due to the altered circumstances. At first instance the company's application was rejected by the *Conseil de Préfecture* of the Department of Gironde. On appeal to the *Conseil d'Etat* (the French superior administrative court) the decision was quashed. The *Conseil* stated that the fact that the coal-producing areas of central Europe were in enemy hands, and ocean transport had become extremely onerous as a consequence of the war, subverted the whole economic basis of the contract and therefore the increased cost 'certainly exceeds the outer limits of the increases that could have been contemplated by the parties when the concessionary contract was concluded'.[42] The *Conseil* took into account the 'general interest which requires the continuation of company services.' It was stated that if the parties were unable to reach an amicable settlement, the court must grant the utility company a claim for a contribution from the consumer so as to cover some part

38 Translated in http://www.legifrance.gouv.fr/.
39 Ghestin et al., (2001), p. 299.
40 Article L313-12, *Code de la consommation*, translation available in http://www.legifrance.gouv.fr/.
41 CE 30 March 1916, *D.* 1916.3.25, S. 1916.3.17.
42 Translation by Aubrey (1963), p. 1175.

of the loss which would otherwise be caused by the continuance of the contract.[43] For that reason, the relief awarded was not a full indemnity but an indemnity with the foreseeable additional burdens deducted. The company had to support that portion of the onerous consequences caused by the supervening events that a reasonable interpretation of the contract would leave to its charge.[44] After this decision, abundant case law along the same lines emerged from the administrative courts.[45]

Therefore, the administrative courts do not adapt the contract to the new circumstances, but the parties are rather invited to reach a settlement. Based on these grounds, it has been stated that there are no technical differences between the case law of the *Cour* and that of the *Conseil* because in both cases that adaptation of the contract by the court is not an available remedy for the affected party.[46] Because the foundation of the doctrine is the necessity to protect the public interest through the continuation of the service, the contractor cannot request the termination of the contract or refuse to perform its obligations and the consequence of the failure to renegotiate is the granting of compensation (*indemnité d'imprévision*) to the contractor which covers part of the additional burden.[47] However, such compensation is provisional since if the economic imbalance becomes permanent (e.g. if the parties are unable to reach a new agreement or the supervening events do not disappear) the case is considered to be one of *force majeure* and then the contract may be terminated.[48]

However, the conditions for the application of the *imprévision* doctrine are very strict: it is only applicable to administrative contracts, i.e. whose object is the execution or operation of a public service (e.g. concessions, procurement contracts for supplies, services or transport).[49] 'Private contracts', i.e. contracts concluded between the authority and private parties with an objective which is different from the ones mentioned above, are therefore excluded. In addition, the supervening events have to be unforeseen, external to the parties and resulting in a far-reaching alteration to the economic balance of the contract which exceeds the reasonable expectations of the parties at the time of contracting.[50] The doctrine is imperative for the parties (*d'ordre public*) and therefore cannot be excluded from the contractual relationship.

The different approach between administrative law and private law has been explained because in private contracts there is no public interest involved while in the performance of administrative contracts the interest of the community requires the continuity of the public service through, if necessary, a revision of the terms originally agreed upon. However, such

43 Zweigert, Kötz (1998), p. 526.
44 Aubrey (1963), p. 1176.
45 For instance, CE 9 Dec. 1932, *S.* 1933-3-39; CE 15 July 1949, *S.* 1950-3-61; See Fauvarque-Cosson (2004) and Ghestin et al., (2001) for further references.
46 Flour et al., (2002), p. 407.
47 Fauvarque-Cosson (2004); Ghestin (1990), p. 133.
48 CE 9 Dec. 1932, *D.* 1933.3.17. See Fauvarque-Cosson (2004).
49 Philippe (1986), pp. 79-80.
50 Fauvarque-Cosson (2004).

an explanation has been criticized because both in private and administrative contracts the public and the private interest are mostly mixed, as is evident in public economic policies (e.g. protective rules or particularly the specific intervention of the French legislator in some cases allowing the revision of contracts), and because some private contracts are also necessary for the correct operation of public services.[51] As a result of such criticism, the *Conseil d'État* has stated that the revision of administrative contracts in cases of *imprévision* is not founded exclusively on the necessities or continuity of the public service but also on the right of the private party to a certain degree of economic equilibrium.[52] In conclusion, it can be stated that the different approach of French administrative and private law has no valid justification nowadays and in this sense it is regarded by modern legal doctrine as being somewhat incoherent.[53]

6. The approach of modern legal doctrine

Notwithstanding what has been stated in the preceding section, modern French legal doctrine supports the revision of contracts in cases of *imprévision*.

In this sense, Ghestin and other French scholars have found that it is necessary for French law to recognize some exceptions to the absolute *pacta sunt servanda* principle because the social efficiency of the contract demands the possibility of the revision or termination of the agreement in restricted cases where serious injustices result from an excessive imbalance between the counter-obligations.[54] In this analysis, the usefulness (*utilité*) of the contract is considered to be a guarantee for the general interest which is complemented with the principle of justice (*le juste*) as a guarantee for the equilibrium between the reciprocal rights of the parties.[55]

Thus, an important part of the modern doctrine is in favour of the possibility of a judicial adaptation in the case of unexpected circumstances. It has been argued that the judge is not a mere interpreter of contracts but a collaborator of the parties in order to give sense to the agreement through inquiring into its common intention.[56] The revision of a contract, as an exceptional remedy in cases of serious change of circumstances, such as unexpected economic or social instability, is considered as the only alternative to the non-performance of the contract and, therefore, its termination. The revision would then be not a cause of insecurity in transactions but a way to preserve the contract and to return stability to the relationship between the parties.[57]

51 *Ibid.*
52 Mazeaud (2008) p. 583; and Fauvarque-Cosson (2004).
53 Fauvarque-Cosson (2004).
54 Ghestin (1990), p. 173. In the same sense, Terré et al., (2002), p. 434.
55 Ghestin (1990), p. 173.
56 Demogue (1923), pp. 525-544.
57 Mazeaud (2008), pp. 583-584.

The revision of contracts is usually supported by paragraph 3 of article 1134, which states that contracts must be performed in good faith. Thus, it has been said that the courts may revise the terms of the contract if its execution will be ruinous for the party affected by the change of circumstances and it is still possible for the other party to continue the contractual relationship after its modification. In the same sense, a revision is linked to the unjust enrichment of the creditor from the performance of the contract in the altered circumstances. The unforeseeability of the new circumstances and the difficulty or onerousness of the performance for the affected party is not enough for the revision of the contract if they are not connected to an unjust profit for the creditor if the contract is performed as it stands.[58]

Accordingly, Denis Mazeaud has stated that the institution of the revision of contract 'has a bright future' because the main arguments against it have currently lost their force. In the first place, the courts are no longer considered to be the main enemy of contractual stability, because in cases where the legislator has granted the courts the power to revise contractual terms, they have used this power with moderation and under strict conditions.[59] In the second place, the traditional view of contracts based on the ideas of the liberal doctrine, by which contracts are the reflection of the equality and the free will of the parties and are therefore fair and immutable instruments, has been replaced by a notion which sees contracts as instruments to promote solidarity, justice and equity. New duties such as loyalty and cooperation (*loyauté* and *coopération*), derived from the general duty of good faith, are imposed on the parties in order to introduce moral aspects to contractual relationships.[60] Besides this, good faith and equity have become the main instruments for the intervention of the courts in the interpretation and performance of contracts. Thus, the *Cour* de cassation has emphasized the relevance of good faith in all contractual phases 'which implies, especially in contracts whose performance takes place successively or in instalments, a sort of ethical solidarity and a community of interest'.[61]

In the same sense, new values in contract law such as the *proportionality* and *continuity* (*proportionnalité* and *pérennité*) of contractual relationships support the notion that in cases of serious imbalances between the counter-performances, the efficiency of contracts is better achieved if the contract is preserved rather than terminated through a system

58 Ripert (1925). Ripert places its ideas with regard to the revision of contracts in a broader theory of the 'abuse of right'. In the case of unexpected circumstances, the foundation of the revision is the abusive exercise of their rights by the creditor, which has as consequences its unjust enrichment and the ruination of the debtor.

59 This was the case in the *loi du 9 julliet 1975*, which gave the courts the power to reduce excessive *clauses pénales* (liquidated damages clauses). See Mazeaud (2008), p. 559, concluding that 'l'existence d'un pouvoir de revision judiciaire ne rime pas fatalement avec l'instabilité contractuelle et n'emporte pas nécessairement la chute des colonnes du temple contractuel.'

60 Terré et al., (2002), pp. 434-440.

61 The Rapport du groupe de travail de la Cour de cassationSur l'avant-projet de réforme du droit des obligations et de la prescription is available at http://www.courdecassation.fr/institution_1/autres_publications_discours_2039/discours_2202/travail_cour_10699.html.

of remedies which provides sufficient alternatives to such an aim.[62] As stated above, the experience in cases in which the courts have been granted powers to intervene in contracts is indeed positive and so the argument relating to risks to the stability of the socio-economic system has lost its relevance.[63] Also the decisions of the *Assemblée plénière* of the *Cour* of 1 December of 1995 with regard to the powers of the courts to determine the contract price have been considered as a positive step towards the legal recognition of *imprévisión*.[64]

However, despite the optimism of the legal doctrine, the approach of the Cour de Cassation is still highly restrictive. Thus, the *Cour* has recently stated that even when the rule of paragraph 3 of article 1134 allows the judge to sanction the bad faith utilization of a contractual right, the provision does not grant him the right to alter the substance of the terms validly agreed upon by the parties.[65] The decision clearly determines the pre-eminence of the principle of the sanctity of contracts as contained in paragraph 1 of article 1134 over the requirement of good faith in its performance as contained in paragraph 3 of the same provision. This has been criticized as being inconsistent in the light of the decisions of the *Cour* which have sanctioned bad faith on the part of the party who refuses to revise the terms of the contract when a change of circumstances has disturbed the economic equilibrium.[66]

Thus, the arguments related to the risks to economic stability still have a strong influence. It has therefore been stated that a general recognition of a revision is considered '*moralement souhaitable mais économiquement dangereuse*' because that would lead to consequences which cannot be measured by the courts and, consequently, a decision with disastrous economic consequences cannot be morally justified. Therefore, '*le facteur moral est subordonné au factor économique*'. To revise contracts is to revise the economy and that is the prerogative of the legislator, not the judge.[67]

In the same sense, the decision of 18 March of 2009 of the *Cour de cassation* has once again confirmed the supremacy of the *pacta sunt servanda* principle as laid down in article 1134 of the Code. The heirs of a lessor claimed an increase in the amount of rent based on the substitution of the lessee's obligation to take care of the lessor with its equivalent in money. The claim was accepted by the *Cour d'appel* with a view to maintaining the contract equilibrium which had been distorted when the care obligation had become impossible. On appeal in cassation the decision was reversed by the *Cour* because the contract did not include any provision regarding the modification of the performance of

62 See Mazeaud (2008) p. 559-561. See Chapter nine.
63 Fauvarque-Cosson (2004).
64 Capitant et al., (2000) p. 131.
65 Cass. com., 10.07.2007, pourvoi n.06-14768, note D. Mazeaud, *RDC* 2007-4-005.
66 *Ibid*.
67 See Flour et al., (2002) par. 411.

the agreed obligations and therefore a revision of the contractual terms implied a violation of paragraph 1 of article 1134.[68]

7. Modern case law

7.1. The limited recognition of *imprévision* through the duty to renegotiate

Recently, the case law of the *Cour de cassation* has provided a limited (but not express) recognition of the effects of unforeseen circumstances. Consistent case law of the *Cour* has held that a duty to renegotiate does exits if performance by one party has become excessively onerous, thereby radically changing the original contractual equilibrium.[69] Based on the last part of article 1134 which establishes the duty to perform contracts in good faith, the *Cour de Cassation*, first by its *Chambre commerciale* and then by its *Chambre civile,* stated that if unforeseen and serious circumstances result in a severe imbalance in contractual equilibrium, the principle of good faith and the duty of loyalty between the parties give rise to a duty for the advantaged party to renegotiate the terms of the contract at the request of the affected party. Thus, in *l'arrêt Huard*,[70] the *Cour* stated that an oil company was liable to pay damages because it had not executed a distribution contract in good faith when it had refused to provide one of its clients with the means (in this case, a price revision) to improve its deteriorated economic situation during the period of performing the contract because the agreed price was no longer competitive. Six years later, in *l' arrêt Chevassus-Marge*,[71] the *Cour* applied the same reasoning in deciding that a principal which had not authorized its commercial agents to fix competitive market prices was indeed liable. In both cases, the duty of loyalty was invoked to incur the liability of the party which refused to renegotiate the agreement when the performance of the contract had become excessively disadvantageous for the other.

The case law of the *Chambre commerciale* was confirmed by the *Chambre civile* in a case on 16 March of 2004.[72] A company which had a franchise over a restaurant run by public organization wanted to terminate of the contract based on a disturbance to the contract's equilibrium. The claim was rejected by the Court of Appeal, which also held that the company had to pay damages for breach of contract. Based upon the duty of good faith as provided in articles 1134 and 1147 of the *Code Civil* the company entered a plea of *cassation* arguing that the imbalance of the obligations as result of the predominance of one party at the time of concluding of the contract, which made performance excessively difficult, imposed on the advantaged party a duty to renegotiate the terms of the contract

68 Civ. 3e, 18 mars 2009, n. 07-21.260, *D*. 2009. AJ 950, obs. Y. Rouquet.

69 Cass. com., 3 November 1992, « *arrêt Huard* », *D*. 1995, Somm. p. 85, note D. Ferrier; Cass. com. 24 November 1998, « *arrêt Chevassus-Marge* », *D*. 1999, IR p. 9; Cass. civ. 16 March 2004, *D*. 2004 Somm. p. 1754, note Denis Mazeaud; CA Nancy 2nd Ch. Com. 26 September 2007, *La Semaine Juridique* No 20, 14 May 2008, p. 29.

70 Cass. com, 3 November 1992, *D*. 1995, Somm. p. 85, note D. Ferrier.

71 Cass. com. 24 November 1998, *D*. 1999, IR p. 9.

72 Cass. civ. 16 March 2004, *D*. 2004 Somm. p. 1754, note D. Mazeaud.

so as to restore the contractual equilibrium. However, the *Cour de cassation* rejected the motion stressing that if the economic imbalance in the obligations was present at the time of concluding the contract and was not the effect of an unexpected change of circumstances, no duty to renegotiate would arise and the disadvantaged party must bear the consequences of its negligence or imprudence when concluding the contract. *A contrario sensu* the *Cour* decision has been interpreted in the sense that if an unforeseen change of circumstances seriously affect the balance between the mutual obligations, a duty to renegotiate will arise in order to restore that balance.[73]

Therefore, the imbalance in the contractual equilibrium between the counter obligations of the parties must be precisely caused by the supervening events during the period of executing the contract. Any imbalance which is present at the time of concluding the contract is not considered to breach the principle of good faith with regard to the principle of freedom of contract and the assumption of equality between the parties.[74] In this sense, the *Cour* made a distinction in its decisions between a structural imbalance in the contract (*déséquilibre structurel du contrat*) and an unforeseen change of economic circumstances (*modification imprévue des circonstances économiques*). In the first case, the affected party cannot rely on that imbalance to terminate the contract or to request renegotiations and it has to perform its obligation whatever the difficulty or onerousness in performing might be if the contract had been freely concluded.[75]

Based on the facts of the mentioned decisions, some French scholars have stressed that this duty only arises if the change of circumstances resulted from the conduct (*fait*) of the advantaged party and therefore its occurrence is not completely independent of the parties.[76] However, in the decision dating from 2004, the *Chambre civile* expressly referred to an unforeseen (*imprévue*) change of the economic circumstances, hence beyond the control of the advantaged party. This statement has been highlighted as relevant by the legal doctrine because the case law of the *Cour* can then be considered as an exception to the principle of the sanctity of contracts based on the first part of article 1134 of the *Code Civil* and to the rejection of revision of contracts in cases of *imprévision*.[77]

73 *Ibid*., p. 1756.

74 The general principle in French civil law is the validity of the '*contrats lésionnaires*', i.e., contracts with a serious but initial imbalance between the mutual obligations. However, the *Cour de Cassation* has relied upon the concepts of *cause* and economic duress (*violence économique*) to avoid contracts with an original imbalance. Also special legislation (consumer and competition law) has adopted a different approach. See Mazeaud (2004), pp. 1757-1758.

75 Unless it proves that the other party is guilty of abusive conduct at the time of concluding the contract, e.g. deceit (*dol*) or duress (*violence*).

76 In this sense, Molfessis, N., *Les exigencies relatives au prix en droit des contracts*, in Le contrat: questions d'actualité, LPA, 5 May 2000, p.41; cited by Mazeaud (2004), p. 1756.

77 *Ibid*.

7.2. The rejection of court revision

In spite of the mentioned developments, the approach of the *Cour de cassation* towards the judicial revision of the contract is still negative. Therefore, it must be stressed that the duty to renegotiate is considered by the *Cour* as a last and only resort for the disadvantaged party in a case of changed circumstances, and no right is granted to have the contract terminated or adjusted by the court.

Accordingly, in a decision on 3 October of 2006,[78] the *Cour de cassation* stated that renegotiation clauses do not in any case (*en aucune façon*) impose a duty to accept the modification of the contract proposed by the counterparty but only a duty to renegotiate under the principles of good faith and fair dealing, and to explore the methods for adapting the contract to the supervening circumstances. In this case, the parties had agreed on two clauses relating to the revision of the contract (the so-called *clause de rencontre* and the *clause d'adaptation et transfert du contrat*) under which the parties were obliged to meet if serious events affected the economic balance between their counter obligations and to explore the methods for adapting the contract to economic, technical or legal changes in order to preserve their mutual interests.

However, some decisions by the French Courts of Appeal seem to admit a possibility for the judge to revise a contract when negotiations have failed. Thus, in a decision in 1976[79] (*Electricité de France c/ Shell Française*), the *Cour d'appel* of Paris held that on account of the common intention of the parties to preserve the contract and to adapt it to new circumstances, and the public interest involved in its performance, the parties had to enter into new negotiations with the assistance of a third party (*un observateur*) appointed by the court in order to settle their differences. Finally, if this new negotiation did not succeed, the court reserved for itself the possibility to adjust the contract.

More recently, a decision by the *Cour d'appel* of Nancy in 2007 set a precedent.[80] In this case, two companies (Novacarb and Socoma) had concluded a contract in 1999 for the supply of steam which was necessary for one party's production process. In 2005, because of the enactment of new legislation which established an exchange system for 'emission quotas of CO2', the supplier (Socoma) obtained a profit of approximately 3 million euros derived from the transfer of surplus quotas. Novacarb claimed that such a profit amounted to a situation of unjust enrichment for Socoma, because the enactment of the new legislation was not contemplated by the parties at the time of the conclusion of the contract and also because Socoma´s profit was in part linked to the execution of the contract by Novacarb, which contributed with investments and production policies to the reduction of the CO2 emissions and therefore to the surplus quotas. On that ground, Novacarb wanted Socoma

78 Cass. com, 3 October 2006, *D*. 2007 n°11, Somm., 767, note D. Mazeaud.

79 CA Paris, 1st Ch. A. 28 September 1976, *La Semaine Juridique* 1978, p. 18810, n. Jean Robert.

80 CA Nancy 2nd Ch. Com. 26 September 2007, *SAS Novacarb c/ SNC Socoma*, *La Semaine Juridique* No. 20, 14 May 2008, p. 10091, n. Marie Lamoureux; *RDC*, 2008/3, p. 739-743 and 759-762, note D. Mazeaud and S. Carval.

to revise the terms of the contract with the aim of restoring the contractual equilibrium and then to incorporate a clause to distribute the profits derived from the transfer of the CO2 emission quotas. The renegotiations did not succeed and then Novacarb sought to have the contract judicially revised, which was denied by the judge at first instance. On appeal, the *Cour d´appel* accepted Novacarb's claim and ordered the resumption of negotiations on the basis of the existence of a duty of loyal collaboration and solidarity between the parties, supported by articles 1134 paragraph 3 (performance in good faith) and 1135 (implied obligations derived from equity), by which the profits derived from the performance of the contract must be shared if both parties have contributed to this result. The court also stated that the enactment of the new legislation was an unforeseeable circumstance at the time of contracting and this had led to a change in the contractual balance that should be corrected.

This decision is interesting for a number of reasons. First of all, it is not a case of excessive onerousness but one of considerable and unexpected (and even undeserved) enrichment for one of the parties. Second, the *Cour d´appel* at the same time ordered the parties to reassume negotiations with the precise objective being to determine if Socoma had to transfer part of the profits derived from the sale of CO2 emission quotas to Novacarb; it also clearly stated that if there was a new failure in the negotiations, the court reserved the right to evaluate the conduct of the parties in the negotiations so as to determine their liability and also to determine the likelihood of sharing quota profits by determining the will of the parties at the time of contracting or the interpretation of the obscure and ambiguous clauses in question.

Therefore, the *Cour d´appel* determined a framework for the negotiations between the parties and, relevantly, if such negotiations turned out to be unsuccessful, the court stated that it had the power to resolve liability between the parties and to revise the contract through its interpretation.

However, it has been argued that in some cases the French courts have revised contracts on grounds which are very similar to unexpected circumstances.[81] Thus, as stated before, according to French law, in a case of *force majeure* the debtor is released from its obligation and the counterparty cannot claim any compensation for the non-performance of the contract (*à l'impossible nul n'est tenu*). Nevertheless, in some situations of partial non-performance derived from *force majeure* the courts have revised the terms of the agreement to allow its performance for the part which is still possible.[82] A good example is provided by a judgment of the *Cour d'appel* of Paris[83] related to lease contracts for illuminated signs in Paris which were restricted by the wartime blackout imposed at the beginning

81 The powers of the courts to revise or determine the contract price, as extended by the decisions of the *Assemblée pléniere* of the *Cour de Cassation* (decisions of 1 December, 1995, *Bull. Civ*. 1995 A.P. No 7, p. 13 ss), have also been interpreted to support the intervention of the judge in cases of *imprévision*. See Capitant et al., (2000), p. 131.

82 Legrand Jr (1987), p. 1040.

83 November 13, 1943, Cour d'Appel, Paris, 1943 *G.P*. II 260 note anom.

of the hostilities in 1939. Because of the restriction, the lessee claimed the termination (*résolution*) of the contract, but the court rejected the claim and ordered a modification of the contract by which the lessee was required to pay 80% of the contract price. The reason given by the court was that the lessee could still benefit from publicity, which was not limited to night-time.

In another decision, the *Chambre sociale* of the *Cour* stated that if an external circumstance (in this case, a statutory modification) renders the obligation of one of the parties partially deprived of its object and *cause*, the counter-obligation may be proportionally reduced.[84] In this case, the *Cour* justified its decision on the grounds of a *fait du prince* which made the performance of one party's obligation partially impossible (therefore being deprived of part of its object and *cause*) and not on the ground of *imprévision*, therefore granting a *résiliation partielle* of the contract.[85]

The described cases are nevertheless not strictly situations of *imprévision*, even if they implied an intervention by the court in the performance of the contract, because they are not directly related to a change of circumstances which rendered the performance of one of the parties much more onerous, therefore seriously altering the contractual equilibrium.[86] As said above, these types of cases can be better categorized as situations involving a partial impossibility of performance.

The reluctance of the *Cour de cassation* to allow the revision of the contract in cases of *imprévision* can be illustrated by a recent decision.[87] In a decision of 29 June 2010, the *Cour*, based on the notion of *cause*, reversed a judgement of the Paris Court of Appeals that had granted to the creditor the specific performance of an obligation which the debtor had unsuccessfully claimed was excessively onerous. In this case, the parties had concluded a contract for 12 years in 1998 for the maintenance of two engines against an annual fixed fee. The *Cour* stated that the decision of the Court of Appeals lacked legal grounds because it did not analyse, as requested by the defendant, whether the change of economic circumstances (the increase in the replacement parts required for the maintenance of the engines) unbalanced the general economy of the contract to the point that it deprived the obligation of the debtor of any real counter-performance to be rendered by the creditor. The decision of the *Cour* de cassation was grounded on article 1131 of the Code Civil, that imposed the requirement of *cause* for the validity of obligations: 'An obligation without cause or with a false cause, or with an unlawful cause, may not have any effect.' Finally, it has to be stressed that the *Cour* did not terminate the contract, but returned the case to the Court of Appeals to review the case on the merits.

84 Cass. soc. 17 June 1981; *Bull civ*. V, No 568, p. 426.

85 Ghestin (1990), p. 307. The author states that in this case the *Cour* did not contradict its stance in refusing to revise contracts in situations of *imprévision*, because it only verified the *résiliation partielle* of the contract derived from partial impossibility as it does in cases of *résiliation totale* where *force majeure* makes the performance completely impossible.

86 Ghestin et al., (2001), p. 289.

87 Cass. com, 29 june 2010, *D*. 2010 n°37, 2481, note D. Mazeaud.

The above-mentioned decision can be interpreted as an implicit admission of the *théorie de l'imprévision* as a ground for the termination (*caducité*) of the contract.[88] As stated before, the legal foundation for the decision was the concept of *cause*, in the sense that a supervening and unforeseeable change of circumstances that severely alters the contractual economy may entail the termination of the contract due to the disappearance of the *cause* of the obligation of the affected party, which is considered in that case to have no existing counter-performance.

It has been argued that the decision of the *Cour* reduces the scope of application of *imprévision* to the extreme situation in which the change of circumstances not only causes a severe imbalance between the counter-performances, but the eventual disappearance of one of them, in the sense that it becomes completely illusory or derisory in relation to the performance due by the affected party. In addition, the main conclusion that can be deduced by the use of the notion of cause to deal with cases of *imprévision* is the implicit rejection by the *Cour de cassation* of granting the courts the power to revise the contract in order to adapt it to the supervening circumstances, because the necessary effect of the absence of *cause* is the termination (*caducité*) of the contract. To sum up, if the mentioned decision is followed by future case law, both the scope and the effects of a change of circumstances will be very narrow in practice, reducing its application to highly exceptional cases.[89]

8. The reform projects

8.1. General remarks

The necessity to modernize the French law of obligations was one of the major issues that were debated on the occasion of the bicentenary of the *Code Civil*. Most French legal scholars agreed that, whatever its inherent merits and historic relevance, the law of obligations as laid down in Title III of Book III of the *Code* needed to be reformed because this regulation had become outdated and had lost its international influence. Similarly, the increasing influence of modern national and international codifications and scholarly restatements have been to the detriment of the traditional weight attached to French law and it has lost its competitiveness and strength as one of the world's leading jurisdictions.[90] In this sense, the evolution of the French law of obligations has taken place outside the *Code*, through case law or legislative instruments such as the *Code de commerce* or the *Code de la consummation*, making the law a difficult area for the common citizen because of its complexity and the lack of legal certainty.[91]

88 As in the others decisions analysed on this Chapter, the *théorie de l'imprévision* is not mentioned explicitly on the judgment of the *Cour*; but the context of the case and the reference to the supervening unbalance of the general economy of the contract can be clearly identified with such a theory.

89 See Mazeaud (2010), p. 2484.

90 See Cartwright et al., (2009); Picod (2009); Castets-Renard (2010).

91 Picod (2009), p. 3; Vogenauer (2009), p. 6.

In this context, three main reform projects have been submitted to public debate. The first such project, the *Avant-projet de réforme du droit des obligations et de la prescription* (*Avant-project Catala*), was presented to the French Minister of Justice in September 2005. The project had been prepared by a group of academics under the chairmanship of Prof. Pierre Catala and supported mainly by the *Association Henri Capitant*. The *avant-projet* was subject to wide analysis by French and international legal scholarly opinion and the reports of the *Cour de cassation*, the *Chambre de commerce* and the *Conseil national des barreaux*.[92] However, its relevance, as 'it has launched a debate on the modernisation of the French law of obligations that was long overdue',[93] was widely criticized (especially its part on contract law) because of its excessive conservative character and the lack of any assessment of comparative law developments.[94] It has also been stated that the *avant-projet* 'is generally ambivalent in relation to matters of policy.'[95]

After the reform of the law of prescription in June 2008,[96] the French Ministry of Justice presented its own *Projet de réforme du droit des contrats* (hereinafter, the *Projet de la Chancellerie*) in July 2008, which had been developed by a working group seconded to the Ministry and by Professor Bénédicte Fauvarque-Cosson.[97] Although in some aspects the *Projet de la Chancellerie* follows the ideas of the *avant-projet Catala*, they differ concerning substantial elements, e.g. the elimination of the concept of cause or the express establishment of governing principles (*principes directeurs*) in the text. It has also been stated that the *Projet de la Chancellerie* 'displays a much greater willingness to bring the Code Civil into line with the contract laws of other European jurisdictions and the current international proposals for law reform.'[98] On the other hand, these features have also been the object of criticism due to their incoherence (because of the plurality of sources) and their extraneous character compared to the French tradition.[99] In the same sense it has been stated that the project, because it widens the powers of the courts, completely

92 See references on Vogenauer (2009), p.16.

93 *Ibid*., p. 21.

94 Thus, the Project contains 'only limited use of goods, no anticipatory breach, no judicial mitigation, no *Nachfrist*, and a very limited introduction of imprévision'. Denis Tallon, (2006) *Revue des contracts* 131-2, cited by Hondius (2007b), p. 837.

95 Sefton-Green (2008). However, the author adds at p. 361 that 'Though this may be seen as a cause of criticism…it could also be viewed as a strength and a virtue, since this may help it gain acceptance within French society at large' citations omitted. See also for a positive evaluation of the avant-projet, Fenouillet (2006).

96 *Loi* n. 2008-561 of 17 June 2008. However, such reform was presented as being based on the corresponding provisions of the *avant-projet Catala*, although the structure and the main rules of the reform have important differences to the mentioned *avant-projet*. See Vogenauer (2009), p. 18.

97 Vogenauer (2009), p. 18. The project is available at http://www.dimitri-houtcieff.fr/files/projet_droit_des_contrats_blog8_2_.pdf.

98 Vogenauer (2009), p. 19. In the same sense, Mazeaud (2008), stating at p. 2676 that the project 'reconciles respect for the fundamental values of traditional French contract law with a spirit of acceptance concerning other ideas and concepts'.

99 Cabrillac (2008), adding at 19 that 'the statement of *principes directeurs* is useless and dangerous'. On the contrary, see Fabre-Magnan (2008), who states that the Chapter on *principes directeurs* is the best in the project and its more original contribution, adding that the project is an indisputable and desirable modernization of French contract law. In the same sense, see Mazeaud (2008).

transforms the spirit of French contract law.[100] However, the project has received more favourable opinions from professional and consumers' associations than the *avant-projet Catala*.[101] Based on comments from legal doctrine, the courts and professionals, as well as the *Projet Terré*, a revised version of the *Projet de la Chancellerie* is expected soon.

The third and last reform project (*Projet Terré*) was prepared by a working group led by Professor François Terré sponsored mainly by the *Académie des sciences morales et politiques*. The project was delivered to the Minister of Justice in December 2008 and published soon afterwards.[102] It has been said that this project is closer to the *Projet de la Chancellerie* rather than to the *avan-projet Catala*, especially because both have a similar comparative and international approach; however, the *Projet Terré* is even more intrepid: the courts are empowered to adapt the contract in cases of *imprévision* (article 92) and the concept of *cause* is completely suppressed (article 13). Nonetheless, the project has received far less attention from legal doctrine.[103]

8.2. The regulation of *imprévision* in the reform projects

With regard to unforeseen circumstances, the three projects expressly recognize, to some extent, the effects of *imprévision* as an exception to the general principle of the sanctity of contracts.

Thus, the *avant-projet Catala* provides a restricted and limited recognition of imprévision in articles 1135-1 to 1135-3:[104]

Article 1135-1: *In contracts whose performance takes place successively or in instalments, the parties may undertake to negotiate a modification of their contract where, as a result of supervening circumstances, the original balance of what the parties must do for each other is so disturbed that the contract loses all its point for one of them.*

Article 1135-2: *In the absence of such an express term, a party for whom a contract loses its point may apply to the President of the tribunal de grande instance to order a new negotiation.*

100 Ghozi, Lequette (2008), p. 2613.
101 Cavalié (2009), p. 70.
102 Terré (2009).
103 See Mazeaud (2009), stating at 1364 that the *Projet Terré* is '*un veritable code de fracture*'.
104 Article 1135-1*: Dans les contrats à exécution successive ou échelonnée, les parties peuvent s'engager à négocier une modification de leur convention pour le cas où il adviendrait que, par l'effet des circonstances, l'équilibre initial des prestations réciproques fût perturbé au point que le contrat perde tout intérêt pour l'une d'entre elles.* Article 1135-2: *A défaut d'une telle clause, la partie qui perd son intérêt dans le contrat peut demander au président du tribunal de grande instance d'ordonner une nouvelle négociation.* Article 1135-3: *Le cas échéant, il en irait de ces négociations comme il est dit au chapitre 1er du présent titre. Leur échec, exempt de mauvaise foi, ouvrirait à chaque partie la faculté de résilier le contrat sans frais ni dommage.* The original text and an English translation are available in Cartwright et al., (2009).

Article 1135-3: *Where applicable, these negotiations should be governed by the rules provided by Chapter I of the present Title.*
In the absence of bad faith, a failure in the negotiations will give rise to a right for either party to terminate the contract for the future at no cost or loss.

The proposed rules have been the object of severe criticism. Thus, it has been stated that the proposed article 1135-1 is superfluous and unnecessary in the light of the principle of freedom of contract, as is clearly laid down in article 1134 of the *Code*. As a consequence, the provision could be a source of uncertainty about the effectiveness of such clauses if it is interpreted as restricting the validity of renegotiation clauses to only long-term contracts or simply if the criteria of the article have in fact been met.[105] The provision refers to a contract which has lost 'all its point' (*tout intérêt)* for one of the parties, a subjective criterion that can be difficult to assess in practice. Besides, the condition provided in article 1135-2 to request the renegotiation of the court in the absence of an express term to that effect, i.e. that the contract has lost its point for the requesting party (*la partie qui perd son intérêt dans le contrat*) is unnecessarily different from the above-mentioned expression in article 1135-1 (that the contract has lost *all* its point) and can therefore lead to confusion.[106] Again, an objective criterion seems to be more appropriate.

The parties have to conduct the renegotiations subject to the requirements of good faith as provided by articles 1104 and 1104-1 of the *avant-projet* for the negotiation phase of the contract. Therefore, the party who breaks off renegotiations in bad faith or due to its fault can be held liable in damages. It has been stated that because the legitimate expectations of the parties are more relevant if the contract has already been concluded, the good faith standard should be stronger than that required at the negotiation stage.[107] If there is no bad faith when renegotiations fail, each party has the right to terminate (*résilier*) the contract 'at no cost or loss'. There is no obligation to provide reasons if there is a refusal to revise the contract and, more importantly, the right to terminate the contract in any case at no cost or loss has been subjected to negative assessments because it could lead to abuses or unfairness in cases where one party has incurred costs which, at least in part, could be fairly assumed by the other party, e.g. when only one of the parties has performed part or all of its obligations or in cases where costs have been incurred due to the (failed) renegotiation of the contract.[108] In addition, the possibility for each party to terminate the contract unilaterally has been assessed as being inadequate in some circumstances where it is preferable to preserve the contract rather than to terminate it because the interest of the counter-party or even the general interest would be better served.[109]

105 See Mazeaud (2007), p. 767 and Fauvarque-Cosson, Mazeaud (2008). In addition, the *Exposé des motifs* of the *avant-projet* seems to reinforce the interpretation which restricts the validity of such clauses to contracts which have 'lost all their point'for one of the parties.

106 Fauvarque-Cosson (2009), p. 44.

107 *Ibid*., p. 45.

108 *Ibid*.. The report by the *Chambre de commerce et d'industrie de Paris* recommends the deletion of that part of the article.. Available at http://www.etudes.ccip.fr/sites/www.etudes.ccip.fr/files/upload/prises-position/reforme-droit-des-contrats-kli0610_synth.pdf.

109 Fauvarque-Cosson, Mazeaud (2008), p. 532.

Finally, article 1135-3 of the a*vant-projet*, in line with traditional French contract law, gives no power to the courts to adapt the contract or to terminate it: the parties make the contract and the judge cannot redraft its clauses. This restricted approach has been criticised by the *Cour de Cassation* as being incoherent with the developments in comparative law and even with recent decisions of the *Cour*.[110] The option was deliberated: 'There is no better solution than one which will have been negotiated by the parties in question themselves…The solution to the problem of supervening circumstances is therefore found in negotiation, thereby solving a contractual difficulty through the contract itself.'[111] The reluctance of the court to intervene in the contract is therefore backed by the drafters of the *Avant-projet*, but no further reasons are given to support such an option.

The *Projet de la Chancellerie* also includes an express provision on change of circumstances, under a section related to the effects of contracts between the parties (Section 1 of Chapter VIII). Although in many aspects this project closely follows the *Avant-projet,* concerning the subject of supervening events its approach is different:

Article 136: *If a change of circumstances, unforeseeable and insurmountable, renders performance excessively onerous for one party who had not agreed to assume the risk, that party may request a renegotiation to the counter-party but shall continue to perform its obligations throughout the renegotiation. In case of a refusal or failure to renegotiate, the judge may, if the parties agree, proceed to adjust the contract, or otherwise to terminate it at a date and on the terms to be fixed.*[112]

Unlike the corresponding provision of the *avant-projet Catala*, the proposed norm does not restrict its application to contracts whose performance takes place successively or in instalments (*contrats à exécution successive ou échelonnée*) and it therefore has a broader scope. Besides, there is no reference to the balance between the counter-obligations, but the relevance lies in the burden of the excessively onerous nature of the performance for one of the parties. As a consequence, the rule might be applicable, for instance, to unilateral contracts.

With regard to the conditions for the application of the provision, the proposed article requires that performance becomes excessively onerous for one of the parties because of an unforeseen and insurmountable change of circumstances. The terminology is in accordance with foreign codifications such as the Italian *Codice Civile* and non-legislative

110 Rapport du groupe de travail de la Cour de cassation Sur l'avant-projet de réforme du droit des obligations et de la prescription, 15 juin 2007; available at http://www.courdecassation.fr/institution_1/autres_publications_discours_2039/discours_2202/travail_cour_10699.html; and Sargos (2009), p. 391.

111 *Avan-projet Catala*, *Exposé des motifs,* translated in Cartwright et al., (2009).

112 Author's own translation. Art. 136 : *Si un changement de circonstances, imprévisible et insurmontable, rend l'exécution excessivement onéreuse pour une partie qui n'avait pas accepté d'en assumer le risque, celle-ci peut demander une renégociation à son cocontractant mais doit continuer à exécuter ses obligations durant la renégociation. En cas de refus ou d'échec de la renégociation, le juge peut, si les parties en sont d'accord, procéder à l'adaptation du contrat, ou à défaut y mettre fin à la date et aux conditions qu'il fixe.*

codifications such as the PECL, the PICC and the DCFR. Additionally, the affected party should not have assumed the risk of the event occurring.

The condition of insurmountability has been criticized because it is too strict and seems to place *imprévision* at the same level as *force majeure* where the insurmountability of the event is a requirement which is accepted by the doctrine. It is argued that if the unforeseen event is also insurmountable then the performance will be impossible and not just excessively onerous or difficult.[113] In this sense, it has been stated that the unforeseeability of the event and the seriousness of its effects for the performance of the obligation should be a sufficient condition for the application of such a provision.[114]

Concerning the effects of *imprévision*, the judge is not entitled to revise the contract terms unless the parties agree. Again, the role of the court with regard to the adaptation of the contract is very limited, because it is unlikely that the parties will agree (after a refusal to renegotiate or a failure in the renegotiations) to hand such a power to the court which in practice makes the application of such a provision illusory.[115] Therefore, in fact the project refuses to recognize the judicial revision of contracts in cases of *imprévision* and retains the traditional French approach to the subject.

However, in the case of a refusal or a failure to renegotiate, the court is also entitled to terminate the contract at a date and on terms to be fixed. This may give to the judge some room to revise the contract through determining an anticipated date for its termination and mutual restitutions or damages to be paid by one or both parties.[116] Therefore, through an indirect mechanism for sharing losses and profits, the judge would contribute to avoiding the effects of the excessively onerous nature of the performance for the affected party. This uncertainty about the role of the judge has been welcomed by some authors because the mere possibility of a judicial intervention may encourage the parties to settle their differences and renegotiate the terms of their contract in order to restore the balance of the counter-obligations.[117]

Finally, the third reform project submitted, the *Projet Terré*, also contains a provision which deals with the effect of a change of circumstances. Just as in the *Projet de la Chancellerie,* the rule is included in the section on the effect of a contract between the parties, but unlike the preceding projects the article also provides a general statement on the *pacta sunt servanda* principle.

Article 92: *The parties are required to fulfil their obligations even if performance has become more onerous.*

113 Witz (2009).
114 Cavalié (2009) p. 73.
115 Ghestin (2009).
116 See Witz (2009) and Rouhette (2009). However, the rule is not absolutely clear in the sense that it could be argued that the judge also requires the consent of the parties to terminate the contract.
117 Rouhette (2009).

However, the parties are bound to renegotiate the contract in order to adapt it or terminate it, when the performance becomes excessively onerous for one of them because of an unforeseen change of circumstances and the affected party has not agreed to assume the risk when entering into the contract.
In the absence of an agreement between the parties within a reasonable time, the judge may adapt the contract in accordance with the legitimate expectations of the parties or may terminate it at a date and on terms to be fixed.[118]

This provision is clearly in line with modern codifications such as the Dutch and the German ones and with non-legislative codifications such as the PECL, the PICC and the DCFR. Thus, the first paragraph of the provision is a reinforcement of the general principle of the sanctity of contracts as laid down in the preceding article 91 which, similar to article 1134 of the *Code*, gives force of 'law' to contracts which have been validly concluded.[119] The exception lies in the case where an unforeseen change of circumstances makes the performance by one of the parties excessively onerous, provided that such party has not assumed the risk of the supervening event.

The scope of the rule is broad and in theory it may be applicable to any kind of contract. In addition, the condition of insurmountability laid down in the *Projet de la Chancellerie* has been removed and it is only required that the supervening event is unforeseen.

If the conditions are met, the parties have a duty to renegotiate the contract in order to adapt it to the new circumstances, or if that is not possible, to agree on its termination. By amending the article, the renegotiation of the contract is envisaged not only as a remedy for the affected party, but also as a duty towards him. Therefore, the other rights provided by the article are conditioned on the fulfilment of such a duty by the party affected by the change of circumstances.

Unlike the two preceding projects, the proposed article provides that in the case of a failure in the renegotiations the judge is entitled to adapt the contract. This solution is in coherence with other provisions of the project which also give the judge the power to intervene in the contract: article 52 (revision of the contract in cases of fraud and duress),

118 Author's own translation. Article 92: *Al. 1 Les parties sont tenues de remplir leurs obligations même si l'exécution de celles-ci est devenue plus onéreuse. Al. 2 Cependant, les parties doivent renégocier pour adapter le contrat ou y mettre fin lorsque l'exécution devient excessivement onéreuse pour l'une d'elles par suite d'un changement imprévisible des circonstances et qu'elle n'a pas accepté d'en assumer le risque lors de la conclusion du contrat. Al. 3 En l'absence d'accord des parties dans un délai raisonnable, le juge peut adapter le contrat en considération des attentes légitimes des parties ou y mettre fin à la date et aux conditions qu'il fixe.* The proposed article is similar to the article 7 :101 of the Revised Principles of European Contract Law, prepared by the Association Henri Capitant des Amis de la Culture Juridique and the Société de Législation Comparée. See Chapter seven for further references.

119 The Project does not include a Section on *Príncipes Directeurs* as the *Projet de la Chancellerie* does, but in the Section on 'Contracts´ it establishes four general principles: freedom of contract, respect for *ordre public* and fundamental rights, good faith and coherence. The principle of the sanctity of contracts was only inserted in the Section on the 'Effects of contracts between the parties'.

article 66 (excessive advantage for one party when an abuse of circumstances has occurred) and article 67 (a significant imbalance deriving from non-negotiated clauses).

Two conditions are required for the judicial revision of the contract: the parties should have spent a reasonable period of time on the failed renegotiations; and the judge has to consider the legitimate expectations of the parties when adapting the agreement. The drafting group expressly rejected the approach of the PECL because of their reference to equity, which may lead to a solution which is far removed from the intention of the parties at the time of concluding the contract. On the contrary, the standard of the legitimate expectations of the parties was considered as an adequate measure for the judge to reform the contract in line with its original economy as was contemplated by the parties.[120]

Besides, in accordance with modern codifications, the provision states that the judge is also entitled to terminate the contract at a date and on terms to be fixed. The proposed article gives no preference to adaptation or termination and therefore it will be the judge who has the possibility to choose between such remedies considering the facts of the particular case.

Finally, it is worth mentioning that the parties are not allowed to unilaterally terminate the contract unless a specific provision grants them such a right, e.g. in long-term contracts of indeterminate duration (article 91 paragraph 3). The comments by the drafting group do not provide any reasons for this choice, but the criticisms of the provisions of the preceding projects must be taken into consideration.

9. Conclusions

The survey of French law has demonstrated that even when there is an important group of scholars who support the express admission of *imprévision* in French contract law, the traditional approach still has a strong influence in the doctrine and case law.

Thus, the *Cour de cassation* seems to have no intention of changing its interpretation of article 1134 beyond the doctrinal statements contained in its reports if there is no express legal text which may support the recognition of *imprévision*. Consequently, its decisions still prefer to adhere to the absolute prevalence of the *loi de contrat* over any disruption to the contractual relationship due to unforeseen circumstances. The recognition of the duty to renegotiate is the only exception to the traditional approach. Thus, the French courts insist on resolving *imprévision* cases through the renegotiation of the agreement by the contracting parties and not through any intervention by the judge in the contract. The reluctance of the *Cour de cassation* to allow the revision of the contract in cases of *imprévision* is confirmed by the above-mentioned decision of 29 June 2010.

120 See Fenouillet (2009), p. 146 and Mazeaud (2009), p. 1366.

In the same sense, two of the projects to reform the law of contract, including the governmental *Projet de la Chancellerie,* do not allow a judicial revision of contracts in cases of *imprévision*. The mentioned projects, as well as the case law, reflect the French traditional idea that the contract is *la chose des partes* by which the parties are always better placed to appraise and to defend their own interests.

Thus, the argument that a general and express recognition of *imprévision* is '*moralement souhaitable mais économiquement dangereuse*' is still strongly present.[121] Any intervention by the courts is considered to be a source of contractual insecurity and economic instability. Besides, the absence of any legal regulation and the rejection of the courts being able to revise contracts in those cases would imply an incentive for the parties to include in the contract express clauses to deal with the risks and effects of supervening circumstances.

However, as stated before, such arguments are not convincing. There is no empirical evidence of any catastrophic consequences for the security of contracts or the economic system in those jurisdictions that accept a revision of contracts when there has been a change of circumstances. Besides, the possibility that the judge may revise the contract can be also considered as an incentive for the parties themselves to regulate supervening events. In addition, the recognition of new duties such as loyalty and cooperation (*loyauté* and *coopération*) and values such as the *proportionality* and *continuity* (*proportionnalité* and *pérennité*) of contractual relationships have been developed for the modern doctrine to support an amended approach to contract law which includes the entitlement of the courts to intervene and revise contracts in cases such as those of changed circumstances.

The final outcome of *imprévision* in French contract law is still uncertain as well as the status of the reform projects on the subject, though the supporters of its recognition are optimistic, particularly of the approving position of the contemporary legal doctrine and its growing recognition in other jurisdictions (including international soft law instrument): 'the context has been never so favourable for the reversal of the rejection of contract revision for *imprévision*'.[122] However, the analysis in this Chapter indicates that such a reversal will not take place if it is not supported by the introduction of an express legal provision to that effect in the *Code Civil*.

121 See Flour et al., (2002), p. 411.
122 Fauvarque-Cosson (2004).

Chapter 4

ITALIAN LAW

1. Introduction

In Italian private law the subject of the disturbance of the contract balance caused by unexpected circumstances is covered under two diverse legal concepts: *eccessiva onerosità* (provided in articles 1467 to 1469 of the *Codice Civile*) and the theory of the *presupposizione*, developed mainly by case law. Although both concepts are related, their foundations, conditions of applicability and effects are different. Nonetheless, in practice such differentiation is not always easy to elucidate and most of contemporary doctrine have argued that the theory of the *presupposizione* should be discarded due to its ambiguity and a lack of legal certainty.

In this chapter, however, the main attention will be on *eccessiva onerosità*, but a complete overview of this subject also requires that the theory of *presupposizione* is examined.

2. The excessively onerous nature of the performance: *eccessiva onerosità sopravvenuta*

As stated in the Chapter on the historical development of the doctrine of unexpected circumstances, the Italian *Codice Civile* of 1865 was substantially based on the French *Code Civil*. Therefore, in accordance with this model, the *Codice* of 1865 did not contain any provision which entitles the debtor to rely on a change of circumstances to terminate or adapt the contract when performance by one of the parties has become excessively burdensome. Articles 1225 and 1226 of this Code only provided relief for the debtor in cases of impossibility caused by *force majeure* (*causa estranea, forza maggiore* or *caso fortuito*) while article 1640 (construction contracts) expressly rejected any revision of the contract price when there had been an increase in the costs of materials or labour. A

strong recognition of the principle of *pacta sunt servanda* was laid down in its article 1123 that literally reproduced article 1134 of the French *Code Civil*.[1]

However, because of the significant influence of German legal doctrine on Italian scholars since the end of the 19th century and the later catastrophic events that affected Italy during the first half of the 20th century, a number of legal theories were developed to support the revision or termination of contracts in cases of unexpected circumstances, the most important being the theory of the *presupposizione*. Accordingly, in exceptional situations, such a theory was accepted by the case law of the late 19th and early 20th centuries to grant relief to the affected party.[2] Special legislation was also enacted to deal with the effects of the First World War on contracts concluded before the decree of general mobilization.[3]

With this background and the prevailing ideas of a social approach to private law, the drafters of the new *Codice Civile* of 1942 included a new Section (articles 1467 to 1469) dedicated to the *risoluzione per eccessiva onerosità* and a special provision on construction contracts (*appalto*, article 1664) which recognize the termination or revision of contracts in cases where performance by one party has become excessively onerous because of a change of circumstances. The possibility to revise contracts is also provided in other articles of the *Codice*: the rescission of contracts when there is an imbalance in the counter-performances (a state of necessity on the part of the debtor and *lesione*, articles 1147 to 1452); lease contracts in cases of *fait du prince* or *caso fortuito* (articles 1623, 1635 and 1636); and insurance contracts when the assured risk increases or decreases (articles 1897 and 1898). Finally, article 2058, applicable to torts, states that the courts may provide equivalent compensation in cases where compensating in nature is excessively onerous for the wrongdoer.

3. The foundations of *eccessiva onerosità*

The introduction of the provisions on *eccessiva onerosità* has been seen as a legislative choice for systematization so as to regulate the balance between the *pacta sunt servanda* principle and the destabilization of the economic equilibrium of many contracts following the First World War.[4] Notwithstanding this express recognition, the foundations of the rules of *eccessiva onerosità* have been intensely discussed by Italian legal doctrine. The *travaux préparatoires* of the *Codice* state that the rules of article 1467 imply the express introduction of the *clausula rebus sic stantibus* in contracts with mutual obligations. However, this statement has been criticized by the legal doctrine because the strict requirements for the application of article 1467 cannot be confused with the theoretical

1 The text of the *Codice Civile* of 1865 is available at http://books.google.nl/books?id=49h5kZnyiPcC&printsec=frontcover&hl=en#v=onepage&q=&f=false.
2 See the Chapter two for further references.
3 D.L. n. 739 of 27 May 1915.
4 Macario (1995) adding that with this choice the legislator discarded the options of special or emergency legislation or the development of theories, through doctrine and case law, to deal with this subject (such as the theory of *presupposizione*).

broad conditions for the application of the *clausula* doctrine, and also because it is said that it would be useless to search for the common will of the parties in situations which, by their very definition, they could not have foreseen.[5]

In legal theory, the doctrine of *causa* has become the classic foundation for the rules on *eccessiva onerosità*. According to this doctrine, the *causa* of the contract is not only a necessary element for the formation of contract, but also for its performance where it is a guarantee for the achievement of the economic function of the contract, which is not attained if the obligation of one of the parties becomes excessively onerous. This doctrine has been criticized because it does not provide a satisfactory explanation as to why the *causa* is not affected when the excessively onerous nature is caused by foreseeable events at the time of contracting. In addition, it is said that the economic function of the contract (e.g. as an instrument of exchange or warranty) remains the same regardless of any variation in the value of the obligations. Similar to the doctrine of *causa*, the economic equivalence between the counter-obligations is argued by some authors to be the foundation of *eccessiva onerosità*. In addition to the above-mentioned criticisms, this theory cannot explain why *eccessiva onerosità* is applicable to unilateral contracts (article 1468).[6]

Nowadays equity (*equità*) is accepted in legal doctrine as the most appropriate foundation of *eccessiva onerosità*. Particularly in this subject, equity implies a duty of collaboration for the parties with the aim being to retain the initial costs of the obligations and therefore to share the risks when they exceed the normal *alea* of the contract.[7] On similar grounds, it has been stated that article 1467 provides a general principle for the protection of the debtor against the risk of an exceptional and unforeseen increase in its performance. Then, the fundamental aspect of the rule is to maintain stability in the sharing of risks under the contract in cases when such stability is disturbed by external circumstances.[8]

Nevertheless, recent case law has stated that article 1467 is a reflection of the theory of *presupposizione* in order to protect the will of the parties from the risk of a severe economic increase in performance derived from a serious and unexpected change of the social or economic environment which was envisaged by the parties at the time of concluding the contract. It is presumed that the parties' will was intended to retain the contractual balance and a fair distribution of the risks.[9]

4. The conditions for the application of *eccessiva onerosità*

The rules of *eccessiva onerosità* are provided in articles 1467 to 1469 of the *Codice Civile*. These provisions are placed in Book IV (On obligations, *Delle obbligazioni*), Title II

5 See Zingales (2005), p. 695.
6 Sacco, De Nova (2004), pp. 983-984.
7 See Zingales (2005), p. 695.
8 Bianca, C.M., cited by Zingales (2005), p. 696.
9 Traisci (2003), pp. 61-63.

(On contracts in general, *Dei contratti in generale*), Chapter XIV (On the termination of contracts, *Della risoluzione del contratto*), Section III (On excessive onerousness, *Dell'eccessiva onerosità*):

Article 1467. *Contracts with mutual obligations:*
In contracts for continuous or periodic performance or for deferred performance, if extraordinary and unforeseeable events make the performance of one of the parties excessively onerous, the party who owes such performance can demand the dissolution of the contract, with the effects set forth in article 1458.
Dissolution cannot be demanded if the supervening onerousness is part of the normal risk of the contract.
A party against whom the dissolution is demanded can avoid it by offering to modify equitably the conditions of the contract.

Article 1468. *Contracts with obligations of one party only:*
In the case contemplated in the preceding article, if the contract is one in which only one of the parties has assumed obligations, he can demand a reduction in his performance or a modification of the manner of performance, sufficient to restore it to an equitable basis.

Article 1469. *Aleatory contract: The provision of the preceding articles does not apply to contracts which are aleatory by their nature or by the intention of the parties*.[10]

Based on these provisions, the legal doctrine and the case law have developed the requirements for the applications of such rules.

4.1. Contracts covered by the provision

The rules cited above are applicable to contracts for continuous or periodic performance or for deferred performance either with reciprocal or mutual obligations (bilateral contracts, article 1467) or with obligations for just one of the parties (unilateral contracts, article 1468). The common feature of those contracts is that the performance takes place

10 Articolo 1467. *Contratto con prestazioni corrispettive:*
Nei contratti a esecuzione continuata o periodica ovvero a esecuzione differita, se la prestazione di una delle parti è divenuta eccessivamente onerosa per il verificarsi di avvenimenti straordinari e imprevedibili, la parte che deve tale prestazione può domandare la risoluzione del contratto, con gli effetti stabiliti dall'art. 1458.
La risoluzione non può essere domandata se la sopravvenuta onerosità rientra nell'alea normale del contratto.
La parte contro la quale è domandata la risoluzione può evitarla offrendo di modificare equamente le condizioni del contratto.
Articolo 1468. (*Contratto con obbligazioni di una sola parte – Nell'ipotesi prevista dall'articolo precedente, se si tratta di un contratto nel quale una sola delle parti ha assunto obbligazioni, questa può chiedere una riduzione della sua prestazione ovvero una modificazione nelle modalità di esecuzione, sufficienti per ricondurla ad equità*).
Articolo 1469. (*Contratto aleatorio – Le norme degli articoli precedenti non si applicano ai contratti aleatori per loro natura o per volontà delle parti*).
Translated by Macario (2005); pp. 311-312.

after a certain period of time since its conclusion. Consequently, the excessively onerous obligation should not have been performed yet: the buyer cannot invoke the remedy on the ground of subsequent severe inflation if he has received the full payment of the price.[11] It is stated that in such a case it is logically impossible that the performance *becomes* excessively onerous and that the remedy is granted to the debtor facing difficulties who is still to perform (*in difficoltà nell'adempimento*) and not to the debtor who has already performed. On the contrary, partial performance or the performance of one or more of the instalments (but not all) does not preclude the application of *eccessiva onerosità*. It is not necessary that the deferred performance was established in the contract, but it is sufficient that such performance was pending because of a 'lawful cause' (*in modo non contrario al diritto*) e.g. temporary impossibility.[12]

Although the *Corte di Cassazione* has in general rejected the application of *eccessiva onerosità* to legal acts other than contracts, in exceptional cases it has granted the remedy with regard to irrevocable offers which have not yet been accepted by the offeree.[13] In those cases, the conclusion of the contract according to the terms of the offer would have resulted in a severe economic burden for the promisor, due to the unforeseen change of circumstances which occurred after the offer was made.

Article 1469 excludes the application of the rules of *eccessiva onerosità* when the contract is aleatory by its nature or due to the intention of the parties. Aleatory contracts have been defined in the case law as those in which one or both parties assume a risk linked to the economic advantage derived from the contract, which therefore becomes absolutely uncertain for such a party.[14] Case law has interpreted this article strictly, in any case rejecting the application of *eccessiva onerosità* to aleatory contracts, but some of the doctrine have argued, based on equity, for a less restrictive interpretation that allows the revision of the contract when the unforeseen event cannot be considered to have been included in the risks assumed by the debtor.[15]

Italian legal doctrine has also discussed the application of article 1467 to 'instrumental contracts' (*contratti strumentali*), e.g. preliminary contracts. Part of the doctrine states that in such contracts it is not possible to establish a balance or an imbalance between the future or promised counter-performances. It is argued that such an assessment is only possible when the definitive contract has been concluded. Nevertheless, the majority of legal doctrine and the case law accept the application of article 1467 to preliminary contracts, stating that it is not the actual content of the obligations which has to be evaluated but their patrimonial consequences for the parties. Therefore, the rules of *eccessiva onerosità*

11 Macario (2010). See also Sacco, De Nova (2004) p. 992; and Traisci (2003) p. 74.
12 Sacco, De Nova (2004), p. 992
13 Philippe (1986), p. 416.
14 Philippe (1986), p. 422.
15 Sacco, De Nova (2004), pp. 987-988, arguing that in the case of insurance contracts the legislator allows the revision of the contract in case of changes to the insured risk (articles 1897 and 1898 of the *Codice Civile*).

are applicable if supervening and unforeseen circumstances have disturbed the economic balance of a preliminary contract in such a way that the conditions of the definitive contract will be completely different from what the parties considered at the time of concluding the preliminary contract.[16] Thus, article 1467 is applicable to contracts which determine the conditions for future sales, for instance when the balance between the price agreed and the building costs for the agreed premises have been severely affected by inflation.[17]

4.2. The behaviour of the affected party

Although it is not expressly mentioned in article 1467, Italian legal doctrine and case law have agreed that the supervening events and their consequences for the contract should not have been attributable to the debtor's behaviour.[18] That is the case, for instance, if the *eccessiva onerosità* derives from a fault on the part of the debtor, or if he could have avoided its effects.

The case law of the *Corte di Cassazione* has broadly interpreted this statement by holding that the debtor who is in default *before* the disruptive events take place cannot invoke the remedies provided by articles 1467 and 1468 even if no formal requirement of performance has been made by the creditor.[19] Nevertheless, some authors have advocated a more restrictive approach. Thus, it is said that if the delay is justified (*legittimo*), e.g. because of a temporary impossibility, a conventional *délai de grâce*, a breach by the other party, or other similar cases, the affected party may rely on the remedies of article 1467 even if he is in default. On the contrary, if the delay is unjustified (*illegittimo*), the affected party has to bear the risks of the *eccessiva onerosità* caused during his delay.[20] It is added that if the contractual liability of the debtor in default is limited to foreseeable damage (article 1225) and also the wrongdoer may rely in some cases on the *eccessiva onerosità* (article 2058), then it is not logical that the debtor in default has to bear, in all cases, the consequences of any supervening onerousness.[21]

In any case, when the debtor´s default is a *consequence* of the change of circumstances, it seems appropriate that he can invoke the articles on *eccessiva onerosità*, because one of the aims of such rules is the protection of the debtor affected by a severe burden on the performance of its obligation. The opposite interpretation would deprive those rules of most of their practical application.

16 Sacco, De Nova (2004), pp. 988-989.
17 Cass. 15.12.1984, n. 6574; cited by Macario (2010). See also Cass, 26.02.1955, n. 583, cited by Sacco, De Nova (2004). Additional references in Philippe (1986), p. 420.
18 See Philippe (1986), p. 425.
19 See references to the case law in Traisci (2003) pp. 72-74; Zingales (2005), pp. 697, 698; and Philippe (1986), p. 426.
20 Zingales (2005), pp. 687, 698.
21 Sacco, De Nova (2004), p. 995

4.3. The nature of the events

4.3.1. Supervening events

The rules of *eccessiva onerosità* only apply to changes of circumstances that take place after the conclusion of the contract. If the relevant circumstances were present at the time of concluding the contract, but were not known to the parties, the rules of mistake could be applicable (article 1427 and ff.). Accordingly, if the imbalance between the performances was present at the time of contracting, the rules of *lesione* may be applicable (article 1448).

4.3.2. Extraordinary and unforeseeable events

Article 1467 requires the disruptive events to be extraordinary and unforeseeable. An extraordinary event has been defined as an event the occurrence of which is not frequent or not regular over time, and it is unforeseeable when it cannot be reasonably expected or it has unknown effects for the reasonable party or the 'average man' (*l'uomo medio*).[22] Recent case law has stated that 'the extraordinary character of the event has an objective nature and is described according to the consideration of elements such as its frequency, its magnitude, its intensity, etc., and is likely to be measured, so as to permit, through a quantitative analysis, at least statistical classifications…while its unforeseeable character has a subjective nature, referring to the *phenomenology of knowledge*.'[23] However, this subjective approach does not imply that foreseeability should be determined only from the internal perspective of the affected party: reference has to be made to more concrete standards such as the quality of such a party, the nature of the contract, the surrounding market conditions and other similar criteria.[24] Therefore, events which under normal conditions a reasonable party should have foreseen must be excluded.[25]

For instance, in a contract for the exclusive concession of a car rental business, the parties agreed on the payment of a fixed annual fee independent from the effective incomes derived from the commercial exploitation of the business. The concessionaire claimed the termination of the contract due to *eccesiva onerosità* because the agreed fee was highly disproportionate in relation to the profits from the concession which were significantly lower than predicted by the parties. The *Corte di Cassazione* rejected the claim stating that a mere imbalance between the counter-performances was not sufficient to establish *eccessiva onerosità* because that imbalance must be the consequence of an extraordinary and unforeseeable event; those conditions were not present in this case since the lower incomes of the concessionaire were not the effect of an abnormal development on the market. In addition, the *Corte* stated that concerning the agreed fixed annual fee, the

22 Traisci (2003), p. 75.
23 Cass., sez. II, 23.2.2001, n. 2661, cited by Zingales (2005).
24 Zingales (2005), p. 698.
25 Traisci (2003), p. 75.

concessionaire had assumed the risks of variations in the results of the business derived from the normal *alea* of the transaction.[26]

With regard to this distinction, it has been argued that if foreseeability is not considered as a quality of the event in itself, but is linked to the aptitude of the specific party to foresee the particular event, then the criterion of foreseeablity may be regarded as similar to the criterion of the normal *alea* (distribution of risks) of the contract. Therefore, the nature of the contract becomes the decisive factor for its determination.[27]

Special attention has been given to inflation and devaluation as suitable events to invoke *eccessiva onerosità*. Initially, the relevance of inflation as an extraordinary and/or unforeseeable event was rejected by the case law of the *Corte di Cassazione* on the ground that inflation was an event of a general nature, reflecting the economic status of the whole country; but soon afterwards it was held that even circumstances of a general nature could lead to excessive oneorusness.[28] After 1960, the *Corte di Cassazione* adopted a broader interpretation providing that variations in the value of currency could only be considered as extraordinary and unforeseeable events when they could be considered to fall outside the normal risks of the contract as assumed and anticipated by an average party; and more precisely that an exceptional and exorbitant variation fulfils the condition required for the application of the remedies provided by article 1467.[29] Then, supervening inflation, just as any other event which disturbs the contractual balance, may justify the termination of a contract by *eccessiva onerosità*, even when this was not caused by exceptional circumstances but has an extraordinary and unforeseeable character.[30]

Thus, in cases of preliminary sales contracts, future sellers have claimed the termination of the preliminary contract with the aim of not concluding the definitive sales contract when the agreed price has suffered a severe devaluation because of changes to the value of money which occurred after the conclusion of the preliminary contract. In these situations, the case law of the *Corte di Cassazione* has stated that the future seller is only entitled to terminate the contract when the devaluation in the price is a consequence of extraordinary and dramatic inflation; but not in cases where the decrease in the value of the price derives from fluctuations on the housing market that are considered to be part of the claimant's sphere of risk.[31]
The assessment of foreseeability is therefore not only related to the *nature* of the event, but also to its *intensity* or consequences, i.e. the extent of the inflation, the devaluation or

26 Cass. civ. Sez. III, 19.10.2006, n. 22396.
27 Sacco, De Nova (2004), p. 996.
28 Cass., 23.04.1947, n. 610; Cass., 23.01.1948, 88; Cass., 19.11.1949, n. 2485; Cass., 20.06.1949, n. 1644; cited by Sacco, De Nova (2004), p. 997.
29 Cass., 15.12.1984, n. 6574; Cass., 9.03.1985, n. 1913; Cass. 16.05.1991, n. 5480; cited by Traisci (2003), pp. 87-88. Logically, the assessment has to be made in relation to the rate at the time of concluding the contract. See Traisci (2003), p. 88.
30 Cass. 8.06.1982 n. 3464 in *Foro it.*, Rep. 1982, voce Contratto in genere, n. 306; cited by Macario (1995).
31 See Cass. civ. Sez. II, 13.02.1995, n. 1559 and Cass. civ. Sez. II, 28.01.1995, n. 1027; cited by Macario (1995).

the increase in prices and their actual effect on the performance of the agreement.[32] Thus, the rules on *eccessiva onerosità* may be invoked even if the inflation was present when the contract was concluded, but its rate became extraordinary and unforeseeable at the time of the performance.[33] The measure (*misura*) of the event is a decisive criterion to determine its unforeseeability.[34] Consequently, a mere variation in costs which falls within the normal fluctuation of prices should be included in the normal *alea* of the contract assumed by the affected party.[35] Instead, even the inclusion of complex indexation clauses in long-term contracts cannot exclude the application of the examined rules if the supervening events can be considered as 'so exceptional and unforeseeable that they frustrate even the agreed clause.'[36]

Finally, it has been stated that the extraordinary and foreseeable character of the disruptive events cannot be subject to an exact theoretical or abstract evaluation but is always subject to the evaluation of the circumstances of the particular case. Therefore, 'the theory is fatally spoiled by practice'[37] because the determination of an event as extraordinary and unforeseeable has been the object of a broad and sometimes contradictory interpretation by the case law. Thus, 'winter harshness' (*il rigore invernale*) cannot be considered as extraordinary because in abstract terms it is a normal occurrence; in the case of contracts concluded in 1914 and 1936 the outbreak of war was considered to be foreseeable; but for contracts concluded during the Second World War it was held that neither the length nor the consequences of the conflict were foreseeable.[38] More recently, the Arab-Israeli war of 1970 was considered to be an extraordinary event with unforeseeable consequences for a contract for the supply of petroleum-based products even if the contract included a clause for the revision of the price.[39] Similarly, as stated previously, it was held that the devaluation of currency, present at the time of concluding the contract, can be considered as unforeseeable if has an unforeseeable *intensity*.[40] Additionally, as mentioned above, the vendor cannot invoke the remedies provided by article 1467 if the loss of value of the counter-obligation (the agreed price) is not a consequence of inflation but of fluctuations in the housing market which were regarded as foreseeable at the time of contracting.[41]

4.4. Excessive onerousness and the normal risk (*alea*) inherent in the contract

For its application, article 1467 requires that the performance of one of the parties has become excessively onerous and that such onerousness is not part of the normal risk (*alea*)

32 Macario (1995).
33 Cass. 30.10.1991, n. 11637, cit.; Cass. 2.12.1986, n. 7119 in *Foro it*., Rep. 1986, voce Contratto in genere, n. 381; Cass. 5.02.1982, n. 670 in *Foro it*., Rep. 1982, voce cit., n. 307; cited by Macario (1995).
34 Cass. 5.02.1982, n. 670 in *Foro it*., Rep. 1982, voce Contratto in genere, n. 307; cited by Macario (1995).
35 Cass., 14.12.1982, n. 6867, in *Riv. dir. comm*., 1984, II, 47; cited by Macario (1995).
36 Cass. 29.06.1981, n. 4249; Cass. 28.11.1958, n. 1373; cited by Macario (2010).
37 Sacco, De Nova (2004), p. 997.
38 See Sacco, De Nova (2004), pp. 996, 997, for the references of the case law.
39 Cass., 29.06.1981, n. 4249, *Foro it*., I., 1981, c 2132; cited by Philippe (1986), p. 428.
40 Cass, 05.02.1982, n. 670, *Mass. Giur. It*., 1982, c. 173, cited by Philippe (1986), p. 428.
41 Cass. Civ.Sez II, 28.01. 1995, n. 1027, cited by Macario (1995).

inherent in the contract. Although both concepts may be distinguished in theory, they are intrinsically related because the excessive onerousness will only be relevant if it is not absorbed by the scope of the risks normally assumed by the affected party under the type of contract in question.

With regard to excessive onerousness, legal doctrine has agreed that its measurement should be based on objective criteria and not in the subjective situation of the specific party.[42] However, there is no agreement about the concept and the extension of excessive onerousness.

With regard to the concept of *eccessiva onerosità*, a minority of the doctrine have argued for a restricted notion, based mainly on the literal terms of article 1467. Then, it is stated that this article only provides the hypothesis by which the performance of one party has become burdensome but not the situation by which the counter-performance has lost its value for the creditor.[43] It is added that the protection granted by articles 1467 and 1468 is only based on the objective aggravation of the particular position of the debtor.[44]

Nevertheless, the majority of the legal doctrine as well as the case law have stated that the concept of excessive onerousness comprises all the situations of a supervening disproportion between the values of the performances which render one of the performances no longer sufficiently profitable in relation to the other; the disproportion may be caused by an exceptional increase in the cost of the debtor's performance (e.g. due to difficulties in its execution or actual increases in prices) or an exceptional reduction in the value of the counter-performance for the creditor (e.g. in the case of severe variations in the value of currency).[45]

Along these lines, recent doctrine has distinguished between direct and indirect onerousness (*onerosità diretta e indiretta*): the onerousness is direct when it directly concerns the performance of the party who invokes the remedy and indirect when it concerns the performance of the counter-party. The distinction becomes relevant in determining when the affected party may rely on the remedies provided in these cited provisions. In the case of direct onerousness, the affected party cannot invoke such rules when its obligation has already been performed; in the case of indirect onerousness it is the counter-obligation which should not yet have been performed.[46] Thus, in the latter case, if the price has been paid in its entirety, the seller cannot invoke the remedy provided by article 1467 on the ground that the money has lost its value because of a devaluation in currency.[47]

42 Sacco, De Nova (2004), p. 998.
43 Scalfi, G., cited by Zingales (2005).
44 Gallo, P., cited by Petrone (2005).
45 Bianca, C.M., cited by Zingales (2005).
46 Roppo, V., cited by Zingales (2005).
47 Trib. Napoli 6.05.1981, in *Foro it*., Rep. 1982, voce Contratto in genere, n. 313; Trib. Forlì 12.04.1983, in *Giur. it.*, 1984, I, 2, 207; Cass. 14.12.1982, n. 6858, in *Foro it*., Rep. 1982, voce Contratto in genere, n. 312; cited by Macario (1995).

The trend in the case law on this subject is clearly towards the global economic evaluation of the contractual relationship, including, within the scope of article 1467, the hypothesis of the loss of value of the counter-performance with the aim being to protect the party affected by the supervening imbalance between the reciprocal obligations.[48] The assessment has to be made by comparing the situation at the time of the conclusion of the contract with the situation at the time of its execution.[49] More precisely, the imbalance has to be present at the time of the request for the termination of the contract.[50]

In addition, according to paragraph 2 of article 1467, the termination of the contract cannot be requested if the supervening onerousness is part of the normal risk (*alea*) inherent in the contract. As stated previously, in theory, Italian legal doctrine distinguishes between this requirement and that of excessive onerousness, arguing that the normal *alea* of the contract is a further limit and an independent condition for the application of article 1467 by which the judge in the specific case may discard the application of such a provision even if the performance is objectively excessively onerous.[51] Thus, the assessment of the excessive onerousness is regarded as a *quantitative* parameter and the determination of the normal *alea* as one of a *qualitative* nature.[52] In other words, the former implies a concrete evaluation of the specific *content* of the counter-performances and the latter an abstract judgment of the *function* of the nature of the contract.[53]

Theoretically, the notion of *normal alea* is a narrower concept than contractual risk, because it implies the internal distribution of risks with reference to a particular category of contracts (*tipo di contratto*).[54] Nonetheless, it has been stated that for determining the scope of the risks assumed by the parties, besides the normal *alea* (inherent in each kind of contract) the specific regulations of the parties on this subject and the foreseeability of the disruptive event should also be considered.[55] Thus, if one of the parties has expressly assumed one or more specific risks (*alea convenzionale*), such a provision prevents the application of the rules on *eccessiva onerosità* if the supervening event was one which was envisaged by the parties.[56]

Accordingly, in the case law the notion of normal *alea* is linked to the nature of the contract, and the foreseeability of the circumstances and their consequences for the economic value of the contract are considered to belong to its integrity.[57] Thus, in practice the courts make a concrete evaluation of the economic sacrifice of the debtor against its justification in the

48 Cass. 15.12.1984, n. 6574, in *Giust. civ.*, 1985, I, 1706; 04.11.1980, n. 5905, id., 1981, I, 1343; 8.03.1978, n. 1158, id., Rep. 1978, voce Contratto in genere, n. 300; cited by Macario (1995).
49 Cass., sez. II, 29.05.1998, n. 5302; Cass., sez. II, 12.05.2003, n. 7266; cited by Zingales (2005), p. 698.
50 Cass. 27.01.1981, n. 608; cited by Macario (2010).
51 Zingales (2005), p. 699.
52 Tartaglia, cited by Macario (1995).
53 Macario (1995).
54 Zingales (2005), p. 699.
55 Sacco, De Nova (2004), p. 999.
56 Nicolò, cited by Marseglia (2007).
57 Philippe (1986), pp. 435-436.

light of the economic value of the agreement, also considering the subjective quality of the parties, with the aim being to make a global assessment of the relationship linked to the nature of the contract.[58] As a consequence, relief will only be granted when the supervening onerosity is beyond the risk that the affected party has to bear in the particular situation. Case law has also stated that the concept of normal *alea* includes the fluctuations in the value of the performances deriving from regular and normal market fluctuations.[59]

5. The effects of *eccessiva onerosità*

With regard to the effects of the *eccessiva onerosità*, the Italian Codice Civile makes a distinction with regard to the nature of the contract. Thus, in the case of bilateral contracts (article 1467) the affected party is entitled to request the termination of the contract and the other party is entitled to propose an equitable modification of the conditions of the contract in order to avoid its termination. On the other hand, in the case of unilateral contracts, article 1468 provides that the debtor may request a reduction in the agreed performance or a modification of the method of performance in order to restore the equitable basis of the contract. The system of remedies provided by the cited rules has been regarded 'as the best manifestation of the originality of Italian contract law'[60] and this has been the inspiration for legal reform in countries such as Argentina and Brazil.

5.1. The termination of the contract (*risoluzione del contratto*)

As said above, article 1467 entitles the affected party to request the termination of the contract. According to the cited article, this is the only available remedy for the affected party and he is not entitled to request any adaptation or modification of the contract by the judge.

On this subject, Italian legal doctrine states that such a termination does not operate automatically but has to be requested from the court (*in via processuale*). For that reason, the mere existence of *eccessiva onerosità* does not produce automatic relief for the debtor and a request for termination by the affected party is a *dichiarazione giudiziale* i.e. it has to be made by means of a court decision.[61]

Nevertheless, the case law is not uniform on the subject. Thus, some decisions have held that the affected party is entitled to automatic relief where the required conditions have been met, independently of a judicial declaration; but in others the *Corte di Cassazione* has stated the necessity of such a judicial declaration in order to rely on the remedies provided by articles 1467 and 1468.

58 Macario (1995).
59 Cass. 17.07.2003, n. 11200; Cass. 04.03.1998, n. 2386; cited by Marseglia (2007).
60 Philippe (1986), p. 437.
61 Sacco, De Nova (2004), pp. 1000-1001.

The subject is intrinsically related to the possibility to exercise the *eccessiva onerosità* as an *exception* (a defence) against the claim of the creditor based on a breach of contract by the affected party. The text of article 1467 seems only to grant the debtor the option to request the termination of the contract as an *action*, i.e. a claim. However, most of the recent case law has accepted the alternative that the disadvantaged party exercises an exception of *eccessiva onerosità*, which in fact implies that such a party may suspend the performance of its obligation if it considers that it has been affected by the supervening excessive onerousness; and when the creditor has claimed (based on a breach of contract) specific performance or damages, he may then oppose the respective defense. If the defense is accepted by the court, the creditor cannot claim damages for the debtor´s delay after the occurrence of the supervening events.[62] Nevertheless, if the right to suspend performance is accepted, contemporary legal doctrine imposes on the affected party the duty to inform the creditor, in good time, of the suspension or modification of the performance.[63] If granted, the termination of the contract has retroactive effects at the time of the claim, but in cases of contracts with periodical performances, performances already executed are not affected.

5.2. An equitable modification of the contract (*reductio ad equitatem*)

Faced with the request to terminate the contract, the advantaged party has the right to avoid this by offering to equitably modify the terms of the contract. As stated previously, the only party entitled to request an equitable modification is the defendant in a judicial procedure for the termination of the contract based on article 1467; so the remedy is not available for the affected party, for instance as a defence against a judicial action for a breach of contract.[64] Besides, no duty to renegotiate is imposed on the advantaged party, who can decide (after the counter-party's request for termination) whether or not to propose an equitable modification of the terms of the contract in order to avoid its requested dissolution.[65] The advantaged party may offer a modification (*offerta di modificazione*) at any time before the declaration of the resolution of the contract by the court.[66]

In principle, the wording in article 1467 does not give the court any power to intervene in the contract or in the offer of an equitable modification made by the advantaged party. Therefore, in the absence of such an offer by the defendant, the court does not have authority to compel a modification of the contract by the parties.[67] Similarly, the court must only assess the 'equity' of the proposal to determine whether the contract will be terminated or modified according to the advantaged party's offer. However, the case

62 Philippe (1986), p. 438.
63 Philippe (1986), p. 438.
64 Cass., Sez. II, 05.01.2000, n. 46; cited by Zingales (2005).
65 Cass. 29.10.1958, n. 3470; Cass. 30.04.1953 n. 1199, cited by Macario (2005), p. 314. In fact, the immediate effect of the 'equitable proposal' is to paralyse the affected party's request for a dissolution until the merits of case are resolved by the judge.
66 Sacco, De Nova (2004), p. 1003.
67 Cass., 30.04. 1953, n. 1199.

law has stated that the advantaged party can also request the court to establish the terms of the equitable modification of the contract, if the court does not consider the offered modification to be equitable.[68] Accordingly, the *Corte di Cassazione* has held that it is not necessary for the validity of the proposal to include the specific indications or limits for the modification of the contract. A generic request to equitably modify based on the merits of the case is deemed to be sufficient.[69]

With regard to the content of the 'equitable offer', the case law has stated that article 1467 c.c. does not compel the advantaged party, in order to avoid the requested termination of the contract, to offer a modification which exactly restores the positions of the parties at the time of contracting. Instead, the offer will be equitable if it contains a modification which is sufficient to return the contractual relationship to a situation where, if present at the time of the supervening events, the affected party would not have been entitled to claim the termination of the contract on the basis of the rules of *eccessiva onerosità*.[70] In other words, it is sufficient that the offer seeks to restore the equilibrium within the limits of the normal *alea* of the contract. Thus, the purpose of the modification in equity is not to realign the value of the performances, but to remove the disproportionate excess beyond the normal *alea* of the contract. Therefore, the affected party still has to bear the negative effects of the supervening events which are within the limits of the normal *alea* of the contract. The fairness of the equitable offer must be measured and evaluated by the court on the basis of such criteria, i.e. a return to the normal *alea* of the contract and not a restoration of the exact economic balance of the contract.[71]

In this sense, it is argued that the protection of the contractual balance does not seem to be the aim of the rules examined, but to safeguard the freely agreed value of the obligation affected by the supervening onerousness.[72] Therefore, the objective equivalence of the counter-performances should not necessarily be the outcome of adapting the contract. Accordingly, the objective of the remedy is to restore the equilibrium between the performances as originally agreed upon by the parties, even if the performance of the affected party has been attributed with a value which is different from the objective market.

However, some decisions have stated that the counter-performances must be adjusted in order to eliminate the economic imbalance, thereby restoring the relationship to a completely objective equivalence.[73] These statements have been criticized by Italian legal

68 Macario (2005), p. 314.

69 Thus, the *Corte di Cassazione* has held that an offer to modify the contract price 'equivalent to the onerousness determined by the court with the merits of the case' is in fact sufficient, Cass. 7 June 1957, n. 2109, cited by Sacco, De Nova (2004); see also Brunner (2009) p. 508. Stating the necessity of a specific offer, Cass., 14.10.1947, cited by Sacco, De Nova (2004) p. 1003.

70 Cass., sez. II, 11.01.1992, n. 247; cited by Zingales (2005).

71 Macario (1995).

72 Cass., sez. III, 26.03.1996 n. 2635, stating that in the Italian legal system there is no general principle of equivalence between counter-performances; cited by Zingales (2005), p. 699.

73 Cass., sez. II. 08.09.1998, n. 8857; cited by Zingales (2005).

doctrine as the aim of the rules on *eccessiva onerosità* is not the maintenance or restoration of an objective balance between the counter-obligations, but to protect the original *subjective* equilibrium as agreed by the parties, taking into account the normal *alea* related to the nature of the contract. It is added that it is incompatible with the *ratio* of the rule to establish a new contractual framework in order to equalize the value of the obligations regardless of the agreed original equilibrium.[74]
Therefore, in practice, Italian case law has allowed the courts to have a high degree of intervention in contracts and, in fact, judicial adaptation can be considered as an available remedy (at least for the advantaged party) in cases of *eccessiva onerosità*.

Addtionally, in spite of the text of article 1467, it has been argued that once the parties have declared their interest in avoiding a dissolution, each party is entitled to request the renegotiation of the contract when the prerequisites of the article are met. In this case, a refusal to negotiate or breaking off negotiations contrary to good faith entitles the affected party to claim damages and the adaptation of the contract by the judge.[75]

Outside the specific scope of article 1467, Italian doctrine has stated that in long-term contracts a *favor contractus* principle can be inferred from the general contract rules governing mistake (article 1432), rescission (article 1450), partial impossibility (article 1464) and unilateral contracts (article 1468) which provide for the continued existence of the contract through its equitable modification.[76] Other rules of the Code on specific contracts, such article 1664, tend to confirm that assertion.[77]

Consequently, it is added that based on the above-mentioned *favor contractus* principle and the duty of good faith which is present in the rules of interpretation, integration and the performance of contracts (articles 1366, 1374 and 1375) a general duty to renegotiate in good faith can be inferred in long-term contracts In this sense, article 1366 provides

74 Cataduella A. and Bianca, C.M., cited by Zingales (2005). The situation is different from the remedy for rescission (*reductio ad equitatem*, article 1447), where the modification in equity is directed towards reaching an objective equilibrium between the counter-obligations.

75 Macario (2005), p. 315.

76 *Ibid.*

77 Article 1664 (building contracts): Supervening hardship or difficulty in performance:
If, as a result of unforeseeable circumstances, there have occurred such increases or reductions in the cost of the materials or of labour as to cause an increase or reduction by more than one tenth of the total price agreed upon, the independent contractor or the customer can request that the price be revised. The revision can only be granted for that part of the difference which exceeds one-tenth.
If in the course of the work difficulties are revealed deriving from geological conditions, water, or other similar causes not foreseen by the parties, which made the performance of the contractor considerably more onerous, he is entitled to just compensation therefore. *(Onerosità o difficoltà dell'esecuzione – Qualora per effetto di circostanze imprevedibili si siano verificati aumenti o diminuzioni nel costo dei materiali o della mano d'opera, tali da determinare un aumento o una diminuzione superiori al decimo del prezzo complessivo convenuto, l'appaltatore o il committente possono chiedere una revisione del prezzo medesimo. La revisione può essere accordata solo per quella differenza che eccede il decimo. Se nel corso dell'opera si manifestano difficoltà di esecuzione derivanti da cause geologiche, idriche e simili, non previste dalle parti, che rendano notevolmente più onerosa la prestazione dell'appaltatore, questi ha diritto a un equo compenso*). Translated by Macario (2005), p. 312.

that the contract must be interpreted in good faith *(Il contratto deve essere interpretato secondo buona fede)* and article 1375 extends this duty to its performance *(Il contratto deve essere eseguito secondo buona fede)*, so when the conditions for actually performing the contract no longer respond to the economic logic underlying the conclusion of the contract, the disadvantaged party has the right to request renegotiations in order to restore the contractual equilibrium.[78]

Finally, an interesting approach is the integration of the contract by the rules of equity, according of article 1374 (*Il contratto obbliga le parti non solo a quanto e nel medesimo espresso, ma anche a tutte le conseguenze che ne derivano secondo la legge, o, in mancanza, secondo gli usi e l'equità*). If the absence of an express renegotiation provision in the contract can be supplemented by rules of equity (assuming that the duty to renegotiate is a consequence of equity in long-term contracts), then the source of the duty to renegotiate would be directly the law and it would not be necessary to examine and interpret the common intention of the parties to establish it.[79]

5.3. The remedy in case of contracts with obligations for one party only (article 1468)

Article 1468 provides that in the case of unilateral contracts, i.e. those with obligations for only one of the parties, the debtor has the right to claim a reduced performance or a modification of the manner of his performance in order to restore it to an equitable basis if such a performance has become excessively onerous within the meaning of article 1467. The *ratio* of such a rule is to protect the debtor who does not receive any counter-performance from a supervening and excessive burden in the execution of its obligation, thereby retaining an equitable proportion in the performance of the affected party.[80]

Contrary to the provision of article 1467, in this case it is the party affected by the *eccessiva onerosità* who is entitled to request the modification of the contract, but he cannot claim its termination. It has been stated that the court has wide powers to decide on the modification of the agreement, which may include not only a reduction in the agreed performance but also other kinds of adjustments in the *manner* of executing such a performance, in accordance with the normal risks of the contract.[81] The assessment of the excessive onerousness must be made by comparing the value of the obligation at the time of the conclusion of the contract with its value at the time of its performance.

6. The theory of the *presupposizione*

The second legal concept related to cases of disturbances to the economy or the equilibrium of contracts is the theory of the *presupposizione*. This theory has been used by the *Corte di Cassazione* since 1932, unaffected by the introduction of the legal provisions on *eccessiva*

78 Macario (1996), p. 312.
79 Macario (1996), p. 314.
80 Tartaglia,P., cited by Zingales (2005), p. 700.
81 Bianca, C.M., cited by Zingales (2005), p. 700.

onerosità by the enactment of the new *Codice* of 1942, to cover heterogeneous cases outside the scope of such provisions, such as unilateral declarations (e.g. testaments) or contracts with instantaneous performance. At the same time, the theory is one of the most discussed and controversial subjects of Italian contract law.[82]

The origin of this theory is the German legal doctrine of the 19th and the beginning of the 20th centuries, especially the work of Bernhard Windscheid who in 1847 elaborated the concept of *Voraussetzung* (presupposition) and the later ideas of Paul Oertmann who developed the theory of the *Geschäftsgrundlage* (the basis of the transaction). The term *presupposizione* is a literal translation of *Voraussetzung*. However, Italian legal doctrine has greatly modified this concept, especially through an increasing objectification of its foundations and conditions of applicability.[83]

In 1932 the *Corte di Cassazione* for the first time admitted the theory of *presupposizione* based on the subjective assumptions of the parties by means of searching for their authentic will. Besides, no clear distinction was made between the *presupposizione* and the *clausula rebus sic stantibus*.[84] After the enactment of the *Codice Civile* in 1942, the early case law justified the use of the theory as an application of article 1467.[85] Recent decisions have confirmed this trend, subsuming the concept in the cited article, by stating that such a provision has introduced, in general terms, the institution of *presupposizione* in the legal order.[86] This assessment has been strongly criticized by Italian legal doctrine arguing that the *ratio* of article 1467 is completely different from that of the mentioned theory and to confuse both concepts is not acceptable either in methodological or in substantive terms.[87]

In this sense, theoretically, *presupposizione* and *eccessiva onerosità* may be distinguished basically because the former is applicable to cases where the expectations of the parties have disappeared and the latter to cases of an objective imbalance between the counter-performances.[88] Thus, the *eccessiva onerosità* is linked to requirements of an objective nature and, on the contrary, the *presupposizione* refers to implicit assumptions and subjective (and even psychological) data. It is added that the hypothetical scope of the *presupposizione* is wider than the scope of the *eccessiva onerosità*, restricted by the terms of article 1467 to certain types of contracts, it being also possible that in the former case the disturbance of the contractual relationship was derived from foreseeable events.[89]

82 Petrone (2005).
83 See Philippe (1986), pp. 440-442.
84 Cass., 15.02.1932, n. 531; cited by Philippe (1986), p. 442.
85 See Philippe (1986), p. 444.
86 Cass., 7.04.2005, n. 7287, cited by Pennazio (2006), p. 676.
87 Degl'Innocenti (2009).
88 Philippe (1986), p. 448, adding that the case law has never made a clear distinction between the two concepts.
89 Terranova, C.G., cited by Pennazio (2006), p. 681.

In order to develop a more objective concept of the *presupposizione*, Italian legal doctrine has construed a notion which is close to the objective concept of *causa*, by which the *presupposizione* is considered to be the 'fundamental aspect of the agreement' (*fondamento dell'affare*), 'the basic situation' (*situazione base*) or the 'common assumption' (*presupposto commune*) shared by both parties, the existence and maintenance of which they have based their consent, without transforming the assumed event into a condition. Then, the objectified motive (*il motivo objettivizzato*) of the contract becomes relevant for a correct interpretation of the agreement and its effects. The investigation into the assumed circumstance is linked to the concrete *causa* of the contract, which in turn is related to the expectations or the motives which induce the parties to accept a mutually structured agreement on the basis of such antecedents. Such an approach prevents one party from relying on individual and subjective motives to avoid its contractual obligations. Case law has supported this interpretation however the main foundation of decisions on the application of this theory is still the provision in article 1467.[90]

The *Corte di Cassazione* has defined the *presupposizione* as 'an unexpressed condition taken into account by both parties, which has an objective nature and whose existence, termination and occurrence are completely independent from the behaviour or the mere will of the parties and is not the subject of their specific obligations'.[91] Despite the apparent unity of the concept, the *presupposizione* has been used by the courts to cover situations as dissimilar as the rescission or the termination of the contract due to the non-occurrence of the presupposed event, the frustration of the purpose of the contract and the disturbance of the contractual basis because of the disappearance of the assumed conditions.[92] Its definition as a 'condition' is also criticized because, by definition, a condition implies the uncertainty of a future event expressly stated in the contract and, on the contrary, the presupposed circumstance is a past, present or future situation not expressly included in the contract and which is regarded as certain by the parties.[93]

With regard to the requirements for the application of the theory of the *presupposizione*, the case law has stated that the events which are the object of the presupposition or assumption have to be objective and independent from the behaviour or the will of the parties. For instance, in a case where the contractor requested the termination of a contract for the installation and supply of a cement factory because of the failure to be granted the necessary administrative permits for the work, the *Corte di Cassazione* rejected the claim on the ground that the procurement of the mentioned permits was expressly stated in

90 Laying down the *causa concreta* as the foundation of the *presupposizione*, see Cass. 8.05.2006 n. 10490. For further references to case law, see Degl'Innocenti (2009) and Pennazio (2006), pp. 681-685.

91 Cass., 9.12.2002, n. 17534, in Giust. civ. mass., 2002, 2155; Cass., 29.9.2004, n. 19563, in CD Juris DATA; C. St., sez. V, 29.7.2003, n. 4312, in Foro amm. C. St., 2003, 2248; Cass., 21.11.2001, n. 14629, in Riv. giur. sarda, 2002, 601; Cass., 24.3.1998, n. 3083, in Giur. it., 1999, 511; cited by Petrone (2005).

92 See Pennazio (2006) and Petrone (2005).

93 See Pennazio (2006), pp. 682-683.

the contract as an obligation of the contractor, and, therefore, there was no circumstance which was external to or independent from the behaviour of such a party.[94]

In second place, the assumption should not be expressed in the contract, because in that case its non-occurrence or disappearance will imply either a case of supervening impossibility or of the non-fulfilment of a condition.

In the third place, the assumption has to be common to both parties or at least known by the counterparty so as to presume that it was part of the basis of the agreement. In that sense, the *Corte di Cassazione* ordered the termination of a contract for the supply of fuel in a case where the purchaser could not obtain an administrative permit for the construction of a petrol station where the fuel had to be delivered because of the enactment of new regional regulations after the conclusion of the supply contract. The *Corte* stressed that even when not expressed in the contract, the construction of the petrol station was an 'integral part' of the agreement, and a common presupposition for the contracting parties; so its non-occurrence entailed and alteration to the economic equilibrium of the contract and an impediment for the enforcement of the supply contract.[95]

Finally, the presupposed events or circumstances can equally be of a past, present or future nature.[96]

In addition, some case law has stated that it is not a requirement that the supervening events which altered the presupposition of the parties were unforeseeable but in any case the affected party should not be assumed to bear the risk of the change in circumstances.[97]

With regard to the (non-)existence of the circumstances at the time of contracting, some decisions have developed the concept of false presupposition (*falsa presupposizione*) for the situation where both parties have given their consent based on a situation which has indeed already failed or is absent at the time of the conclusion of the contract. Most of the judicial decisions are related to preliminary sales contracts where the existence of administrative permits for the use of immovable property for special purposes or to build on a plot of land was assumed. This approach is rejected by the legal doctrine, because it is argued that such cases are covered by the provisions of mistake and therefore have their own particular regulation. It is added that in the case of the *presupposizione* the assumed event should not already be in existence because of a change that occurred *after* the conclusion of the contract.[98]

The lack of coherence in the case law especially with regard to its nature is reflected in the remedies granted to the parties. Normally, two remedies have been considered to

94 Cass. 23.09.2004, n. 19144; cited in Pennazio, p. 674.
95 Cass. civ. Sez. II, 24.03.1998, n. 3083.
96 Degl'Innocenti (2009).
97 Philippe (1986), p. 463.
98 Pennazio (2006), p. 686.

be applicable: rescission or nullity (*invalidità*) in the case of '*falsa presupposizione*', and termination (or in wider terms ineffectiveness, *inefficacia*) when the future presupposed event does not occur or fails. Those remedies have the common feature of dissolving or putting an end to the contractual relationship, which is justified in doctrine because of the nature of the *presupposizione*, i.e. the occurrence or permanence of those circumstances considered by the parties to be decisive for the continuation or performance of the contract. Therefore, the lack of such circumstances makes it unlikely that an interest exists for the parties to preserve the relationship and to rely on remedies such as the adaptation of the contract.[99]

Italian legal doctrine has criticized the theory of the *presupposizione* because of its imprecise foundation and scope, which make it difficult to systematize and therefore contribute to the uncertainty of the law on this subject. Thus, it has been said that the courts have used such a theory as a 'magic formula' to deal with a range of highly dissimilar situations which they are not able to manage through the regular techniques of interpretation or the application of the legal norms.[100] It is added that, in any case, the theory should only be applicable to cases related to the supervening change in the presupposed conditions, but not to situations of *falsa presupposizione* which must be covered by the rules of mistake.

7. Conclusions

Unexpected circumstances are expressly regulated in Italian contract law in general terms by articles 1467 to 1469 of the *Codice Civile* of 1942.

The regulation provided by those articles is original and it has influenced other jurisdictions such as Argentina and Brazil. Based on those provisions, legal doctrine and case law have developed a coherent system of rules for the application of *eccessiva onerosità*. For instance, the relationship between the extent of the required excessive onerosity and the sphere of risks assumed by the affected party is especially remarkable in this effect.

Nevertheless, the system of remedies provided by such rules for cases of bilateral contracts has proved to be inadequate to properly protect the interests of the parties. As seen above, the affected party only has the right to claim the termination of the contract but not its adaptation; and the counter-party is free to propose (or not) an equitable modification to adjust the contract to the new circumstances. Therefore, in theory the adaptation of the contract depends exclusively on the will of the advantaged party.

The lack of a specific court power to adjust a contract in cases of changed circumstances and the non-existence of a general principle in the *Codice Civile* for the modification of contracts by the courts have not prevented case law from developing indirect ways to

99 See Degl'Innocenti (2009).

100 Belfiore, A., cited by Degl'Innocenti (2009), referring also to Macario, F., *La dottrina della presupposizione,* who defines the assumption as 'a false problem' or 'a mere verbal formula' utilized to respond to questions about the limits of the self-determination of the parties.

intervene in contracts by adapting them, especially when the courts have decided that they can determine the terms of an equitable modification when the offer to modify by the advantaged party is made in general terms, or when such a party requests the court to determine the 'new' equitable conditions. This approach has been supported by legal doctrine in order to develop the *favor contractus* principle which gives preference to the preservation of the contract through its adaptation to the new circumstances over the termination of the relationship.[101]

Nevertheless, the express regulation of *eccessiva onerosità* has not prevented the courts from still relying on the theory of the *presupposizione*, which was developed before the enactment of the code to deal with disturbances to the contract by supervening events, to justify interventions in contracts in a wide range of situations. This has been strongly criticized by the legal doctrine, especially because of its vagueness and uncertain scope. At the end of the day, the theory of the *presupposizione* seems to be used by the courts as a complement to the restricted rules on *eccessiva onerosità* for cases which cannot be covered under such provisions and even to deal relatively easily with cases which might be analyzed in the light of other legal concepts such as mistake or *causa*.

101 See Macario (2010) and Traisci (2003).

Chapter 5

LATIN AMERICAN JURISDICTIONS – CHILEAN AND ARGENTINIAN LAW

1. Introduction

In the present chapter, the subject of unexpected circumstances will be analyzed through a comparative study of two Latin American legal systems: Chile and Argentina. These legal systems have been selected because they have an opposite legal approach to the subject. In addition, a general survey of the Latin American system of private law and of the countries under examination will be included with the aim being to provide sufficient information about the legal context in Latin America.

1.1. The Latin American system of private law: a civil law system

Latin American law is without any doubt part of Western law. Besides this, Latin American jurisdictions are, to a great extent, civil law systems. Traditional comparative law places Latin America within the Romano-Germanic legal family, attached to the French group of influence.[1] With a different terminology, Zweigert and Kötz categorize Latin America in the Romanistic legal family, i.e. those legal systems which adopted the French Civil Code as a main source of inspiration.[2]

Therefore, the links between Latin American private law and European private law cannot be denied, particularly with regard to its origins. However, the originality of Latin American law has also been stressed because of the variety and selection of its sources: 'Latin America is original in a first sense, and it is interesting to study, because it has adopted in whole neither French law, nor Spanish law, nor Portuguese law, nor Italian law, nor German law. It has made the effort to take the best of each from those laws…'[3] The special and typical features of Latin American legal systems have been sometimes oversimplified in terms of their public law being 'more North American than European'

1 See David (1950).
2 Zweigert, Kötz (1998), p. 73.
3 David, R., *L'Originalité des Droits de l'Amérique Latine*; cited by Esquirol (1997), p. 463.

and their private law 'more European than North American'.[4] In the end, although being placed undoubtedly in the Civil law tradition, Latin American jurisdictions should be regarded as systems with unique and particular features, and not as simple replicas of one or more European legal systems.

In this sense, Latin American law (or better, the law from Latin American countries) appears as an interesting subject for law scholars. However, because of a series of simplistic assumptions related to the influence of European law in the origin and development of Latin American legal systems, Latin American law (especially with regard to private law) remains to a large extent unexplored or is ignored by comparative law scholars.[5] On the contrary, as a consequence of its multiple foreign origins, comparative law is an imperative tool for Latin American law scholars and lawyers. Thus, treatises, textbooks and case law annotations frequently contain comparative notes and references to foreign legislation and legal doctrine. Therefore, 'nowhere else does comparative law become of such practical value.'[6]

1.2. The development of private law in Latin America since the nineteenth century

1.2.1. The nineteenth century: Codification as a tool for territorial and juridical unification and the influence of the Code Civil

After independence from Spanish colonization in the early nineteenth century, one of the first objectives of the new republics was the enactment of civil codes as a consolidation of their new status: 'the very act of establishing new national law was an assertion and validation of national identity and power.'[7] Additionally, Spanish colonial law was a symbol of the old regime and was also based on a complex system of sources, with a lack of uniformity and contradictory rules, making it difficult to know and apply the law.[8]

As to the task of codification, the French Civil Code was the main source of inspiration for the drafters of Latin American codes. On the one hand, from a legal perspective, because of its strong links with Roman law, this does not represent a complete break with the previous colonial sources such as *Las Siete Partidas* or the *Fueros*; and it was the only available model of a national and unifying Code at that time.[9] On the other

4 Merryman, Clark (1978), p. 207.
5 Kleinheisterkamp (2006); pp. 262-263.
6 Kleinheisterkamp (2006), stressing in this regard the gap between legal scholarly works and case law, which usually does not refer to comparative law and its legalistic and formalistic position, '…it is to the universities, not the courts, that one looks for progress. Practical conditions and business requirements are rarely taken into account.'
7 Mirow (2004), p. 104. The invasion of Spain by Napoleon in 1808 was the starting point for the independence process of Latin America. For instance, Argentina declared its independence in 1816 and Chile in 1818.
8 Mirow (2005b), p. 304.
9 Zweigert, Kötz (1998) p. 113. The Prussian General Land Law of 1794 and the Austrian Civil Code of 1811 were also available at that time, but both were linked to absolute and monarchical regimes and had a

hand, from a philosophical perspective, it was considered a reflection of the ideals of the French Revolution as individual freedom, equality under the law, private property and the separation of powers.[10] Finally, in practical terms, it was easily accessible for Latin American jurists and for the elites who were at that time highly competent in the French language.[11]

Nevertheless, the influence of the *Code Civil* in the Latin American codes of the nineteenth century was far from uniform. A group of early codifications can be considered as mere translations of the *Code Civil*: Haiti (1825), Bolivia (1830 and 1845), Peru (1836), Costa Rica (1842) and the Dominican Republic (1845). In a second group of codifications, led by the Chilean Civil Code (1855), the *Code Civil* and its comments were the main source of inspiration (especially with regard to the law of obligations), but were far from being simple copies of the French model and they became original and modern instruments. Finally, the *Code Civil* turned out to be only one of a large number of sources in the last influential Code of the nineteenth century, i.e. the Argentinian Civil Code of 1869.[12] As will be stated in the next section, with regard to the Latin American civil codes enacted in the twentieth century, the influence of the *Code Civil* diminished to a great extent.

However, the Code's loss of influence over and in *positive law* should not hide its still vast influence as a dogmatic framework of thought for Latin American jurists with regard to private law: …'it is a grammar, a glossary, a *mentalité* that continues today.'[13] Thus, the Code's contemporary influence in Latin American private law can be easily traced, e.g. in the concept of private law itself, the role of the judiciary and the structure of legal education. In addition, the *Code* is frequently used by scholars, judges and practising lawyers as a link to the European legal culture: 'It is an assertion of Latin American continuity with a great European tradition…Mention of the *Code* ties Latin America to its own and to Europe's *ius commune*…to invoke the *Code Napoleón* is to affirm the Europeanness of Latin American law'.[14] As an implicit consequence, this reference to Europe also entails a desire for differentiation from the legal, cultural and political sphere of influence of the United States.[15]

conceptualism and abstraction which was not familiar to Latin American jurists. Besides, regarding their structure, both instruments included not only private law but also public law provisions and the huge volume of the Prussian General Land Law (almost 20,000 articles) were decisive factors to exclude them as main sources of inspiration. See Guzmán Brito (2004).

10 Murillo (2001), p. 5.

11 Mirow (2005b), p. 305, adding that 'France served as a model in mid-nineteenth century Latin America not only in politics and legislation, but also in culture, fashion, language and intellectual outlook.'

12 Guzmán Brito (2004).

13 Mirow (2005a), p. 191.

14 Mirow (2005a), p. 192.

15 Mirow (2005a), p. 192, adding that 'By embracing European law, Latin American lawyers construct barriers to the United States.' One possible explanation for this resistance is that most of the impact of U.S. law in Latin American private law took place through the implementation of economic reforms imposed by authoritarian regimes in the 1980s and 1990s.

With regard to legal theory, the use (and especially in early attempts, the mere transplant) of foreign sources in the nineteenth century's codification in Latin America also led to the borrowing of secondary sources, such as comments, textbooks and other scholarly works.[16] The use and analysis of such sources were common to most Latin American countries when domestic scholars wrote their own treatises or commentaries, leading to a vast influence of continental sources (including Roman law) in the interpretation and application of the provisions of the new Codes. Therefore, 'successful codification also meant that the countries adopting these sources had, once again as they did during the *ius commune* period, much in common with the advanced countries of Europe.'[17]

1.2.2. The twentieth century: The (relative) influence of the United States

The significant influence and impact of American law and legal culture over the Western world has been the subject of a large number of studies.[18] Latin America has not been an exception to such a phenomenon. Geopolitical interests turned Latin America into a region of concern for the United States. The Second World War weakened the Latin American links with Europe and the Cold War encouraged the United States to influence legal change in Latin America as a political strategy against communism.[19]

The impact of the law and legal thinking of the United States has been significant in public law, especially with regard to judicial review, the concept of the rule of law and the protection of individual rights through the constitution.[20] Also institutional and procedural aspects of the law have been the subject of advice from U.S. lawyers and academics to Latin American Governments: 'Initiatives have included: studying the judiciary and court systems and making recommendations for increasing their independence; improving the training of government lawyers, judges, and other personnel; increasing the efficiency and transparency of legal proceedings; and making changes in legal education.'[21]

However, with regard to private law, the extent of such an influence is not homogeneous. Thus, in banking, commercial and finance law the introduction of U.S. concepts and institutions have been significant; e.g. in securities, foreign investments, corporations and trusts.[22] Also international commercial agreements such as NAFTA or bilateral treaties on free trade between the U.S. and some Latin American countries have led to the reform of domestic Latin American law in fields such as professional and financial services, intellectual property and environmental protection.[23] Finally, the role of institutions

16 Mirow (2004), p. 142.
17 Mirow (2004), p. 129
18 For two different perspectives, see Mattei (2003) and Hondius (2005).
19 Mirow (2005a), p. 185.
20 In this field, the impact of U.S. law and legal thinking can be traced back to the independence process in the nineteenth century, when the U.S. Constitution of 1787 and its related literature heavily influenced the thinking of Latin American leaders.
21 Mirow (2005a), p. 187.
22 Mirow (2004), pp. 210-217.
23 Mirow (2004), p. 170.

such as the IMF or the World Bank in the adoption of legislative changes should not be underestimated.[24]

However, with regard to the traditional core of private law, Europe is still the main point of reference. Thus, the Italian Civil Code was the model for the new Codes of Bolivia (1975) and Peru (1984) and has influenced the reform of the Argentinian Civil Code of 1968, the new Civil Code of Paraguay (1987), as well as the law of obligations in the new Brazilian Civil Code (2002). The reforms in family law which took place after the themed-twentieth century in most Latin American jurisdictions were also based on legislation from European countries such as Spain, France, Italy and Germany.[25] Finally, new codifications such as the Dutch Civil Code (1992), the 2002 reform of the German BGB and the PECL are increasingly being scrutinized by Latin American legal scholarship.[26]

As a consequence, the impact of U.S. law and legal theory have been confined to specific areas of the law but have failed to achieve a change in the legal thinking of Latin American jurists. Thus, the success of movements such as Law and Economics has been much more modest than in Europe.[27] The so-called Law and Development Movement of the 1960s and 1970s, specifically directed towards Latin America, was also a failure.[28]

Finally, domestic legal developments should not be underestimated. An important amount of domestic Latin American doctrinal literature have been developed in the twentieth century, replacing and complementing the European sources, but still relying considerably on them.[29] As a consequence, the structure and terminology of private law remains to a large extent in line with the Civil law tradition, with a rationalistic and abstract approach to the analysis of law.[30]

24 See Kleinheisterkamp (2006), p. 292, who gives as examples the adoption of new laws on arbitration in Bolivia and Paraguay based on the UNCITRAL Model Law on International Commercial Arbitration.

25 For a complete survey of the process of codification, decodification and recodification in Latin America, see Moreteau, Parise (2009).

26 Paradoxically, this reference to Europe also implies as a secondary effect the assimilation of U.S. legal developments, as in the case of the regulation of product liability.

27 See Del Granado, Mirow (2008), noting at 293 that law and economics, 'as an academic discipline, … remains notoriously absent from the curricula in most Latin American law schools'.

28 See Merryman (1977).

29 For a critical view of the excesses of this reliance on foreign sources, see Kleinheisterkamp (2006), stating at 295 that 'Some – but certainly not all – academic studies also seriously suffer from a wild eclecticism which lacks reflection…the law of the author's own jurisdiction may receive little attention, and rarely is there an attempt to appraise a particular legal rule against the background of the Latin-American socio-economic scene.'

30 On the opposed pragmatic and empirical roots of the Anglo-American legal culture, see Del Granado, Mirow (2008), pp. 296-297.

2. Chilean law

2.1. The Chilean Civil Code

The core of Chilean private law can still be found in the Civil Code. The private law curriculum of the law schools is based on its structure and method. Although relevant reforms to the law of persons, family law and inheritance law were introduced in the second half of the twentieth century, the books on property law and obligations have remained without significant modifications.[31]

The Chilean Civil Code was adopted in 1855 and entered into force on January 1, 1857. The code was drafted by the Venezuelan jurist and humanist Andrés Bello, who began his work in 1833.[32] It is composed of 2,525 articles distributed over four books (Persons; Property; Successions and Gifts; and Contracts and Obligations), besides an introductory title (*Título Preliminar*) and a concluding title (*Título Final*) of only one article.

The Chilean Civil Code has been referred to as the most influential codification in the development of Latin American private law and as a remarkably novel and original work.[33] Accordingly, Bello´s code was adopted in its entirety in El Salvador (1859), Ecuador (1860),[34] Venezuela (1863), Nicaragua (1871), Colombia (1873) and Honduras (1880).[35] The Chilean Code also heavily influenced the codifications of Uruguay (1869), Mexico (1871 and 1884), Guatemala (1877), Costa Rica (1888) and Paraguay (1876).[36] Finally, the Chilean Code was taken into consideration by Velez and Freitas when drafting the Civil Codes of Argentina and Brazil.[37]

31 Regardless of the enactment of an important amount of special legislation, e.g. consumer law, labour law, loans, leases, etc.

32 For a detailed study of the drafting and history of the Chilean code, see Guzmán Brito (1982); and Mirow (2001).

33 Mirow (2004), and Zweigert, Kötz (1998) p. 114, adding that 'In its structure (the Chilean code) …is superior to the Code civil, and in its language it is equally clear and forceful'. Several authors have stressed the relevance and quality of Bello´s code: '(the Chilean Civil Code)…in most respects it is the best of all Spanish-American codes' Sherman (1919); 'the first and best-known civil code in South America is that of Chile of 1855…' Wieacker (1995); '(the Chilean code)…has secured a place as the most celebrated legal code of nineteenth-century Latin America', Jaksic (2006), p. 157; Kleinheisterkamp (2006), 'the Chilean codes were to prove the most influential models of codification in Latin America', p. 282.

34 The case of Ecuador is the best example of the influence of Bello´s Code. The Supreme Court discarded its own project once it learned about the Chilean Code: 'The Supreme Court, being free of pride or vanity, believes that there is no harm in adopting what has been already been done. Therefore, it has not hesitated to step back, leave its own work aside and examine the (Chilean) code. From its examination we concluded that its plan is preferable to that of the Court, and that its doctrines and even style can be adopted by us…' Statement of the Supreme Court of Ecuador, February 21, 1857; cited by Jaksic (2006), p. 175.

35 The Chilean Code is still in force (with amendments and modifications) in Ecuador, El Salvador, Colombia and Honduras.

36 See Mirow (2001) p. 292, Guzmán Brito (2004) and Jaksic (2006), pp. 174-176.

37 Bello´s Code is recognizable as the direct source of 170 articles of the Argentinian Civil Code. See Mirow (2004) p. 140.

As stated above, Bello relied on the *Code Civil* and its commentators as a major source of inspiration. However, Spanish medieval law as the *Siete Partidas*, the works of the historical school of law (particularly Savigny's thinking), and other codes in force at that time (e.g. Louisiana and Sardinia) also played an important role in the elaboration of the Code.

The success of Bello´s Code can be explained by its compromise between tradition and change, with the great influence of Roman law that made the terminology and concepts of the new codification recognizable for Latin American contemporary jurists. In the end, 'Roman law appeared from every angle, and as result the civil code became totally and absolutely a Romanistic document.'[38] Thus, the Chilean Code was assumed to be a new version of Latin America's juridical tradition and not as a mere imposition of a foreign code.[39]

However, Bello's Code was also a product of its times. Thus, the conservative and liberal features of the Chilean Civil Code reflected the Chilean social and economic context at that time; i.e., an autocratic and even authoritarian presidential regime, which sought political stability and economic growth (through private property, economic freedom and industry) as the main goals for the country.[40] In this sense, with regard to patrimonial law, the principles of the protection of private property (article 582) and of the freedom of contract (article 1545) are strongly stated in the Code.[41]

2.2. The role of case law and legal thinking in the Chilean legal system

Following the general tendency of Civil law systems, in the Chilean legal system the doctrine of precedent or *stare decisis* has no legal force.[42] Therefore, the courts are not bound by their own previous decisions or by previous decisions from superior courts. The principle is laid down in article 3 of the Civil Code: '*Only the legislator may interpret or explain the law in general and binding terms, and judicial decisions are not binding*

38 Guzmán Brito (1982), p. 171. Roman law was not only considered by Bello through its primary sources but also through the Code Civil, the *Siete Partidas* and Savigny's works. For further references to the Roman law foundations of the Chilean Civil Code, see Jaksic (2006), pp. 170-174.

39 Guzmán Brito (1991), p. 211.

40 Mirow (2001), p. 329.

41 Article 582 of the Code states that '*Property is the right to arbitrarily enjoy and dispose of a thing, provided that it is not prohibited by law or against the rights of third persons*'. (El dominio (que se llama también propiedad) es el derecho real en una cosa corporal, para gozar y disponer de ella arbitrariamente; no siendo contra la ley o contra derecho ajeno). Article 1545 states that '*Contracts lawfully entered into are a law for the contracting parties and cannot be invalidated except by mutual consent or for causes authorized by law.*' (Todo contrato legalmente celebrado es una ley para los contratantes, y no puede ser invalidado sino por su consentimiento mutuo o por causas legales). Author's own translation.

42 For an overview of the role of precedent in different legal systems, see Hondius (2007a).

outside the case in which they are held'.[43] However, in practice, *jurisprudencia*[44] is taken into account by the courts in their decisions and is therefore also used by lawyers as supportive argumentations in their cases.[45] Nevertheless, because of the lack of legal force given to precedents, judicial decisions do not usually refer in their reasoning to previous case law which could influence the judgment. That makes it very difficult to trace and identify the real weight of a precedent in a judicial decision.[46]

In addition, the classical Chilean legal doctrine and particularly the judiciary have a formalistic approach to the law, based on a distorted interpretation of the legal positivism school related to the School of Exegesis in the early 19th century.[47] Under this view, the text of the norms (the *letter* of the law) is the main component of the juridical system and the judge is only the vehicle for its application to the particular cases through deductive reasoning based on syllogism. General principles of law are only considered to be vague and generic concepts, and external considerations (such as the social or economic consequences of a doctrine or decision) are simply not taken into account or not expressed in judicial decisions.[48] In the case of legal doctrine, even when general principles of law are often developed and cited, their analysis is mainly abstract and formalistic.

Thus, the analysis of the arguments is characterized by the strong influence of the legal positivism school, especially the French exegetic school (School of Exegesis), trying to find the reasons in the wording of the law rather than in more moral, social or systematic arguments. Legal certainty is considered the cornerstone of the whole legal system, and therefore, an interpretation from outside the wording of the law is very restricted.[49]

Only in the 1960s and 1970s were some efforts made to fill the gap between law and society and therefore to 'open the law' to sociological and empirical studies and to generate new juridical knowledge and theories.[50] With this purpose, at the main Universities the legal studies curriculum was reformed to include 'scientific and empirical research' and thus led

43 Art. 3: 'Sólo toca al legislador explicar o interpretar la ley de un modo generalmente obligatorio. Las sentencias judiciales no tienen fuerza obligatoria sino respecto de las causas en que actualmente se pronunciaren.' Author's own translation.

44 A set of judicially analogous decisions based on the same legal and theoretical arguments held in similar cases by superior courts.

45 Accatino (2002), p. 566.

46 See Accatino (2002), pp. 568-572, stressing that there is no procedural or substantive rule which requires the judge to refer to previous case law in his/her decision.

47 Gonzalez (2003).

48 The French tradition can also be traced here: '…especially in the (French) Court of Cassation, every effort is made to make the text of the judgment as dense and compact as possible…judgments of the Court of Cassation never contain references to previous decisions made by itself or any other court, or even references to legal writing…', Zweigert, Kötz (1998), pp. 122-23.

49 See Strömholm (1985), stating that in its pure formulation, the School of Exegesis requires that 'To understand the exact meaning of the codes, it was necessary to set out from the text, from the text alone, and not from its sources', p. 271.

50 Sierra (2003), pp. 5-7.

the analysis of the law beyond the mere study of positive norms.[51] However, the 1973 coup d'état put a violent end to the process of reformation and soon afterwards the Universities returned to the old curriculum.[52] As a consequence, legal studies once again focused largely on the mere analysis of legal norms through more or less exegetic methods.[53]
These features resulted in a lack of substantive argumentation in the case law. Most of the time, judicial decisions are limited to a simple enunciation of the applicable legal norms without any analysis as to the reasons for such an application and in any case without the reasons for rejecting or accepting the argumentation of the parties.[54] These characteristics make the analysis of the case law difficult and they discourage academics from studying case law; however, this situation has been changing in recent times. In spite of that, the decisions of the Appeal Courts and the Supreme Court are regularly reported, and the most important law reviews devote a section to the analysis of recent and relevant case law.[55] Thus, even with the difficulties highlighted above, 'the persuasive authority of cases contextualized by legal doctrine'[56] should not be underestimated in Chilean law.

Finally, it must be said that the future of legal theory and education is not so pessimistic in Chile. Since the 1990s, the main law schools have changed their politics with regard to legal education. A new generation of young professors holding PhDs or *Doctorados* have slowly replaced the old generation of practising lawyers in the teaching of law. In addition, research has been supported as one of the main activities in law schools and therefore a growing number of legal publications has been produced.

51 Sierra (2003), p. 7.

52 On September 11th, 1973, the armed forces headed by General Augusto Pinochet overthrew the democratically elected President, the socialist Salvador Allende, and seized power in a bloody coup. Pinochet ruled the country from 1973 to 1990 with a brutal right-wing dictatorship.

53 A 1976 speech by the then President of the Supreme Court is a clear example of this tendency: 'It is necessary that law students learn our legal reality in all the subjects of positive law, and not be taught mere theories without any transcendence for their professional life. Our positive law is vast and diversified enough to fill all the study years of the future lawyers'. Cited by Sierra (2003) at p. 9, author's own translation. The same perspective can be found at the beginning of the 1990s, again in a speech by the President of the Supreme Court at that time: 'The law is given by the political power – the Legislative and Executive powers – and they state what is just, not being the judge allowed to discuss the justice of the law'. Cited by Bravo Lira (1998), author's own translation.

54 Even though the procedural norms require that the parties have to provide the grounds for their presentations, it is usual that a second instance decision by a Court of Appeals is limited to a brief and single sentence rejecting the appeal: '*Se confirma la sentencia de primera instancia*' (The first instance decision is approved).

55 In addition, all the decisions of the Courts of Appeals and the Supreme Court are also available online on the website of the Judiciary, www.poderjudicial.cl. A main source for the study of case law is the *Repertorio de Legislación y Jurisprudencia Chilenas*, with annotations and comments on the provisions of the Codes and the main legislation of Chile. Each legal provision is followed by a brief reference to its sources and the related relevant case law, with comments on the judicial interpretation of the provision by the superior courts.

56 Hondius (2007a).

2.3. Unexpected circumstances in Chilean law: *teoría de la imprevisión*

The subject of unexpected circumstances is analyzed in Chilean legal theory under the heading of *teoría de la imprevisión* or simply *imprevisión*.[57] In the following sections, a review of the legal doctrine and case law related to the subject will be provided.

2.3.1. The binding force of contract in Chilean private law. Article 1545 of the Civil Code and the rejection of imprevisión

The main obstacle to the application of *imprevisión* in Chilean private law has been article 1545 of the Civil Code, which is based on article 1134 of the *Code Civil* and is one of the reflections of the nineteenth century's prevailing liberal doctrine and individualism, and consequently, of the freedom and sanctity of contracts. Accordingly, in the Code's system, the parties are free to enter into a contract and to pursue their own interests. Profits derived from a contract are neither restricted nor limited, with the exception of *lesión* in the sale of immovable goods and some restrictions on the amount of interest on loans.

Based on the cited provision, traditional Chilean legal doctrine rejects the possibility of a revision of contracts in cases of *imprevisión* and in any other case which is not expressly regulated. This provision has been interpreted by legal doctrine as an insurmountable obstacle to the acceptance of the *imprevisión*. Therefore, it is argued that even if it is true that the Civil Code does not expressly reject *imprevisión*, the lack of a provision cannot be considered as a mere 'omission' by the drafter, which certainly was aware of the different theories concerning the effect of unexpected circumstances. Therefore, the *omission* can be interpreted as a *rejection*.[58] In this sense, it is added that the historic background of the Code explains the extraordinary force given to the principle of the sanctity of contracts, and therefore any attempt to find other underlying principles may be regarded as artificial.[59] Accordingly, the stability of transactions is considered to be one of the bases of the economic system and of the whole social order.[60] As a conclusion, the provisions of the Civil Code leave no room for the application of *imprevisión* in Chilean private law, and therefore the introduction of an express legal provision is required for its recognition.[61]

On theoretical grounds, the provision of the cited article 1545 is also justified as a *natural* consequence of the free consent of the parties in the conclusion of a contract.[62] Thus, for Chilean legal doctrine the foundation of the binding force of contracts is the autonomy of the will; and consequently, if a contract is binding it is because it is a manifestation of the

57 With regard to such a designation, the influence of French legal doctrine is evident (*théorie de l'imprévision*).
58 De la Maza (1933).
59 *Ibid*., and Abeliuk (2001).
60 De la Maza (1933).
61 *Ibid*., and Abeliuk (2001).
62 Abeliuk (2001), p. 117.

freely expressed will of the parties.[63] In this sense, article 1545 would be the manifestation of two principles, *pacta sunt servanda* and the autonomy of the will. However, recently some authors have stated that the real source of the binding force of contracts is not the will of the parties, but the law itself, which through the statement in article 1545 gives binding force (force of law) to an agreement between the parties.[64]

Finally, although there is no general provision in the Civil Code concerning *imprevisión*, some particular rules do allow the modification of specific contracts in cases of unexpected circumstances: articles 2003 rule 2a (construction contracts – *contrato de construcción*), 2180 (loan for use – *comodato*) and 2227 (bailment – *depósito*). On the contrary, articles 1983 (lease of rural property – *arrendamiento de predios rústicos*) and 2003 rule 1 (construction contracts – *contrato de construcción*) expressly reject the modification of such contracts on the basis of a change of circumstances.

2.3.2. The reinforcement of pacta sunt servanda *through property law*

The binding force of contracts has been reinforced in Chilean law through property law, with the constitutional recognition of an ownership right over 'immaterial goods' or 'incorporeal property', which include the contractual rights of creditors (article 19 n.24 of the Chilean Constitution).[65] Therefore, there is a real superposition of rights: a property right (ownership) over a personal right (credit).[66] Through the recognition of his right of ownership, the creditor has a constitutional action (*recurso de protección*, provided by article 20 of the Chilean Constitution) to claim the protection of his contractual right against any illegal or arbitrary privation, perturbation or threat to such a right (article 20 of the Chilean Constitution).

Therefore, creditors are protected against legislative intervention in already concluded contracts. Thus, the legislator cannot modify the terms of contracts through legal provisions enacted after the conclusion of such contracts. Regarding the ownership right over contractual rights, a legal provision which deprives or reduces such rights will be considered as expropriatory and, therefore, unconstitutional.[67] As a concequence, a legal provision is only applicable to transactions concluded after its enactment.

As stated before, in Chilean private law there is no express general provision which allows for the revision and consequent modification of contracts in cases of unexpected circumstances. Therefore, because of the lack of such an express provision, the constitutional

63 See Domínguez et al., (2008), p. 514.
64 See Pizarro (2004).
65 Article 19 n.24 of the Chilean Constitution states that *The Constitution guarantees to all persons: The right of ownership in its diverse aspects over all classes of corporeal and incorporeal property* (La Constitución asegura a todas las personas: El derecho de propiedad en sus diversas especies sobre toda clase de bienes coporales o incorporales). Author's own translation.
66 Domínguez et al., (2008).
67 See Sacco Aquino (2006); Cordero (2006).

protection of the right of property over immaterial goods (including personal rights) may be argued as a major objection to the judicial revision (and even the termination) of contracts in such cases. The intervention of the court in a concluded contract would deprive the creditor of a certain right (his ownership right over the personal right derived from the contract) which is constitutionally protected. Thus, if the legislator is not entitled to modify the terms of a current contract, a judge cannot do so either.[68]

However, such an objection may be countered by arguing that the *imprevisión* theory can be construed as an already existing and underlying principle through the interpretation of the positive norms of the Code. Therefore, a judge would only be 'applying the law' in force at the time of the conclusion of the contract, which is also part of the contract.[69]

Another option is to give the effects of *imprevisión* an interpretative nature. In this sense, one author has argued that the aim of *imprevisión* is not to allow intervention in and the modification of the contract by a third party (a judge), but to construct the contract in accordance with its nature and the will of the parties, expressed through a common intention. Thus, the judge may terminate the contract or fill the gaps which are present between the intention of the parties and the effects of the unforeseen events. Therefore, in this approach, the contract is not technically *modified*, even when its actual *wording* is altered by the intervention of the judge, who is only restoring the true intention and will of the parties through interpretation.[70]

2.3.3. Contemporary legal doctrine: good faith as the basis for imprevisión

Most of the contemporary Chilean legal doctrine argues for the application of *imprevisión* in Chilean private law, based on article 1546 of the Civil Code, which provides the principle of good faith in the performance of contracts.[71] Although good faith is not included as a general duty or principle by any provision in the code, on the basis of a large number of specific provisions which state the existence of such a duty in particular areas of the law, Chilean legal doctrine is in unanimous agreement that good faith is one of the core principles of the Civil Code. In this sense, such a principle is regarded as one of the central concepts of the whole law of obligations, applicable not only at the performance stage

68 López Santa María (1998), p. 211.

69 Article 22 of the Act on the retroactive effect of the law states that 'The law in force shall be deemed to be part of the contract'; *(Ley sobre efecto retroactivo de las leyes, artículo 22: En todo contrato se entenderán incorporadas las leyes vigentes al tiempo de su celebración)*. Author's own translation.

70 Dörr (1985). See infra, *Guillermo Larraín Vial con Servicio de Vivienda y Urbanización de la Región Metropolitana*, 11.11.2006, Corte de Apelaciones de Santiago.

71 Article 1546: 'Contracts must be performed in good faith and are consequently binding not only as to what is expressed therein, but also with regard to all consequences which are derived from the nature of the obligation, or belong to it by statute or usage' *(Los contratos deben ejecutarse de buena fe, y por consiguiente obligan no sólo a lo que en ellos se expresa, sino a todas las cosas que emanan precisamente de la naturaleza de la obligación, o que por la ley o la costumbre pertenecen a ella)*. Own translation). The direct sources of this provision are articles 1134 and 1135 of the *Code civil*. However, the Chilean legislator did not incorporate the concept of equity (*l'équité*) in the provision, because it was considered unnecessary regarding other provisions of the Code. See Abeliuk (2001), p. 119.

(as article 1546 expressly states), but also in pre-contractual negotiations and during the process of concluding the contract.

With regard to the *imprevisión* theory, good faith in performance is considered to be a limit on the power to claim the execution of the contract by the creditor, when the performance of the contract as agreed implies an unjustified and serious detriment to the debtor derived from external events, which is unforeseen by both parties at the time of the conclusion of the contract. Therefore, the affected party (the debtor) has the right to require a reduced performance if such a performance is not in accordance with the standards of good faith.[72]

In the same sense, it is argued that the provision of article 1545 cannot be read in isolation and should be interpreted in accordance and with the limits of the principle of good faith as stated in article 1546. Thus, the literal performance of the contract is prevented if such a performance is contrary to good faith standards. In such a case, because the creditor has not fulfilled its duty to perform in good faith, the debtor is protected by the *exeptio non adimpleti contractus* (provided by article 1552 of the Code) and therefore is entitled to refuse to perform its own obligation.[73] In sum, good faith is a requirement for the performance of the contract (with consequences for both parties) and is therefore an *integral part* of its content.[74]

In addition to the duty of good faith, other arguments based on a broad interpretation of the texts of some provisions of the Civil Code have been argued for the application of *imprevisión* in Chilean private law:

– The concept of *causa* (the French *cause*). *Causa* is one of the requirements of the existence of contracts, and is defined in the Code as *the motive which induces the parties to contract* (art. 1467).[75] Following the theories of Capitant and Josserand, it is argued that *causa* is the motive of the party to enter into the contract with the purpose being to request the performance of the counter-obligation. It is added that the *causa* of the contract is not only required to be present at the time of concluding the contract, but also in the course of the performance in its entirety.[76] Therefore, a serious alteration in the performance of the obligation by supervening events will lead to the disappearance of its *causa*, leading to the nullity of the contract.[77]

72 Dörr (1985) p. 269 and Fueyo (1990), p. 182, stressing that the opposite case is also possible: the creditor is entitled to require the adjustment of the debtor's performance to the standards of good faith.
73 Dörr (1985), p. 269. This provision is regarded as an application of the general principle of good faith. See Fueyo (1990), pp. 201-202.
74 Fueyo (1990), p. 183.
75 Article 1467, second paragraph: *Se entiende por causa el motivo que induce al acto o contrato.*
76 Dörr (1985), p. 265.
77 Dörr (1985), p. 266.

However, such arguments have been criticized for a number of reasons. First, the concept of *causa* is far from being uniform in legal doctrine, and the theories of Capitant and Josserand have been contested by modern authors. Second, the absence of *causa* inevitably leads to the nullity (or even the non-existence) of the contract, i.e., the dissolution of the transaction with retroactive effect. Therefore, remedies such as the adaptation of the contract or even its termination with a fair distribution of losses would not be possible under this approach.[78]

– It is also argued that the expression *causas legales* (legal causes, i.e., expressly authorized by the legislator) in article 1545 allowing for the modification of a contract should be interpreted in a broad sense, including not only the authorization of an express legal provision, but also any other *juridical cause* (*causa jurídica*) which leads to such a result, i.e., with grounds in general principles of law and based on a legal theory which is broadly accepted. The case of the *teoría de la imprevisión* would be a juridical cause with a sufficient legal foundation to justify the adaptation or termination of the contract within the terms of the cited article 1545.[79]

– Lastly, it is affirmed that in the case of commutative contracts (*contratos conmutativos)*; i.e. with reciprocal obligations which are considered to be equivalent by the parties (article 1441), the equivalence between the counter-performances would be an inherent element of the agreement.[80]

Therefore, if after the conclusion of the contract, such equivalence is severely disturbed by unforeseen and extraordinary circumstances, the purposes of the parties may be deemed to have been frustrated and the contract (with regard to its original nature) has been transformed into another completely different contract to that agreed upon by the parties. The utility of both parties would be of the essence for this kind of agreement: if a heavy burden is placed on one of the parties making its performance much more difficult or onerous than the counter-performance of the other party, the affected party has the right to request the court for a remedy which will restore, if possible, the original nature of the contract, or to declare its termination because it has been transformed into a contract which is different to that agreed upon by the parties.[81]

Finally, with regard to the requirements for the application of *imprevisión* to a particular case, Chilean legal doctrine requires the following conditions to be met:[82]

78 Peñailillo (2000b).

79 Peñailillo (2000a), p. 233, adding that the expression 'legal' in article 1545 is a consequence of the prevalence of positivism at the time of enacting the Civil Code.

80 According to the Chilean Civil Code (articles 1439 to 1441), bilateral contracts (*contratos bilaterales*), i.e. contracts with reciprocal obligations, may be aleatory (if the expected equivalent consists of an uncertain possibility of a loss or gain for one of the parties) or commutative.

81 In the words of article 1444, when one of the elements of the essence of a contract is absent, the contract is transformed into a different one (*degenera en otro contrato diferente)*.

82 See Illanes (2000), and Peñailillo (2000a), pp. 223-225.

– The supervening event has to be unforeseeable at the time of concluding the contract. The test of unforeseeability has to be carried out on objective grounds, i.e. with regard to a reasonable party of the same kind and in the same circumstances.

– The supervening event has to make the performance of the affected party excessively onerous, thereby severely altering the economic equilibrium of the contract. Thus, performance is still possible, but has become extremely burdensome for the debtor.[83] Related to this condition, the obligation of the affected party should not yet have been performed. The possibility of diminishing the value of the performance received by the affected party is not usually analyzed by Chilean authors.[84]

– The supervening event has to be independent of the will of and outside the affected party's sphere of control, i.e. the occurrence of the event should not have been caused by the fault or negligence of the affected party.

– Finally, *imprevisión* would only be applicable to long-term and commutative contracts. It is argued that only in this case does the economic imbalance between the counter-obligations justify intervention in the contract. However, one author has stated that the only requirement is the pending status of the performance of the obligation, without negligence or fault on the part of the affected party, regardless of its origin (contractual or non-contractual).[85]

2.3.4. The discussion about the need of a legal reform

Contemporary doctrine agrees with the possibility to admit *imprevisión* into the present text of the Civil Code, but Chilean doctrine is divided with regard to the necessity of a legal reform for the introduction of a general and express rule on *imprevisión*. Some authors state that an express recognition of *imprevisión* would open the gates to unjustified and mass litigation and would lead to abuses by disadvantaged parties.[86] The principle of the sanctity of contracts and legal certainty would be in danger in an issue which is of major importance for economic stability. An express legal provision would lead to the courts widely intervening in contracts, and doubts about the capacity and quality of the courts to deal with this subject are also implied in this line of argumentation.[87] It is argued that

83 If the performance is impossible, the rules on *caso fortuito* or *fuerza mayor* (*force majeure*) are applicable.

84 Only Peñailillo states the possibility to include the 'loss of the purpose of the contract' or *frustación del contrato* as a case of *imprevisión*. See Peñailillo (2000a).

85 Peñailillo (2000a), p. 231.

86 Thus, Illanes (2000) states at p. 222 that 'Experience shows that the legal systems which have incorporated a provision allowing the effects of unforeseen circumstances have faced greater problems than the ones they were trying to solve' (author's own translation). However, Illanes does not provide any empirical data to support this statement.

87 Thus, Dörr argues that 'if the incorporation of the *imprevisión* theory into the (Italian) Civil Code has not led to the disastrous consequences of the Argentinian experience, this is because of the competence of the judiciary' (author's own translation). Again, no empirical support is given. With regard to the effects

only if the courts have to resort to general principles of law (and not to an express power given by the legislator) will the scope of *imprevisión* remain restricted to exceptional and extraordinary cases and will not give raise to a general rule. In this sense it is added that because of the role of precedent in the Chilean legal system, the decisions of the courts would not create any rule of law with general applicability, but would only be binding for the parties in the particular case. Therefore, the principle of the sanctity of contracts would be not weakened.[88]

On the other hand, the enactment of an express provision regulating *imprevisión* is supported by a number of authors.[89] Such a provision should recognize *imprevisión* in exceptional cases and authorize the court to revise the contract subject to strict requirements. With regard to the role of the judiciary, it is stressed that there is no reason to think that the courts will not apply the norm with caution and restraint, especially if the rule is drafted as an exception to the general *pacta sunt servanda* principle in article 1545, and it would therefore only be applicable subject to strict conditions. It is argued that there is no reason to think that the courts will be prudent and reasonable without an express provision, and the contrary if the *imprevisión* is expressly recognized.[90]

2.3.5. The (failed) project of reform

The lack of any political will to introduce major reforms in the law of obligations (and therefore in the Civil Code) is demonstrated by the fact that the only Law Reform Project on the subject of unexpected circumstances was archived by the Senate in 2004.[91] The Project had been presented by a group of Deputies in 1991 and although it was approved by the Chamber of Deputies, it was never discussed by the Senate, and, as stated above, it was definitively shelved in 2004.

The Project intended to introduce, by means of a specific statute (therefore, without an express modification of the Civil Code) the judicial revision of civil and commercial contracts when extraordinary, unforeseeable and external circumstances render the performance of the obligation of one of the parties excessively onerous.

The action would have been granted exclusively to the affected party, who could request the modification of the contract with the aim of restoring the equilibrium between the counter-obligations at the time of the agreement. The affected party was also entitled

of *imprevisión*, Dörr states that the proper remedy is the termination of the contract 'which avoids the serious danger of giving power to the judges to modify the effects of the contract', Dörr (2000), p. 229.

88 Dörr (2000), p. 229.

89 Caprile (2007), Abeliuk (2001), Peñailillo (2000a).

90 Peñailillo (2000b), p. 242.

91 Boletín 309-07, project on 'Judicial Revision of Civil and Commercial Contracts' (Revisión judicial de contratos civiles y mercantiles). Under Chilean law, if a legislative project is not discussed by the competent Commission of the Senate within two years after its presentation, the Senate, with the agreement of the Chamber of Deputies, has the power to archive such a Project, which is technically equivalent to a rejection.

to request the resolution or termination of the contract, but only if the modification of the contract was not suitable in the particular case. A short prescription period was established: six months after the occurrence of the circumstance which resulted in the excessively onerous nature of the performance.

On the other hand, similar to article 1467 of the Italian Civil Code, the defendant could avoid termination by offering to increase its obligation or to reduce the obligation of the affected party in order to restore the contractual equilibrium. The powers of the courts were broad: the judge could modify the contract with the purpose of restoring the equivalence between the obligations of the parties or, if such a modification was not possible, the judge could resolve or terminate the contract but without retroactive effect.

The project also established a short procedure (*procedimiento sumario*) in which the judge had the power to immediately suspend performance and to order the payment of any non-disputed obligation before coming to a final decision in the case. The rules provided by the statute were mandatory, i.e. they could not be altered or excluded by the parties. Finally, if the claim was rejected, the affected party (the claimant) had to pay the costs of the procedure and (eventually) damages to the defendant.

2.3.6. The situation of Chilean administrative law

Similar to France, administrative regulations and case law have admitted the application of the *imprevisión* theory. Contrary to the situation in private law, arguments related to public interest have been stressed in accepting the effect of the excessively onerous nature of performance in contracts concluded between a private party and a public body or an authority for the provision and exploitation of public utilities or services.[92]

Thus, in administrative decisions, the *Contraloría General de la República*[93] has expressly recognized the application of *imprevisión* in cases related to administrative contracts concluded between a public body and a private party, stating that 'even if the general rule in administrative contracts is that the private party has to bear the risks of the performance of the contract, exceptionally and in extraordinary cases, such as *imprevisión*, the authority has to bear some of the risks of the contract...when this is necessary to preserve the economic equilibrium between the parties'[94] The cases related to lump-sum contracts where the private party had requested the modification of the contract price because of an increase in the original costs due to the occurrence of unexpected circumstances.

92 See Morales (1998).

93 The *Contraloría General de la República* is the superior and independent body in charge of controlling the actions of the Administration as to their legality (article 87 of the Chilean Constitution).

94 Author's own translation. Resolutions N°41.409 of 02.12.1994, N°35.989 of 28.09.2001, N°35.996 of 02.08.2005 and N°10.624 of 06.03.2006. Rejecting the *imprevisión* in the particular case, but recognizing its applicability to administrative contracts, Resolutions N°41.183 of 15.12.1997, N°25.127 of 26.5.2005 and N°31.163 of 05.08.2005.

Similarly, the Act on Concessions for Public Infrastructure expressly recognizes the revision of concession contracts as a consequence of supervening events.[95] Article 19 states that the public proposal (the offer) for the granting of the concession must contain the procedure for and the period in which the concessionaire (the private party) may request the revision, '…in cases of supervening events, of the tariff system, of the mechanisms or formulas for the adjustment of such tariff, or of the contract duration.'[96] The request for a revision has to be addressed first to the Ministry (which in a strict sense is the counterparty of the concessionaire) and if there is no agreement between the parties, an independent Commission is entitled to resolve the controversy.[97]

Legal doctrine has stated that the reference in the Act to 'supervening events' has to be understood as a reference to situations of *imprevisión*, and *vis-à-vis*, the same conditions should be required for their application as in private law.[98] If such conditions are met, the terms of the contract have to be revised to restore the economic equilibrium of the relationship.

One interesting feature of the Act is the express regulation of the distribution of risks in a concession contract. Thus, article 22 provides that the concessionaire has to bear all the risks in the construction stage, including situations of *force majeure*. On the contrary, the risks in the operation stage (the use of the concession) are distributed between the parties, which have to contribute to the costs resulting from *force majeure* regarding the circumstances of the particular case. However, the Commission has held that even during the construction stage, in the case of an unforeseeable increase in the administrative costs (more than 120%) which were not anticipated by the parties at the time of concluding the contract, the new costs have to be distributed between the concessionaire and the public authority.[99]

2.3.7. The case law

2.3.7.1. The rejection of *imprevisión* by the Supreme Court

Until recently, there was no reported case law that directly addressed the subject of *imprevisión*. As will be mentioned below, only in 2006 did a decision of the Court of Appeal of Santiago accept the application of that doctrine in Chilean private law. On the other hand, historically the Chilean Supreme Court (*Corte Suprema de Chile*) has firmly adhered to the principle of the sanctity of contracts as provided by article 1545 of the Civil

95 *Decreto no. 900, que fijó el texto fundido, coordinado y sistematizado de la Ley de Concesiones de Obras Públicas*.

96 On the other hand, the public authority is entitled to modify certain conditions in the contract based on reasons of 'public interest', but in any case, it has to compensate the costs of such modifications for the private party.

97 Article 36 of the Act provides for a special procedure for the resolution of conflicts between the parties, giving jurisdiction to an independent Commission.

98 Caprile (2007), pp. 150-151.

99 See Caprile (2007), p. 151. Decision of 12.04.2001, reported in www.camsantiago.com.

Code, laying down the supremacy of the agreed terms of the contract over any power of the courts to revise them. Thus, in the landmark case of *Galtier v. Fisco,*[100] the Supreme Court held that the courts had no power to ignore or revise the terms of the contract, either by reasons of equity, custom or administrative rules. The case concerned the construction of public utilities in the Chilean port of Valparaíso. In the case, the building contractor claimed the payment of the contract price in pounds of gold rather than the agreed paper money, which had been severely devalued after the First World War. The Supreme Court rejected the claim and stated that the contract had to be performed as originally agreed, regardless of the losses or the detriment suffered by one of the parties.

The *Repertorio de Legislación y Jurisprudencia Chilenas* reports eight decisions on *Casación* by the Supreme Court, which state that the decision of a lower court is null and void if such a decision ignores the binding force of a contract through the omission or alteration of the terms agreed by the parties.[101] These decisions were delivered in *recursos de casación* related to the scope and interpretation of article 1545 in cases where one of the parties had tried to elude the performance of its obligation, but in such cases the (non-)application of *imprevisión* was not discussed.[102] Because of this, the legal doctrine stated that the Chilean Supreme Court had never rejected or accepted the application of the *imprevisión* theory in a particular case, concluding that the subject can be considered to be unresolved at a judicial level.[103]

The lack of a relevant precedent explains the enthusiastic statements of the legal doctrine with regard to the decision delivered by the Court of Appeal of Santiago which accepted the application of *imprevisión*.[104] The case related to a construction contract. In this case, a construction company and the Housing and Urbanism Service of Santiago (SERVIU – a public body) concluded a lump-sum contract for the construction of a large number of social houses. The construction company performed the contract as agreed, but claimed the payment of the higher costs incurred due to the occurrence of unexpected circumstances during the performance: the soil depth was greater than the one provided by the engineers of SERVIU and also the parcel of land on which the houses had to be built had legal impediments for the construction of social housing. Such circumstances led to a change in the construction methods as agreed at the time of concluding the contract and to the extension of the period for performance, with the consequence that the costs for the company had sharply increased. The claim was based on the *imprevisión*

100 *Gaceta de los Tribunales* of 1925, l.er Sem., p. 23. *RDJ*, T. 23, sec. 1, p. 423 (10 January 1925) 'Los tribunales carecen de facultad para derogar o dejar sin cumplimiento la ley del contrato, ya sea por razón de equidad, o bien de costumbre o reglamentos administrativos'. In the same sense, the Supreme Court stated that article 1545 gives the force of law to the terms of a contract, and therefore such terms should be observed by the contractual parties and the courts (*RDJ*, T. 37, sec 1, p. 520, 1940).

101 See López Santa María (1998).

102 Illanes (2000), pp. 187, 198.

103 Domínguez et al., (2008), p. 521.

104 *Guillermo Larraín Vial con Servicio de Vivienda y Urbanización de la Región Metropolitana*, 11.11.2006, Corte de Apelaciones de Santiago. See Alcalde Rodríguez (2007). For criticism to the decision, see Momberg (2008).

theory: the economic equilibrium of the contract had been severely altered by unexpected circumstances (the soil depth and the legal impediments related to the parcel of land), which were unknown to the parties at the time of the conclusion of the contract. The legal basis of the claim was mainly the principle of good faith in the performance of contracts, as laid down in article 1546 of the Civil Code and the specific provision for construction contracts in article 2003 paragraph 2 of the Civil Code. SERVIU rejected the claim based on the express terms of the contract which stated that the risks of the contract had to be borne by the building contractor, thereby denying that party's right to request damages or modifications to the contract because of losses, damage or any other causes. In addition, SERVIU stated that *imprevisión* was not applicable to the particular case because the contractor had been negligent in examining the technical conditions for construction. Thus, SERVIU's report expressly stated the necessity of further studies to determine the exact depth of some areas of the soil. In addition, the contract stated that the contractor had to verify the technical reports provided by SERVIU, assuming the risks for any incomplete or erroneous statement.

The first instance court and the Court of Appeal admitted the claim and therefore the payment of the higher costs incurred by the affected party. The decision of the Court of Appeal raises a number of interesting observations. First, states that the *pacta sunt servanda* principle as a cornerstone of the law of obligations, but at the same time it adds that '*imprevisión* is not a danger to such a principle… on the contrary; the contract is reinforced because it gives the parties the possibility to keep the juridical situation intact as it was at the time of contracting'.[105] The court added that the evidence presented was sufficient to establish an 'alteration of the basis of the transaction' because the equivalence of the counter-obligations is essential regarding the nature of the contract concluded by the parties. Therefore, if such equivalence is disturbed, the *imprevisión* theory has to be applied to regulate situations not covered by the original contract and outside the will of the parties. Finally, the court stated that 'to require the claimant to bear the higher costs of the performance is to compel him to assume an unexpected obligation, that is, not due and outside the contractual relationship…with a significant loss to him and an unjust enrichment for the defendant…a situation which has to be revised by applying the *imprevisión* theory, which does not mean in any case revising the contract but only restoring its exact meaning and scope.'

The approach of the Court to the *imprevisión* theory was clearly directed towards considering it as an tool for interpreting the will of the parties in order to determine the 'true meaning and scope' of the agreed obligations. Implicitly, that approach entails that the court does not intervene in or adjust the contract, and therefore the principle of *pacta sunt servanda* is not in jeopardy.

105 '(*dicha teoría) no es, en ningún caso, un peligro para tal principio… por el contrario, se puede afirmar que ésta se ve reforzada por cuanto da la posibilidad a los contratantes de conservar inalterada la situación jurídica que asumieron al vincularse*.' *Considerando octavo* of the Court of Appeals' decision. Author's own translation.

Theoretically, the statements contained in the decision can be supported, particularly because of its innovative approach concerning Chilean case law and doctrine to the relationship between *pacta sunt servanda* and *imprevisión*. However, the decision can also be criticized because, considering the circumstances of the case, the conditions usually required by the legal doctrine for the application of *imprevisión* were not present.

Firstly, on the date of the claim, the contract had already been performed by both parties. Chilean and comparative doctrine state as one of the requirements for the application of *imprevisión* that the (supposedly excessively onerous) obligation of the affected party should not yet have been performed. This is not simply a formal requirement, but is related to the excessively onerous nature of the performance of such an obligation. The new circumstances must place an intolerable burden upon the debtor if its obligation is performed as agreed. Therefore, if such an obligation has already been performed, it can be presumed that the new burden was not excessive or intolerable. The facts of the case support that conclusion since the new costs alleged by the affected party were nearly 30% above the agreed price, which is far from the parameter which is usually required for an increase to be considered excessively onerous or to entail a significant alteration to the contractual equilibrium.

Secondly, it can be argued that the circumstances alleged to be unexpected by the affected party should have been foreseeable for a reasonable contractor in the same circumstances. The fact that the SERVIU report expressly stated the necessity of further studies to determine the exact depth of the soil is an antecedent which cannot be ignored by a professional party. The express assumption of the risk relating to the terms of the technical reports confirms that the affected party was negligent in its analysis of such reports.

Finally, no mention was made in the decision about the distribution of the risks in the contract. Normally, the risks in a lump-sum contract are borne by the building contractor,[106] a rule which is confirmed in the case by the express terms of the contract. In addition, as mentioned above, the supervening onerosity in relation to the price which was originally agreed was far from excessive, so it can be deemed to be included in the normal sphere of risks of the affected party. There is no evidence in the case to support a change in the legal and contractual provisions concerning the assumption of risks by the contractor. Moreover, as said above, the risk of inaccuracies in the technical reports was expressly regulated in the contract and assumed by the building contractor.

In any case, the apparent aperture towards the recognition of imprevisión by the above-cited decision was reversed by a recent decision of the Supreme Court which, in the light of the existing provisions of the Civil Code, expressly denied the possibility to apply the theory of imprevisión in Chilean private law.[107] The case was related to a claim for the agreed remuneration for professional services rendered by the claimant to the defendant

106 The Chilean Civil Code expressly provides for such a rule (article 2003 no. 1).
107 *South Andes Capital S.A. c/ Empresa Portuaria Valparaíso*, Corte Suprema, 09.09.2009, rol 2651-08.

deriving from a contract for the design of a business model and financial advice to an infrastructure construction project that the defendant intended to develop through public bidding. The defendant alleged, among other defences, an unforeseen change of circumstances between the time of the conclusion of the agreement (2003) and the execution of the infrastructure project (2006), which resulted in a severe decrease in its expected benefits, as a consequence rendering the performance of the contract agreed with the claimant excessively onerous for the defendant.

The claim was allowed both by the court of first instance and the Court of Appeal of Valparaíso, which ordered the payment of the remuneration as agreed in the contract. Based, inter alia, on the duty to perform in good faith (article 1546 of the Civil Code), the defendant entered a plea of *casación* arguing that the performance sought under the new conditions caused by the unforeseen change of circumstances, which imposed on him an excessive and unjustified burden, implied a violation by the claimant of its duty to perform the contract in good faith.

The Supreme Court rejected the motion, expressly stating that article 1545 of the Civil Code excludes the possibility of accepting the imprevisión theory in Chilean private law because under that norm the contract cannot be terminated or adjusted by the courts, but only by the mutual consent of the parties. The Court added that neither article 1546 nor article 1560 (interpretation of the contract on the basis of the parties' intention) are legal grounds to invoke *imprevisión*, because neither the duty of good faith nor the intention of the parties are contravened if the creditor claims the performance of the contract as agreed.

The statements of the Supreme Court plainly indicate a clear and strong rejection of the recognition of imprevisión in Chilean private law in the light of the legal provisions in force. The decision is not based on the non-concurrence of one or more of the conditions usually required by the legal doctrine for the operation of *imprevisión* in a particular case, but it only refered to the lack of a legal ground for its *general* recognition as a ground of relief for the debtor. Additionally, the decision represents an evident rejection of the 2006 decision delivered by the Court of Appeal of Santiago that recognised the availability of *imprevisión* in Chilean law.

2.3.7.2. Arbitral decisions

It is commonplace for Chilean legal doctrine to state that with regard to arbitral case law, the situation of *imprevisión* is opposite to that in judicial case law, because in the former imprevisión has been usually accepted as a ground of relief for the debtor. However, as will be demonstrated in the following paragraphs, that assertion is highly debatable.

In effect, arbitral courts have accepted the application of *imprevisión* in some cases.[108] Most of the cases are again related to construction contracts concerning additional costs borne by the building contractor deriving from unexpected difficulties in the construction process, which were unknown at the time of contracting, e.g., relating to the soil composition or an increase in the price of materials or labour.[109] In all these decisions, the arbitral judges stated that the application of the *imprevisión* theory is compatible with the law of obligations provided by the Civil Code, because the *pacta sunt servanda* principle (art. 1545) must be interpreted in the light of and with the limitations related to the nature of the specific contract and the principle of good faith in performance (article 1546). Thus, in the case of *commutative* contracts (art. 1441), the balance between the counter-obligations is part of the essence of the relationship and, therefore, if performance by one party becomes extremely burdensome because of extraordinary and unexpected circumstances, this party has the right to request the restoration of the original contractual balance.

However, the limited number of cases makes it difficult to come to any general conclusions as to the willingness of arbitral judges to broadly apply the *imprevisión* theory. On the contrary, some authors have argued that the cited cases are extraordinary and the general rule is still that the Chilean courts refuse to revise contracts based on these grounds.[110] In this sense, one of the decisions states that 'the application of the *imprevisión* theory in this case cannot lead one to draw general conclusions about the acceptance of such a theory in Chilean law'.[111] Two recent unreported cases seem to confirm these statements.

a) The Gas Atacama case[112]

In November 1998, Gas Atacama Generación S.A. (an electricity generation company, henceforth *Gas Atacama*) agreed with Empresa Eléctrica de Antofagasta S.A. (hereafter *Emel*) to supply electricity to a number of electricity distribution companies owned by the latter. The contracts stated that Gas Atacama would supply all the power and electricity that Emel´s companies would require to meet the needs of their clients, and that Emel would exclusively buy the required electricity from Gas Atacama. The contract was agreed for a term of 12 years and the price was fixed following the regulated price set by the administrative authority. The generation of electricity by Gas Atacama was mainly based on natural gas supplied by Argentinian providers.[113] When the supply of gas from Argentina was reduced to 75%, Gas Atacama requested the termination of the contracts based, among other grounds, on the *imprevisión* theory, because the fulfilment of the obligations for the period

108 The decisions reported are *Pavez y Cia. Ltda. c/ Alemparte* (1983), *Sociedad de Inversiones Mónaco Ltda. c/ ENAP* (1986), *Sociedad Constructora La Aguada c/ Emos S.A.* (1994), *Chilesat S.A. c/ Smartcom PCS S.A.*(2005). See Illanes (2000) and Domínguez et al., (2008).

109 Therefore, some of the cases may be qualified as antecedent impossibility. See Treitel (2004).

110 Domínguez et al., (2008) p. 522.

111 *Pavez y Cia. Ltda. c/ Alemparte* (1983); cited by Domínguez et al., (2008).

112 *Gas Atacama Generación S.A. c/ Empresa Eléctrica de Antofagasta S.A.*, of 24.01.2008, unreported.

113 For details concerning the Chilean-Argentinean gas crisis, see the introductory Chapter.

and in the terms agreed would lead the company to an economic disaster, since the substantial rise in electricity generation costs would result in it incurring significant losses (approximately US$ 450,000,000). Gas Atacama argued that the assumption of such costs implied a severe alteration to the contractual equilibrium and a higher requirement of liability than that agreed upon in the contract. The Argentinian non-compliance with the international agreement which regulated the trade in gas was alleged as an unexpected and unforeseeable circumstance. Articles 1441 (commutative contracts), 1444 (essential elements of a contract) and 1546 (good faith in performance) of the Civil Code were cited as a legal basis for the claim.

On this ground, the arbitrator rejected the claim because in the relevant provisions of the contract Gas Atacama stated that it would provide all the energy requirements of Emel with no specific designation as to the source of the generation of that electricity. In addition, the relevant contractual provision states that Gas Atacama would provide the energy requirements from its own generation plant and/or from generation plants owned by third parties. In short, the arbitrator stated that the duty of Gas Atacama was to provide power and electricity as required by Emel, even through third parties and not to provide power and electricity *exclusively generated by natural gas*. Based on the contractual provisions, the arbitrator stated that Gas Atacama had assumed all the risks related to the production of electricity.

The arbitrator also stated that the contracts concluded by the parties were subject to the statutory rules of the legislation on the provision of electricity (Ley General de Servicios Eléctricos, DFL 4, 2007) as an activity of regulated public utilities having an impact on and implications for the community. Therefore, to guarantee the quality, security and continuity of the provision of electricity, the parties were subject to a special strict liability regime and then only *force majeure* was a valid ground for the termination of the contract. In this sense, the arbitrator qualified the supply obligation as an *obligación de resultado*, similar to the French *obligatión d'resultat*.

Finally, based on Gas Atacama's construction of a double-source generation plant (gas and oil) and the contractual provisions regarding the fulfilment of the supply obligation even through third parties, the arbitrator also rejected the unforeseeable nature of the circumstances alleged by Gas Atacama. In this sense, the arbitrator stated that the lack of natural gas as a source for the generation of electricity could not be avoided as a possibility for the affected party, considering its experience and sophistication and the magnitude of the investments involved in the agreement.

b) The Guacolda case[114]

However, in a case also related to the gas crisis, the request for a modification of the contract was accepted by the arbitrator. In this case, an electricity generation company, Empresa Eléctrica Guacolda S.A. (henceforth *Guacolda*), concluded a contract with Empresa Minera Mantos Blancos S.A. (a mining company, hereafter *Mantos Blancos*) for the supply of energy by which the former agreed to provide all

114 *Empresa Eléctrica Guacolda S.A. c/ Empresa Minera Mantos Blancos S.A.*, of 25.04.2007, unreported.

the power and electricity required by the latter. The contract was concluded in 1994 for a period of 10 years, and the price was fixed with an indexation clause related to variations in the Consumer Price Index-USA (CPI) and variations in the coal price. In accordance with the relevant provision, the contract was renegotiated and extended in 2003 with two modifications in the price: a reduction of the original price for the period 2004 and 2005; and a new price for the period 2005-2010. The basis for the new price was the regulated price fixed by the administrative authority at that date, but with an indexation clause linked to the 75% variation in the Consumer Price Index-USA.

In 2006, Guacolda requested the termination of the contract arguing a breach of the duty to renegotiate and to have the terms of the contract revised by Mantos Blancos because the commercial equilibrium of the contract had been severely altered by unexpected and serious changes in the circumstances surrounding the transaction, i.e., the restrictions on gas supplies by Argentina, with significant consequences for the market and the regulated price of the electricity. Therefore, Guacolda argued that the economic equilibrium of the contract was notably distorted because the agreed price did not reflect the commercial conditions and the will of the parties at the time of contracting, resulting in the company finding it excessively onerous to perform the contract and significant losses thereby resulting therefrom. Based on the argument of the excessive and supervening onerous performance, as a secondary claim, Guacolda requested the revision of the contract price by the judge if the termination would be rejected, with the aim of adapting it to the new commercial and market conditions.

Mantos Blancos rejected both claims pointing to the non-existence of an express or implicit price revision clause and, therefore, to the fact that an obligation for the parties to renegotiate and eventually modify the contract if new circumstances arose did not exist. In this sense, Mantos Blancos argued that the extension and modification of the original contract in 2003 was based on an express clause providing for the possibility of such an extension, but this was not related to a general obligation to revise the contract, nor could it be considered as an antecedent to establish such a duty. With regard to the excessively onerous performance, Mantos Blancos alleged that there was no evidence of a significant increase in the generation costs of Guacolda to lead to such a conclusion and that its behaviour was opportunistic and contrary to good faith.

In the decision, the arbitrator accepted the arguments of Mantos Blancos regarding the non-existence of a revision clause, and, moreover, stated that such clause should always be express if it is related to essential elements of the transaction such as the contract price, thereby rejecting the claim to have the contract terminated because of a breach of the duty to renegotiate.

However, the arbitrator accepted the claim for the revision of the contract price based on the occurrence of an unexpected and unforeseeable change of circumstances

> which affected the structure of the whole electricity market,[115] leading to a serious imbalance in the economic equilibrium of the contract as at the time of its conclusion. The balance between the counter-obligations was considered by the judge as an essential element of the transaction: '…the price of electricity has experienced significant increases which have changed the nature of long-term contracts related to this market. Therefore, the complete performance of the contract as agreed implies to ignore a totally different context as at the time of its conclusion, and would lead to a break in one of the essential elements of bilateral and onerous contracts, which is its *commutativity*' (i.e., the balance between the counter-performances). The notions of *causa* (article 1467 of the Civil Code) and the *commutative* nature of the contract (article 1441) were the legal basis for the decision. The arbitrator fixed the new price based on one of the (rejected) proposals by Guacolda to Mantos Blancos.[116]

Beyond the particularities of the two cases mentioned above, it is evident that the main reason for rejecting or to accepting the claim of the affected party was the different assessment of the change of circumstances that caused the excessive burden as a valid ground for relief. The contradictory outcome of the cases reflects the lack of a proper doctrinaire development of the subject, and the necessity for a comprehensive regulation that may serve as a guide for the doctrine and the case law concerning an adequate approach to the subject.

3. Argentinian law

3.1. The Argentinian Civil Code

The Argentinian Civil Code was drafted by Dalmacio Vélez Sarfield, who spent five years doing so.[117] The Code was adopted in 1869 and it entered into force on January1, 1871. With regard to its structure, Vélez followed the ideas of the Brazilian scholar Augusto Texeira de Freitas: Two preliminary titles and four Books (Persons; Personal rights related to civil relationships; Real rights; and Common rules for real and personal rights).[118]

Vélez relied on varied and miscellaneous sources for the drafting of the Code: Roman law through the works of Savigny, Mayns and other commentators; the Civil Code of Louisiana; the French legal doctrine and commentators on the Code Civil; the Chilean Civil Code; the *Siete Partidas* and the draft of the Spanish Civil Code by García Goyena.[119] However,

115 Basically, the substantial decrease in the gas supplied by Argentina and the increasing domestic energy demand.
116 However, the indexation clause was not modified by the decision.
117 Lerner (2002) p. 172.
118 Guzmán Brito (2006) p. 677.
119 Mirow (2004), p. 139.

as stated, maybe their main sources were the works and the project of the Brazilian Civil Code drafted by Augusto Texeira de Freitas.[120]

The eclectic nature of the Argentinian Code made it an interesting model for other Latin American countries: Paraguay adopted it in 1876 and it influenced the Codes of Nicaragua (1904) and Panama (1916).[121] However, the Code also was soon criticized on political and legal grounds. Based on the latter, the work of Vélez was attacked because of its use and reproduction of foreign sources, especially its strong reliance on Freitas' work and French law to the detriment of Spanish sources such as the *Siete Partidas*. The form and the syntax of the Code were also criticised as being defective.[122]

As a consequence of such criticism, the Argentinian Code has been the subject of a series of general reform attempts, many of them unsuccessful. Thus, the projects of 1926 (*Bibiloni Project*), 1936 and 1954 (*Llambías Project*) were not approved or even discussed by the Argentinian National Congress for a number of reasons. However, important modifications to the law of obligations were introduced by Act 17.111 of 1968. The reform affected about 200 articles of the Code (i.e. approximately 5% of the whole Code) but introduced relevant concepts and legal institutions originally not provided by the Code: the principle of good faith in the conclusion, interpretation and performance of contracts (article 1198); *lesión enorme* (*laesio enormis*, article 954); the doctrine of *abus de droit* (article 1071); *imprevisión* (article 1198); and *resolución* (termination) in cases of breach of contract (article 1204).[123]

Finally, in 1991 the President vetoed a reform project approved by the Chamber of Deputies and the Senate, which sought to unify civil and commercial obligations (officially known as the *Project to Unify the Civil and Commercial Legislation* of 1987). After the veto, two different commissions (one appointed by the National Congress and the other by the Executive) worked on new versions of the project, but none of them were finally approved by the Congress. However, such proposals were the basis of a new reform project drafted by a commission of well-known law scholars appointed by the Executive. In 1998 the Commission submitted the *Project to Reform the Argentinian Civil Code Unified with the Commercial Code* to the President. At this point in time, the project is still under discussion in the Congress.[124]

120 Karst and Rosenn, *Law and Development in Latin America: A Case Book*, state at 46 that 1200 articles of Velez's Code have as a direct source the draft code of Freitas, adding that 'almost none of the Argentinoan Code's 4051 articles are original', cited by Mirow (2004), p. 140.

121 See Guzmán Brito (2000) pp. 235, 254.

122 See Mirow (2004), p. 141.

123 See Lerner (2002), pp. 181-185.

124 The text of the Project with notes and foundations are available at http://www.biblioteca.jus.gov.ar/bibliotecadigital.html.

3.2. The doctrine of *stare decisis* in Argentinian law

Because situations of changed circumstances have been the subject of an important number of judicial decisions, and therefore case law has played an important part in the development of the subject in Argentinian law, it is relevant to understand the role of case law (*jurisprudencia*) in the Argentinian legal system, which also requires a brief review of the political system and of the judiciary in that country.

The Constitution of Argentina establishes a federal system of Provinces (*Provincias*), with a Federal Government and Provincial Governments, which reserve to themselves all the powers not delegated to the Federal Government.[125] The main source of the Argentinian Constitution was the Constitution of the United States, so to a certain extent its text as well as the case law of the U.S. Supreme Court have been considered as a source of interpretation for its provisions.[126] Notwithstanding their similarities, one main difference between the U.S. and the Argentinian Constitution is the power granted by the latter to the Congress in article 75(12), which authorizes the Argentinian Congress '*to enact Civil, Commercial, Criminal, Mining, Labour and Social Security Codes, in unified or separate bodies, provided that such codes do not alter local jurisdictions, and their enforcement shall correspond to the federal or provincial courts depending on the respective jurisdictions for persons or things;…*' Therefore, the provinces are prevented from enacting such codes, though the enactment of procedural legislation is part of the Provincial Governments' jurisdiction.

Following the U.S. model, Argentina has both federal and provincial court systems. Article 116 of the Argentinian Constitution provides that '*the Supreme Court and the lowers courts of the Nation are empowered to hear and decide all cases arising under the Constitution and the laws of the Nation*'. Such jurisdiction is restricted in matters covered by the powers given to the Provincial Governments. Article 117 adds that '*in the aforementioned cases the Supreme Court shall have appellate jurisdiction, with such regulations and exceptions as Congress may prescribe*.' If a case is under the jurisdiction of the provincial court system, the Supreme Court generally has no jurisdiction to hear the case, except in very restricted cases (*recurso extraordinario*) related to the constitutionality of a legal provision or the validity of a right or privilege derived from a constitutional or legal provision.[127]
Specifically with regard to the legal force of the *stare decisis* doctrine, as stated before in the case of Chile and in general with regard to civil law systems, in principle the decisions of the superior courts are not binding on the lower courts and only have a particular effect for the parties to the case, regardless of its persuasive (but not binding) value. Therefore,

125 See inter alia Articles 1, 5 and 121 of the Argentine Constitution, available in English at http://pdba.georgetown.edu/Constitutions/Argentina/argen94_e.html#title1firstdivisionch3. The official text is available at http://www.argentina.gov.ar/argentina/portal/documentos/constitucion_nacional.pdf.

126 See Garay (1991), stating at 174 that 'in construing constitutional provisions modeled after the U.S. Constitution, the Argentine Supreme Court has often considered U.S. constitutional precedent and the opinions of U.S. constitutional scholars.'

127 Articles 14, 15 and 16 of the Judiciary Act No. 48 of 1863 (*Ley No. 48 de 1863 sobre Jurisdicción y Competencia de los Tribunales de Nacionales*).

no provisions in the Argentinian Constitution or the Civil Code grant binding force to the decisions of the superior courts.

However, throughout the twentieth century this situation changed with the introduction of legal provisions in provincial procedural legislation which confer binding force on decisions or agreements of plenary meetings (*Plenos* or *Plenarios*) of the judges of the superior courts. In this case, the dicta of these decisions or agreements are binding on the court that issued them as well as the lower courts.[128]

In addition, the Supreme Court has developed the doctrine of *stare decisis* through its own case law.[129] In a decision from 1870, the Court affirmed, without modification, the decision of a federal judge who stated that lower courts have to adjust their procedures and judgments to the decisions of the Supreme Court rendered in similar cases.[130] In a following decision in 1883, the Supreme Court stated that its decisions are only binding for the particular case, but 'there is a moral duty for the lower judges to align their decisions to those where the same Court has ruled in analogous cases.'[131] The reasons for such a duty were mainly the hierarchical superiority of the Supreme Court and legal certainty. More recent decisions have clarified this doctrine: the lower courts have to follow the doctrine laid down by the Supreme Court's *jurisprudencia* in its function as the supreme interpreter of the Constitution and the legislation enacted thereunder.[132] Therefore, a lower court decision which departs from precedent without providing new grounds which justify such a departure lacks a proper foundation and should be reversed.[133] A lower judge is allowed to ignore a precedent, but only if the judgment is based on express and new foundations or on grounds not examined by the Supreme Court. Consequently, if such a decision does not follow the case law of the Supreme Court without proper reasoning related to new grounds as stated above, it can be considered arbitrary and then the Court has the power to reverse it via a *recurso extraordinario*.[134] In conclusion, the Argentinian Supreme Court's case law is in principle binding for the lower courts, which are nevertheless entitled to depart from such a precedent if they provide consistent and new foundations compared to those examined by the Court in its previous decisions. Later this doctrine was followed (as being applicable to its own decisions) by other federal and provincial superior courts.[135]

128 See Sagüés (2006), p. 24, stating that such provisions raise serious constitutional objections because may confer legislative powers on the judiciary and also restrain the freedom and independence of lower courts to apply the law in particular cases.

129 See Garay (1991), pp. 194-199 and Sagüés (2006), pp. 25-29 for a detailed analysis of the cases.

130 *Rivera c. García Aguilera*, CSJN 9:53.

131 *Pastorino v. Ronillon*, CSJN 25:368.

132 For instance, *Cerámica San Lorenzo*, CSJN, *La Ley*, 1986-A-178.

133 Garay (1991), p. 195.

134 Sagüés (2006), p. 27, who qualifies this Supreme Court doctrine as a 'customary constitutional rule'.

135 But see Sagüés (2006), p. 30, who states that historically the Argentinian lower courts have been reticent rather than enthusiastic with regard to this rule, and have tried to find alternative procedural ways to avoid it. However, the author adds that nowadays the situation is changing and the lower courts are more willing to follow the Supreme Court's precedent.

3.3. Unexpected circumstances in Argentinian law: the doctrine of *imprevisión*

3.3.1. The revision of the contract in the Argentinian Civil Code

Argentinian legal doctrine has stressed that after the reform of the Civil Code by Act 17.711 of 1968, the judicial revision of contracts in Argentinian private law is generally possible in three cases: *laesio enormis* (article 954), *abus de droit* (article 1071), and *imprevisión* (article 1198).[136] In this Chapter, in addition to *imprevisión*, the doctrine of *abus de droit* will be analyzed because it has been used by legal doctrine and case law to complement the former, especially when the conditions required for *imprevisión* were not met in the particular case.

On the contrary, the bulk of special legislation enacted in times of economic crises (so-called 'emergency legislation' by legal doctrine and case law) will not be the object of particular analysis in this research even when such legislation authorizes the possibility to modify or revise contracts. The main reason for that exclusion is that most such legislation has been reformed, abolished or even declared unconstitutional, giving rise, in some cases, to complex and contradictory solutions with a difficult practical application, which are complex to systematise in a general study of the subject as the present research intends to be.[137]

3.3.2. Developments in legislation and case law

In its original version, the Argentinian Civil Code strongly supports the principles of freedom of contract and *pacta sunt servanda*. Vélez Sarfield stated in the notes of the code's draft that 'we would cease to be accountable for our actions if we were allowed by the law to amend all our errors or imprudence' and therefore 'the free consent of the parties, given without fraud, mistake or duress and in accordance with the legal formalities, should make contracts irrevocable.'[138] Accordingly, article 1197 states that 'Agreements made in contracts are for the parties a rule to which they should conform as to the law itself'.[139] Thus, the *imprevisión* doctrine was not included in a general provision, even when some rules allowed the revision of obligations in specific subjects, e.g., alimony obligations. Only in the case of *force majeure* could the debtor be released from his contractual obligations (articles 513 and 514).
The reform projects of 1926 and 1936 did not include the regulation of *imprevisión*, but they incorporated the duty of good faith in the performance of contracts which was absent in the original version of Velez's Code. On the contrary, the reform project of 1954 was the first to propose the express regulation of unexpected circumstances (article 1025), following the Italian *Codice Civile* as a model.[140] Finally, Act 17.711 of 1968 introduced

136 Belluscio, A., and Zanonni, *Código civil comentado*, cited by Araujo (1997).
137 See van Plateringen, (2001).
138 Cited by Alterini (2007).
139 Art. 1197: 'Las convenciones hechas en los contratos forman para las partes una regla a la cual deben someterse como a la ley misma'. Author's own translation.
140 Flah, Smayevsky (2003), p. 18.

the *imprevisión* theory in the second paragraph of article 1198. The direct source of such a rule is Recommendation 15 of the Third National Congress of Civil Law (Córdoba, 1961) which, in turn, was based on the article 1467 of the Italian *Codice*.[141]

Even before the introduction of the present text of article 1198 into the Civil Code, the case law had recognized the application of the *imprevisión* theory. Thus, in a decision of 1953, the Court of Appeals in Civil Matters[142] (CNCiv.) held that when unexpected and unforeseeable circumstances, external to the common intention of the parties, significantly change the conditions taken into account by such parties at the time of contracting, equity and general principles of law allow the contract price to be modified.[143] After the National Congress of Civil Law of 1961, affected parties were more willing to bring an action or a defence based in *imprevisión* and therefore the case law also became more common, either for or against the application of the doctrine.[144] In cases where the doctrine was accepted, the main foundations for the decisions were general references to equity, good faith and general principles of law. In contrast, a lack of an express recognition, the principles of security of transactions and *pacta sunt servanda* were the arguments raised to reject its application.

3.3.3 Act 17.711 and the introduction of imprevisión *in the Argentinian Civil Code*

As stated before, the *imprevisión* theory was incorporated into the Argentinian Civil Code by Act 17.711 of 1968, which introduced relevant reforms to the whole law of obligations in the Code. In this regard, the Report of the Draft Commission stated that the intention of the reform was to increase the prevalence of the 'moral rule' as the proper standard of conduct, thereby introducing institutions which were absent from the original individualist philosophy of the Code, such the *laesio enormis* (article 954), the a*bus de droit* (article 1071), the duty of good faith in the conclusion, interpretation and performance of contracts and the *imprevisión* doctrine (both included in article 1198). In the same sense, a prominent role is given to equity as a concept to be considered by the courts in their decisions (articles 907 and 1069).

With regard to *imprevisión*, the relevant provision is the second part of article 1198, a rule clearly inspired by article 1467 of the Italian *Codice Civile*:

Article 1198 (second part): *In bilateral commutative contracts and in unilateral onerous commutative contracts for deferred performance or for continuous performance, if extraordinary and unforeseeable events make the performance of one of the parties excessively onerous, the affected party may demand the termination of the contract. The same principle is applicable to*

141 Araujo (1997), p. 96. The Second National Congress of Civil Law (Córdoba, 1937), which analyzed the reform project of 1936 also recommended the inclusion of the *imprevisión* doctrine in such a project; see Moisset de Espanés (1996).

142 Cámara Nacional de Apelaciones en lo Civil de la Capital Federal.

143 CNCiv. sala C, 1953, *LL*, 75-255; cited by Flah, Smayevsky (2003), p. 141.

144 For reported cases see Moisset de Espanés (1996); and Flah, Smayevsky (2003), pp. 141-142.

aleatory contracts when the excessive onerousness is derived from causes which are external to the inherent risks of the contract.

In contracts for continuous performance, their termination will not affect that which has already been performed.

Termination cannot be demanded if the affected party has been at fault or is in default. A party against whom the dissolution is demanded may prevent this by offering to improve equitably the conditions of the contract.[145]

Although the specific foundation for such a provision has been discussed by the Argentinian legal doctrine, there is no doubt that that is a reflection of the purpose of the *moralization* of the law of obligations by the 1968 reform, especially through the introduction of the principles of good faith and equity. Thus, the cited provision can be regarded as a natural consequence of the first part of article 1198, which lays down the duty of good faith in contractual relationships:

Article 1198 (first part): *Contracts should be concluded, interpreted and performed in good faith and in accordance with what the parties are likely to have understood or could understand, acting with care and foresight*.[146]

This provision has been interpreted as imposing an imperative standard and duty on the parties and the courts. On the one hand, the parties do not only have to avoid negligent behaviour with regard to their counterparty, i.e. to conduct themselves with care and foresight; but good faith also imposes on them an active duty of collaboration with the legitimate interests of the other party, i.e., to act with loyalty and honesty with regard to the spirit and purposes of the contract.[147] In this sense, it is contrary to good faith to compel the debtor to perform the contract if the counter-performance he receives has become insignificant when considered in the light of the original economic balance of the contract.[148] It has been also stated that 'this provision relies on the preservation of the basis of the transaction, as established with the standards of good faith and honesty.'[149] All the

145 Art. 1198 (second paragraph): 'En los contratos bilaterales conmutativos y en los unilaterales onerosos y conmutativos de ejecución diferida o continuada, si la prestación a cargo de una de las partes se tornara excesivamente onerosa, por acontecimientos extraordinarios e imprevisibles, la parte perjudicada podrá demandar la resolución del contrato. El mismo principio se aplicará a los contratos aleatorios cuando la excesiva onerosidad se produzca por causas extrañas al riesgo propio del contrato. En los contratos de ejecución continuada la resolución no alcanzará a los efectos ya cumplidos. No procederá la resolución, si el perjudicado hubiese obrado con culpa o estuviese en mora. La otra parte podrá impedir la resolución ofreciendo mejorar equitativamente los efectos del contrato.' Author's own translation.

146 Art. 1198 (first paragraph): 'Los contratos deben celebrarse, interpretarse y ejecutarse de buena fe y de acuerdo con lo que verosímilmente las partes entendieron o pudieron entender, obrando con cuidado y previsión.' Author's own translation.

147 Facco (2009), pp. 158-160.

148 Flah, Smayevsky (2003), p. 23.

149 Alterini, A. and López Cabana, R., *Cuestiones Modernas de Responsabilidad Civil*, La Ley, Buenos Aires, 1988, p. 87, cited by Flah, Smayevsky (2003). The cited authors refer to Lehman with regard to

following Reform Projects expressly included articles providing for the duty of good faith as a general principle of the law of contract.[150]

On the other hand, as a rule for the construction and interpretation of contracts, the standard of good faith has to be sought by the judge in every case, using the background and purposes of the contract in relation with the previous and subsequent behaviour of the parties to construct the contractual relationship in accordance with an objective standard of good faith, even if such a construction is different from the actual intention of the parties as expressed in the wording of the contract.[151]

Additional to good faith, the Argentinian legal doctrine has justified the legal recognition of the *imprevisión* doctrine based on a number of foundations, among others: Windscheid's theory of presupposition; Oertmann's theory of the basis of the transaction and its alternatives reformulations (e.g. by Lehman and Larenz); the role of *causa* and the equivalence between the counter-obligations of the parties as an essential element of the contract.[152] However, the case law has widely supported the provision of article 1198 in the principle and duty of good faith in the performance of contracts, as an instrument to correct situations of injustice in cases of serious alterations in the economic equilibrium of the counter-obligations, which placed an excessive burden on one of the parties: 'The purpose of article 1198, whose foundation is the moral rule and the principle of good faith, is to avoid that an external circumstance, which distorts the normal effects of a contract, turns such a contract into a source of excessive profit for one of the parties and into a source of extreme loss for the other'.[153]

3.3.4 The conditions for the application of article 1198

3.3.4.1. Contracts covered by the provision

Article 1198 is applicable to bilateral commutative contracts and to unilateral onerous commutative contracts for deferred performance or for continuous performance, and to aleatory contracts when the excessively onerous nature is derived from causes external to the inherent risks of the contract.

the concept and conditions for a circumstance to be considered as basis of the transaction. The Project for the Unification of Civil and Commercial Legislation of 1987 (vetoed by the President in 1991, see above) expressly introduced the theory of the basis of the transaction in the first part of its article 1197: '*Agreements made in contracts are for the parties a rule to which they should conform as to the law itself if the circumstances which led to each party to conclude the agreement, and which were accepted by the other or could have been accepted if expressed, are present at the time of performance*.' Author's own translation.

150 With regard to the two most relevant projects, see article 1197 second part of the Project for the Unification of Civil and Commercial Legislation of 1987; and articles 395, 920, 966, 967, 1023, 1024 and 1063 of the Project for the Reform of the Argentinian Civil Code Unified with the Commercial Code of 1998.

151 Flah, Smayevsky (2003), p. 23.

152 See Flah, Smayevsky (2003), pp. 30-31.

153 CNFed. Civ. y Com., sala II, 1978/09/22, *Suaya, A. c/ Scandinavian Airlines System*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 220.

As in Chilean law, *bilateral contracts* are those with reciprocal obligations (art. 1138) and *unilateral contracts* are those where only one of the parties assumes an obligation to the benefit of the other. The contract is *onerous* if the mutually expected benefit relies on the performance of the reciprocal obligations, and *gratuitous* if one party obtains a benefit without any performance of its own (article 1139). Finally, the contract is *commutative* where the reciprocal obligations are considered to be equivalent by the parties;[154] and *aleatory* if the expected equivalent consists of an uncertain possibility of a loss or gain for one of the parties (article 2051). With regard to the latter, the provision requires that the excessively onerous nature was not the consequence of the inherent risk of the contract. For instance, contracts which included a 'U.S. dollar clause', i.e. a clause linking the amount of the contract price to the value of the U.S. dollar on the exchange market, concluded during the extremely economically unstable period after the governmental change in the exchange policy of February 1981, were considered by the courts to be aleatory contracts and therefore excluded from the application of article 1198, because the risk of variations in the U.S. dollar exchange rate was considered to be inherent to the contract.[155] However, such a specification seems to be unnecessary because in every case, regardless of the type of contract, the circumstances which render the performance excessively onerous have to be outside or exceed the normal risk of the contract. Additionally, the express inclusion of aleatory contracts is arguable because in such contracts uncertainty is part of the nature of the agreement, and therefore, the parties have assumed the change of circumstances as a normal consequence. In this regard, the Italian *Codice Civile* expressly excludes aleatory contracts from the application of the rules of *eccessiva onerosità*.[156]

As a common feature the contract should be for deferred or continuous performance, i.e. those obligations which are not performed at the same time as the conclusion of the contract but during a period of time after such a conclusion. In this sense, it has been held that for the application of this requirement it is enough that 'the change of circumstances takes place in the period of time between the conclusion of the contract and its performance, without formally requiring a contract for deferred or for continuous performance.'[157] Moreover, most of the case law agrees that the obligation of which it is alleged that it is excessively onerous should not yet have been performed. Therefore, if the price has been completely paid, the seller who has accepted it without any reservation of his/her rights cannot subsequently invoke the remedies of article 1198 to terminate or revise the contract. In general, 'the provision of article 1198 is not applicable when the juridical relationships derived from the contract have already been extinguished'.[158]

154 The Civil Code contains no definition of such a category of contracts, but legal doctrine agrees with the concept set out above. See Flah, Smayevsky (2003), p. 34.

155 C1° Civ. y Com., San Isidro, sala II, 1985/02/19, *Climberg G. c/ Chiro Tarrab, A.*; CNCiv., sala B, 1987/04/07, *Spada de Makintach, S. c/ Tonelli, C.*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 235.

156 See article 1469 of the Italian *Codice Civile*.

157 CNCiv., sala C, 1979/07/05, *Hofman, M. c/ González, E.*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 234.

158 CNCiv., sala E, 1978/09/05, *Barcheta, C. y otro c/ Asociación Civil Santísima Cruz*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), with further references to similar cases at pp. 244-246.

Finally, some of the legal doctrine have criticized the exclusion of gratuitous contracts, because there is no reason to consider the debtor in such a contract any differently from a debtor in a commutative contract.[159] However, this exclusion has been supported since one of the main foundations of the *imprevisión* doctrine, i.e. the preservation of the economic equilibrium between the counter-performances, cannot be applied to gratuitous contracts where only one of the parties assumes an obligation for the benefit of the other.[160]

3.3.4.2. The excessively onerous nature of the performance

Article 1198 requires that the performance of one of the parties has become excessively onerous. This condition has been linked by Argentinian legal doctrine and case law to the (relative) equivalence of the counter-obligations which is considered as part of the nature of commutative contracts. Thus, it is argued that the contract, as the most important instrument for the exchange of goods and services, is subject to the principle of commutative justice and therefore intervention by a third party (the judge) in the contract is legitimate when extraordinary circumstances lead to a complete rupture in the economic balance of the contract as was intended by the parties upon its conclusion.[161] Therefore, the performance becomes excessively onerous if it loses its economic relationship with the counter-performance, making the sacrifice much larger than the benefit for one of the parties and vice versa.[162]

As a consequence, the assessment of this degree of onerousness requires a comparison between the counter-performances, is intrinsic in the contractual relationship and cannot be made only with reference to the performance of the affected party.[163] Therefore, if both counter-obligations have increased or decreased in value with similar intensity, the original balance is not altered and so there is no case of an excessively onerous performane.[164] Similarly, external considerations, such as the effects of the contract's performance on the economic situation of the affected party, are not sufficient or adequate standards for the

159 See Flah, Smayevsky (2003), p. 37.

160 Mosset Iturraspe, J., *Contratos*, Buenos Aires 1978, p. 138, cited by Flah, Smayevsky (2003); and in similar terms, CNCiv., sala G, 1981/02/10, *Hughes, L. c/ Alonso Soto, L. y otros*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 243.

161 See Cornet (2002).

162 Ghersi, C., *Contratos civiles y comerciales*, p. 307, cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 164.

163 Flah, Smayevsky (2003) p. 38, See CNCom. Sala D, 08.03.84 *Beltramino A. c/ Banco Argentino de Inversión*: 'The onerousness required by article 1198 cannot be valued taking into account only the performance of the party which alleges the *imprevisión,* but is related to the equivalence of the reciprocal obligations of the parties, so that the deferred performance ceases to be economically correlative and therefore the performance of the contract as concluded leads to a disproportion in such a performance to the benefit of one of the parties and to detriment of the other'; cited by Cornet (2002).

164 Smayevsky, M., *Reflexiones acerca de la aplicación de la teoría de la imprevisión en el contrato de compraventa*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 166.

configuration of excessive onerousness if they do not have a consequence for the internal equilibrium of the counter-obligations of the parties.[165]

Case law has stated that because of the general terms of article 1198, determining excessive onerousness cannot be made by arithmetical parameters, but is a task for the judge who has to consider the circumstances of the particular case in order to establish the seriousness of the detriment in the balance of the contract as considered by the parties at the time of its conclusion.[166]

Finally, the loss of value of the agreed counter-performance has also been recognized by the case law as a situation of excessive onerousness, especially in cases related to the sale of real property where the contract price has become insignificant because of the devaluation of currency or hyperinflation.[167]

3.3.4.3. Extraordinary and unforeseeable events

For the application of article 1198, the excessively onerous nature of the performance should be caused by extraordinary *and* unforeseeable events. Both concepts are intrinsically linked and it is mostly difficult to distinguish them in legal doctrine and especially in the case law. As a common feature, the events have to take place after the conclusion of the contract and should be external to the parties.[168]

However, due to the theoretical difficulties in distinguishing the above-mentioned conditions, the concept of 'extraordinary' has been related by legal doctrine to unusual events, which do not normally occur and are therefore unpredictable for the average citizen. The event should be of a general nature, affecting society as a whole or at least an entire category of parties in the same situation and not only related to the personal circumstances of the affected party.[169] On the other hand, unforeseeability is related to the aptitude of the parties to foresee and to anticipate such events, acting with proper diligence and care, according to the circumstances of the particular case.[170]

Additionally, for qualifying a circumstance as extraordinary and unforeseeable, case law has usually used the same parameters as in cases of force majeure, especially in relation to articles 514 and 901 of the Argentinian Civil Code, stating that 'such an event should be analyzed in relation to the provision of article 514 of the Civil Code, and therefore it

165 Lorenzetti R., *La excesiva onerosidad sobreviniente*, p. 165; and case law cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), pp. 167 and 260-262.
166 See references to case law in Digesto Práctico La Ley: Revisión de los Contratos (2003), pp. 260-261.
167 CNCiv., sala B, 1981/05/14, *Pasqualucci, D. y otra c/ Sticca, J.*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 259, with further references to case law.
168 See Digesto Práctico La Ley: Revisión de los Contratos (2003), pp. 250-252.
169 See Ghersi, C., *Contratos civiles y comerciales*, p. 307, cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 164.
170 Cáceres, H. and Pizarro, R., *Cláusula de pago en 'valor dólar'*, cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 165.

should be supervening, external to the will of the parties and outside the normal standard of foreseeability for such parties, as well as being unavoidable even with the diligence required in similar cases' and that 'similar to the cases of *force majeure* and *cas fortuit*, the events in cases of *imprevisión* have to be serious, exceptional, abnormal and unavoidable, supervening in the conclusion of the contract and outside the *alea* or risk inherent to the contract'.[171]

3.3.4.4. Inflation as an extraordinary and unforeseeable event

The fact that Argentina has suffered at least three serious economic crises since the 1970s with devastating effects on the performance of deferred or periodic obligations derived from contracts concluded before such crises, makes it necessary to analyse inflation as a relevant event for the application of article 1198. All of the mentioned crises were characterized by an accelerated hyperinflationary process and/or a dramatic drop in the value of currency caused by the government's economic decisions and policies.[172]

With that in mind, both the legal doctrine and the case law have stated that since inflation became a normal feature of the Argentinian economic system from the early twentieth century onwards, its occurrence and effects are indeed foreseeable for the parties to long-term contracts or with deferred performance. Thus, inflation has become an inherent risk in most types of contracts and then the parties cannot invoke it as an extraordinary and unforeseeable event to appeal to the remedies provided by article 1198.[173] In this sense, case law has stated that 'according to settled and uniform case law, endemic or structural inflation is not an unforeseeable event which can be alleged for the termination or readjustment of the counter-performance under the doctrine of *imprevisión*, because it has been part of our economy for a long time';[174] and that 'the inflation in Argentina is a circumstance which is not extraordinary or unforeseeable, because it was incorporated many years ago as a normal trend in our economy'.[175] The same criterion is applicable when the contract was concluded in a period of economic instability or when hyperinflation had already begun. Then it is considered that the parties deliberately assumed the risks related to serious variations in the value of currency: 'the parties who concluded a contract before June 1975 were astonished by a sudden inflation which was extraordinary and

171 CNEsp., Civ. y Com, sala III, 1979/12/18, *Minedar S.A. y otro c/ Cohen, L.*, and CNFed. Civ. y Com., sala II, 1979/08/30, *López, M y otra c/ Gobierno Nacional*. See also CNCom., sala B, 1985/08/28, *Turimar S.A. c/ Banco Río de la Plata*, interpreting *a contrario sensu* article 901 and stating that an event is extraordinary and unforeseeable if 'it is totally outside the ordinary and natural course of things'. All cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), pp. 252-253.

172 The three crises mentioned above are those of June 1975 ('*rodrigazo*'), February 1981 and December 2001 ('*corralito*').

173 Mayo, J., *Teoría de la imprevisión y cláusula dólar*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 162.

174 CNCiv., sala C, 1978/10/19, *Buscarini L. c/ Rut Don S.A.*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 278

175 CNCiv., sala F, 1979/06/29, *Vitulio, A. c/ Wadek, S.A.*; cited in Digesto Práctico La Ley: Revisión de los Contratos (20), p. 280.

unforeseeable; but the contracts concluded after that date, in a period of extreme economic instability, should be regarded as transactions in which the economic consequences of the governmental policies were foreseen by the parties'.[176]

However, also both legal doctrine and case law agree that the general rule set out above is not applicable in cases of a sudden and accelerated inflation deriving from the government's economic policies which could not be anticipated by reasonable and diligent parties. In such cases, the normal evolution of the inflationary curve is disrupted dramatically and cannot therefore be regarded as integrating the foreseeable risks assumed by the parties in a completely different social and economic environment.[177] Most precisely, it is the *intensity* of the inflation which can be regarded as an extraordinary and unforeseeable circumstance, and therefore totally outside the legitimate expectations of the parties.[178] Therefore, even if the contract include devices such as stabilization clauses, such clauses do not prevent the application of *imprevisión* when the contract was concluded under normal economic conditions which were subsequently radically disturbed by extraordinary and unforeseeable events. It is argued that the aim of such clauses is to anticipate reasonably foreseeable circumstances and consequently cannot be regarded as covering events which were never considered (because they were unforeseeable) by the parties.[179] Thus, it has been held that 'when the contractual terms which were agreed upon to provide stability to monetary obligations are surprisingly altered in their normal course by an event which is external to the parties and is extraordinary and unforeseeable, then judicial intervention is allowed to reduce the unfair effects of a contractual unbalance'.[180]
Finally, it is important to emphasize the relevance of analysing the circumstances of each particular case for the qualification of an event as foreseeable. Thus, case law has stated that 'the analysis of the devaluation of February 1981 with regard to its foreseeability should be made in concrete terms, taking into account the previous behaviour of the parties, its aim with regard to the 'dollar clause', the economic meaning of the contract and the date of its conclusion'.[181]

176 CNCiv., sala C, 1978/11/16, *Bocaratto, O. y otros c/ Asociación Santísima Cruz*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 264.

177 Smayevsky, M., *Reflexiones acerca de la aplicación de la teoría de la imprevisión en el contrato de compraventa*; Abatti, E., Dibar, A., Rocca, I., *La imprevisión contractual*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), pp. 160-161. A large number of decisions handed down in relation to the economic crises of 1975 and 1981 have confirmed these statements. See Flah, Smayevsky (2003) pp. 166-176; and Digesto Práctico La Ley: Revisión de los Contratos (2003) pp. 263-286.

178 See Cornet (2002), adding that in some cases the contract changed its nature from being commutative to aleatory.

179 Mosset Iturraspe, J., *Dólar e imprevisión*; and Cáceres, H. and Pizarro, R., *Cláusula de pago en 'valor dólar';* cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), pp. 159-160.

180 CNCIv. Sala C, 24.11.83 *Rinkevich Alberto y otra v. Uresandi Jorge A.,* E.D. 107-631*, cited by* Cornet (2002). However rejecting the application of article 1198 in such a case, see CNEsp., Civ. y Com., sala III, 1981/06/19, *Fipa S.A. c/ Casco S.A.;* cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 246.

181 CNCiv, sala C, 31.05.83 *Yacub Enrique v. Mar Caribe* S.R.L. J.A. 1983-IV-53, cited by Cornet (2002).

3.3.4.5. The influence of the affected party in relation to the disruptive events: fault and default[182]

The condition that the party affected by *imprevisión* should not be in default when invoking article 1198 has been criticized by Argentinian legal doctrine. The main objection is that in most cases a breach of contract by the affected party will be precisely the consequence of the excessively onerous nature of its performance. Thus, if that party cannot rely on the remedies provided by article 1198, the *ratio legis* of such a provision would be distorted.[183] As a consequence of such criticism, this requirement has been strictly construed: only if the debtor's default is the *cause* of the excessive onerousness, will the affected party not be allowed to invoke *imprevisión* to be released from its obligations. On the contrary, if the breach of contract is irrelevant to the occurrence of the excessive onerousness, which is independent from such a breach, the affected party is not prevented from relying on the provision of article 1198.[184] Thus, case law has stated that 'the breach of contract of the affected party is not an absolute obstacle to invoke the *imprevisión* theory, if its default has been irrelevant to the excessive onerousness of its performance, since in that case the cause of such excessive onerousness is not the debtor's default but an external cause and therefore it would have also taken place without such default'.[185] In the same vein, it has been held that 'only if the breach of contract is previous to the extraordinary and unforeseeable event, is the debtor prevented from relying on the provision of article 1198'.[186]

Closely related to the above condition, the provision also requires the absence of fault on the part of the affected party, i.e. that the event which is the cause of the excessive onerousness should be external to the affected party.[187] Therefore, such an event should not be caused by the affected party's fault and neither that the fault should be the cause of the excessive onerousness deriving from such an event.[188] If the debtor had the opportunity to avoid the consequences of the disruptive events he cannot subsequently invoke the provision of article 1198.[189]

This requirement is also strongly linked to the unforeseeable nature of the events, because the party who did not take the necessary measures with regard to a foreseeable event which

182 In the context of this research, default means any non-performance of his obligation by the debtor or affected party.

183 Flah, Smayevsky (2003), p. 40.

184 Ghersi, C., *Contratos civiles y comerciales*, p. 308; and Alterini, A., *Contratos civiles, comerciales y de consumo*, p. 452; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), pp. 168-169.

185 CNCiv., sala g, 1984/10/09, *Scialabba, M. c/ Petracca Inmobiliaria S.R.L.*; cited by Flah, Smayevsky (2003).

186 CNCiv., sala B, 1982/05/17, *Amestoy, R. c/ Pontineri, L. y otros*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 291.

187 Mosset Iturraspe, J., *Contratos en dólares*, Ediciones La Rocca, Buenos Aires, 1990. pp. 76 ff., cited by Araujo (1997).

188 Spota, A., *Desvalorización monetaria e imprevisión contractual*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003).

189 CNCiv., sala D, 1981/06/12, *Ragno C. c/ Lovecchio, N.;* cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 288.

might affect its performance can be regarded as negligent and, therefore, is prevented from requesting the termination or adaptation of the contract within the terms of article 1198. Thus, 'if the excessive onerousness alleged by the debtor is the consequence of omitting to take measures which he could take, he is not allowed to rely on his own negligence to obtain relief from his obligations'.[190]

Finally, in relation to the provision of the first part of article 1198, which requires that the parties act with care and foresight, it has been held that 'the *imprevisión* theory demands active, opportune and diligent behaviour which properly considers the legitimate interests of the counterparty and the principle of the security of transactions'.[191]

3.3.4.6. Express assumption of risks. The exclusion of article 1198 by the parties

Similarly to most Western legal systems, one of the basic principles of the Argentinian law of contracts is freedom of contract (article 1197). As a consequence, the parties may freely agree on the allocation of risks in the contract, e.g. stating that one or more particular risks are assumed exclusively by one of the parties. Argentinian legal doctrine is in agreement that this kind of clause is valid provided that the party assuming the risk consents thereto.[192] Thus, the bargaining process and the situation of the parties are relevant in establishing the extent of the clause. Furthermore, such an assumption should be strictly construed and in good faith, being only applicable to the specific situations provided in the contract and in cases which can be regarded as reasonably foreseeable by the parties.[193] It is added that outside the cases which can be clearly derived from the nature of the contract, this assumption should be express.[194] Case law has held that waiving the right to invoke *imprevisión* by the affected party *after* the occurrence of the disruptive events may be also implied from the behaviour of the affected party and the circumstances surrounding the case, e.g. whether such a party has completely performed its obligation despite the excessive onerousness.[195] Nevertheless, the mere fact that the affected party did not rely on the *imprevisión* remedies immediately after the occurrence of the extraordinary events, or that the burdensome obligation was partially performed, are not sufficient to amount to an implied waiver of its right.[196]

190 CApel. Concepción del Uruguay, sala civ. y com., 1978/07/11, *Musachi, V. c/ Benítez, R.*, cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 288.

191 CNCiv., sala C, 1981/02/12, *Scinnameo, C. c/ Gelvan, J. y otros*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 289.

192 Cornet (2002); Flah, Smayevsky (2003), p. 44.

193 Borda, G., *La reforma del Código Civil. Teoría de la imprevisión*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003); and Rezzónico, L.; *Estudios de las obligaciones en nuestro Derecho Civil*, T. I, p. 184; cited by Cornet (2002).

194 See Cornet (2002).

195 CNCiv., sala B, 1987/04/07, *Spada de Makintach, S. c/ Tonelli, C.*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 303.

196 CS, 1981/10/13, *Cicero, R. c/ Romero, J.;* cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 303.

It is disputed in the legal doctrine whether the parties may exclude the application of *imprevisión,* as provided by article 1198, in their contractual relationship. Based on the freedom of contract and the undisputed right of contractual parties to assume the consequences of *force majeure* (article 513 of the Argentinian Civil Code), some of the legal doctrine accept the validity of clauses which generally exclude the application of article 1198. It is argued that if the debtor is legally allowed to assume the consequences of a performance which has become impossible, the debtor may equally assume the consequences of a performance which has become *only* excessively onerous.[197] On the other hand, it has been stated that as an application of the principle of good faith, the provision of article 1198 is imperative and therefore cannot be excluded from the contract by the parties.[198] It is added that the provision allowing for a waiver of force majeure as an excuse for performance is related to ordinary and reasonably foreseeable cases of force majeure, and therefore the same logic should be applied to cases of *imprevisión*: a party cannot assume the risk of an unknown or unforeseeable event, because such an assumption logically implies the foreseeability of the event and the associated risk.[199] Therefore, the consequences of an unforeseeable risk which is not allocated by the nature of the contract or by a specific and express provision in that contract must be shared by the parties regarding the circumstances of the particular case. In any case, the exclusion of *imprevisión* is not allowed in consumer contracts because such a provision is regarded as an unfair contractual term.[200]

With regard to this subject, case law has accepted the validity of a general exclusion of article 1198, stating that such a provision is inapplicable 'if the parties foresee in the contract 'any' kind of alteration in the exchange market' and that 'there is no impediment to give full effect to the waiver of the right to invoke the *imprevisión* theory…';[201] but also stressing that such an exclusion cannot be presumed and should be interpreted under strict standards.[202]

3.3.5. The effects of imprevisión

3.3.5.1. The rights of the parties

Provided that the above-mentioned requirements are met, article 1198 states that the affected party can demand the termination of the contract and the other party has the right to avoid such a dissolution by offering to modify, in an equitable way, the conditions of the contract.

197 Cornet (2002).
198 Borda, A., *Influencia de las medidas económicas del año 2002 sobre las relaciones contractuales entre particulares*; cited by Cornet (2002).
199 Mosset Iturraspe (1994).
200 Article 37 of Act 24.240 on the Defence of the Consumer and its regulation (D.R. 1798/94).
201 CNCom., sala E, 1984/10/08, *Nelson, J. c Di Tomaso, Z.,* cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 241.
202 CCiv. y Com. Rosario, sala IV, 1981/09/24, *Izquierdo, J. c/ Miotto, A.;* cited by Cornet (2002).

Nevertheless, an important part of the legal doctrine supports the opinion that the affected party not only has the right to request the termination of the contract, but also its modification or adaptation to the new circumstances. In this sense, it is argued that the principle of *favor contractus,* which can be derived from several provisions of the Civil Code (e.g. articles 656, 1069, 1633, 1638 and 2056) and the aim of Act 17.711 to introduce equity standards in contractual relationships, also allows the affected party to request an adaptation of the contract.[203] Therefore, the interpretation of article 1198 should provide a solution which preserves the reasonability and equity of the transaction as concluded by the parties, an aim which is not satisfied in all cases with the resolution of the contract.[204] Additionally, it is argued that if the affected party may claim the resolution of the contract, which is an extreme remedy, logically he is entitled to request a less absolute and not expressly prohibited remedy such as the modification of the contract.[205] On the other hand, it is contended that compared with the provision of article 954 where in cases of *laesio* the affected party is expressly entitled to request the adaptation of the contract, in article 1198, in contrast, the legislator has not provided such a remedy to the party affected by *imprevisión*. Therefore the will of the legislator cannot be interpreted differently from that expressed in the legal norm. Moreover, it is argued that the revision of a contract is a much more complex and significant remedy than its resolution, because it implies setting the common consent of the parties aside and imposing the will of a third party (the judge) upon them.[206]

The case law is not uniform with regard to this subject, but in a 1992 decision the Argentinian Supreme Court strongly rejected the right of the affected party to request the adaptation of the contract in cases provided by article 1198. The Court stated that 'the text of article 1198 only gives the affected party the right to request the resolution of the contract, granting the offer of an equitable modification only to the other party. This Court has repeatedly decided that the first rule for the interpretation of the law is to give full effect to the legislator's intention, that the first source for the determination of that intention is the text of the law, and that judges should not replace the legislator but should apply the legal norm as is stated. It would be a serious infringement of such rules to concede to one of the parties a right that the law does not confer upon him…especially when an omission or mistake by the legislator cannot be presumed, which clearly chose one of the different options proposed by the foreign legal doctrine and legislation…'[207] In the same sense, the Supreme Court has rejected *ex officio* readjustments in cases where neither party had requested the revision of the contract, but only its resolution, based on the constitutional right to due process and other procedural rules as *ultra petita*.[208]

203 Flah, Smayevsky (2003).
204 See Morello (1994).
205 Spota, A., *Desvalorización monetaria e imprevisión contractual;* and Borda. G. *Tratado de Derecho Civil,* pp. 146-147*;* cited by Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 174.
206 Flah, Smayevsky (2003), p. 41.
207 CS 21/04/92 *Kamenszein, Víctor J. y otro c/ Fried de Goldring, Malka y otros;* J.A. 1992-IV-166*;* full text in Morello (1994), pp. 21-24.
208 Araujo (1997) p. 99.

Finally, with regard to the right of the advantaged party to propose an equitable modification of the contract, although some decisions have stated that such a proposal should to be made in specific terms and the judge may only assess its equity with no power to modify it,[209] most of the doctrine and case law support the possibility for the advantaged party to propose the adjustment in general terms, indicating its willingness to modify equitably the conditions of the contract and allowing the judge to establish the specific terms of such a modification.[210]

3.3.5.2. Remedies provided by article 1198: Termination and adaptation of the contract

Regarding the termination of the contract, article 1198 states that in contracts for continuous performance their termination (*resolución*) will not affect that which has already been performed. Thus, in these cases a resolution has no retroactive effect, e.g. in a lease contract the lessor does hot have to return to the lessee the payments already made and the same can be applied to contracts for personal services. But in a sales contract by instalments, 'the sums already paid by the buyer should be returned monetarily corrected…to attempt a fair compensation to the creditor' and 'to preserve, even in the termination of the contract, the equivalence of the counter-performances which have to be returned'.[211] In addition, the remedy of termination has to be limited to 'cases where a revision is not possible or does not lead to satisfactory solutions'.[212]

On the other hand, if the advantaged party's proposed equitable modification is accepted or the contract is revised by the judge, the adaptation of the contract should have as its primary aim the equitable share between the parties of the effects of the unforeseeable risk and 'to correct the evident unfairness imposed by the new circumstances, so that the transaction will still be a good deal for the creditor and a bad but bearable deal for the debtor'.[213] Thus, the judge does not have to restore the counter-obligations to an absolute equivalence or to rewrite the contract to ideally adapt it to the standards of commutative justice, but only to equitably rectify the significant imbalance between the counter-performances.[214] In this sense, the Supreme Court has stated that 'the protection granted to the affected party by article 1198 of the Civil Code cannot lead to simply transferring

209 CNCiv., sala C, 20/10/78; CNEsp., Civ. y Com,, sala V, 13/12/76; CNEsp., Civ. y Com., sala III, 18/12/79; cited by Araujo (1997), p. 100.

210 CCCiv. y Com. Córdoba, 1978/06/05, Yapur, J. c/ Giorno, M.; adding that 'such an interpretation prevents the risk that the judge, confronted with an insufficient proposal by the advantaged party, determines that a termination of the contract is necessary'. Cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 330.

211 SC Bs.As. 03.06.80; cited by Cornet (2002).

212 CNCiv., sala G, 1982/05/03, *Fucaracce, J. c/ Capellán, J.*; cited by Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 318.

213 CNCiv., sala D, 1984/02/22, *Martínez, M. c/ Gentile*; CNCiv., sala G, 1981/02/10, *Hughes, L. c/ Alonso Soto, L. y otros,* adding that 'the *imprevisión* doctrine is not an instrument to set aside bad deals but to avoid a gross infringement of justice'. Cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), pp. 317-318.

214 CNCiv. Sala G, 1980/10/03, *Sommer, E. c/ Kirschenheuter, L.*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 319.

to the other party the consequences of the imbalance which was sought to be remedied… the nature of the *imprevisión* theory prevents that, under the excuse of protecting one of the parties, the burden is placed on the other party, thereby resulting in a situation which is analogous to the alleged unfairness and creating a new affected party replacing the former'.[215] Therefore, the application of the remedies provided by article 1198 cannot involve the transfer of the excessive onerousness from the affected party to the creditor.

3.4. A reference to *abus de droit*

As examined above, in Argentinian private law the main device for requesting a revision and/or the termination of a contract which has become excessively onerous is the *imprevisión* doctrine as provided by article 1198 of the Civil Code. Nevertheless, also the doctrine of *abus de droit* (article 1071) has been used in a number of cases as a complement to *imprevisión* in the event that the strict conditions for its application are not met in the particular case.

As stated before, *abus de droit* was introduced in article 1071 of the Civil Code by Act 17.111 of 1968:

Article 1071: *The regular exercise of a right or the fulfilment of a legal obligation cannot turn any act into an illicit one. The law does not protect the abusive exercise of rights. It will be considered as such when the purpose of the law granting the rights is contradicted, or when the limits of good faith, morality and* bonnes moeurs *are exceeded.*[216]

The provision is included under the title of *'Illicit acts'* and therefore its application is not restricted to the field of contract law. Legal doctrine has stated that the provision does not require fault or bad faith on the part of the right holder to turn the exercise of a right into abusive behaviour, but it is sufficient that such an exercise goes beyond the limits stated in the provision (good faith, morality and *bonnes moeurs*), resulting in damage to the affected party and infringing the purposes intended by the law with the granting of the right.[217] It is also added that the provisions of articles 1071 and 1198 are complementary and a manifestation of the principle of good faith and the 'moralization' of the law of contract by Act 17.711. As a consequence, the *abus de droit* doctrine of article 1071 can be used to require the judicial revision of a contract in situations of evident injustice but where the strict requirements of *imprevisión* are not met because of the facts of the particular case.[218]

215 C.S., 10/06/992, *Astilleros Príncipe y Menghi S.A. c/ Banco Nac. De Desarrollo*; cited by Morello (1994).

216 Artículo 1071**:** 'El ejercicio regular de un derecho propio o el cumplimiento de una obligación legal no puede constituir como ilícito ningún acto. La ley no ampara el ejercicio abusivo de los derechos. Se considerará tal al que contraríe los fines que aquélla tuvo en mira al reconocerlos o al que exceda los límites impuestos por la buena fe, la moral y las buenas costumbres.' Author's own translation.

217 See Moisset de Espanés (1996).

218 Spota, A., *Desvalorización monetaria e imprevisión contractual;* cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), pp. 184-185.

These doctrinal statements have been supported by case law, which is mostly related to cases of real property instalment contracts where the seller is in default in the performance of the obligation to transfer the property and the agreed price has become insignificant because of hyperinflation. Typically, such contracts confer on the buyer the right to pay in advance all pending instalments when the seller is in breach of its obligation to transfer the property and therefore to immediately claim the right to acquire the property, which implies a severe injustice when the price has become worthless compared to the property.[219] Then, the application of *imprevisión* as provided by article 1198 faces two main problems: the affected party (the seller) is in default and, in addition, he cannot require the adjustment of the contract but only its termination.

These problems were resolved by the courts by resorting to *abus de droit*, arguing that the payment or even the intention to pay the instalments by the debtor with valueless currency amounts to an abusive exercise of its rights when the contractual equilibrium has been severely altered by external circumstances, so that the performance of the contract as agreed is notoriously inequitable because it leads to excessive profits for one party and severe losses for the other party.[220] In such a situation it is presumed that with the requirement of performance the creditor intends to take unjustified and undue advantages at the expense of the debtor.[221] It is added that 'the right to require the performance of the contract is not absolute, and neither are any legal rights, because to be lawfully protected their exercise has to be regular, that is, in accordance with the aims by which they were granted and with the principle of good faith, morality and *bonnes moeurs*'.[222] The courts have expressly stated that a breach of contract by the seller or the lack of other conditions for the application of *imprevisión* do not prevent the power of the courts to revise the contract based on the provision of *abus de droit* in order to restore the economic balance of the counter-obligations.[223] Under this interpretation, some decisions have stated that in these cases the courts may revise the contracts *ex officio*, i.e. even if *abus de droit* has not been invoked by the claimant as a ground for such a revision, because article 1071 and the provisions related with the principle of good faith (article 1198 paragraph 1) and *bonnes moeurs* (article 953) are regarded as imperative norms where the public order is involved and therefore the court is entitled to apply them without any request by the parties.[224] However, this interpretation has been reversed by the Supreme Court because in such a

219 Grigera (1985), p. 65.

220 SC Buenos Aires, 1981/03/25, *Brussi, M. c/ Tamborenea, J.*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 350.

221 JNCiv., No. 59, 2002/07/10, *Ellaque, I. c/ Casa Schwarz S.R.L.*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 358.

222 SC Buenos Aires, 1980/07/01, *Zavalía H. c/ Fromaget, C.*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 355.

223 CNCiv. sala F, 1979/06/06, *Gerez, José c/ Acuario S.A.*; SC Buenos Aires, 1980/07/01, *Zavalía H. c/ Fromaget, C.*; Against the application of *abus de droit* in these cases, see CNCiv., sala C, 1982/02/04, *Fernández, H. c/ López G. y otro*. All cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), pp. 352-355.

224 Cám. Civil Capital, Sala E. 8/07/1976, *Santoiana, S. y otra c/ García, J. y otros*; Cam. 5ª Civil y Com. Córdoba, 6/04/1988, *Olmedo, J. c/ Labiux, C.*; cited byMoisset de Espanés (2001).

case the advantaged party is prevented from properly exercising its right to defence and therefore the constitutionally guaranteed due process is infringed.[225]

A minority of the legal doctrine have rejected the use of *abus de droit* as an alternative tool to *imprevisión* for the revision of contracts, arguing as major grounds that the restrictions and exceptions of the *pacta sunt servanda* principle should be based on clearly stated positive norms and not on 'a law-making activity based upon vague general moral principles whose sole interpreters are judges and arbitrators' adding that 'the notion of general moral principles and *gute Sitten* has no legal effect outside the limits traced by positive legal rules'.[226] Finally, it is stressed that 'the courts, under cover (sic) of a pretended application of the *abus de droit* doctrine, have created for themselves an autonomous right to impose a new contract upon the parties against their will or without consulting them; a device inspired by more or less vague *ius naturale* principles and neither authorized nor justified by applicable positive law norms'.[227]

4. Conclusions

The comparative survey of the Latin American jurisdictions analyzed above has demonstrated that, regardless of their common origin and shared features as part of the Civil law tradition, the approach to and the trend concerning the problem of unexpected circumstances has been completely divergent.

On the one hand, Argentinian legal theory and case law have developed a consistent doctrine with regard to the subject of unexpected circumstances. Thus, the conditions and effects of *imprevisión* have been widely analyzed in theory and tested in practice, especially in periods of economic crisis which have affected Argentina since 1975. However, the right of the affected party to rely on the *imprevisión* doctrine has not led to the instability of the socio-economic system through the destruction of the principle of the sanctity of contracts or reliance on their enforcement but, on the contrary, they have become a tool to correct unjust and undesired effects of such a system for contractual parties. The fact that, after Act 17.711 of 1968, each project to reform the Civil Code has included a provision on *imprevisión* confirms that this doctrine has been positively evaluated by the Argentinian legal community.

On the other hand, until recently the Chilean case law concerning *imprevisión* was technically non-existent and in a number of decisions the Supreme Court had reaffirmed the principle of the sanctity of contracts. In the *South Andes* case, the Court expressly rejected the possibility of applying *imprevisión* in the light of the legal provisions in force, which were interpreted as excluding the revision of contracts in cases of changed circumstances and, on the contrary, as a manifestation of the absolute prevalence of the

225 CS, 1980/04/01, *Frizza, j. c/ Rodríguez, J.*; cited in Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 357.
226 Grigera (1985), pp. 67-68 with references to case law and the legal doctrine.
227 *Ibid.*, p. 68.

principle of *pacta sunt servanda*. Addtionally, its development in legal doctrine is evidently less than in other legal systems. This lack of development is reflected in the contradictory argumentation in and the outcome of the few judicial and arbitral decisions which have analyzed in depth the application of *imprevisión* in the last few years.

The different approach adopted by Argentinian and Chilean law deserves further study, which should include interdisciplinary analyses, e.g. from a sociological perspective. However, as a preliminary hypothesis, the reasons for such a dissimilar approach are not the differences in the economic history of both countries: between 1972 and 1976 Chile suffered hyperinflation which was just as severe as the one which affected Argentina; and later at the beginning of the 1980s the devaluation of its currency led to a banking crisis and the bankruptcy of several companies.[228] The reasons for the reluctance seem to be the formal and positivistic approach to the law by both the judiciary and legal doctrine. The mere reference to positive legal norms still prevails over the search for and the construction of general principles in judicial and scholarly argumentation. Therefore, with a Civil Code the text of which strongly supports the role of the binding force of contracts rather than the protection of weaker parties or solidarity in contract law, the rejection or the restricted acceptance of *imprevisión* is not a surprising feature of Chilean private law.

228 See Rosenn (1978).

Chapter 6

THE COMMON LAW JURISDICTIONS – ENGLISH AND AMERICAN LAW

1. Introduction. Terminology: frustration, impossibility and impracticability

In English law, frustration is a concept which exceeds the usual meaning of *imprévision*, excessive onerosity, hardship, changed circumstances or other similar expressions used in Civil law. Thus, the term frustration of contract includes at least three different situations: the case where the performance has become physically or legally impossible, the case where the performance has become impracticable (i.e. extremely onerous or difficult) and the case where the counter-performance has lost its value to the creditor (frustration of purpose).[1] In other words, frustration of contract refers to the whole doctrine of being discharged from contractual obligations by supervening events, irrespective of the type of event which brings about this discharge.[2] English law also refers to 'frustration of the adventure', a special kind of event which may discharge a contract, i.e. where performance has not become permanently impossible but is regarded as amounting to a frustration of the commercial object of the contract.

On the other hand, in American law the term frustration is used to cover situations of frustration of purpose. Besides, impossibility and impracticability are in theory distinguished from one another, but nowadays the doctrine of impracticability seems to cover both cases of impossibility and supervening excessive onerosity or difficulty.[3]

1 See Kull (1991).

2 Treitel (2004)p. 66. The author also refers to the expression of 'frustrating breach', i.e. the type of breach which is sufficiently serious to justify the victim's rescission of the contract, stating that such a concept involves cases which are distinct from the doctrine of frustration, i.e. discharge by supervening events.

3 See Williston, Lord (1990), §77:1 and Comment a, §261, Restatement (Second) of Contracts. In the same sense, section 2-615 of the UCC: 'Excuse by Failure of Presupposed Conditions' applies to the case when 'performance as agreed has been made impracticable'. It has been argued that 'The Code omitted use of the term 'impossibility' because it was generally agreed by the drafters that in some situations nonperformance should be excused even though it had not become scientifically impossible', Sommer (1974), p. 549.

In this section, the term frustration will be used to describe the *effect* of supervening events on the contract. Then, a contract may be frustrated by impossibility or impracticability. Conversely, the expressions impossibility, impracticability, frustration of purpose and, in general, change of circumstances, will be used in the sense of *causes* which may frustrate a contract.

2. English law

2.1. Origins of the doctrine of frustration

As stated above, in English law the problem of the effect of supervening events on the performance of the contract is covered under the general doctrine of frustration. It is a general statement that under early English common law an impossibility of performance arising after a contract had been entered into was not an excuse for non-performance.[4] The landmark case in that regard is *Paradine v Jane*[5] where the tenant of a farm (Jane) was sued for rent by the owner (Paradine). The tenant pleaded that he had been dispossessed of his land for three years by the army of Prince Rupert 'an alien born, enemy to the King and the kingdom', which prevented him from using the land and therefore taking profits from it. The court rejected Jane's plea and therefore held that he was liable in debt for rent under the lease also for the period when he had been dispossessed of the land. The rule stated by the court was that 'When the party by its 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 his contract.' This statement is the foundation of the so-called doctrine of absolute contracts or the absolute rule of performance by which impossibility is not a ground for discharging the debtor. Such a rule was well-established at the beginning of the 19th century although there are no clear reasons for that acceptance, and the choice of the courts for such a rule was the subject of strong criticism by contemporary legal doctrine.[6]

After the mid 19th century, the rule was qualified by the establishment of the doctrine of frustration as stated in *Taylor v Caldwell*.[7] In that case, a contract to rent a music hall was discharged when the music hall was destroyed by fire just before its scheduled use (six days before the first concert), with no fault being attributed to either party. After stating that the absolute rule of performance was the general rule a new general rule (in the form of an exception to the already mentioned rule of strict or absolute performance) was laid down by Judge Blackburn: 'In contracts in which the performance depends on the continued existence of a given person or thing, a condition is implied that the

4 See Wladis (1987) and Treitel (2004).

5 82 Eng. Rep. 897 (K.B. 1647) (Aleyn 26). See Treitel (2004), pp. 19-29 and Wladis (1987), pp. 1575-1585 for a detailed analysis of the case.

6 See Schlegel (1968), p. 420-422, stating that 'the reasons for its ready acceptance and the accompanying disregard of legal history are not wholly apparent even today'. For further criticism of the interpretation of this case, see Treitel (2004), pp. 19-26, Wladis (1987), pp. 19-29.

7 122 Eng. Rep. 309 (Q.B. 1863).

impossibility of performance arising from the perishing of the person or thing shall excuse the performance.'[8] The decision established the so-called implied condition theory: 'the great object of making the legal construction such as to fulfil the intention of those who entered into the contract.'[9] Because the existence of the hall was essential for the performance of both parties, the decision also excused both from performance: the lessor was excused from paying reliance damages and the lessee from paying the agreed rental price.[10]

The doctrine in *Taylor v Caldwell* was further applied in *Appleby v Myers*,[11] where the plaintiffs agreed to assemble a whole steam engine and associated machinery in the defendant's factory. The contract price was payable on completion of the work. After some of the machinery was in place, an accidental fire destroyed all of the defendant's premises including the machinery already in place. The court discharged the contract and excused both parties from further performance, extending the doctrine of *Taylor* to the perishing of something which is essential for the performance, but that is not the direct subject of the contract.

The doctrine was later applied in cases of personal services where the performer had become unable to perform[12] and to physical damage to a ship specified in the performance.[13] At the end of the 19th century the doctrine was laid down in the British Sale of Goods Act.[14] Besides, the doctrine supported the discharge of a contract in cases of a failure of the source of supply (when the source is specified in the contract)[15] and when the method of performance had become impossible (if the contract provides that it is to be performed only by a particular method).[16] Further, by the doctrine of supervening illegality, a contract whose performance was legal at the time of its conclusion may be discharged if such a performance becomes illegal due to a change in the law or public policy.[17]

8 *Ibid*. at 314.

9 *Ibid*. at 312. This statement can be regarded as following a subjective approach to determine the implied condition, i.e. based on the actual intent of the *specific parties* to the contract. On the contrary, an objective approach entails that the implied term is that which *reasonable men* would have included in the contract in a similar situation. See Schlegel (1968), p. 443.

10 For criticism of such an outcome, see Wladis (1987) and Treitel (2004).

11 (1867) L.R. 2 C.P. 651.

12 *Boast v. Firth*, 4 L.R.-C.P. 1 (1868) and *Robinson v. Davison*, 6 L.R.-Ex. 269 (1871).

13 *Nickoll & Knight v. Ashton, Edridge & Co.*, [1901] 2 K.B. 126 (C.A.).

14 'Where there is an agreement to sell specific goods, and subsequently the goods, without any fault on the part of the seller or buyer, perish before the risk passes to the buyer, the agreement is thereby avoided.' Sale of Goods Act, 1893, 56 & 57 Vict., ch. 71, § 7, *re-enacted as the* Sale of Goods Act, 1979, ch. 54, § 7.

15 *Howell v. Coupland*, 1 Q.B.D. 258 (C.A. 1876); *Thornett v Yuills Ltd*, [1921] 1 K.B. 219. See *CTI Group Inc. v Transclear SA (The Mary Nour)*, [2008] 1 All E.R. (Comm) 192, where the court stated that 'Where a seller made an unqualified promise to sell he bore the risk of a failure of his contemplated source of supply where that source was not the specified source or the goods were not specific goods and the supplier was not excused by frustration.'

16 *Nickoll & Knight v Ashton Edridge & Co.* [1901] 2 KB 126 (C.A.).

17 See Wladis (1987), pp. 1600-1603.

Finally, it has to be emphasized that, even nowadays, the supervening impossibility of performance is not in itself a ground for being discharged from a contract under English Common law. If the contractual duty of the party is strict, i.e. there is not a mere assumption by the parties about the continued possibility of performance but the debtor has undertaken that his performance will be possible, being discharged from the contract by supervening impossibility is not an available remedy for such a party. In the same sense, it has been stated that even after *Taylor*, the doctrine of absolute contracts still survives to some extent and 'many of the actual decisions in which *Paradine v Jane* was applied are still regarded as good law.'[18]

2.2. Frustration in cases of excessive onerosity or impracticability

2.2.1. Introduction

As stated in the preceding section, at the beginning of the 20th century the doctrine of frustration, as laid down in *Taylor*, discharged a contract only in cases where performance had become impossible but not merely impracticable. Thus, in *Turner v. Goldsmith*[19] and in *Ashmore & Son v. C.S. Cox & Co.*[20] the court stated that performance had not become physically impossible, and the lack of such physical impossibility was a ground for holding the obligor to his bargain.

In general, English law does not provide relief to the debtor on grounds of impracticability, i.e. when performance has become excessively onerous or burdensome for the debtor. The only clear cases in which English law discharges a contract when there is no impossibility are the situations covered by the doctrine of frustration of purpose, which has however been subject to a narrow and strict application by the courts.

As will be examined further, the situation of this subject in English law is in theory completely different from American law. Thus, 'the English cases do not provide a single clear illustration of discharge' on grounds of pure impracticability, i.e. in cases where the obligation of one party has become excessively onerous, and 'the possibility of such discharge appears to have been denied on a number of occasions in the House of Lords.'[21]

Although some English decisions have made reference to 'commercial impossibility', 'commercially impracticable' and 'serious impediments' to justify an excuse for non-performance; those decisions were delivered in cases dealing with the scope and operation of express contractual clauses and were therefore not related to the English common law doctrine of discharge.[22] Thus, the prevailing view is that a situation of impracticability

18 Treitel (2004), p. 19.
19 [1891] 1 Q.B. 544 (C.A.).
20 [1899] 1 Q.B. 436 (1898).
21 Treitel (2004), p. 283.
22 *Ibid*., p. 282, adding that in other cases the courts do not clearly distinguish between impossibility and impracticability in their statements, e.g. in *Scottish Navigation Co Ltd v. Souter & Co* [1917] 1 K.B. 222 at

or excessive onerousness is not a ground to frustrate a contract under English common law.[23]

2.2.2. The rejection of impracticability as a ground for being discharged from a contract: development of the case law

It has been stated that the cases covered by the doctrine of the *frustration of the adventure* were the first in which a party was excused when the performance did not appear to be physically impossible.[24] This doctrine was developed in a series of cases involving delay in the performance of charterparties, either arising from a blockade,[25] running aground[26] or congestion at the docks.[27] In addition, the doctrine generally applies to contracts which do not determine a specific time for performance.[28] The question for the courts was whether a temporary excuse is likely to cease in time for performance to affect the object of the contract. In all the cases, it was held that an inordinate delay which destroys the object of the commercial adventure excuses the performance of the contract: 'the time necessary for getting the ship off and repairing her was so long as to put an end, in a commercial sense, to the commercial speculation entered upon by the shipowner and the charterers.'[29]

Cases of a temporary unavailability of the subject-matter have also been accepted as a ground of frustration when the performance, if resumed after the impediment has ceased, would impose substantially different obligations from those originally undertaken. Thus, in *Metropolitan Water Board v Dick, Kerr & Co*. the contractors claimed relief from a six-year construction contract concluded in 1914 when in 1916 they were required to cease work by a Governmental order based on war legislation. The House of Lords allowed the claim on the ground that 'that the interruption created by the prohibition was of such a character and duration as to make the contract when resumed a different contract from the contract when broken off, and that the contract had ceased to be operative.'[30] The decision stressed that it was highly likely that the economic conditions would be so different after the end of the War that they would mean a substantive increase in costs for the performing party.[31] The same reasoning was applied in a case where the temporary impediment was

236,237 where the court qualified the same fact as 'quite impracticable in a commercial sense' and later as 'impossible'.

23 See *British Movietonenews Ltd v London & District Cinemas* [1952] A.C. 166 (1951); *Thames Valley Power Ltd v Total Power Gas Ltd* [2006]1 Lloyd's Rep 441.

24 Schlegel (1968), p. 424.

25 *Geipel v Smith*, L.R. 7 Q.B. 404 (1872).

26 *Jackson v Union Marine Ins. Co.*, L.R. 10 C.P. 125 (1874).

27 *Dahl v Nelson, Donkin, & Co.*, 6 App. Cas. 38 (1881).

28 E.g. in the case of charterparties performance is usually subject to general limits as 'with all convenient speed'. See Wladis (1987), p. 1604.

29 L.R. 10 C.P. 125 (1874).

30 [1918] A.C. 119.

31 'On the whole matter I think that the action of the Government, which is forced on the contractor as a vis major, has by its consequences made the contract, if resumed, a work under different conditions from those of the work when interrupted. I have already pointed out the effect as to the plant, and, the contract

considered to bring the originally agreed remuneration out of line with that payable at the end of the delay.[32]

The rigid attitude of the English courts in denying relief in cases of excessive onerousness is also reflected in a number of cases relating to contracts affected by the outcome of the First World War which caused an increase in the costs of the goods to be delivered by the seller or placed severe difficulties for performance. Thus, in *Blackburn Bobbin Co v TW Allen & Sons,*[33] where the outbreak of the War cut off the normal supply of Finland timber, it was held that the failure of the intended source of supply of the seller does not frustrate the contract even when it may be very difficult and expensive to find an alternative supplier.

Later, in *British Movietonesnews Ltd v London District Cinemas,*[34] cinema owners requested the termination of a contract concluded during the Second World War for the supply of newsreels because of a change of circumstances after the end of the War. The Court of Appeal upheld the claim but the House of Lords reversed the decision stating that '[t]he suggestion that an "uncontemplated turn of events" is enough to enable a court to substitute its notion of what is "just and reasonable" for the contract as it stands, even though there is no "frustrating event" appears to be likely to lead to some misunderstanding. The parties to an executory contract are often faced, in the course of carrying it out, with a turn of events which they did not at all anticipate – a wholly abnormal rise or fall in prices, a sudden depreciation of currency, an unexpected obstacle to the execution or the like. Yet this does not of itself affect the bargain that they have made.'[35] Notwithstanding the fact that the case is not strictly one of excessive onerosity or impracticability, the statement by the House of Lords that 'a wholly abnormal rise or fall in prices' do not affect the agreement of the parties, has been considered as a 'rejection of the very principle of impracticability.'[36]

In *Davis Contractors Ltd v Fareham UDC*, the House of Lords again rejected a claim to discharge a contract thereby holding that the contract had not been discharged because '[t]he fact that, without the fault of either party, there had been an unexpected turn of events, which rendered the contract more onerous than had been contemplated, was not a ground for relieving the contractors of the obligation which they had undertaken…'[37]

being a measure and value contract, the whole range of prices might be different.' Lord Dunedin, *ibid*. at 130.

32 *Bank Line Ltd. V Arthur Capel & Co.*, [1919] A.C. 435.

33 [1918] 2 KB 467, CA. Further references to the case law in Treitel (2004), p. 284.

34 [1952] A.C. 166.

35 Lord Simon, *Ibid*. at 185. On Appeal, Lord Denning had stated that 'If the ensuing turn of events was so completely outside the contemplation of the parties that the court is satisfied that the parties, as reasonable people, cannot have intended that the contract should apply to the new situation, then the court will read the words of the contract in a qualified sense; it will restrict them to the circumstances contemplated by the parties; it will not apply them to the uncontemplated turn of events, but will do therein what is just and reasonable…' [1951] K.B. 190 at 201.

36 Treitel (2004), p. 285.

37 [1956] A.C. 696 at 697.

In this case contractors had entered into a building contract to build 78 houses for a local authority for a fixed sum within a period of eight months, but due to unexpected circumstances adequate supplies of labour were not available and the work took 22 months to complete. The contractors argued that such events had discharged the contract, but the claim was rejected by the House of Lords on the grounds mentioned above. The decision is also relevant because there the Law Lords attempted to find a theoretical synthesis of the doctrine of frustration. In this regard, Lord Reid, citing Viscount Simon on *British Movietonenews*, stated that 'It appears to me that frustration depends, at least in most cases, not on adding any implied term but on the true construction of the terms which are in the contract, read in the light of the nature of the contract and of the relevant surrounding circumstances when the contract was made . . . On this view, there is no need to consider what the parties thought, or how they or reasonable men in their shoes would have dealt with the new situation if they had foreseen it. The question is whether the contract which they did make is, on its true construction, wide enough to apply to the new situation: if it is not, then it is at an end.'[38] The opinion of Lord Radcliffe also emphasizes the necessity of a radical or fundamental difference between the performance as contemplated by the parties and the performance under the new circumstances: '. . . frustration occurs whenever the law recognises that, without default of either party, a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract. *Non haec in foedera veni*. It was not this that I promised to do.'[39]

The so-called *Suez cases* are a clear illustration of the approach of the English courts with regard to supervening difficulty or expense in performance. The cases concerned the closure of the Suez Canal because of the war between Egypt and Israel at the end of 1956. After the closing of the Canal, ocean freight rates were increased because of the longer alternative route (around the Cape of Good Hope) and a decrease in the availability of ships (also because each voyage took longer than before). The four relevant reported cases concerned contracts for the sale of commodities in bulk concluded before the actual closing of the Canal and in each case the seller had defaulted, claiming frustration based on this closure. All cases reached the Court of Appeal where frustration was dismissed and the seller was held to have breached the contract. One case reached the House of Lords, *The Tsakiroglou,*[40] and was unanimously affirmed. The facts were similar to the other cases: By a written contract dated October 4, 1956, the sellers had agreed to sell to the buyers Sudanese groundnuts for shipment c.i.f. Hamburg during November/December, 1956. On November 2 the Suez Canal was closed to navigation, but the goods could have been shipped around the Cape of Good Hope, which was more than twice as long and freightage by this route was therefore far more costly. Based on those difficulties, the sellers failed to ship the goods. To determine frustration, the Law Lords used the 'fundamentally different' test (Lord Reid) and the 'radically different' test (Lord Radcliffe) as enunciated in *Davis*.

38 *Ibid*. at 720, 721.
39 *Ibid*. at 729.
40 *Tsakiroglou & Co. v Noblee Thorl*, [1962] A.C. 93.

In their considerations, they concluded that, regarding the facts of the case, performance by shipping via the Cape of Good Hope was 'not commercially or fundamentally different' from performance by shipping via Suez, 'since shipment was due to be made by some route during November/December… [and] there was no stipulated date for arrival at Hamburg. Nothing appears to suggest that the Cape voyage would be prejudicial to the condition of the goods or would involve special packing or stowing, nor does there seem to have been any seasonal market to be considered.'[41] Thus, the only difference was the increase in the cost of freight, which was not considered to be a sufficient ground in *itself* for a finding of frustration.

The same reasoning was provided in another of the Suez cases, *The Eugenia*,[42] i.e. that a mere increase in costs was not sufficient to satisfy the test of a 'fundamentally different obligation' and therefore to justify the frustration of the contract: 'The fact that it [performance] has become more onerous or more expensive for one party than he thought is not sufficient to bring about a frustration. It must be more than merely more onerous or more expensive. It must be positively unjust to hold the parties bound. …The voyage round the Cape made no great difference except that it took a good deal longer and was more expensive for the charterers than a voyage through the canal.'[43] The difference in the duration of the whole voyage (108 days via the Canal and 138 via the Cape) and the nature of the cargo (iron and steel goods) were again decisive for rejecting frustration.

However, the statement that excessive onerosity or impracticability is not a ground for discharging a contract under English law 'cannot be strictly proved', and the lack of authority compared to American law in cases such as those derived from the energy crisis of 1973 'suggests that the argument has not been regarded even as a plausible one.'[44] It has been argued that excessive onerosity may find its way into English law if it is combined with other situations which imply an obstacle to the performance as actually agreed by the parties. Then, if performance can be achieved in a completely different manner to that which was contemplated 'it would not be an abuse of language to say that the task contemplated under the original contract had become an impossible one to perform.'[45] The problem with this interpretation is that it does not establish a clear limit or distinction between situations of impossibility and situations of excessive onerosity, the latter remaining only as a complement criterion in cases where the performance can only be rendered by a completely different method than that originally agreed upon.

The possibility of a revalorisation of a monetary debt by one of the parties as payment for goods or services has not been recognised in English law. Only in cases of services rendered before the frustration of the contract may a court order the payment of a reasonable remuneration which is even different from that agreed upon in the contract,

41 *Ibid*. at 122-123.
42 *Ocean Tramp Tankers Corporation v V/O Sovfracht (The Eugenia)*, [1964] 2 Q.B. 226 (C.A. 1963).
43 *Ibid*. at 239-240 (Lord Denning).
44 Treitel (2004), pp. 285-286.
45 *Ibid*., p. 289.

but those payments only refer to past and not to future performances.[46] In the same sense, is doubtful whether in cases of inflation a discharge may be granted to the party to whom the payment has to be made because the money to be received has lost its original value. Thus, in *Wates Ltd v GLC* the court stated that 'Things may have turned out differently from what the parties contemplated in that inflation increased, not at a trot or at a canter, but at a gallop. But that difference in degree or tempo was not so radical a difference from the inflation contemplated and provided for as to frustrate the contract.'[47] This statement left open the possibility of a discharge in a case of extreme inflation, but taking into account the general approach of English law to a change of circumstances, it is unlikely that a situation which is different from a total collapse of the currency may be considered as a sufficient ground to discharge the contract.

Some situations may lead to the frustration and consequent discharge of the contract when impracticability is combined with other situations related to impossibility. That is the case of temporary impossibility or delay, or where the party has to incur costs to avoid a supervening illegality.[48] More relevant, also an express clause in the contract providing for the discharge of the contract in situations of *force majeure* or similar events may in its true construction apply to a situation of excessive onerosity,[49] although that is not the general rule: in a number of decisions it has been held that sellers cannot rely on a force majeure or 'prohibition to export' clause in the case of a sudden and severe increase in costs or prices.[50] It must be emphasized that even if impracticability is regarded as ground of frustration, such a result emanates from the construction of the express provision of the contract, and not as part of the common law doctrine. Finally, it is possible in English common law for the parties to expressly provide in the contract that supervening hardship, impracticability or other equivalent situations may discharge or suspend the contract.[51]

2.3. The doctrine of frustration of purpose

The doctrine of frustration of purpose applies when supervening events make performance by one party useless to the other or, in other words, reduce completely the value of such performance for the recipient. It is clearly not a case of impossibility, because the performance of the contract is technically and/or physically possible, but becomes pointless in order to achieve the purpose of the contract.

The doctrine was established in *Krell v. Henry*,[52] one of the coronation cases,[53] where the rule in *Taylor* was then extended to cover not only the destruction of a specific thing

46 *Ibid*., p. 303.
47 (1987) 25 Build. L.R. 1 at 35, cited by Treitel (2004), p. 304.
48 *William Cory & Son v London Corporation*, [1951] 1 K.B. 8 (affirmed [1951] 2 KB 476).
49 *Ford & Sons Oldham Ltd v Henry Leetham Ltd*, (1915) 21 Com. Cas. 55.
50 See the references in Treitel (2004), pp. 294- 295.
51 *Ibid*., p. 294.
52 [1903] 2 K.B. 740.
53 A large number of cases resulted from the coronation events, but the most remarkable and cited has been *Krell v Henry*. For a reference to the other cases, see Wladis (1987), p. 1609.

but also the non-occurrence of a 'state of things'. In this case, the defendant agreed to hire a flat to the claimant for two days from which he could view the procession route for King Edward VII's coronation. The contract contained no express reference to the coronation procession, or to any other purpose for which the flat was rented; however, the claimant had advertised in an announcement placed in his window that windows to view the coronation procession were to be let in those premises. A deposit was paid when the contract was entered into. As the procession did not take place on the days originally determined because of the King's illness, the defendant declined to pay the balance of the agreed rent and the claimant instigated proceedings to recover it. In his speech, Vaughan Williams LJ justified the extension of the doctrine in *Taylor* and justified the discharge of the contract: 'It is not essential to the application of the principle of *Taylor* v. *Caldwell* that the direct subject of the contract should perish or fail to be in existence at the date of performance of the contract. It is sufficient if a state of things or condition expressed in the contract and essential to its performance perishes or fails to be in existence at that time. In the present case the condition which fails and prevents the achievement of that which was, in the contemplation of both parties, the foundation of the contract, is not expressly mentioned either as a condition of the contract or the purpose of it; but I think for the reasons which I have given that the principle of *Taylor* v. *Caldwell* ought to be applied.'[54]

It is interesting to note that this statement makes express reference to the foundation of the contract, a concept which has been widely used in civil law jurisdictions to justify the application of supervening onerousness as a ground to terminate or modify the contract. As stated before, the relevance of *Krell* is the expansion of the *Taylor* doctrine to the perishing of a state of things, not necessarily the subject-matter of the contract, but considered to be a basic foundation thereof. Moreover, the case was not one of impossibility for either party: the use of the flat and the payment of the money were both possible.[55]

However, the doctrine has been narrowly applied by the English courts, presumably on the ground that it entails a greater threat to the principle of the sanctity of contracts than the rule of discharge by impossibility as laid down in *Taylor*.[56] Thus, in another of the coronation cases, *Herne Bay Steam Boat Company v Hutton*,[57] an agreement in writing was entered into between the plaintiffs and the defendant to the effect that the plaintiffs' steamship *Cynthia* would be 'at the disposal' of the defendant on June 28 to take passengers from Herne Bay 'for the purpose of viewing the naval review and for a day's cruise round the fleet; also on June 29 for similar purposes.' Because of the King's illness, the naval review was cancelled on June 24. On June 29 the defendant repudiated the contract in toto. During the two days in question the fleet remained anchored at Spithead. The plaintiffs brought an action to recover the balance less the profits made by their use of the ship

54 [1903] 2 K.B. at 754.
55 However, it can be argued that the obligation of the owner was to provide the use of rooms *with* a view of the procession. Then, as the procession had been cancelled, this obligation became impossible to perform. See Wladis (1987), p. 1613.
56 Treitel (2004), p. 329.
57 [1903] 2K.B. 683.

during the two days in question. The Court of Appeal held that the plaintiffs were entitled to recover because '(1.) the venture was the defendant's, the risk being his alone; and (2.) the happening of the naval review was not the sole basis of the contract, so that there had been no total failure of consideration, nor a total destruction of the subject-matter of the contract.'[58]

Curiously, the judgment in *Herne Bay* was delivered a few days before and by the same judges as those in *Krell*, but no reference to the former was given in the latter decision. The contrast between the outcomes of the cases has been highlighted by several commentators, mostly with no satisfactory explanation. One such explanation is that in *Krell* the hirer of the room was acting as a private party, a consumer, and in contrast, in *Herne Bay* the hirer of the boat was acting in a business capacity and then the court was not willing to release him from that which had turned into a bad bargain.[59] Complementary to this argument, it has been argued that both the *Krell* and *Herne Bay* cases were decided on the ground of the equities of the particular facts which distinguish each case, such as the connection between the thing hired and the event; the existence of reliance expenses for the owners; and the advertisement made by the owner in *Krell* to rent the rooms in order to view the procession, which was not present in *Herne Bay*. These have been stated as reasons for 'the fact that the *Krell* principle played a relatively insignificant role in the subsequent development of the English law of impossibility.'[60]

Two major restrictions for the application of the doctrine can be deduced from a comparison of the two cases. Firstly, the supervening event has to frustrate the *common* purpose of the contract which is intended to be achieved by *both* parties. Secondly, if the frustration of purpose is partial, a discharge is rejected by the courts if *any* (relevant) part of the contractual purpose can still be attained.

The restrictive attitude of the English courts towards the doctrine of the frustration of purpose is well reflected in *Amalgamated Investment & Property Co v John Walker & Sons Ltd,*[61] where a contract was concluded for the sale of a warehouse which had been advertised as being suitable for occupation or redevelopment. Two days after the contract was signed, the property was included in the statutory list of buildings of 'special architectural or historic interest', thus substantially diminishing the possibility of obtaining permission for redevelopment and reducing the value of the property from the contract

58 Id at 683. In their speeches, the Lords Justice highlighted the unilateral purpose of the defendant, which was prevented by the cancellation of the review: 'when the contract is properly regarded, I think the purpose of Mr. Hutton, whether of seeing the naval review or of going round the fleet with a party of paying guests, does not lay the foundation of the contract within the authorities' (Vaughan Williams LJ at 688); 'it is a contract for the hiring of a ship by the defendant for a certain voyage, though having, no doubt, a special object, namely, to see the naval review and the fleet; but it appears to me that the object was a matter with which the defendant, as hirer of the ship, was alone concerned, and not the plaintiffs, the owners of the ship' (Romer LJ at 690).

59 See Brownsword (1985).

60 Wladis (1987), p. 1620.

61 [1977] 1 W.L.R. 164.

price of £1,700,000 to only £200,000. The Court of Appeal dismissed the purchaser's claim to have the contract discharged because, unless otherwise provided in the contract, they have to assume the 'inherent risk which all owners of buildings incurred, that the building could be listed as of architectural or historic interest'.[62] However, the court recognized that the vendors were aware of the intention of the purchasers to redevelop the building and they 'did not warrant in any way that planning permission could be obtained for the development of the property… [and] there was no stipulation in the contract relating to anything of that kind.'[63] Finally, Buckley LJ also agreed that the case does not satisfy the 'radically different test' laid down by Lord Radcliffe in *Davis Contractors*: 'It seems to me impossible to bring the circumstances of the present case within the test enunciated by Lord Radcliffe. One cannot say that the circumstances in which performance, i.e. completion [by payment of the balance of the purchase price and by conveyance of the property], will be called for would render that performance a thing radically different from that which was undertaken by the contract. On the contrary, completion, according to the terms of the contract, would be exactly what the purchasers promised to do, and of course the vendors.'[64] The outcome of the case shows that even in a case of an extreme loss of value of the counter-performance, the English courts are not willing to set aside a contract if performance is still possible and has not become totally different from that which was agreed.

Hence, similar to impracticability, the doctrine of frustration of purpose has been considered under English law as a source of uncertainty and dangerous for the principle of the sanctity of contracts. Therefore, 'English cases provide no illustration of discharge by 'pure' frustration of purpose since the coronation cases.'[65] Certainly, in the coronation cases the doctrine was established in terms which were very similar to analogous concepts in civil law jurisdictions such as the German *Geschäftsgrundlage* or the Italian *presupposizione*, but unlike the situation in those jurisdictions, any later development of the doctrine in English law has been almost non-existent.

2.4. The effects of frustration

In English common law, frustration terminates the contract with effect from the time of the frustrating event: if a contract is frustrated, each party is released from any further obligation to perform.[66] Furthermore, frustration operates automatically irrespective of the wishes of the parties[67] and therefore may be invoked by either party and not only by the party affected by the supervening event. Consequently, as a general principle, English

62 *Ibid*. at 165. The purchasers also claimed a discharge on the ground of a mutual mistake, which was dismissed because at the time of the conclusion of the contract there was no mistake of fact about the surrounding conditions of the agreement (the building was listed two days after such conclusion).
63 Buckley LJ, *ibid*. at 173.
64 Sir John Pennycuick, *ibid*. at 177.
65 Treitel (2004).
66 Beale H.G. et al., (2001), p. 482.
67 McKendrick (1991), p. 38; and Treitel (2004).

common law does not provide mechanisms to adjust contracts where a substantial change of circumstances has occurred[68] so 'each party loses the benefit of the bargain and each party bears his own reliance losses'.[69]

2.4.1. The common law rules in cases of performance rendered before frustration

The general rule stated above was applicable in the first place even in cases of the partial performance of the contract before the onset of frustration. With regard to this subject, English common law distinguishes between money paid or payable before discharge and cases where a party has performed in part by some other way before the contract is frustrated.[70]

In the first case, the original rule at common law was that such payments were not repayable.[71] Thus, in *Chandler v Webster,*[72] one of the *Coronation Cases*, the contract provided for a payment of £141 15s in advance. The sum had become due and the amount of £100 was paid before the cancellation of the procession. Based on a total failure of consideration, the hirer sued to recover the money paid; and the defendant counter-claimed for the unpaid balance (£41 15s). The Court of Appeal held for the defendant on both claims, based on the principle that frustration discharges only future obligations. The decision stressed that, notwithstanding the arbitrariness of the rule, its certainty was a higher value to preserve, so 'the law treats everything that has already been done in pursuance of the contract as validly one, but relieves the parties for further responsibility under it.'[73] This statement of the law was strongly criticized as being an unfair and unsatisfactory way of allocating the loss, which fell wholly on one party which would also receive no part of what he had bargained for in exchange for the payment.[74]

However, the logic behind this case is interesting because it illustrates the position of the judiciary with regard to intervening in a contract to shift losses between the parties. The opinion of Sir Richard Collins, MR in *Chandler* is revealing in this respect: 'The rule adopted by the Courts in such cases is I think to some extent an arbitrary one, the reason for its adoption being that it is really impossible in such cases to work out with any certainty what the rights of the parties in the event which has happened should be. Time has elapsed, and the position of both parties may have been more or less altered, and it is impossible to adjust or ascertain the rights of the parties with exactitude.'[75] Faced with the uncertainty of the result, the courts applied a rule similar to the *res perit domino*: the loss

68 Beale H.G. et al., (2001), p. 886.
69 Kull (1991), p. 18.
70 See Treitel (2004), pp. 589 et seq.
71 Beale H.G. et al., (2001), p. 482.
72 [1904] 1 K.B. 493.
73 Sir Richard Collins, MR, *Ibid*, at 500.
74 Treitel (2004), p. 590. The rule was also criticized by the House of Lords in a case where Scottish law was applicable, saying that *Chandler* could lead to 'monstrous' outcomes (*Cantiare San Rocco SA v Clyde Shipbuilding and Engineering Co Ltd* [1924] A.C. 266 at 247-248, 258-260).
75 [1904] 1 K.B. 493, at 499-500.

from the destruction of property is to be borne by the owner, so the 'tenant's loss, in this view, is no more unfair than any other destruction of property (by unavoidable casualty) occurring shortly after its purchase from the prior owner; and there is no more reason to shift it in the one case than in the other.'[76] In the end, the basic rule was simple: the courts would not intervene to shift gains and losses from a frustrated contract.[77]

Because of these failures, *Chandler* was overruled by the House of Lords in *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd.* (the *Fibrosa* case).[78] In this case, the plaintiff buyer (a Polish company) had made an advance payment of £1,000 (the contract price was £4,800) for machinery that was to be delivered c.i.f. Gdynia. Before any shipment had been made, the contract was frustrated by the German occupation of Poland. The buyers were entitled to recover the £1,000 as money paid for a consideration which had wholly failed. The rule that because of the total failure of consideration, under a contract which has not been frustrated a party is entitled to claim in restitution the money paid when no part of the counter-performance has been received was also extended when the contract has been frustrated unless the parties have agreed otherwise.[79]

However, it was admitted that 'while this result obviates the harshness with which the previous view (*Chandler*) in some instances treated the party who had made a prepayment, it cannot be regarded as dealing fairly between the parties in all cases, and must sometimes have the result of leaving the recipient who has to return the money at a grave disadvantage. He may have incurred expenses in connection with the partial carrying out of the contract…He may have to repay the money, though he has executed almost the whole of the contractual work, which will be left in his hands.'[80] This defect in the rule could be overcome by authorizing judges to appraise the performance of both parties with the aim being to enforce an equitable composition, but in the view of the House of Lords such an authority could only be conferred by statute.[81]

With regard to the cases where a party has rendered in part some performance other than a payment of money, and after that a partial performance the contract is frustrated by a supervening event, the rule under English common law relies on the nature of the obligation of the performing party. If this obligation is the delivery of goods, and some of the goods were delivered before the contract was frustrated, the other party has to return the goods or to pay the price at the contract rate. On the other hand, if the obligation is to provide services, and after some of the work has been done the contract is frustrated, the other party has to pay nothing (even a proportionate sum) because at the time of the

76 Kull (1991), pp. 26-27.
77 Kull (1991), p. 31.
78 [1943] A.C. 32.
79 Beale H.G. et al., (2001) p. 482.
80 Viscount Simon L.C. in *Fibrosa*,. at pp. 49-50.
81 *Ibid.*; Kull (1991), p. 35. The rule laid down in *Fibrosa* contains another restriction: it only applies where there is a total failure of consideration. If the failure is only partial, under common law none of the advance payments would be recoverable. In the context of frustrated contracts, the rule is represented by *Whincup v Hughes*, (1871) L.R. 6 C.P. 78. See Beale H.G. et al., (2001) p. 484 and Treitel (2004), pp. 591-594.

discharge its liability had not yet accrued.[82] Thus in *Appleby v Myers*[83] it was held that the plaintiffs were not entitled to any payment because 'having contracted to do an entire work for a specific sum, can recover nothing unless the work be done…'[84] so the price had not yet been earned when the contract was frustrated. This rule has also been criticized as unsatisfactory because it can lead to an unjust enrichment of the party who received the partial performance without having to make any payment for this partial performance, especially because it can be applied to situations where the benefit received by partial performance was not destroyed by the frustrating event (as in *Appleby*).[85]

2.4.2. The Law Reform (Frustrated Contracts) Act 1943

The rules examined in the paragraphs above may seem far removed from the civil law concept of the adaptation of a contract, but they are relevant to establish a 'default rule' that can be derived from these decisions: the courts would not intervene to shift gains and losses from a frustrated contract. Accordingly, only the parties can allocate, by means of their express provisions in the contract, the gains and losses derived from an unexpected circumstance which has frustrated the contract.

Because of the criticism, inadequacy or insufficiency of the rules in *Fibrosa* and *Appleby*, they were modified by the Law Reform (Frustrated Contracts) Act 1943. In short, the Act provides that if a contract is frustrated, any sums paid and payable in pursuance of the contract before the time of discharge as well as other benefits conferred for that purpose shall be recoverable, against the retention by the other party of the expenses incurred by him before the time of discharge in, or for the purpose of, the performance of the contract. The standard for the courts in determining such recovery or retention is what the court considers just, having regard to all the circumstances of the case.

Section 1(2) and 1(3) of the Act provides:

> (2) *All sums paid or payable to any party in pursuance of the contract before the time when the parties were so discharged (in this Act referred to as 'the time of discharge') shall, in the case of sums so paid, be recoverable from him as money received by him for the use of the party by whom the sums were paid, and, in the case of sums so payable, cease to be so payable*:
> *Provided that, if the party to whom the sums were so paid or payable incurred expenses before the time of discharge in, or for the purpose of, the performance of the contract,*

82 Beale H.G. et al., (2001), p. 484. See Treitel (2004), p.597, who distinguishes whether the obligation of the performing party is an 'entire' one, i.e. one which must be completely performed before the agreed counter-performance (usually a payment of money) becomes due, as opposed to obligations which provide for payment in instalments as specified stages of the work have been reached.

83 (1867) L.R. 2 C.P. 651.

84 *Ibid.* at 661.

85 Treitel (2004), p. 598, stating that 'the performing party should have a remedy in respect of any unjust enrichment which his partial performance may have conferred on the recipient'.

the court may, if it considers it just to do so having regard to all the circumstances of the case, allow him to retain or, as the case may be, recover the whole or any part of the sums so paid or payable, not being an amount in excess of the expenses so incurred.

(3) *Where any party to the contract has, by reason of anything done by any other party thereto in, or for the purpose of, the performance of the contract, obtained a valuable benefit (other than a payment of money to which the last foregoing subsection applies) before the time of discharge, there shall be recoverable from him by the said other party such sum (if any), not exceeding the value of the said benefit to the party obtaining it, as the court considers just, having regard to all the circumstances of the case and, in particular,*

(a) the amount of any expenses incurred before the time of discharge by the benefited party in, or for the purpose of, the performance of the contract, including any sums paid or payable by him to any other party in pursuance of the contract and retained or recoverable by that party under the last foregoing subsection, and

(b) the effect, in relation to the said benefit, of the circumstances giving rise to the frustration of the contract.

However, the Act has been criticized because it does not provide the courts with the authority to adjust all performance losses, but only in relation to down payments and expenses deducted from such down payments, and because little concrete guidance is given to the courts as to the actual allocation of losses between the parties.[86] It has been said that another weakness of the Act is that reliance loss is taken into consideration only as set off against the return of prepayments or other valuable benefits received in pursuance of the contract, so if a party has not received such payments or benefits, he cannot recover his reliance expenditures.[87] Additionally, the common law rules still apply to cases not covered by the Act, i.e. a contrary agreement between the parties and contracts for the carriage of goods by sea, insurance contracts and contracts for the sale of specific goods where the cause of the frustration is the perishing of the goods.[88]

The principle behind the Act and its limitations were clearly stated by Robert Goff J in *BP Exploration Co. (Libya) Ltd. v Hunt* (No 2)[89]: 'The principle, which is common to both s.1(2) and (3), and indeed is the fundamental principle underlying the Act itself, is prevention of the unjust enrichment of either party to the contract at the other's expense…and indeed is the basic principle of the English Law of restitution, of which the Act forms part…The Act is not designed to do certain things. (i) It is not designed to apportion the loss between the parties…(ii) It is not concerned to put the parties in the position in which they would have been if the contract had been performed. (iii) It is not concerned to restore the parties to

86 Trakman (1984), pp. 481-482.
87 Weiss (1960), p., 1072.
88 1943 Act, section 2(3) and 2(5).
89 [1982] 1 All ER 925.

the position they were in before the contract was made. A remedy designed to prevent unjust enrichment may not achieve that result;...'[90]

As said above, with regard to an adjustment other than a post-discharge apportionment of losses between the parties, English law rejects the notion that the courts have any power under common law to adapt or modify contracts in cases of changed circumstances.[91] However, the effects of some cases can be regarded as similar to a modification or an adaptation of a contract:[92]

- In cases of partial performance (other than a payment of money) before the discharge of the contract, a restitutionary award can be made under s. 1(3) of the Law Reform (Frustrated Contracts) Act 1943. In theory, such an award may exceed the contract price, e.g. if the measure of recovery is the benefit received by the defendant and such benefit exceeds the originally agreed contract price.[93] On the contrary, if the award does not exceed the contract price, it can also imply a 'modification' of the contract because a payment has to be made by one party to the other for less than the performance originally agreed.
- The situation in which performance takes place under a contract after it has been discharged, but before the parties realize this. In that case, the party who has performed is entitled to a *quantum meruit* claim on a restitutionary basis.[94] If the amount recoverable exceeds the contract price, the result is in the end comparable to a modification of the original contract.
- Cases in which a party may have a partial or temporary excuse for non-performance and those in which the principle of *pro rata* allocation would apply if it were recognized by English law. In such cases, contractual obligations can be modified, but only in the sense of reductions and it is not possible to claim for an increase in the counter obligation. Besides, these are not true cases of frustration since it is necessary for its operation that the requirements of frustration are not satisfied.

2.4.3. The rejection of a duty to renegotiate

In this context, the approach of English law to an implied duty to renegotiate is also negative. A link is traced from the (pre)negotiation stage: 'as a general rule, there is no inherent (implied) duty of good faith, loyalty or co-operation between the parties negotiating for a contract, and the parties cannot even create an express legal obligation

90 *Ibid.*
91 Treitel (2004), p. 584, stressing that the only exceptions have been special war legislation.
92 *Ibid.*, pp.585, 586.
93 However, that possibility is doubted by Treitel (2004), p. 585 and in American contract law the Restatement 2nd of Contracts provides in §468(3) that the measure of restitution is 'the benefit derived from the performance…not exceeding, however, a ratable proportion of the contract price'.
94 A *quantum meruit* (Latin, 'as much as he deserved') claim is provided to recover payment for the reasonable value of services rendered, e.g. in cases of quasi-contractual relationships or as an equitable remedy to provide restitution for unjust enrichment. See Black's Law Dictionary (2004).

to conduct their negotiations in good faith'.[95] The main reasons for such a rejection are the lack of certainty in the notion and the content of a duty to negotiate in good faith, and the inherently adversarial position of the negotiating parties. Thus, in the leading English case *Walford v Miles* Lord Ackner stated:[96] 'A duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent with the position of a negotiating party. It is here that the uncertainty lies…There can be thus no obligation to continue to negotiate until there is a 'proper reason' to withdraw. Accordingly, a bare agreement to negotiate has no legal content'.[97]

The same approach is applied to the renegotiation stage. Thus, as a consequence of the absence of a duty to perform in good faith, an implied duty to renegotiate is not accepted in English law. However, the arguments for such a rejection are weaker in the case of express renegotiation clauses. The argument of the inherently adversarial position of the parties finds little support considering the fact that the parties are already in a contractual relationship in which performance has been affected by supervening events, and which the parties have expressly provided for. On the other hand, the argument of a lack of certainty is also weak if there is an express provision stating that the contract should be renegotiated, since then, regarding the facts of the particular case (especially the fact that there is already a contract and a possibility to ascertain reasonable costs and losses derived from the failure of renegotiations) it should be feasible for a court to give specific content to such an express provision and to 'construct criteria to determine what is to be expected of parties engaging in negotiations in good faith…rather than defeating the intentions of the parties by rejecting out of hand the very notion of an obligation to renegotiate.'[98] Recent case law in the context of renegotiation clauses seems to support this approach. In *Petromec Inc v Petroleo Brasileiro SA,*[99] Longmore LJ stated that 'It would be a strong thing to declare unenforceable a clause into which the parties have deliberately and expressly entered…to decide that it has 'no legal content' to use Lorde Ackner's phrase would be for the law deliberately to defeat the reasonable expectations of honest men…'[100]

95 Cartwright (2009b), p. 52.

96 [1992] 2 AC 128, 138 (HL).

97 As Cartwright states, an agreement to negotiate can be saved by the inclusion of an express mechanism of resolution of the controversy in the case of failure of negotiations (*Cable & Wireless plc v IBM United Kingdom Ltd* [2002] EWHC 2059 (Comm), [2002] 2 All ER (Comm) 1041) or if it includes terms which allow the court conclude that the dispute can be resolved by the imposition of reasonable terms (*Foley v Classique Coaches* Ltd [1934] 2 KB 1, 10 (CA)). The author also stresses that 'especially in commercial cases the courts are reluctant to hold that they cannot give effect to the parties clearly expressed agreement. But if there is a simply a bare agreement to negotiate, or to negotiate in good faith, at present the English courts cannot give effect to it'. Cartwright (2009b), pp. 56-57.

98 Cartwright (2009b), p. 67.

99 [2005] EWCA Civ 891, [2006] 1 Lloyd´s Rep 121.

100 American law seems to adopt a different approach with regard to renegotiation clauses. Thus, Farnsworth states that the party who contravene the renegotiation clause 'would at least run the risk of committing a material breach that would give the affected party a right to terminate the contract'. Farnsworth (2004), p. 482.

However, a renegotiation of the contract by the parties has been achieved in some cases through indirect means such as granting the affected party the right to terminate the contract.[101] Thus, in *Staffordshire Area Health Authority v South Staffordshire Waterworks Co.*[102] a contract was entered into in 1929 between a hospital and a waterworks company to the effect that the company would 'at all times hereafter' supply water to the hospital, at prices fixed in the contract. By 1975, the price was clearly inappropriate due to inflation (the cost of supplying water had raised to over 18 times the contract price) and the water company gave notice to the hospital of its intention to terminate the contract after six months. The hospital refused to accept the notice as valid. The first instance judge upheld the hospital's claim, but the Court of Appeal reversed the decision and held that the notice was effective because 'the words 'at all times hereafter' mean that the obligations granted and accepted by the agreement were only intended to persist during the continuance of the agreement; and the agreement…was determinable on reasonable notice at any time'[103] Therefore, the agreement in its true construction was of indefinite duration and in that case a term is implied entitling either party to terminate by reasonable notice.[104] The final outcome of the case was an incentive for the hospital to request that the terms of the original agreement be renegotiated in order to avoid a termination of the contract.[105]

In addition, English common law considered renegotiated agreements to be invalid due to a lack of consideration in the cases which, as a result of the renegotiation, one party merely promised to perform what he was already bound to do under the original contract.[106] However, this doctrine was qualified in *Williams v Roffey Bros. & Nicholls (Contractors) Ltd.*,[107] In this case, the defendants (building contractors) employed the

101 Collins (2003), pp. 362-363.

102 *Staffordshire Area Health Authority v South Staffordshire Waterworks Co*, [1978] 3 All ER 769, Court of Appeal (1978), [1978] 1 W.L.R. 1387.

103 [1978] 1 W.L.R. 1387, at 1407, Cumming-Bruce L.J.

104 Treitel (2004), p. 297. However, as Treitel stresses, the Judges differed in their reasons for allowing the appeal. Lord Denning M.R., in his minority view stated that '…the rule of strict construction is now quite out of date. It has been supplanted by the rule that written instruments are to be construed in relation to the circumstances as they were known to or contemplated by the parties; and that even the plainest words may fall to be modified if events occur which the parties never had in mind and in which they cannot have intended the agreement to operate…' and 'So here the situation has changed so radically since the contract was made 50 years ago that the term of the contract 'at all times hereafter' ceases to bind: and it is open to the court to hold that the contract is determined by reasonable notice.' [1978] 1 W.L.R. 1387, at 1395, 1398.

105 Collins (2003) at p. 342 states that it is an open question in English law whether the effect on the parties' willingness to renegotiate contracts gives the courts an express authority to revise contracts.

106 *Stilk* v. *Myrick*, 2 Camp 317, 6 Esp 29 (1809). In contrast, in American contract law the UCC provides in article §2-209 that 'An agreement modifying a contract within this article needs no consideration to be binding'.

107 *Williams* v. *Roffey Bros. & Nicholls (Contractors) Ltd.*, 1 QB 1 (Eng. C.A. 1991). In the decision, Purchas L.J. stressed that '…the rule in *Stilk* v. *Myrick* remains valid as a matter of principle, namely that a contract not under seal must be supported by consideration. Thus, where the agreement upon which reliance is placed provides that an extra payment is to be made for work to be done by the payee which he is already obliged to perform then unless some other consideration is detected to support the agreement to pay the extra sum that agreement will not be enforceable.', 1 QB 1 (Eng. C.A. 1991), at 21. Another reason for the turn towards a broad concept of consideration was the development by the courts of the doctrine of

plaintiff (a carpenter) as a subcontractor to carry out part of the refurbishing of 27 flats for a housing association. Because of financial problems (mainly caused by the original price for the work being too low), close to the deadline for the delivery of the houses, the plaintiff had only completed the work in nine of the houses. The defendants then promised to pay him an extra amount per completed flat, but after some flats were completed, they refused to pay the new agreed amount. The plaintiff stopped work and brought an action for payment, which was awarded by the first instance judge and confirmed by the Court of Appeal. In its decision, the Court held that the 'practical' benefit obtained by the defendants with the new agreement was valid consideration, despite the fact that the counterparty's obligation was the same as that agreed under the original contract. 'There was clearly a commercial advantage to both sides from a *pragmatic point of view* in reaching the (new) agreement…' because 'As a result of the agreement the defendants secured their position commercially.'[108] In other words, '…performance of a contractual duty owed by the promisee to the promisor can constitute consideration for the new promise if that performance in fact confers a benefit on the promisor.'[109] Therefore, under this pragmatic approach to consideration, if there is no economic duress present in the request for renegotiation by the disadvantaged party (e.g. taking unfair advantage of the problems which will raise if he does not perform his obligations), the new agreement reached by the parties is indeed enforceable.

2.5. Conclusions

Under English law, the doctrine of impossibility as an excuse has remained essentially unchanged since the end of the nineteenth century and, therefore, a party will only be excused in specific and restricted situations from a contractual obligation in the case of events that make the performance impossible. If the consequence of the supervening circumstances is to render the performance *only* excessively burdensome but not impossible, the attitude of the courts has been to deny relief to the affected party on this ground: '[I]t is not hardship or inconvenience or material loss itself which calls the principle of frustration into play. There must be as well such a change in the significance of the obligation that the thing undertaken would, if performed, be a different thing from that contracted for.'[110]

Thus, the so-called *Paradine* principle still applies, and even when 'there has been some broadening of the traditional excuse doctrines, but that has been accomplished through the logical development of those doctrines, rather than by their synthesization into broader theory of excuse and application of that theory to factual patterns not covered by traditional doctrines.'[111]

economic duress to deal with cases in which one party has forced the other to enter into a revision of the agreement to achieve some extra advantage over the original terms. See Beale H.G. et al., (2001), p. 115.

108 Purchas L.J., 1 QB 1 (Eng. C.A. 1991), at 22. Emphasis added.

109 Treitel (2002), p. 22.

110 Lord Radcliffe, *Denny, Mott & Dickson Ltd.* v. *James B. Fraser & Co. Ltd.* [1944] A.C 265, at 274-275.

111 Wladis (1987), p. 1629.

Similar to French law, English common law seems to give extraordinary value to certainty through the prevalence of the principle of the sanctity of contracts 'even though the result of doing so might occasionally appear to be harsh to one of the parties.'[112] As stated by Lord Simonds in the *Tsakiroglou* case, the doctrine of frustration must be applied within very narrow limits.[113] Again, it is not for the courts to establish a doctrine to deal with a change of circumstances in an equitable or just manner, but for the parties in their contracts or for the legislator through specific intervention in times of general economic or social disturbance.

The above statement may be supported by the fact that the foundations or theoretical basis for the doctrine provided in the relevant decisions on the subject tend to justify it from the contract *itself*. Thus, the theory of the implied term or condition as stated in *Taylor v Caldwell* by Blackburn J. tries to give effect to the intention of the parties expressed in an implied condition: the courts would not regard an obligation as absolute if the parties themselves did not intend it to be absolute.[114] Similarly, the true construction theory attempts to justify frustration through the true meaning of the agreement so it is not applicable to the new situation, which is considered to be radically or fundamentally different from what the parties considered at the time of the conclusion of the contract.[115] Then, the courts seem to avoid considerations based on external parameters or values such as equity or justice, although statements stressing the relevance of a just and reasonable result are occasionally laid down in some decisions;[116] the justification of frustration as the just or fair solution has been expressly rejected as inappropriate by the House of lords in the *British Movietonenews* case.[117] Nowadays, the theory of a true construction appears to be the most accepted basis for the doctrine of frustration in English law.[118]

112 Treitel (2004), p. 285.

113 *Tsakiroglou & Co. v Noblee Thorl*, [1962] A.C. 93, at 115.

114 [1916] 2 A.C. 397.

115 See *Davis Contractors Ltd v. Fareham Urban District Council* [1956] A.C. 696.

116 E.g. Lord Sumner in *Hirji Mulji v. Cheong Yue Steamship Co. Ltd*., [1926] A.C. 497, at 510: 'It is really a device, by which the rules as to absolute contracts are reconciled with a special exception which justice demands.'; Denning, L.J., speaking for the Court of Appeal in the *British Movietonenews* case, [1951] 1 K.B. 190 at 200: '[T]he court really exercises a qualifying power - a power to qualify the absolute, literal or wide terms of the contract - in order to do what is just and reasonable in the new situation'; Bingham LJ in *J Lauritzen AS v Wijsmuller BV (The Super Servant Two)*, [1990] 1 Lloyd's Rep. 1 at 8: 'The object of the doctrine was to give effect to the demands of justice, to achieve a just and reasonable result, to do what is reasonable and fair, as an expedient to escape from injustice where such result from enforcement of a contract in its literal terms after a significant change of circumstances.'

117 Viscount Simon expressed the concern of the House of Lords for some expressions of the judgement delivered by the Court of Appeal and then stated in *British Movietonenews,* [1952] A.C. 166 (1951) at 185 that 'The suggestion that an "uncontemplated turn of events" is enough to enable a court to substitute its notion of what is "just and reasonable" for the contract as it stands, even though there is no "frustrating event", appears to be likely to lead to some misunderstanding.' concluding that frustration of the contract as held by the court is 'not because the court in its discretion thinks it just and reasonable to qualify the terms of the contract, but because on its true construction it does not apply in that situation.' In the same sense, Lord Hailsham L.C. in *National Carriers Ltd v Panalpina (Northern) Ltd*, [1981] A.C 675 at 686 stated that the theory of the just and reasonable result 'though it admirably expresses the purpose of the doctrine, it does not provide it with any theoretical basis at all.'

118 A skeptical view with regard to the justification of frustration through an abstract theory was represented by Lord Wilberforce in the *National Carriers* case: 'Various theories have been expressed as to its

The search by the courts for a theoretical basis of the doctrine of frustration is strongly influenced by the necessity to explain it as a departure from the theory of absolute contracts and, therefore, as a qualified exception to the principle of the sanctity of contracts.[119] This may explain the tendency to find the justification in the contract itself, which implies a formal safeguard of such a principle, especially in commercial transactions, where *pacta sunt servanda* is regarded as a superior value than the just solution of a particular case.

Finally, even if the theory of a just and reasonable result would mean that it is the foundation of the doctrine of frustration in English law, its practical importance is severely impaired by the fact that in English common law the frustration of a contract always leads to its automatic and complete discharge. Therefore, even if the intention of the parties, the true construction of the contract or considerations of justice would demonstrate that the better solution is an adjustment of the relationship or an apportionment of losses, the strict application of the doctrine provides no alternative for the outcome of the case: the total discharge of the contract. This is the main obstacle to a proper development of the doctrine in English law: 'Since the effect of frustration is to kill the contract and discharge the parties from any further liability thereunder, the doctrine cannot be hastily invoked, but must be kept within very narrow limits and ought not to be extended.'[120]

3. American law. The doctrine of impracticability

The American doctrine of impracticability or commercial impracticability is derived from the common law doctrine of the impossibility of performance.[121]

This doctrine is widely recognized under American law. Classic textbooks such as that by Williston state that a party may be excused when performance is 'not obtainable except by means and with an expense impracticable in a business sense' and, accordingly, the First Restatement of Contracts provided that 'impossibility means not only strict impossibility but impracticability'.[122]

An interesting feature of American law is that the doctrine of impracticability has been developed not only by case law and legal doctrine, but has also been statutorily recognized in the provisions of the Uniform Commercial Code (section 2-615) and in the not formally binding but highly influential §261 of the Restatement (2nd) of Contracts

justification in law: as a device by which the rules as to absolute contracts are reconciled with a special exception which justice demands, as an implied term, as a matter of construction of the contract, as related to removal of the foundation of the contract, as a total failure of consideration. It is not necessary to attempt selection of any one of these as the true basis: my own view would be that they shade into one another and that a choice between them is a choice of what is most appropriate to the particular contract under consideration.' [1981] A.C 675 at 693.

119 See Treitel (2004), pp. 642-643.

120 Bingham LJ in *J Lauritzen AS v Wijsmuller BV (The Super Servant Two)*, [1990] 1 Lloyd's Rep. 1 at 8.

121 Farnsworth (1981), p. 12.

122 Cited by Nottage (2008), pp. 395-396.

(1981).[123] Therefore, in this chapter not only the case law will be examined, but also the mentioned provisions.

3.1. The concept of impracticability

Impracticability is usually defined as an excused performance by the party that suffers extreme, unreasonable and unforeseeable hardship due to an unavoidable event or occurrence.[124] This definition is based on the official comments to the UCC and the Restatement (2nd).

Thus, §261, Comment d of the Restatement (2nd) states that 'Performance may be impracticable because extreme and unreasonable difficulty, expense, injury, or loss to one of the parties will be involved.' With regard to the UCC, neither section 2-615(a) nor its comments provide a definition of impracticability, but Comment 4 mentions an increase in costs 'due to some unforeseen contingency which alters the essential nature of the performance' and comments 1 and 3 expressly distinguish impracticability from the traditional Common law doctrines of impossibility and frustration of purpose in order to clarify that relief can be granted even though no physical or legal obstacle makes performance impossible.

Nevertheless, it is also stated that the mere fact that performance becomes more expensive or difficult than the parties anticipated is not sufficient to rely on the excuse of impracticability. Then, the problem is to determine when a situation makes performance impracticable. Both the comments of the UCC and the Restatement (2nd) stress the necessity of unforeseen severe difficulties or increases in costs 'well beyond the normal range' for the performance of the affected party to be excused. As mentioned above, Comment 4 of Section 2-615 of the UCC adds that a mere increase in costs does not excuse performance unless the increase in costs is the consequence of some unforeseen contingency which alters the essential nature of the performance. As will be further analyzed, the courts have used different methods to solve the problem, from a simple quantitative measurement of the supervening cost to a more complex qualitative assessment of the entire relationship. However, as will be demonstrated, in such an assessment the courts tend to analyze the cases in question in the light of the requirements for the classic doctrine of impossibility rather than those that may be suitable for a less strict doctrine of commercial impracticability. The consequence of this attitude has been the judicial rejection of most of the affected parties' claims.

Therefore, although impracticability is an available excuse for the debtor, the courts are extremely reluctant to apply it: 'The commercial impracticability doctrine is recognized, but rarely allowed as an excuse for non-performance.'[125] In the same sense, it has been

123 Hereafter the Restatement (2nd).
124 Williston, Lord (1990), §77:11, p. 2.
125 *McGinnis v Cayton*, 312 S.E.2d 765 (W. Va. 1984) at 775 (Harshbarger, J., concurring).

stated that the doctrine 'is frequently invoked, but only rarely and erratically applied.'[126] This approach has been criticized by an important part of the American legal doctrine on the ground that it is not consistent with the text of the UCC, the intent of the drafters and the underlying purposes and policies of the Code.[127]

3.2. Impracticability in the UCC and the Restatement (2nd)

As stated above, the doctrine of impracticability, with regard to the sale of goods, is provided for in section 2-615(a) of the UCC:

> *Excuse by Failure of Presupposed Conditions.*
> *Except to the extent that a seller may have assumed a greater obligation and subject to Section 2-614:*
> *(a) Delay in performance or nonperformance in whole or in part by a seller that complies with paragraphs (b) and (c) is not a breach of the seller's duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.*[128]

The Restatement (2nd) of Contracts (1981) contains a similar rule in §261:[129]

> *Discharge by Supervening Impracticability*
> *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 on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.*

As stated above, neither the UCC nor the Restatement define impracticability in their provisions, but such a concept is derived from their official comments in the sense that performance is impracticable if it can only be rendered with extreme, unreasonable

126 Halpern (1987), p. 1134.
127 Prance (1986), pp. 463-467.
128 Last revised or amended in 2003. Section 2-614 deals with Substituted Performance and paragraphs b) and c) of section 2-615 read as follows: (b) If the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, the seller must allocate production and deliveries among its customers but may at its option include regular customers not then under contract as well as its own requirements for further manufacture. The seller may so allocate in any manner that is fair and reasonable. (c) The seller must notify the buyer seasonably that there will be delay or nonperformance and, if allocation is required under paragraph (b), of the estimated quota thus made available for the buyer.
129 The provision in the Restatement largely relies on the terminology of the UCC, as expressly stated in Comment d. Besides, §261 provides for the general principle of a discharge due to supervening impracticability, and the traditional categories of the common law impossibility are covered in the three following provisions: the supervening death or incapacity of a person necessary for performance (§ 262), supervening destruction of a specific thing necessary for performance (§ 263), and supervening prohibition or prevention by law (§ 264).

and unforeseeable hardship due to an unavoidable event or occurrence.[130] However, the comments are not completely clear with regard to the determination of impracticability. American legal doctrine agrees that the intention of the drafters was to substitute the common law doctrine of impossibility with the doctrine of commercial impracticability as a 'current form of an evolutionary process that has been molded by commercial practices and mores, with the trend being to soften and liberalize the ancient rule of early common law…'[131] Thus, the official comment 3 of section 2-615 states that 'The additional test of commercial impracticability (as contrasted with "impossibility," "frustration of performance" or "frustration of the venture") has been adopted in order to call attention to the commercial character of the criterion chosen by this Article'.[132] In the same sense, comment d of section §261 of the Restatement 2nd stresses that the excuse of supervening impracticability may operate to discharge a party's duty *even though* the event has not made performance absolutely impossible.

According to the text of section 2-615, two basic conditions are needed to establish the excuse of commercial impracticability:[133]

– The performance must have become 'impracticable', and
– Such impracticability must have been caused 'by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made.'

Legal doctrine and the case law, based mainly on the official comments of the section, have included additional requirements such as the fact that the risk of the disruptive event was not allocated explicitly or implicitly to the promisor; and that impracticability must have resulted without any fault on the part of the affected party.[134]

The courts have been extremely strict in the interpretation and application of these conditions, as will be further analysed in detail in the following sections. Nevertheless, in general the assessment of the mentioned conditions has been made in the following way:

a) Based on official comments 1 and 4 of the UCC, which state that impracticability must result from 'unforeseen circumstances not within the contemplation of the parties at the time of contracting' and the rise in costs must be caused by 'some unforeseen contingency which alters the essential nature of the performance', the courts have used a 'foreseeability test' to ascertain the condition that the disruptive event was one that the parties assumed would not occur. Then, if the occurrence of the

130 Williston, Lord (1990), §77:11, p. 2.
131 55 A.L.R. 5th 1, p. 20.
132 That assessment is confirmed by the fact that the destruction of specific goods (one of the classic situations in the English common law of frustration) is covered in a different provision of the UCC (section 2-613). However, section 2-615 applies where a particular source of supply is exclusive under the agreement and fails through casualty (official comment 5, section 2-615).
133 See York (1990), p. 223, with reference to the case law.
134 Halpern (1987), p. 1147; Classen (1990), p. 384, Declercq (1995), p. 218, all with references to the case law.

disruptive event was not reasonably foreseeable, the promisor cannot be presumed to have assumed the risk derived form that event; but if the event was foreseeable and the promisor failed to protect himself by an express contractual provision, he will be deemed to have assumed the risk of the disruptive event.[135] Foreseeability is therefore the criterion by which the courts determine which party has assumed the risk of the occurrence of the contingency event.

Additionally, the courts have applied an objective standard for the foreseeability test, which means that the question is not whether the disruptive event was foreseen but whether it might reasonably have been foreseen under the circumstances.[136] For the excuse to become operational, it is not sufficient that the event was *unforeseen* – it has to be *unforeseeable*.

Finally, the courts have considered the foreseeability test to be dispositive, in the sense that it is analysed *before* examining whether the performance has become impracticable (i.e. severely burdensome). Thus, 'if a contingency is foreseeable, the section 2-615 is unavailable…'[137] and it becomes unnecessary to consider the question of what increase (i.e. the amount thereof) constitutes impracticability.[138]

b) With regard to the assessment of impracticability, a number of methods have been developed by the courts. Those methods will be further examined, but in practice the courts usually only consider a performance to be impracticable if it has become virtually impossible, thereby dealing with the 'Code Impracticability very much like the common law of impossibility'.[139] Thus, extremely supervening increased costs or difficulty does not seem to be enough to excuse the affected party.[140] The official comments require that the affected party is expected to use reasonable efforts to surmount the supervening impediments to performance and may only rely on the excuse if, in spite of such efforts, the performance is still impracticable.[141]

Relating to the effects of the excused performance due to impracticability, official comment 6 of section 2-615 states that 'neither sense nor justice is served by either answer when the issue is posed in flat terms of "excuse" or "no excuse," adjustment under the various provisions of this Article is necessary, especially the sections on good faith.' In the same sense, official comment 11 stresses that the promisor has to perform his obligation 'to the extent which the supervening contingency permits.' These statements reflect the reasoning

135 York (1990), pp. 223-224, citing *Eastern Air Lines, Inc. v McDonnell Douglas Corp.*, 532 F.2d 957 (5th Cir. 1976) at 992: '[The} promisor can protect himself against foreseeable events by means of an express provision in the agreement'.; see also *Waldinger Corp v CRS Group Engineers, Inc.* , 775 F.2d 781 (7th Cir. 1985).

136 Halpern (1987), p.148, citing the litigation in *Westinghouse I* and *II*.

137 *Waldinger Corp v CRS Group Engineers, Inc.* , 775 F.2d 781 (7th Cir. 1985) at 786.

138 *Iowa Electric Light and Power Company v. Atlas Corporation,* 467 F.Supp. 129 (N.D. Iowa, 1978) at 135.

139 Walter (1986), p. 259.

140 The criticisms of both the foreseeability and the impracticability test will be highlighted after the analysis of the case law.

141 Comment d, section §261 Restatement 2nd.

that an automatic and complete discharge of the contract is not always considered to be the best outcome in cases of impracticability. The comments may also be interpreted as giving the courts the power not only to decide on a fair distribution of losses, but also to adapt the terms of a contract for future performance. As will be analysed in Chapter nine, that kind of adaptation has been generally rejected by the American courts.

Section 2-616 confirms the above-mentioned statements and therefore under the norms of the UCC impracticability does not automatically terminate the contract. The affected party must give reasonable notice to the other party before being excused from any remaining obligations to perform and any obligation to pay damages. This excused failure to perform then affects the other party's duties to perform *as if* the excused party had broken the contract. The fact that the contract is still 'alive', regardless of the occurrence of the contingency amounting to impracticability, makes it possible that the duty of good faith may be applied at this stage of the relationship.[142]

Similarly, §272 of the Restatement 2nd makes a number of mitigating doctrines (e.g. restitution, reliance damages) available to the parties so as to avoid the negative effects of the complete discharge of the contract. The provision also allows the courts to supply a term which is reasonable in the circumstances so as to avoid injustice, including the situation of 'salvag[ing] a part of the agreement that is still executory on both sides.'[143]

Under common law rules, a partial performer may recover under the theory of *quasi contract* for the amount of benefit conferred by the incomplete performance. On the other hand, if impracticability prevents performance in its entirety, the affected party is equally completely excused.[144]

Additionally, section 2-615(a) is in principle only applicable to sellers. This scope has been explained because, at least in cases of market movements, the seller's loss is theoretically infinite (prices may rise indefinitely) but the buyer's loss can never exceed the contract price. Comment 9 states that the section may be applied to buyers in exceptional cases 'where the buyer's contract is in reasonable commercial understanding conditioned on a definite and specific venture or assumption.'[145] On the contrary, §261 of the Restatement 2nd is drafted in general terms and is therefore applicable to any of the parties which have been affected by the supervening events.

142 See Nottage (2008).

143 Comment c §272 Restatement 2nd.

144 Williston, Lord (1990) §77:23 p. 3.

145 Thus, in *Nora Springs Coop. Co. v. Brandau*, 247 N.W.2d 744 (Iowa 1976) the court stated that 'While [Iowa's version of the UCC] expressly mentions sellers, the explanations...make it evident the provisions should also be equally applicable to buyers.' Also in *International Minerals & Chemical Corp. v Llano Inc.,* 770 F2d 879, 41 UCC Rep Serv (CBC) 347 (10th Cir 1985), the defence of impracticability was granted to the buyer. Other courts have denied the availability of the defence to buyers on grounds that the relevant jurisdiction had not adopted official comment 9. See *A.L.R.* 5th 1 pp. 27-28.

Finally, it is interesting to note that the parties may even agree to perform in spite of impracticability, therefore assuming greater liability than that provided in section 2-615, but they are not free to completely discard the application of such a provision: 'express agreements as to exemptions designed to enlarge upon or supplant the provisions of this section are to be read in the light of mercantile sense and reason, for this section itself sets up the commercial standard for normal and reasonable interpretation and provides a minimum beyond which agreement may not go.'[146]

3.3. The development of the case law

As stated above, the origins of the doctrine of impracticability are rooted in the doctrine of an excuse due to physical impossibility as stated in *Taylor v. Caldwell*.[147] In the American case which is considered to be the source of the impracticability doctrine, *Mineral Park Land Co. v. Howard*,[148] the relation between the two doctrines was made explicit: 'A thing is impossible in legal contemplation when it is not practicable; and a thing is impracticable when it can only be done at excessive and unreasonable cost.'[149] In this case, the defendants had agreed to remove all the earth and gravel from the plaintiff's land, estimated to be 114,000 cubic yards in size. After clearing a little over 50,000 cubic yards, the defendants stopped because the rest of the earth and gravel were underwater and could only be removed 'at an expense of ten or twelve times as much as the usual cost per yard.' The California Supreme Court reversed the decision of the lower court and excused the defendants, stating that the mere fact that performance had become more expensive or unprofitable is not a ground to excuse the promisor; but that, as in this case, the difference in costs was so great as to have the effect of making performance impracticable so that the promisor could be excused.[150] It has been stated that even when the doctrine of this case is clear and simple, its usefulness is weak because it provides little guidance on its application in complex commercial situations, especially in relation to the quantification of impracticability.[151]

3.3.1. The methods for determining impracticability

Since *Mineral Park*, the courts have resorted to a number of methods to determine impracticability. The simplest is a mere quantitative analysis, as in the above-mentioned

146 Official comment 8, section 2-615. The comment adds that the extension of the liability of the promisor may also be implicit according to the particular circumstances, e.g. based on trade usage applicable to the contract.

147 Section 2-613 of the U.C.C. is considered as a statutory recognition of the common law doctrine with regard to physical impossibility.

148 172 Cal. 289, 156 P. 458 (1916).

149 Judge Sloss, *Ibid*. at 293, 156 P. at 460.

150 With regard to *Mineral Park*, Treitel states that this is truly a case of *antecedent* (rather than *supervening*) impossibility, covered in English law under the doctrine of mistake rather than frustration. See Treitel (2004), pp. 263-265.

151 Halpern (1987), pp.1133-1134. Similarly, it has been stated that 'the doctrine of commercial impracticability is easy to state and difficult to apply', Walt (1990).

case: the amount of the loss in relation to the original contracting conditions which makes performance impracticable. Then, 'a formidable line of cases has followed the litany of quantification, finding that increases costs alone, and particularly cost due to market fluctuations, will not provide the basis for relief without a finding that such costs are "excessive" or extraordinarily high.'[152]

In some cases the courts have used this quantitative analysis in a narrow sense, i.e. only examining the contract at issue, as in *Asphalt International, Inc. v. Enterprise Shipping Corp*. where the owner of a tanker was excused from performing a charter party agreement when the vessel had been rammed amidships while being loaded and which was treated as a total loss by its owner because the tanker could only be repaired at an 'excessive and unreasonable cost' (the $1,500,000 in question far exceeded the $750,000 pre-collision fair market value of the vessel). The court stated that the owner could enjoy the defence of impracticability even though it suffered no financial hardship but, rather, received a windfall profit by virtue of the insurance proceeds it collected because 'the doctrine of commercial impracticability focuses on the reasonableness of the expenditure at issue, not upon the ability of a party to pay the commercially unreasonable expense.'[153] A similar assessment was made in the *Alcoa* case, where the court established the losses of Alcoa only in relation to the performance of the particular contract with Essex, thereby discarding other parameters such as its overall financial condition or its position in the aluminum market.[154]

The criterion of the quantification of any increased costs was also considered by the courts to reject an excuse by the affected party in the American cases relating to the closure of the Suez Canal in 1956. Thus, in *Transatlantic Financing Corporation v. United States*,[155] the increased cost of $44,000 over and above the contract price of $305,000 did not amount to impracticability.[156] Similarly, in *American Trading & Products Corp. V. Shell International Marine Ltd*. the same line of reasoning was followed.[157] As in the English Suez cases, the

152 Halpern (1987), p. 1138 (citations omitted).

153 667 F.2d 261 at 266.

154 499 F. Supp. 53 (W.D. Pa. 1980). See Halpern (1987), pp. 1134-1135. The *Alcoa* case will be discussed in detail below.

155 363 F.2d 312 (D.C. Cir 1966).

156 'While it may be an overstatement to say that increased cost and difficulty of performance never constitute impracticability, to justify relief there must be more of a variation between expected cost and the cost of performing by an available alternative than is present in this case, where the promisor can legitimately be presumed to have accepted some degree of abnormal risk, and where impracticability is urged on the basis of added expense alone' 363 F.2d 312 at 319 (citations omitted). The decision cited the English Suez cases to support its conclusion. See also *Natus Corp. v. United States* where the court stated that relief on grounds of impracticability is allowed when performance would be *economically unrealistic*; 371 F.2d 450, 457 (Ct. Cl. 1967), cited by Prance (1986), p. 472, note 55.

157 453 F.2d 939 (2d Cir. 1972) at 942: '[I]t is urged that American law recognizes that performance is rendered impossible if it can only be accomplished with extreme and unreasonable difficulty, expense, injury or loss. There is no extreme or unreasonable difficulty apparent here. The alternate route taken was well recognized, and there is no claim that the vessel or the crew or the nature of the cargo made the route actually taken unreasonably difficult, dangerous or onerous'. In this case, the claim was for an extra pay-

court also stressed the nature of the cargo as being relevant for finding that there was no frustration.

Conversely, the quantification of impracticability was the main ground for granting relief in *Florida Power & Light Co. v. Westinghouse Electric Corp*.[158] In this case the plaintiff sought damages for the breach of a contract which it had with the defendant for the removal and disposal of spent nuclear fuel. At the time of the contract, the government had a programme in place for the reprocessing of spent nuclear fuel which was discontinued after the contract was signed. As a consequence, the fulfilment of the contract for the defendant would have resulted in a loss over $80 million, against an anticipated profit of $20 million. The court held that Westinghouse could be excused from performing the contract on the ground that the discontinuation of the reprocessing of commercial nuclear plants by the Federal Government was unforeseeable, and because the alternative performance 'represents an unreasonable and excessive cost to Westinghouse.'[159]

On the other hand, for the quantification of impracticability some courts have analyzed the entire context of the transaction, including the impact of the alleged onerosity on the economic situation of the promisor, its relative position on the market and even its related contracts with third parties. Thus in *Westinghouse I* and *Westinghouse II* the court stated that 'impracticability by reason of additional expense is not to be determined by reference to the loss, or failure, or profit, from one particular contract term in isolation. Rather, it is to be judged from the perspective of the entire undertaking.'[160] Thus, the court examined the complete context of the contract, including the benefits for Westinghouse during the period of performing the contract. As a conclusion, the court found that the projected losses for Westinghouse deriving from the performance of the contract were not so excessive as to make performance impracticable in the particular case.[161] The overall profits of the affected party were taken into account by the court in its decision in *Louisiana Power & Light Co. v. Allegheny Ludlum Industries Inc.*[162] In that case, the court stated, while examining the defendant's overall profits, that an increase of 38% in the price under the contract was not enough to provide relief on the ground of section 2-615(a) of the UCC.[163]

ment of $132,000 over and above the $417,000 agreed in the contract. The English Suez cases were also cited as a source of authority.

158 826 F. 2d 239 (1987).

159 *Ibid*. at 277. The court also stressed at 276 that the alternative method of performance (storing the spent fuel) 'is an entirely different scenario, with tremendously increased costs of performance and with a means of performance not contemplated or intended by the parties...'

160 *Westinghouse I*, 517 F. Supp. 440 (E.D. Va. 1981) and *Westinghouse II*, 597 F. Supp. 1456 (E.D. Va. 1984).

161 The court stated that the costs 'might be sufficient to constitute impracticability in another context' but that such costs were not unacceptable because they were 'just under 50% of total contract revenues'. *Westinghouse I*, 517 F. Supp. at 454 and *Westinghouse II*, 597 F. Supp. at 1477.

162 517 F. Supp. 1319 (E.D. La. 1981).

163 Thus, the decision stressed that '[T]hat had Allegheny performed under the contract as written, it would have sustained a loss of $428,500 on the contract and that the planned profitability of the Wallingford plant [property of Allegheny and supplier of the condenser tubing object of the contract] would have been reduced to an overall profit of $589,500 for the year of performance…There are also no facts which

Similarly, in *Eastern Airlines Inc. v. Gulf Oil Corp*.[164] Gulf sought a price increase in a contract for the delivery of jet fuel based on the sharp increase in oil prices due to the energy crisis of 1973. Eastern rejected any price increase and sued Gulf for breach of contract. One of the defences raised by Gulf was commercial impracticability under section 2-615 of the UCC. One of the grounds which the court used to allow the claim and to reject the impracticability defence was that Gulf had increased its profits in 1974 by more than 25% and therefore it could cover its losses by other market transactions.[165]

The position of the party in the relevant market was also considered as one of the grounds to deny relief in *Iowa Electric Light and Power Company v. Atlas Corporation*[166] where it was stated that the seller's increase in production costs of between 50% to 58% above the contract price did not entitle it to be discharged from or to adjust the contract based on the theory that its performance had become commercially impracticable, especially where the seller was in a position to protect itself to some extent by entering into new profitable contracts with other buyers

The expansive approach to the quantification of impracticability has been contended because it 'raises serious obstacles to consistency in the application of the doctrine' in the sense that it entails enormous process costs in litigation and has only an ad-hoc value limited to the particular facts of each case.[167] Similarly, without regard to the outcome of the particular cases, the approach of the courts in most of the cases where the amount of the increased costs formed the foundation of the decisions has been criticized as it has 'virtually no precedential value because it is utterly unclear at which point the court will draw the line of impracticability and decide where seller's discomfort is sufficient.'[168]

Another approach to determining impracticability is a *qualitative* examination of the affected performance: 'The emphasis should be on the degree to which performance has been made different, rather than upon the degree of financial hardship suffered.'[169] Then the question for the court changes from 'how much' to 'how different' the performance has become after the occurrence of the disruptive events. The inconvenience of appealing to criteria which are external to the contract (such as the financial position of the party in question) is thereby avoided.[170] Thus, in *Eastern Air Lines, Inc. v. McDonnell Douglas*

indicate that Allegheny would have been unprofitable during 1976 in either its overall corporate structure or in its Wallingford Tubular Division had it performed under the contract as written.' 517 F. Supp. 1319 (E.D. La. 1981) at 1324.

164 415 F. Supp. 429 (1975).

165 Supporting this approach, Treitel states that 'large-scale enterprises…are capable of turning steep price-rises to their *general* advantage; and accordingly the mere fact that they suffer losses on *individual* contracts should not be a ground for discharging those contracts.' Treitel (2004), p. 269.

166 467 F.Supp. 129 (N.D. Iowa, 1978).

167 Halpern (1987), p. 1137.

168 Prance (1986), p. 474.

169 Speidel (1980), p. 266.

170 Halpern (1987), p. 1139.

Corp.[171] the court stated that 'The rationale for the doctrine of impracticability is that the circumstance causing the breach has made performance so vitally different from what was anticipated that the contract cannot reasonably be thought to govern.'[172]

The same reasoning was applied in *Asphalt International, Inc. v. Enterprise Shipping Corp.* where the court analyzed whether the disruptive events 'would alter the essential nature of the contract'[173] and this also applied in *International Minerals & Chemical Corp. v. Llano, Inc.* In the latter case, Llano (the seller) and IMC (the buyer) concluded a sales contract in 1972 for the supply and delivery of natural gas for ten years. The contract contained a 'take or pay' clause, by which the buyer could perform in one of two ways; it could either take the minimum purchase obligation for natural gas and pay, or, if the buyer did not take this minimum amount, it was obliged to pay for the minimum amount of gas anyway. Due to a supervening governmental regulation, the buyer was forced to change its methods of production which led to a decrease in its requirements for natural gas under the minimum agreed amount. Therefore, IMC did not take its obliged minimum amount of natural gas during the last eighteen months that the contract was in effect (January, 1981-June, 1982). Based on these facts, IMC brought an action seeking a declaratory judgment to the effect that it was excused from its obligation to pay for natural gas under a 'take or pay' contract, and Llano counterclaimed for the amount it claimed it was due under the contract. The Court of Appeals found in favour of IMC based on an adjustment clause that provided for a reduction in the buyer's minimum purchase obligation as well as its minimum bill obligation in the event that the buyer was unable to receive gas as provided in the contract for any reason which was beyond the reasonable control of the parties. The court stated that the term 'unable' might be construed in light of common law and the New Mexico Uniform Commercial Code 1978, § 55-2-615 (equivalent to section 2-615 of the UCC) and was therefore considered to be synonymous with 'impracticable'. For the determination of impracticability, the court relied on a qualitative approach: 'The important question is whether an unanticipated circumstance has made performance of the promise vitally different from what should reasonably have been within the contemplation of both parties when they entered into the contract. If so, the risk should not fairly be thrown upon the promisor.'[174]

3.3.2. The foreseeability standard

The requirement of a standard to determine the allocation of risks when the contract was silent with regard to the consequences of disruptive events for performance led the courts to developed 'a doctrine of commercial impracticability that combines the quantification of impracticability with the judicially imposed standard of foreseeability as a mirror of intent.'[175] Thus, the courts constructed the intent of the parties regarding the allocation

171 532 F.2d 957 (5th Cir. 1976).
172 Halpern (1987), p. 991, Williston, Lord (1990), §77:16.
173 667 F.2d 261 at 266.
174 770 F2d 879, 886, quoting *Wood v. Bartolino,* 48 N.M. 175, 146 P.2d 883, 886, (1944).
175 Halpern (1987), p. 1140.

of risks in cases of contract silence through the concept of foreseeability, a fiction which replaces the 'implied condition' of the impossibility doctrine.

Initially, the concept of foreseeability was considered as one of the criteria for determining impracticability, just as the magnitude of the loss or difficulty. However, foreseeability has recently been elevated to being the decisive and prior standard for the establishment of impracticability as an excuse. As stated before, the foreseeability test is considered by the courts as a fundamental indication of the intention of the parties with regard to the distribution of the contractual risks. Thus, it has been held that 'The applicability of the defence of commercial impracticability…turns largely on foreseeability…If the risk of the occurrence of the contingency was unforeseeable, the seller cannot be said to have assumed that risk. If the risk…was foreseeable, that risk is tacitly assigned to the seller…'[176] The unavailability of the defence for the promisor is based on the presumption that he might have contractually protected himself against the effects of the (foreseeable) disruptive event. In addition, a positive answer to the foreseeability question is in itself dispositive: '[W]here the occurrence complained of are some degree foreseeable…it becomes unnecessary to reach the question of how much increase constitutes impracticability.'[177]

Further, as mentioned previously, the foreseeability test is measured by the courts through an objective standard. Then, the relevant issue is whether the event was *foreseeable* (i.e. that the parties could have foreseen the event as a possibility) and not whether the event was *foreseen* (i.e. that the parties actually foresaw a certain contingency).[178]

Along these lines, a bulk of cases have also denied relief because the circumstances which rendered the performance burdensome (the 'contingency' in UCC words) were not considered to have been unforeseen or unforeseeable for the affected party.

Thus, in *Maple Farms, Inc. v. The City of Elmira School District*,[179] the claimant contracted to supply and deliver milk to a school district for one school year at a fixed price per half pint. Six months after the contract was granted, the mandated price of raw milk had risen by 23%, with the net result that the cost to the claimant of delivering half a pint of milk to the school had increased by 10.4% over its agreed price. The court rejected the claim stating that the contingency was 'not totally unexpected' for the claimant and added that is of the essence in a fixed price contract to place the risk of increased prices firmly in the hands of the seller.[180] Similarly, in *Security Sewage Equipment Co. v. McFerren*[181] the court

176 775 F.2d 781 (7th Cir. 1985) at 786 (citations omitted).
177 *Iowa Electric*, 467 F. Supp. at 135.
178 Halpern (1987) p. 1148, citing the litigation in *Westinghouse* I and II; York (1990) p. 224. See *Bende and Sons, inc. v. Crown Recreation, Inc*., 548 F. Supp. 1018 (E D NY 1982) at 1022: 'the foreseeability requirement does not entail contemplation of a specific contingency; rather, it is sufficient that the contingency that eventually occurred could have been foreseen as a real possibility that would affect performance.'
179 76 Misc. 2d 1080, 352 N.Y.S. 2d 784 (1974).
180 However, it has to be conceded that the increase in costs did not amount to impracticability in a commercial sense.
181 14 Ohio St. 2d 251, 237 N.E.2d 898 (1968).

stated that only an event which is 'unforeseen and unusual' is capable of discharging the affected party.

The allocation of the risk to the seller derived from a price escalator provision was also the main reason to deny relief in *Publicker Industries, Inc. v. Union Carbide Corp*.[182] and in *Missouri Public Service Co. v. Peabody Coal Co*.[183] In both cases, the Arab oil embargo of 1972 led to an increase in production costs for the seller (just under 100% in *Publicker* and more than 50% in *Missouri*). Again, in both cases the courts stated that the presence of a price escalator clause was conclusive evidence that the parties had contractually allocated the risk of all cost increases to the seller, whether or not the increased costs fell under the escalator or outran it thereby making the performance extremely unprofitable.[184] Finally, the courts also stated in both cases that the Arab oil embargo was not a contingency which complied with the standard required by section 2-615(a) because it was foreseeable.[185]

The determination of the allocation of risk through the contract clauses related to the price has also been used in cases in which the buyer has claimed relief because the market value of the goods in question had fallen. Thus, in *Hancock Paper Co. v. Champion International Corp*.[186] the decision stressed that a drop in market prices, even if caused by one of the parties to a prior contract, was not a 'supervening impossibility' but merely an 'unanticipated difficulty'. The court, relying on Comment 4 to section 2-615, added that the decrease in the market price was 'exactly the sort of risk which a fixed price contract was intended to cover', but it did not definitively discard the possibility of relief in such a case: in the case at hand, the decrease did 'not reach the level of severity required to excuse performance under either the Restatement or the UCC.'[187]

Similarly, in *Northern Illinois Gas Co. v. Energy Co-operative Inc*.[188] in 1973 a long-term supply contract for naphtha was concluded between NI-Gas (the buyer, a public utility company which distributed natural gas to customers) and Energy Co (the seller-supplier). At the beginning of 1980 it became apparent to NI-Gas that the demand for natural gas was decreasing while the price of naphtha was steadily increasing. These changes were essentially caused by the federal decontrol of natural gas supplies in 1978 and increases in the price of crude oil which determined the price charged for naphtha. On March 17, 1980, NI-Gas filed a suit seeking a declaratory judgment to the effect that it had no

182 17 U.C.C. Rep. Serv. (Callaghan) 989 (E.D. Pa. 1975).
183 583 S.W.2d 721 (Mo. Ct. App. 1979), *cert. denied*, 444 U.S. 865 (1979).
184 In *Publicker* there was a cap on the price escalator, which was not the case in *Missouri*.
185 'Such a possibility [the oil embargo] was common knowledge and had been thoroughly discussed and recognized for many years by our government, media economists and business, and the fact that the embargo was imposed during the term of the contract here involved was foreseeable.' *Peabody* case at 728. In *Eastern Airlines Inc. v. Gulf Oil Corp*. the same reasoning was followed by the court: the claim was rejected *inter alia* because of the existence of a price escalator clause and the foreseeability of the Arab oil embargo.
186 424 F. Supp. 285 (1975).
187 *Ibid*. at 290.
188 461 N.E. 2d 1049 (1984).

further obligations under the contract. The court relied on a number of grounds to reject the buyer's claim. With regard to foreseeability, the court stated that 'the question of whether the non-occurrence of an event was a basic contract assumption is a question of foreseeability'[189] and, furthermore, in the particular case and most importantly, in general, fluctuations in the market prices of oil and gas, which might adversely affect either party, must be regarded as foreseeable. Additionally, the court relied on two contractual clauses: the 'take or pay' clause, which was interpreted as an assumption for the buyer to guarantee performance regardless of its necessities for the seller's product; and the 'flexible pricing' clause, which demonstrated the intention of the parties to protect themselves from the risks of market variations.

Again, in *Northern Indiana Public Service Co. v. Carbon County Coal Co*.[190] a public utility company (NIPSCO) filed a suit seeking a declaration that it was excused from its obligations under a long-term (20-year) fixed-price coal contract concluded in 1978 because after five years it was able to buy electricity at prices below the costs of generating electricity from coal bought under the contract with Carbon County. Thus, in 1983 NIPSCO requested permission to raise its rates to reflect the increased fuel charges. Some NIPSCO customers opposed the increase on the ground that NIPSCO could reduce its overall costs by buying more electrical power from neighbouring utilities and then reselling it to its customers, thereby producing less of its own power, and the Indiana Public Commission stated that the adverse effects of the long-term coal supply contracts had to be borne by NIPSCO and not by its customers. However, the court recognized the possibility that a buyer might also be discharged by the common law doctrine of frustration (outside but analogous to that of section 2-615), but the claim was rejected because of the existence of the fixed minimum price clause which for the court expressly burdened the buyer with the risk of any reduction in the value of the goods beyond such a minimum.[191] The court stated that 'Since impossibility and related doctrines are devices for shifting risk in accordance with the parties' presumed intentions, which are to minimize the costs of contract performance, one of which is the disutility created by risk, they have no place when the contract explicitly assigns a particular risk to one party or the other. As we have already noted, a fixed-price contract is an explicit assignment of the risk of market price increases to the seller and the risk of market price decreases to the buyer, and the assignment of the latter risk to the buyer is even clearer where, as in this case, the contract places a floor under price but allows for escalation.'[192]

189 *Ibid*. at 954, citing *Eastern Air Lines v. Gulf Oil Corp.*

190 799 F. 2d 265 (1986).

191 The court added that the existence of a price escalator demonstrated that the price could increase over the fixed minimum but could not be reduced beyond such a minimum. Besides, as well as in this case, the reliance on the doctrine of frustration of purpose and on a *force majeure* clause failed since the buyers could still use the goods for their intended purpose, but to do so was unprofitable because they were impeded from increasing their rates.

192 799 F. 2d 265 (1986) at 278.

The trend of the courts seems clear: the existence of a fixed-price contract will exclude the claims of the parties based on market price variations, even if such variations are serious and unexpected. Similarly, a price escalator which places a ceiling on contract price increases is considered as placing the risk of a substantial increase in costs on the seller; and a price escalator with a fixed minimum will place the risks of substantial price decreases on the buyer. Such reasoning seems to leave no room for excusing the affected party who always has to bear the risk of a supervening change of circumstances.

The foreseeability standard was also the ground for denying relief to the seller in *Iowa Elec. Light & Power Co. v Atlas Corp*. In this case the court stated that '*Before* reaching the question of impracticability…the court must consider whether the non-occurrence of contingencies complained of were at the heart of the contract, that is, were they foreseeable.'[193] The court concluded that some of the contingencies alleged by Atlas were to some degree foreseeable and capable of being contractually protected against and were to some extent a consequence of internal corporate decisions. However, the court also conceded that part of the supervening burdensome increase in production costs was a consequence of unforeseen circumstances and, due to the fact that it was impossible to determine the proportion of the increase due to these unforeseen circumstances, the doctrine of impracticability could not be applied. The aim of the courts to restrict the application of the impracticability defence through the foreseeability standard was expressly stated by the court in *Barbarossa and Sons, Inc. v. Iten Chevrolet, Inc.*:[194] 'The second requirement of section 2-615, *similar to the common law impossibility* defence, concerns the determination of whether the risk of the given contingency was so unusual or unforeseen…'

Nevertheless, it is also true that the seller has been discharged by the courts in some significant decisions, such as in *Eastern Air Lines, Inc. v. McDonnell Douglas Corp.*,[195] and *Alcoa*[196]

In the first case, the seller (McDonnell) was excused from paying damages for the late delivery of commercial aircraft to Eastern. One of the reasons argued by the seller for the late delivery was the governmental policy which pressurized commercial companies to give preference to military aircraft for the Air Force due to the Vietnam War. However, the court relied on a contractual clause for 'excusable delay' to grant relief to MacDonnell. In general the court stated that the seller was entitled to raise any defence available to it under the impracticability doctrine found in U.C.C. section 2-615 and then 'the provision of the excusable delay clause exempting McDonnell from liability for delays beyond its control should be interpreted as incorporating the Code's commercial impracticability doctrine…a promisor can protect himself against foreseeable events by means of an express

193 467 F. Supp.129 (N.D. Iowa 1978) at 134.
194 265 N.W.2d 655 (Minn. 1978).
195 532 F.2d 957 (5th Cir. 1976).
196 499 F. Supp. 53 (W.D. Pa. 1980). The Alcoa case will be discussed in detail below with regard to the adaptation of contract by the courts.

provision in the agreement. Therefore, when the promisor has anticipated a particular event by specifically providing for it in a contract, he should be relieved of liability for the occurrence of such event regardless of whether it was foreseeable… In this case, it is clear that Eastern specifically "contemplated and voluntarily assumed" the risk that deliveries would be delayed by governmental acts, priorities, regulations or orders.'[197]

3.3.3. The criticism concerning the foreseeability standard

The primacy of foreseeability as the decisive factor in establishing impracticability has been criticized by legal doctrine and even in some judicial decisions. In general, it is considered that 'The requirement is impossible to satisfy under any reasonable reading of "unforeseen" or "unforeseeable," because few things are "unforeseen" and nothing is "unforeseeable.'"[198]

Thus, it is stressed that the fact that a contingency or event was foreseeable does not necessarily demonstrate the intention of the parties with regard to the allocation of risks in such a contingency.[199] The automatic conclusion of the courts that if a contingency was foreseeable (and not only foreseen) and not provided in the contract as an excusable event for the promisor then the intent of the parties was to assign the risk of such a contingency to the promisor has been criticised as being unrealistic and fictional.[200] There can be several reasons why the parties do not provide expressly for a contingency in the contract, especially from the perspective of additional transaction costs which are required to include the event in the contract, e.g. the time required to negotiate the terms of the inclusion of the contingency or the necessity for commercial parties to conclude an agreement expeditiously. Even if the parties are unable to agree about the distribution of the risks of a certain contingency, they may want to conclude the contract anyway. It is impractical to require and expect that the parties might be aware of and to have discussed all the contingencies that may affect the performance of the contract, and even more unreasonable to expect that they are going to expressly provide for such contingencies in the contract.[201]

The foreseeability test has also been criticised as being ambiguous because the finding of the foreseeability of a certain event is related to the degree of specificity or generality by which the event is examined by the court.[202] Thus, the more general the inquiry by the court, the more likely it is that the contingency will be deemed foreseeable.

197 *Ibid.* at 991-992.
198 Prance (1986).
199 Halpern (1987), p. 1144.
200 York (1990), p. 231.
201 See Sirianni (1981). In the same sense, comment c of §261 of the Restatement 2nd states that 'Factors such as the practical difficulty of reaching agreement on the myriad of conceivable terms of a complex agreement may excuse a failure to deal with improbable contingencies.'
202 See Sirianni (1981), p. 58, and York (1990), p. 232.

Finally, the foreseeability test has been considered inadequate to determine the real intention of the parties because the disruptive event is analyzed by the court *ex post*, with *all* the information about a certain event being available. There is a possibility that hindsight may influence the court's decision and therefore 'possibilities which seemed remote to the parties at the time of contracting may appear to have been patently foreseeable *ex ante*.'[203]

3.4. Frustration of purpose in American law

Under American contract law, the doctrine of frustration of purpose is usually also generally addressed as *frustration* or *commercial frustration*. Section 2-615 of the UCC does not expressly regulate this doctrine but part of the legal literature and some judicial decisions have construed the provision to include such a doctrine. Official comment 9 is cited in support of this interpretation in the sense that the situation described in the comment to grant relief to the buyer is typically a case of frustration of purpose.[204]

Frustration of purpose is expressly provided for in Section §265 of the Restatement (2nd) of Contracts under the title 'Discharge by Supervening Frustration': *Where, after a contract is made, a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary.*

In general, legal literature and case law have stated that three elements are required for the operation of the doctrine of commercial frustration: (1) the purpose that is frustrated must have been the *principal* purpose of that party in making the contract; (2) the frustration must be *substantial*; and (3) the non-occurrence of the frustrating event must have been a basic assumption on which the contract was made.[205]

As stated before, relief on the ground of impracticability is rarely granted by the American courts, and the same can be said in cases of frustration of purpose where 'discharge of a party's obligations under this doctrine...has been limited to situations in which a virtually cataclysmic, wholly unforeseeable event, renders the contract valueless to one party.'[206]

However, in some cases a party has been excused when the main purpose of the contract has been frustrated. Thus in *La Cumbre Golf & Country Club v. Santa Barbara Hotel Co.*,[207] a hotel was excused from paying the agreed monthly fee to a country club which had

203 York (1990), p. 234.
204 Official comment 9 states that where the buyer's contract 'is in a reasonable commercial understanding conditioned on a definite and specific venture or assumption… the reason of the present section may well apply and entitle the buyer to the exemption'.
205 Williston, Lord (1990), §77:12 p.1; *Chase Precast Corp. v. John J. Paonessa Co., Inc.*, 409 Mass. 371, 566 N.E.2d 603 (1991), *State v. Boley*, 279 Kan. 989, 113 P.3d 248 (2005).
206 *United States v. General Douglas MacArthur Senior Village, Inc.* 508 F.2d 377 (2nd Cir. 1974) at 381.
207 205 Cal. 422, 271 P. 476 (1928)

extended golfing privileges to the guests of the hotel for a fixed term. After the hotel was destroyed by an accidental fire, the owners sought to be relieved from the agreement. The court upheld the claim stating that the agreement was subject to an implied condition that the hotel continued to have guests. Likewise, in *Parrish v. Straton Cripple Creek Mining & Development Co.*,[208] a trucking company agreed with a mining company to haul all of the coal from one of the promisor's mines which was destined for a specific milling company. Shortly after concluding the agreement, the milling company became bankrupt and consequently the mining company terminated the agreement with the trucking company, which sued for breach of contract. The court dismissed the claim and excused the mining company from any breach and any resultant liability on the ground that the contract was subject to the implied condition, assumed by both parties, that the milling company would continue to operate.

3.5. The effects of impracticability

As stated before, maybe because the usual remedy for impracticability and frustration of purpose is an excuse for further performance, despite the availability of a range of loss-sharing remedies in the UCC and the Restatement (2nd) of Contracts, 'judges historically have refused to spread the burden of a contract discharged because its performance has been rendered commercially impracticable'.[209] Nevertheless, it has been argued that American common law has adopted a more liberal approach than English common law regarding restitution to adjust losses in these cases.[210] In the same sense, the existence of a duty to renegotiate has been also proposed as an effect of change of circumstances. Both subjects will be analysed on the following paragraphs.

3.5.1. Renegotiation of the contract

American legal doctrine has argued for the existence of a duty to renegotiate for the advantaged party when the performance of the other party has become severely burdensome. The main grounds for that statement are the existence of the duty of good faith in performance and the necessary cooperation and flexibility imposed on the parties in the context of (particularly) long-term relationships.[211]

However, the academic efforts to support the existence of ex post bargaining duties have been not followed by American case law. In *Louisiana Power & Light Co.* v. *Allegheny Ludlum Industries, Inc.*[212] Louisiana Power entered into a contract with Allegheny in which the latter agreed to supply condenser tubing to the former for three nuclear plants. Before the time of delivery, Allegheny sent a letter seeking additional compensation for the performance under the contract because of a substantial increase in its costs and suggesting

208 116, F. 2nd 207 (10th Cir.), *cert denied*, 312 U.S. 698 (1940).
209 Trakman (1984).
210 Kull (1991), p. 33.
211 These grounds will be analyzed in detail in the Chapter on Renegotiation.
212 517 F.Supp. 1319 (D.C.La., 1981)

a renegotiation of the contract price. Louisiana Power chose not to meet with Allegheny to discuss the matter. Finally, after rejecting an offer by Allegheny to supply the tubing at Allegheny's full costs (a higher price than agreed) and given the non-performance by Allegheny, Louisiana Power entered into a new contract with another vendor for the supply of the required condenser tubing and sued Allegheny to recover the monetary difference between the Louisiana Power/Allegheny contract and the contract with the new vendor, plus the expenses which it had incurred in the re-solicitation of bids for the tubing. One of the defences raised by Allegheny was bad faith by Louisiana Power in refusing to agree to a meeting in a timely fashion to discuss the renegotiation of the contract. In this regard, the court stated that the buyer had no legal obligation which would have required it to engage in a renegotiation or even to discuss a renegotiation of its contract with the seller and cited *Missouri Pub. Serv. Co. v Peabody Coal Co*. to support the decision.[213] Similarly, in *Ehredt Underground Inc. v. Commonwealth Edison Co.*[214] it was held that a party was not bound to renegotiate the contract, notwithstanding any change in circumstances.

3.5.2. Adjustment of contract

In a limited number of cases, the courts have split the losses between the parties after the contract was fully performed, and although restitution and reliance damages can be granted in cases of commercial impracticability, these remedies can be insufficient to return the parties to their position before the contract was concluded.[215]

Court intervention may be supported by the texts of the UCC and the Restatement (2nd) of Contracts. Thus, Comments 6 and 7 attached to section 2-615 of the UCC state that 'neither sense nor justice' is served by an either/or answer to discharge, and changed circumstances may 'require…a good faith inquiry seeking a readjustment of the contract terms'. Other sections of Article 2 allow the courts to 'make' contracts for the parties: sections 2-308, 2-309 (gap filling), section 2-302 (permitting the court to carve up unconscionable contracts), section 2-716 (authorizing orders of specific performance subject to terms which the court views as 'just').[216]

The application, by analogy, of section 2-719 of the UCC and Article 2's general approach to performance and adjustment have also been used to justify an equitable adjustment

213 'Where an enforceable, untainted contract exists, refusing modification of price and seeking specific performance of valid covenants does not constitute bad faith or breach of contract.' 583 S.W. 2d 721 at 725 (Mo.App.1979), *cert. denied*. 444 U.S. 865, 100 S.Ct. 135, 62 L.Ed.2d 88. See also *Gelco Exp. Corp. v Ashby*, 689 S.W.2d 790 (Mo. Ct. App. W.D. 1985); *USX Corp. v International Minerals & Chemicals Corp*., not reported, in F.Supp., 1987 WL 20427 (N.D.Ill.) holding that 'there is no good faith duty, independent of the contract, to renegotiate the contract'.

214 848 F.Supp. 797 (N.D.Ill. 1994) at 814.

215 See *National Presto Indus., Inc. v United States*, 338 F.2d 99, 109-12 (Ct. Cl. 1964), *cert. denied*, 380 U.S. 962 (1965); *Northern Corp. v Chugach Elec. Ass'n*, 518 P.2d 76, 82-85 (Alaska) *modified on rehearing,* 523 P. 2d 1243, 1243-47 (Alaska 1974); cited by Hubbard, at 103.

216 Hillman (1987). The author adds that courts, under equity powers, have a tradition of adjusting contracts, e.g. covenants not to compete.

by the court. 'The full remedy…is to delete the original price term, substitute a new one derived from the commercial context and order the process of further bargaining and adjustment to proceed'.[217]

It has been argued that the open nature of section 2-615 and its comments, admitting a judicial allocation of losses but providing little concrete guidance to the courts as to *how* to adjust the contract terms to distribute the losses between the parties 'has generally prompted United States courts to search for an absolute excuse on grounds of 'impossibility' or 'commercial impracticability'… (thus) an excuse for nonperformance is either granted or emphatically denied'.[218]

Similarly, §§ 158(2), 204 and 272(2) of the Restatement (2nd) of Contracts provide that in different cases the courts can apply a reasonable term to adjust the rights of the parties when normal remedies will not prevent injustice.

In spite of these texts, the only decision which has clearly modified the future performance of a contract through an equitable adjustment is *Aluminum Co. of America v. Essex Group, Inc*. (the *Alcoa* case).[219] In this case, a long-term contract (sixteen years and an option for Essex to extend it by five additional years) concluded in 1967 provided that Alcoa would convert alumina supplied by Essex into molten aluminum. The contract contained a flexible price adjustment formula based on the Wholesale Price Index – Industrial Commodities (WPI), but the index failed to account for the steep increase in the price of electricity resulting from the 1973 energy crisis, which was a principal element in the production costs and therefore the contract became increasingly and highly unprofitable to Alcoa, with projected losses of $60 million if the contract would continue until the agreed date.[220] The Federal District Court held that ALCOA was entitled to relief basically on the grounds of mistake and impracticability; but the relief took the form of a modification of the contract through the substitution of the agreed price adjustment formula by a new one defined by the court with the aim being to share between the parties the losses and risks created by the unexpected circumstances and then to reduce the losses of ALCOA to manageable proportions.

The necessity of a failure by the parties to agree to a contract modification and the intervention of the court as last resort was stressed in the *ALCOA* decision: 'The Court gladly concedes that the parties might today evolve a better working arrangement by negotiation than the Court can impose. *But they have not done so*…Only a rule which

217 Speidel (1981), p. 419. Section 2-719(2) of the UCC provides that 'Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act'; in other words, normal remedies available under Article 2 become operative. Speidel states that 'if the agreed term involves price rather that a remedy, and if the price term fails its intended purpose, then the initial term, should, unless the parties have clearly stated its exclusive character, be deleted and the 'gap' filled by a 'reasonable price at the time of delivery" (as provided by article 2-305(4) of the UCC).

218 Trakman (1984) at pp. 482-s483, adding that the Restatement (2nd) of Contracts is similarly unhelpful.

219 499 F. Supp. 53 (W.D. Pa. 1980).

220 However, the contract was highly profitable for Alcoa between 1968 and 1974.

permits judicial action…will provoke a desirable practical incentive for businessmen to negotiate their own resolution to problems which arise in the life of long term contracts.'[221] However, on appeal, the Court of Appeals urged the parties to settle rather than press forward with their appeals, and finally, because of the uncertain result of the appeal, they did so before the case was heard. Thus, the trial judge's decision (to rewrite the contract to produce a price arrangement after failed ex post bargaining between the parties) never came into effect. Nevertheless, despite the revolutionary approach by Justice Teitelbaum and the extensive and controversial literature on the case, the decision was not followed in later cases and only two judges (one concurring opinion in a West Virginia Supreme Court and one a Federal magistrate judge in New Jersey) have embraced the rule.[222]

In any case, the necessity for the court to adopt an active role has been stressed by the supporters of judicial adaptation. Within the scope of procedural law or equitable jurisdiction, the judge might develop settlement strategies, thereby inducing the parties to an agreement by direct intervention or appointing an expert to support them in the negotiations.[223] In the *Westinghouse* litigation,[224] a large number of long-term contracts for the delivery of uranium at a fixed price ($10 per pound) were concluded by Westinghouse. When the uranium price rose on the international market to $40 per pound, Westinghouse, based on article 2-615 of the UCC, declared that it would not honour the delivery contracts. In the following consolidated litigation the parties were called to reach a settlement by the Court. Justice Merhige stated that '…the Court is convinced that the parties themselves are in a far better position to find an equitable solution'[225] and for that purpose the court appointed a settlement 'master' under Federal procedural rules to encourage and assist the parties in reaching an amicable adjustment of the claim. Finally, all suits were settled out of court.[226] Similarly, in *McGinnis v Cayton*[227] Justice Harshbarger stressed that 'Long-term contract problems that arise because of fundamental shifts in the balance or equities of the original relationships are best resolved by the parties. Courts should do all they can to encourage settlement and private resolution…'[228] In the same sense, it has been argued that the real value of the *ALCOA* case was its role as a coercive force for a mutual agreement upon settlement.[229].

221 499 F. Supp. 53 (W.D. Pa. 1980) at 91-92.
222 *McGinnis v Cayton*, 312 S.E.2d 765 (W. Va. 1984) and *Unihealth v U.S. Healthcare Inc.,* 14 F. Supp. 2d 623 (D.N.J. 1998). See White, Peters (2002), p. 1973, noting that although both opinions referred to Alcoa, the facts and final outcomes of the cases do not follow the decision by Justice Teitelbaum.
223 See Speidel (1999), p. 414.
224 *In re* Westinghouse Elec. Corp. Uranium Contracts Litig., 517 F. Supp. 440 (E.D. Va. 1981).
225 517 F. Supp. at 461.
226 Wall St. J., April 16, 1981, p. 16; cited by van Dunné (1987) p. 427. The Westinghouse litigation has been cited by one author as 'a case of compelled renegotiation', see Perillo (1997), p. 26.
227 312 S.E.2d 765 (W. Va. 1984).
228 *Ibid.* at 781.
229 Macaulay (1985), pp. 465, 475, 476.

As stated before, judicial authority in favour of an adjustment is weak in American law. Thus, in *Iowa Elec. Light & Power Co. v Atlas Corp*.[230] the court stated that sections 2-716 (specific performance) and 2-209 (waiver) of the (Iowa) Uniform Commercial Code do not provide a basis for a court to adjust the price in favour of the seller where its production costs have greatly increased. However, regarding section 2-615, the court admitted that under that provision a discharge or adjustment can be granted to a seller, but it stated that in the particular case the conditions for its applicability were not satisfied.[231]

As Trakman points out, in this case the court was unable to determine the extent of the foreseeability involved in the increasing costs of energy at the time of contracting by the defendant. Although some degree of unforeseeability was admitted by the court, it denied any form of relief to the defendant. On the contrary, it can be argued that partial foresight and partial control over disruptive contingencies may justify a partial relief and, therefore, a modification of the agreement's performance.[232]

Finally, one intermediate solution is to condition specific performance to the advantaged party's consent to the fair and equitable revision proposed by the affected party, which has been recognized in American case law in relation to a price adjustment[233] and in the Restatement (Second) of Contracts. It has been argued that section 2-716(2) of the UCC also provides the court with the authority to impose a price adjustment through a conditional decree on specific performance.[234]

3.6. Conclusions

The American doctrine of impracticability strongly reminds one, at least theoretically, of the civil law theories of excessive onerosity or *imprévision*. In this respect the title of section 2-615 (Excuse by Failure of Presupposed Conditions) is self-evident. The doctrine was included in the Code with the aim being to excuse a party from performing its obligations when that performance has become extremely and unreasonably onerous or difficult due

230 467 F. Supp.129 (N.D. Iowa 1978), *revised on other grounds*, 603 F.2d 1301 (8th Cir. 1979). Other cases denying a revision and granting specific performance to the buyer have been *Eastern Air Lines v. Gulf Oil Co*., 415 F. Supp. 429 (S.D. Fla 1975), *Publicker Industries v. Union Cardibe Co*., 17 U.C.C. Rep. Serv. (Callaghan) 989 (E.D. Pa. 1975), *Missouri Pub. Serv. Co. v. Peabody Coal Co.*, 583 S.W. 2d. 721, *cert. denied*, 444 U.S. 865 (1979).

231 In particular because 1) the seller (Atlas) was in the best position to protect itself in the contract from the risk which caused its loss (the 'vagaries of the marketplace'); and 2) increases of 50-58 percent in the costs are not sufficient to constitute commercial impracticability.

232 Trakman (1984), p. 484.

233 *Willard v. Tayloe*, 75 U.S. (8 Wall.) 557 (1869); *City of LaFollette v. LaFollette Water, Light & tel. Co*., 252 F. 762 (6th Cir. 1918).

234 Speidel (1981), p. 417. Section 2-716(2) provides that *'The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just'*. However, in *Iowa Electric Light & Power Co*. v. *Atlas Corp*., the court stated that it had no power to condition the decree of specific performance under this section, because the language of the Code referred to terms of payment in the sense of time, place or manner among others, and not to changes in the actual contractual price term.

to the occurrence of unforeseen circumstances, and not only when such performance has become physically impossible.[235]

The text of section 2-615 and the official comments thereto are clear in emphasizing the intention of the statute that impracticability must be analysed in the context of the commercial setting of the contract and not in the light of abstract notions like absolute contracts or impossibility. The omission of the term 'impossibility' in section 2-615 is a clear demonstration that the intention of the drafters was that excused performance was also applicable in situations which are different from that in which performance has become 'scientifically' impossible.

Nevertheless, even though to a lesser extent than in English law, the rule of absolute contracts still seems to have an influence in American law. Then, the parties are first called upon to deal with the effect of supervening circumstances through their contractual provisions.[236] Nevertheless, the American impracticability doctrine is based on and is derived from the doctrine of impossibility. Therefore, in the absence of a contract clause, it is *conceptually* very difficult for a court to excuse a party when a supervening event makes the performance extremely onerous or difficult, but not impossible. As stated before, for assessing the conditions for the application of impracticability the courts frequently rely on the parameters of impossibility.

Given the availability of the defence of impracticability and remedies which are different from the total discharge of the contract, the American courts have nevertheless rigorously restricted its application through the imposition of the foreseeability requirement, which has been strictly interpreted: for there to be a lack of foreseeability, supervening effects must be substantial or cataclysmic.[237] If the court considers the event to have been 'reasonably foreseeable' for the affected party and if the contract does not provide for performance if the contingency occurs, it is presumed that the party who naturally bears the risk chose to assume it. In other words, the court presumes that the parties intended the obligor to assume the risk.[238] This approach has been severely criticised: 'The distorted standards of unforeseen and unforeseeable deny section 2-615(a) any effect. Moreover, to deny relief of any contingency not contractually specified utterly flies in the face of section 2-615, the very purpose of which is to provide relief when the contract is silent.'[239] The objections

235 See Williston, Lord (1990) §77:1 pp. 1-45.

236 'The obligor who does not wish to undertake an extensive contractual obligation can always negotiate to accept a lesser burden', Williston, Lord (1990), §77:16, p. 2.

237 *Metropolitan Life Ins. Co. v. RJR Nabisco, Inc*., 716 F. Supp. 1504 (S.D. N.Y. 1989), cited in Williston, Lord (1990) §77:11, p. 1.

238 See *Harvey v. Lake Buena Vista Resort*, LLC, 568 F. Supp. 2d 1354 (M.D. Fla. 2008), judgment aff'd, 2009 WL 19340 (11th Cir. 2009); *Clean Uniform Co. St. Louis v. Magic Touch Cleaning, Inc*., 300 S.W.3d 602 (Mo. Ct. App. E.D. 2009); cited in Williston, Lord (1990), §77:11. See Williston, Lord (1990) §77:16, p.1: if the risk of the supervening event that has frustrated performance under the contract was foreseeable, then it should have been discussed in the contract; where the contract is silent, the absence of such a provision gives rise to the inference that the risk was assumed.

239 Prance (1986), p. 482.

to that reasoning were stressed above: the lack of a provision in the contract regarding the supervening event may be caused by a series of factors which are different from the presupposed intention of the parties that the obligor bears the risk of the event occurring. Thus, comment b of section §261 of the Restatement 2nd expressly discards the dispositive role of the foreseeability of the disruptive event for the finding of impracticability: 'The fact that the event was foreseeable, or even foreseen, does not necessarily compel a conclusion that its non-occurrence was not a basic assumption'.

It is also true that in most of the cases the dicta of the decisions do not absolutely rule out the likelihood of a discharge due to impracticability, but the claims were dismissed by a combination of requirements construed by the courts to extremely restrict the doctrine. Then, even though, theoretically, it can be argued that the affected party *might* be excused in some exceptional situations, the practical outcome of the cases demonstrates that to be given such a excuse is almost impossible for the promisor.

In this context, of all the methods used by the courts for the appraisal of impracticability, the qualitative assessment of impracticability seems to be the more appropriate: 'The true distinction is not between difficulty and impracticability...The important question is whether an unanticipated circumstance...has made performance of the promise vitally different from what was reasonably expected.'[240] The role of foreseeability must not be discarded; it is only one parameter inserted in the particular circumstances as a means to determine if a contingency could reasonably have been foreseen by the parties and they saw it as a real possibility that could affect performance.

Because of the unsatisfactory results and interpretation of the doctrine of impracticability, it has been proposed that the subject has to be examined in terms 'of the overall and gross imbalance, oppression or unfairness' constituting 'substantive unconscionability as a basis for equitable adjustment.' Then, the question is to develop fairness norms rather than fictions to 'discover' the mutual intention of the parties. Under this fairness assessment, the doctrine of impracticability and even the adjustment of the contract are 'appropriate both when risk allocation is unclear, and if the hardship is severe enough, even when the intention to allocate the risk is manifest.'[241]
Some judicial decisions have stressed the necessity of the prevalence of fairness and equity considerations over forms or legal fictions to deal with and fill contractual gaps and to adapt the relationship to unexpected changes. The use of the unconscionability standard is suggested as a method to avoid 'purely semantic distinctions' (such as the search for what was foreseeable or foreseen) and also as a tool to achieve 'the commendable goals of preserving the contract's fairness and original equitable balance'. It has been stressed that 'Freedom of contract means freedom to agree or assent; not freedom to be forced to agree, to be presumed to have assented, to be cornered to into something that one has not remotely considered, or to be denied meaningful choice...Freedom of contract does not vindicate

240 Williston, Lord (1990), §77:23 p. 3.
241 See Halpern (1987), pp. 1167-1168.

tolerance of blatant inequities or unconscionable acts. Our society values fundamental fairness, equality, honesty, cooperation and ethics.'[242] Similarly, other decisions point out that 'The doctrine of commercial impracticability focuses on the reasonableness of the expenditure at issue, not upon the ability of a party to pay the commercially unreasonable expense.'[243] In the same sense, some courts have stated that for the configuration of the excuse of commercial impracticability 'the cost of performance has become in fact so excessive and unreasonable that the failure to excuse performance would result in grave injustice.'[244] The mentioned arguments will be developed more extensively in the Chapters on Adaptation and Renegotiation.

242 *McGinnis v Cayton*, 312 S.E.2d 765 (W. Va. 1984) at 770 (Harshbarger, J. concurring).
243 *Asphalt International, Inc. v. Enterprise Shipping Corp*., 667 F.2d 261 (2d. Cir.1981) at 266.
244 *Gulf Oil Corp. v. Federal Power Comm'n*, 563 F.2d 588 (3rd Cir. 1977) at 389. In the same sense, *Sabine Corp. v. ONG W., Inc*., 725 F. Supp. 1157.

PART III

COMPARATIVE SURVEY
INTERNATIONAL INSTRUMENTS OF CONTRACT LAW

Chapter 7

INTERNATIONAL INSTRUMENTS OF CONTRACT LAW – THE APPROACH OF THE CISG, THE PICC, THE PECL AND THE DCFR

1. Introduction

The present Chapter will analyse the approach of four different international instruments of contract law concerning the subject of a change of circumstances: the Convention on Contracts for the International Sale of Goods (CISG), the UNIDROIT Principles of International Commercial Contracts (PICC), the Principles of European Contract Law (PECL) and the Draft Common Frame of Reference (DCFR). One of these instruments, the CISG, is an international convention and is therefore binding for its signatories. The other three can be considered as soft-law or non-legislative codifications in the sense that they are not based on a sovereign's will and have been drafted outside the political sphere of states and governments.[1] In spite of their different nature and origins, all are nowadays relevant and their study cannot be avoided in the field of comparative contract law.

Thus, before the publication of the DCFR, it was argued that the PICC and the PECL could be considered as the more relevant set of modern principles of contract law, at least from an academic point of view.[2] Internationally, both are competitors and they are comparable in many respects: their preparation, drafting and aims, especially the purpose of being a restatement of contract law and then serving as a model for national legislators or as the applicable law when the parties have agreed thereon.[3] Nowadays, the more recent DCFR must also be taken into account because of its declared purpose to be a model for a political Common Frame of Reference in contract law, and especially to be an academic instrument for the analysis of and research into European private law. Moreover, without considering the criticism about the drafting procedure or the substantive solutions included therein, the DCFR 'is likely to play a prominent role in the further development of European contract law', even if it remains, to a great extent, pure soft law.[4]

1 See Jansen (2010), p. 7.
2 See Hondius (2004), p. 863.
3 Zimmermann (2006), pp. 6-7.
4 See Hesselink (2008), p. 70.

On the other hand, the relevance of studying the CISG relies on its nature as the applicable law in all the jurisdictions which are the subject of this research, except England & Wales. Additionally, in general the CISG has been considered as a success in terms of the 'greatest legislative achievement aimed at harmonizing private commercial law.'[5] Although such a statement can indeed be contested, the importance of the CISG should not be underestimated: the Convention is in force in 76 countries, it is increasingly applied by domestic and international courts and it has influenced, directly and indirectly, a number of domestic legislations, including even EU legislation as in the case of the Consumer Sales Directive.[6]

2. The approach of the CISG

It is disputed in legal doctrine whether the notion of a change of circumstances is applicable to a contract regulated by the CISG. Part of the legal doctrine argue that under the CISG a party can only seek relief if its performance has become impossible, but others extend that possibility to cases of severe hardship due to changed circumstances. The subject will be analysed in the following sections, together with an overview of the system of exceptions and of gap filling of the Convention, which is necessary for a proper understanding of the matter.

2.1. The CISG system of exemptions

The CISG is usually regarded as a system of strict contractual liability because a party is liable for all events within its control independently of its negligence.[7] Articles 79 and 80 provide the only available relief for a party who has failed to perform: he has to prove that the failure was due to an impediment beyond its control and which was reasonably unexpected at the time of contracting:[8]

Article 79

(1) A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he 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 it or its consequences.

(2) If the party's failure is due to the failure by a third person whom he has engaged to perform the whole or a part of the contract, that party is exempt from liability only if:

(a) he is exempt under the preceding paragraph; and

(b) *the person whom he has so engaged would be so exempt if the provisions of that paragraph were applied to him.*

5 Lookofsky (1991), 403 (1991).

6 For a detailed analysis of the influence of the CISG on international and domestic contract law, see Ferrari (2010).

7 Lindström (2006), p. 2.

8 Article 80 will be not analyzed because it is irrelevant for the purposes of this research.

(3) The exemption provided by this article has effect for the period during which the impediment exists.
(4) The party who fails to perform must give notice to the other party of the impediment and its effect on his ability to perform. If the notice is not received by the other party within a reasonable time after the party who fails to perform knew or ought to have known of the impediment, he is liable for damages resulting from such non-receipt.
(5) Nothing in this article prevents either party from exercising any right other than to claim damages under this Convention

Based on the text of the above cited article, legal doctrine has usually determined the following prerequisites for a party to claim the application of the exemption: a) the existence of an impediment beyond its control; b) which is unforeseeable at the time of the conclusion of the contract; and c) which is unavoidable (either the impediment itself or its consequences). The mentioned prerequisites are also subject to the principle of reasonability.[9]

The above-mentioned article merely provides an exemption from damages to the breaching party. The other remedies provided by the Convention remain in principle available although that can be qualified regarding the circumstances of the particular case.[10]

The provision was drafted with the express intention to create an autonomous concept to grant relief to the non-performing party to an international sales contract, in order to avoid the influence of related domestic law concepts in a particular case.[11]

2.2. Gap filling in the CISG

The examination of the Convention's system of gap filling is relevant because it has been argued that the notion of a change of circumstances is a matter which is not expressly resolved by the CISG and therefore should be settled by the application of its article 7.2. In this regard, the Convention provides for a clear (in theory) system of gap filling. In matters not expressly regulated by it, but that can be considered to be included within its scope, article 7.2 applies:

Article 7.2. Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.

9 See Lindström (2006) and Lookofsky (2005).
10 The other main remedies available to the non-breaching party are specific performance, avoidance of the contract and a reduction in the contract price. But, for instance, the right to claim specific performance is necessarily related to the nature and extent of the excusing impediment. See Garro (1994).
11 See Lindström (2006), p.5 and Kruisinga (2004), p. 125.

Then, if a legal situation is considered to be governed under the scope of the Convention (and therefore not rejected by it) but it is not expressly or completely regulated by the CISG, the matter has to be resolved by referring to the general principles on which the Convention is based. However, the Convention fails to determine or express any general principles.[12] With the exception of the principle of good faith mentioned in article 7.1, it has been legal doctrine which has deduced some general principles from the provisions of the Convention itself, e.g. the principles of reasonableness, *favor contractus*, or mitigation.[13] Nevertheless, it is argued that those general principles cannot only be deduced from the text of the Convention, but also from external principles which are generally considered to be general principles of international trade or commerce.[14]

In this sense, the PICC have been considered to be adequate to complement and fill the eventual gaps in the CISG. The goal of uniformity in the application of the Convention and the task of the courts will be facilitated with the use of the PICC in the context of article 7.2.[15] Such a purpose is expressly laid down in the Preamble to the Principles: '[These Principles] may be used to interpret or supplement international law instruments'. It is added that reasons of fairness also support the application of the PICC since resorting to uniform law is better in that it equally protects the interest of both parties rather than solving the dispute according to some domestic jurisdiction which can benefit only one of them.[16] The avoidance of the threat to uniformity and conceptual autonomy that a reference to domestic solutions represents seems to be the general background on which the applicability of the PICC relies.[17]

Nevertheless, the assertion that the PICC incorporate or represent general principles of international trade must be qualified concerning some points. The Principles state in their introduction that in some matters the texts adopted were considered as the 'best solutions, even if still not yet generally adopted.'[18] More in particular, with regard to the CISG, that Convention was an obligatory point of reference for the Working Group and some of its provisions were incorporated in the Principles, but at the same time in other matters Unidroit derogated from or expanded upon the CISG when this was considered appropriate.[19]

This can be true in particular with regard to hardship, taking into account that the approach of both instruments is completely different with regard to the remedies adopted

12 Kruisinga (2004), p. 18.
13 Lindström (2006), p. 20.
14 *Ibid*.
15 Bonell (1996), pp.34-36. But see Schlechtriem, Schwenzer (2010), stating at p. 139 that sets of rules such as the PICC, the PECL or the DCFR 'are not principles on which (the CISG) is based as required by the wording of article 7.2' and therefore 'they may only serve as an additional argument for a solution advocated when filling internal gaps'.
16 Garro (1994), p. 1159.
17 See Kruisinga (2004), pp. 18 ff.
18 PICC, Introduction, XV.
19 *Ibid*. See also Slater (1998), p. 231

by article 79 of CISG and article 6.2.3 of PICC. In addition, it is far from clear that the provisions of the PICC on this subject represent 'internationally recognized principles', especially taking into account the different approach of the civil and common law systems in the issue.

Thus, the most problematic of the eventual remedies in cases of changed circumstances, i.e. adaptation of the contract by the court, is completely unfamiliar to the common law tradition. Thus, in English common law, frustration terminates the contract with effect from the time of the frustrating event: if a contract is frustrated, each party is released from any further obligation to perform. Consequently, as a general principle, English common law does not provide mechanisms for adjusting contracts where a substantial change in circumstances has occurred. On the other hand, under the U.S. doctrine of commercial impracticability, the provisions of the UCC and the Restatement (Second) of Contracts provide a number of mitigating doctrines (e.g. restitution, reliance damages) to avoid the negative effects of the complete discharge of the contract, and even the comments of the relevant provisions have been interpreted as giving the court the power not only to decide on a fair distribution of losses, but also to adapt the terms of a contract for future performance; in practice the courts have been extremely reluctant to adjust a contract to supervening circumstances.[20]

On the contrary, 'continental' solutions mostly provide an (at least implicit) duty to renegotiate and the possibility to adjust the contract by the court as the legal consequences of changed of circumstances. Thus, article 6:258 (complemented by article 6:260) of the Dutch Civil Code (*Burgerlijk Wetboek – BW*) and §313 of the German Civil Code (*Bürgerliches Gesetzbuch – BGB*) deal expressly with the effects of unforeseen circumstances giving to the Court the power to modify or terminate the contract in that case. Similar provisions are contained in the Portuguese and Greek Civil Codes. Along the same lines, Italian case law has interpreted Article 1467 of the Italian Civil Code as giving the Courts the power to adapt the contract to the new circumstances; however, the text of the provision only grants the affected party the right to terminate the contract and the advantaged party the right to offer an equitable modification.[21] The French and Belgian rejection of *imprévision* seem to be the main exception to this trend.[22] Finally, the acceptance of hardship and its effects on the binding force of contracts is also replicated in non-European civil law jurisdictions.[23]

2.3. Hardship under the CISG

There is no doubt that article 79 of the Convention is applicable to situations of *force majeure*, i.e. cases where performance has become completely impossible. However, the

20 For a detailed analysis of English and American law, see Chapter six.
21 See Chapter four.
22 French law is examined on Chapter three.
23 The Civil Codes of Argentina, Brazil, Peru and Paraguay expressly admit a change of circumstances as a ground for relief for the affected party. The main exception is Chile, where the doctrine of *imprevisión* has been rejected by the Courts. See Chapter five.

answer is more difficult when the question is whether the exemption under article 79 is also applicable to situations of hardship. Legal doctrine is divided on this and the case law is too thin on the ground to give a definitive answer.

Therefore, the first issue to be ascertained is whether hardship is an exemption which is excluded or even rejected implicitly or expressly by the CISG. If the answer to this question is in the affirmative, then the party who fails to perform because of hardship commits a breach of contract and is therefore fully liable under the Convention. On the other hand, if the answer is that hardship is a matter which is covered by the Convention, two alternatives are possible: the issue is regulated by article 79 or it is a matter which is governed by the Convention but is not expressly resolved therein and must therefore be settled in conformity with the general principles on which the Convention is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law (art. 7.2).[24] A variation of the second alternative is also possible: hardship is governed by article 79 but the CISG does not regulate in exact term how cases of changed circumstances have to be decided upon, and therefore, again, article 7.2 is applicable.[25]

Part of the legal doctrine has argued that a party cannot seek relief for breach of contract under the Convention on grounds which are different from those provided by article 79, which excludes hardship. Thus, it has been stated that 'Article 79 CISG only governs impossibility of performance and the majority of academic opinion supports that a disturbance which does not fully exclude performance, but makes it considerably more difficult/onerous *(e.g.*, change of circumstances, hardship, economic impossibility, commercial impracticability, *etc.)* cannot be considered as an impediment (doctrine of *clausula rebus sic stantibus*)'.[26] The main reasons in support of that interpretation are the legislative history of the provision which resulted in a rule which is stricter than its 'predecessor' article 74 of the ULIS and the rejection of proposals for the incorporation of an express provision on the subject.[27]

Additionally, it has been argued that the principle of good faith cannot be a ground to discard solutions expressly regulated by provisions of the Convention, which has opted for a unitary concept of exemptions under article 79 and has therefore discarded the theory

24 Cf. Lindström (2006), pp. 11-12.
25 Kruisinga (2004), p. 153.
26 Flambouras (2002).
27 See references in Lindström (2006), pp. 14-15; and Rimke (1999), stressing that the history of article 79 rules out the assumption of the existence of a gap on the subject. But see Garro (2005), at IV.12 arguing that 'the drafting history of the Convention evidences that the discussions were not sufficiently conclusive on this question'; and CISG-AC Opinion No. 7, (2007) at 28, Rapporteur A.M. Garro, stating that '(the historical) background is insufficient to warrant the conclusion that CISG Article 79 cannot exempt a party from performing its obligations, in whole or in part, when the impediment is represented by a totally unexpected event that makes performance excessively difficult'.

of changed circumstances.[28] It has also been stressed that the use of good faith as the legal basis of situations of changed circumstances on international trade would endanger the aim of uniformity of the Convention, because gives too much room for divergent judicial interpretation.[29]

On the other hand, some of the legal doctrine have argued that changed circumstances are matters which are regulated by article 79 of the Convention. The main arguments are related to the concept of impediment and the reasonable overcoming of its consequences by the affected party. Thus, Lando states that the rule of article 79 is applicable to both situations of total impossibility and situations where performance has become severely burdensome so that it would be unreasonable to expect performance.[30] It has been added that the relevant issue is to determine what effort a party can reasonably be expected to make in order to overcome the consequences of the impediment. The conclusion is that article 79, interpreted in the light of the observance of good faith in international trade, cannot be read as imposing on the affected party an obligation to take on extraordinary responsibilities in order to perform.[31] Therefore, the 'limit of sacrifice' is linked to the reasonability standard.[32]

Thus, Honnold states that the concept of impediment in article 79 has to be interpreted in the sense that such an impediment must prevent performance, even though that does not mean that such performance has become literally impossible 'but rather such extreme difficulty in performance as amounts to impossibility from a practical (although not technical) point of view.'[33] Therefore, economic difficulties and dislocations can also be considered as an impediment in the context of article 79 if they are sufficiently extreme.[34] Flechtner, supplementing Honnold's opinion, argues that however economic difficulties may configure an excuse on the grounds of article 79, this provision must preclude recourse to domestic rules and national hardship-like doctrines because article 79 exhaustively regulates the effect of changed circumstances on the parties' obligations. Accordingly, the system of remedies under article 79 must prevail over any other alternatives provided by the mentioned doctrines (e.g. the duty to renegotiate or the adaptation of the contract by the court).[35]

28 Tallon (1987) In the same sense, Slater (1998) at p. 259 states that 'no remedy based on hardship is available [under CISG] and that the nonperforming party is not excused from performing his or her contractual obligations'.

29 Rimke (1999).

30 O. Lando *Udenrigshandelens krontrakter*, 3rd ed. (Copenhagen: DJØF Forlag, 1987), 299, cited by Lindström (2006), p. 13.

31 *Ibid*.

32 But see Schlechtriem, Schwenzer (2010) at p. 1076 stating that 'as a rule, price fluctuations amounting to over 100 per cent do not yet constitute a ground for exemption'.

33 Honnold, Flechtner (2009), p. 628, 432.2. In the same sense, Schlechtriem, Schwenzer (2010), referring at p. 1076 to 'unreasonable costs in relation to the contract price'.

34 Evidently, also the other conditions in article 79 must be fulfilled to grant relief to the breaching party.

35 Honnold, Flechtner (2009), pp. 630-632, 432.2. In the same sense, Rimke (1999), stating that 'Despite the fact that Article 79's "impediment" connotes a barrier that prevents performance, it refers to a more flex-

With regard to the remedies, article 79.5 provides that 'Nothing in this article prevents *either* party from exercising any right other than to claim damages under this Convention' (emphasis added). Hence, also the party affected by hardship may request the avoidance of the contract and, if it is appropriate for overcoming the hardship, a reduction of the contract price. Both remedies may be used, to a certain extent, as devices to distribute the losses resulting from the disturbing event between the parties and therefore to 'adapt' the contract to the changed conditions.[36] In the same sense, it has been argued that the mechanism of remedies provided by the CISG, combined with the duty to mitigate (if considered as a general principle) may lead in practice to flexible results to be adopted by a court.[37]

It has even been argued that the remedy of a price reduction in article 50 is a reflection of a general principle of the Convention with regard to an adjustment or an adaptation to the contract in cases where there is a disturbed equilibrium between the counter-performances that can be used 'as a springboard to develop a general rule of adjustment in hardship cases.'[38] In the same sense, the principle of good faith has been used to establish an obligation to cooperate in the adjustment of the contract and to grant to the court the power to adapt the contract by interpreting the intention of the parties in the light of the aforementioned principle.[39] The mentioned principle has also been used to argue the existence of a duty to renegotiate the terms of the contract in order to restore the balance between the performances.[40]

2.4. The approach of the case law

Although in other matters regulated by the CISG there has been abundant case law either by national and arbitral courts, as stated above, in the case of changed circumstances the case law is still insufficient to draw definitive conclusions. Then, although it has been argued that the trend seems to be the acceptance that article 79 is also applicable to situations of

ible standard than force majeure… The adaptation of the contract by the judge, however, is not expressly allowed by the CISG, and must therefore be regarded as impossible.'

36 In this sense, it has been stated that 'CISG Article 79(5) may be relied upon to open up the possibility for a court or arbitral tribunal to determine what is owed to each other, thus "adapting" the terms of the contract to the changed circumstances. Other than the payment of damages, a court or arbitral tribunal may order, if justified under the CISG, the termination of the contract as of a certain date. Of course, it is impossible to require specific performance as called by the contract, but a flexible method for the purposes of adjusting the terms of the contract may be obtained by resorting to price reduction under CISG Article 50.' Garro (2005) at IV.16; and CISG-AC Opinion No. 7, (2007), Rapporteur A.M. Garro, at 40.

37 See Schwenzer (2008), p. 724. It is argued that a general duty of mitigate can be deducted from article 77 of the Convention, which states that '*A party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to take such measures, the party in breach may claim a reduction in the damages in the amount by which the loss should have been mitigated.*'

38 Schlechtriem (1999). It must to be said that the cited author qualifies such statements as speculative.

39 For references, see Kruisinga (2004), p. 150.

40 CISG-AC Opinion No. 7, (2007), Rapporteur A.M. Garro, 40.

hardship,[41] the reported cases are not conclusive and in fact demonstrate that the approach of the courts to the subject is very restrictive, imposing high standards for the nature and consequences of the impediment to be considered as an excuse under article 79. In practice, such standards imply that only in situations amounting to impossibility will relief be granted to the affected party.[42]

Thus, in cases where a price fluctuation was the ground for seeking relief, the courts rejected the claims even with variations of more than 100% over the agreed price. For instance, relief was denied in a case where the international market price of the goods in question had increased by between one and two times the contract price from the time of the conclusion of the contract and the agreed date of shipment for the goods.[43] In another decision, the seller sought relief based on the non-delivery of goods by its supplier. The court stated that the requirements for an exemption under article 79 of the Convention had not been fulfilled because the seller was not exempted if its supplier had not delivered, even if the supplier's action was unforeseeable and a breach of contract. The court added that such an impediment can be overcome by the seller as long as there are replacement goods available on the market, stressing that an excess of the absolute limit of sacrifice had not been reached in spite of the fact that the market price that had to be paid for substitute goods had tripled.[44]

Similarly, significant drops in the market price or major reductions of the repurchase price by the final customers of the buyer have also been rejected as grounds to invoke the impediment under article 79.[45]

In all the cited cases, the reason for the court to reject the application of article 79 was that in international transactions the possibility of market price fluctuations are assumed to be higher than in domestic markets and therefore they have to be considered as foreseeable for the parties involved in international trade.

41 See Schwenzer (2008), p. 713. On the contrary, See Garro (2005), stating at IV.2 that judicial decisions 'are too few and inconclusive to this date to warrant a stable trend either excluding or including hardship within the purview of CISG article 79'.

42 Even in *Nuova Fucinati S.p.A. v. Fondmetall Int'l A.B*, 14 January 1993, District Court of Monza, where an increase of 30% on the agreed price was alleged by the seller as ground of relief, the Court stated that the CISG, in contrast to the Italian *Codice Civile*, was not applicable to situations of change of circumstances, but only to cases of absolute impossibility. Available at http://cisgw3.law.pace.edu/cases/930114i3.html.

43 China International Economic & Trade Arbitration Commission [CIETAC], 02 May 1996, CISG 1996/21, available at http://cisgw3.law.pace.edu/cases/960502c1.html.

44 OLG Hamburg, 1 U 167/95, 28 February 1997, vailable at http://cisgw3.law.pace.edu/cases/970228g1.html#ca. The court stated that the the transaction (sale of iron-molybdenum from China) was very speculative.

45 See *Vital Berry Marketing NV v. Dira-Frost NV*, Rechtbank [District Court] van Koophandel Hasselt,02/05/1985, available at http://cisgw3.law.pace.edu/cases/950502b1.html; and *Société Romay AG v. SARL Behr France*, French Cour de Cassation, 30 June 2004, available at http://cisgw3.law.pace.edu/cases/040630f1.html#cx.

Relief based on article 79 has also been denied in cases concerning problems with the storage of the goods, negative developments on the internal market and a revaluation of currency;[46] severe reductions in (but not a total loss of) tomato crops and a resulting price increase;[47] and a refusal by the seller's supplier to deliver the goods which were the subject of the contract.[48]

A recent decision by the Belgian Supreme Court (*Hof van Cassatie*) is the first reported case that does not follow the mentioned trend.[49] The analysis of the case is relevant because it is related to two contentious issues, the Convention's mechanism for gap filling and the inclusion of hardship as an excuse which is available to the parties in an international sales contract, in particular with regard to the effect of price fluctuations on the obligations of the parties.

In the case, the parties concluded a number of sales contracts for the delivery of steel tubes. After the conclusion of the contract, the price of steel unforeseeably increased by 70%. The contracts did not contain any price adaptation clause. Due to the mentioned rise in costs, the seller (a French company) requested an adjustment of the contract price but the buyer (a Dutch company) refused every proposal to modify the contract and insisted on its performance as originally agreed upon. The buyer claimed a breach of contract and damages, and the seller counterclaimed an adjustment to the price based on the unforeseen and drastic increase in costs. In summary proceedings, the seller was ordered to deliver the agreed goods against the payment of the contract price plus the consignment of half of the proposed price increase.

At first instance, the Commercial Court of Tongeren rejected the application of hardship as a ground for the requested adaptation to the contract price on the basis that this situation was not covered by article 79 or any other provision of the CISG. The Court of Appeal of Antwerp reversed the first instance decision stating that the existence of an explicit rule on *force majeure* in the Convention (i.e. article 79) does not imply that the possibility for the parties to invoke hardship in cases of unforeseeable changed economic conditions is excluded. Further, the Court of Appeal concluded that a request for a price adaptation based on hardship was not against the principles on which the Convention is based, but

46 Bulgarian Chamber of Commerce and Industry [BTTP (Bulgarska turgosko-promishlena palata)], 11/1996, 12 February 1998, available at http://cisgw3.law.pace.edu/cases/980212bu.html#cd.

47 OLG Hamburg, 1 U 143/95 and 410 O 21/95, 04 July 1997, available at http://cisgw3.law.pace.edu/cases/970704g1.html. On similar terms, see *Agristo N.V. v. Macces Agri B.V.*, Rb Maastricht, 9 July 2008, where the seller alleged a drastic fall on the crop and harvest of potatoes as a ground for relief because of extreme weather conditions: 'It can be expected from a diligent grower that he considers the weather circumstances when entering into a sales contract concerning future harvest insofar that he can fulfill his duty to deliver in 90% of the cases. This means, in the instant case, that [Seller] can only rely on an impediment beyond control, if the harvest stayed behind the minimum of crop achieved in 90% of the years', available at http://cisgw3.law.pace.edu/cases/080709n1.html#cx.

48 Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry, 155/1994, 16 March 1995.

49 *Scafom International BV v. Lorraine Tubes S.A.S*; Hof van Cassatie, 19 June 2009, N°C.07.0289.N, English translation available at http://cisgw3.law.pace.edu/cisg/wais/db/cases2/090619b1.html#ctoc.

since that situation is essentially different from one of *force majeure* (regulated in art. 79) the dispute must be decided in conformity with the law applicable by virtue of the rules of private international law (art. 7.2), in this case French law. The Court added that under French domestic law the duty to perform contracts in good faith, included in the last part of article 1134 of the *Code Civil*, imposes on the parties the duty to renegotiate the terms of the agreement if an unforeseen change of economic circumstances renders the agreed performance unjustified under the new circumstances. On this basis, the Court ruled that the negative of the buyer to renegotiate the terms of the contract entailed a breach of the duty of good faith in performance and granted damages to the seller.

The buyer appealed in cassation to the Belgian Supreme Court. The Supreme Court rejected the buyer's plea and confirmed the findings of the Court of Appeal but on different grounds, thereby stating that unforeseen circumstances which result in a serious disturbance of the contract equilibrium can amount to an impediment in the context of article 79 of the Convention and considering that there is a gap in the subject that must be filled by the general principles of the law of international trade (article 7.2). The Court added that under those principles, in particular incorporated in the PICC, the party affected by a change of circumstances that fundamentally disturb the contractual balance is entitled to request the renegotiation of the contract.

The approach of the Court implies that the notion of an impediment in article 79 is broad enough to include not only an absolute impossibility of performance but also cases in which the performance has became excessively onerous for one of the parties. Particularly with regard to the conditions required for hardship, the decision by the Belgian Supreme Court seems to be the first which accepts an excuse on grounds of hardship based on a price increase concerning the goods that are the object of the contract, because generally it is stated (both in legal doctrine and case law) that price fluctuations are foreseeable for the parties involved in international trade.[50]

In its decision, the Supreme Court adopted the mentioned view that hardship is governed by article 79 but the CISG does not regulate in exact terms how cases of changed circumstances have to be decided upon, and therefore, article 7.2 is applicable.

In this regard, the decision of the Court implies that the 'general principles' mentioned in article 7.2 are not only those contained in the Convention itself (internal principles) but also those that may be deduced from international commercial law (external principles). Additionally, without regard to the doctrinal disputes mentioned above, the PICC were considered by the Court to be the main restatement of international commercial law and therefore the main source for the courts to look for and find such general principles and to apply them to particular cases.

50 See Schwenzer (2008), p. 709, adding at 716 that 'all decisions dealing with hardship under article 79 concluded that even a price increase or decrease of more than 100 per cent would not suffice' (references omitted). As mentioned above, in the case, the price increase amounted to 70%.

3. The approach of non-legislative codifications: the PICC, the PECL and the DCFR

Just as modern codifications do, these sets of principles contain express provisions to deal with a change of circumstances. Thus, the PICC deal with the subject under the heading of *hardship* in articles 6.2.1 to 6.2.3.

Article 6.2.1. *'(Contract to be observed) Where the performance of a contract becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligations subject to the following provisions on hardship'*.

Article 6.2.2. *'(Definition of Hardship)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 (a) the events occur or become known to the disadvantaged party after the conclusion of the contract; (b) the events could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract; (c) the events are beyond the control of the disadvantaged party; and (d) the risk of the events was not assumed by the disadvantaged party.*

Article 6.2.3. *'(Effects of Hardship) (1) In case of hardship the disadvantaged party is entitled to request renegotiations. The request shall be made without undue delay and shall indicate the grounds on which it is based. (2) The request for renegotiation does not itself entitle the disadvantaged party to withhold performance. (3) Upon failure to reach agreement within a reasonable time either party may resort to the court. (4) If the court finds hardship it may, if reasonable, (a) terminate the contract at a date and on terms to be fixed; or (b) adapt the contract with a view to restoring its equilibrium.'*

Similarly, the PECL and the DCFR also expressly regulate a *change of circumstances* in article 6:111 and rule III.–1:110 respectively.

Article 6:111. *'Change of Circumstances': '(1) A party is bound to fulfil its obligations even if performance has become more onerous, whether because the cost of performance has increased or because the value of the performance it receives has diminished. (2) If, however, performance of the contract becomes excessively onerous because of a change of circumstances, the parties are bound to enter into negotiations with a view to adapting the contract or terminating it, provided that:(a) the change of circumstances occurred after the time of conclusion of the contract,(b) the possibility of a change of circumstances was not one which could reasonably have been taken into account at the time of conclusion of the contract, and (c) the risk of the change of circumstances is not one which, according to the contract, the party affected should be required to bear. (3) If the parties fail to reach agreement within a reasonable period, the court may: (a) terminate the contract at a date and on terms to be determined by the court; or (b) adapt the contract in order to distribute between the parties in a just and equitable manner the losses and gains resulting from the change of circumstances.*

In either case, the court may award damages for the loss suffered through a party refusing to negotiate or breaking off negotiations contrary to good faith and fair dealing.'

Article III.-1:110. *Variation or termination by court on a change of circumstances: (1) An obligation must be performed even if performance has become more onerous, whether because the cost of performance has increased or because the value of what is to be received in return has diminished. (2) If, however, performance of a contractual obligation or of an obligation arising from a unilateral juridical act becomes so onerous because of an exceptional change of circumstances that it would be manifestly unjust to hold the debtor to the obligation a court may: (a) vary the obligation in order to make it reasonable and equitable in the new circumstances; or (b) terminate the obligation at a date and on terms to be determined by the court. (3) Paragraph (2) applies only if: (a) the change of circumstances occurred after the time when the obligation was incurred, (b) the debtor did not at that time take into account, and could not reasonably be expected to have taken into account, the possibility or scale of that change of circumstances; (c) the debtor did not assume, and cannot reasonably be regarded as having assumed, the risk of that change of circumstances; and (d) the debtor has attempted, reasonably and in good faith, to achieve by negotiation a reasonable and equitable adjustment of the terms regulating the obligation.*

The content of the rules, despite the differing terminology, is similar and because of this its examination will be made jointly, but nevertheless stressing any differences when necessary.

3.1. General considerations

3.1.1. The general rule

The general rule is the prevailing binding force of contracts (*pacta sunt servanda*), which is expressly laid down in all the relevant articles, even if the principle of the sanctity of contracts has already been established in a general provision.[51] The aim is to clarify the exceptional character of the rule on changed circumstances with regard to the mentioned *pacta sunt servanda* principle.

This exceptional nature is confirmed in the comments of the articles. Thus, the Official Comment of the PICC states that 'performance must be rendered as long as it is possible and regardless the burden it may impose on the performing party.' Similarly, the Official Comment of the PECL stresses that the rule on a change of circumstances will only apply in exceptional cases.

51 As in the case of Article 1.3 of the PICC (*A contract validly entered into is binding upon the parties. It can only be modified or terminated in accordance with its terms or by agreement or as otherwise provided in these Principles)* and article II.- 1:103 of the DCFR (Binding effect. (*1) A valid contract is binding on the parties. (2) A valid unilateral undertaking is binding on the person giving it if it is intended to be legally binding without acceptance. (3) This Article does not prevent modification or termination of any resulting right or obligation by agreement between the debtor and creditor or as provided by law).*

In particular, according to the Official Comment of the DCFR, the rule is considered as a limitation to the principles of freedom in the sense of party autonomy, freedom of contract (article II.- 1:102) and security, which are considered as contractual security that is primarily reflected in the rule on the obligatory force of contracts (article II.- 1:103). The basis for this restriction is the principle of justice: 'it may be *unjust* to enforce the performance of contractual obligations that can literally still be performed according to the original contract terms if the circumstances in which the obligations were assumed were completely different to those in which they fall to be enforced'.[52] However, the basic proposition of the DCFR is that 'in normal situations there is no incompatibility between contractual freedom and justice' so 'in some situations, freedom of contract, *without more*, leads to justice'.[53] In the case of the rule on a change of circumstances this means in particular that 'the parties remain free, if they wish, to exclude any possibility of adjustment without the consent of all the parties.'[54] The extent of this statement will be discussed below.

The exceptional nature of the rules on a change of circumstances has been confirmed by the scarce reported case law that has relied on the rules of the PICC as the main or a complementary foundation. An example is a case where a Dutch and a Turkish party had concluded a contract for the installation of machinery for the production of lump sugar. The law which was applicable to the contract was Dutch law. After the conclusion of the contract the Turkish buyer refused to pay the agreed amount of the advance payment, invoking financial difficulties due to a sudden drop in the market demand for lump sugar. The buyer invoked article 6:258 of the Dutch Civil Code (the law applicable law to the case) as a ground of relief. The ICC International Court of Arbitration rejected the defence of the buyer not only based on Dutch law, but also relying on article 6.2.1 of the PICC, which was cited because of the international nature of the dispute.[55]

3.1.2. Scope of the rules

By their very nature, the relevant provisions of the PECL and the UPICC are only applicable to contractual obligations. In contrast, in the case of the DCFR, its article III.-1:110 is applicable to contractual obligations and obligations arising from a unilateral juridical act. The inclusion of the latter category is not a common feature of national jurisdictions or international instruments, but taking into account that a large number of unilateral juridical acts (and in some case of unilateral contracts) have a gratuitous nature (i.e. the debtor does not receive any counter-performance), the protection granted to the debtor

52 DCFR, Principles, p. 47.

53 DCFR, Principles, p. 39. Of course, that assertion is *only* true in the hypothetical situation in which the parties are fully informed and in an equal bargaining position. The problem is that in most cases that hypothesis is not present, because there are asymmetries in information and/or the bargaining power between the parties.

54 DCFR, Principles, p. 47.

55 ICC International Court of Arbitration, Zürich, September 1996, n. 8486, available at http://www.unilex.info/case.cfm?pid=2&do=case&id=630&step=Keywords. Other cases are cited in Bonell (2006) and McKendrick (2009), p. 716.

facing a serious and unforeseen change of circumstances in these cases is completely justified.

The Official Comments of the DCFR also stress the exclusion of obligations which arise by the operation of law. That option seems justified, since in those cases the law itself provides mechanisms to adjust (or not to do so) the obligations imposed on the debtor, e.g. in Family law with regard to maintenance obligations. In the case of non-contractual liability, the arguments of protecting good faith and fair dealing cannot be applied, as well as the equilibrium between counter-performances. Besides, in that situation, the victim is entitled to reparation for the damage suffered, regardless of the onerousness or difficulty for the person liable to comply with such an obligation.

3.2. The conditions for the application of the remedies

3.2.1. The effect of changed circumstances on the parties' obligations

Although the three instruments under analysis require that the supervening events have a severe consequence for the obligation of the parties, including either an increase in the cost of the performance to be rendered or a decrease in the value of the expected counter-performance, conceptually there are some differences concerning when this disturbance becomes relevant for the application of the respective provisions.

Thus, the PICC definition of hardship is based on the fundamental alteration of the equilibrium of the contract. It has been argued that the word *fundamental* implies a high threshold for the configuration of hardship, reflecting the general rule laid down in article 6.2.1.[56] The approach of the PECL may be regarded as similar, even when the emphasis of article 6:111 is placed on the supervening excessive onerosity of the affected party's performance. Unlike the PICC, the PECL Official Comment adds that such excessive onerosity takes place when the changed circumstances result in a 'major imbalance in the contract' so that the contract is 'completely overturned by events'. Although no reference is made in the PICC to an excessive burden for the affected party as consequence of the supervening events, it is considered that such a condition is implicit in the requirement that the alteration of the contract equilibrium has to be fundamental.[57]

On the other hand, the approach of the DCFR can be considered to be more restrictive. Thus, the DCFR not only requires that the performance has become excessively onerous, but it also has to be *manifestly unjust* for the debtor to perform the obligation as agreed (article III.- 1:110(2)). The Official Comment, similar to the PECL, adds that in the case of a contract this means that 'the whole basis of the contractual relationship can be regarded as completely overturned by events'.[58] Neither in the PECL nor in the PICC a reference

56 McKendrick (2009), p. 718, stressing the difference with other concepts as 'material' or 'substantial' that implies a lower threshold.
57 *Ibid*., pp. 719-720.
58 DCFR, Official Comment, p. 713.

to the justice or injustice of the supervening onerousness or the contractual imbalance is made. Similarly, domestic legislations also avoid any reference to the criteria of fairness or justice.[59]

The interpretation of the expression 'manifestly unjust' may be problematic. There is no doubt that considerations of justice are the fundamental nature of and the background to the provisions on changed circumstances, but at the same time the conditions stated for its application have to avoid, as far as possible, subjective parameters that can be arbitrarily interpreted both in favour of or against any of the parties. Thus, the assessment of justice may lead the court to examine, for the application of the provision, factors which are external to the contract itself, e.g. the economic situation of the promisor, its relative position on the market and even its related contracts with third parties.[60] This approach has been contended because it 'raises serious obstacles to consistency in the application of the doctrine' in the sense that it entails enormous processing costs in litigation and it only has an ad-hoc value which is limited to the particular facts of each case.[61] In this sense, Italian legal doctrine has agreed that the assessment of onerousness should be based on objective criteria and not in the subjective situation of the specific party.[62]

In any case, the assessment of the onerousness of the performance as being excessive or severe is difficult and a case-by-case analysis cannot be avoided. Furthermore, such an assessment cannot be made by means of arithmetical parameters, but is a task for the court that has to consider the circumstances of the particular case in order to establish the seriousness of the consequences for the debtor in maintaining performance as agreed.[63] The assessment has to be made by comparing the situation at the time of concluding the contract with the situation at the time of its execution. Particularly, in the case of bilateral contracts, the evaluation has to be made with regard to the whole transaction and not only the obligation of the affected party. Therefore, a comparison between the counter-performances is required in order to determine whether the economic balance of the

59 Article 1467 of the Italian Civil Code only requires that performance by one of the parties has become excessively onerous. The German BGB refers to a fundamental change of circumstances (*Störung der Geschäftsgrundlage*) which has become the basis of the contract (§313.1). The French reform projects also mention the excessive onerousness of the performance or a disturbance to the contractual equilibrium as relevant parameters. The Dutch BW may be considered as an exception because its article 6:258 is applicable in the case that 'unforeseen circumstances which are of such a nature that the co-contracting party, according to criteria of reasonableness and *equity*, may not expect that the contract be maintained in an unmodified form.'

60 This has been the approach in some American decisions: *Louisiana Power & Light Co. v. Allegheny Ludlum Industries Inc.,* 517 F. Supp. 1319 (E.D. La. 1981); *Iowa Electric Light and Power Company v. Atlas Corporation,* 467 F.Supp. 129 (N.D. Iowa,1978); *Eastern Airlines Inc. v. Gulf Oil Corp*., 415 F. Supp. 429 (1975). See Chapter six.

61 Halpern (1987), p. 1137.

62 Sacco, De Nova (2004), p. 998. See Chapter four.

63 See UPICC, comments to article 6.2.2. It is worth noting that its previous version (1994) contained a paragraph which was suppressed in the 2004 version: 'If, however, the performances are capable of precise measurement in monetary terms, an alteration amounting to 50% or more of the cost or the value of the performance is likely to amount to a "fundamental" alteration.'

contract has been fundamentally altered as was intended by the parties upon its conclusion. Therefore, even when the supervening events have made the performance of the affected party excessively onerous, if the counter-performance is also severely burdened by the new circumstances, the relevant provisions are not applicable.

3.2.2. The change of circumstances must have occurred after the time when the obligation was incurred

This is a common prerequisite both in uniform law instruments as well as in domestic jurisdictions. The aim is to distinguish the rules on a change of circumstances from (principally) the rules of mistake. Then, if the relevant circumstances were already present at the time when the obligation was incurred, but they were ignored by the parties or at least by the affected party, the rules on mistake may be applicable, provided that the conditions for its application are met.

Nevertheless, article 6.2.2(a) of the PICC also includes the case where 'the events… become known to the disadvantaged party after the conclusion of the contract'. Therefore, the provision may be applied to events that occurred before the conclusion of the contract but were ignored by the affected party, giving the opportunity to claim on grounds of hardship that can conceptually be considered as cases of mistake.

3.2.3. The debtor did not take into account, and could not reasonably be expected to have taken into account, the change of circumstances

This requirement can be summarized stating that the change of circumstances has to be *reasonably unforeseen* for the debtor. The introduction of the standard of reasonableness to measure the foreseeability of the events implies that the condition is not satisfied with a mere subjective analysis of the particular situation of the debtor, i.e. its internal perspective; rather, the measure has to be in relation to 'a reasonable person in the same situation of the debtor'.[64] Therefore, the assessment must include objective standards such as the quality of the affected party, the nature of the contract, the surrounding market conditions and other similar criteria. The reasonableness standard is also related to the aptitude of the debtor (as an average party or a reasonable man in the same situation) to foresee and to anticipate such events, acting with proper diligence and care, according to the circumstances of the particular case.[65]

Article III.-1:110(2)(b) of the DCFR expressly states that the foreseeability test is applicable not only in relation to the *possibility* of a change of circumstances, that is, its occurrence; but also to the *scale* of such change, i.e. its magnitude or intensity. This is an improvement in comparison with the respective provisions of the PECL and the UPICC that refer only to the possibility of the occurrence of that change. In some cases, even a foreseeable event may have an unforeseeable *intensity*. The assessment of foreseeability is therefore not only

64 DCFR, Official Comment, p. 714.
65 See Chapters four and five.

related to the nature of the event, but also to its magnitude or consequences concerning the obligations of the parties.[66] As will be examined further on, the inclusion of the scale of the change of circumstances as a measure of foreseeability may have consequences for the express or implied assumption of risks by the parties.

3.2.4. The exceptional nature of the change of circumstances

In contrast to the PICC and the PECL, the DCFR requires that the change of circumstances must be 'exceptional'. However, a definition of the term 'exceptional' is not provided in the Official Comment and the corresponding Illustration (2) is unclear. The insertion of the requirement which is under analysis is justified in the Comment as a consequence of the consultation with the stakeholders who criticized the lack thereof in the PECL.[67] Again, the reasons for such concern are not specifically stated but can be deduced in relation to the general intention to place strict limits on the application of the rules on changed circumstances.

The absence of such a definition is understandable since in the concept of 'exceptional' it is difficult in both theory and practice to delimit and distinguish it from the further requirement of foreseeability, especially when foreseeability is linked to the standard of reasonableness, which is again related to concrete (i.e. objective) standards and not only to the internal perspective of the affected party.[68]

Taking into account the mentioned requirement of foreseeability, one option is to link the exceptional nature of the change of circumstances to objective standards capable of external and even neutral assessment. For instance, the event should be unusual (not frequent or not regular over time) and of a general nature (affecting society as a whole or at least an entire category of parties in the same situation).[69]

The requirement that the change of circumstances is of an exceptional nature can be questioned. From a comparative perspective, in most cases that requirement is not present. As analysed above, the PICC does not include the requirement that the change of circumstances has to be exceptional or extraordinary but only requires that the disruptive events could not reasonably have been taken into account by the affected party. The provisions of domestic jurisdictions such as the German BGB (§313) and the Dutch BW (article 6:258) follow the same trend. Likewise, the relevant provisions of the different proposals for the reform of the law of obligations in France include only the foreseeability

66 Italian and Argentinean case law has adopted this approach. See Chapters four and five for further references.

67 DCFR, Official Comment, p. 713.

68 Reasonableness is defined in Article I.–1:104: *Reasonableness is to be objectively ascertained, having regard to the nature and purpose of what is being done, to the circumstances of the case and to any relevant usages and practices*.

69 This has been the approach of domestic jurisdictions having provisions with a similar requirement, as Italy and Argentina. See Chapters four and five for further references.

test with regard to a change of circumstances.[70] In similar terms, the Revised Principles of European Contract Law does not require that a change of circumstances has to be exceptional or extraordinary, but only 'reasonably unforeseeable'.[71]

Even the assertion that the requirement is implied in the PECL is somewhat doubtful. The text of article 6:111 refers just to a change of circumstances and when the comments refer to 'exceptional circumstances' this is in relation to the exceptional nature of the rule (as an exception to the *pacta sunt servanda* principle) and not specifically as a condition of the change of circumstances in itself as relevant.[72]

Additionally, the DCFR rules on impossibility do not require the impediment to be 'exceptional' (article III.- 3:104) but that it must be beyond the debtor's control. The requirement is therefore linked to external causes outside the debtor's sphere of control, but in any case it is conditional upon being 'exceptional'. Then, the internal coherence between the provisions on impossibility and a change of circumstances means that the suppression of the exceptionality requirement is preferable. This is particularly true if it is assumed that, in practice, it may be difficult to distinguish between situations of impossibility and a change of circumstances.[73] If the essential difference between the two institutions is the *consequence* of the supervening events for the obligation of the debtor (in the former case performance becomes impossible and in the latter case excessively onerous) then the requirements for the operation of both provisions should be consistent with regard to the *causes* of the mentioned consequences. As the comments state, the provision on a change of circumstances 'must be read along with the Article on "impossibility."' In sum, the external nature of the circumstances and the standard of reasonable foreseeability should be common requirements for these two provisions. This is the approach of the PICC, which in the provisions on hardship and on *force majeure* (article 7.1.7) require, as a common requisite, that the events must have been beyond the control of the affected party.

70 See Chapter three.

71 Article 7:101: Change of Circumstances (modification of article 6: 111) (1) If a contract becomes deeply unbalanced during its execution due to a change of circumstances that could not reasonably be foreseen, the parties must renegotiate it in order to revise or terminate the contract. (2) If, in spite of the good faith of the contracting parties, the renegotiations do not succeed within a reasonable time, the parties can terminate the contract by common agreement; if this does not happen, a court can equitably revise the contract or deprive it of future effect. The Revised Principles of European Contract Law were prepared by the Association Henri Capitant des Amis de la Culture Juridique and the Société de Législation Comparée. See Fauvarque-Cosson et al., (2008).

72 See PECL, art. 6:111, Official Comment A.

73 The Official Comment of the DCFR states at p. 711 that 'there is sometimes a very fine line between a performance which is only possible by totally unreasonable efforts, and a performance which is only very difficult even if it may drive the debtor into bankruptcy'. In the same sense, the Official Comment in article 6.2.2 of the UPICC adds that 'there may be factual situations which can at the same time be considered as cases of hardship and of force majeure', p. 187. On the distinction and relation between impossibility and a change of circumstances, see the introductory Chapter.

It can be argued that the requirement of exceptionality places too heavy a burden on the affected party to rely on the provision and may have the effect that it cannot be invoked in practice. The requirement of reasonable foreseeability is sufficient both to protect the general principle of the sanctity of contracts and the interests of the creditor. The standard of reasonableness implies objective criteria for measuring foreseeability and does not rely only on the internal considerations of the debtor, therefore providing legal certainty to the process of assessing that foreseeability and avoiding eventual opportunistic behaviour by the debtor.

3.2.5. Risk allocation

The three instruments being studied require that the affected party did not assume the risk of a change of circumstances. Their Official Comments clarify that such an assumption may be express or implied, arising from the nature of the transaction or other relevant circumstances of the particular case.

With regard to the latter category, this prerequisite overlaps with the others. Thus, if the change of circumstances was reasonably foreseeable, and the debtor did not take any measures to protect himself, it can be considered that he assumed the risk of that change. In the same sense, if the supervening onerousness of the obligation (the *consequence* or *effect* of the change of circumstances) is not excessive, then it can be considered as being included in the normal risks of the contract. In that event, in most cases, the allocation of risks *ex-post* is determined by the concurrence (or not) of the other conditions laid down for the application of the rules. The nature of the contract as a parameter for the distribution of risks is also problematic because without regard to clear exceptions such as some speculative transactions, the determination of what is considered to be the *nature* of the transaction is far from clear. For example, it can be argued with similar strong and valid arguments that the essential element in a long-term relationship is to protect the parties from future changes and therefore the party affected by a change of circumstances must to assumed to bear the risks of such a change; *or*, that long-term relationships are essentially incomplete and therefore a change of circumstances implies the necessity to adapt the relationship.

The implied assumption of risks has been used by the courts to reject the application of the PICC hardship provisions in particular cases. Thus, in a case decided by the Supreme Court of Lithuania, the buyer of shares in a company refused to pay the total agreed price (20% had already been paid) on the ground that between the conclusion of the contract and the date for paying the balance, the company had become insolvent with the consequence that the value of the shares had considerably diminished. On rejecting the buyer's defence, the Court stressed the special nature of the goods (shares) and that the risk of fluctuations in the price of the shares was deemed to be assumed by the buyer.[74] In another case, a

74 *G.Brencius v. Ukio investicine grupe*, Supreme Court of Lituania, 19.05.2003, n. 3K-3-612, available at http://www.unilex.info/case.cfm?pid=2&do=case&id=1183&step=Abstract.

Mexican grower (the defendant) and a U.S distributor (the claimant), entered into a one-year exclusive agreement according to which the grower undertook to produce specific quantities of squash and cucumbers and to provide them to the distributor on an exclusive basis. The grower did not perform the contract arguing that its failure to deliver the goods was due to the destruction of the crops by a series of extraordinarily heavy rainstorms and flooding caused by the meteorological phenomenon known as 'El Niño'. According to the grower these events amounted to a case of force majeure and/or hardship. The Centro de Arbitraje de México rejected both grounds of relief and it stated, in particular concerning hardship, that although the alleged events substantially increased the grower's costs in performing, in the context of a distributorship agreement concerning specific quantities of goods to be delivered, a vegetable grower *typically* takes on the risk of a crop destruction by rainstorms and flooding.[75]

Concerning an express ex-ante distribution of risks, the parties are in principle free to agree on the allocation of risks in the contract, e.g. stating that one or more particular risks are exclusively assumed by one of the parties. In that case, the party who assumed the risk of the change of circumstances cannot later rely on the remedies provided for that situation.

However, because that assumption implies an aggravation of the responsibility of the debtor, it should be strictly construed and in good faith, being only applicable to the specific situations provided in the contract and in cases which can be regarded as reasonably foreseeable for the parties. Furthermore, the bargaining process and the situation of the parties are relevant in establishing the extent of the clause.[76]

In addition, as stated before, the inclusion of the *scale* of the change of circumstances as a measure of foreseeability may have consequences for the express or implied assumption of risks by the parties. Then, even when the contract includes express clauses dealing with the consequences of particular supervening events and placing the burden of the risk of the occurrence of such events on one of the parties, if the intensity or scale of those events can be regarded in the particular case as being unforeseeable and therefore totally outside the legitimate expectations of the parties, the debtor is entitled to invoke the remedies for a change of circumstances.

For instance, if the contract includes a stabilization clause, such a clause does not prevent the invocation of the remedies when the contract has been concluded under normal economic conditions (e.g., with a regular fluctuation in the values of currencies or in the rate of inflation) which were subsequently radically disturbed not by the *occurrence* of the event itself (which may even have been already present, as in the case of inflation) but by its extraordinary and unforeseeable *intensity*. It can be argued that the aim of such clauses

75 Centro de Arbitraje de México (CAM), 30.11.2006, available at http://www.unilex.info/case.cfm?pid=2&do=case&id=1149&step=Abstract.

76 A similar approach has been adopted in Argentina. See Chapter Five.

is to anticipate reasonably foreseeable circumstances as well as their foreseeable effects for the obligations of the parties, but they cannot be regarded as covering consequences which were never considered (because they were unforeseeable) by the parties.[77]

A further problem arises in relation to a general assumption of risks by the debtor. In this case, the debtor assumes a higher degree of liability, because in theory he has to perform his obligation without considering any supervening event that may affect it. Therefore, the application and interpretation of this kind of general clause must be even more restricted than those clauses dealing with the assumption of risks concerning particular events. Besides all the restrictions previously stated (especially with regard to the scale or intensity of the change of circumstances) the text proposed in the Revised Principles of European Contract Law seems appropriate:

Article 7:102: *Clauses relating to the Allocation of Risk. A clause which allocates the major part of the risk of a change of circumstances to one of the parties is only valid where it does not bring about unreasonable consequences for that party. The clause cannot be applied when the change of circumstances is due, either completely or in part, to the party to whose benefit such a clause operates*.

The provision has the aim of preventing the parties from completely avoiding the application of the rules on a change of circumstances. In comparative law, as an expression of good faith, the provisions concerning a change of circumstances are considered to have a mandatory nature in Germany,[78] the Netherlands[79] and Italy.[80]

The last assertion is linked to the problem concerning the mandatory or dispositive nature of the provisions on a change of circumstance. The DCFR comments on the principle of security seem to imply that the rules on a change of circumstances are not mandatory, since, as already stated, 'the parties remain free, if they wish, to exclude any possibility of adjustment without the consent of all the parties.'[81] Therefore, the parties could exclude the application of article III.- 1:110 to their contractual relationship, which would imply that the party affected by a change of circumstances would have to bear the risk of such a change in all cases.[82] The approach of the DCFR with regard to mandatory rules is restrictive and the test of fairness is preferred in order to protect the weaker party, then, 'usually it would be sufficient that a term is not binding on the aggrieved party if *in the particular circumstances* it is unfair'.[83] Therefore, the fact that the rules on a change of

77 *Ibid*.
78 Rösler (2007), p. 490.
79 See Hondius, Grigoleit (2010), forthcoming.
80 Trabucchi (2001), p. 724.
81 DCFR, Principles, p. 47, paragraph 21. The comment refers to article II.- 1:102 (party autonomy) and III.- 1:110(3)(c) as a ground for its assertion.
82 In a bilateral contract, the exclusion may be laid down for the obligations of both parties or only for one party.
83 DCFR, Principles, pp. 42-43.

circumstances are not mandatory for the parties is consistent with the general approach of the DCFR concerning restrictions to the freedom of contract.

However, for a number of reasons, the best option seems to be to consider the rules on a change of circumstances to be mandatory for the parties. Those rules are a reflection of the principle of justice (as a qualified exception to security) and more particularly of the duty to act in accordance with good faith and fair dealing, which 'may not be excluded or limited by contract or other juridical act.'[84] Hence, the rules on a change of circumstance are contained in the mandatory nature of the mentioned duty. It is contradictory to state, on the one hand, that the parties cannot themselves avoid the duty of good faith, but, on the other, that this is possible in specific cases that are a consequence of such a duty. A conclusion such as this would imply that the content of the duty to act in good faith would be emptied and its practical application would be denied.[85]

A logical argument may be also added: if the parties exclude the application of the rules on a change of circumstances it is the same as if they (or one of them) assume *all* the risks (and therefore the liability) of *all* changes of circumstances (both foreseeable and unforeseeable) that may affect performance. The problem is that the assumption of a risk implies at least that the party who assumed the risk should reasonably be expected to have taken the occurrence of that risk into account. In other words, it is not logically possible to assume the risk of the occurrence of an unforeseeable change of circumstances because such an assumption necessarily requires the (reasonable) foreseeability of the risk by the debtor. Therefore, a clause that generally excludes the application of article III.- 1:110 or that allocates all the risks of performance on one party cannot be considered as valid and, in any case, it will not be applicable with regard to reasonably unforeseeable changed circumstances that may affect performance and which (because they were reasonably unforeseeable) cannot be regarded as being included in the contractual clause.[86]

3.2.6. The request for renegotiation

The final condition for the application of the provisions on a change of circumstances is the request to renegotiate the contract by the affected party. Both the PICC and the PECL do not include the request to renegotiate as an express a requirement in the respective articles, but since the parties may only resort to the courts after renegotiations have failed, it follows that it is compulsory for the debtor to make such a request if he wants to rely on the provisions on changed circumstances. In contrast, article III.- 1:110(2)(d) of the DCFR expressly states as a condition for its application that 'the debtor has attempted, reasonably

84 Article III.- 1:103(2) of the DCFR.

85 The imperatives of 'not taking undue advantage' and 'no grossly excessive demands' are regarded as a manifestation of justice and complement the duty of good faith and therefore also support this conclusion.

86 See Mosset Iturraspe (1994), p. 295, who states that it is not possible to assume a risk that one could not know or anticipate and that to argue the contrary is to admit the fiction that it is possible to foresee the unforeseeable.

and in good faith, to achieve by negotiation a reasonable and equitable adjustment of the terms regulating the obligation.'

The attempted renegotiation has to be reasonable and in good faith, which implies that renegotiations must be requested without undue delay and the grounds on which the request for renegotiation is based must be indicated. Consequently, the request must be made just after the affected party has knowledge of the supervening events and must specify what the new circumstances are and how they affect its performance so that the counterparty may properly consider the request. The duty of good faith also entails that the proposals have to be serious, coherent and provide all the necessary information for their adequate evaluation by the counter-party. In addition, a reasonable time must be established for the renegotiation process.[87]

The DCFR adds that the adjustment proposed by the affected party must be 'reasonable and equitable.' This has to be interpreted in the sense that, to be reasonable and equitable, the proposed adjustment of the contract cannot entail an absolute restoration of the contractual balance as agreed by the parties at the time of concluding the contract, but just to eliminate the excessive onerousness of the performance so that the transaction will still be a good deal for the creditor and a bad but bearable deal for the debtor. In short, the rule cannot be used as a way of *completely* shifting the risks from one party to the other.[88]

3.2.6.1. The absence of an obligation to renegotiate

The DCFR Official Comment expressly states that article III.- 1:110 does not impose an obligation to negotiate but, instead, 'in order to encourage negotiated solutions' the debtor has to request renegotiations if he wants to rely on the remedies provided by the article. Regardless of that intention, it is difficult to see how negotiated solutions will be encouraged if the Comments themselves state that 'there is no question of anyone being forced to negotiate or being held liable in damages for failing to negotiate'. The main reason for changing the approach followed by the PECL is that a duty to renegotiate is 'undesirably heavy and complicated.' However, the Comments do not provide any further argumentation to support such a statement other than a criticism of 'some stakeholders' and an example of an exceptional nature, which is far from persuasive.[89]

Consequently, good faith is required for the affected party to request renegotiations, but on the contrary it can be argued that such a duty is not imposed on the advantaged party at the same stage, which seems to contradict the general duty of good faith provided by article III.- 1:103.[90] Then, even a complete and unjustified refusal to enter into renegotiations would not lead to sanctions for the advantaged party.

87 See Chapter eight for further references.
88 Italian and Argentinian law have adopted a similar approach. See Chapters four and five.
89 DCFR Official Comment, pp. 712-713.
90 III.–1:103: Good faith and fair dealing. *(1) A person has a duty to act in accordance with good faith and fair dealing in performing an obligation, in exercising a right to performance, in pursuing or defending a*

However, it can also be argued that article III.- 1:103 is applicable to the creditor in this situation and therefore the breach of the duty of good faith may prevent him from exercising or relying on the rights and remedies arising from the non-performance of the contract by the debtor; e.g. specific performance and damages. This is a natural consequence of the DCFR's general approach to good faith, since the duty of good faith – the requirement for the parties to act in good faith – is considered as a duty and not an obligation.

In similar terms, it is has been argued that under the PICC there is no express obligation for the advantaged party to enter into renegotiations, especially if the relevant provision is contrasted with article 6:111 of the PECL.[91] Nevertheless, this argument is not totally convincing, since it is not superfluous that article 6.2.3 expressly *entitles* the disadvantaged party to request renegotiations. If such a party is so entitled because he has a *right* to do so, consequently the advantaged party has the *duty* to enter into renegotiations. Additionally, the request for renegotiations is included in the provision that deals with the *effects* of hardship. It would be nonsense to expressly grant such a right for the affected party with no counter-duty for the advantaged party because obviously both of them may always require a renegotiation of the contract, even if no hardship is present. The official comments of the PICC confirm this interpretation when it is expressly stated that 'the disadvantaged party does not lose its *right* to request renegotiations simply because it fails to act without undue delay'. In the same sense, Bonell does not question the existence of a duty to renegotiate as the primary effect of hardship under the PICC, stating that 'Art.6.2.3 (Effects of Hardship) *grants* that party the right to request the renegotiation of the contract in order to adapt its terms to the changed circumstances'.[92] Arbitral decisions have also recognized the existence of a duty to renegotiate under article 6.2.3 of the PICC.[93] As mentioned above, the Belgian *Hof van Cassatie* has held, in a case concerning an international sales contract governed by the CISG, that under the principles of the law of international trade, in particular incorporated in the PICC, the party affected by a change of circumstances that fundamentally disturb the contractual balance is entitled to request a renegotiation of the contract.[94]

remedy for non-performance, or in exercising a right to terminate an obligation or contractual relationship. (2) The duty may not be excluded or limited by contract or other juridical act. (3) Breach of the duty does not give rise directly to the remedies for non-performance of an obligation but may preclude the person in breach from exercising or relying on a right, remedy or defence which that person would otherwise have.

91 McKendrick (2009), p. 722; and DCFR, Official Comment, p. 713.

92 Bonell (2005), p. 118.

93 2000 Arbitral Award ICC International Court of Arbitration (No.10021); and December 2001 Arbitral Award ICC International Court of Arbitration (No. 9994), cited in Bonell (2006), pp. 337, 817, 985. In the latter decision, the Court expressly stated that the duty to renegotiate in cases of changed circumstances 'is also prevailing in international commercial law (see PICC art. 6.2.2 and 6.2.3)'. In the same sense, Centro de Arbitraje de México (CAM), 30.11.2006, available at http://www.unilex.info/case.cfm?pid=2&do=case&id=1149&step=Abstract.

94 *Scafom International BV v. Lorraine Tubes S.A.S*; N°C.07.0289.N..

On the contrary, the PECL expressly recognize the existence of a duty to renegotiate in the case of changed circumstances.[95] Legal doctrine agrees that if the reason for the failure is the unjustified refusal by one party to enter into negotiations or if the reason for breaking off negotiations is abusive conduct or bad faith, the affected party may claim damages. In this case, damages caused by a delay and the costs incurred when relying on attaining the failed agreement could be awarded.[96] The PECL expressly follow this approach considering the obligation to renegotiate as independent from the remedies granted in a case of changed circumstances. Thus, the last paragraph of article 6:111 states that 'In either case [the termination or adaptation of the contract by the court], the court may award damages for the loss suffered trough a party refusing to negotiate or breaking off negotiations contrary to good faith and fair dealing'.

3.3. Remedies

If the conditions stated above are fulfilled, and the parties could not reach an agreement concerning the contract's adjustment to the new circumstances, either of the parties may bring the matter before the courts.[97] The courts have wide powers and can either modify the contract or terminate it whichever is the more suitable in a specific case.

The termination of the contract is the easiest and more drastic solution. However, this solution cannot be the most appropriate for the interests of the parties, particularly if both want to preserve the contract or if another kind of interest is involved in the transaction, such as third parties' or public interests. Then, the option of giving the courts wide powers to determine the terms of the termination (e.g. concerning retroactivity, the date, restitution, non-performed or partially performed obligations) seems appropriate to mitigate the eventual inconvenience of this remedy.[98]

Although there is not an order of preference between termination and adaptation, it follows from the principle of *favor contractus* that the court first has to explore the eventual adaptation of the relationship to the changed circumstances. With regard to this adaptation, the aim laid down in the provisions is to make the obligation reasonable and equitable under the new circumstances. The PECL and DCFR Official Comments add that in the case of contractual obligations this entails re-establishing the contractual balance 'by ensuring that *any* extra costs caused by the unforeseen circumstances are borne fairly by the parties. They should not be placed solely on one of them.'[99]

95 Article 6:111(2) provides that '*If, however, performance of the contract becomes excessively onerous because of a change of circumstances, the parties are bound to enter into negotiations with a view to adapting the contract or terminating it.*'

96 Berger (2003), p. 1369. See also Mazeaud (2007) p. 767.

97 In theory, the right is granted to either party, but in practice this will in most cases be the debtor who will request the intervention of the court on these grounds, either as an action or as a defence.

98 See Chapter nine for further references.

99 PECL Official Comment, p. 326; DCFR Official Comment, p. 715.

However, those statements are not completely correct and may lead to confusion. As stated with regard to the equitable proposal to adjust the contract, the aim of the adjustment or adaptation is not to restore *completely* the economic equilibrium of the contract as and when it was concluded, but simply to eliminate the excessive onerousness of the performance. Thus, it is not correct that *any* costs resulting from the supervening circumstances must be fairly shared by the parties, but only those costs that can be considered to be beyond the 'limit of sacrifice', 'i.e. the threshold where performance has not only become "more onerous", but "excessively onerous"'.[100] Taking such a limitation into account, the court must 'seek to make a fair distribution of the losses between the parties...the adaptation will not necessarily reflect in full the loss entailed by the change in circumstances...'[101] Therefore, considering that the binding force of contracts is a general principle, the affected party must bear the risk of any increased performance until it becomes excessively onerous.[102]

A further restriction to the powers of the courts is the prohibition on redrafting the entire contract or changing its nature.[103] Therefore, any modification of the contractual terms cannot in any case result in a new and completely different contract being imposed on the parties, e.g. changing the subject-matter of the contract or imposing a new and completely different obligation for one party.

3.4. Conclusions

The examination of the international instruments of contract law included in this Chapter has revealed that the contemporary trend is to recognize the effect of changed circumstances on the parties' obligations, conferring wide powers to the courts to decide on the termination and adaptation of the contract. The three non-legislative codifications examined follow this approach, and their provisions can be considered as being equivalent to a great extent, despite the more restrictive attitude of the DCFR with regard to the requisites and effects of a change of circumstances.

In this regard, the exceptional nature of the change of circumstances and the condition that, as a consequence of such a change, it would be manifestly unjust to hold the debtor to his obligation are excessive requirements for the application of the rule. To avoid an eventual abuse of the rule by parties only looking to escape from bad dealings, the reasonable foreseeability test and the excessive onerousness of the performance seem to be adequate and sufficient prerequisites in this respect.

Similarly, the rejection of renegotiation as a duty for both parties is against the general trend in European and international contract law. The reasons stated for that rejection are far from clear, and they oppose the generally accepted assertion that the parties themselves are in the best position to adjust or adapt the contract terms to the new circumstances. In

100 Brunner (2009), p. 499. See also Sacco, De Nova (2004), p. 1003.
101 UPICC Official Comment 7, art. 6.2.3.
102 See Chapter nine.
103 See PECL Official Comment, p. 117.

this sense, the law and the courts should encourage the parties, as far as possible, to find a way to settle their conflict by agreement.

On the other hand, the inclusion of the scale of the change of circumstances as a measure for assessing its foreseeability must be considered as a positive innovation of the DCFR in comparison with the PICC and the PECL.

With regard to the CISG, the subject of a change of circumstances remains unsettled both in legal doctrine and in case law.[104] This fact demonstrates that the option of the drafters to exclude the regulation of the subject from the CISG was not the best, because too much room has been left for diverging interpretations. It is not realistic to assume that the parties themselves will always provide for solutions in their agreements. On the contrary, a number of factors may prevent the inclusion of express clauses in this respect, e.g. because the parties are not always sufficiently sophisticated or there is not enough time to settle the deal in all its details. Besides, situations of hardship have a great potential to arise in international commercial transactions as well as in long-term contracts. The approach of the PICC, the PECL and the DCFR, with an express and clear legal provision regulating the concept, the requirements and the effects of a change of circumstances seems to be the best option in solving more of the problems and discussions on the subject.

In this sense, the decision of the Belgian *Hof van Cassatie*, by which the concept of impediment includes cases of excessive onerosity due to an unforeseen change of circumstances, and referring to general principles to fill the gap in the CISG, appears to be the right approach to the problem. The express purpose, stated in art. 7.1 of the Convention, of promoting uniformity in its application is an issue which is of major relevance and that cannot be omitted by the courts. The great differences between national legal systems with regard to the acceptance, the requirements and the effects of hardship or a change of circumstances would result in uncertainty for the parties if the courts rely on domestic law to decide a dispute.

Although it can be argued that the hardship rules as contained in the PICC can be used as a reflection of the general principles on which the CISG is based, that approach has advantages that make it preferable. The Convention suffers from the deficiencies resulting from its own legal nature: being an international convention is the product of necessary and unavoidable compromises and updating it to incorpoate new developments is extremely difficult. Then, the only alternative to avoid the danger that the Convention becomes an obsolete and static instrument is through the incorporation of innovative and, at the same time, well-grounded doctrines by legal scholarship and case law. It would be a mistake to interpret literally the words of article 7.2 (the general principles on which [the

104 Lindström (2006), p. 22, stating that '"article 79 is a chameleon-like example of superficial harmony" and that 'it is possible to interpret the Article so that it suits the interpreters' background the best.' (references omitted); and Tallon (1987), 'the general wording of Article 79 leaves much room for judicial interpretation'. In the same sense, Honnold, Flechtner (2009), p. 627, 432.1. 'Article 79 may be the Convention's less successful part of the half-century of work towards international uniformity'.

Convention] *is based*) in order to restrict its application only to principles which exist at the time of the enactment of the Convention.

PART IV

THE EFFECTS OF A CHANGE OF CIRCUMSTANCES

Chapter 8

THE DUTY TO RENEGOTIATE AS AN EFFECT OF CHANGED CIRCUMSTANCES

1. Comparative assessment. The double role of renegotiation

The comparative survey of the national legal systems and non-legislative codifications included in the research has demonstrated that the renegotiation of the contract is regarded in most of them as a condition and/or effect in cases of changed circumstances.

Thus, both in Italy and the United States the existence of a duty to renegotiate for the advantaged party in cases of severe disruptions to the counterparty's performance has been argued on the basis of the principle of good faith, the duties of cooperation and flexibility, and, particularly in Italy, the positive approach of the *Codice Civile* to the *favor contractus* principle. Nevertheless, in practice American case law has rejected the existence of a duty to renegotiate the contract in cases of impracticability.

Similarly, in France the limited recognition of *imprévision* by the case law has been made in order to grant the affected party the right to claim the renegotiation of the contract in order to restore its economic balance. The basis for such a right and the corresponding duty is the principle of good faith (article 1134 of the *Code Civil*) and the duty of loyalty between the parties

In addition, in all the non-legislative codifications a renegotiation is regarded as a *requisite* for the affected party to later rely on the rules of changed circumstances if the negotiations fail. However, the existence of a *duty* to renegotiate is rejected by the DCFR, it is contended in the case of the PICC, and it is only certain in this respect in the PECL.

With regard to the Latin American jurisdictions, renegotiation has not been a primary concern for Argentinian legal doctrine and case law. In the same way, the only reported arbitral decision in Chile referring to the subject expressly rejects the existence of such a duty in the absence of an express contractual provision.

Finally, the more restrictive approach to the subject is the English common law, due to the absence of a duty to perform in good faith. Accordingly, even the effectiveness of express renegotiation clauses is contended.

Considering these statements, if renegotiation is deemed to be a duty and is therefore binding for *both* parties, its role in cases of changed circumstances is a double one:

On the one hand, it is a condition or requirement for the affected party to invoke the other available remedies granted by the legal system for these cases; and
On the other hand, it is an effect of the change of circumstances, since the advantaged party is bound to enter into the required renegotiations if the relevant conditions are present.

2. Source of the duty

In addition to the comparative assessment of the legal systems included in the research, it is interesting to note that most Civil Law European legal systems do not expressly impose a duty to renegotiate; although their legislation does recognize the effect of unexpected circumstances. Thus, the question is disputed in Germany because in the new §313 of the German Civil Code (*Bürgerliches Gesetzbuch – BGB*), which introduced the express recognition of the doctrine of *Störung der Geschäftsgrundlag* (disturbance of the contractual basis) there is no express reference to a duty to renegotiate. However, the primacy of adaptation over termination as the desirable solution to conflict between the parties leads to the conclusion that such a duty does exist. In this sense, even before the *BGB* reform, it had been argued that regarding special legislation and the philosophy of many court decisions the normal legal consequence of the collapse of the foundation of the transaction was that the parties were initially obliged to attempt to renegotiate an adaptation of the contract in good faith.[1] As in German law, article 6:258 (complemented by article 6:260) of the Dutch Civil Code (*Burgerlijk Wetboek – BW*) does not expressly refer to a duty to renegotiate, but some authors have stated that such a duty could be supported by the general provision on reasonableness and equity (article 6:248 *BW*).[2]

Due to these reasons, it seems relevant to search for an adequate source of the duty to renegotiate, with the aim being to justify its configuration as an effect in cases of changed circumstances.

2.1. Good faith and the nature of the contractual relationship as a source. An inherent or implied obligation

In American legal theory, the ideas developed by Ian Macneil on the relational theory of contract support the existence of a duty to cooperate between the parties which is implied

1 See Karampatzos (2005), p. 134, stressing that the parties are *obliged* to enter into negotiations before they go to court (emphasis added); and Horn (1985a), p. 15.
2 See for further references Busch et al., (2002), p. 289.

since flexibility and any adjustment of the relation are essential with regard to the necessary incompleteness of the parties' projection at the time of concluding a relational contract.[3] In the light of this theory, in long-term contracts *ex post* bargaining duties may be imposed on the advantaged party, e.g. in any event a legal duty to negotiate in good faith when required by the disadvantaged party, and in an extreme situation also a legal duty to accept an equitable adjustment which has been proposed in good faith by the disadvantaged party.[4] These duties arise because there are a number of prescriptive norms deriving from both within and outside the contractual relationship and their importance fluctuate with the relational aspects of the transaction. Common to all contracts is 'contractual solidarity' (the norm of holding exchanges together) which is intensified in long-term contracts and expanded and supplemented by two relational norms which enhance the continuation of relationships: 'the preservation of the relationship' and 'the harmonization of relational conflict'. The latter implies that the parties must be flexible, transact in good faith, develop trust and achieve coordination in the resolution of conflicts.[5]

In short, it requires permanent cooperation between the parties in the performance of the contract with the aim being to preserve it, which includes a duty to analyze and discuss in good faith the proposal of the disadvantaged party to adjust the contract in the light of unexpected circumstances. According to Speidel, 'the justification for the imposition of bargaining duties derives from two reinforcing normative propositions. The first is the judgement that the advantaged party should share through compromise the unbargained for gains and losses caused by unanticipated change. The second is that when unanticipated change imperils the long-term supply contract, the advantaged party should make every reasonable effort to preserve and adjust the relationship and to harmonize conflict.'[6]

Good faith has also been used in American legal doctrine as a basis to impose on the advantaged party a duty to renegotiate if the performance of the other party has been affected by unexpected circumstances and has become excessively burdensome. Good faith in the performance requires 'the cooperation of one party where it was necessary in order that the other might secure the expected benefits of the contract.'[7] This cooperation implies flexibility and a disposition with the aim of preserving the contract if one of the parties is faced with adverse circumstances. Both parties are under a duty to act in good faith which implies 'the duty to refrain from rendering performance impossible and to do everything that the contract presupposes should be done by a party to accomplish the contract's purpose'[8] The obligation to act in good faith in the performance and enforcement of the contract is recognized in the Uniform Commercial Code (UCC), article §1-304, Obligation of good faith: 'Every contract or duty within [the Uniform Commercial Code]

3 See Macneil (1980).
4 Speidel (1981), p. 404.
5 See Macneil (1980).
6 Speidel (1981), p. 405.
7 Farnsworth (1963), 672.
8 Williston, Lord (1990), §77:10, p. 306.

imposes an obligation of good faith in its performance and enforcement'.[9] The Restatement 2nd of Contracts also recognizes the existence of a duty to act in good faith in §205, which provides that 'Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement'

Similar grounds have been developed in France to support the existence of a duty to renegotiate; where consistent case law has held that a duty to renegotiate does exits if performance by one party has become excessively onerous, thereby radically changing the original contractual equilibrium.[10]

Based on the last part of article 1134 which establishes the duty to perform contracts in good faith, the French *Cour de Cassation*, first by its *Chambre commerciale* and then by its *Chambre civile,* stated that if unforeseen and serious circumstances result in a severe imbalance in contractual equilibrium, the principle of good faith and the duty of loyalty between the parties give rise to a duty for the advantaged party to renegotiate the terms of the contract at the request of the affected party. In both cases, the duty of loyalty was invoked to incur the liability of the party which refused to renegotiate the agreement when the performance of the contract had become excessively disadvantageous for the other. The case law of the *Chambre commerciale* was confirmed by the *Chambre civile* in a case on 16 March of 2004; which *a contrario sensu* the *Cour* has been interpreted in the sense that if an unforeseen change of circumstances seriously affect the balance between the mutual obligations, a duty to renegotiate will arise in order to restore that balance.[11]

Nevertheless, it must be stressed that the duty to renegotiate is considered by the *Cour de Cassation* as a last and only resort for the disadvantaged party in a case of changed circumstances, and no right is granted to have the contract terminated or adjusted by the court.

Based on the *favor contractus* principle and the duty of good faith which is present in the rules of interpretation, integration and the performance of contracts (articles 1366, 1374 and 1375 of the *Codice Civile*) a general duty to renegotiate in good faith has been inferred in long-term contracts by Italian legal doctrine. It is stated that when the conditions for actually performing the contract no longer respond to the economic logic underlying the conclusion of the contract, the disadvantaged party has the right to request renegotiations in order to restore the contractual equilibrium.[12] Additionally, also the integration of the

9 Good faith itself is defined in §1-201(20) of the UCC as 'honesty in fact and the observance of reasonable commercial standards of fair dealing.'

10 Cass. com, 3 November 1992, « *arrêt Huard* », D. 1995, Somm. p. 85, note D. Ferrier; Cass. com. 24 November 1998, « *arrêt Chevassus-Marge* », D. 1999, IR p. 9; Cass. civ. 16 March 2004, D. 2004 Somm. p. 1754, note Denis Mazeaud; CA Nancy 2nd Ch. Com. 26 September 2007, La Semaine Juridique No 20, 14 May 2008, p. 29.

11 Cass. civ. 16 March 2004, D. 2004 Somm. p. 1754, n. Denis Mazeaud.

12 Macario (1996), p. 312.

contract by the rules of equity provided by article 1374 of the *Codice* has been stressed has a source of the duty to renegotiate.[13]

It is also argued that the past conduct of the parties may support the existence of a duty to negotiate even if there is no express provision to this effect in the contract. If the parties have negotiated on each occasion when changed circumstances have occurred, that pattern of conduct will generate a reasonable expectation that the disadvantaged party will request negotiations and a duty for the advantaged party to enter into such negotiations if the contract is disturbed by these changed circumstances.[14] In American Contract Law, the provisions of the UCC relating to trade custom,[15] the course of dealing[16] and the course of performance[17] support this argument. The same can be said if the position of the parties at the time of contracting reveals legitimate expectations of such a duty to be present in the contract, e.g. when the parties have a history of previous dealings and the contract entails the continuation of a mutual profitable relationship, especially if the aim of the contract is to ensure a supply or a market at a reasonable price and is not merely speculative.[18]

In this context, the approach of English law to an implied duty to renegotiate is somewhat negative. A link is traced from the (pre)negotiation stage: 'as a general rule, there is no inherent (implied) duty of good faith, loyalty or co-operation between the parties negotiating for a contract, and the parties cannot even create an express legal obligation to conduct their negotiations in good faith'.[19] The same approach is applied to the renegotiation stage. Thus, as a consequence of the absence of a duty to perform in good faith, an implied duty to renegotiate is not accepted in English law. However, the arguments for such a rejection are weaker in the case of express renegotiation clauses.[20]

13 *Ibid.* p. 314.

14 Speidel stressed that 'if the pattern of conduct (the "is") generated an internal norm that facilitated joint or shared purposes (the "ought"), the refusal of one party to negotiate would be bad faith, here a form of relational opportunism.' See Speidel (1996), p. 544.

15 §1-303(c) of the UCC defines usage of trade as 'any practice or method of dealing having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question.'

16 A course of dealing is 'a sequence of conduct concerning previous transactions between the parties to a particular transaction that is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.' (§1-303(b) UCC).

17 §1-303 (a) of the UCC provides that 'A "course of performance" is a sequence of conduct between the parties to a particular transaction that exists if: (1) the agreement of the parties with respect to the transaction involves repeated occasions for performance by a party; and (2) the other party, with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without objection.'

18 Hillman (1987), pp. 4-5, refers to Palay when stating that 'parties with "strong relational ties" do not worry about a contract's initial terms. Instead, they assume that the contract will be adjusted in light of changed circumstances'.

19 Cartwright (2009b), p. 52.

20 See Chapter six for further references.

2.2. Express contract provision. The renegotiation clause

2.1.1. Concepts

The renegotiation clause may be defined in general as an express provision in the contract which provides that at specified times or on the occurrence of particular events or circumstances, one party may request the other to renegotiate or review certain clauses or terms of the contract.[21] Usually, but not always, they are linked to extraordinary events outside the normal ambit of the contract. The main purpose of such clauses is to preserve or restore the economic equilibrium of the parties' contractual obligations as originally agreed upon and to provide flexibility in the contractual relationship in order to facilitate its survival.[22] If the clause also provides that the parties, when there is a failure to reach an agreement, may refer their problem to a third party for either a recommendation or a binding decision, it can be labelled also as an *adaptation clause*.[23]

These clauses should not be confused with *force majeure* clauses, which generally cover future situations where events are beyond the control of the parties and render the execution of the contract impossible, either temporarily or permanently.[24] Usually these clauses provide for special remedies (such as a suspension and extension of the contractual performance period for the time equivalent to the period of the *force majeure* situation) and they do not mainly have the intention of ensuring or re-establishing the commercial balance of the contract, although sometimes they can also contain a duty for the parties to negotiate in order to overcome the effects of the *force majeure* event.[25]

On the other hand, a renegotiation clause is usually related to or integrated in a *hardship clause*. These clauses attempt to anticipate and deal with the situation where unforeseen circumstances fundamentally change the contractual equilibrium so that an excessive, normally economic, burden is imposed on one of the parties.[26] Furthermore, hardship clauses are often drafted so as to provide a solution which is more flexible than a mere termination of the contract; they aim to adapt the contract and, sometimes, to distribute cost.[27] In this way, the hardship clause has the same purpose as a renegotiation clause, namely providing flexibility for the parties' obligations in cases of unexpected circumstances affecting the commercial equilibrium of the contract.[28]

However, it has been argued that the difference between hardship and *force majeure* is clear at a theoretical level, but as far as contracts in practice are concerned, the examples

21 Salacuse (2001), p. 1509, stating that '[in this case] it is an intra-deal renegotiation because it takes places within the legal framework established in the original contract'.
22 Horn (1985c), p. 130 and Berger (2003), p. 1364.
23 Salacuse (2001), p. 1517. Renegotiation clauses have also been labeled as 'reopener provisions'.
24 Böckstiegel (1985), p. 159.
25 Berger (2003), p. 1352.
26 Böckstiegel (1985), p. 159.
27 Horn (1985b), pp. 3, 5.
28 As stated before, the duty to renegotiate may also arise as a *legal consequence* of hardship.

of circumstances giving rise to the application of hardship or *force majeure* clauses include certain events which do not correspond to the strict theory of the respective concept.[29] So, in practice, modern hardship clauses may be labelled as *force majeure* clauses and *vice versa*, and the events themselves cannot be subject to fine distinctions.

Though a considerable analysis of renegotiation clauses has been made with regard to international transactions, and the positive opinion concerning their advantages; it has been stated that they are not regularly included by the parties involved in such kind of transactions.[30] Considering their less complex nature and economic relevance, the same conclusion can be reached concerning domestic transactions. However, the restriction of such clauses to the renegotiation of certain provisions of the contract only and under strict conditions (mainly substantial changes in market prices) is seen as useful in increasing the stability of long-term relationships and reducing the possibilities to terminate or breach a contract.[31]

2.2.2. Structure and content of the clauses

According to Fontaine, hardship clauses typically contain two main parts: the first part defines the *situation* in which the clause will apply and the second part exposes the *procedure* which will be applicable in the event of the situation occurring.[32] *Vis à vis*, that structure is applicable to renegotiation clauses.

The applicability of the clause include two elements: the description of certain more or less determined circumstances, which trigger the clause; and subsequently the consequences for the contract relationship resulting from these circumstances, which is generally a relevant change in the original balance of the contract.[33]

The definition of the events triggering the duty to renegotiate is the basis for the successful application of the clause. In principle, a precise specification of the events can be regarded as the best option to secure contract stability and to avoid litigation concerning the applicability of the provision, determining exactly the circumstances which give rise to the duty. However, these special risk clauses have the disadvantage of overcoming the principle

29 Fontaine (1976), p. 56.

30 Gotanda (2003), p. 1464 noting that, 'U.S. business in particular may be reluctant to include compelled renegotiation and adaptation clauses both because of the legal system's reliance on the principle of *pacta sunt servanda* and because such clauses are not regularly used in common-law countries, as they are in civil-law countries, like Germany and the Netherlands'. On the other hand, *force majeure* clauses are frequently included in long-term contracts as a mean to allocate the risks of supervening events. See Wagner (1995), p. 62.

31 Weintraub (1992), pp. 16-17, stating that, according to a survey question on this issue, 41.9% of the general counsel of U.S. businesses would include a renegotiation clause in long-term contracts to protect against substantial changes in market prices.

32 Fontaine (1976), p. 59.

33 For further details, see *Ibid.* pp. 68-70.

of *pacta sunt servanda* only for the specific events described therein.[34] The principle of the sanctity of contracts being the general rule, an extension to other contingencies not included in the clause would be considered as contradicting the parties' intention, especially if they are professionals such as international businessmen. In this sense, it has been held that a contractual adjustment clause for currency fluctuations is not applicable when commodity prices collapse.[35] However it has also been argued that '…the mere presence of a hardship clause should not in itself exclude the application of the general law on changed circumstances…the general law on changed circumstances remains applicable to all changes not covered by a hardship clause'[36] That conclusion seems to be correct, but a binding general law on changed circumstances should be applied in this case. General renegotiation clauses seem to be more appropriated in the case of complex long-term contracts because of the impossibility for the parties to anticipate every hypothetical situation.

Concerning the *consequences* of the triggering events for the contract, the change in the commercial equilibrium of the contract or a gross inequity between the reciprocal obligations are open concepts that can be narrowed and defined with a determining criterion on *when* the imbalance exists (e.g. stipulating a prefixed increment in the seller's costs as the measure for the imbalance).

With regard to the procedure which is applicable when the particular situation occurs, provisions diverge from a simple agreement to renegotiate the contract, formulated without any further details to the regulation of an extremely complex procedure, involving in particular recourse to third parties.[37]

Finally, with regard to the content of the duty, renegotiation clauses in general often include only a broad reference to good faith, fairness and/or equity as the guiding principles to be observed by the parties in the process of reaching a new agreement.[38] Based on these principles and on the inherent aim of the clause (the preservation of the contract through the restoration of the economic balance of performances) a catalogue of obligations to be fulfilled in the renegotiation procedure has been proposed.[39] The situations concerning the hypothetical existence of a duty to agree and the consequences of a failure to negotiate will be examined in the following sections.

34 Berger (2003), p. 1363.
35 ICC Award N°2478 (1974), 3 Y.B. Com. Arb. 222 (1978); ICC Award N°5953 (1989), reprinted in 117 *J. du Droit Int'l* 1056 (1990).
36 van Houtte (1993), p. 110.
37 Fontaine (1976), p. 59.
38 Berger (2003), p. 1363.
39 *Ibid.*, p. 1364.

3. Content of the duty to renegotiate. Obligations and rights of the parties

Whatever the source of the duty to renegotiate (an inherent obligation, an express legal or contractual provision), the content of such a duty has also been the subject of controversy. As stated before, legal or contract provisions do not generally provide more than general references to principles or duties such as good faith, fair dealing or cooperation to be applied to the process or even to the outcome of the negotiation.

3.1. Duty to renegotiate in good faith

The duty to renegotiate implies that the parties must enter into discussions on the terms and effects of the original contract and it is uniformly accepted that negotiation must be subject to the general principle of good faith. Therefore, the duties of fair dealing and cooperation are imposed on both parties: proposals and counterproposals have to be serious, coherent, reasonable and provide all the necessary information.40 The parties should conduct the negotiations with flexibility and must avoid inappropriate behavior with regard to the counterparty's proposals, e.g. unjustified delays in responding to adjustment offers from the counterparty or abusively breaking off negotiations. In this regard, in the Aminoil case the arbitral tribunal laid down that 'general principles that ought to be observed in carrying out an obligation to negotiate, – that is to say, good faith as properly to be understood; sustained upkeep of the negotiations over a period appropriate to the circumstances; awareness of the interests of the other party; and a persevering quest for an acceptable compromise.'[41]

The principle of good faith also imposes on the disadvantaged party the duty to request renegotiations without undue delay and to indicate the grounds on which the request for renegotiation is based.[42] Consequently, the request must be made just after the affected party has knowledge of the supervening events and must specify what the new circumstances are and how they affect its performance so that the counterparty may properly consider the request. To sum up, both parties should search for reasonable and appropriate modifications, taking into account the interests of the counterparty and maintaining efforts to reach agreement within a reasonable period of time.[43]

40 However, for Speidel a duty to negotiate in good faith is imposed on the advantaged party 'regardless of the seller's motive or the reasonableness of the initial proposal'. Speidel (1981), p. 408.

41 *Kuwait v. American Independent Oil Company (Aminoil)*, March 24, 1982, reprinted in 21 I.L.M 976, 1014 (1982). The arbitral tribunal referred to the decision of the International Court of Justice in the *North Sea Continental Shelf* cases: '… (the parties) are under an obligation so to conduct themselves that the negotiations are meaningful, which will not be the case when either of them insists upon its own position without contemplating any modification of it.' *I.C.J Reports*, 1969, 4 pp. 47-48.

42 See PICC article 6.2.3(1).

43 Berger (2003), pp. 1365-1366.

3.2. Duty to agree or to accept the counterparty proposal

One interesting question concerning this subject is whether the advantaged party is under a duty to accept the revision of the contract along the lines proposed by the affected party when that proposal is adequate and suitable for both parties' interests. In this regard, there is no uniform legal or academic solution.

Thus, in a decision on 3 October of 2006,[44] the *Cour de cassation* rejected the existence of a duty to adjust, stating that renegotiation clauses do not in any case impose a duty to accept the modification of the contract proposed by the counterparty but only a duty to renegotiate under the principles of good faith and fair dealing, and to explore the methods for adapting the contract to the supervening circumstances.

In the same sense, some arbitral tribunals have concluded that the failure of the parties to reach an agreement after a renegotiation period does not constitute a breach of contract because 'an obligation to renegotiate is not an obligation to agree' and that 'it is clear that such a duty (to renegotiate) does not include an obligation…to reach agreement…(and the party is not) legally required to enter into such an agreement, however reasonable it may be.'[45]

In spite of the scholarly arguments, American case law does not support the idea of a duty to accept an equitable proposed adjustment. On the contrary, the decisions in *Missouri Pub. Serv. Co. v Peabody Coal Co*.[46] and *Iowa Elec. Light & power Co. v Atlas Corp*.[47] indicate that there is no duty to accept an adjustment: 'Where an enforceable, untainted contract exists, refusing modification of price and seeking specific performance of valid covenants does not constitute bad faith or breach of contract.'[48]

Under this interpretation, the only obligation for the parties is to effectively enter into negotiations and to conduct those negotiations in good faith; but the modification of the contract is not an obligation but merely a possibility and there is no liability if a refusal by the advantaged party is not due to his abusive conduct or bad faith, even though the proposed adaptation of the contract to the new circumstances is reasonable and adequate for both parties' interests.

However, some authors such as Oppetit have stressed that if the parties include a renegotiation clause in the contract, the duty of good faith and the intention of the parties in incorporating the clause, i.e. increasing stability and the aim of preserving the

44 Cass. com, 3 October 2006, D. 2007 n°11, Somm., 767, note D. Mazeaud. See Chapter three.
45 *Kuwait v American Independent Oil Company* (Aminoil), March 24, 1982, reprinted in 21 I.L.M 976, 1004 (1982), and *Wintershall A.G. v Gov't of Qatar*, 28 ILM 795 pp. 814, 841 (1989), cited by Berger (2003), p. 1367.
46 583 S.W. 2d 721 (Mo.App.1979), *cert. denied*. 444 U.S. 865, 100 S.Ct. 135, 62 L.Ed.2d 88.
47 467 F. Supp.129 (N.D. Iowa 1978).
48 *Peabody* case, at 725.

contractual relationship when there is a change of circumstances, impose the duty to accept a reasonable modification proposal.[49] It has also been argued that in German law such an obligation arises when the adjustment criteria and the aim of the adjustment have been clearly defined in the contract.[50]

Similarly, in the light of the relational theory of contract, it is not unreasonable to impose a duty upon the advantaged party to agree to a reasonable proposed modification offered by the disadvantaged party in good faith. 'The advantaged party 'should' have accepted the equitable adjustment in the interest of redistributing undeserved gains and losses and preserving the relationship; the disadvantaged party is entitled to a remedy consistent with what 'should' have been done.'[51]

If the existence of a duty to agree is accepted, then the essential question is when a proposed modification is fair and reasonable. The analysis has to take place in two directions.[52] First, hypothetical opportunism by the disadvantaged party must be examined. The request for a modification has to be based on external and verifiable circumstances rather than on the strategic purposes of the affected party, such as the intention to capitalize on short-term market fluctuations. One parameter in this sense can be whether the unexpected event affects a large class of parties in the same situation and not only the disadvantaged party to the contract. Another parameter is the role of inflation as a disruptive event, so the hazard of 'seller opportunism' is highest when the change has produced dramatically higher market prices for the goods involved and lowest when the cost of production has been increased and the same can be said when the proposal involves changes in quantity rather than price.[53] Also, the methods of negotiation become relevant and considerations that would support invalidating an agreed ex post modification for duress are significant to determine any eventual bad faith or opportunism by the party requesting negotiations. Second, the proposal must be equitable under the new circumstances. The burden is on the disadvantaged party, which may attempt to establish the increased costs, the risks assumed in the contract and those that were not (therefore caused by the unexpected events) and submit a proposal according to a reasonableness criteria and with all the relevant information. The standard of reasonableness is directly related to the distribution of the additional costs generated by the change. In this regard, the affected party must necessarily bear part of the new costs derived from the unexpected circumstances. The proposal has to be limited to what is strictly necessary for the performance not to become manifestly unfair for the affected party. A 'compensation' proposal which does not take

49 Oppetit (1974), pp. 794, 807.
50 Berger (2003), p. 1367.
51 Speidel (1981), p. 416.
52 *Ibid.,* pp. 408-410.
53 Williamson (1979), pp. 250-252. See also *Aluminium Co. of America v. Essex Group, Inc.*, 499 F. Supp. at 93: 'Inflation will often increase the value of goods so that a seller could sell his goods for more than the stipulated contract price. This causes the seller disappointment and brings the purchaser a profit. But within a broad range this sort of market risk is assumed by parties to along term contract. It would be highly disruptive to commercial relations and to transaction plans to allow parties to escape their contracts generally on this ground.'

advantages of profits which were unbargained at the time of the contract can be regarded as equitable and reasonable.[54]

3.3. Renegotiation period

A renegotiation of the contract necessarily implies a period of uncertainty with regard to the effects of the contract as originally agreed. Again, legal or contractual provisions usually do not include rules with regard to this subject, which can be relevant if the negotiation period is extended.

As a general principle, it can be stated that the contract remains in force unless the parties have otherwise agreed. Withholding performance by the disadvantaged party may be justified only in exceptional circumstances[55] which must be demonstrated by such a party.

However, also a 'minimum performance rule' could be established: considering the intention of the disadvantaged party in order to preserve the contract rather than seeking its termination or discharge, the request for a renegotiation could (or should) include an offer of a 'minimum performance' of the disadvantaged party's obligation to be performed during the renegotiation period. For example, besides a price adjustment as the main proposal, the offer by the seller could include a reduction in the quantity of goods to be delivered during the negotiations. If the proposal does not include such 'minimum performance', any party could request the court to grant this.

Finally, in general if the renegotiation is ordered by the court, the decision must include the conditions for the performance of the contractual obligations during the renegotiation period, stating a specific period of time within which the renegotiations have to be achieved.

4. Consequences when renegotiations fail

4.1. Termination and damages

Even if negotiations were conducted in good faith by both parties, they can fail to reach an agreement because of legitimate discrepancies. In this case, because there is no breach of an obligation, the effects of the failure of renegotiations can be mainly reduced to the termination or adaptation of the contract by the judge.[56]

54 Speidel (1981), p. 410, arguing that 'a constant standard might be that the disadvantaged party should be paid the actual, additional costs of production plus the percentage of profit that would have been made under the original contract'. However, a fair distribution of losses implies that the affected party must assume part of the new costs. See Chapter nine for further references.

55 PICC, article 6.2.3.

56 It is assumed that the grounds for applying the effects of the unexpected events are justified and that the performance of the contract as agreed is not a suitable remedy.

On the other hand, if the reason for the failure is the unjustified refusal of one party to enter into negotiations or if the reason for breaking off negotiations is abusive conduct or bad faith, the affected party may also claim damages.[57] In this case, damages caused by delay and the costs incurred when relying on reaching the failed agreement could be awarded.[58]

The termination of the contract is the easiest and more drastic solution. However, this solution cannot be the most appropriate for the interests of the parties, particularly if both want to preserve the contract or if there is another kind of interest involved in the transaction, such as third parties' or public interests. If the court has the possibility to determine the terms of the termination (e.g. concerning retroactivity, the date, non-performed or partially performed obligations) the inconvenience of this remedy may be mitigated, which is the solution adopted by the PICC, PECL and the DCFR. A detailed analysis of termination as an effect in cases of a change of circumstances will be provided in Chapter nine.

4.2. Adaptation or revision of the contract by the courts

The most controversial solution is the possibility to allow the courts to adjust the contract if the parties cannot reach an agreement. The issue of the revision of the contract by the court will be extensively analysed in the next Chapter. However, in the following paragraphs some specific issues will be examined, particularly with regard to the inter-relationship between a failure in the renegotiations and a further adjustment by the courts in that case.

Continental modern Civil Law codifications such as the German *BGB* and the Dutch *BW* expressly provide the possibility for the court to adapt the contract in cases of changed circumstances. On the other hand, English common law rejects the notion that the courts have the power at common law to adapt or modify contracts in the light of supervening events.[59] As mentioned, the effect of frustration in English law is the automatic and total discharge of the contract. This is also true with regard to the remedy of *rectification*, governed by the principle that 'Courts do not rectify contracts, they may and do rectify documents',[60] that is, it is limited to correcting mistakes in the text of a written agreement, which is laid down in terms which are different from those agreed by the parties.

The possibility of adapting a contract in international commercial arbitration relies mainly on a combination of the renegotiation clause and an arbitration agreement, conferring clear competence to the third party to adjust the contract in the case of an unsuccessful

57 Specific performance of the duty to renegotiate does not appear as a realistic solution, since the enforcement of such a duty (which implies a behavioral attitude by the party) would be only illusory.

58 Berger (2003). See also Mazeaud (2007), p. 767, stating that in this case recoverable damages would be the amount of '*le prédujice consistant dans la perte d'une chance d'obtenir le mantein du contrat*'.

59 Treitel (2004), p. 584.

60 *Mackenzie v Coulson* (1869) L.R. 8 Eq. 369 at 375.

outcome of the negotiations between the parties. Thus, in the *Aminoil* case the arbitrators stressed that 'generally speaking, a tribunal cannot substitute itself for the parties in order to make good a missing segment of their contractual relations – or to modify a contract – unless that right is conferred upon by the law, or by the express consent of the parties'.[61] However, other arbitral awards have stated that the court has the power to modify an agreement on equitable grounds under hardship provisions, but always as a qualified exception to the *pacta sunt servanda* principle.[62]

In the French legal tradition the contract must remain untouched so there can be no intervention by a judge, notwithstanding any circumstances which threaten its existence. The basis of the *Cour de Cassation's* rejection of the possibility to judicially revise or adjust contracts can still be found in the mentioned *Canal de Craponne* decision: it would be extremely dangerous to leave the contract to the individual sense of equity or public interest of judges, thereby threatening the economic system and the security of transactions. Thus, only the parties by their mutual agreement may adjust or modify the contract, because they are the only ones who are qualified to determine the terms of the contract which protect their mutual interest. As stated before, in line with the French legal tradition, both the *Avant-projet* and the *Projet de la Chancellerie* are very much restricted with regard to the court intervening in the contract. However, as examined in the Chapter on French law, some decisions by the French Courts of Appeal seem to admit the possibility for the judge to revise a contract when negotiations have failed.[63]

Additionally, French doctrine has also proposed that in a case in which one party has a predominant position over the other to determine the terms of the contract, and when the change of circumstances (and therefore the contractual imbalance) is due to the conduct of that party, the advantaged party may be obliged to adapt the contract.[64]

As said above, a completely different approach is provided by the PECL, the DCFR and the PICC, which state that if the parties' negotiations do not succeed within a reasonable period either party may resort to the courts to request the adaptation of the contract to the new circumstances. The courts have wide powers and can either modify the contract or to terminate whichever is the more suitable in a specific case. In addition, the PECL state that if the advantaged party refuses to enter into negotiations or breaks off negotiations contrary to good faith and fair dealing, the court may award damages for the loss suffered.[65]

61 *Aminoil* case, March 24, 1982, reprinted in 21 I.L.M 976, 1004 (1982). This statement is closely related to whether or not a contract adaptation is still arbitration and to determine the existence of a *dispute* between the parties because of the failure of the renegotiation. The issue is relevant because the recognition and enforcement of the award relies on this question. See Berger (2003), p. 1370 *et seq*.

62 See ICC Award No.7365/FMS (May 5, 1997) and No.9479 (Feb. 1999); cited in Bonell (2006), p. 338.

63 *Electricité de France c/ Shell Française*, CA Paris, 1st Ch. A. 28 September 1976, La Semaine Juridique 1978, p. 18810, n. Jean Robert ; and CA Nancy 2nd Ch. Com. 26 September 2007, *SAS Novacarb c/ SNC Socoma*, La Semaine Juridique No. 20, 14 May 2008, p. 10091, n. Marie Lamoureux.

64 Mazeaud (2007), p. 769.

65 As an alternative remedy to adaptation, the disadvantaged party can also request the termination of the contract.

Also, some scholars in American contract law do support the intervention of the courts in cases of a failure in the parties' negotiations.[66] These authors have argued that in long-term contractual relationships, clean or either/or solutions (i.e. the assumption of the risks by the disadvantaged party or completely discharging the contract) are not the best options in view of the complexity and importance of the interests involved, not only relating to the contracting parties, but also with third parties not directly (or not at all) represented in the litigation and in some cases even with a public interest. Accordingly, in most cases, the survival of the contract must be preferred to its termination (either by breach or discharge) although any adjustment must be made by the court as last resort. In this sense, 'the law is doing merely what the parties would have done in the interest of the relationship had they been required to deal with the matter at its inception.'[67]

Nevertheless, the consequences of unsuccessful negotiations are usually linked to bad faith by the requested party, either in the form of a refusal to renegotiate or breaking off negotiations. Hillman proposes three approaches if bad faith by one party is the reason for the failure to adjust.[68] The first approach would be to find that adjustment is an implied condition precedent to the disadvantaged party's performance and to excuse that party. A second less rigorous approach would be to order the parties to engage in good faith bargaining through some method (e.g. mediation) in order to achieve a settlement. Finally, if the parties still cannot reach an agreement (or the court believes that to induce the parties to a new renegotiation would be futile), a third approach would be for the court itself to adjust the contract.

Speidel has also stated that a court-imposed price adjustment may be appropriate if the advantaged party has acted improperly in the renegotiation process.[69] Accordingly the intervention of the court is only justified as a remedy for the advantaged party's unjustified refusal to accept an equitable adjustment proposed in good faith, thereby supporting the court intervention in Comments 6 and 7 to section 2-615 of the UCC, which state that 'neither sense nor justice' is served by an either/or answer on discharge: changed circumstances may 'require…a good faith inquiry seeking a readjustment of the contract terms' and with the application, by analogy, of section 2-719 and Article 2's general approach to performance and adjustment. 'The full remedy…is to delete the original price term, substitute a new one derived from the commercial context and order the process

66 Modification of contracts is not unknown under American common law. The *reformation* of a contract is a discretionary equitable remedy to be granted where the drafting does not reflect the actual agreement between the parties, but is not available if the mistake by the parties concerns a future matter that affects contract terms that have clearly been consented to. *Nichols v. Shelard National Bank*, 294 N.W.2d 730 (Minn. 1980); *Japhe v. A-T-O Inc.*, 481 F2d 366 (5th Cir. 1973). See Speidel (1981), p. 379, note 45. Compare with *rectification*, as stated above.

67 Halpern (1987), p. 1173.

68 Hillman (1987), pp. 18-19.

69 Speidel (1981), pp. 395, 405. It must be stressed that the author restricts the possibility of judicial adjustment to 'long-term contracts', which have special attributes, e.g. extended duration, complex and specialized reliance, idiosyncratic purposes, relational norms and complicated third parties and public interests related thereto.

of further bargaining and adjustment to proceed'[70] In any case, the adoption of this view implies that the court has to evaluate the conduct of the parties and the motives of the refusal to negotiate or the failure of renegotiations in order to grant the adjustment of the contract, and not merely to intervene because the parties have failed to reach an agreement.

The requirement of a failure by the parties to agree to a contract modification and the intervention of the court as last resort was stressed in the *ALCOA* decision, and in any case, the necessity for the court to adopt an active role has been stressed by the supporters of judicial adaptation as a consequence of failed renegotiations.[71] Within the scope of procedural law or equitable jurisdiction, the judge might develop settlement strategies, thereby inducing the parties to an agreement by direct intervention or appointing an expert to support them in the negotiations.[72] This was the approach of the court in the *Westinghouse* litigation[73] and in *McGinnis v Cayton*.[74] Accordingly, it has been argued that the real value of the *ALCOA* case was its role as a coercive force for a mutual agreement upon settlement.[75]

5. Conclusions

In the case that the existence of a duty to renegotiate is recognized in situations of a change of circumstances, it can be considered to have a double role for the parties.

First, the request for renegotiation should be a *condition* to invoke the provisions or rules of unexpected circumstances. Therefore, the disadvantaged party can only rely on those rules if the renegotiation of the agreement has been previously requested in order to adapt it to the new circumstances. Only if renegotiations have failed, can the disadvantaged party apply for court intervention.
Second, the advantaged party is bound to enter into renegotiations when they have been requested in accordance with good faith, which in particular in this case entails for the affected party to request renegotiations without undue delay and to indicate the grounds on which the request for renegotiation is based.

In addition, some details concerning the content and the effects of this duty have to be determined:

70 *Ibid.*, pp. 418-419. Section 2-719(2) of the UCC provides that 'Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act'; in other words, normal remedies available under Article 2 become operative. Speidel states that 'if the agreed term involves price rather that a remedy, and if the price term fails its intended purpose, then the initial term, should, unless the parties have clearly stated its exclusive character, be deleted and the 'gap' filled by a 'reasonable price at the time of delivery.' (as provided by article 2-305(4) of the UCC).
71 499 F. Supp. 53 (W.D. Pa. 1980) at 91-92. See Chapter six.
72 See Speidel (1981), p. 414.
73 *In re* Westinghouse Elec. Corp. Uranium Contracts Litig., 517 F. Supp. 440 (E.D. Va. 1981).
74 312 S.E.2d 765 (W. Va. 1984).
75 Macaulay (1985), pp. 475-476.

– Negotiations must be conducted under the general principle of good faith so the duties of fair dealing and cooperation are imposed on both parties.

– Consequently, both parties are under a duty to agree, but are limited to accepting a fair and reasonable modification proposal. The disadvantaged party is entitled to request the court for a remedy (in this case, an adaptation of the contract) and this must be consistent with what *should* have been done as a consequence of the application of good faith, fair dealing and cooperation.

– Only in extraordinary circumstances is the disadvantaged party allowed to withhold performance, but a 'minimum performance rule' could be established: the requesting party should include an offer of minimum performance during the renegotiation period or, in its absence, any party can request this from the court.

– If the request for negotiations fails because of an unjustified refusal to enter into those negotiations or if the reason for breaking off negotiations is abusive conduct or bad faith by one party, the affected party has the right to claim for the damage caused by the delay and the costs incurred in reliance on reaching the failed agreement.

– If both parties have acted in good faith but negotiations do not succeed within a reasonable period, the solution provided by the PICC, the PECL and the DCFR appears to be the more appropriate: either party may resort to the courts to request an adaptation of the contract to the new circumstances an the courts have wide powers and can either modify the contract or terminate whichever is the more suitable in the specific case.

– In all cases, the courts must play an active role in encouraging the parties to reach an agreement.

Finally, it has to be emphasized that the existence of a duty to renegotiate does not necessarily imply uncertainty or a reduction of contractual stability. On the contrary, renegotiation provides flexibility for the parties to seek a better adaptation of the contract to new and unforeseen circumstances. Thus, '…may ultimately reduce the likelihood of a dispute between the parties…and may be seen as a means of stabilizing the relationship…'[76] In this regard, the preventive role of a hypothetical adaptation of a contract by the courts can also be an incentive to the parties to settle their differences rather than entering into a legal dispute, a breach of contract or a termination of the relationship.

76 Gotanda (2003), p. 1469.

Chapter 9

THE ADJUSTMENT OF THE CONTRACT AS EFFECT OF CHANGED CIRCUMSTANCES

1. Introduction

1.1. Comparative assessment

The comparative survey has shown that non-legislative codifications such as the PICC, the PECL and the DCFR recognise the adaptation of a contract as one of the available remedies for the affected party in cases of unexpected circumstances, thereby granting broad powers to the court in order to reach an adequate result for both parties.

On the other hand, court adjustment is not provided as a general remedy by the national jurisdictions included in the research, as well as the CISG. This is clearly the case of England & Wales, France and Chile. With regard to American law, however, an adaptation can be argued to be an available remedy for the parties on the basis of the provisions of the UCC, but in practice the courts have been very reluctant to grant it and therefore the situation can be considered to be similar to the above-mentioned jurisdictions.

Finally, with regard to Italy and Argentina, the practical outcome is opposite to that just mentioned for American law. Thus, even when the Italian *Codice Civile* provides for an adaptation of the performance only in cases of unilateral contracts, both in Italy as well as in Argentina the legal doctrine and the case law have allowed the intervention by the courts in cases of changed circumstances in order to adapt the contract to the new events, especially through assessing the equity of the creditor's eventual counter-proposal compared to the affected party's request to terminate.

1.2. Terminology and the concept of adaptation

The terminology used in the analysis of this issue is far from uniform. For instance, in French legal writing the term *révision* is often employed, which is not the case in common law jurisdictions.[1] In this work, the terms adaptation, adjustment, modification and revision will be used interchangeably to refer, in general, to a court intervening in a contract with the aim of adapting it to new circumstances to the extent and under the conditions stated in the following sections.

The concept or definition of the 'judicial adjustment of contracts' is essential to configure the subject of this chapter. In this regard, the differences between civil and common law are substantial, because the latter includes situations which are not usually considered as a revision or modification in civil law. Due to the fact that in the common law the effect of frustration and impracticability is that the contract is discharged and the obligations of both parties are thereby automatically terminated, apportioning the losses between the parties after the termination of the contract is also regarded as a judicial intervention or revision of the agreement. In civil law jurisdictions that could be considered as a mere situation of termination with an award of damages. Again, because of the classical rule of common law which holds the parties strictly liable for a failure to fulfil their obligations, the prevention of such a strict performance through the anticipated termination of the contract granted by the courts may also be regarded as a modification in those jurisdictions.[2] Thus, in the common law the modification of a contract is usually related to the apportioning or allocation of losses between the parties *after* the contract becomes frustrated (and therefore discharged), taking into account any prepayments, benefits and expenses mutually conceded or incurred by the parties, but not usually with a modification of the obligations of one or both of the parties concerning the performance of the contract *in the future*. Consequently, as a general rule, no modification of an executory contract is allowed in the common law. On the other hand, a standard definition of 'judicial revision of contracts' in the civil law could be 'a judicial intervention to modify, directly or functionally, a contract entered into by the parties, combined with an enforcement of the contract in its amended version.'[3]

In this sense, as stated in the Introductory Chapter, an adaptation of a contract in the light of changed circumstances implies *the modification of the obligations of one or both parties, at the extent that the performance of the contract by the affected party is possible*

1 In France, the meaning of such a term would be 'the modification of a legal act so that the latter can be adapted to the circumstances', Gérard Cornu, *Vocabulaire juridique de l'Association H. Capitant, P.U.F., 4th ed. (1994)*, cited by Mekki, Kloepfer (2010). However, the word 'révision' is unknown in the French Civil Code, see Legrand Jr (1988), p. 911. With regard to American common law, see Levasseur (2008), p. 591, stating that in Black's law dictionary the term 'revision' is not linked to the concept of a contract, and that in the Restatement (2nd) of Contracts, neither revision nor modification are mentioned in the index or in the table of contents.

2 See Collins (2003), p. 294.

3 Legrand Jr (1987), p. 968. The author used the expression 'functional' to refer to indirect modifications, i.e., cases where the word 'revision' is not actually used by the court.

or bearable, with the aim to restore their equilibrium when it has been severely disrupted by unexpected events. Therefore, after its modification, the contract can be enforced in its adjusted version.

Finally, it is important to state that the concept of revision is closely linked to the concept of interpretation, i.e. the process by which the judge seeks to give effect to the intention of the parties when such an intention is absent or is inadequately expressed in the contract;[4] because many cases of judicial revision take place where there is a gap in the contract, and even if there is no such a gap, an adjustment to a contract attempts to reflect the original purposes of the parties by adapting it to the new circumstances. At the end of the day, a revision always implies a process of interpreting the aims and intention of the parties, as well as the conditions surrounding the agreement.

2. The difficult case for the adaptation of contracts

As observed above, even when a change of circumstances can be considered as a ground of relief for the affected party, a contract adaptation is still a highly resisted remedy. Therefore, the traditional and still the only effect of unexpected circumstances in several jurisdictions is the discharge or termination of the contract. This is the solution in the Common Law jurisdictions just as it was at one time in Germany. Again, significant problems can arise when restitution or reliance damages will not suffice to return the parties to their original positions, e.g., the costs of improvements to objects which can no longer be used if performance by the counterparty is excused.[5] Additionally, it can be claimed that the rejection *in general* of a change of circumstances in countries such as France and Chile is strongly linked (and confused) with the possibility to grant to the courts the power to revise the contract and modify it in order to adapt it to the new circumstances.

Due to these considerations, it seems relevant to state the main foundations that justify intervention by a court in a contract as a consequence of a change of circumstances. Additionally, the usual arguments against court adjustment will be exposed and contested.

2.1. Foundations

As a general statement, the principle of good faith in the performance of contracts and, consequently, the duties of cooperation and flexibility can be argued to be the main foundations for adapting contracts. When the contract is not considered to be exclusively a means to attain the interests of each party without any consideration being given to

4 *Ibid*., at 967.

5 Hubbard (1982), p. 103. The author states the example of the contractor who has spent money on capital improvements or even a manufacturing plant that depends on a cheap source of supply in order to be profitable. If the supply is either unavailable elsewhere or prohibitively expensive at the time that performance is excused, the manufacturer may want to avoid a heavy loss notwithstanding the availability of remedies such as restitution or reliance damages.

the counterparty's interests but, on the contrary, is regarded to be an instrument which requires permanent cooperation between the parties in order to preserve the legitimate expectations of *both* parties, it may be considered as reasonable for the parties to expect an adjustment of the agreement when it is severely disrupted by supervening and unforeseen circumstances. As stressed in the Chapter on Renegotiation, the express or implicit acceptance of cooperation and flexibility by the parties as norms of conduct to govern their relationship implies that a renegotiation and adjustment can be considered as necessary consequences of a supervening change of circumstances.

In particular, in some cases, adjustment can be justified by the circumstances surrounding the contract and the nature of the contractual relationship. This is the case in transactions which are part of a broad or long-term relationship between the parties; e.g. a supply contract which has been preceded by or even contemporary to other similar or related contracts and transactions between the same parties. In such cases, the parties may dispense with contract formalities and detailed provisions, because their primary intention is the continuation of their relationship, since they are aware of the benefits (e.g. ensuring a supply or a market at a reasonable price) and the costs (e.g. investing in finding a new counterparty and a market substitute). Then it can be argued that these circumstances create an expectation of flexibility so that the affected party may reasonably expect the other party to cooperate in cases of serious disturbances to the contractual interest (equilibrium). 'Put another way, both parties can increase mutual gains from the contract by remaining flexible after signing the contract, thereby saving costs related to planning for risks and bickering after contract breakdown'.[6] In addition to these *relational* arguments, the objective existence of trade customs or previous conduct between the parties allowing for adjustments also provide support for the adaptation of the contract when new circumstances arise.

Again, especially in long-term relationships, because of the difficulty in anticipating or preventing future contingencies or the specific details thereof and the costs of negotiating and drafting meticulous provisions, the parties use indeterminate formulations in their agreements, e.g., to do something in a 'commercially reasonable time', to use 'best efforts', to take 'appropriate measures', etc.[7] It can be argued that these kinds of provisions imply the intention to adjust and adapt the contract to future circumstances. Therefore, the expectations of the parties are more readily satisfied if the performance of the contract is adapted to the new circumstances rather than if the performance is discharged or strictly performed. 'Under this analysis, broad or flexible obligations…are an implicit request for equitable definition of the standards for subsequent performance, with the interests of both parties to be taken equally into account.'[8]

6 Hillman (1987), pp. 5-6.
7 Goetz, Scott (1985), p. 317, stating that, in the context of relational contracts, 'the obvious solution to incompleteness - express particularization - incurs great risks of misinterpretation.'
8 Goetz, Scott (1985), p. 319.

In cases where an implied agreement cannot be found, a justification for judicial gap filling may be based on the desire to require the parties to share unallocated losses.[9] Thus, the silence of the parties with regard to particular risks does not necessarily mean that those risks were implicitly allocated to one party. This is especially true in long-term relationships, which may often be incomplete in their cover because of the difficulty in properly describing obligations arising well in the future.[10] Even provisions such as price adjustment formulas cannot be interpreted to cover all kinds of risks and, therefore, subjecting one party to all the losses. Neither party can be considered as an absolute and unconditional insurer of the other, so the affected party cannot be forced to perform under unexpected and calamitous circumstances.[11] The gap in the agreement regarding the risk allocation concerning changed circumstances will produce 'undeserved' gains and losses if they are allocated solely to one party. Under this view, the sharing of losses (and gains) deriving from unexpected circumstances between the parties is a method to avoid the unfairness of 'an all or nothing' solution.[12] In this respect, Fried states that this 'principle of sharing', as a mitigation of the 'promise principle' (the principle of fidelity to one's word), arises when there is a gap in the agreement which cannot be filled and therefore cannot be governed by the 'promise principle', so according to the 'principle of sharing' parties 'joined in a common enterprise … have some obligations to share unexpected benefits and losses in the case of an accident in the course of that enterprise.'[13]

In this sense, the emergence of a new concept of contract has been stressed: from the liberal notion of a contract linked to a timeless and immutable instrument, a reflection of the equality and the liberty of the parties, to a notion related to an instrument to promote solidarity, justice and equity.[14]

Thus, under the classic dogma of the sanctity of contracts and the assumption of a free and therefore fair agreement, it is natural that a subsequent revision is envisaged as a threat to formal justice and a source of insecurity. But for modern doctrine, security, or better, immutability, is not the only and supreme value which should be sought in contract law. New values to be applied to contractual relationships, such as *proportionality* and *continuity*, have been advocated to support the legitimacy of a revision.[15] The first such value compels corrections and even sanctions in cases of significant imbalances between the counter-obligations as a result of the abuse of a dominant position or the excesses of one party. In addition, according to the second value, a revision of the contract is regarded as an alternative to its extinction due to a dramatic change in the economic equilibrium of the contract because of unexpected events, which implies an excessive and unjust burden in the performance by one of the parties, and consequently, his (financial) ruination.

9 Hillman (1987), p. 15.
10 Trakman (1984), p. 488.
11 Hillman (1987), p. 15.
12 Speidel (1981), p. 406.
13 Fried (1981), pp. 69-73.
14 Mazeaud (2008), p. 560.
15 *Ibid*., p. 561, referring to the principles of '*proportionnalité*' and '*pérennité*'.

Therefore, revising the contract emerges as a method to save it from its collapse and to provide stability and continuity to the contractual relationship.[16]

In all these cases, the adjustment of the contract by the court arises as a natural remedy if the parties cannot reach an agreement between themselves.[17]

Judicial intervention has also been justified on the grounds of substantive evidence of unfairness for one party or undue public harm if the losses are borne by only one (excused or not) party.[18] The injustice of the 'all or nothing' approach is reflected by the fact that in most cases the non-performance is caused by extraneous and independent circumstances over which the parties have no control as neither of them is responsible for their occurrence. Imposing a total loss on only one party (holding one of them liable or, conversely, completely free of responsibility) can reasonably be regarded as unfair if none of the parties has demonstrated fault, liability or control over the occurrence of unpredictable or unforeseeable events that have disrupted the contract.[19] Also splitting the loss between the parties (which implies, in most cases, the preservation of the relationship) can avoid indirect but serious spill-over effects for the interests of third parties, especially when they are dependent on the party who has to bear the burden. Contracts for the supply of public utilities are the best example: 'Holding energy suppliers fully responsible for losses caused by extraneous circumstances…not only imposes financial hardship on those suppliers; it may also bring devastating consequences to a large, innocent group of interdependent producers and suppliers and to the ultimate consumers relying on the distribution network.'[20]

Further arguments in support of contract adaptation are expressed in the following section, where they are contrasted with the main reasons that are frequently used to argue against the possibility for the courts to revise contracts.

2.2. Arguments for and against a judicial adjustment

Most of the arguments for and against contractual adaptation are related and overlap each other. However, in the following section a systematization of such arguments is intended.

16 In this sense, Starck et al., (1996) n° 1421, stating that '*Refuser le rééquilibrage du contrat, n'estce pas s'exposer à ce quíl soit inexécuté par impossibilité financière d'y satisfaire? Au contraire, autoriser sa révision, c'est render tolerable son execution; ce qui est à la fois server la sécurité et rendre justice*'.

17 Speidel (1981) and Hillman (1987), p. 17, 19; who only support this view if bad faith by one of the parties results in the failure of the negotiations.

18 Trakman (1984), pp. 484-489, 519.

19 *Ibid*.,, pp. 484-485.

20 *Ibid*., p. 486.

2.2.1. A violation of the principle of the sanctity of contracts and the free will of the parties

This argument assumes that agreements are planned and carefully designed. The parties, through express provisions or through their silence, allocate and distribute all the risks between them. Any adjustment to the agreement is therefore a threat to the freedom of contract and planning and a restriction of the parties' autonomy. The judicial adjustment of contracts is therefore an illegitimate interference with the explicit or implicit agreement of the parties.[21] Because the legitimacy of contractual relations is based on the free will and the agreement of the parties, the courts would have no power to impose a new agreement without the free assent of both parties.[22] Therefore, the maxim that 'a court will not make a contract for the parties' has to be applied without exception. In this regard, Dawson states that this is a major 'issue of civil liberty', adding that 'if the contract that was previously in force has through frustration ceased to exist, how can the parties to it be compelled to accept a 'contract' that is manufactured by a court to replace it?'[23] As the contract is the 'private law'[24] of the parties, any judicial intervention is excluded by definition, because a contract is an expression of individual sovereignty and private ordering.[25]

However, if it is assumed that the contract cannot be analyzed in isolation of the relevant surrounding circumstances of the transaction, and the fact that the contract is the private law of the parties also assumes the normality of such circumstances during the life of the contract; then any adjustment to the contract if these circumstances seriously change is not a danger or a threat to the will of the parties, but is actually a way of restoring it to its real and effective scope.[26] The contract cannot be limited to the four corners of a document, because 'promises…are made against an unexpressed background of shared purposes, experiences, and even a shared theory of the world'.[27] Because, presumably, at the time of contracting the parties intended to accomplish their expectations through the retention of the contract and not through its collapse, then the adjustment of some terms of the agreement to altered circumstances will strengthen rather than weaken the will of the parties.

Further, several arguments can be made to oppose those arguments against adaptation. In the first place, the assertion as to the non-existence of the contract after its frustration can be easily refuted if we change the premise that frustration leads to the immediate and absolute discharge of a contract and instead assert that the contract is not automatically

21 Collins (2003), p. 295.
22 Hillman (1987), p. 27.
23 Dawson (1984), p. 18.
24 See article 1134 of the French *Code Civil* which is followed by several civil law jurisdictions, e.g. article 1983 of the Louisiana Civil Code and article 1545 of the Chilean Civil Code.
25 Arthur Jacobson, *The Private Use of Public Authority: Sovereignty and Associations in the Common Law,* 29 Buff. L. Rev. 599, 615-29 (1980); cited by Gillette (1984), p. 571.
26 M. Morin, *La loi et le contrat*, 49-50 (1927); cited by Litvinoff (1985), p. 61.
27 Fried (1981), p. 88.

terminated and that a wide range of remedies (including a judicial revision) is available to the parties.

In addition, if it is accepted that in some cases a duty to adjust is implied, freedom of contract can be used not against, but as a justification for a judicial revision. Court intervention would be a form of specific performance, therefore enforcing the parties' intention.[28] The same can be argued in cases of broad or indeterminate formulations, which can be regarded as an expression of the parties' intended flexibility and an adjustment to the contractual relationship in the light of changed circumstances.

Also the claim that a major issue of civil liberty is involved if courts are allowed to adjust contracts ignores the fact that courts often intervene in contracts through different methods such as gap filling, interpretation or construction. In addition, when the power to adjust contracts is given to the courts, they seem to use it under very strict circumstances and only in exceptional cases.

On the other hand, if no express or implied agreement can be established between the parties with regard to the adjustment of the contract to future events, but it is accepted that there is a gap in the contract concerning the risk allocation for the specific case, the freedom of the parties is not impinged because there is in fact no 'agreement' to adhere to. In this case, owing to the lack of consent and the duty of cooperation and flexibility, neither party should have the unilateral right to insist on performance or to be completely excused from it and the failure of the parties to allocate the risk of a contingency can be regarded as an implicit consent to the court's intervention to adjust the agreement for the parties.[29] The recognition of a gap in the contract concerning a *reasonably unforeseeable* circumstance necessarily implies that the parties did not deal with the matter when concluding the contract and therefore the intervention of the court is not interference in the contractual freedom of the parties.

The consent of the parties is not in danger because they never consented to the unforeseen contingency. The events and their consequences were not the subject of negotiation so they fall outside the field of consent and no obligation to accept or bear those risks can be derived from the promises that the parties have been made to each other.[30] Therefore, it would be unfair upon the dissolution or the forced performance of the contract to compel one party to bear the burden as that party never consented to (or foresaw) such a risk in the first place.[31]

28 Hillman (1987), p. 27.
29 *Ibid*., p. 28.
30 See Gillette (1984).
31 Of course, if the parties have recognized and negotiated concerning a risk and its assumption, the argument for a court adjustment is very weak. The same can be said in cases where there is sufficient and available information about a risk for one or both parties. However, the limits of foreseeability and the differences between the foreseeability of a risk and the foreseeability of its consequences have to be taken into account.

In other words, the task of the court would be to supply the necessary terms that the parties would have negotiated and chosen if they were considered to be at issue. Again, under this view, the judicial role appears to be closer to an enforcement of the parties' own agreement rather than drafting a new one.[32] The difficulty inherent in the complex question of how the courts may determine how the parties would have allocated the risk of a particular frustrating circumstance is analyzed in following sections.

If the parties had no volition at all about the events which caused the contractual disturbance, 'any resolution of the problem is necessarily imposed by the court'.[33] In this sense, it has been said that the Restatement (2nd) of Contracts deals with impracticability and frustration of purpose as cases of omission by which the parties failed to agree on a provision defining their rights and duties in the case of an event which results in impracticability or frustration.[34] Thus, §§ 158(2), 204 and 272(2) allow the court to adjust the rights of the parties by supplying a reasonable term to cover the omission. Consequently, 'it would be irrational to ignore the gaps in contracts, to refuse to fill them. It would be irrational not to recognize contractual accidents and to refuse to make adjustments when they occur.'[35]

According to a sociological approach, the nature of contract as a careful and planned relationship has been disputed. 'Contract planning and contract law, at the best, stand at the margin of important long-term continuing business relations. Business people often do not plan, exhibit great care in drafting contracts, pay much attention to those that lawyers carefully draft, or honor a legal approach to business relationships.'[36] Even if the parties have foreseen events or circumstances which could render the performance of the contract much more difficult or onerous, they could have decided not to include them in the contract because the costs or the length of the negotiations concerning those provisions would have been too high compared with the benefits of concluding the contract. In this case, there is no reason to subject one party to all the loss of such events and there is no danger to the principle of the freedom of contract (because there never was an agreement between the parties) if the loss, through a contract adjustment, is distributed among the parties.

In relation to the freedom of the parties to contract, it has also been said that a court adjustment will force the parties to adhere to a contract that they want to terminate.[37] However, this argument begins with the assumption that it is the will of the parties to terminate their relationship, which is not always the case. In fact, if performance is possible but extremely onerous and a duty to renegotiate is imposed, the situation will be exactly the contrary because the affected party is compelled to make an offer of

32 Kull (1991), p. 43.
33 Fried (1981), p. 65.
34 Hubbard (1982), p. 106.
35 Fried (1981), p. 69.
36 Macaulay (1985), p. 467.
37 Hillman (1987), p. 28.

performance to the advantaged party, and then, a basis for the adaptation by the court can be established.[38] Moreover, the alternative to accept the court adjustment or to terminate the contract can be granted to the advantaged party, in every case with measures to avoid any unjust enrichment by either party. This choice will prevent the negative effects of a forced performance in these cases.[39]

Opponents to adjustment also point to the impossibility for the courts to determine with any certainty what the parties would have provided *ex-ante* if they had bargained over the occurrence of the disruptive event and its consequences. Accordingly, any adjustment would finally be the imposition of the court's will and not a reflection of the supposed intention of the parties.[40] But this may be the proper role of the courts with regard to the effects of frustration with the use of implied terms or conditions: 'to assume the rôle of the reasonable man, and decides what the reasonable man would regard as just on the facts of the case. The hypothetical 'reasonable man' is personified by the court itself. It is the court which decides.'[41]

A final argument against adjustment is related to the classical view of freedom of contract, where no objective tests of value exist by which prices can be substituted for what the parties have in fact agreed.[42] Any assessment or evaluation of the fairness of contracts would be impossible because there is no objective criterion by which to evaluate the (mutual) obligations of the parties and to determine when an imbalance between them is sufficient to justify intervention in the contract. Objective criteria are prevented by the 'subjective nature of values' represented by the circumstances that constitute the flow of supply and demand and which determine, at a precise time and in an exact place, the price and conditions agreed upon by the parties.

Nevertheless, it has to be admitted that from a purely economic point of view there is no objective standard to assess the precise value of reciprocal obligations, but the non-existence of objective standards must not prevent interventions in contracts in cases of substantive unfairness through rational mechanisms.[43] In addition, nothing prevents concepts such as fairness or cooperation from being included in such rational mechanisms, the purpose of an adjustment being to avoid undeserved inequities in the distribution of the losses between the parties and not to attain the exact and accurate ex-ante terms which hypothetically the parties should have concluded.

38 Assuming that the conditions for unexpected circumstances are met. On the contrary, the court will of course reject the affected party's claim and the contract will stand as agreed.

39 Hillman (1987), p. 28, suggests for these cases a decree of conditioned performance, by which the court grants the buyer specific performance, conditioned on the buyer's acceptance of the adjustment and therefore he would have the choice of either ending the deal or accepting the performance of the adjusted contract.

40 Gillette (1984), p. 568.

41 *Fibrosa*, at 70-71, cited by Kull (1991), p. 36.

42 Collins (2003), p. 281.

43 Collins (2003), p. 282.

2.2.2. Lack of expertise on the part of judges

A second argument against the adjustment of contracts by the courts is related to the capability or aptitude of judges to do so. In this sense, it has been argued that neither judges' training nor their experience qualify them for the task of redrafting or supplying the terms of a contract for the parties.[44] It may be added that because of the natural limitations of litigation, in long-term and complex contracts the courts have insufficient guidance concerning the appropriate terms for an adjustment. Therefore, especially in complex commercial relationships, because of their expertise the parties involved are the only ones capable of adjusting the provisions of a contract in an adequate or satisfactory manner.

However, this argument is based on two premises which are not always present in cases of unexpected circumstances: the complexity of the contractual relationship and the attributes of the parties as experts. In a large number of cases, e.g. transport or loan contracts, those characteristics are at least not a distinguishing feature of the contract, particularly if we consider the position of one of the parties (for instance, it may be the first such agreement entered into by one of the parties). As a consequence, not all adjustments or adaptations are necessarily complex, e.g. an extension of the period of performance, or a change of the place of delivery. Even if the adjustment concerns one of the main elements of the contract, such as a price adjustment, the judge is not allowed (or able) to redraft the entire contract or change its nature.[45]

In addition, the argument of complexity and the subsequent incompetence of judges is also weak because, outside the issue of the adjustment of contracts, there are many complex cases decided by the courts. Civil and commercial litigation provide a vast number of examples: damages, securities, mergers, patents, insolvency, etc. In sum, complexity is not exclusive to adjustment cases and so the judicial incompetence argument raises doubts concerning the capability of the entire judicial system.[46]

The benefit of hindsight is also a good reason to allow the courts to revise contracts. The accurate and current information provided by hindsight give the court enough tools to adjust and even improve the agreements concluded by the parties under completely different conditions, so the adapted contract may reflect the parties' goals under new circumstances.[47] In this sense, in *Alcoa*, the court stated that '…in this dispute the Court has information from hindsight far superior to that which the parties had when they made

44 Dawson (1984), p. 37, adding that 'nothing in their prior training as lawyers or their experience in directing litigation and giving coherence to its results will qualify them to invent viable new designs for disrupted enterprises, now gone awry, that the persons most concerned had tried to construct but without success'.

45 See PECL, Official comments, p. 117.

46 Hillman (1987), p. 26, stating additionally that 'doubtful also is whether alternative dispute resolutions forums (or in extreme cases, the legislature) would be superior to judicial adjustment.'

47 Hillman (1987), p. 26; Kull (1991), p. 38, stating that 'there are few contracts that could not be improved by the courts if 'fairness' (with the benefit of hindsight) is accepted as the measure'.

their contract. The parties may both be better served by an informed judicial decision based on the known circumstances than by a decision wrenched from words of the contract which were not chosen with a prevision of today's circumstances.'[48]

Finally, even if it is accepted that a court is far from being ideally suited to adjust contracts, this does not mean that courts should not be allowed to adjust contracts between parties who cannot privately resolve their dispute.[49] If the parties are unable to reach an agreement on the adaptation of their contract, either by private initiative or by an order of the court, e.g. encouraging the parties to settle as in the *Westinghouse* uranium litigation, judicial discretion is necessary to avoid or at least to reduce the unfairness and negative effects of the 'all or nothing' approach for the contracting parties as well as for third parties.

2.2.3. Increase in the costs of contracting and litigation

Another objection to the court adjustment of contracts is that it is bad policy since it increases the costs of contracting and litigation, and discourages some parties from concluding long-term contracts. Thus, the possibility of court intervention in the contract provisions would lead to an increase in transaction costs because the parties will attempt to avoid the uncertainty of such an intervention (and its results), thereby including in the contract the allocation of any hypothetical risk whatever its actual relevance for the relationship.[50] Litigation would also increase because disadvantaged parties, aware of their judicial adjustment option, will often request court intervention to obtain relief from bad or prejudicial agreements.

Nevertheless, these arguments can be interpreted in an opposite way. Hence, the introduction of a rule providing for the duty to adjust and ultimately the possibility of a court intervention can be more efficient than the non-recognition of the effect of unexpected circumstances or an all or nothing approach because in the latter cases the parties will incur high transaction costs by trying to avoid the possibility of the contract being terminated by subjecting one party to all the risk or selecting a remedy that would preserve the agreement.[51]

In the same sense, the hypothetical uncertainty and even the possibility of court intervention may induce the parties to reach out of court settlements. A court adjustment would be 'a form of coercive mediation'[52] by which the amount of litigation may be reduced. On the other hand, the discharge alternative may encourage the affected party to suspend performance, refuse settlement and wait for the action of the other party. Besides, not only

48 *Alcoa*, 499 F. Supp at 91.
49 Hillman (1987), p. 19.
50 See Kull (1991), pp. 46-48.
51 See Hillman (1987), pp. 30-31, adding that 'parties to long-term contracts frequently pay little attention to contract rules…it is therefore unlikely that any adjustment rule will have much effect on future behavior of the parties'.
52 Macaulay (1985), p. 476.

the amount of settlements but also their quality may be improved because each party will know that the court is unlikely to decide totally in its favour so the parties cannot abuse of their bargaining positions, e.g. the suppliers of commodities with no or few market alternatives.[53]

Even from the perspective of an economic analysis, it is arguable that the increase in litigation will only occur for an initial period, because 'since litigation, especially at the appellate level, generates precedents, the upsurge in litigation will lead to a reduction in legal uncertainty. Hence, the amount of litigation will fall in the next period'.[54]

Non-intervention by the courts is also supported by the assertion that an ex-ante explicit or implicit allocation of risk by the parties is the most efficient (and only legitimate) method of adjustment. This approach assumes that the parties have enough knowledge of the nature and effects of the eventual risk concerning the performance of the contract and also make reasonable choices with that information. Court adaptation is therefore beyond the limits of the agreement and imposes an unjustifiable and inefficient ex post adjustment of losses upon the parties.[55] The allocation of risks being the primary reason for a party to enter into a contract, any modification to the risk allocation as the parties originally agreed would seriously affect the purposes of the contract. This view is related to law and economics' theoretical concept of completely contingent contracts, i.e. 'contracts whose terms spell out the appropriate course of action for every party in every conceivable state of the world'.[56]

However, the practical feasibility of fully contingent contracts can be contested by the simple fact that it is not realistic to require the parties to provide for *all* future contingencies that *may* affect their relationship. The opposite conclusion will entail enormous transaction costs and lengthy and difficult negotiations for the parties.[57] Additionally, the parties might, without any fault of their own, erroneously analyse relevant information for the allocation of risks, or simply dismiss their allocation because of their remoteness.[58] If it

53 Hillman (1987), pp. 32-33 stating that 'the hope for complete release may explain, for example, why the dispute between Westinghouse Electric and operators of forty-nine nuclear power plants concerning Westinghouse's agreement to supply uranium to the plants was not settled prior to a court decision…after a decision that Westinghouse was liable for expectation damages, the utility owners of the plants agreed to settle under 'extremely lenient terms'…this suggests that Westinghouse must have held out, hoping to win a complete release from its duties under the contract.'

54 R.A. Posner, *Economic Analysis of Law*, 3d ed., Boston, Little, Brown, 1986, at 511, cited by Legrand Jr (1988), p. 943.

55 See Trakman (1984), p. 501.

56 Talley (1994), p. 1206.

57 See Talley (1994), p. 1206, citing Williamson, The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting (1985), who states that several factors may prevent completely contingent contracts: the impossibility to anticipate all the contingencies that may require contract adaptation in the future; the fact that appropriate adaptations for future contingencies will not be evident until the circumstances materialize; and the existence of legitimate disputes between the parties in relation to the extent and influence of the future contingencies over the contract.

58 Hillman (1998), p. 227.

is assumed that the parties are not able to anticipate the nature or effects of all future contingencies, then some risks can be regarded as not allocated and consequently the test for *ex ante* efficiency is not applicable. Even in cases of an express risk allocation, a dramatic change in the surrounding conditions concerning the transaction may make that allocation economically inefficient.[59]

Lastly, even if the efficiency approach is correct in stating that a court adjustment regime can increase contracting and litigation costs, the economic outcome of a legal regime is not the only factor to be taken into consideration. The benefits in terms of the fairness of the outcome to particular parties cannot be evaluated under efficiency parameters and may outweigh other hypothetical costs as mentioned above; so 'at the margin perhaps a fair resolution of disputes maximizes the benefits to society of long term contracts by encouraging people to enter into them.'[60]

2.2.4. Adjustment leads to uncertainty and it is unclear

Concerns about court adjustment are also based on its lack of certainty and clarity. Thus, it is argued that the conditions for judicial intervention are ambiguous and therefore the courts are not provided with clear rules to determine precisely when an adjustment is appropriate.[61] Besides, the discretion of the courts with regard to the terms of the adaptation of the contract would also lead to uncertainty about the final outcome of the case for the parties. Finally, intervention by a judge in the contract through its modification would necessarily entail arbitrariness in the decision.

Nevertheless, it can also be said that any 'court dispute' is far from clear; however, the applicable rules seem to be clear. Not even the clearest provision is able to provide complete certainty to the parties with regard to the rule to be applied in court and therefore the outcome of their dispute is also tinged by non-clarity. In addition, uncertainty must not be confused with the discretion or the powers given to a court to solve a dispute.[62]

A related concern is whether the availability of a court adjustment as a remedy would lead to a relaxation of the conditions and standards required for the application of the doctrine of unexpected circumstances in general.[63] When a jurisdiction allows the application of such a doctrine, the conditions to be met are very strict and, in general, the courts only grant some relief to the affected party in extraordinary cases. The certainty of this approach

59 Trakman (1984), p. 502.
60 Hillman (1987), p. 33.
61 Hillman (1987), p. 3. In this regard, Dawson (1984) at p. 31 states that there is '…an ambiguity that seems to be deliberately maintained as to how disruptive the unforeseen change must be for courts to acquire the power to 'readjust' terms'.
62 Hillman (1987), p. 31 states that 'In addition, the present impracticability approach, although it typically ultimately favors the buyer, is itself confusing. Was a risk allocated? What events were foreseeable? When is performance sufficiently costly to be impracticable?' Indeed, the only rule that can provide absolute certainty in this issue would be one of strict contract liability without any exceptions.
63 Hubbard (1982), p. 106.

is evident if it is contrasted with others where the standards are broader. In this sense, it has been argued that if courts have the powers to adapt contracts, 'Since the losses will not fall entirely on one party or the other, the courts should be willing to recognize excuse defenses more often…'[64] Nevertheless, a contrasting situation can be just as likely: with the power to adapt a contract, courts may be extremely cautious in revising and adjusting a valid contract concluded by the parties, granting the adjustment only in extraordinary and exceptional cases. In fact, the response of the classical theory of contract (to deny relief or to grant a complete discharge) is simpler than a remedy allowing for the contract to be adjusted, which requires much more argumentation and technical analysis on the part of the court, and, therefore, will only be granted in exceptional cases.

With regard to the hazard of the judicial adjustment being arbitrary, it has been argued that such a hazard is mitigated or avoided by several means. Thus, the courts have to justify their decisions providing the legal and technical arguments which support it. The right to appeal is also a means to avoid judicial abuses. In addition, self-imposed constraints such as loyalty to the legislator, respecting the role that it performs and an awareness of the consequences of its decisions on the legal community and general public opinion are relevant factors to inhibit arbitrariness.[65]

Finally, the benefits of the supposed certainty of the approach which denies the power of courts to adapt contracts are outweighed by other kinds of benefits such as fairness and the protection of the 'purposes and expectations of the parties', as stated before.[66]

2.2.5. A risk to the whole economic system

An economic system based on an uninhibited market classically implies a place where free individuals use their resources and judgment to attain advantageous bargains. The distribution of wealth is achieved by incentives, such as the certainty and enforcement of contracts, which allow individuals to judge and calculate the risks and benefits of entering into the market 'so to remove those incentives by judicial revision of terms to adjust prices and obligations in the light of changing market conditions would tend to undo the market system itself.'[67]

In this sense, it has been argued that the sanctity of contracts and a reliance on their enforcement provides the necessary stability for the economic markets. Business could suffer serious economic disruptions because parties would be reluctant to enter into long-term transactions and contracts of shorter duration would become more prevalent. Without the stability provided by long-term contracts, manufacturers would be unable to

64 Wallach (1979), p. 229.
65 See Legrand Jr (1988), pp. 930-932, adding that 'the decisions show that the courts are restrained in their use of revision and that, when they resort to it, they carefully steer a middle course designed to give each party a share in the outcome'.
66 Hubbard (1982), p. 107, referring to *Alcoa*.
67 Collins (2003), p. 294.

limit its risks and/or to maintain a stable price for their goods. Then, 'society would bear the burden of increased prices and possibly increased unemployment if the manufacturer were forced out of business.'[68] In the same sense, concerning the *Alcoa* case, it was stated that the decision of the court 'undermine[d] public faith in the legal system.'[69]

Similarly, it is argued that even if in cases related to public services the revision and adjustment of the contract can be justified to protect public interests such as the supply of utilities, on the other hand, in cases in which only the interests of private parties are involved, such justification does not exist and, on the contrary, to allow the adaptation of a contract which has become ruinous for one party implies the danger of a 'chain reaction' of claims by other affected parties and therefore the entire system collapsing.[70] Because of its position and its capacity to evaluate the general consequences of measures across the whole system, the only legitimate entity to intervene in situations of economic or social crisis would be the legislator, not the judge.[71] In this sense, it has been stressed that the revision or the termination of contracts in cases of a serious economic imbalance derived from unexpected circumstances may only be granted if the resulting injustice deprives the contract of its social benefit or efficacy.[72] Consequently, the particular interests of the parties involved are not a sufficient reason for a revision, and only in cases of a danger to the whole economic system or relevant public interests is there a role for the legislator to decide and determine the conditions for the revision of contracts.

Therefore, a general recognition of a revision is considered '*moralement souhaitable mais économiquement dangereuse*' because that would lead to consequences which cannot be measured by the courts and, consequently, a decision with disastrous economic consequences cannot be morally justified. Thus, '*le facteur moral est subordonné au factor économique*'. To revise contracts is to revise the economy and that is the prerogative of the legislator, not the courts.[73]

However, as stated above, even in cases of express legislative authorization, judges are still very reluctant to use their powers to revise and adapt the terms of contracts. The danger of a 'chain reaction' or a collapse of the economic system has not been empirically proven and, on the contrary, it can be said that in such cases the courts adopt a restrictive approach. This is the case in France, where the *loi du 9 julliet 1975* gave the courts the power to reduce excessive *clauses pénales* (liquidated damages clauses), but the courts have used this power with moderation and under strict conditions.[74] In addition, 'to raise

68 Classen (1990), p. 406.
69 White, Peters (2002), p. 1963.
70 Flour et al., (2002), n°418.
71 See Mazeaud et al., (1996), p. 861.
72 Ghestin et al., (2001), p. 336-337, stating that 'La révision ou la résiliation du contrat consécutive à un déséquilibre économique des préstations n'est admissible que si l'injustice qu'elle crée rend le contract inutile ou risque de le priver de son utilité sociale'.
73 See Flour et al., (2002), par. 411.
74 Mazeaud (2008), p. 559, concluding that 'l'existence d'un pouvoir de revision judiciaire ne rime pas fatalement avec l'instabilité contractuelle et n'emporte pas nécessairement la chute des colonnes du temple

the matter of unlitigated contracts as an objection to judicial innovation is to bring forth 'the not unfamiliar floodgates argument invariably advanced `whenever it is suggested that the law might be changed".[75] As stated before, the strict requirements for the legal relevance of a change of circumstances and the imposition of renegotiation as a duty for both parties (without the suspension of the performance, but in very restrictive cases) may provide an incentive for private settlement rather than judicial disputes.

Finally, most of the time, the revision and judicial adjustment of contracts do not lead to economic instability; on the contrary, such a revision is the result of such instability and can therefore be regarded as a remedy against economic, political or social turbulence, thereby providing good grounds to allow the (adapted) performance of contracts instead of their termination.[76]

3. The extent and content of modification. The powers of the court

Once the power of the courts to adjust contracts is established, the next step is to determine the extent of such powers and the methods by which they have to be exercised.

The first limitation to the discretion of the court is the prohibition on redrafting the entire contract or changing its nature.[77] Therefore, any modification of the contract terms cannot in any case result in a new and completely different contract being imposed on the parties, e.g. changing the subject-matter of the contract or imposing a new and completely different obligation for one party.

A second general statement is that the purpose of court adaptation is to distribute the losses caused by the unexpected circumstances to the extent that the performance of the contract by the affected party is possible or bearable.[78] In other words, the adjustment does not necessarily have to reflect the full loss resulting from the change of circumstances and therefore to restore *completely* the economic equilibrium of the contract as when it was concluded. It would not be consistent with the principle of the sanctity of contracts if the court would allow one party, even if performance for that party has become more onerous, to be completely relieved of the costs resulting from the disruptive events.[79] Then all those costs would have to be borne by the advantaged party, which is not an acceptable solution. Consequently, '…up to the "limit of sacrifice", i.e. the threshold where performance has not only become "more onerous", but "excessively onerous", the aggrieved party bears the risk that the cost of performance may increase or that the value of the performance it receives

contractuel.' In the same sense, Fauvarque-Cosson, paragraph 17.

75 Lord Roskill, in *National Carriers Ltd V Panalpina (Northern) Ltd* (1980) [1981] A.C. 675 (H.L.) at 714.

76 In this sense, Mazeaud (2008) p.578 y ss, stating at p. 583 that '…l'idée de révision judiciaire…constitue, en effet, en situation de crise, la seule alternative à l'inexécution du contrat, à sa rupture, et le seul remède propre à sauvegarder le contrat, à assurer sa pérennité'.

77 See PECL Official comments, p. 117.

78 Brunner (2009), p. 499; and Sacco, De Nova (2004), p. 1003.

79 See article 6.2.1of the PICC, paragraph (1) of art. 6:111 of the PECL and article III – 1:110 of the DCFR.

may diminish',[80] a conclusion that can be applied to most commercial relationships in which a greater or lesser risk of fluctuations in market prices or costs must be taken into account by the contracting parties. As a consequence, part of the extra costs should necessarily be borne by the affected party. Because of these reasons, the allocation of the loss with regard to the benefits conferred to the promisee cannot be measured only by the market value of the goods after the occurrence of the disruptive events because in that case the loss will be completely shifted to the advantaged party. This approach implies that in most cases the promisor has assumed some risk and cannot be granted the full market price.[81]

A (following) more complex problem is to find a method by which to distribute the loss between the parties. Even in cases of express statutory regulation, the legal provisions do not provide any guidance in this regard or only refer to principles or general concepts. Thus, the relevant provisions of the PECL state that the court may adapt the contract in order to distribute the losses and gains between the parties in a just and equitable manner; article III – 1:110 (2) (a) of the DCFR provides for a reasonable and equitable variation of this obligation; the PICCrefers to reasonableness in restoring the contractual equilibrium; and the Italian article 1467 and the Argentinian article 1198 refer to the equitable modification of a contract.

The same can be said of the Common law jurisdictions. Thus, the Frustrated Contracts Act, which gives the courts the power to adjust some of the performance losses of the parties in case of frustration, provides limited assistance to the judge to determine the sums for those adjustments, empowering the court to do so 'if it considers it just…having regard to all the circumstances of the case'. Similarly, comment 6 to UCC §2-615 states that a court adjustment is possible 'in situations in which neither sense nor justice is served' by an 'excuse or no excuse' solution. The comment also refers to good faith and to the purposes and general policy of the Code. Again, §272(2) of the Restatement (2nd) of Contracts provides that 'the court may grant relief on such terms as justice requires'. Because of these weak guidelines, it has been argued that English and U.S. courts have made little use of the powers granted by those instruments and rather prefer an approach based on a complete excuse or no excuse.[82]

In this regard, the modification of the contract may be granted by the court by different means. Therefore, the court may decide to partially set aside the obligation of one of the parties, for instance diminishing the quantum of the goods to be delivered or the term originally agreed upon. A more drastic measure may be to increase the obligation of one party (in most cases, the price to be paid) in the interest of the other unduly burdened party.[83]

80 Brunner (2009), p. 499. See also Sacco, De Nova (2004), p. 1003.
81 Hubbard (1982), p. 110.
82 See Trakman (1984), pp. 482, 504-505.
83 Rhode (1959), p. 183.

However, to establish an objective and standardized method for adjusting the contract can be difficult. One alternative is to 'isolate the causes of each portion of the loss and then to allocate the risk of each cause to one or the other party' so that 'each party would bear the portion of loss attributable to risks allocable to him'.[84] A related proposed formula is that courts should distribute the losses in proportion to the parties' relative ability to control the risk.[85] These approaches have evident practical difficulties and do not take into account that in most cases some of the risks of the contract cannot be allocated particularly to one of the parties. Also, the extent to which the parties were aware of the risk at the time of contracting may imply great difficulties for its determination.

Other 'objective' standards also appear inadequate. Thus, the relative ability of each party to sustain the loss has been proposed as an alternative method. In this sense, in Germany the courts have stated that the financial situation of the parties must be evaluated, so that the loss has to be imposed on the financially stronger party.[86] Of course this approach is itself questionable, and (if considered) must be strongly balanced with other factors such as the ability of such a party to prevent the loss from occurring.[87] Another objective suggested parameter is to require both parties to share equally the performance losses in those cases when neither party could have avoided either the occurrence of the losses or their harmful effects.[88] The evident advantage of this approach is its certainty. On the other hand, there is the inflexibility of the 'all or nothing' approach by just placing the solution somewhere in the middle, thereby failing to provide a rational framework for the allocation of losses, and it does not consider those cases in which the parties are not equally innocent in causing the loss but have different degrees of responsibility in the assumption of the contractual risks.[89]

However, some concrete guidance may be provided to the court by the analysis of different factors and circumstances related to the agreement. Thus, from an *internal* perspective of the relationship, the court may analyse the goals and expectations of the parties when entering into the contract, thereby examining, e.g., the relevant information at the pre-contractual stage, the final agreed contract terms and the *ex-post* negotiations on the consequences of supervening events. Additionally, from an *external* perspective, the court can examine the conditions surrounding the agreement; for instance, similar contracts and their modification, either concluded by the parties or by others under comparable

84 Hubbard (1982), p. 109.
85 Trakman (1984), pp. 506 ss.
86 Rhode (1959).
87 See Trakman (1984), p. 503, adding that 'to maintain otherwise would be to discourage parties from taking precautions against the disruption of their performance'.
88 See Hillman (1987), p. 25, proposing a splitting of losses in short-term agreements, but also adding that it 'would be difficult to administer in long-term supply contexts.'
89 See Trakman (1984), p. 503, stating that 'contractors who are "risk managers" usually should assume a greater share of responsibility for the 'managed' risk of harm, even though the source of that harm may not have been beyond their control.'

conditions, with the aim being to establish a common parameter derived from analogous transactions[90]

Finally, it is important to state that the basis of and the justification for a valid method of loss sharing and adjustment cannot be limited to a simple distribution of such losses based only on a stereotypical characterization of the parties' agreement.[91]

4. Termination of the contract

The termination of the contract is the easiest and more drastic solution in cases of a change of circumstances. The comparative survey of the previous Chapters has showed that termination is a common remedy not only in jurisdictions with express provisions to deal with changed circumstances but also in those with a restrictive approach to the subject, when in exceptional cases a defence based on those grounds is admitted by the courts.

Thus, termination is the primary (and in theory exclusive) right of the affected party under Italian and Argentinian law. In contrast, in the case of the three non-legislative codifications analysed, it is considered as the final alternative for the court, which in theory has to evaluate the possibility of continuing the contract through its modification and only if that is not possible can the contract then be terminated.

Similarly, if frustration is recognised under English common law, the effect is the complete and automatic termination (discharge) of the contract, i.e. each party is released from any further obligation to perform and each party has to bear its own losses. This is true even in the case of American law, where despite the availability of a range of loss-sharing remedies in the UCC and the Restatement (2nd) of Contracts, the courts usually applied an all or nothing approach to cases of impracticability, and therefore refuse to spread the burden of a contract discharged on that ground. In the same way, since the CISG does not include a court adjustment as a general remedy which is available for the parties, part of the doctrine states that even if a change of circumstances is admitted as a ground of relief under the Convention, the effect would be the termination of the contract.

However, termination cannot be the most appropriate solution for the interests of the parties, particularly if both want to preserve the contract or if there is another kind of interest involved in the transaction, such as third parties' or public interests. If the judge has the possibility to determine the terms of the contract's termination (e.g. concerning retroactivity, its date, non-performed or partially performed obligations) the inconvenience of this remedy may be mitigated. As stated above, that is the solution adopted by the PICC, the PECL, and the DCFR that grant the courts broad powers for such a determination in order to assure a fair distribution of losses and damages between the parties.

90 See Hillman (2009), p. 601.
91 Trakman (1984), p. 503.

Although the provisions of the non-legislative codifications do not give prevalence to adaptation over termination as available remedies for the parties, the PECL's Official Comment states that termination should used as a last resort by the courts in order to preserve the contract as far as possible. A similar statement has been made by Argentinian case law, which has stressed that the remedy of termination has to be limited to 'cases where a revision is not possible or does not lead to satisfactory solutions'.[92] To some extent, the termination of the contract can be considered to be always a modification, because in any case it will entail the end of the relationship before the term originally agreed.

The analysis of the technical or procedural issues concerning the termination of the contract is outside the scope of the present research. However, two facts should be taken into consideration in cases of changed circumstances: First, the disruptive circumstances are external to both parties, so the creditor has not influenced their occurrence or consequences on the obligation of the affected party; and second, it has performed its own obligation or is willing to perform. In other words, the advantaged party can be considered as an *innocent* party. In this sense, the PICC's Official Comment stressed that termination in a case of changed circumstances deserves to be treated differently since it is not a case of the defective or non-performance of the contract.[93] This special treatment implies that the court has to consider the circumstances of the particular case in order to establish the adequate conditions for terminating the contract. In this respect, some general considerations concerning the effects and extent of the termination of the contract can be made.

Thus, as a general principle, the advantaged party, who has neither caused the disruptive event nor collaborated to aggravate its effects on the counterparty's performance, should not be negatively affected by the termination of the contract and, therefore, he should be entitled to recover the reasonable expenses incurred in reliance on the contract, and even the damages that the non-performance of the contract has caused him. Those damages should be determined in relation to the risks that should be assumed by the debtor under normal conditions, i.e. applying the same parameter (the limit of sacrifice) for the adjustment of the contract. Therefore, the affected party may still be deemed responsible for the (non-excessively) onerous performance of the contract.

The broad powers of the court concerning the subject imply that termination does not necessarily have a retroactive effect. Thus, in contracts for periodic or continuous performance the effects of termination do not extend to performance which has already been rendered.[94] Then, even when the parties are in general free with regard to future obligations derived from the contract, a termination may still have retroactive effects concerning performances totally or partially rendered and also the distribution of costs and the determination of damages to be paid. For instance, despite the fact that pending

92 CNCiv., sala G, 1982/05/03, *Fucaracce, J. c/ Capellán, J.*; cited by Digesto Práctico La Ley: Revisión de los Contratos (2003), p. 318.
93 PICC Official comments, p. 191.
94 Article 1198 of the Argentinian Civil Code expressly provide that solution.

obligations are generally extinguished, the judge could provide for the fulfilment of some of them after the date of the termination with the aim being to prevent undeserved damage to one of the parties.

In addition, if renegotiation is considered to be a previous condition for the affected party to rely on the rules of changed circumstances, a termination can only be requested after an attempt at renegotiation has failed. This allows the problems related to an unilateral declaration of termination by the affected party to be avoided, which also in fact implies the unilateral suspension of the performance.

Finally, it can be argued that a termination should always be an available remedy for the *innocent* advantaged party, so that when confronted with a request for adjustment by the counter-party, he can choose to terminate the contract rather than continue the relationship. However, this right to terminate can be inconsistent with the eventual existence of a duty to adjust and with the principle of *favor contractus*. In any case, such a right should be subject to two qualifications: it can only be exercised after an attempt at renegotiation has failed and it cannot be claimed if the termination seriously affects the rights of third parties (e.g. in the case of public utilities whose interruption may affect a large number of consumers).

5. Conclusions

The classical approach to the effect of unexpected circumstances, if it is recognised by a given legal system, is the termination of the contract. However, important problems for the contracting and third parties can arise if the contract is terminated rather than adjusted so as to preserve the relationship.

In this regard, the parties themselves are certainly the best situated to adapt the contract provisions to the new circumstances; but this assessment must not prevent an intervention of the court after the failure of the renegotiation process. Judicial discretion is necessary to avoid or at least to reduce the unfairness and negative effects of the all or nothing approach for the contracting and third parties. In all cases, the judge must play an active role in encouraging the parties to reach an agreement.

Allowing the courts to adapt contracts in cases of unexpected circumstances, for the reasons and with the limits stated in this Chapter, implies widening the boundaries of such a doctrine from its limited function as an excuse for non-performance to a more useful role as a remedy in that situation.[95] As a consequence, the interest and purposes of *both* parties are presumably better protected if the contract is preserved rather than terminated, giving the courts the necessary powers, through rational mechanisms, to distribute between the parties the losses resulting from the supervening events.

95 See Trakman (1984), p. 484.

In this Chapter, the foundations for the recognition of the courts' power to adjust contracts to new circumstances have been extensively discussed and contrasted with their main counter-arguments. The option for one or the other also implies an option for the desired values that a society wants to prevail in contract law, so beyond the doctrinal justifications the need for a political choice cannot be avoided.

With regard to the extent of the powers of the courts to adapt the contract, the major difficulties are related to the methods of and the parameters for distributing losses between the parties. In any case, the court cannot redraft the entire contract or change its nature, nor shift the losses completely from one party to the other. Additionally, the distribution process requires the court to examine the agreement both from an internal and an external perspective.

Finally, concerning the termination of the contract, the best option seems to be to consider it as a last resort for the court, with the aim being to preserve the contract, as far as possible, through its adjustment to the new circumstances. Only if the interests of both parties are better served by the termination of the agreement should the court grant such a request. The powers of the courts in this respect should be wide in order to overcome the inconveniences of the anticipated ending of the contract for the parties, especially concerning the position of the *innocent* advantaged party that should not be negatively affected by the termination of the agreement.

Chapter 10

CONCLUDING REMARKS

The comparative overview of the different legal systems analysed in this research, as well as the CISG and the non-legislative codifications, has shown that, today, there are still great divergences in the approach to the recognition and effects of a change of circumstances on the binding force of contracts. Nevertheless, the general trend seems to be the acceptance of changed circumstances as a ground for relief for the affected party, thereby granting him a number of alternatives when the performance of his obligation has become excessively onerous.

1. The general but not absolute principle of *pacta sunt servanda*

It is self-evident that *pacta sunt servanda*, as a principle involving both the freedom and sanctity of a contract, remains as one of the cornerstones of contract law and is therefore a general rule to be observed by the parties and the courts. This is the case in all the jurisdictions and the non-legislative codifications included in the research, and certainly in most of the contemporary legal systems of the world.

However, its prevalence is not absolute and nowadays there is a general agreement on the necessity for it to be restricted in order to balance it with other principles or values considered to be worthy of protection, such as substantive fairness and good faith, and their consequential duties such as cooperation and flexibility. It has thus been stated that 'freedom of contract does not vindicate tolerance of blatant inequities or unconscionable acts; freedom of contract means freedom to agree or assent: not freedom to be forced to agree, to be presumed to have assented, to be cornered into something that one has not remotely considered, or to be denied meaningful choice'.[1] In other words, the stability and security of transactions do not involve the absolute intangibility of the agreement. Thus, the binding force of a contract cannot be reduced to performance as literally agreed upon by the debtor, but must consider the reasonable expectations of both parties upon the conclusion of the contract.

1 *McGinnis v Cayton*, 312 S.E.2d 765 (W. Va. 1984) at 772 (Harshbarger, J., concurring).

Concluding remarks

There is no doubt that the purpose of a contract is to establish rights and corresponding obligations for the parties. For the purpose of certainty the parties look at what has been agreed. But that certainty not only refers to the performance of the counter-party, but also to the party's own performance. Then, a supervening change of circumstances can not only be analyzed from the point of view of the creditor, but also from the point of view of the debtor. The performance in the new situation could be something which is completely different to that agreed upon when originally concluding the contract.

In addition, classical contract law and continental Civil Codes were designed for microeconomic 'one-shot' or 'discrete' transactions and not for long-term or complex relationships, which are usually regulated by exceptional rules or specific provisions and statutes. However, a contract can be considered to be more of a *relationship* than a *transaction*. For that reason, it can be argued that general principles such as *pacta sunt servanda* or the sanctity of contracts cannot be applied strictly and must be contrasted and qualified with the special characteristics of long-term relationships, particularly the impossibility for the parties to avoid uncertainty despite careful planning. Thus, 'the possibility of trouble caused by change will be expected as normal (although the precise nature and impact will be unknown) and flexibility, cooperation, and adjustment will be regarded as essential.'[2] In particular, long-term relationships, either created and/or governed by a single contract or by a complex mixture of one or more contracts and other legal or extralegal relations, require a special regime which encourages cooperation and flexibility by the parties so as to adapt their relationship to the circumstances which will arise through its entire existence, assuming the presence of gaps because it is simply not possible for the parties to anticipate and foresee all future events and their consequences for the relationship.

The previous observations must not restrict the extension of the doctrine of changed circumstances to only long-term relationships. As affirmed in the Introductory Chapter, the foundations of the doctrine support its application in all cases in which supervening and unforeseen circumstances result in a severe burden for the pending performance of an obligation, either derived from a contract or a unilateral act.

In particular, those statements imply two consequences for cases of changed circumstances:

a) As a general rule, the debtor must fulfil his obligation even if performance has become *more* onerous than he expected.
b) The parties are in principle free to distribute the risks of supervening circumstances.

However, if the performance has become *excessively* onerous due to *reasonable unforeseeable* circumstances, the affected party is entitled to rely on a proper set of remedies directed at the restoration of the agreement until the limit of an *adequate* sacrifice for the debtor. At the same time, the mandatory nature of the rules on a change of circumstances entails

2 Speidel (1981), p. 401.

that is not possible to agree on a complete shift of *all* the risks (foreseen and unforeseen) to be borne by one of the parties, because in practice that would imply the exclusion of such rules.

2. Receptive and unreceptive legal systems

Based on the comparative overview provided in Chapters three to seven, a systematic analysis of the legal systems and the non-legislative codifications included in the research leads to their classification into receptive and unreceptive legal systems. The distinction is grounded on the readiness (or not) of the legal system to recognise situations of changed circumstances as being legally relevant, granting the possibility to the affected party to rely on a system of remedies in that case.

2.1. Receptive legal systems

Of the legal systems included in the research, Italy and Argentina can be considered as receptive. The same conclusion can be made with respect to all the non-legislative codifications analysed, i.e. the PICC, the PECL and the DCFR. All of them include a set of one or more express rules to deal with the subject.

In this sense, the legal provisions of the Italian and Argentinian Civil Codes present marked similarities, which is due to the fact that the former was one of the models for the Argentinian Civil Code's reform in 1968. The same can be said with regard to the provisions included in the non-legislative codifications, whose corresponding nature is evident.

Based on the analysis of these receptive legal systems, the following points can be laid down:

2.1.1. Scope of the rules

Traditionally, the scope of the rules on changed circumstances has been restricted to contractual obligations. Thus, in Italy the rules are applicable to contracts for continuous or periodic performance or for deferred performance, but aleatory contracts are excluded. Similarly, in Argentina the provision on *imprevisión* is applicable to contracts for deferred performance or for continuous performance, and even to aleatory contracts when their excessively onerous nature is the result of causes which are external to the inherent risks of the contract.

The provisions of the non-legislative codifications are broader in scope and are applicable to contracts in general, being restricted only by the scope of the respective instrument.[3] In

3 Thus, the rules of the PICC are intended to be applicable to international commercial contracts.

addition, in the case of the DCFR, its provision on a change of circumstances is applicable to *obligations* in general, either emanating from a contract or from another juridical act.

2.1.2. Requirements

2.1.2.1. The nature of the disrupting events

Supervening events
As a common feature, all receptive legal systems require that the changed circumstances take place after the conclusion of the contract. The aim is to distinguish the rules on a change of circumstances from (principally) the rules of mistake. Then, if the relevant circumstances were already present at the time when the obligation was incurred, but they were ignored by the parties or at least by the affected party, the rules on mistake may be applicable, provided that the conditions for its application are met.

Extraordinary circumstances
The condition that the supervening circumstances must be extraordinary is required by Italian and Argentinian law, as well as by the DCFR. Although there is no clear definition of what is considered to be 'extraordinary'; the extraordinary nature of the events in question is linked to their objective measurement, especially in relation to criteria such as their frequency, general nature and intensity. This condition is not imposed by the PICC or the PECL.

Unforeseeable circumstances
All the receptive legal systems require that the supervening circumstances were unforeseeable, or, in other words, that they could not be reasonably taken into account or anticipated by the affected party. However, this does not mean that the assessment of the foreseeability of the events must be subjective, but, on the contrary, the mentioned legal systems have developed or included in their regulations the standard of reasonableness, in order to include objective criteria for such a measurement, such as, for instance, the quality of the parties, the nature of the contract or the surrounding market conditions. The goal is that the evaluation is not made from the internal perspective of the debtor but from the perspective of a reasonable person in the same situation as the debtor.

2.1.2.2. Excessive onerousness

The concept of excessive onerousness or onerosity is considered by the receptive legal systems to include either the situation of an increase in the cost of the performance to be rendered or a decrease in the value of the expected counter-performance. However, beyond this general concept, due to the fact that, at the end of the day, any numerical parameter is bound to be arbitrary, there are no clear standards for its practical determination. In any case, it is agreed that the burden upon the performance of the affected party has to be significant and therefore implies a high threshold for its configuration. In the case of bilateral contracts, this involves a fundamental or major alteration to the equilibrium

of the contract as intended by the parties upon its conclusion. Due to its problematic theoretical determination, the final assessment of the severity of the detriment for the debtor and its impact on the overall relationship will ultimately rest on the court's analysis of the circumstances of the particular case.

2.1.2.3. Distribution and assumption of risks

In all the receptive legal systems, supervening onerosity can only be claimed if the risk of the change of circumstances was not one which, according to the nature of the contract or the express agreement of the parties, the affected party should be required to bear. Again, there are no clear parameters to define the sphere of risks that should be assumed by each party, i.e. those that are inherent to each kind of contract; and therefore the determination of such risks will depend on the particular circumstances of the case. Concerning the contractual distribution of risks, the parties can in principle freely agree that one or more risks will be assumed by one of them. If applicable, that allocation is only limited by the mandatory nature of the rules on a change of circumstances, so that the parties cannot elude the eventual application of such rules by means of a complete shift of the contract's risks.

2.1.3. Effects

2.1.3.1. The role of renegotiation

The renegotiation of the contract has a dual role in the receptive legal systems analysed. On the one hand, it is regarded as a prerequisite for the affected party to be able to subsequently rely on the rules of changed circumstances if the negotiations fail. That is the case for the PICC, the PECL and the DCFR. In general, the attempted renegotiation has to be reasonable and in good faith.

On the other hand, a renegotiation may also be considered as a duty for *both* parties, which in practice entails its configuration as an effect of a change of circumstances. However, renegotiation is not expressly recognised as a common effect of changed circumstances by the receptive legal systems. Thus, neither the Italian nor the Argentinian Civil Codes provide for it as a right for the affected party and consequently there is no corresponding obligation for the creditor to enter into a renegotiation of the contract. Nevertheless, Italian legal doctrine has argued that such a duty does exist based on the principles of *favor contractus* and the duty of good faith. With regard to the non-legislative codifications, only the PECL expressly recognise it as an effect through its configuration as a duty for both parties. That role is discussed under the PICC and it is expressly rejected by the DCFR.

2.1.3.2. Adaptation

The modification of the contract by the court is not provided as a general remedy by the national jurisdictions included in the receptive legal systems. Thus, the Italian *Codice*

Civile only provides for it in the case of unilateral contracts. However, both in Italy as well as in Argentina, the legal doctrine and the case law have recognised the intervention of the courts in cases of changed circumstances in order to adapt the contract to the new events, especially by assessing the fairness of the creditor's eventual counter-proposal. In this sense, it can be said that in practice the adjustment of a contract is an available remedy for the affected party in those legal systems. Concerning the non-legislative codifications, they all grant wide powers to the courts to intervene in the contract in cases where circumstances have changed, with the aim being to make the obligation of the affected party both reasonable and equitable under the new circumstances.

2.1.3.3. Termination

Termination is a primary right belonging to the affected party under Italian and Argentinian law. In contrast, in the case of the non-legislative codifications, it is considered as a last resort for the courts, which in theory have to evaluate the possibility of continuing the contract by means of its modification, and only if that is not possible can the court terminate the contract. In any case, the courts are granted broad powers to make such a determination in order to ensure a fair distribution of losses and damages between the parties.

2.2. Unreceptive legal systems

As stated above, in unreceptive legal systems, the general rule is to deny any relief to the party affected by a change of circumstances. Falling within this category are the legal systems of England & Wales, the United States, France and Chile, as well as the CISG. The outcomes of cases in these unreceptive legal systems are in general negative for the affected party and when they are recognized, the effects of a change of circumstances are limited to a duty to renegotiate or to terminate the contract; in both cases with an eventual, and in most cases, partial ex-post distribution of losses; but no power to adjust the contract is granted to the courts. Even in cases of a limited legislative recognition (as in the USA through the UCC), the factual approach to the subject is very restricted and the practical result (the rejection of the affected party's claim) is the same.

The following subsections summarize the foundations for such a rejection and also the exceptions recognised by such legal systems.

2.2.1. The reasons for the rejection

The first thing to consider is that in the majority of the unreceptive legal systems, most of the contemporary legal doctrine is in favour of the admission of a change of circumstances as a ground for adapting the contract or for relief to the affected party. Then, the reasons for the rejection of that acceptance must be sought mostly in the decisions of the courts.

In this respect, the different styles in the drafting and the foundations of judicial decisions are evident. Thus, in the case of France and Chile, the justification of the courts in rejecting an adjustment or termination of a contract in these circumstances is based on formal grounds, i.e., the existence of a legal provision that firmly and generally lays down the principle of *pacta sunt servanda* and, at the same time, the unavailability of a legal (statutory) ground for accepting a change of circumstances as an exception to such a principle, which would allow a revision of the contract by the courts. Then, the *letter* of the law becomes the major impediment to the recognition of *imprévision*. Furthermore, in most cases social, economic or legal policy reasons are absent from the decisions.

In contrast, with regard to the court decisions from the Common law jurisdictions, the situation is different. Thus, the English courts give express prevalence to the principle of the sanctity of the contract and today the doctrine of absolute contracts as established in *Paradine v. Jane* still applies as a general rule, being the doctrine of frustration (which includes impossibility, impracticability and frustration of purpose) a very restricted excuse. Therefore, the decisions of the courts have stressed that the doctrine of frustration must be applied within very narrow limits and that it is not for the courts to establish a doctrine to deal with a change of circumstances in an equitable or just manner, but for the parties in their contracts or for the legislator through specific intervention in times of general economic or social hardship. This explains the fact that the justification of frustration is sought in the contract itself, e.g., through its 'true construction', and not in external parameters or values such as equity or justice.[4]

In cases before the US courts the application of the doctrine of impracticability has been restricted by the imposition of a high standard of foreseeability: most of the events were deemed to be reasonably foreseeable and therefore it was for the affected party to prevent their occurrence through an express provision in the contract. If that was not the case, the courts presume that the parties intended the obligor to bear the risk. In criticizing the *Alcoa* case (which provided for the adaptation of the contract) the courts have stressed policy reasons for rejecting the adjustment of contracts in cases of changed circumstances, mainly the loss of predictability and certainty for contracting parties which enter into long-term relationships and the inappropriateness for the courts to intervene in a freely agreed contract.[5] Again, it is assumed that it is for the parties to deal with changed circumstances in their contract through the inclusion of an *ex-ante* allocation of risks.

4 See e.g. the statements of the court in *British Movietonenews* and in *National Carriers*, cited *supra* in Chapter six.

5 'Under the logical consequences of [Alcoa] there would be no predictability or certainty for contracting parties who selected a future variable for to measure their contract liability', *Wabash, Inc. v Avnet, Inc*., 516 F.Supp. 995,999 n.5 (N.D. III. 1981); 'it is not the responsibility or function of this court to rewrite the parties' contract to provide for [unforeseen] circumstances', *Aultman Hosp. Ass'n v Cmty. Mut. Ins. Co*., 544 N.E.2d 920, 924 (Ohio 1989); cited by Hillman (2009), p. 599.

2.2.2. Exceptional recognition and limited effects

In exceptional cases, unreceptive legal systems do recognise some situations of a change of circumstances as being legally relevant, but, in any case, the remedies for those situations are very limited and do not include an adjustment by the courts.

2.2.2.1 Frustration of purpose

Under English law, frustration of purpose is the only clear case where a change of circumstances is accepted as a ground to relieve the affected party, but the effect is the termination of the contract, not its adjustment. This doctrine applies when supervening events make performance by one party useless to the other or, in other words, completely reduce the value of such performance for the recipient. The principle was established in *Krell v. Henry*,[6] one of the so-called Coronation cases. However, it has been narrowly applied by the English courts and after the Coronation cases its practical application and development can be regarded as non-existent. In the same sense, despite the fact that this doctrine is also recognized in the United States, relief based on this ground has been rarely granted by the courts.

2.2.2.2. Limited effects

Renegotiation
French case law has restrictively recognized situations of changed circumstances, specifically in cases of *modification imprévue des circonstances économiques,* thereby granting the affected party the right to claim a renegotiation of the contract in order to restore its economic balance. The basis for such a right and the corresponding duty is the principle of good faith (last part of article 1134 of the *Code Civil*) and the duty of loyalty between the parties. However, it must be stressed that the duty to renegotiate is considered by the *Cour de Cassation* to be a last and only resort for the disadvantaged party in a case of changed circumstances, and no right is granted to have the contract terminated or adjusted by the court. The duty to renegotiate is also included as an effect of *imprévision* in the three projects to reform the French law of obligations that have been submitted to public debate. Recent case law on the CISG has also recognised the existence of a duty to renegotiate in international sales contracts.

Termination
If frustration is recognised under English common law, the effect is the complete and automatic discharge of the contract, i.e. each party is released from any further obligation to perform and each party has to bear its own losses. This is true even in the case of American law, where despite the availability of a range of loss-sharing remedies in the UCC and the Restatement (2nd) of Contracts, the courts usually apply an all or nothing

6 [1903] 2 K.B. 740.

approach to cases of impracticability, and therefore refuse to spread the burden of a discharged contract on that ground.

Distribution of losses and damages
French case law has established that in the case of abusive conduct or bad faith by the party which is subject to the duty to renegotiate, the other party is entitled to claim damages. In this case, damages caused by a delay and the costs incurred when relying on reaching the failed agreement could be awarded.

In English law, the problems of adjustment that arise when one party has fully or partially performed before the frustrating event occurs are covered by common law rules and the Law Reform (Frustrated Contracts) Act 1943, which was enacted in order to overcome the insufficiency of the common law rules on the matter. However, the Act has been criticized because it does not provide the courts with the authority to adjust all performance losses and, therefore, does not completely solve the shortcomings of the common law rules in this respect. With regard to American common law, it has been argued that it has adopted a more liberal approach concerning restitution to adjust losses in these cases, because in a limited number of situations the courts have split the losses between the parties after the contract was fully performed. Nevertheless, although restitution and reliance damages can be granted in cases of commercial impracticability, these remedies can be insufficient to return the parties to their position before the contract was concluded.[7]

2.3. Evaluation

The analysis of the jurisdictions included in this research has demonstrated a coincidence between the availability of express legal regulations and receptive legal systems.[8] Additionally, both in Argentina and Italy the introduction of rules on a change of circumstances in their Civil Codes is regarded as a reflection of a broader reform based on the reception of the ideas on the moralization or socialisation of private law. Additionally, the analysis of receptive legal systems shows that in these jurisdictions both the legal doctrine and the case law have developed a complex and comprehensive system for the application of the doctrine, thereby determining its scope, conditions and effects.

On the other hand, even the availability of a legal provision does not guarantee the 'receptiveness' of a legal system, as the case of the United States has demonstrated. Although it can be argued that even unreceptive legal systems in some cases apply recognised legal

7 See Hubbard (1982), p. 103.

8 The conclusion is of course not absolute. A paradigmatic case of a receptive legal system concerning this subject is Germany, where from the beginning of the 20th century the adjustment of contracts in cases of changed circumstances was accepted by the courts without any express provision on the subject in the BGB (only in 2002 was the doctrine of *Wegfall der Geschäftsgrundlage* recognised in §313). The same can be said, but to a lesser extent, of Spain. See Martínez Velencoso (2003).

concepts to deal with situations of a change of circumstances,[9] it seems clear that such systems deny relief to the affected party in *hard* cases in which excessive onerousness is claimed as the main ground for such relief.

The broader recognition of the effects of changed circumstances is found in the non-legislative codifications studied in this research. In fact, their approach is opposite to most of the national legal systems included in the research (England & Wales, the United States, France and Chile) as well as the CISG. Also purely concerning the letter of the law, the recognition of the concept in the Civil Codes of Italy and Argentina is more limited than those of the PICC, the PECL and the DCFR. Therefore, without detriment to the intrinsic and substantial value of their rules at the level of legal theory, it can be problematic to consider them as a reflection of the 'state of affairs' on the subject. Nevertheless, it is also true that the acceptance of the doctrine of a change of circumstances is increasing at an international level, and the trend is towards its express recognition. This is the case in modern codifications such as the Dutch, the German and the Brazilian, and also the projects to reform the law of obligations in France and Spain include express provisions on the subject.[10] In this sense, the influence of legal doctrine and non-legislative codifications on the development of law must not be underestimated.[11]

3. An attempt at a synthesis

Based on the comparative survey of the legal systems and non-legislative codifications included in this research, and the specific analysis of renegotiation and adaptation as intended effects of a change of circumstances, the following sections contain an attempt at systematization and providing a synthesis as to what can be considered to be the better approaches to the subject. This will be done taking the aims of the research and its hypothesis into consideration.

3.1. The advantages of legal recognition

The arguments with regard to the limitation of the principle of *pacta sunt servanda*, stressed elsewhere in this research, are equally applicable in supporting the recognition of a change of circumstances as a ground for the adaptation of the contract or relief for the affected party.

On the other hand, the *necessity* of a reform can be based on other considerations. As affirmed above, the courts' rejection of the unreceptive civil law legal systems is based

9 See Hondius, Grigoleit (2010), forthcoming, stressing that 'cases of unexpected circumstances can be approached using conventional doctrines of contract law such as mistake, constructive interpretation, impossiblity of performance and *laesio enormis*.'

10 *Propuesta de Anteproyecto de Ley de Modernización del Código Civil en Materia de Obligaciones y Contratos*, available at http://www.mjusticia.es/cs/Satellite?blobcol=urldescarga1&blobheader=application%2Fpdf&blobkey=id&blobtable=SuplementoInformativo&blobwhere=1161679155283&ssbinary=true

11 For an analysis of the role of non-legislative codifications as legal authorities, see Jansen (2010).

principally on formal and not on substantive grounds. Consequently, without any legal reform, it is much more difficult to change the approach of unreceptive civil law legal systems because the reasoning is formally grounded on the letter of the law and not on debatable argumentations. Thus, in France, even when the reports of the *Cour de cassation* support the judicial revision of the contract in cases of *imprévision*, in its decisions this alternative is consistently denied in light of the provisions of the *Code Civil*. The grounds for the rejection of *imprevisión* by the Chilean Supreme Court are also formalistic. This restrictive attitude by the courts is not only present in civil law jurisdictions, but also in English common law, where it has been argued that fundamental changes in general contract law are subject to statutory intervention because the courts find it difficult or even inappropriate to make those changes themselves.[12] This can be demonstrated by the enactment of the Law Reform (Frustrated Contracts) Act 1943, the introduction of which was justified because of the inadequacy or insufficiency of the common law rules on the subject. Therefore, it seems that without the support of an express general regulation, the courts will continue with their reluctance to establish a doctrine to deal with a change of circumstances.

The argument that the absence of any regulation promotes self-regulation with regard to a change of circumstances by the inclusion of express contract clauses is highly debatable. First, the empirical evidence is not conclusive in this respect and even the relevance of contract law for the parties has been subject to some qualifications.[13] Second, the argument can be reversed in the sense that the *availability* of judicial intervention can be an incentive for the parties to regulate the matter in the contract as a means to avoid the intervention of the courts. Third, by definition, the doctrine applies to *unforeseen* circumstances, and therefore only to cases which are not (implicitly or expressly) contemplated by the parties.

The catastrophic effects of the recognition of a change of circumstances and consequently of the power of the courts to adjust contracts in such cases have not currently been empirically proved. On the contrary, the situation in the receptive legal systems examined shows that the doctrine is well accepted by their legal literature and that its application has not led to the destruction of their economic or legal systems. The courts have exercised their powers restrictively and with moderation. Thus, for instance, in Argentina all the (unsuccessful) Civil Code reform projects have included one or more provisions to deal with the subject, confirming its positive evaluation by the legal community. In the same sense, a good evaluation of the Italian provisions and that country's related legal doctrine and case law is demonstrated by the fact that it has been a model for a number of reforms on the subject, including in Argentina and, more recently, Brazil.

Finally, the enactment of rules that include the definition, requirements and effects of a change of circumstances may in fact *increase* legal certainty, because the parties and the

12 Cartwright (2009a), p. 160.
13 See Hillman (2009), Macaulay (1985).

courts will be aware of the precise conditions for the application of the rules and therefore the possibility of contradictory case law is less likely to occur. The development of case law and legal doctrine in the receptive legal systems analysed in this research shows that they have developed a comprehensive and sophisticated set of rules to deal with the subject.

3.2. Minimum conditions

If express legal regulation is considered to be the best approach to deal with situations of a change of circumstances, the following minimum conditions for its recognition can be stated:

3.2.1. Scope of application

As stressed elsewhere in this research, although the doctrine of a change of circumstances is likely to be applied to long-term relationships, there is no conceptual impediment to its application to all kinds of contracts and even to obligations derived from a unilateral act, subject only to the condition that performance has not yet been rendered. The inclusion of non-contractual obligations under the scope of this doctrine is not a common feature of national jurisdictions or non-legislative codifications (with the exception of the DCFR), but it does seem appropriate since most unilateral acts (as well as unilateral contracts) have a gratuitous nature and therefore the protection of the debtor (who does not receive any counter-performance) may be considered to be even more justified than in the case of bilateral contracts.

3.2.2. Mandatory nature of the provisions

The rules dealing with a change of circumstances should be of a mandatory nature and, consequently, the parties are not permitted to completely exclude their application. Because the essential foundation of the notion and the rules on changed circumstances is the duty of good faith, which in most jurisdictions and non-legislative codifications cannot be excluded or limited by the parties, the above-mentioned rules necessarily have to share that mandatory nature. Additionally, if the parties are allowed to exclude the rules on changed circumstances, that exclusion would become a normal contract clause and therefore the content of the duty to act in good faith would be watered down and its practical application would be denied. Thus, legal systems which have expressly regulated the subject usually consider those rules to be mandatory.[14]

As a consequence, even if the contract contains a clause that involves a general assumption of risks for one of the parties, that party can always rely on the rules on a change of

14 That is the case for Italy, the Netherlands and Germany. Official comment 8 of section 2-615 of the UCC also stresses that the parties are not free to completely discard the application of such a provision. The mandatory nature of the rules on *imprevisión* is discussed in Argentina.

circumstances with regard to the occurrence or scale of the supervening events that can be deemed to be reasonably unforeseeable in the particular case.

3.2.3. Excessive onerosity

As stated above, the delimitation of the excessive onerosity of the performance which is considered to be relevant by the rules on changed circumstances is extremely difficult to assess beyond a general conceptual statement. Most of the legal systems examined finally stress that such a delimitation will rely to a great extent on the particular circumstances of the case. In this sense, two general points can be determined:

a) The concept should include *both* the situation of an increase in the cost of the performance to be rendered and a decrease in the value of the expected counter-performance; and
b) Any alteration in the performance of the affected party's obligation must be *fundamental*. In the case of bilateral contracts, this implies a severe imbalance between the reciprocal obligations of the parties to the point where the economic foundations of the contract have been overturned.

3.2.4. Reasonable unforeseen circumstances

In order to avoid the reference to subjective criteria for the assessment of foreseeability and, on the other hand, to prevent the courts using the parameter of foreseeability as a device to discard most of the debtor's claims based on the assumption that most future events are to a certain degree foreseeable, the better approach seems to be the inclusion of reasonableness as an objective criterion for determining the foreseeability of the disruptive events. The parameter would be related to the average party in the same position as the debtor and acting with due diligence and care. Then, mere subjective criteria such as the personal circumstances of the debtor or its internal perspective are discarded for considering foreseeability; but at the same time the criterion is not so strict as to consider (in fact) almost any supervening circumstances to be foreseeable.

The inclusion of reasonableness as the objective parameter to measure the foreseeability of the supervening events makes unnecessary the addition of supplementary requirements for the relevance of the supervening circumstances, such as their extraordinary nature, because parameters such as the latter would be included in the assessment of what is reasonably foreseeable for the affected party, a concept that is sufficient to provide legal certainty and to protect the interests of the creditor.

3.3. The effects of changed circumstances

With regard to the effects of a change of circumstances, the main hypothesis stated at the beginning of this study has been confirmed by the research: as a first effect of a change of circumstances a duty to renegotiate must be imposed on the parties. The existence of

such a duty entails that for the debtor the request for renegotiations is a condition for later invoking the provisions on a change of circumstances. If both parties have acted in good faith but negotiations do not succeed within a reasonable period, either party may resort to the courts to request an adaptation of the contract to the new circumstances and the courts have wide powers and can either modify the contract or terminate it; the latter alternative would be considered as a last resort.

3.3.1. Renegotiation

Although the existence of a duty to renegotiate is not expressly contemplated in most of the legal systems included in the research (the PECL being the only certain example), its existence and convenience is argued by the majority of the legal doctrine and, in some cases, also by court decisions. The duty to renegotiate is a necessary consequence of the existence of the principle of *favor contractus* and of the duties of flexibility and cooperation that arise from the duty to perform in good faith.

Then, in the light of these principles and values, when an unexpected and supervening event affects the contractual relationship, e.g. imposing an enormous burden on one of the parties' performance or otherwise affecting the contractual balance, it can be argued that the principles of fairness and good faith give rise to a 'duty to adjust' in order to avoid fortuitous advantages to one party at the expense of the other, thereby restoring the lost contractual equilibrium through the sharing of losses.[15]

Because the parties are in a better position to resolve their disputes and find a solution in line with their mutual intentions, the renegotiation of the contract arises as the first effect of a change of circumstances. In this sense, the aim of revising the contract through renegotiation (and if it is unsuccessful through court adjustment) is to preserve the parties' initial reasonable expectations of mutual benefits and gains. For instance, one can reasonably presume that in a supply contract the parties do not intend to permit the supplier to increase prices without an equivalent increase in its costs and consequently it is also not the intention of the parties to permit the buyer to take advantage of an unexpected market situation, e.g. increasing its own prices for third parties, while insisting on the strict performance of the supplier's obligation at the price fixed before serious inflation or an increase in costs.[16]

The content of the duty to renegotiate and the consequences of a failure by the parties to reach an agreement are subject to the principle of good faith, so the duties of fair dealing and cooperation are imposed on both parties. This essentially entails that the parties must conduct the negotiations with flexibility and search for reasonable modifications, taking into account the interests of the counterparty and with the aim being to reach agreement within an appropriate period of time. Based on the principle of good faith, it can also be

15 See Halpern (1987), p, 1129.
16 Hillman (1987), p. 21.

argued that the parties are under a duty to agree, which is limited to accepting a fair and reasonable modification proposal. Therefore, if the request for negotiations fails because of an unjustified refusal to enter into those negotiations or if the reason for breaking off negotiations is abusive conduct or bad faith by one party, the affected party has the right to claim for the damage caused by the delay and the costs incurred in reliance on reaching the failed agreement

Concerning the suspension of performance during the period of renegotiations, only in extraordinary circumstances should the disadvantaged party be allowed to withhold performance, but a 'minimum performance rule' could be established: the requesting party should include an offer of minimum performance during the renegotiation period or, in its absence, any party can request this from the court.

Finally, as stressed in general with regard to the recognition of the doctrine of a change of circumstances, the existence of a duty to renegotiate does not necessarily imply uncertainty or a reduction of contractual stability. On the contrary, the necessity to renegotiate (without suspending performance) may be an incentive to settle rather than to engage in judicial disputes. Renegotiation provides flexibility for the parties in seeking a better adaptation of the contract to new and unforeseen circumstances and may be seen as a means of stabilizing the relationship.[17]

3.3.2. Adaptation

If both parties have acted in good faith but negotiations do not succeed within a reasonable period, the solution provided by the PICC, the PECL and the DCFR appears to be the more appropriate: either party may resort to the courts to request an adaptation of the contract to the new circumstances and the courts have wide powers and can either modify the contract or terminate it, whichever is the more suitable in the specific case.

The foundations of granting the courts the power to adjust the contract in cases of changed circumstances are similar to those stressed for the acceptance of the doctrine in general and for the duty to renegotiate: the general principle of good faith, the more specific *favor contractus* and the duties of cooperation and flexibility. Therefore, if cooperation and flexibility are considered as a natural consequence of the duty to perform in good faith, and the general approach of a given legal system is the *favor contractus*, it may be considered as reasonable for the parties to expect an adjustment to the agreement when it is severely disrupted by supervening and unforeseen circumstances. However, because of the strong resistance to this remedy, it seems necessary to stress some of the arguments to properly justify it.

One of the main objections to judicial intervention in the contract is that it would be a violation of the *pacta sunt servanda* principle and therefore an illegitimate interference

17 Gotanda (2003), p. 1469.

with the explicit or implicit agreement of the parties. This view assumes that contracts are complete and carefully planned by the parties.

However, that argument obviates the fact that in these cases the parties are *ex-post* dealing with *reasonable unforeseeable* circumstances, which necessarily implies that the parties did not deal with the matter when concluding the contract. If, in addition, those circumstances are outside the sphere of risks that the affected party is deemed to assume in the particular case, then intervention by the courts cannot be regarded as an interference with the contractual freedom of the parties. Conceptually the situation entails a gap in the parties' agreement and then the failure in the allocation of the risk may be considered to be an 'implicit consent to allow the court to intervene to adjust the agreement for them'.[18] Even more so, if the circumstances of the case make it possible to establish an implicit and legitimate expectation of an adjustment and flexibility in the case of a severe disruption to the relationship, then judicial intervention can be deemed to be a form of specific performance, enforcing the parties' intention with regard to the implied 'duty to adjust'.[19]

Another strong argument against a court adjustment is that it will lead to legal uncertainty and to an increase in disputes. Again, there is no definitive empirical evidence to support that assertion. On the contrary, the strict requirements placed on the operation of a change of circumstances, the necessity of previous renegotiation and the hypothetical uncertainty and even the possibility of court intervention may induce the parties to avoid court settlements. A court adjustment would be 'a form of coercive mediation'[20] by which the amount of litigation may be reduced. In any case, when the court is entitled to intervene in the contract, there is to some extent the risk of arbitrariness. In spite of the establishment of general and objective standards for adjusting the contract, the risk of arbitrariness cannot be avoided completely, but is present in any judicial decision. Legal science is not mathematics and there are no arithmetical solutions which are provided.

Additionally, the danger of a 'chain reaction' or a collapse of the economic system has not been empirically proven and, on the contrary, when the courts are granted certain powers to revise private agreements, they are used with restraint and only exceptionally. In most cases, it is not a judicial revision that leads to economic instability but, on the contrary, the necessity to revise a contract is caused by an economic or social upheaval.

The more complex issue concerning contract adaptation is the determination of a reliable set of rules or standards for the court to adjust the contract to the new circumstances. In this respect, some guidelines can be suggested:

a) As a general rule, the court is not entitled to redraft the entire agreement or change its nature.

18 Hillman (2009), p. 601.
19 Hillman (1987), p. 27.
20 Macaulay (1985), p. 476.

b) The distribution of losses is limited to making the burdened performance bearable for the affected party; it is not the aim of the adjustment to restore the economic balance of the contract completely. The losses should not be shifted from one party to the other, and then the court does not have to restore the counter-obligations to an absolute equivalence or to redraft the contract so as ideally to adapt it to the standards of commutative justice. Considering that the binding force of contracts is the general principle, the affected party must bear the risk of any increased performance until it becomes excessively onerous. In general, the outcome of the adjustment should mean that the transaction is still a good deal for the creditor and a poor but bearable deal for the debtor.

c) The establishment of a method to distribute the risks between the parties and therefore also the supervening losses and costs in accordance with the principles stated in the previous paragraphs is a difficult task. National legal systems and non-legislative codifications provide no or little guidance on the subject. Nevertheless, some parameters can be proposed:[21]
   - From an *internal* perspective of the relationship, the court has to analyse the goals and expectations of the parties when entering into the contract. For this purpose, the court would examine, among other things, the relevant information at the pre-contractual stage, the final agreed contract terms and the *ex-post* negotiations on the consequences of the supervening events.
   - From an *external* perspective, the court can examine the conditions surrounding the agreement; for instance, similar contracts and their modification, either concluded by the parties or by others under comparable conditions, with the aim being to establish a common parameter derived from analogous transactions.

3.3.3. Termination

Termination should be limited to cases in which the adjustment of the contract is either not possible or is an unsatisfactory solution, especially from the perspective of the advantaged party. To some extent, the termination of the contract can always be considered as a modification, because it will in any case entail the end of the relationship before the term originally agreed.

As a principle, the advantaged party, who has neither caused the disruptive event nor collaborated in aggravating its effects, should not be negatively affected by the termination of the contract and, therefore, he should be entitled to recover any reasonable expenses incurred while relying on the contract, and even the damages that the non-performance of the contract has caused. Damages should be limited by the risks that the debtor should have assumed if the contract had been performed under normal conditions, i.e. applying the same parameter (the limit of sacrifice) for the adjustment of the contract. For these purposes, the court should have wide powers to establish the terms of the termination,

21 Hillman (2009), p. 601

e.g. concerning retroactive effect, its date, restitution issues, non-performed or partially performed obligations, etc.

Finally, it can be argued that termination should always be a remedy which is available for the *innocent* advantaged party, so that when confronted with the request of the counter-party to adjust the contract, he can choose to terminate it rather than continue the relationship. However, this right to terminate can be inconsistent with the eventual existence of a duty to adjust. In any case, such a right should be subject to two qualifications: it can only be exercised after an attempted renegotiation has failed; and it cannot be claimed if the termination seriously affects the rights of third parties (e.g. in the case of public utilities).

4. The political choices

As has been mentioned elsewhere in this research, the principle of *pacta sunt servanda* is and should be the general rule in most modern legal systems. Therefore, in principle, contractual obligations validly concluded must be fulfilled, even when their performance has become more onerous than expected at the time of concluding the contract.

The limits to that principle and their foundations have also been examined, especially with regard to the justification for the recognition of the doctrine of a change of circumstances as one of those exceptions.

Regardless of those dogmatic justifications, the recognition of a change of circumstances also implies a political choice, because the different attitudes with regard to the subject are related to different views on the role of legal rules and in particular of contract law. The decision is essentially linked to the vision and the desired role of contract law in society; as well as to the values which are considered to be relevant in contract law.[22]

In this sense, the emergence of a new concept of a contract has been stressed: from the liberal notion of a contract linked to a timeless and immutable instrument, a reflection of the equality and the liberty of the parties; to a notion related to an instrument to promote solidarity, justice and equity.[23] Thus, the contract is considered to be a union of balanced interests, an instrument of loyal cooperation and a result of the mutual confidence of the parties.[24]

One cannot deny the economic function of contract, but that function cannot be considered as exclusive and the sanctity of a contract cannot imply that one of the parties can use a contract for its exclusive individual interest, especially if that use implies the economic

22 Halpern (1987), pp. 1166-1168, stating that 'Determination of when difficulty or expense will warrant relief, and the nature of that relief, rests ultimately on public policy with respect to contractual relationships'.

23 Mazeaud (2008), p. 560.

24 Mazeaud (1999), p. 632. In France this concept of a contract is linked to the legal doctrine of *solidarisme contractual*.

ruination or the complete frustration of the legitimate expectations of the other party. The valid and valuable purpose of contract law to facilitate exchanges and transactions does not imply that only economic efficiency has to be its exclusive goal. It is a good thing that promises should be kept, both economically and socially, but it is equally not good that all promises must be kept at all times, without exception. Contracts should be enforced only as long as, and to the point that, it is reasonable that they should be enforced.[25]

In this sense, the recognition of a change of circumstances as a remedy for the affected party may be considered as another aspect of the renovated importance of justice and fairness as a counterbalance to the general principle of freedom of contract. Because the issue is related to the balance and co-existence of fundamental principles of contract law, the regulation of a change of circumstances has to be inserted in a coherent system of underlying values, as a representation of the choice of a general system of contract law and not simply as an irritant element which may lead to contradictory or arbitrary results.

Thus, the foundations of the 19th century civil codes and classical contract law cannot remain untouchable in spite of the economic and social reality of today.[26] The complexity of modern contractual relationships and, in general, of the social and economic environment, requires similar weight to be given to values other than the classical values of freedom, security and certainty, such as *favor contractus*, cooperation, solidarity and flexibility. Nowadays, the multiple and even countless factors that can affect the legitimate expectations of the parties are more relevant because of strong economic interdependence due to the process of globalization which has led to multiple close and complex economic interrelationships.

Practical experience shows that it is impossible for the parties to contemplate the occurrence and scope of *all* the possible factors that may *potentially* disturb their obligations, and, in addition, to negotiate the distribution of the *possible* risks that can arise from the occurrence of those *hypothetical* circumstances. It is not realistic to assume that the parties themselves will always provide for solutions in their agreements. On the contrary, a number of factors may prevent the inclusion of express clauses in this respect, e.g. the parties are not always sufficiently sophisticated, the excessive costs of the negotiations, the existence of asymmetries in the available information or the position of the parties, or simply because there is not enough time to settle the deal in all its details.

Therefore, beyond the level of reasonable foreseeability, the law must protect the party affected by a change of circumstances that severely disturbs the contract equilibrium or places an extreme burden on its performance, thereby making him responsible beyond his sphere of risk and his reasonable expectations.

25 Schlegel (1968), p. 447.
26 Mazeaud (1999), p. 631.

The author thinks that an express and clear legal provision regulating the concept, the requirements and the effects of a change in circumstances is always the best option to resolve more of the problems and discussions on the subject. As Windscheid stated more than 100 years ago in relation to the rejection of the inclusion of the *clausula rebus sic stantibus* doctrine in the BGB: 'Thrown out of the door, it will always re-enter through the window.'[27]

27 B. Windscheid, 'Die Voraussetzung', (1892) 78 *Archiv für die civilistische Praxis* 197, cited by Zimmermann (1996), p. 581.

Resumen

RESUMEN EN ESPAÑOL

El objeto de esta investigación es el estudio de los efectos que tiene sobre la fuerza obligatoria del contrato el acaecimiento de circunstancias sobrevinientes e imprevisibles; las cuales provocan que su cumplimiento se torne excesivamente oneroso o bien producen la frustración del fin del contrato. Para estos efectos, se realiza un análisis comparado de la doctrina, legislación y jurisprudencia de sistemas legales pertenecientes al Derecho Civil (Francia, Italia, Argentina y Chile) y al *Common Law* (Estados Unidos e Inglaterra). La selección de sistemas jurídicos implica a su vez que se han considerado en el análisis tanto países del continente europeo como del americano. Además, debido a su creciente relevancia, se incluye el análisis de codificaciones doctrinarias o no legislativas e instrumentos de derecho internacional de los contratos: los Principios UNIDROIT sobre Contratos Comerciales Internacionales (PICC), los Principios de Derecho Europeo de Contratos (PECL), el Borrador de Marco común de Referencia (DCFR) y la Convención de la Naciones Unidas sobre los Contratos de Compraventa Internacional de Mercaderías (CISG). La investigación se ha estructurado como un análisis sucesivo de los sistemas jurídicos seleccionados, seguida de un análisis en profundidad, en capítulos separados, de las materias relativas a las consecuencias o efectos de un cambio de circunstancias. Además, la parte introductoria considera también un estudio histórico de la materia.

El análisis comparado de los sistemas legales incluidos en la investigación ha demostrado que existen grandes diferencias en el reconocimiento y efectos de un cambio sobrevenido de circunstancias sobre la fuerza obligatoria del contrato. Sin embargo, la tendencia general parece ser hacia su reconocimiento como remedio o excusa para la parte afectada, otorgándole una serie de alternativas para los casos en que el cumplimiento de su obligación ha devenido en excesivamente onerosa, sin perjuicio de la mantención del principio *pacta sunt servanda* como regla general.

En particular, lo anterior implica que en caso de un cambio sobrevenido de circunstancias:

a) Las partes son en principio libres de distribuir los riesgos derivados de tales circunstancias.
b) Como regla general, el deudor debe cumplir sus obligaciones aún cuando su ejecución haya devenido más onerosa de lo originalmente pactado.

Sin embargo, si el cumplimiento ha devenido en *excesivamente* oneroso debido al acaecimiento de circunstancias *razonablemente imprevisibles*, la parte afectada tiene el derecho a ejercer una serie de remedios destinados al restablecimiento del negocio hasta el límite de un adecuado sacrificio. Al mismo tiempo, la naturaleza imperativa de las normas legales que regulen la materia implica que no es posible para las partes acordar que todos los riesgos (previstos e imprevistos) sean asumidos por sólo una de ellas, ya que en la práctica ello implicaría la derogación de tales normas para el caso particular.

En relación con los efectos de un cambio de circunstancias, el estudio incluye el examen del deber de renegociación, la revisión del contrato por el juez y su terminación.

En particular, en cuanto al deber de renegociación, se han analizado las posibles fuentes de tal deber, esto es, la buena fe, la naturaleza de la relación jurídica y las cláusulas expresas de las partes.

A falta de norma legal expresa, el principal fundamento para el establecimiento de un deber de renegociación ha sido el principio de buena fe, en particular en cuanto al deber de las partes de ejecutar el contrato de buena fe, que se concretiza en específicos deberes de conducta para las partes tales como el de cooperación y de preservación del contrato (*favor contractus*).

En cuanto a su contenido, es uniformemente aceptado que el proceso de renegociación debe sujetarse al principio general de buena fe, lo que implica una serie de conductas particulares que deben ser observadas por ambas partes durante este período. Así, la parte afectada por la excesiva onerosidad debe requerir la renegociación del contrato en el más breve plazo y sin demora injustificada. En el mismo sentido, propuestas y contrapropuestas deben ser serias, razonables y coherentes, proveyendo la información necesaria para un claro entendimiento por la parte contraria. Derivado del principio general de buena fe, surge también un deber de cooperación que implica que las partes deben conducir las negociaciones con flexibilidad y tomando en consideración no solo sus intereses, sino los de su contraparte, evitando por tanto las dilaciones injustificadas como el término abusivo o intempestivo de las negociaciones.

Además, como principio general puede establecerse que el contrato se mantiene vigente a menos que las partes acuerden expresamente lo contrario. Solo en circunstancias muy excepcionales puede permitirse a la parte afectada suspender el cumplimiento de sus obligaciones. Al efecto, puede establecerse un requisito de "cumplimiento mínimo" del contrato por la parte que solicita la renegociación. Así, considerando que la intención del contratante que requiere la renegociación es preservar la relación contractual y no terminarla, y que la ejecución del contrato es posible aun cuando mucho más onerosa, la propuesta de modificación debería incluir también una propuesta de "cumplimiento mínimo" del contrato durante el período de renegociaciones, que sea razonable para los intereses de ambas partes. Dicha propuesta puede incluso coincidir con la propuesta

general de modificación, sin perjuicio que esta sea en definitiva rechazada o alterada durante las negociaciones.

En cuanto al eventual deber que tendrían las partes de aceptar la propuesta formulada por la otra, cuando dicha propuesta es justa, razonable y se adecua a los intereses de ambas partes, la existencia de tal obligación se ha fundado también en el principio general de buena fe y sus derivados, estos es, los deberes de cooperación y lealtad comercial. Así, la parte afectada tendría derecho a un remedio consistente en exigir al juez, a través de la adaptación del contrato, aquello que debería haberse aceptado por la contraparte como una modificación adecuada de la relación en los términos antes señalados.

Aun cuando las partes hayan actuado de buena fe durante el proceso de renegociación, este puede fracasar debido a legítimas discrepancias que les impidan llegar a un acuerdo sobre la adaptación del contrato a las nuevas circunstancias. En este caso, debido a que no hay incumplimiento de algún deber de conducta u obligación, los efectos del fracaso de las negociaciones se reducen a la extinción del contrato o a su adaptación por un tercero imparcial (en general el juez o un árbitro). Por otra parte, si ha sido la actuación de mala fe de una de las partes la que ha impedido el acuerdo, o si simplemente una de las partes se ha negado injustificadamente a renegociar el contrato, la otra tiene derecho a demandar los perjuicios que de tal actuación se deriven, además de la resolución del contrato. En cualquier caso, si las negociaciones no prosperan dentro de un período razonable, cualquiera de las partes puede recurrir al juez para solicitar la adaptación del contrato a las nuevas circunstancias.

En relación a la revisión del contrato por el juez, el estudio de derecho comparado ha demostrado que las codificaciones doctrinales aceptan expresamente esta alternativa en casos de cambio de circunstancias. Al contrario, la adaptación del contrato por el juez no es contemplada en términos generales ni expresos por los sistemas jurídicos nacionales incluidos en la investigación, así como tampoco por la CISG. Ello es así incluso en sistemas jurídicos como el estadounidense, en el cual, en base las normas del *Uniform Commercial Code*, la adaptación del contrato puede ser considerada como uno de los remedios disponibles para las partes en casos de *impracticability*. Sin perjuicio de lo indicado, en los casos del derecho argentino e italiano, la situación es la inversa: las normas legales que regulan el cambio de circunstancias no incluyen expresamente la posibilidad que el juez revise el contrato para adaptarlo a las nuevas condiciones, pero la doctrina y la jurisprudencia han señalado como válida la intervención judicial del contrato en estos casos.

En este estudio, los argumentos y bases para la revisión judicial han sido extensamente analizados y contrastados con sus principales objeciones. Al efecto, la preferencia por uno u otro implica necesariamente una opción respecto de los valores que una sociedad determinada prefiere para el derecho de contratos. De este modo, más allá de las discusiones doctrinarias o filosóficas, la necesidad de una opción política no puede ser eludida.

Establecidas las bases para la revisión del contrato por el juez, es necesario determinar la extensión y límites a que debe sujetarse tal facultad.

Dos son las limitaciones principales que deben imponerse al juez:

- En primer lugar, la adaptación del contrato no puede significar la alteración esencial de la naturaleza del acuerdo celebrado por las partes, de manera que en definitiva resulte completamente diverso al originalmente celebrado por los contratantes; por ejemplo, cambiando el objeto de la prestación de una o ambas partes.

- En segundo lugar, el fin de la adaptación del contrato debe ser el distribuir las pérdidas producidas por el cambio de circunstancias hasta el punto de hacerlas soportables para la parte afectada. En otras palabras, la modificación no debe implicar que se restaure completamente el equilibrio inicial del contrato, trasladando la totalidad de las consecuencias del cambio de circunstancias de una parte hacia la otra. De esta manera, hasta el 'limite de sacrificio', esto es, el punto en que la prestación se ha transformado de onerosa en *excesivamente* onerosa, la parte afectada debe soportar el riesgo que los costos de su prestación hayan aumentado o que el valor de la contraprestación que recibe haya disminuido. Lo anterior es especialmente relevante en el caso de transacciones comerciales donde es razonable que las partes hayan previsto o asumido hasta cierto punto el riesgo de variaciones de precios o costos. En definitiva, parte de los costos derivados del cambio de circunstancias deben ser necesariamente soportados por la parte afectada.

Un problema más complejo es establecer un método para adaptar el contrato y efectuar la distribución de los costos entre las partes. Las normas que admiten la revisión del contrato por el juez generalmente no entregan parámetros ni reglas para tales efectos, sino que se refieren a principios generales. Así por ejemplo, los PECL hablan de una distribución justa y equitativa de las pérdidas y ganancias entre las partes y el DCFR se refiere a una razonable y equitativa modificación de la obligación de la parte afectada. En el mismo sentido, los códigos italiano (art. 1467) y argentino (art. 1198) hablan de la modificación equitativa del contrato para estos casos.

Sin perjuicio de lo anterior, el juez puede encontrar algunos puntos de referencia concretos para la adaptación del contrato. Así, desde una perspectiva *interna*, el juez puede examinar las negociaciones precontractuales, su relación con los términos finalmente acordados, como asimismo las negociaciones que hayan tenido lugar después del cambio de circunstancias. El análisis de estos antecedentes permitirá al juez determinar la intención y expectativas de las partes al concluir el contrato, de modo de establecer de mejor forma la distribución de los riesgos del mismo. Además, desde una perspectiva *externa*, el juez puede analizar las condiciones que han rodeado tanto la celebración como la ejecución del contrato, como por ejemplo, negocios similares celebrados entre las partes o con terceros bajo circunstancias comparables, eventuales ajustes o modificaciones a tales acuerdos, el comportamiento de otros actores relevantes en el mercado específico, etc. El objeto

del análisis es establecer parámetros comunes derivados de transacciones o situaciones análogas que puedan aplicarse al contrato en litigio.

En cuanto a la terminación del contrato como remedio en caso de cambio de circunstancias, el estudio ha demostrado que ella es contemplada tanto en las jurisdicciones que la admiten expresamente dicha situación como en aquellas en que sólo es admitida en casos excepcionales.

En cierto sentido, la extinción anticipada del contrato puede considerarse una especie de modificación, ya que implica poner término al contrato en una fecha o circunstancias diversas a las acordadas originalmente por las partes. Por ello, para evitar que parte de los riesgos se trasladen injustificadamente a una de los contratantes y se produzcan otros perjuicios a las partes o terceros, las codificaciones doctrinarias confieren expresamente al juez amplios poderes para fijar los términos de la extinción anticipada del contrato. Así, por ejemplo el juez puede determinar la retroactividad o no de la terminación, su fecha, las retenciones o indemnizaciones que mutuamente deban hacerse las partes, la suerte de las obligaciones pendientes o parcialmente ejecutadas, etc. De esta manera, se trata de asegurar una justa división de las pérdidas y ganancias entre las partes, según lo ya explicado al analizar la modificación del contrato.

El análisis sistemático de los sistemas legales incluidos en el estudio ha permitido clasificarlos en *receptivos* y *no receptivos*, según su disposición para reconocer o no los casos de cambios de circunstancias como una situación jurídicamente relevante que permita a la parte afectada recurrir a un sistema adecuado de remedios en tales casos.

De acuerdo a la clasificación anterior, Italia y Argentina pueden estimarse como sistemas legales receptivos. Lo mismo sucede con las codificaciones doctrinarias incluidas en la investigación, esto es, los PICC, los PECL y el DCFR. Todos ellos incluyen una o más normas que regulan expresamente la materia.

Al contrario, pueden calificarse como sistemas legales no receptivos a Inglaterra, los Estados Unidos, Francia y Chile, así como también a la CISG. En todos ellos existe en general una actitud negativa de la jurisprudencia a acoger casos de cambio de circunstancias, los que sólo son reconocidos en situaciones muy excepcionales y con efectos limitados: el deber de renegociación (Francia) o la terminación del contrato (Inglaterra y Estados Unidos). Sin embargo, en ninguno de ellos se otorga al juez la facultad de revisar el contrato, y en general no existen mecanismos para distribuir entre las partes las pérdidas y costos derivados del cambio de circunstancias. Lo anterior es cierto aún en sistemas legales como el norteamericano, pese al reconocimiento expreso de la *impracticability* en el *Uniform Commercial Code*.

Como conclusión general, el reconocimiento de los casos de cambio de circunstancias como situación jurídica relevante para otorgar un sistema de remedios al deudor afectado, puede considerarse como una manifestación de la renovada importancia que actualmente

se otorga a valores como la justicia y la buena fe como contrapartidas a los principios generales de la libertad contractual y la fuerza obligatoria del contrato. Así, el contrato es considerado como unión de intereses recíprocos, un instrumento para la cooperación leal y el resultado de la mutua confianza entre las partes. La complejidad de las relaciones contractuales modernas y en general, del ambiente social y económico, requiere que se otorgue un peso similar en el derecho de contratos a nuevos valores como la cooperación, la solidaridad y la flexibilidad, diversos pero complementarios de los clásicos como la libertad, la seguridad y la certeza jurídica.

En base a lo anteriormente expresado, se concluye que la parte afectada debe tener a su disposición un sistema de remedios destinados a obtener el restablecimiento del acuerdo hasta el límite de sacrificio que le sea soportable, el cual debe incluir el deber de renegociación, y en caso de fracaso de las renegociaciones, la revisión del contrato por el juez. Además, se sostiene que la mejor alternativa es el reconocimiento expreso de las situaciones de cambio de circunstancias, a través de normas excepcionales pero flexibles, que regulen su ámbito de aplicación, condiciones y efectos.

NEDERLANDSE SAMENVATTING

I Inleiding en historisch perspectief

1. Inleidende opmerkingen

Het onderzoek richt zich op de studie van situaties waarin onvoorziene omstandigheden ertoe leiden dat nakoming van een overeenkomst ernstig wordt bemoeilijkt of bezwaard, of waarin deze onmogelijk wordt.
Het onderzoek omvat een vergelijkende analyse van enkele Europese civil-law rechtsstelsels (Frankrijk en Italië), van de Engelse en Amerikaanse common-law stelsels en van Latijns-Amerikaanse civil-law stelsels (Chili en Argentinië). Naast nationale rechtsstelsels werd tevens onderzocht hoe het vraagstuk wordt benaderd in moderne modelcodes of 'restatements' van het internationaal contractenrecht. Zo bevat het onderzoek een analyse van het Verdrag der Verenigde Naties inzake internationale koopovereenkomsten betreffende roerende zaken (CISG), de UNIDROIT Beginselen van internationale handelsovereenkomsten (PICC), de Beginselen van Europees Overeenkomstenrecht (PECL), en de Draft Common Frame of Reference (DCFR).

Het onderzoek omvat zowel een vergelijkend overzicht van de betreffende rechtsstelsels met een historische studie van het onderwerp, als een analyse van de gevolgen van gewijzigde omstandigheden voor de verbintenissen van partijen. Het onderzoek is opgezet als een combinatie van opeenvolgende analyses van de bestudeerde rechtsstelsels en een gelijktijdige studie van deze rechtssystemen met betrekking tot het hoofdonderwerp van het onderzoek, d.w.z. algemene beschrijvingen van de bestudeerde rechtsstelsels worden gevolgd door afzonderlijke hoofdstukken, waarin de onderwerpen die de gevolgen of effecten van onvoorziene omstandigheden (heronderhandeling, aanpassing, beëindiging) betreffen, grondiger worden geanalyseerd. Voor deze opzet werd gekozen om de lezer te informeren over de algemene ontwikkeling van het onderwerp in het rechtsstelsel waarin deze geïnteresseerd is en/of om deze de mogelijkheid te bieden om specifieke informatie te verkrijgen ten aanzien van een of meer mogelijke gevolgen van onvoorziene omstandigheden.

2. Historisch overzicht

Pacta sunt servanda (overeenkomsten dienen te worden nagekomen) is een in alle belangrijke rechtsstelsels erkend beginsel, dat een hoeksteen vormt van zowel het contractenrecht als de rechtstheorie van het contract. Historisch onderzoek heeft echter aangetoond, dat dit niet altijd zo is geweest, sterker nog, dat de oorspronkelijke betekenis van het beginsel verschilt van de er door de klassieke rechtstheorie van het contract aan toegekende betekenis.

Het Romeinse recht kende de algemene beginselen *pacta sunt servanda* en *clausula rebus sic stantibus* niet. Beide ideeën werden ontwikkeld door de canonisten op basis van morele overwegingen en vervolgens overgenomen door de natuurrechtsgeleerden, die deze toepasten op het gebied van het privaatrecht. Beide leerstukken werden verder uitgewerkt als zijnde uitingen van de menselijke wil en bijgevolg deel uitmakend van elke belofte, niet als tegengesteld hieraan, maar als aanvulling erop. Bovendien werd het *pacta sunt servanda* beschouwd als een gevolg van de aanvaarding van het consensualisme in het contractenrecht, aangezien het ontbreken van formaliteiten ertoe leidde dat juridische werking diende te worden toegekend aan het enkele woord van degene die een toezegging deed (*promisor*); van deze notie, dat alle wettig gesloten overeenkomsten geldig zijn, evolueerde het beginsel vervolgens tot het concept van de absolute kracht van overeenkomsten onder alle omstandigheden.

De verwerping van de diverse leerstukken van onvoorziene omstandigheden is kenmerkend voor de 19e eeuw en vormt een natuurlijk gevolg van de wilsleren en de liberale doctrine. De rechtsleer brak in de 19e eeuw in het algemeen met de theorieën van het natuurrecht en had als belangrijkste kenmerk het gebruik van het concept van de wil als de uitsluitende bron van alle voorwaarden van de overeenkomst, zonder acht te slaan op andere concepten, zoals de billijkheid of de aard van de transactie, als bronnen van contractuele voorwaarden of als middelen ter beperking van de wil van partijen. Deze verwerping was echter niet van lange duur en in de loop van de 20e eeuw werden in de rechtswetenschap en de jurisprudentie een aantal theorieën ontwikkeld, die de beëindiging of wijziging van een overeenkomst voorstaan, indien nakoming hiervan nadien bezwarend wordt geacht.

II Vergelijkend overzicht. Nationale rechtsstelsels.

1. Frans recht

De Franse *Code Civil* bevat geen expliciete regeling van de gevolgen van gewijzigde omstandigheden voor de bindende kracht van overeenkomsten en het probleem valt in het Franse recht onder de *théorie de l'imprévision.* De traditionele rechtsleer verwerpt de toepassing van de *imprévision,* en de *Cour de Cassation* heeft sinds de toonaangevende zaak van *Canal de Craponne* in haar jurisprudentie consequent geweigerd om overeenkomsten te beëindigen of te herzien op basis van *imprévision.*

Daarentegen vindt men in de moderne Franse rechtsleer, evenals in projecten ter herziening van de *Code Civil*, in uiteenlopende mate wel steun voor de uitdrukkelijke erkenning van *imprévision*. In recente jurisprudentie werd de theorie eveneens in beperkte mate erkend, doordat in een dergelijk geval een verplichting tot heronderhandelen werd opgelegd. In de praktijk kan de belanghebbende partij in situaties, waarin een wijziging van omstandigheden is opgetreden, echter nog steeds geen rechtsvordering tot aanpassing van de overeenkomst door de rechter instellen en wordt de traditionele benadering nog steeds gehandhaafd.

2. Italiaans recht

In het Italiaanse privaatrecht valt het onderwerp van de verstoring van de balans binnen een contractuele verhouding ten gevolge van onvoorziene omstandigheden onder twee verschillende juridische begrippen: *eccessiva onerosità* (geregeld in de artikelen 1467 t/m 1469 van de *Codice Civile*) en de voornamelijk in de jurisprudentie ontwikkelde theorie van de *presupposizione*. Ondanks het feit dat beide begrippen verwantschap vertonen, verschillen zij zowel wat betreft de grondslagen als de voorwaarden voor toepasselijkheid en de gevolgen ervan. In de praktijk valt het onderscheid echter niet altijd eenvoudig te maken, en in de hedendaagse doctrine overheerst de mening dat het leerstuk van de *presupposizione* beter kan worden afgeschaft, wegens de ambiguïteit ervan en wegens het ontbreken van rechtszekerheid.

Het is gebleken, dat het systeem van rechtsvorderingen voor bilaterale contracten van de *Codice Civile* niet toereikend is om de belangen van partijen op adequate wijze te beschermen. De belanghebbende partij is enkel gerechtigd tot het vorderen van beëindiging van de overeenkomst, niet tot wijziging ervan; bovendien bezit de wederpartij de vrijheid tot het (al dan niet) voorstellen van een billijke wijziging ter aanpassing van het contract aan de nieuwe omstandigheden. De aanpassing van de overeenkomst hangt derhalve in theorie uitsluitend af van de wil van de bevoordeelde partij.

Het ontbreken van een specifieke bevoegdheid van de rechter tot aanpassing van een overeenkomst bij gewijzigde omstandigheden en de afwezigheid van een algemeen beginsel in de *Codice Civile* voor het wijzigen van een overeenkomst door de rechter hebben niet verhinderd, dat men in de jurisprudentie indirecte wegen ontwikkelde om zich in overeenkomsten te mengen door deze aan te passen, in het bijzonder wanneer rechters beslisten dat zij de voorwaarden van een billijke wijziging konden vaststellen, indien het aanbod tot wijziging door de bevoordeelde partij in algemene bewoordingen was vervat, of indien deze partij de rechter verzocht, de 'nieuwe' billijke voorwaarden vast te stellen. De rechtsleer ondersteunt deze aanpak ter ontwikkeling van het *favor contractus* beginsel, dat de voorkeur geeft aan het behoud van de overeenkomst door een aanpassing hiervan aan de nieuwe omstandigheden boven de beëindiging van de verhouding.

3. Latijns-Amerikaanse rechtsstelsels. Chileens en Argentijns recht.

Het vergelijkend onderzoek van de Latijns-Amerikaanse rechtsstelsels heeft aangetoond dat deze, ongeacht hun gemeenschappelijke bron en gedeelde kenmerken als onderdeel van de civil-law traditie, een geheel uiteenlopende benadering van en trend met betrekking tot het probleem van de onvoorziene omstandigheden kennen.

Enerzijds hebben de rechtswetenschap en de jurisprudentie in Argentinië een consistente doctrine ontwikkeld met betrekking tot het thema van de gewijzigde omstandigheden. De voorwaarden en de gevolgen van *imprévision* zijn uitgebreid in de theorie geanalyseerd en in de praktijk getest, in het bijzonder gedurende de economische crises die Argentinië sinds 1975 hebben getroffen. Het recht van de belanghebbende partij om te vertrouwen op het leerstuk van de *imprévision* heeft echter niet geleid tot instabiliteit van het sociaal-economisch systeem door aantasting van het beginsel van de onschendbaarheid van contracten, of van het vertrouwen op de nakoming ervan, maar is integendeel een middel geworden om de onrechtvaardige en ongewenste gevolgen van een dergelijk systeem voor de partijen bij een overeenkomst te corrigeren. Het feit dat, sinds de Wet 17.711 van 1968, elk project tot herziening van het Burgerlijk Wetboek een bepaling bevat met betrekking tot *imprévision* onderstreept, dat dit leerstuk door de Argentijnse juridische gemeenschap positief wordt beoordeeld.

Anderzijds bestond er tot voor kort technisch gezien geen Chileense jurisprudentie met betrekking tot *imprévision* en heeft de hoogste rechter in een aantal uitspraken het beginsel van de onschendbaarheid van overeenkomsten bekrachtigd. In de *South Andes* zaak verwierp de rechter expliciet de mogelijkheid om *imprévision* toe te passen in het licht van de geldende juridische bepalingen, die werden geïnterpreteerd als zouden zij de aanpassing van overeenkomsten in geval van gewijzigde omstandigheden uitsluiten en, integendeel, een uiting zijn van de absolute overheersing van het *pacta sunt servanda* beginsel. Daarnaast blijft de ontwikkeling ervan in de rechtsleer duidelijk achter bij andere rechtsstelsels. Deze gebrekkige ontwikkeling wordt weerspiegeld in de tegenstrijdige argumentatie in, en de uitkomst van, de weinige rechterlijke- en arbitrage-uitspraken die in de laatste paar jaren de toepassing van *imprévision* grondig hebben geanalyseerd.

De verschillende aanpak gehanteerd door het Argentijnse en het Chileense recht verdient een nadere studie. Deze dient interdisciplinaire analyses te bevatten, bijvoorbeeld vanuit een sociologisch perspectief. Als voorlopige hypothese geldt, dat de gronden voor de eerdergenoemde verschillende aanpak echter niet gelegen zijn in de verschillende economische geschiedenis van beide landen: tussen 1972 en 1976 ging Chili gebukt onder een hyperinflatie die deze in Argentinië evenaarde; en later, in de vroege jaren 80, resulteerde de devaluatie van de Chileense munt in een bankencrisis en het faillissement van diverse bedrijven. De redenen voor terughoudendheid lijken te zijn gelegen in de formele en positivistische benadering van het recht door zowel de rechterlijke macht als de rechtsleer. Uit de argumentatie van rechters en wetenschappers blijkt dat deze de voorkeur geven aan het louter verwijzen naar positieve juridische normen boven het zoeken naar

en de interpretatie van algemene beginselen. Aangezien de tekst van het Burgerlijk Wetboek de rol van de bindende kracht van overeenkomsten vooropstelt, ten koste van de bescherming van zwakkere partijen of van solidariteit binnen het contractenrecht, vormt de verwerping of beperkte aanvaarding van *imprévision* in het Chileense privaatrecht geen verrassing.

4. De common law rechtsstelsels. Engels en Amerikaans recht.

Het Engelse recht kent de traditionele regel van het common law contractenrecht, dat degene die een toezegging doet (*promisor*) volledig aansprakelijk is bij een schending van diens contractuele verplichtingen. In *Paradine v. Jane* stelde de rechter dat de *promisor* nooit is ontheven van diens verplichting tot nakoming. In *Taylor v. Caldwell* werd vervolgens de basis gelegd voor het moderne leerstuk van de ontbinding als gevolg van later intredende gebeurtenissen. In deze zaak werd het volgende algemene beginsel geformuleerd: 'overeenkomsten waarbij nakoming afhankelijk is van het voortbestaan van een bepaalde persoon of zaak, bevatten de stilzwijgende voorwaarde, dat de onmogelijkheid van nakoming voortvloeiend uit het omkomen van de persoon /tenietgaan van de zaak zal leiden tot de bevrijding van nakoming'. Deze regel geldt echter uitsluitend indien nakoming onmogelijk is geworden. Indien later intredende omstandigheden *enkel* tot gevolg hebben dat nakoming buitenproportioneel bezwarend, echter niet onmogelijk is, plegen rechters om deze reden een vordering van de belanghebbende partij af te wijzen. Evenals het Franse recht lijkt de Engelse common law buitengewoon veel waarde te hechten aan zekerheid door het laten prevaleren van het beginsel van de onschendbaarheid van contracten, zelfs indien dit voor een der partijen zo nu en dan tot een 'hardvochtige' uitkomst zou kunnen leiden.

Bovendien wordt het praktische belang van het leerstuk van *frustration* in het Engelse recht [leer dat nakoming onmogelijk is door gebeurtenissen die zich na het sluiten van de overeenkomst hebben voorgedaan] in ernstige mate beperkt door het feit, dat in de Engelse common law de *frustration* van een overeenkomst altijd leidt tot een automatische en volledige ontbinding ervan. Zelfs indien uit de bedoeling van partijen, de juiste interpretatie van de overeenkomst of om overwegingen van redelijkheid en billijkheid zou blijken, dat een aanpassing van de verhouding of een verdeling van de verliezen de beste oplossing zou zijn, biedt de strikte toepassing van het leerstuk geen alternatief voor de uitkomst van de zaak: de volledige ontbinding van de overeenkomst. Dit kan worden beschouwd als het grootste obstakel voor een goede ontwikkeling van het leerstuk van de gewijzigde omstandigheden in het Engelse recht.

In het Amerikaanse recht is het leerstuk van de *impracticability* (te onderscheiden van *impossibility,* (onmogelijkheid)) erkend sinds de zaak *Mineral Park Land Co. v. Howard* en later in Article 2, Section 615 van de *UCC* en § 261 comment a van de *Restatement (2nd) of Contracts.* Op basis van deze bepalingen werd in de jurisprudentie het concept ontwikkeld van de *commercial impracticability*: een situatie waarin 'de kosten van nakoming in feite zo

excessief en onredelijk zijn geworden, dat het niet vrijstellen van nakoming zou resulteren in een ernstig onrecht. ‘

Desalniettemin, misschien omdat de gebruikelijke remedie in het geval van *impracticability* en *frustration of purpose* de ontheffing van verdere nakoming vormt, heeft de Amerikaanse rechter het leerstuk uiterst restrictief toegepast en verleent deze zelden vrijstelling van nakoming, indien nakoming van de overeenkomst uitzonderlijk bezwarend is geworden. Dienovereenkomstig is men in de jurisprudentie de opvatting toegedaan, dat voorzieningen op basis van *impracticability* enkel dienen te worden toegewezen in situaties, waarin volledig is voldaan aan de strenge vereisten voor onmogelijkheid (*impossibility*). Rechters hebben, ondanks het ter beschikking staan van een reeks voorzieningen in de UCC en de Restatement (2nd) of Contracts ter verdeling van de verliezen, steeds geweigerd de lasten van een ontbonden overeenkomst te verdelen, omdat de nakoming ervan commercieel *impracticable* was geworden.

Het Amerikaanse leerstuk van de 'impracticability' doet, althans in theorie, sterk denken aan de civil-law leerstukken van uitzonderlijke bezwarendheid of imprévision. De titel van section 2-615 (vrijstelling bij gebreke van vooronderstelde voorwaarden) spreekt in dit opzicht voor zich. Het leerstuk werd opgenomen in de Code met het doel een partij vrij te stellen van de nakoming van diens verplichtingen, indien nakoming als gevolg van het optreden van onvoorziene omstandigheden extreem en onredelijk bezwarend of moeilijk was geworden, en niet enkel indien nakoming fysiek onmogelijk was geworden. De regel van de absoluutheid van het contract lijkt in het Amerikaanse recht echter nog steeds invloedrijk te zijn, zij het in mindere mate dan in het Engelse recht. Partijen dienen de gevolgen van onvoorziene omstandigheden allereerst op te vangen via hun contractuele bepalingen. Daarnaast is het Amerikaanse leerstuk van de *impracticability* gebaseerd op, en afgeleid van het leerstuk van de onmogelijkheid. Bij het ontbreken van een contractuele clausule is het derhalve voor een rechter *conceptueel* gezien erg moeilijk om een partij vrij te stellen van nakoming indien een onvoorziene omstandigheid nakoming buitengewoon bezwarend of moeilijk, echter niet onmogelijk maakt. Dientengevolge vertrouwen rechters bij de beoordeling van de voorwaarden voor toepassing van *impracticability* vaak op de parameters van het leerstuk van de onmogelijkheid.

III Internationale 'restatements' van het contractenrecht. De benadering van het Weens Koopverdrag, de UNIDROIT beginselen, de PECL en de DCFR.

De bestudering van de in dit onderzoek betrokken internationale instrumenten van het contractenrecht heeft aangetoond, dat de huidige trend bestaat in de erkenning van het gevolg van gewijzigde omstandigheden op de verplichtingen van partijen, waarbij aan de rechter ruime bevoegdheden worden toegekend om te beslissen over een beëindiging of aanpassing van de overeenkomst. De drie onderzochte codificaties (zonder status van wetgeving) volgen deze aanpak en de betreffende bepalingen komen in belangrijke

mate overeen, ondanks de restrictievere benadering van de DCFR met betrekking tot de voorwaarden voor en de gevolgen van een wijziging van omstandigheden.

Wat het Weens Koopverdrag betreft bestaat zowel in de rechtsleer als in de jurisprudentie onduidelijkheid ten aanzien van het thema van een wijziging van omstandigheden. Dit toont aan, dat de keuze van de opstellers om de regeling van het onderwerp buiten het Weens Koopverdrag te houden geen goede was, aangezien men zo te veel ruimte heeft opengelaten voor uiteenlopende interpretaties. Het is niet realistisch om te veronderstellen dat partijen zelf in hun overeenkomsten altijd voor oplossingen zullen zorgen. Integendeel, een aantal factoren kan juist aan de opname van expliciete clausules in de weg staan, zoals het onvoldoende gesofisticeerd zijn van partijen of het ontbreken van tijd om alle details van de deal te regelen. Bovendien is er een grote kans dat 'hardship' situaties zich voordoen bij internationale commerciële transacties en bij contracten voor de lange termijn. De benadering van de UNIDROIT beginselen, de PECL en de DCFR, met een expliciete en heldere juridische bepaling aangaande het concept, de voorwaarden en de gevolgen van een wijziging van omstandigheden lijkt de beste optie ter oplossing van meer problemen en discussies over het onderwerp.

IV De gevolgen van een wijziging van omstandigheden

1. De verplichting tot heronderhandelen

Buiten de in het onderzoek betrokken rechtsstelsels is het interessant te constateren, dat het merendeel der Europese civil-law rechtsstelsels geen expliciete verplichting tot heronderhandelen kent. Om deze reden lijkt het van belang te zoeken naar een passende bron voor de verplichting tot heronderhandelen, om de opname ervan als een gevolg bij gewijzigde omstandigheden te rechtvaardigen. Als bronnen worden in het bijzonder het beginsel van de goede trouw en de aard van de overeenkomst geanalyseerd, evenals expliciete contractuele bepalingen (heronderhandelingclausules).

Ten aanzien van de inhoud van de verplichting tot heronderhandelen wordt algemeen aangenomen dat de onderhandelingen worden beheerst door het algemene beginsel van de goede trouw. De verplichting tot eerlijk onderhandelen en tot samenwerken geldt aldus voor beide partijen. Dientengevolge zijn beide partijen gehouden om tot overeenstemming te komen, maar hoeven zij enkel een fair en redelijk wijzigingsvoorstel te accepteren. De belanghebbende partij is gerechtigd tot het instellen van een vordering bij de rechter (in dit geval tot aanpassing van de overeenkomst), en dit dient in overeenstemming te zijn met datgene wat op grond van de goede trouw, van fair onderhandelen en van samenwerking *zou moeten* zijn gedaan. De belanghebbende partij is slechts in uitzonderlijke situaties gerechtigd tot het weigeren van nakoming, maar er zou een 'minimale nakomingregel' kunnen worden ingesteld: de verzoekende partij zou een aanbod van minimale nakoming gedurende de heronderhandelingtermijn kunnen opnemen, of bij gebreke hiervan, kan elke partij een verzoek hiertoe indienen bij de rechter.

Zelfs indien beide partijen te goeder trouw hebben onderhandeld, kan het voorkomen dat zij op grond van legitieme tegengestelde belangen niet tot overeenstemming komen. Omdat er in dit geval geen sprake is van de schending van een verplichting, zijn de gevolgen van het mislukken van de onderhandelingen hoofdzakelijk beperkt tot de beëindiging of aanpassing van de overeenkomst door de rechter. Indien de reden van het mislukken echter is gelegen in de ongerechtvaardigde weigering van een partij om in onderhandeling te treden, of indien de reden van het afbreken van de onderhandelingen is gelegen in wangedrag of kwade trouw, is de belanghebbende partij tevens gerechtigd tot het vorderen van schadevergoeding. In dit geval zou een vordering tot vergoeding van de door de vertraging geleden schade en van de als gevolg van het vertrouwen op de mislukte overeenkomst gemaakte kosten kunnen worden toegewezen.

Indien de onderhandelingen niet binnen een redelijke termijn tot een goed resultaat leiden, kan elk der partijen zich in ieder geval tot de rechter wenden met het verzoek om de overeenkomst aan te passen aan de nieuwe omstandigheden, en heeft de rechter ruime bevoegdheden tot het wijzigen of beëindigen van de overeenkomst, al naargelang hetgeen in de omstandigheden van het specifieke geval het meest passend is.

2. Aanpassing en beëindiging van de overeenkomst

Uit het vergelijkend overzicht is gebleken dat de codificaties zonder status van wetgeving (de modelcodes), zoals de UNIDROIT Beginselen, de PECL en de DCFR, aanpassing van een overeenkomst erkennen als een der beschikbare rechtsmiddelen voor de belanghebbende partij in geval van onvoorziene omstandigheden, en aldus aan de rechter ruime bevoegdheden toekennen om een passend resultaat voor beide partijen te bereiken.

Daarentegen voorzien noch de onderzochte nationale rechtstelsels, noch het Weens Koopverdrag in aanpassing door de rechter als een algemeen rechtsmiddel. Dit is zonder meer het geval in Engeland & Wales, Frankrijk en Chili. Wat het Amerikaanse recht betreft kan gesteld worden dat de UCC-bepalingen aan partijen een basis bieden ter aanpassing van de overeenkomst, maar in de praktijk is de rechter zeer terughoudend gebleken bij de toewijzing ervan en derhalve kan de situatie geacht worden overeen te komen met de eerdergenoemde rechtsstelsels. In Italië en Argentinië komt men in de praktijk tot een aan het zojuist vermelde Amerikaanse recht tegenovergesteld resultaat. Ondanks het feit, dat de Italiaanse *Codice Civile* enkel in geval van een eenzijdige overeenkomst voorziet in aanpassing van de nakoming, hebben de rechtswetenschap en de jurisprudentie, zowel in Italië als in Argentinië, in gevallen van gewijzigde omstandigheden een interventie door de rechter toegestaan ter aanpassing van de overeenkomst aan de nieuwe omstandigheden.

In dit onderzoek is uitgebreid ingegaan op de gronden voor een erkenning van de rechterlijke bevoegdheid tot het aanpassen van een overeenkomst aan nieuwe omstandigheden en werden deze geplaatst naast de voornaamste tegenargumenten. Een voorkeur voor het een boven het ander impliceert tevens een voorkeur voor die waarden, die men als

maatschappij in het contractenrecht wenst te laten prevaleren. Naast de dogmatische rechtvaardiging dient er dus een politieke keuze te worden gemaakt.

Het belangrijkste probleem bij de vaststelling van de reikwijdte van de bevoegdheden van de rechter tot aanpassing van de overeenkomst vormen de methodes en de randvoorwaarden voor het verdelen van de verliezen tussen partijen. In geen geval kan de rechter de gehele overeenkomst herschrijven, de aard ervan wijzigen of de verliezen volledig van de ene partij naar de andere verleggen. Bovendien dient de rechter de overeenkomst in het kader van het verdelingsproces vanuit zowel vanuit een intern als een extern perspectief te bekijken.

Tenslotte lijkt het de beste optie om beëindiging van de overeenkomst te beschouwen als een laatste redmiddel voor de rechter en het accent te leggen op een maximaal behoud van de overeenkomst door een aanpassing hiervan aan de nieuwe omstandigheden. De rechter zou een verzoek tot beëindiging van de overeenkomst enkel mogen toewijzen, indien de belangen van beide partijen hiermee beter zijn gediend. De rechter zou hier dienen te beschikken over ruime bevoegdheden ter compensatie van de ongemakken van de voorziene beëindiging van de overeenkomst voor partijen, in het bijzonder wat betreft de positie van de *onschuldige* bevoordeelde partij, die niet mag worden benadeeld door het beëindigen van de overeenkomst.

V Conclusies

Uit het vergelijkend overzicht van de verschillende in dit onderzoek geanalyseerde rechtsstelsels, het Weens Koopverdrag en de modelcodes volgt, dat er vandaag de dag nog grote verschillen bestaan in de benadering, de erkenning en de gevolgen van een wijziging van omstandigheden op de bindende kracht van overeenkomsten. De algemene trend lijkt echter de erkenning van gewijzigde omstandigheden als grond voor een voorziening voor de belanghebbende partij, aan wie, indien nakoming van diens verplichting buitengewoon bezwarend is geworden, een aantal alternatieven wordt toegekend.

Dit leidt voor het geval van gewijzigde omstandigheden in het bijzonder tot de volgende twee conclusies:

a) De algemene regel is, dat een debiteur diens verplichting dient na te komen, zelfs indien nakoming *bezwarender* is geworden dan deze verwachtte.
b) Partijen zijn in principe vrij om de risico's van onvoorziene omstandigheden te verdelen.

Indien nakoming echter *buitengewoon* bezwarend is geworden als gevolg van *redelijkerwijs onvoorzienbare* omstandigheden, is de belanghebbende partij gerechtigd om te vertrouwen op een passend stelsel van remedies ter herstel van de overeenkomst binnen de grenzen van een *adequaat* verlies voor de debiteur. Tegelijkertijd volgt uit het dwingendrechtelijke karakter van de regels aangaande gewijzigde omstandigheden, dat het niet mogelijk is om overeen te komen dat *alle* risico's (voorziene en onvoorziene) volledig worden

verschoven en door een der partijen dienen te worden gedragen, omdat dit in de praktijk zou neerkomen op de uitsluiting van deze regels.

Op basis van het in het onderzoek gepresenteerde vergelijkende overzicht leidt een systematische analyse van de bestudeerde rechtsstelsels en modelcodes tot een indeling in 'receptieve' en 'niet-receptieve' rechtsstelsels. Het onderscheid is gebaseerd op de (al dan niet) ontvankelijkheid van een rechtsstelsel voor erkenning van de juridische relevantie van gewijzigde omstandigheden, waarbij aan de belanghebbende partij in een dergelijk geval de mogelijkheid wordt geboden om te kunnen vertrouwen op een stelsel van rechtsvorderingen.

Van de onderzochte rechtsstelsels kunnen Italië en Argentinië worden beschouwd als zijnde 'receptief'. Dezelfde conclusie kan worden getrokken met betrekking tot alle geanalyseerde modelcodes, d.w.z. de UNIDROIT Beginselen, de PECL, de DCFR. Deze bevatten allen één of meer expliciete regels met betrekking tot het onderwerp.

Tot de categorie van de 'niet-receptieve' rechtsstelsels behoren de rechtsstelsels van Engeland en Wales, de Verenigde Staten, Frankrijk en Chili, en het Weens Koopverdrag. Zaken in deze niet-receptieve rechtsstelsels leiden in het algemeen voor de belanghebbende partij tot een negatieve uitkomst, en indien gewijzigde omstandigheden al worden erkend zijn de gevolgen hiervan beperkt tot een verplichting tot heronderhandelen of tot het beëindigen van de overeenkomst, wat in beide gevallen gepaard gaat met een mogelijke, en in de meeste gevallen gedeeltelijke, ex-post verdeling van de verliezen. Een bevoegdheid tot het aanpassen van de overeenkomst door de rechter wordt niet erkend. Zelfs indien sprake is van een beperkte erkenning in de wetgeving (zoals in de Verenigde Staten via de UCC) is de feitelijke benadering van het onderwerp zeer beperkt en is het resultaat in de praktijk (afwijzing van de vordering van de belanghebbende partij) hetzelfde.

De algemene conclusie van de studie luidt dat de erkenning van gewijzigde omstandigheden als een remedie voor een belanghebbende partij kan worden beschouwd als een ander aspect van het hernieuwde belang van rechtvaardigheid en billijkheid als tegenwicht tegen het algemene beginsel van de contractsvrijheid. De overeenkomst wordt dan beschouwd als een samenspel van uitgebalanceerde belangen, een middel tot loyale samenwerking en het resultaat van wederzijds vertrouwen van de partijen. De complexiteit van de hedendaagse contractuele verhoudingen, en van de algemene sociale en economische omstandigheden, vereist dat gelijk gewicht wordt toegekend aan andere dan de klassieke waarden van vrijheid, veiligheid en zekerheid, namelijk aan samenwerking, solidariteit en flexibiliteit. De belanghebbende partij is in het bijzonder gerechtigd om te vertrouwen op een adequaat stelsel van remedies, dat tot oogmerk heeft de overeenkomst binnen de grenzen van een adequaat verlies voor de debiteur te herstellen, en de verplichting omvat tot heronderhandelen en, indien de heronderhandelingen mislukken, tot aanpassing van de overeenkomst door de rechter. Tevens wordt gesteld dat rechtsstelsels het onderwerp het beste kunnen regelen door middel van een expliciete wettelijke regeling in de vorm van een flexibele maar uitzonderlijke regel die de omvang, voorwaarden en gevolgen van

gewijzigde omstandigheden voor de verplichtingen van partijen regelt, zoals dit in het algemeen is geregeld ten aanzien van de leerstukken van onmogelijkheid of *force majeure* in civil-law systemen.

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Curriculum Vitae

Rodrigo Andrés Momberg Uribe was born in Osorno, Chile, on 18 December 1972. He graduated with a Bachelor's degree in Law with Honours from the Universidad Austral of Chile in 1999 and in the same year he was admitted to the bar by the Supreme Court of Chile. Since then he has worked as an attorney at law and a legal adviser, mainly in Civil and Commercial Law before the Chilean courts. In 2002 he received a Master of Laws in European Private Law from Utrecht University.

From 2002 onwards he has been an Assistant Professor at the Faculty of Law of the Universidad Austral of Chile and from July 2005 until February 2008 he was appointed as Secretary General of the same University.

In 2007 he was awarded with the Prince Bernhard Scholarship by the Foundation "The Spanish, Portuguese and Ibero-American Institute". On February 2008 he joined the Molengraaff Institute of Private Law at Utrecht University as a PhD researcher and until March 2011 he worked on his doctoral thesis, collaborating at the same time in teaching at the bachelor and master's levels. Rodrigo Momberg has published in the field of consumer, contract and European private law.

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