PART I

Introduction and context

1 Introduction: An approach to the issues and doctrines relating to unexpected circumstances

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1. Setting the scene

A contract, once concluded, binds the parties and is intended to remain binding even if the circumstances change. For instance, if the financial position of one of the parties changes, his or her need for the object of the contract alters or the value of the object goes up or down, the validity of the contract itself will not be affected. However, some occurrences that go beyond the reasonable expectations of the parties may raise serious doubts as to the binding nature of contracts. For instance, what about the effect of events such as natural disasters, an oil crisis, an armed conflict or – to mention a quite recent significant event – a fundamental financial crisis? These or similar issues have been dealt with by courts in all European legal systems at some point and the historical perspective (cf. Chapter 2) reminds us that the issue of how to deal with unexpected circumstances has a long tradition in jurisprudence. In this Introduction we shall begin our comparative analysis with a survey of the central questions that dominate the issue of unexpected circumstances and prepare the ground for the more detailed analysis in the overview and case studies.

The eventualities of life are infinite and, therefore, the legal issues referring to unexpected circumstances present a kaleidoscopic picture. Still, it is possible to identify some categories of fact patterns that occur regularly and involve specific issues. Accordingly, in the questionnaire that was drafted as a starting point and that forms the backbone of our comparative analysis we have distinguished between four groups of unexpected circumstances that have proven to be of particular relevance in the context of private law:

- Group A: the equivalence of exchange is substantially affected;
- Group B: one party's use of contractual goods or services is substantially affected;

- Group C: failure of specific purposes (other than A and B);
- Group D: mutual mistake concerning the calculation underlying the contract.

In Group E some miscellaneous issues will be discussed.

2. *Pacta sunt servanda*

All jurisdictions dealt with in this volume – and most, if not all, other legal systems respecting individual liberties and the freedom of contract – are based on the principle that contractual obligations should be observed as the basis of contract law. In some jurisdictions with a statutory regime this principle has been codified, in others, like in common law jurisdictions, it is recognised on the basis of judicial tradition. The binding nature of contracts is traditionally referred to by the notion of *pacta sunt servanda* – the Latin of which perhaps misleadingly suggests that this was already a principle of Roman law, as we shall see in Chapter 2.

From a more general point of view, *pacta sunt servanda* is one aspect of the notion of individual autonomy. Under this idea individuals determine the rules governing their transactions by consent. It is a prerequisite of the freedom of contract that the rules that are consented to are binding on the relevant party as otherwise the agreement would be of little more than moral value and the functioning of contractual exchange would be endangered. Thus, freedom of contract corresponds with responsibility.

It would, of course, be irreconcilable with the principle of *pacta sunt servanda* if the validity of the contract was generally conditioned upon all the expectations of the parties and their realisation. This is particularly evident in light of the fact that the parties can generally examine the relevant information, assess the probability of uncertain events and specify the content of the contract according to their expectations and their willingness to take risks. On the other hand, in some cases the assessment of future developments and their comprehensive coverage by stipulations may be impossible or go beyond reasonable efforts.

Therefore, the issue of unexpected circumstances as it shall be explored in this volume refers to the limitations that are inherent in the contractual allocation of risks: it is not convincing to attribute the responsibility for the consequences of unexpected circumstances unilaterally to the burdened party based on the concept of *pacta sunt servanda* because a strict allocation of all exceptional events cannot be based on an autonomous act of contractual risk allocation. The limitations to

contractual risk allocation are the reason why it is recognised in all European jurisdictions that the occurrence of unexpected circumstances may, under certain conditions, influence the validity of the rights and duties resulting from the contract. On the other hand, the principle of *pacta sunt servanda* and its fundamental function in a free society demand that the standard applied to loosening the binding terms of the contract must be restrictive.

3. General approach

In the different European jurisdictions, there are various legal concepts directed at achieving an equitable outcome where, due to unexpected circumstances, the strict stipulations of the contract or rules of law do not provide just results. Even though the objective of this study is to focus on the general phenomenon of unexpected circumstances rather than on specific doctrines, two important aspects will limit the scope of our analysis. First, the doctrines relevant in our context are directed at distributing risks arising from events that are not referred to specifically in the parties' agreement. It is not an issue of unexpected circumstances as defined for the purposes of this book if an eventuality materialises that has been specifically provided for in the contract even if the consequences may be burdensome to one party. Second, the concepts in question refer to events that are typically beyond the specific legal responsibility of either party. Cases of one-sided mistake or ('regular') breach of contract will be disregarded.

As far as the doctrinal solutions are concerned, two approaches that are used in the jurisdictions to deal with unexpected circumstances can be distinguished. On the one hand, cases of unexpected circumstances can be approached using conventional doctrines of contract law such as mistake, constructive interpretation, impossibility of performance and *laesio enormis* (cf. Section 4). On the other hand, in most legal systems there are doctrines that go beyond the conventional doctrines by identifying certain unexpected circumstances as an exception to the binding nature of the contract (cf. Section 5).

The latter doctrines are the most important source for our considerations and will prove to be essential in dealing with unexpected circumstances. Hence, they will play a major role in our comparative analysis. However, there is also a strong tendency to solve cases of unexpected circumstances using conventional contractual doctrines; these doctrines will play a significant role in the individual case reports.

4. 'Conventional' doctrines (relief based on the contract)

The doctrines in the first category refer to the contract itself as the basis for relief and will be referred to as conventional doctrines because they all apply generally and without specific regard to the unexpected and extraordinary nature of the event in question. Examples of such conventional doctrines are concepts such as (constructive) interpretation (especially implied terms), mistake, impossibility of performance and *laesio enormis*. In virtually all national reports, before addressing the unexpected event as such, the outcome of the case is assessed first based on conventional doctrines and many issues of unexpected circumstances are dealt with on the basis of such doctrines. These conventional doctrines do not openly address a conflict between the contractual agreement and the principles of equity but rather try to find a solution based on the (hypothetical) intentions of the parties that are adjusted to the unexpected event or on certain flaws in the mechanism of contracting such as mistake.

5. 'Exceptional' doctrines (relief based on extraordinary effects on the contract resulting from unexpected events)

The doctrines in the second category, on the other hand, provide relief for the burdened party on the basis of the extraordinary effects resulting from the unexpected circumstance in question. These doctrines are applied when relief cannot be derived from the parties' (hypothetical) intentions or from a flaw in the mechanism of contracting. It is the essence of these doctrines that they go beyond the contract itself, addressing the equity conflict between the (flawless but silent) contract and the extrinsic effects. Hence, the principle of equity is the basis of relief.

We call these doctrines exceptional because they openly derive an exception to the binding nature of the contract from the occurrence of an extrinsic effect. They can be put together under the heading *frustration of contract*. Frustration in this very broad sense means that the expectations of one or both parties have altered significantly after the conclusion of the contract and that this problem should be solved by a specific rule of law, separate from the contractual agreement. In a more technical sense, frustration of contract is a common law doctrine. In order to allow a first glance at the conceptual background, we shall outline

this doctrine and some similar notions applied in various jurisdictions to solve problems of unexpected circumstances on a general level.

A. Doctrine of Frustration

The common law doctrine of frustration of contract is well explained in Lord Radcliffe's speech in *Davis Contractors Ltd* v. *Fareham UDC*[1] (see the England and Ireland, and Scotland sections of Chapter 4).

> Frustration occurs whenever the law recognises that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which the performance is called for would render it a thing radically different from that which was undertaken in the contract. *Non haec in foedera veni*. It was not this that I promised to do.

Frustration is applied in cases which can generally be described as cases of impossibility but it is also extended to situations of frustration of purpose and illegality. While its scope potentially covers all unexpected circumstances, the courts are very reluctant to apply this doctrine. Only radical changes to the obligation will be taken into account under this doctrine.

The effect of frustration is to discharge the parties from future performance. In England, however, the effect is modified by the Law Reform (Frustrated Contracts) Act 1943, which allows for equitable compensation after the discharge of the contract.

B. Wegfall der Geschäftsgrundlage

In Germany, 'exceptional' relief is based on the notion of '*Wegfall der Geschäftsgrundlage*' that was introduced in legal literature, then recognised by the courts and finally codified in the German Civil Code with the reform of the German law of obligations (*Schuldrechtsreform*) that entered into force in 2002. In essence, the doctrine of *Wegfall der Geschäftsgrundlage* states that the binding character of the contract is suspended if the fundamental expectations of the parties are not fulfilled. These expectations may relate to matters already present at the time of contracting or to later events. Relief is only granted on the basis of *Wegfall der Geschäftsgrundlage* if the expectations are not accounted for in the contract or in more specific rules of law. If a case of *Wegfall der Geschäftsgrundlage* can be established, the court can either adjust the contractual obligation or allow a party to terminate the contract. The

[1] [1965] AC 696.

doctrine of *Wegfall der Geschäftsgrundlage* has been influential in many other jurisdictions, e.g. in Austria, Greece, Italy and Portugal.

C. Doctrine of assumptions

The doctrine of assumptions is applied in Denmark and Sweden and resembles the concept of *Geschäftsgrundlage*. Under this concept, a party may be relieved from its contractual obligations if the contract has unexpectedly become more burdensome. Similar to the German concept of *Geschäftsgrundlage*, the doctrine of assumptions can include mistakes at the time of conclusion as well as changes in circumstances after the conclusion of the contract. As far as the requirements of the doctrine are concerned, it bears a strong resemblance to the doctrine of *Geschäftsgrundlage*: in order to be operative, an assumption must be material and it must have been visible to the other party. If the doctrine applies, it generally allows a party to terminate the contract but the courts can also use it to adapt the contract. A concept that is very similar to the doctrine of assumptions and *Geschäftsgrundlage* is the doctrine of presupposition (*presupposizione*, *pressuposição*) which can be found in the legal systems of Italy and Portugal.

D. Clausula rebus sic stantibus

The doctrine of *clausula rebus sic stantibus*, as it is applied in Spain and Slovenia, focuses on circumstances that arise after the formation of the contract. It is applied in cases where performance has become extraordinarily burdensome (Spain) or where the balance of contractual obligations is fundamentally altered (Slovenia).

6. Legal consequences

Regardless of the respective doctrine, three different types of remedies can be distinguished in cases of a justified claim based on unexpected circumstances: the contract may be (i) terminated, (ii) adjusted or (iii) renegotiated.

A. Termination of the contract

A termination of the contract[2] provides for legal certainty in determining the consequences of the unexpected event as the rescission of the

[2] For simplification, we use the term 'termination' in the editors' comments to refer to all the different remedies that render the contract ineffective and may thereby lead to some kind of restitution (e.g., avoidance, rescission, cancellation etc.).

contract and the restitution of a (partial) exchange can be defined in an unambiguous way. In consequence, once a relevant claim has been accepted, there is little discretion left for the judge. The problem with termination is, however, that it only provides for an all-or-nothing solution, which might not always be appropriate taking into account the nature of the unexpected event and the resulting burdens. In particular, termination may completely shift the burden of the unexpected event to the party who would have benefited from it under the terms of the contract. Hence, jurisdictions that only offer termination as a remedy are more likely to apply very strict standards with regard to the requirements of entitlement to relief. The example of the doctrine of frustration in England, where the remedy of termination was complemented by compensation under the Law Reform (Frustrated Contracts) Act 1943, shows that such a lop-sided approach to the problem of unexpected circumstances is not very convincing.

B. Adjustment of the contract

The all-or-nothing approach of termination can be avoided if the terms of contracts are adjusted in accordance with the unexpected event and the principle of equity. An adjustment of the contract can be achieved by different methods. It can be qualified as an operation of law which the courts are called upon to carry out (e.g., the Netherlands, Spain, Sweden). An alternative mechanism is to entitle the burdened party to request adjustment which is then enforced by the courts (e.g., Germany, Italy). Another option is to combine termination of the contract with a claim of compensation for the party who would have benefited from the contract (e.g., England under the Law Reform (Frustrated Contracts) Act 1943). All the methods of adjustment have in common that they leave wide discretion to the courts in determining a fair allocation of risks related to the unexpected circumstances in accordance with the principle of equity. Therefore, the price of an equitable allocation of the risks is that courts strongly interfere with the parties' contractual dispositions. Consequently, the parties have little certainty with regard to the outcome of a lawsuit.

C. Renegotiation

The issue of court powers and of legal certainty may be solved if the adjustment of the contract is left to a process of renegotiation between the parties. It goes without saying that, in all jurisdictions, the contract can be saved if both parties decide to renegotiate and adjust their deal to

unexpected circumstances. The problem with this solution is whether and how the law can enforce a duty to renegotiate. While most jurisdictions are reluctant to recognise a duty to renegotiate in good faith, the PECL formulates such a duty (Art. 6:111 (2) PECL). The difficulty of applying a duty to renegotiate in good faith is that there is no exact standard available to define the conduct that is required by the parties. In addition, a duty to renegotiate in good faith can never fully replace rules of law on termination or adjustment as renegotiations may fail even if they are conducted in good faith. Therefore, the duty to renegotiate must be complemented by a fall-back rule that involves the general problems of termination and adjustment, as can be seen in the PECL (Art. 6:111 (3) PECL). This technique was considered undesirably complicated and heavy-handed by the DCFR, which therefore does not impose an obligation to negotiate but makes it a requirement for a remedy under Art. III.-1:110 DCFR that the debtor should have attempted in good faith to achieve a reasonable and equitable adjustment by negotiation.[3]

7. 'Open' versus 'closed' legal systems

Our analysis, which is based on the general introductory sections of the national responses to our questionnaire as well as on general theoretical reflections on the problem of unexpected circumstances, has indicated that two aspects are essential in evaluating the general approach to problems of unexpected circumstances. The first relevant aspect is the question of whether a general exceptional doctrine addressing unexpected circumstances is available. The second relevant aspect is whether a mechanism for adjusting the contract is generally available as a remedy. As the solutions reached in the jurisdictions will vary based on whether a combination of these two conceptual aspects is available or not, we will distinguish between two groups of jurisdictions with regard to these two essential aspects: the 'open' and the 'closed' jurisdictions.

[3] Christian von Bar and Eric Clive (eds.), *Principles, Definitions and Model Rules of European Private Law/Draft Common Frame of Reference* (Munich: Sellier, 2009) vol. I, p. 113. See Gerrit De Geest, 'Specific Performance, Damages and Unforeseen Contingencies in the Draft Common Frame of Reference', in: Pierre Larouche and Filomena Chirico (eds.), *Economic Analysis of the DCFR/The Work of the Economic Impact Group within CoPECL* (Munich: Sellier, 2010) pp. 123–32.

We shall refer to those jurisdictions that have established a general 'exceptional' doctrine specifically addressing the issue of unexpected circumstances that can lead to an adjustment of the contract as 'open' legal systems. 'Closed' legal systems, conversely, are those jurisdictions that do not offer such a doctrine either because they do not have a general 'exceptional' remedy addressing unexpected circumstances or, even if they have such a doctrine (as most legal systems do), this doctrine cannot lead to an adjustment of the contract as a general rule.

This distinction leads to the following groups of jurisdictions:

(i) 'open' legal systems are those of Austria, Germany, Greece, Italy, Lithuania, the Netherlands, Portugal, Spain and Sweden. The DCFR and the other model codes specified below in more detail can also be qualified as an 'open' system.
(ii) 'closed' jurisdictions are those of Belgium, the Czech Republic, Denmark, England, France, Ireland, Scotland and Slovenia.

As the respective national doctrines are not very homogenous, such a distinction is inevitably somewhat rough. On a closer look, with the concept of frustration and the wide judicial discretion with regard to damages under the Law Reform (Frustrated Contracts) Act 1943, England arguably has many characteristics of an 'open' jurisdiction. However, due to the limited scope and the restrictive requirements of the doctrine of frustration, in terms of the doctrinal approach and the results achieved, England is more in line with the group of 'closed' jurisdictions and will therefore be found in this group.

It needs to be stressed that the distinction between 'open' and 'closed' jurisdictions is essentially a doctrinal distinction that is based on the nature of the legal concepts applied rather than on the results that are achieved in the cases in our questionnaire. It depends on the availability of an 'exceptional' concept providing for contractual adjustment as a general form of relief. Even though 'closed' legal systems tend to be more reluctant to grant relief in situations of unexpected circumstances, this is not necessarily always the case. There may be 'exceptional' concepts that allow for termination of the contract and, of course, cases of unexpected circumstances may be solved based on 'conventional' doctrines. In particular, an adjustment of the contract can often be achieved by constructive interpretation and therefore even in a 'closed' legal system the contract can be adapted. Likewise, in the 'open' jurisdictions, relief as such can be subject to strict requirements. Hence, the results reached in an 'open' jurisdiction can be more restrictive than in