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The Application of the Hardship Theory

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Abstract: This paper presents an analytical view of the concept of hardship as described in Art.79 CISG, Art.8:108 PECL and Art. 7.1.7 UNIDROIT Principles, in contrast with certain legal systems. The purpose of the article is to analyze the possibility of applying the provisions on hardship from the UNIDROIT Principles in order to release a party from its contractual obligations although the CISG is the governing law of the contract. The paper begins with the demarcation of the principle of pacta sunt servanda, or sanctity of the contract, in connection with the concept of hardship, thus being avoided the burden bearing of such a change of circumstances only by the party on which it falls. The paper goes on to describe the requirements and the consequences of the application of hardship according to the above mentioned international instruments, pointing out certain differences between four important legal systems.

Keywords: changed circumstances; rebus sic stantibus; frustration; impracticability

1. Introduction

In the Roman Law, if contractual performance became impossible for both parties, the principle pacta sunt servanda could be eluded. In the same manner, if performance became impossible only for one party, he was no longer bound to fulfill his obligations as long as he proved the lack of negligence or fault in performing the contract.[1]

Despite these exemptions, the founding principles of Roman law, the sanctity of the contract and the formalism, converge towards the rejection of the hardship theory. Nevertheless, if the burdensome obligation could be fulfilled, thus not being impossible, one could invoke the clausula rebus sic stantibus. It was considered that the contract contained an implicit provision according to which the main elements of the contract had to remain unchanged. The Canonic Law was actually the one that accomplished the transition towards the modern perspective of contractual dynamics. The starting point in founding the paradigm of the hardship theory was the dichotomy just-legal. The just concept represented the application of the equity principle by the Church and the legal concept corresponded to the governmental power. Between these two concepts a concrete-abstract correspondence or individual-general one was established. The constant inconsistency of these legal concepts generated a paradox that could be solved only through a juridical artifice: a contractual mechanism that would

[1] Cicero: "si glaudium apud te sana mente deposuerit, repetat insamens, reddere peccatum sit, officium non reddere".

guarantee the application of the law both just and legal.[1] This mechanism was widely spread as rebus sic stantibus, linked to the principle of sanctity of the contract.

After the 19th century, having as background the Liberal doctrine, the principle of the parties autonomy of will is propelled as a main contract interpreting rule. That was a consequence of the influence of the political, economical and social area. Thus, the literal content of the contract regains the value held before the instill of the just or fair concept in interpreting the contractual provisions. The tendency was either to abandon the concept of rebus sic stantibus, or to severely narrow its application. The sanctity of the contract theory tale quale comes forth due to the decay of the just principle, owed to the constant intemperances in interpreting the contracts. Therefore, on the background of this general will of protecting the security of the economic circuit, the principle rebus sic stantibus was outlasted only in International Public Law.[2] The purpose of the hardship theory consists in reinstating the interest of performing the contract affected by a severe unbalance through its adaptation. In modern law the hardship theory is important especially in the financial and economic areas.

2. The Hardship Theory

The Hardship situation is generally defined as the situation in which, during the performance of a long term contract, certain events occur without the parties' fault and these events lead to the fundamental change of the contractual elements taken into consideration at the conclusion of the contract. The hardship situation generally occurs either due to an increase in the performance costs of one of the parties or due to a minimization of the value of the counter-performance. Hardship situations can be defined in three manners: from a synthetic point of view, an analytic one and a hybrid one: a mixture of the above. From the synthetic point of view, the hardship situation lato sensu can be any event that would jeopardize the performance of the contract in the initial terms. The analytic point of view takes into consideration, in an exhaustive manner, all the situations that may lead towards a contractual imbalance. But because both of these definitions lack either thoroughness or generality, a third one is therefore preferred: a combination of the general guidelines in defining hardship and of non-exhaustive, indicative examples. First of all, the hardship situation may be an application, a specific modality of clausula rebus sic stantibus from the theory of international contracts, according to which the substantial changes of the circumstances which lead towards the conclusion of the contract may generate the contracts‘ revision or suspension. Nonetheless, the hardship may be considered as being a custom or a usage of the international commerce. According to art. 9 CISG and art.1.8 Unidroit Principles, the usages are trade practices widely spread and known, which are respected in a certain branch of activity. We have to point out the fact that the general principles and the usages in international trade are actually the rules that define the lex mercatoria. An important development of the hardship notion determined by the dynamics of the international contractual practice and of lex mercatoria has been established. Also, the existence of a gap between the non-national solutions and the national ones has been admitted. The hardship notion expresses in fact the modernized concept of the omnis intellegitur rebus sic stantibus.

[1] St Augustin: "semper subintellegitur haec conditio, si res in eodem statu manserit"(...)"quod propter novum casum novum datur auxilium"; St Thomas d'Aquino"si sint mutatae conditiones personarum et negotiarum" Summa Theologica. 2.2, q110,a,3, a, d, 5.

[2] In art. 62 of the Viena Convention, 1968/69.

Nevertheless, the revision of the contract will not necessarily reflect the loss suffered by the aggrieved party. During the process of contract revision, every single provision will be considered, including those regarding the value or to the amount to which the party is held to sustain the contractual risks of different nature or derived from different causes. Therefore, not the gravity of the occurred changes is the most important, but their impact on the contractual elements, this leading towards the substantial alteration of the contractual provisions. The hardship case is therefore described not in an absolute manner but in a relative one, by applying in concreto the hardship situation to the contract's provisions

3. Conditions for the Hardship Application

Before fulfilling the necessary conditions, certain pre-conditions or premises must be met: the lack of fault of the debtor, the absence of a contract adaptation clause and the licit character of the contract's non-performance. The debtor's lack of fault must be evaluated in an objective manner, corroborated with the absence of bad faith in the debtor's conduct. In the case of concurrent fault, in other words in the hypothesis in which, in addition to the debtor's fault in producing the contractual changed circumstances, an external act occurs, the situation will be solved by ascerting the causality link according to civil law rules or through partial indemnity, according to the criteria invoked for force majeure.

The absence of an adaptation clause or its inefficiency derived from the different nature of the covered risks or from the disproportionate effect of the occurred risks makes the hardship theory applicable. But the presence of such a clause leads towards the application of the principle of the parties' autonomy of will, thus excluding the hardship theory application similarly with a positive competence conflict. The rules of contractual hardship state that the aggrieved party will be held liable both for minor risks, which do not severely imbalance the contractual economy, but also for the major risks that lead towards the breach of the contract taken into account by the parties at the moment of the conclusion of the contract or for those that depend on the contract's nature.

More conditions must be fulfilled to apply the hardship theory. In this perspective, the disrupting event must either occur or become known to the aggrieved party only after the conclusion of the contract. Also, the aggrieved party must have been in an objective impossibility of acknowledging the possibility of the event's occurrence at the moment of the contract's conclusion and the event must have been beyond the aggrieved party's control. From this standpoint, the party must have not made any admission of liability in case of the event's occurrence, neither explicit nor implicit; moreover, it must not be incident neither an error nor a lesion. But if the aggrieved party knew about the event's possibility of occurrence when the contract was concluded and took no protection measures, it is considered that the party made an implied commitment of the risk generated by the occurrence of contractual imbalance. The unforeseeable character of the event is not actually a feature of the event itself, but it's referring to its result upon the contractual economy. It must be analyzed at the moment of the event's occurrence as it expresses a relative, stricto sensu unforeseeable event. The hardship situation may consist in the occurrence of an unforeseeable situation or unforeseeable effects having a particular feature: neither insurmountability nor irresistibility are sufficient conditions for the revision of the contract. The nature of the event leading towards contractual disproportion it is rather irrelevant at a first view. But the stricto sensu analysis of the hardship generating situations points out that these events have a financial or economical origin, thus being the case of the pecuniary obligations and not the case of every patrimonial obligation.

However, in the juridical literature the opinions are highly divided. It is therefore discussed whether the nature of the event must characterize the constitutive situations or the effect produced over the contractual economy. On one hand, the previous and independent existence of such situations constitutive or exclusive of hardship has been denied, grounding this point of view on the assertion that such a situation actually consists of an event derived from the addition of more hypostases. On the other hand, the conclusion was reached that some situations could be found, regardless of their nature, which could constitute the premises for hardship application.

Despite these discussions, it is considered that the nature of the unbalancing event is not as important compared to the economical or financial direct effect on the breach of the contractual equilibrium. (Zamsa, 2006, p. 98) However, the nature of the event can have a general character represented by different political, economical or technical circumstances, unforeseeable for the parties at the conclusion of contract. The event must be external to the parties' will. Therefore, the occurrence of the event must be beyond the control of the aggrieved party, which must not be in the situation of non performance at the moment of applying the hardship theory. Moreover, the breach of the contractual equilibrium must have certain intensity in comparison to the contractual economy, this being also relative criteria. Nevertheless, the bearing of the effects only by one contractual party is a subsidiary, subjective criteria, and the condition of contractual equity being interpretable. (Sitaru, 2008, p. 652) In order to enable us to discuss about the effects of the application of hardship theory we must begin from the doctrinal classification of the notion of "obligatory contractual content" and "obligational, compulsory or bonding content". (Zamsa, 2006, p. 33) The contract's effects consist in the creation, the modification or the annihilation of rights. From this point of view, we must restate that the contract may not generate only obligations, aspect which is exemplified through the translative or extinctive contracts that do not generate obligations stricto sensu.

However, through the "obligational or bonding content", one can designate the total amount of obligations derived from jurisprudence even though they are legally consecrated. As an example we indicate the application of the principle of good faith corroborated with the principle of negotiation, of parties' cooperation and security of the civil circuit. The contract revision during its implementation is the main effect of the application of hardship theory. Its amendment may be done in a contractual, legal or juridical manner, thus avoiding the contract's binding character. Nevertheless, it is stated that this amendment refers to the quantitative alteration of performance and not to the qualitative one. Firstly, the aggrieved party may ask for negotiations; the request must be immediately issued and must contain all the reasons on which it is grounded. The introduction of this request does not entitle the party to ask for the suspension of the performance of the contract. Nonetheless, the parties may insert different clauses that define a maximum term for negotiations. If an agreement is not reached after such an unequivocal term, the contract can be suspended. However, in case of delay or insufficient communication from the aggrieved party, even though this conduct is not sanctioned, it will be taken into account during the phase of checking the conditions for the application of the hardship theory, being capable of altering its retroactive effect. The notification must contain the description of the altering effect of the event and of the consequences over performance. By notification, the party expresses its intention towards the application of hardship in order to obtain the revision of the contract. Nonetheless, if the contract contains any clause regarding the suspension of the contract during negotiations, this will be applicable. The obligation for negotiations (Cedras, 1985, p. 265) is an obligation of diligence and its failure does not disregard the contractual provisions; even though it is strongly recommended the good faith negotiation in order to obtain the adaptation of the contract, the parties cannot be forced into reaching an agreement as a result of the negotiations.

The non performance of the obligation of negotiation may consist in an unjustified refusal of taking part in the negotiations or by attending them while displaying an attitude of bad faith. The party distressed by the nonperformance of the negotiating obligation could demand the temporary suspension of the contract on the grounds of exceptio non adimpleti contractus, or request the termination of the contract and the indemnity and interest payment by the liable party.[1]

Nevertheless, if the negotiating refusal is due to the fact that is a serious doubt regarding the application of hardship according to the case's circumstances, the judge or the arbitrator will establish if the conditions for the hardship application are fulfilled. The contract adaptation may be realized in different ways: by the modification of the main obligation's object, by the changing of the performance or of the performance term, by creating new obligations or by suppressing certain obligations and in the meantime by creating different ones. In this last case, if by interpreting the parties' intention the will of substitution by object changing does not result, the initial contract holds good, altered after the occurrence of the hardship situation. Still, the parties can insert in the contract some provisions regarding the necessity of reentering into force of the previous contractual provision in case the hardship situation ends. (Florescu & Parvu, 2009) Nevertheless, if the negotiations fail, despite the fact they were conducted in good faith, the performance of the contract either continues in view of the initial established terms or the contract is terminated. However, the parties have recourse to the court.[2] The court may either ascertain the termination of the contract at a specific date or adapt the contract with the purpose of reestablishing the contractual equilibrium. Following the negotiations, an additional act or a new contract can be concluded. According to the parties' attitude, the court has more options at its disposal. It can decide the termination of the contract or its adaptation in the cases establishing the hardship situation if the counter party does not recognize the hardship situation or in the case of unjustified refusal of negotiating, of breaching the cooperation obligation and good faith negotiation or if the parties can not reach an agreement about the established hardship situation. Moreover, the court can impose to the parties to begin and carry on negotiations or it can confirm the contractual terms and reject the request for the revision of the contract. Nevertheless, the parties can appeal to a third party in order to solve the matter. This third party can be an arbitrator, a mediator, an expert or a legal adviser. On one hand, the last three can suggest to the parties a solution for the adaptation of the contract, for its termination or for its maintenance in accordance with the initial contractual terms. It should be noticed that this suggestion is not binding for the parties and it is subsumed to the alternative dispute resolution methods. On the other hand, the arbitrator issues an arbitral award in solving the dispute; this award or decision has a jurisdictional character, binding for the parties. Also, if the parties have inserted in the contract a general arbitration clause, it is extended ex oficii over the hardship clause.

First of all, the arbitrator has to analyze the existence of a hardship situation. If this situation cannot be established, the contract stands. But if the hardship situation is identified, the arbitrator will invite the parties to negotiate in order to adapt the contract. Generally, the arbitrator does not have to give any resolution but he has to decide the applicable law.[3]

4. Different Legal Systems

[1] ICC Hardship Clause 2003.
[2] Deleanu, S, "Hardship clause" RDC, 9/1996, p. 141.
[3] Maskow, Dietrich (1992). Hardship and Force Majeure, 40 Am.J.Comp.L., at 657 et seq.

Because the parties have the possibility choosing as lex contractus a national law, the regulation of hardship or imprevision theory in different national law systems must be taken into consideration. In the German legal system, the hardship theory was regulated in the year 2000 in the German Civil Code, BGB, art.313, having its origins in the '20th monetary crisis.[1] According to the German law, the legal basis for hardship theory is in fact the principle of good faith and the interpretation of the contract in the "fill in the gaps" manner, in contrast with the possibility of invoking the abuse of rights.

Because the contract is the law of the parties, the judge is held with regard to the contract as a premise towards deliberation. Nevertheless, in case of contractual gaps, these must be filled according to the standards utilized by the reputed traders. On the other side, the risk allocation is regulated either by using objective criteria like the dimension or the equivalence of the contractual imbalance, or through an objective interpretation of the contract. Therefore, in case of a hardship situation, the court is entitled either to terminate the contract or to adapt it in order to equitably allocate the unforeseen excessive burden. In the American legal system one can observe the existence of twin theories: first of all, the impracticability of performance theory and the frustration of purpose theory.[2] These two theories have a certain resemblance due to the effects of their application: either the suspension of contractual performance or its termination. There are however differences more important than these similarities. In case of frustration, the events that occur make the counter performance worthless whereas in case of impracticability one may observe either an impossibility of performance or an increasing burden in fulfilling the contract. We outline the fact that in case of frustration one party may avoid the performing of the contract by paying indemnities. (Schwartz, 2010, p. 13) The frustration theory applies only in case of extraordinary and unexpected circumstances, in case of a radical decrease of the counter performance and it operates in the advantage of the parties that must give money in exchange, absolving the party for which the counter performance value became worthless during the performance of the contract, between its conclusion and termination. This theory was founded on the idea of gap filling, thus attempting to supplement on the basis of what is equitable and reasonable what the parties would have inserted in the contract if they would have foreseen the occurrence of the unbalancing event. (Horn, 1985, p. 15 and the next)

The frustration proof is obtained by pointing out the purpose sine qua non for the conclusion of the contract and by certifying its total or main frustration due to the occurrence of an extraordinary, relatively unforeseeable and external event. Nevertheless, the aggrieved party must not have produced the event and must not have been at fault. The impracticability theory applies in case of a radical increase of the performance costs, absolving the party for which the performance became excessively burdensome or impossible to perform unless the contractual provisions prescribe implicitly or explicitly something else. This theory gives odds to the party whose performance consists in delivering goods or services. The frustration clause can be limitedly detailed or exemplified similarly to the force majeure clause, by listing the events that lead towards frustration. The force majeure clause represents the similar standard clause to the impracticability clause because it has the same function and it applies to the same cases. We must underline that in general, both in the American and in English law the principle pacta sunt servanda is closely observed, even though contractual non performance is not a consequence of the culpa in contrahendo. Moreover, for breaching the contract there can be awarded indemnities. In the Italian legal system the hardship theory is expressly regulated in art.1467-1469 Civil Code, dating back to the year 1942. The Italian law presents two applications

[1] Wegfall der Geschaftsgrundlage, literally means the disappearance of the fundament of the contract.
[2] Krell vs. Henry, 1902, regarding the frustration theory and not the impracticability one; likeways, Taylor vs. Caldwell

for this theory: Eccessiva onerosita or sopravenienza, regulated by the Civil Code and presupposizione, having jurisprudential origins.

The first application must meet certain criteria: either the increase of performance costs or the immediate and direct effect on the contractual performance doubled by the fact that the new difficult circumstances would exceed the element of normal alea typical to the contractual risk. The effect of this first application consists in either the adaptation of the contract or its termination. It should be observed that if the court decides the termination of the contract the counterparty could offer an equitable indemnity for maintaining the contract. The second application must meet the following criteria: the circumstances' alteration must lead towards the fulfillment of an assumed situation, considered by the contractual parties as an essential contractual element at the moment of its conclusion, certain to happen. Moreover, the event that leads towards the altering of the contractual circumstances must be objective, beyond the parties'control or will and exterior to any obligations assumed by the parties. The effect of this application consists in the termination of the contract. (Geamănu, 2008, p. 169)

In the French legal system the dichotomy between the civil contracts, of private law and the administrative ones, of public law, is obvious. In general, the contract must be performed as long as the performance is possible, no matter how burdensome it becomes. The hardship theory applies to all the contracts that are confronted with events that generate contractual unbalance as long as they meet the conditions for the theory's applicability.[1] The theory is generally applied for long term contracts has been hastily drawn on the sole ground that they are essentially long term. But the hardship domain is in fact a lot wider. The theory's admissibility is found especially in contracts where the public administration is a contractual party and the contract's object is a lease, public works, trades and delivers, services, transportation, and others, with the purpose of ensuring the public service continuity.[2] Indeed, the vast majority of the resolutions regarding this theory can be found in the administrative law.[3]

Nevertheless, the works contract is a genuine example of the application of the hardship theory. Consequently, even if the law states that the contractual price cannot be changed if it was determined as a flat price[4] in practice three exceptions can be encountered. First of all, the parties have the possibility of inserting certain contractual clauses regarding price indexation. Another apparent exception is the acceptance of the modification of the price by the client. A third one is the applications of the hardship theory according to which the additional works that have generated an imbalance of the contractual economy which may lead towards the changing of the price. [5]

Therefore, the aggrieved party can receive a certain amount of compensation. Moreover, if the economical event leads towards a total misfit with the reality of the contractual clauses, the parties can revise the contract in order to modify the clauses that have become obsolete. Nevertheless, if the parties cannot reach an agreement the court can decide to terminate the contract.

[1] Therefore, the events must be unpredictable, exterior to the parties (if the event is irresistible for the parties the force majeure theory could be applied); the contractual economy must be radically unbalanced (resembling with the lesion) and it must be temporary ;

[2] The hardship theory originates in a decision called "Compagnie générale d'éclairage de Bordeaux" from 1916 Conseil d'Etat, n° 59928.

[3] Conseil d'Etat, 9 décembre 1932, n° 89655, Compagnie de tramways de Cherbourg.

[4] According to art. 1793 from the French Civil code, the flat price is subject to no alteration even though some additional works may be indispensable.

[5] Cass. 3ème civ. 20 janv. 1999.

5. Conclusion

The international dynamics exceed the control field of the contracting parties. In this horizon perpetuum mobile the institution of a fixed, stable contract, opaque towards the external influences became outdated. In the foreground the concept of adaptability, flexibility, suppleness appears. This consists in fact in the transposition into practice of the theory of double perspective upon the binding force of contracts. Thus, for a better understanding of the principle pacta sunt servanda one can imagine two visions: the first one is static, fixed and immovable. This is the traditional vision, the safe way towards ensuring the performance of the contract as it was concluded. This perspective is protected against the occurrence of different events that could alter the contractual equilibrum after the conclusion of the contract. It was stated that the static vision is the only one that makes a certitude out of the principle of the parties' autonomy of will. The second vision puts forward an innuendo: the pacta sunt servanda principle should have a flexible, dynamic, open character, able to reevaluate the idea of just, fair, righteous and equity indicated by the Canonic law, founded on the principle of good faith. According to this formula, one must not establish a causality link between the agreement of the contractual parties and the contract's binding force. Even though such an agreement represents an essential contractual element, the binding force has its causa princeps in the idea of equity, morality or utility. Therefore a certain transition from the individualistic vision imposed by the liberal doctrine of the 19th century, towards a general, wider perspective is observed. One may notice the cyclic character of any idea: what is confirmed by a century is refuted by another in a dialectics of history. The novelty of hardship regulation is therefore obsolete: the Roman law regulated this theory and the Canonic law did this as well. It is very likely that in the near future the theory will be regulated at a higher, supranational level in order to harmonize the national legal systems.

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