

FACULTY OF LAW OF THE UNIVERSITY OF MACAU

A STUDY ON ECONOMIC HARDSHIP



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This work has not been submitted anywhere else, either in part or whole, for a degree or other academic credits.

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1 INTRODUCTION

Since its establishment, the principle of *pacta sunt servanda* has evolved over thousands of years. This principle, which means that contracts and clauses are laws with binding force between parties, requires that every contracting party must keep his promise and fulfill his obligation. It is well accepted by people all over the world and can be widely found in contract laws in different jurisdictions since it is recognized as the reflection of the natural justice and that any effective activity without reliable promise is not possible. As it is expressed that "It is a fundamental principle of law, which is constantly being proclaimed by international courts, that contractual undertakings must be respected. The rule *pacta sunt servanda* is the basis of every contractual relationship."¹

However, commercial practice demonstrates that there positively exist events or changes, which may result in relevant performance being impossible or pointless or substantial breach of the economic equilibrium between contracting parties of a contract, none of whom could foresee it so as to take any effective measure to avoid or control such events or offset the adverse outcome resulted from the events at the time and under the circumstances of the conclusion of the contract. In such situations, the rigid application of the principle of *pacta sunt servanda* will no doubt lead to the opposite of justice and generate unfairness. The question about whether a person may be discharged from his contractual obligations by supervening events and the question about whether the contract should be modified in changed circumstances have been envisaged for centuries. To deal with these problems, legislators, judges and legal scholars from different countries establish various rules and theories.

¹ *Sapphire v. National Iranian Oil Company award*, March 15, 1963, *I.L.R.* (1967); 136 at 181.

It could be found the contradiction between two principles in contract law, namely the principle of sanctity of contract or *pacta sunt servanda* on the one hand and the principle of *clausula rebus sic stantibus* on the other hand.

The principle of *clausula rebus sic stantibus* is generally accepted and applied in the field of international public laws. It is an implied provision in a lot of treaties that if the conditions which the treaty is concluded under and the circumstances which a treaty is concluded in have dramatically changed, the treaty at issue will lose its binding force. This principle of *clausula rebus sic stantibus* is developed from the Roman law of contract. It means that “the contract contained an implied term (*clausula*) that certain important circumstances must remain unchanged (*sic stantes*).”²

Contract laws in every legal system have been adjusting the balance between these two principles in order to get the best balance, which is conformable to its economic and social circumstance. The balance alters owing to any possible change in law. It is not exaggerating to say that the balance differs from system to system, from subject to subject, even from time to time.

In the UK, the rule of “absolute contract”³ was dominant until in 1863. In *Taylor v. Caldwell*⁴ case, the doctrine of frustration was introduced. The doctrine of frustration of contract was applied at first only in the situation where the performance was absolutely impossible because physical subject-matter of the contract had perished.

² Frederick R. Fucci, *Hardship and Changed Circumstances as Grounds for Adjustment or Non-Performance of Contracts*. Available online at: <http://www.cisg.law.pace.edu/cisg/biblio/fucci.html>

³ *Paradine v. Jane* (1647) AI 26, 82 ER 897.

⁴ *Taylor v. Caldwell*, 3 B & S 826 (Eng. 1863)

Afterwards, the doctrine was quickly applied to cases where, although the subject-matter of the contract was not destroyed, the commercial purpose contemplated by the contracting parties was frustrated. (*Jackson v. Union Marine Insurance*⁵) In 1902, the doctrine of frustration of purpose was established in the case *Krell v. Henry*⁶. After the First World War, the doctrine of frustration of contract was widely applied in cases of both factual and legal impossibility, in cases of frustration of purpose and extended to cases where the change of circumstances makes the performance drastically dissimilar from what was originally agreed in the contract⁷.

In the US, the term “impracticability” is used in laws instead of the term “impossibility” used in the UK laws. As the Article 2-615 of the Uniform Commercial Code (UCC) stated that: “Except so far as a seller may have assumed a greater obligation...delay in delivery or non-delivery in whole or in part...is not a breach of his duty under a contract for sale if performance as agreed upon has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made.”⁸

In the continental law system, the principle of *clausula rebus sic stantibus* also develops. The situations both in German and France are two important representatives.

In the middle of the nineteenth century, the German scholar Bernhard Windscheid put forward the presupposition theory. Unfortunately, this doctrine was severely criticized and failed to be introduced in the German Civil Code (BGB). Windscheid’s theory

⁵ *Jackson v. Union Marine Insurance*, L.R. 10 C.P. 125. (Eng. 1874)

⁶ *Krell v. Henry*, 2 K.B. 740 (Eng. 1903)

⁷ *Davis Contractors Ltd. v. Fareham U.D.C.* [1956] 696; *F. A. Tamplin Steamship Co. v. Anglo Mexican Petroleum Products Co.*, [1916] 2 AC 397.

⁸ See Article 2-615 of the UCC.

was then revised by Oertmenn, who put forward the doctrine of the basis of the contract, which was accepted by German courts. One of the reasons, I think, is the dramatic changes in economics during and after the two World Wars. The German Civil Code (BGB) eventually introduced the doctrine of the basis of the contract in § 313 with the title “Interference with the basis of the contract”⁹.

Generally speaking, the French courts still keep rigid view to the cases in regard to change of circumstance. They hardly decided to release the obligator unless the unforeseeable events constitute *force majeure* which made the agreed performance impossible, not only more onerous. French scholars tried to introduce the doctrine of *imprévision*, or to expand the concept of *force majeure* or other articles in the Civil Code in order to handle hardship, supervening events less severe than *force majeure*, but nearly none of the efforts was accepted by the courts. The only notable exception is given by the *Conseil d'etat* in the case about contracts related to the provision of public utilities. In that case, the court decided to adapt the contracts based on the argument that it is important for the public interest to continue with contracts which are essential to the regular supplying of fundamental public services and production.

In the modern times, international treaties and legal practices have made great effort in establishing rules on contract in order to facilitate international commercial trade. Some of them lay down rules on the issue of change of circumstance. Two notable instruments are United Nations Convention on Contracts for the International Sale of Goods (the CISG) and the UNIDROIT Principles of International Commercial Contracts (the PICC).

The Article 79 of the CISG rules the cases of non-performance of a party which due to

⁹ The articles of BGB are available online at : <http://www.iuscomp.org/gla/statutes/BGB.htm#b2s3t5>

“an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences”¹⁰. According to the legislative history of the CISG and the study of the wording, this article is concerned with impediment close to *force majeure*. The situation where the required performance becomes much more onerous but not impossible is not covered by the CISG. Gaps left by the CISG were then handled by the PICC. The PICC distinguished supervening events which make a contractual performance impossible and which severely wreck the equilibrium during the contracting parties. The supervening events that resulting in impossibility were categorized as *force majeure* and which ruined the equilibrium between contracting parties as hardship, a new concept that did not belong to any existing jurisdiction. The legal effect of *force majeure* is to excuse the non-performing party. In case of hardship the contracting party who invokes hardship is entitled to request renegotiations, and the courts can adapt the contract if either party requests so. The fairly comprehensive provisions and the flexible attitude of the PICC accord more autonomy to contracting party and render the court a choice to keep the contract in effect to facilitate international commerce, which deserve high praise.

The legislation history in Chinese mainland expresses a wavering attitude of the legislators towards the doctrine of *clausula rebus sic stantibus*. The rule about the change of circumstances once was provided in the Economic Contract Law. But the Contract Law which replaced the Economic Contract Law in 1999 only had provisions on *force majeure* and kept silence for a decade on hardship which is less severe than *force majeure*. Until 2009, two new promulgated judicial interpretations filled the gap in the Contract Law. These two interpretations lay down substantial and procedural rules on hardship.

¹⁰ See Article 79 of the CISG

Nowadays, the financial crisis which is derived from the US and then spreads all over the world has generated huge market disturbance. The dramatic change of the price, the devaluation of currency, the bankruptcy of corporations and other matters may result in economic hardship. Meanwhile, Chinese real estate market also experiences server change after the authorities enact new policy. It is necessary to make a simple analysis about the rules on the economic hardship in different jurisdictions and international instruments in order to give some ideas to deal with the problems arising from current economic situation.

This thesis is aimed to make a general introduction to the rules on economic hardship in different legal jurisdictions, including the doctrine of frustration, the rules on *force majeure* and the rules on hardship. Then following the comparison, the trend of evolution of such rules is summarized.

After the introduction in the first part, the second part of the thesis is concerning both the legal theories and judicial practices in different legal jurisdictions. A brief introduction is made on the legal theories in UK, US, France, Germany. Moreover, the rules and legal practices in UK, US, France Germany and Macau will be analyzed. The study also refers to two significant international contract laws: United Nations Convention on Contracts for the International Sale of Goods (the CISG) and the Unidroit Principles of International Commercial Contracts (the PICC). In the third part, a brief analysis is made on the new published judicial interpretations in the Contract Law in Chinese mainland. Following the comparisons on the wording of related provisions and legal practices regarding these rules, some suggestions about the Chinese law are given in the forth part. The conclusion of this thesis is stated in

the last part.

