

Velimir Živković, LL.M (Belgrade),
Magister Juris (Oxford)
PhD Candidat, University of Belgrade Faculty of Law
Institute of Comparative Law, Belgrade

Originalni naučni rad
UDK: 347.44(44+420+430)

HARDSHIP IN FRENCH, ENGLISH AND GERMAN LAW

The contracts are made to be kept – pacta sunt servanda. This maxim surely is the cornerstone of any effective contract law system, but it cannot, and never has, reigned supreme in each and every legal system. Unexpected events that dramatically change the landscape of a particular contract do occur, rendering its performance sometimes impossible but more often much more onerous for one party. This article deals with the second situation. The aim is to analyze the standpoint of three major European legal systems – French, English and German – on the issue of what (if anything) happens to the contract and rights of the parties if contractual performance becomes more onerous than initially envisaged. This area offers fertile ground for comparative analysis as it will be shown that these three major legal systems adopt genuinely different solutions. These can be sorted on a scale, with the French law being by far the least responsive and German law on the other containing codified rules to flexibly deal with these situations.

Keywords: *hardship, frustration, French law, English law, German law*

INTRODUCTION

The question whether or not the parties should strictly hold on to their contractual bargain regardless of the changed circumstances has deep historical roots. Roman law generally opposed any subsequent modifications of contracts as for a long period of time contractual obligations had a strong religious connotation. It was not until the rise of canon law doctrine that the effect of changed circumstances gained recognition. This was expressed in another well known maxim of contract law – *rebus sic stantibus*. The core idea can be expressed simply – the contract stays the same as long as the circumstances that surrounded it when it was made remain the same. The doctrine's acceptance started with the glossators, and included such strong

proponents as Grotius before becoming a part of early European civil law codifications such as the Prussian Landrecht.¹

The three modern laws that will be the focus of the discussion in this article have not, however, uniformly followed either the old Roman or the canon law principles.² And this is to be expected, as historical development was markedly different in all three legal systems. What was common was the need to address the issues of changed circumstances, manifesting themselves in the disturbance of contractual equilibrium after the contract conclusion. Simply put, this is a situation in which the *duties* of one party become *excessively* onerous, either because the cost of its performance changes significantly enough or because the value of the counter-performance diminishes significantly enough. This situation is commonly today being referred to by its English name hardship despite this term not having a proper legal meaning in England, and this term will be used as a shorthand unless stated differently.

Dealing with hardship is always under the proviso that the performance of the contract does not become (physically or legally) impossible. In such cases, different set of rules often comes into play. It is not the goal of this article to deal with impossibility of performance in the named legal systems, as this is an interesting area that deserves an article of its own. However, as will be shown, the boundary between impossibility and hardship is sometimes very fluid and the two are even addressed together, as with the English doctrine of frustration. It will thus be necessary to discuss, in appropriate places, the solutions that each of these systems provides for situations of impossibility as well.

This article will address each of the systems separately, before concluding with comparative observations. In addition, some short digressions will be given regarding other legal systems with solutions that can be of importance for the discussion. When dealing with hardship provisions in each of the systems, the focus will be on historical development as well as key foundations of positive law.

It is hoped that the overview of the solutions will show the level of deep difference between these systems, which can be contrasted to current attempts to converge on European level. It is also hoped that realizing the trends and approaches in comparative law can be beneficial for Serbian legislator in this area, especially bearing in mind the current work on new Serbian civil code.

¹ K.Zweigert, H. Kötz, *An Introduction to Comparative Law*, 1998.³, 518.

² H.Rosler, 'Hardship in German Codified Private Law – In Comparative Perspective to English, French and International Contract Law', *European Private Law Review* 3/2007, 487.

FRENCH LAW

The French law stands on one extreme pole of potential solutions. This is manifested by the provisions of Code civil (CC) and court jurisprudence which point to the same conclusion – there is no possibility to adapt or terminate a *private law* contract in French law due to hardship, unless the parties themselves made an appropriate hardship clause. According to French jurisprudence which has stemmed from Articles 1147 and 1148 of CC, termination of contracts is possible only in cases of *force majeure* (terms *cas fortuit* and *cause étrangère* are used interchangeably). It can be best described as ‘all or nothing’ position – the contract is either possible, and thus to be performed as agreed or impossible and thereby either terminated fully or partially by operation of law or suspended in cases of temporary impossibility. It is important to note that term private law was emphasized with a reason, as this assertion does not hold true for public law contracts in which a characteristically French doctrine of *imprévision* is applied. This doctrine will be elaborated in more detail, but it is important first to understand the roots and details of the general private law rule.

2.1. THE DEVELOPMENT OF THE LAW

The juridical test of the CC provisions in cases of hardship came in the middle of XIX century. The case that remains the crucial precedent (there were some similar ones earlier) to this day is *Cannal de Craponne* of 6 March 1876.³ In that case Cour de cassation set aside the lower court of appeal’s decision which allowed for the adaptation of the contract, namely contractual remuneration, in accordance to what can be deemed as *rebus sic stantibus* principles. A contract for provision of water from the Craponne canal was concluded in 1567 and by 1873 the contractual remuneration paid by the receivers amounted to no more than a token amount, wholly disproportionate to counter-performance. The court of appeal in Aix, after the heirs of de Craponne family sued and asked for adaptation, allowed for the contractual amount to be adjusted in accordance with contemporary reality, openly proclaiming that this was recognized in law.⁴ But Cour de cassation rejected such a position in singularly stern language: ‘[...] under no circumstances is it for the courts, however fair their decision may appear to them to be, to take into account the time and the circumstances in order to substitute new terms for those which have been freely accepted by the

³ Cass civ, 6.3.1876, D 1876.I.93.

⁴ See H.Beale et al, *Cases, Materials and Text on Contract Law*, Hart Publishing 2010.², 1131.

contracting parties'.⁵ This position has in principle held ground ever since. It has been suggested that this stance is the result of historical lack of trust in the role of the judge after the French Revolution, and the reluctance to allow the power to modify the contract as the expression of will of the parties.⁶ Another fear is the potential for 'chain reactions' in which modification just breeds more modifications.⁷

The main challenge to this position could have come out of situations arising after First and Second World Wars. As will be seen below, it was the post-WWI crisis that caused major legal consequences in this area in Germany. Although the scale of hyperinflation and economic disaster in France was not the same as in Germany, France nevertheless suffered rampaging inflation reaching 500% in monetary depreciation. In spite of this, Cour de cassation held to the same principles. In another important judgment on 6 June 1921,⁸ it decided that no equitable consideration permits the courts to vary the terms of the contract. Briefly regarding the facts, a farmer was required to return a fixed amount of capital alongside a herd to the owner, with the amount fixed in 1910. The owner demanded an increase in capital to be returned due to both war and post-war inflation, by this was flatly rejected. Once again the language of imposing a law on oneself, clearly derogated from the ubiquitous Article 1134 CC, was used to justify claiming that every risk of future increases was accepted by the contracting party. It is truly hard to accept that this included such a change of circumstance as to make the owed sum as much as 5 times smaller.

Such a position is indeed considered by the majority of French doctrine to be untenable.⁹ After the lack of change even after the First World War troubles and inflation, the legal doctrine strongly voiced the idea of change, while proposing different basis for it - ranging from the good faith considerations of Article 1134 (3) CC to invoking old *clausula rebus sic stantibus* as an unwritten principle of the law.¹⁰ It should, in all fairness, be

⁵ *Ibid.*

⁶ See E.Baranauskas, P.Zapolskis, 'The Effect of Change in Circumstances on the Performance of Contract', *Jurisprudence*, 4 (118) 2009, 200 and A. Karampatzos, 'Supervening Hardship as Subdivision of the General Frustration Rule: A Comparative Analysis with Reference to Anglo-American, German, French and Greek Law', *European Review of Private Law* 2/2005, 144.

⁷ M.Mekki, 'Hardship and modification (or "revision") of the contract', 8-9, available at: <http://ssrn.com/abstract=1542511>.

⁸ Cass civ, 6.6.1921, D 1921.I.73.

⁹ H.Beale et al., 1134.

¹⁰ K.Zweigert, H.Kötz, 525.

said that there were also authors which for a long time opposed allowing the interference of courts.¹¹

Despite some lower court rulings in favour of adaptation due to hardship, Cour de cassation remained firm. In such a situation it was necessary for the legislator to intervene to mitigate most obvious difficulties. A special law in 1918 (*Loi Failliot*) gave the courts power to rescind pre-war contracts and grant damages if necessary.¹² This was similarly repeated after Second World War, but has remained in essence an isolated, piecemeal solution.

While the rather apparent harshness and criticism levied by the doctrine failed to produce tangible results in the sphere of private law contracts, the overarching 'public interest' did so for administrative law contracts. The division between these two types of contracts, the administrative ones being characterized by a state entity as one of the parties with special contractual powers and public service in some form as the subject matter of the contract, is (as far as Europe is concerned) peculiarly French.¹³ Despite some differences from private law contracts in areas of contract formation, content and performance, strictly legally speaking there is no obvious reason for the position on hardship to be different regarding administrative contracts. This has not prevented Conseil d'État, final level appellate body for administrative contract disputes, to take such a substantively different stance. Similarly to *Canal de Craponne* in private law, 1916 *Gaz de Bordeaux*¹⁴ case is the landmark in public law contracts jurisprudence regarding hardship. The facts are rather simple – due to German occupation of French coal mines and the corresponding drastic increase in coal price, the company which provided gas for lighting of Bordeaux streets by an administrative contract with the city commune fell into precarious economic position. Unless the company was allowed to increase the contract price for gas, it would likely go into liquidation with the effect that Bordeaux would be left without city lights. In deciding that such an outcome was unacceptable from the public interest viewpoint, Conseil d'État allowed for the price to be modified due to changed circumstances and thereby created the doctrine of *imprévision*.¹⁵ The term is also used as a French version of the English term hardship, despite the fact that its field of application is limited. This field of application has shrunk further due to the fact, noted by the Conseil d'État itself, that administrative

¹¹ M.Mekki, 1.

¹² *Ibid.*, 527.

¹³ L.Brown, J.Bell, *French Administrative Law*, Butterworth 1993,⁴ 192-193.

¹⁴ Conseil d'État, *Compagnie générale d'éclairage de Bordeaux*, 30.3.1916, Rec. Lebon p. 125.

¹⁵ Applied also in, for example, decisions 9.12.1932, S.1933.3.39 and 15.7.1949, S.1950.3.61.

contracts commonly introduced clauses which provide for similar cases.¹⁶ Yet, the doctrine itself remains in force – in a case involving the drastic 1973 increase in oil prices, Conseil d'État ruled that instead of repudiating the contract, the company suffering the consequences of it should have claimed *imprévision*.¹⁷

The presence of public interest as a differentiating factor between these two lines of jurisprudence remains commonly pleaded, but doubtfully strong ground. It has been said, and this position should be supported, that it is not acceptable to treat private interests so differently as many of them actually accrue together to form a public or general interest.¹⁸ An example of private contract dealing with environmental matters is an example as good as any – although formally private interests are pursued, failure of the contract (caused by the lack of possibility to adapt it) might have obvious consequences for the public good.

2.2. POSITIVE LAW AND PROPOSALS FOR REFORM

For private law contracts in France, which without doubt remain far more numerous, the legal situation is as follows: unless you provide for hardship yourself or it is one of narrowly defined and specially legislated cases, there will be no possibility to either suspend own performance, ask for renegotiation or ask the court for adaptation in cases of changed circumstances. There most certainly is no possibility for the contract to come to an end automatically. The French position is followed in Belgium, Luxembourg, Quebec, Chile, Louisiana¹⁹ but not in Italy,²⁰ The Netherlands,²¹ or Spain.²²

It has been pointed out sometimes that there might be some recent examples of such rigid practice changing. Since Article 1134 (3) and 1135 CC and the notions such as good faith leave some space for the courts to exercise moderating power, there seem to be some steps in that direction.²³

¹⁶ Conseil d'État, 2.4.1960, Recueil de jurisprudence, Pedard.

¹⁷ Conseil d'État, *Société Propetrol*, 5.11.1982.

¹⁸ B. Fauvarque-Cosson, 'Le changement de circonstances', *Durées et contrats*, R.D.C. 2004, 73.

¹⁹ M.Mekki, 8.

²⁰ Italian Codice civile, Arts. 1467-1469.

²¹ H.Beale et al., 1146-1147.

²² P.Mazzacano, 'Force Majeure, Impossibility, Frustration & the Like: Excuses for Non-Performance; the Historical Origins and Development of an Autonomous Commercial Norm in the CISG', *Nordic Journal of Commercial Law* 2/2011, 46.

²³ C.Brunner, *Force Majeure and Hardship under General Contract Principles*, Wolters Kluwer 2009, 404-405; M.Mekki, 11 and case law cited there.

However, both progressive²⁴ and traditionalist²⁵ approaches have examples in the jurisprudence of Cour de cassation. Another example of the first is a recently imposed obligation to renegotiate contracts to rebalance disproportionate contractual duties.²⁶ This quite pragmatic duty of renegotiation stems from the general principle of good faith. Overall, it would be hard to say that there is a definite turn towards implementing *imprévision*, but the times ahead might be bringing more change.

Even if it is often commonly accepted that the current rules in French law should change in order to accommodate *imprévision* principles in civil and commercial contracts as well, the proposals for reform are not uniform. Divisions in jurisprudence and doctrine are echoed in reform proposals. For example, often cited *Avant-projet Catala*²⁷ puts emphasis on renegotiation, in a sense that a party has a right to demand the President of the *tribunal de grande instance* to order new negotiations to adapt the contract, which are to be conducted in good faith. If these negotiations fail, absent bad faith, each party has a right to terminate a contract *pro futuro*, at no further cost or loss. Noticeably, there is no right of court adaptation of the contract. The so called *F. Terré project's solution*²⁸ imperatively puts the obligation of parties to renegotiate in cases of excessively onerous performance for one party, but if no solution is reached in reasonable time, a judge is allowed to adapt or end the contract. The French Ministry of Justice 2008 project²⁹ also gives the party a right to demand renegotiation (without any court involvement in that process) while sanctioning that the same party must continue with its performance during these renegotiations. Should renegotiations be refused or fail, the judge may adapt the contract *if the parties so agree* or put an end to it on conditions he sees fit. Peculiarly, while all of the proposals feature renegotiations in one form or another, the judge's power to adapt the contract is either non-existent, semi-present (conditioned on parties' agreement) or fully allowed. It remains rather interesting to see which variant will eventually be accepted and how much the influence from

²⁴ Cass com, 3.11.1992, Bull civ IV.338.

²⁵ Cass com 18.11.1979, Bull civ IV.329.

²⁶ Cass civ, 16.3.2004, Jur. P. 1754.

²⁷ *Avant-projet de réforme du droit des obligations et du droit de la prescription*, Arts. 1135-1 to 1135-3, available at: http://www.ladocumentationfrancaise.fr/docfra/rapport_telechargement/var/storage/rapports-publics/054000622/0000.pdf, 19.09.2012.

²⁸ F.Terré, *Pour une réforme du droit des contrats*, Dalloz 2008., 23, Art. 92.

²⁹ *French Ministry of Justice Project (July 2008)*, Art. 136, referred to in: H.Beale et al., 1135.

modern European and international contract law instruments (DCFR, CESL, UNIDROIT Principles) will play a role in that choice.³⁰

2.3. CONTRACTUAL CLAUSES DEALING WITH HARDSHIP

It is to be expected that businessmen needed to devise their own solutions to deal with hardship. Contractual clauses aimed to clarify the terms used by the law are common in cases of defining *force majeure*. Hardship clauses in French law are somewhat different as they need to 'define' a whole institute and not just its scope, but they are generally common as the first ones and often put together in one single *force majeure and hardship* clause. It is also possible, as in other laws to discern between indexation clauses which deal with monetary depreciation and general hardship clauses which deal with other changes in circumstances.

As for indexation clauses, France has had an early turbulence regarding the issuance of paper money (*assignats*) during the Revolution, which caused the Code Civil to accept a strict monetary nominalism rule for all money debts (Article 1895), which squarely fits with the general rejection of *imprévision* as described above. The approach towards indexation clauses thus varied over the years, and was at first different in regards to international (generally allowed) and domestic (much stricter control) contracts.³¹ Cour de cassation intentionally lifted all restrictions in its *Guyot* decision,³² but the legislator reacted quickly by an Order of 1958 which in essence still adopts a varied approach which explicitly prohibits certain types of indexation, while allowing others if they are directly related to the subject-matter of a particular agreement or activity. The practice thus remains not fully coherent, and the voices for removal of restrictions (especially since the advent of euro) are commonly heard.³³

General hardship clauses in France in addition to defining what hardship is or will be also need to define a procedure to be followed, most likely the one of renegotiations. French courts have had a good sense to aid the parties by agreeing to enforce their bargains in this regard. In that regard, the illustrative judgment is of Cour d'appel de Paris,³⁴ in which it was held that a clause requiring the parties to consult one another in certain circumstances may be given effect by ordering negotiations under the supervision of a third party. In general, French practice has developed rather

³⁰ More on that M.Mekki, 3-6.

³¹ Cass civ, 3.6.1930, DP 1931.1.5.

³² Cass civ, 27.6.1957, D 1957.649.

³³ H.Beale et al., 1162-1163.

³⁴ Cour d'appel de Paris, 28.9.1976, JCP 1979.II.18810.

elaborate systems of hardship clauses, often envisaging the role of arbitrators in establishing what is fair and reasonable under the circumstances.³⁵ It is not thus surprising to see that these clauses have also been a point of great interest for the doctrine.³⁶

ENGLISH LAW

English law position regarding hardship is similar, but not exactly the same as French.

While hardship itself is not recognized as a source of adapting a contract or granting termination, the doctrine of frustration, which will be explained below, provides some potential remedies. Especially important in this context is the frustration of purpose as a part of the doctrine. Such a situation puts English law in between French and German, but one has to note that it is still significantly closer to French law.

THE DEVELOPMENT OF THE LAW

As in so many other areas of contract law, England law followed its own distinctive way when it comes to changed circumstances. One of key historical factors was the fact that English law has not been largely (if at all) influenced by the canon law doctrine of *clausula rebus sic stantibus*.³⁷ English law has started from a position of extreme strictness - even the impossibility of performance was not be taken into account as a changed circumstance with legal effects on contract. In the famous case of *Paradine v Jane*³⁸ a verdict was reached that a tenant had to pay rent even if the leased property was occupied by 'King's enemies' and he himself was forcibly evicted. The only way for the tenant to prevent this absurd situation was to provide against it in contract – the court was not there to help.

Later developments, started in the middle of XIX century, resulted in the creation of the doctrine of *frustration* which brings together both the cases of impossibility of performance (physical and legal) and the cases where the performance is still possible, but the underlying purpose of the contract is frustrated. The cases of impossibility can be equated with French *force majeure* and German counterparts which will be briefly mentioned

³⁵ K.Zweigert, H.Kötz, 527.

³⁶ See, for example, M.Fontaine, 'Les clauses de hardship', *Droit et pratique du commerce international*, 7/1976 and Y.Lequette, 'De l'efficacité des clauses de hardship', *Liber Amicorum Christian Larroumet*, Paris 2010.

³⁷ H.Rosler, 18.

³⁸ (1647) Aleyn 26, 27; 82 ER 897, 897.

below. But the real focus of the discussion should be on this second group of cases, which goes beyond the strictness of the French general rule. As will be seen, it is a very specific type of hardship that can only be to some extent accommodated to its definition given above.

The historical development of the doctrine of *frustration* started with overturning the strict *Paradine v Jane* rule in relation to impossibility of performance. The key case is *Taylor v Caldwell*³⁹ where a music hall that was contracted out for several concerts burnt down completely before the commencement of the contract. No provision was made for such a situation in the contract itself, but judge Blackwell J held that in contracts in which the performance depends on the continued existence of a given person or thing a condition is implied that the impossibility of performance arising from the perishing of the person or thing shall excuse the performance. In a sense, this was not truly overruling *Paradine*, as much as using the exception it allowed and saying that there was a term of the contract, but implied in law and not stipulated by the parties. The consequence of finding *frustration* (although it was not called that way yet) was the discharge of the contract for the future – everything accrued before was to remain as it was, including the duty to pay the money due under the now discharged contract.

An extension from pure impossibility to frustration of purpose came in famous Coronation cases, caused by the cancelled coronation of King Edward VII and the accompanying processions and parades. The first of these is *Krell v Henry*.⁴⁰ The claimant agreed to hire out an apartment to defendant for two days in order for the defendant to see the coronation procession through Pall Mall. After the cancellation of the procession, the defendant refused to pay the agreed sum. Obviously, there was no obstacle to the contract being physically performed. But the Court of Appeal found the contract frustrated as the coronation procession, ‘the foundation of the contract’ in minds of contractual parties, failed. The ‘foundation of the contract’, also called the ‘contractual adventure’⁴¹ became a feature to be analyzed in future cases which, it must be said, were not particularly common. Frustration remains a rare occurrence in practice. Interestingly, in another Coronation case, *Herne Bay*,⁴² there was no finding of frustration despite circumstances being similar. A boat rental contract, made in order to see the naval parade and the fleet ships, was not frustrated by the cancellation. Explanations for this differ, two main being that it was still possible to see the fleet (without the parade) as a sufficient ‘foundation’, and

³⁹ (1863) 3 B&S 826, 122 ER 309.

⁴⁰ [1903] 2 KB 740 (CA).

⁴¹ *Jackson v Union Marine Insurance Co Ltd* (1874) LR 10 CP 125.

⁴² *Herne Bay Steam Boat Co v Hutton* [1903] 2 KB 683.

that Herne Bay company was, unlike parties in *Krell*, a professional which regularly conducted such tours.⁴³

POSITIVE LAW

The doctrine further evolved to reach its modern form. The most important development was the rejection of the 'implied terms' theory and the formation of the modern test for frustration. In *Davis Contractor Ltd v Fareham UDC*,⁴⁴ Lord Radcliffe emphasized that the implied term about an event that the parties by definition could not have foreseen presents a logical difficulty. Instead, it was postulated that: 'frustration occurs whenever the law recognizes 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.'⁴⁵ This has since been used as the modern test of frustration, and is especially important due to other clarifications that have been made by Lord Radcliffe. This test does not include 'economic' hardship, meaning that the increase in cost of performance is not enough to trigger the application of frustration. More specifically: 'it 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'.

Such language clearly limits the usefulness of the doctrine for the cases which are usually considered as hardship. Yet, in cases such as *Krell v Henry*, it can be said that the value of counter-performance for one party became non-existent. This has not occurred due to economic reasons, but the end result is that a party is obliged to pay full contract price for, in essence, now worthless performance. Viewed in this way, it is still within the scope of drastic contractual disequilibrium and hardship. The truth, of course, remains that such situations are rare and that many more common occurrences of disequilibrium due to economic fluctuations are not included within this scope.

It should be emphasized that apart from this limited and admittedly stretched concept of hardship, English jurisprudence can also offer examples of dealing with situations that can be seen as hardship through contract construction. The leading and often cited case is *Staffordshire Area Health Authority v South Staffordshire Waterworks Co*.⁴⁶ The contract (concluded in

⁴³ H.Beale et al, 1114-1115.

⁴⁴ [1956] AC 696.

⁴⁵ For more on this judgment see H.Beale et al., 1115-1117 (emphasis added).

⁴⁶ [1978] 3 All ER 769, CA.

1929) provided for the supply of water by the defendant at the same price ‘at all times hereafter’. The court of appeal decided in 1978, after the defendant stopped performing due to the price becoming derisory, that there was a right to terminate such a contract at reasonable notice. Lord Denning MR specifically concluded that there was an implied term to that effect in every contract that stipulated supply of goods and services for unlimited time at fixed remuneration. It can be seen that again there seems to be no mention of the possibility to adapt the terms of the contract. Contract termination remains, as in case of frustration, the only available option.

The consequences of frustration, consisting of non-retroactive termination, are prone to leave one contractual party at a disadvantage. Since everything accrued is left as is, and there is no possibility to sue for damages (as no one is at fault – if someone is then there is no frustration), it is quite possible for a large misbalance of performance made and benefits gained to occur. The English law on restitution (unjustified enrichment) here provides only very limited assistance – only if absolutely nothing was performed by one party (‘total failure of consideration’) is it possible for one party to claim restitution.⁴⁷ To remedy this, legislative intervention (prompted in part by Second World War circumstances) occurred via *Law Reform (Frustrated Contracts) Act 1943*. Frustration itself was not there defined, leaving intact the definition found in jurisprudence. But the consequences of occurred frustration were modified. If money has been paid or become payable by either party to the other before the moment of frustration, it must be repaid (or ceases to be payable)-but if the party to whom the sums have been paid or are payable has incurred expenses in performance of the contract before the time of frustration, the court may allow him to retain a sum up to the total of his expenses. In deciding the sum, the court retains broad discretion. Additionally, if before the time of frustration one party has conferred a benefit on the other which has not yet been paid for under the contract, the court may require the party who received the benefit to pay for it. The sum payable remains under the court’s discretion, but the court is required to take into account the incurred expenses and the effect on the value caused by the circumstances of the frustration. The Act, however, has been rarely applied in practice.⁴⁸

In summary, the position of English law is that only impossibility of performance and the frustration of purpose of the contract can lead to legal consequences. In the words of the modern test, the original obligation must become something ‘radically different’. Economic fluctuations, even drastic, cannot lead to this, and only potential avenue for these to be of importance

⁴⁷ J.Cartwright, *Contract Law: An Introduction to the English Law of Contract for the Civil Lawyer*, Hart Publishing, 2007, 242 and case law cited there.

⁴⁸ *Ibid.*

would be the construction of contract and finding of implied term to that effect, provided of course that the parties did not make some provisions themselves. Once frustration is found, there is no possibility to adapt the terms of contract – it is to be terminated *ex tunc*, with the consequences of such termination specially prescribed by the 1943 Act. In general, frustration remains a rare occurrence, with rules which can be deemed too uncertain for everyday business.

It is commonly stated that the rules of frustration, and lack of any possibility to adapt the contract, are hardly satisfactory. It is interesting to note that the famous English judge Lord Denning considered that the doctrine of frustration as it exists is the product of the fact that England never faced the scale of inflation or other problems which plagued Germany after World Wars. If it did, he was of the opinion that the doctrine itself would soon succumb to the widespread adaptation of contract by courts.⁴⁹ The fact remains that today there seem to be no widely recognized proposals for reform. This in large part can be attributed to the proliferation and sophistication of hardship clauses which everyday practice, as in France, created to mitigate the harshness of the general rule.

CONTRACTUAL CLAUSES DEALING WITH HARDSHIP

The need to define the changed circumstances and the consequences of them more precisely was especially felt by the commercial parties in England. As in France, it is possible to distinguish between indexation and general hardship clauses.

Indexation clauses have been, however, significantly less contentious than in French law. In a somewhat similar vein to the fact that lack of drastic inflationary disturbances precluded the creation of more radical hardship provisions, the fact that pound sterling was a strong and stable currency created less need for the courts to deal with or worry about indexation clauses.⁵⁰ When the need did occur, the courts eventually adopted a liberal attitude. In *Multiservice Bookbinding v Marden*⁵¹ Chancery Division decided that there was no contravention of public policy in situations where the payment of debt (both capital and interests) was index linked to Swiss franc. The practice of indexation had become widespread by the time of that decision, and the British Parliament found no reason to intervene and restrict

⁴⁹ B.Markesinis, H.Unberath, A.Johnston, *The German Law of Contract: A Comparative Treatise*, Hart Publishing 2006,², 329.

⁵⁰ H.Beale et al., 1151.

⁵¹ [1978] 2 All ER 489. Also followed in *National Building Society v Registry of Friendly Societies* [1983] 3 All ER 296.

it.⁵² It is worth mentioning, however, that there were cautionary voices to the practice earlier – Lord Denning called the practice ‘disturbing’ and was generally opposed to it.⁵³ This view did not gain ground and it is unlikely that it will in future.

General hardship clauses are commonly found in both negotiated and standard (such as building) contracts. A clause usually contains a list of situations which would trigger a specific remedy, and such lists offer far greater certainty than judging if something has become ‘radically different’ than originally contracted. Choosing own set remedies instead of termination also offers advantages, as it is possible to contract for the financial adjustments to the contract, their amount or a role of a third party in determining them. What is not possible, however, and thus conflicts with French reform proposals for example, is to agree for a renegotiation. English law in general does not allow for the enforceability of ‘agreements to agree’ or to conduct negotiations in good faith, all of this illustrated by the well known *Walford v Miles*⁵⁴ judgment. Despite some recent signs of potential change,⁵⁵ it is still the case that an English court would not enforce a clause to renegotiate a contract, unless there is also some form of third party involvement. Potential remedies for hardship thus remain more limited than in French or German law.

GERMAN LAW

The manner in which German law deals with hardship stands on the other pole of potential solutions from French law. After the 2002 modernization of the German civil code (*Bürgerliches Gesetzbuch – BGB*), German legislator codified the developed jurisprudence in its § 313. German law thus offers codified powers to the judge to adapt or terminate the contract which has become excessively difficult for parties to perform or which has (similar to English frustration of purpose) become pointless for one party. It is important to emphasize that the codification of the rule was merely complementary to the existing case law, which remains important (if not crucial) source of explanation for the application of hardship provisions.⁵⁶ As for the terminology, before the codification the term usually used for hardship was *Wegfall der Geschäftsgrundlage* (disappearance of the contractual basis or collapse of the underlying basis of the transaction), which has been changed to *Störung der Geschäftsgrundlage* - disturbance of

⁵² H.Beale et al., 1154.

⁵³ *Treseder Griffin v Cooperative Insurance Society* [1956] 2 QB 127.

⁵⁴ [1992] 2 AC 128 (HL).

⁵⁵ *Petromec Inc v Petroleo Brasileiro SA* [2005] EWCA Civ 891.

⁵⁶ B.Markesinis, H.Unberath, A.Johnston, 324.

the contractual basis. The change of name does not presuppose any change in the concept of hardship.⁵⁷

THE DEVELOPMENT OF THE LAW

The historical development of German law on hardship is a quite fascinating legal journey. The medieval doctrine of *rebus sic stantibus*, as noted before, exerted a strong influence in legal systems which eventually came to form modern Germany. However, the rise of German historical school and of will theories resulted in the doctrine becoming less and less accepted. It was not a part of the original BGB as a result of this, and despite strong efforts made in that direction by the famous German scholar Windscheid and his theory that, put simply, promisors usually assume that the intended legal consequences will occur only in certain circumstances.⁵⁸ Nominally, German law at the time was akin to French ‘all or nothing’ approach – either the contract is impossible to perform and thus terminated in accordance with BGB § 275 or it was to be performed. Such an attitude, with minor modifications in practice, persisted until the end of the First World War and the unprecedented hyperinflation which struck the Weimar Republic.⁵⁹ Faced with a situation in which a 20 Pfennig post mark in less than two years became a 500 trillion mark postmark, the highest German court (*Reichsgericht* – RG) needed to find a solution to alleviate drastic injustice caused by it. The first attempt was the doctrine of ‘economic ruination’ which was attached to BGB § 275 rules on impossibility. In essence, RG applied this article in situations where performance constituted unreasonable and unforeseeable hardship for one party, and as a result relieved that party from performance.⁶⁰ What needed to be shown was that performance in such conditions would result in that party’s economic ruination and likely liquidation. This conveniently pegged this doctrine to an existing legal institute (always a good option for German courts) but had an obvious disadvantage in that not every (or most) situations could be accommodated to such a scenario. Not every contractual party would be ruined if it performed a specific contract, but that does not mean that it would not suffer great hardship for which it was not be blamed. A new solution had to be developed.

As the inflation raged on, RG resorted to more drastic measures. Basing decisions on impossibility was abandoned and RG, after a short

⁵⁷H. Rosler, 485.

⁵⁸ B.Markesinis, H.Unberath, A.Johnston, 320-321.

⁵⁹ The RG held firm even during the war, see H.Beale et al, 1138.

⁶⁰ See RG 15.10.1918, RGZ 94, 45, 47; 21.9.1920, RGZ 100, 129, 130 et seq. Also, H.Rosler, 488.

return to pure *rebus sic stantibus* doctrine,⁶¹ embraced the new concept of the collapse of the basis of transaction, which it formally attached to all-encompassing BGB § 242 on good faith.⁶² Additionally, the scholarly work of Oertmann (interestingly, Windscheid's son in law) who proposed the theory of the failure of the basis of the transaction at about that time, came as a suitable source of inspiration for the court.⁶³ The strong opinions are voiced, however, that this doctrine was simply a useful ornament to true intentions of the court – trying to mitigate the drastic unfairness which occurred at the daily basis at any cost and by all means.⁶⁴ The well known RG decision of 21 September 1922 can also be seen as the start of the trend that the primary intention of the court should be to revise the contract, with termination being only the ultimate solution.⁶⁵

But not only that – in a truly unprecedented court decision, RG in 1923 decided that because of inflation the *Reichmark* was no longer a valid legal tender in Germany.⁶⁶ This prompted a fierce debate between the court and the government about the role of judiciary in Germany, and eventually led to the adoption of legislation which was aimed to mitigate some of the problems of hyperinflation.⁶⁷ According to the RG, and the later jurisprudence which to this day follows the same path, the fundamental circumstances whose disappearance causes the collapse of the basis are ‘perceptions shared by both parties as evident at the closing of the contract, or perceptions of one party, discernible to and not objected to by the other party, of the existence, present or future, of certain circumstances that form the basis of their willingness to contract’⁶⁸ This indicates that these circumstances might be non-existent from the beginning or disappear later. Furthermore, German law sees no problem in this failure being only partial.

As could have been expected, similar problems occurred after the Second World War, and were eventually and partially remedied by the 1952 Act on assistance to contracts. But in cases not covered by the Act, the courts continued to make important decisions and further refine the doctrine of the collapse of contractual basis. A famous 1953 case regarding the sale of drill hammers to East Germany⁶⁹ confirmed that the primary task of the

⁶¹ RG 21.09.1920, RGZ 100, 129, 131.

⁶² RG 3.2.1922, RGZ 103, 328; 27.6.1922, RGZ 104, 394.

⁶³ B.Markesinis, H.Unberath, A.Johnston, 322.

⁶⁴ *Ibid.*, 323.

⁶⁵ See also RG 27.06.1922, RGZ 104, 394.

⁶⁶ RG 28.11.1923, RGZ 107, 78.

⁶⁷ B.Markesinis, H.Unberath, A.Johnston, 329-330.

⁶⁸ BGH 1.6.1979, BGHZ 74, 370, 372; BGH 28.4.2005, BGHZ 163, 42, 48.

⁶⁹ BGH 16.01.1953, MDR 1953, 282.

judges was to adapt the contract equitably, but also clearly confirmed the use of the doctrine in cases similar to English frustration of purpose. The case, in brief, revolved around the fact that the buyer of drill hammers was prevented from exporting them to East Germany (which was the only place they could have been used due to their outdated model) because of the Berlin blockade. The seller was aware of the buyer's intentions, but these were not part of the contract. The seller sued the buyer when he terminated the contract and refused to pay. There were no issues of monetary depreciation here, but BGH nevertheless applied the doctrine (again hinged on § 242) and adapted the contract in a way that the buyer was obliged to pay one quarter of the amount due.

Starting from a well-known 1978 case which dealt with the consequences of the 1973 rise in oil prices,⁷⁰ the BGH warned that the use of the doctrine of the basis of transaction should be only used where it was 'indispensable for avoiding intolerable results, irreconcilable with law and justice.' The spotlight was to be on objective allocation of risk, and not on quick jumps to equitable considerations. This has been repeated since, and played a major role in forming the now codified rule of BGB.⁷¹ Another major upheaval, the German reunification, prompted a series of decision applying the doctrine of collapse of contractual basis with a return to more equitable considerations. A classic example is the BGH decision of 14 October 1992 where it was held that this doctrine should be implemented in order to save the contract, taking into account good faith requirements.⁷²

POSITIVE LAW

The BGB § 313 which codifies all these developments consists of three parts, which deals with objective foundations of the contract, subjective foundations and situations where adaptation is not possible. Regarding objective foundations, §313 (1) BGB proclaims that in situations where due to disturbance of equivalence of mutual performance or only when the burden falls on one party, and to that extent that the parties had they known about it in advance, would not have concluded the contract in its present form. If that is the case, there is the right of one party to demand from the court to adjust the contract, which will be done if the court determines that one party cannot be reasonably held to its original contractual obligations. Determining whether or not the party can be reasonably held is to be done by taking into account the circumstances of

⁷⁰ BGH 8.2.1978, JZ 1978, 235.

⁷¹ See also BGH NJW 1977, 2262; BGH NJW 1978, 2390; BGHZ 74, 370 and B.Markesinis, H.Unberath, A.Johnston, 344-346.

⁷² See H.Beale, 1144-1145.

each case, and especially the allocation of risk which is provided by contract or by law. It is possible to see that this emphasis on the allocation of risk can be attributed to modern developments of hardship jurisprudence in Germany, while not forgetting that the courts can be prone to revert to equity considerations in cases of large upheavals as well. This is also made possible by the fact that §313 still leaves ample room for policy considerations.⁷³ However, the primary emphasis, according to doctrine, should be on risk allocation.⁷⁴

Interestingly, § 313 (2) extends the rule from the first subsection to a change in subjective perception of circumstances – if there is a mutual error regarding the basic factual circumstances which are the foundation of the contract, the same remedies can be applied. § 313 (3) contains a residual solution if adaptation is not possible – the party suffering hardship can terminate the contract retroactively in accordance with the BGB rules (§ 346 and others). It is also to be said that, according to § 314 BGB, retroactive termination is not possible in cases of performance of continuing obligations and the only possibility is the *ex nunc* effect. Generally, it is accepted that there is no prior obligation to attempt renegotiation before adaptation by court becomes an option.⁷⁵

It should be mentioned that the German permissive attitude towards adaptation (but only, of course, in extreme circumstances of hardship) has been an inspiration for a number of national laws and harmonizing instruments. Often quoted in that regard are the UNIDROIT Principles of International Commercial Contracts.⁷⁶ In a manner resembling an avalanche this acceptance of hardship regulation in international soft law instruments prompts more national laws to accept hardship provisions. A very illustrative example in that regard is Lithuania which fully transplanted UNIDROIT PICC solutions. Grappling with such a transplant by Lithuanian courts is useful for comparative law purposes and will, hopefully, be elaborated in more detail in comparative law doctrine.⁷⁷

1.1. Contractual clauses dealing with hardship

Due to the developments in jurisprudence and now in legislation, there was not so much pressing need to fill the gaps in hardship regulation by contractual clauses as it was in France and England. Still, these clauses

⁷³ B.Markesinis, H.Unberath, A.Johnston, 324.

⁷⁴ *Ibid.*, 325.

⁷⁵ H.Beale, 1147.

⁷⁶ Arts. 6.2.1, 6.2.2, 6.2.3.

⁷⁷ The author would like to thank Paulis Zapolskis of Mykolas Romeris University in Vilnius for comments and materials on hardship in Lithuanian law.

remain the suggested way of dealing with hardship and offer more possibilities to foresee the potential problems.

Indexation clauses in Germany are under stricter control than in England and German legal system in that regards resembles the French one. The key developments were successive legislative acts which imposed restrictions on indexation clauses and accompanying jurisprudence which tended to limit those restrictions. The 1948 Currency Act reformed the monetary system, introduced the Deutch Mark and subjected every indexation clause validity to previous authorization by the Bundesbank. The bank itself was restrictive, but the courts in a number of decisions constructed the need for authorization as narrowly as possible.⁷⁸ However, some clauses were not authorized in any circumstances, including index linking to money trading or capital markets, price of gold, DM purchasing power and average wage or pension levels. The 1948 Act was superseded by the 1998 Act introducing the Euro (which kept the authorization system, but moved it to another body) and then the 2007 Act on price clauses, which eliminated the need to obtain an authorization from a government body. Indexation clauses were prohibited as a rule, but a number of exceptions based on jurisprudential developments and previous Bundesbank practice were kept.

As for general hardship clauses, there main virtue in German law is that they can introduce the need and procedure for renegotiation in cases of hardship, which is not prescribed in § 313. In general, these clauses are held to be valid in German law, which is not surprising due to the overall attitude towards hardship. The restriction, however, does exist after the BGB reform of 2002. The hardship clause in a contract cannot be drafted in such a way to seriously undermine the balance struck in § 313.⁷⁹ Clearly, German law is resolute in avoiding the situation in which a hardship clause can become a source of unfairness itself despite the idea of it being the promotion of equity.

2. Conclusion

The legal issues surveyed above remain a point of deep divergence in prominent European legal systems. This divergence is the combined result of differences in legal philosophy and historical circumstances which influenced each of the systems, but the question remains for how long it will be possible for them to remain diverse. Most prominently, the needs of commerce have shown that regulating hardship is a necessity, and this does not differ in any of the systems analyzed. However, French and English legislators for now remain content to leave this area of law in the hands of parties themselves and their contractual clauses. German law, on the other

⁷⁸ For case law see H.Beale, 1155-1156.

⁷⁹ *Ibid.*, 1166.

hand, saw the need not only to rely on jurisprudence but to codify adaptation due to hardship.

If one takes a look at the current offering of harmonizing instruments in Europe (PECL, DCFR, CESL) and the world (UNIDROIT PICC) there is no doubt that the German approach, further enriched by the demand to renegotiate the contract before applying for court adaptation, is the preferred one. French reform proposals, despite illustrating on their own the controversies which still exist in France on this issue, also generally point in the same direction. Accompanied by the number of national laws influenced by German law and those instruments, it can be said that the general European trend is towards flexible regulation of hardship.

As a side note, it can be said that Serbian law is squarely within that trend. The rules of Serbian Law on Obligations,⁸⁰ despite some peculiarities, allow for adaptation of contracts in cases of hardship or for termination in cases where that is not possible. It can be expected that same general attitude, with possible refinements, will remain when and if a new Civil code was promulgated.⁸¹

It remains to be seen how soon the convergence, which in author's opinion is inevitable, comes to French and English law in the form of accepting the possibility of court adaptation and termination of contracts in cases of hardship. French law seems to be on the brink of such development, and could to it perhaps without large disturbances. The transposition of *imprévision* to private law is certainly much less troublesome than creating a new rule from scratch or transplanting one from foreign law or a European harmonizing instrument. Such inclusion would at least vindicate the long-lasting proposals made in French doctrine.

This implies that English law might have a much longer way to go. It is thus interesting to see how the English courts might handle the inclusion of hardship provisions via Common European Sales Law (which will, if accepted as it stands, be 'the second contractual regime' in England) and whether or not they would be as flexible as when the principle of good faith was similarly introduced by European legislation. Be that as it may, it can be concluded that hardship as a legal phenomenon is definitely here to stay in Europe and is making inroads into the global scene. It remains for the comparative lawyers to track its progress.

⁸⁰ Arts. 133-136.

⁸¹ J.Perovic, 'Promenjene okolnosti u srpskom ugovornom pravu i izvorima uniformnog ugovornog prava', *Anali Pravnog fakulteta u Beogradu* 1/2012, 192.

Velimir Živković,
diplomirani pravnik-master, Magister Juris (Oxford),
doktorant Pravnog fakulteta Univerziteta u Beogradu
Institut za uporedno pravo

PROMENJENE OKOLNOSTI (HARDSHIP) U FRANCUSKOM, ENGLISKOM I NEMAČKOM PRAVU

Ugovori se sklapaju da bi se poštovali – pacta sunt servanda. Ovo načelo je zasigurno temelj svakog delotvornog sistema ugovornog prava, ali ne može biti, niti je ikada bilo, apsolutno superiorno u bilo kom pravnom sistemu. Neočekivani događaji koji dramatično promene ugovorne okolnosti se zaista i dogode, rezultirajući nekad nemogućnošću a još češće otežanim ispunjenjem ugovora za jednu stranu. Tema ovog članka je ta druga situacija. Cilj je analizirati poziciju tri velika evropska pravna sistema – francuskog, engleskog i nemačkog – po pitanjima šta se (ako išta) dešava sa ugovorom i pravima stana u situacijama kada ispunjenje ugovora postane značajno teže nego što je prvobitno dogovoreno. Ova oblast predstavlja plodno polje za uporednu analizu usled toga što ova tri sistema usvajaju suštinski drugačija rešenja. Ova rešenja mogu biti predstavljena u vidu skale, gde francusko pravo u najmanjoj meri pruža mogućnost reagovanja u ovakvim situacijama dok na drugoj strani nemačko pravo sadrži kodifikovane odredbe koje se ovim pitanjima bave na fleksibilan način.

Ključne reči: *promenjene okolnosti, hardship, francusko pravo, nemačko pravo, englesko pravo*