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INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

WORKING GROUP FOR THE PREPARATION OF PRINCIPLES
FOR INTERNATIONAL COMMERCIAL CONTRACTS

Chapter 5

PERFORMANCE

Section 2: Hardship

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discussions during the meetings of the Working Group held in Rome
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(1946 501 100)

1. Introduction

The purpose of this study is to determine the effect of the proposed changes on the operations of the Army.

The study is based on the following assumptions:

1. The proposed changes are necessary.

2. The proposed changes are feasible.

3. The proposed changes are desirable.

The study is based on the following assumptions:

Note

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CHAPTER 5

PERFORMANCE

SECTION 2: Hardship

INTRODUCTION

The increasing internationalisation of economic life has heightened the interdependence not only of individual countries, but also of individual partners and economic processes. Disturbances in one part of the world may therefore affect contracts between parties located in quite different parts of the world. There has thus been a particular increase of the economic risks involved.

Long term contracts of different kinds (e.g. erection of plants, cooperation, successive deliveries, credit agreements) are of increasing importance. They are frequently the victim of economic disturbances, in particular because their extended duration makes them more vulnerable to such events.

Contracts for considerable values which influence the economies of whole nations or the economic situation of very large companies have become an important feature of present day international economic relations. They are also particularly sensitive to economic change.

The above mentioned trend of development was one of the reasons for including rules on hardship in these Principles. These rules are intended to strengthen the principle pacta sunt servanda by providing for exemptions where an application of this principles would lead to a breakdown of the contract rather than to its performance, thus having an effect which is the opposite of that it is intended to have.

Although the problem of changed circumstances addressed here is of particular importance to current international economic relations, it has already been considered at a national level, and national legal systems have attempted to deal with it. The experience gained at a national level have been considered in this attempt to solve the problem for the purposes of these Principles with a view to being of guidance for international practice.

Article 5.2.1
(Pacta sunt servanda)

If the performance of a contract is rendered more onerous for one of the parties, he is nevertheless bound to fulfil his obligations, unless a case of hardship occurs.

COMMENTS

a. Obligation of the parties to fulfil the contract

The article makes it clear that as a rule a party is bound to fulfil his obligations under a contract, even if losses are to be expected rather than the profits originally hoped for. Although this is the general philosophy underlying the Principles as a whole, it has been repeated here in order to stress the exceptional character of the departures from the rule.

b. Exception in case of hardship

The concept of "hardship" is defined in Article 5.2.2, while the effects of hardship on the contract are laid down in Article 5.2.3. The purpose of the present article is therefore only that of indicating that there might be exemptions from the duty to perform. Hardship is not the only event of this kind: more frequent are the exemptions indicated in Art. 6.1.4 and Art. 6.1.3.

Illustration 1

Forwarding Agent FA has a two-year contract with Carrier C to ship certain goods every month from Hamburg to New York for a fixed price. Referring to fluctuations in the fuel price in the aftermath of the 1990 Gulf crises, C asks for a 5% increase of the rate for August 1990. The claim is not justified as C has to bear such risks.

CROSS REFERENCES

Arts. 5.1.1, 6.1.3 and 6.1.4.

Article 5.2.2
(Definition of hardship)

- (1) There is a case of hardship where
 - [(a) the occurrence of events fundamentally alters the equilibrium of the contract, thereby placing an excessive burden on one party, and]
 - (b) this occurrence of events arises or becomes known or ought to have become known to the [parties] [disadvantaged party] after the conclusion of the contract and could not reasonably have been taken into account at the time of the conclusion of the contract, and
 - (c) these events are beyond the control of the [parties] [disadvantaged party].
- (2) A party is excluded from invoking a case of hardship
 - (a) in as far as this case arises after the relevant performance has been rendered or
 - (b) he has assumed the risks forming the hardship.

COMMENTS

a. Structure of the article

Paragraph 1 of the present article lays down the criteria which have to be fulfilled for there to be a case of hardship. The article further prohibits reliance on hardship under certain circumstances. On the other hand, the article does not restrict hardship to specific types of contract. Therefore, even short term sales contracts may exceptionally be affected by hardship. These will most often not actually be covered by the definition, but if they exceptionally were to be so, hardship could be raised also with reference to them.

b. Fundamental alteration of the equilibrium of the contract

This is the most important aspect of a hardship situation, but since within the Working Group no consensus has as yet been reached, lit. (a) is placed in square brackets.

In practice there are two main forms of hardship. The first one is characterised by the fact that the equilibrium of the contract has been severely disturbed (e.g. the price of raw materials which forms an important part of the price has increased manifold; new safety regulations which require far more expensive technical solutions have entered into force). The second relates to situations where the purpose of the contract can no longer be fulfilled (e.g. the plant which according to the contract was to have been reconstructed has been destroyed by an earthquake). In the latter case further distinctions can be made, such as, for example, whether what is affected is the performance of both parties (as is the case in the above example), or of only one of the parties (e.g. one of the parties buys something for reexportation but this is later prohibited), or whether or not each party knew of the presuppositions under which the other party had entered into the contract (e.g. whether the seller knew of the buyer's intention to reexport the goods). It proved difficult to deal with all these possibilities in detail, but after all it was not necessary to do so, as in all these cases the equilibrium of the contract is affected. Either a party will have to make greater efforts to perform, or the value of the other party's performance will be decreased.

Since reliance on hardship is the exception (cf. Art. 5.2.1 and Comments), if the alteration of the equilibrium of the contract is not fundamental, hardship may not be invoked. The main problem is of course the determination of what is "fundamental". This obviously depends on the circumstances of the case, and it is therefore not possible to give more precise indications. Most important are, of course, alterations in the value of the performances (e.g. alterations of the equilibrium of 50% or more should be looked upon as fundamental).

Hardship differs from force majeure in that it does not render performance completely impossible, although it does become much more burdensome for one party or useless for the other. Special legal consequences are derived from this (cf. Art. 5.2.3), but it is not possible to draw a sharp distinction.

c. Excessive burden on one party

The exceptional character of hardship is further stressed by the last half sentence of lit. (a) which addresses the situation of the aggrieved party. If the alteration of the equilibrium does not have as a consequence that an excessive burden is placed on one of the parties,

then even if that alteration is fundamental, this may nevertheless not be considered as hardship, for example, where the value of the contract at stake is relatively low in comparison with the other activities of that party.

d. Arises or becomes known or ought to have become known after the conclusion of the contract

Where a party knows of the events constituting hardship he is able to take them into consideration and he is therefore not allowed to rely on hardship. In practice, the knowledge of the disadvantaged party is decisive. It is obvious that the other party may not defend himself against the consequences of hardship if only he knew about the relevant facts (venire contra factum proprium). On the other hand, each party has to make the necessary efforts to learn about events which may influence the performance of the contract.

e. Could not reasonably have been taken into account

Circumstances which had not yet occurred at the time of the conclusion of the contract cannot be accepted as hardship if they could have been taken into consideration at that time. For this purpose, what is decisive is not whether it is imaginable that a certain event may occur, but rather whether it is probable that the performance of the contract would be disturbed by the occurrence of certain events, and if so to what extent. In this connection neither an over-optimistic nor an over-pessimistic approach can be taken as a yardstick.

Sometimes the circumstances change gradually, and only the final result can be deemed to constitute hardship. If the circumstances have started to change before the conclusion of the contract, then hardship will as a rule only be accepted if the subsequent changes take a dramatic course. Where changes have started to occur after the conclusion of the contract, then hardship can be invoked if the difference between the situation at the time of the making of the contract and that at the time of performance is so important that it amounts to hardship. It follows from the general principle of good faith that the aggrieved party has to inform the other party when a hardship situation is likely to develop and is liable for damages if he does not do so (cf. Art. 1.5 and also Art. 5.2.3(1)).

f. Beyond the control

This presupposition has to be formulated rather sharp in the special context of a hardship situation. Where the or the consequences thereof can be overcome by the party affected, though with unreasonable costs or other efforts, they may nevertheless be hardship as distinguished from force majeure, but where the events are under the control of that party they can clearly not be invoked as hardship.

g. Hardship after the relevant performance

According to paragraph 2 hardship can only be invoked, i.e. the request for renegotiation must be made before performance has occurred. Where performance has been rendered, the aggrieved party may be considered to have overcome the hardship.

If the performance has been partially rendered when hardship occurs, the renegotiation process will generally refer only to those parts of the performance which are still outstanding. However, given the highly discretionary nature of renegotiations, as well as of the other decisions which may be taken in the context of hardship, this distinction will in practice not be so sharply drawn. Thus, an adequate adaptation of the contract may well consider, albeit perhaps impliedly, imbalances between performances which have already been rendered at the time the request is made.

h. No consideration of risks assumed by the disadvantaged party

The word "assumed" makes it clear that the risks need not be taken over by the disadvantaged party expressly, but may be placed upon him as a result of the very nature of the contract in question. Whoever makes a speculative transaction may not invoke hardship if it fails. It must be borne in mind that only circumstances which fundamentally alter the equilibrium of the contract constitute hardship, so the risk of, for example, a moderate inflation always has to be borne by the creditor of a monetary obligation.

Illustration 1

In an international contract concerning the removal of refuse one party (A) undertakes to make a contract with a suitable refuse collector in his country to store the refuse there on behalf of the other party (B). The contract is valid for four years and has a fixed price per ton. After two years the environmental protection movement in A's

country gains ground and forces the government to prescribe prices for storing refuse which are ten times higher than they were before. This price has to be paid also by A. This is an obvious hardship case, although hardship may only be invoked for the time after the price increase.

CROSS REFERENCES

Arts. 5.1.1 and 6.1.3.

Article 5.2.3 (Effects of hardship)

(1) In case of hardship the disadvantaged party is entitled to request renegotiations, provided he does so without undue delay. The request shall indicate the grounds on which it is based.

(2) On failure to open renegotiations according to paragraph 1, or in default of agreement within a reasonable period, or if one party terminates renegotiations either party may resort to the court.

(3) Upon request of either party the court may, after having ascertained the presuppositions for invoking a hardship case,

(a) either terminate the contract at a date and on terms to be fixed, or

(b) adapt the contract with a view to restoring the equilibrium of the contract before the hardship.

COMMENTS

a. Purpose of the article

This article deals with the procedure for the adaptation of the contract, if hardship has occurred.

b. The disadvantaged party is entitled to request renegotiations

By definition hardship does not render performance impossible; therefore the adaptation of the contract is the most suitable reaction to a hardship situation. The aim of

renegotiation is adaptation. Most frequently adaptation will take the form of an increase of remuneration, but it can also take the form of a modification of the non-monetary performance, or even of both performances (observance of new safety regulations against price increases), or it may also result in the termination of the contract with a regulation of the consequences of this termination.

If the contract provides for means of automatic adaptation, such as, for example, indexation clauses, the right to renegotiation is excluded for the hardship cases covered by them.

c. Without undue delay

A request for renegotiation is to be made without undue delay once it is clear that hardship has occurred. This may prove to be particularly difficult where the change in the circumstances is gradual (cf. Art. 5.2.2 comment (e)). Where the time limit is not observed the disadvantaged party does not lose his right to ask for renegotiation, but he will be liable for any damages resulting from the fact that the other party was requested to renegotiate the terms of the contract with delay.

d. Indication of the grounds

The requirement of an indication of the grounds is intended to enable the non-disadvantaged party to judge for himself whether or not the request for renegotiation is justified. Without any indication of the grounds the request is incomplete and is not considered to have been raised in time, unless the grounds are so obvious, that it would amount to an abuse of right if the other party insisted on the grounds being expressly given.

e. Recourse to court

The article provides for a general possibility to have recourse to courts if the renegotiation process fails in one way or the other.

What is meant by "in default of an agreement within a reasonable period" will depend on the complexity of the issue and cannot be predetermined by stating fixed time limits.

If the parties do not agree on the fact that a hardship situation has arisen, the court will have to take two decisions. First, whether or not hardship has occurred. That

a court should be entitled to make such a determination may be acceptable to most jurisdictions because it is an application of law, however vague the relevant criteria may be. The second decision of the court will be that of fixing in lieu of the parties the terms either for the termination of the contract or for the restoration of the equilibrium. No guidelines are given for the first of these two alternatives, and those given for the second are only very general in character. The effects of termination in general are covered in Art. 6.5.1, but these effects may be modified by decisions of the court relating to hardship. Efforts to describe the purpose of the adaptation of the contract by the court in a more precise way than just as restoring its equilibrium have not been successful, particularly as it is necessary to consider different categories of cases which are difficult to define and which would make the rules clumsy and disproportionate as compared to other problems.

It may be doubted that a court decision modifying a contract can still be considered to come within the jurisdictional function of the court, and indeed in certain countries this is not accepted. On the other hand, there is a tendency both at national and at international level to attribute greater powers to the courts also in this respect. The decisions a court is empowered to take in accordance with the article under consideration are clearly intended to overcome a possible deadlock developing between the parties. Nevertheless, the mere possibility of a court making such decisions may induce the parties to reach an agreement - perhaps with the assistance of a court - instead of running the risk of having unexpected terms imposed upon them.

Where a decision by an arbitral tribunal is agreed upon, such an arbitral tribunal shall have the same powers as the ordinary courts (cf. Art. 1.7).

Illustration 1

Same factual situation as in illustration 1 to Art. 5.2.1. A immediately informs B of the price increase and asks that the fixed price be increased tenfold. B recognizes that there is a case of hardship, but refuses to accept the proposed price increase. After one month of fruitless discussions A submits the case to the agreed arbitral tribunal. If B has no interest in continuing with the contract, e.g. because he can find less expensive alternatives, the arbitral tribunal should terminate the contract, possibly with no other consequences deriving therefrom, or, if refuse in the meantime already has had to be

stored at the higher price, by distributing the losses between the parties. If A delayed in informing B about the price increase then he must bear such losses as damages. If the price increase does not make the deal meaningless for B, the court has to determine the amount by which A can increase the price, taking into account inter alia the fact that A's original profit does not change substantially, i.e. it does not increase proportionally as his own activities remain more or less the same.

CROSS REFERENCES

Arts. 1.7, 3.12 and 6.5.1.

LITERATURE

RODIERE/TALLON, Les modifications du contrat au cours de son exécution en raison de circonstances nouvelles, Paris 1986.

(To be completed and up-dated when work on the Principles has been completed.)