# THE DOCTRINE OF CHANGE OF CIRCUMSTANCES: COMPARATIVE STUDY OF US, GERMAN AND KYRGYZ LAW

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## Abstract

The principle of sanctity of contract is the cornerstone under the law of contract. However, in business practice, the performance of the contractual terms for one of the parties may become extremely burdensome or impracticable due to an unexpected turn of events. In such exceptional cases, the disadvantaged party may be excused from the performance. The present work is devoted to the investigation of the controversial issues related to the doctrine of hardship (impracticability, a material change of circumstances). Taking into account approaches of different legal systems to interpretation, application, and consequences, the author analyzes the elements and effects of the invocation of the hardship defense. Specifically, the work contains a comparative analysis of legal regulation of these issues in the United States, Germany and the Kyrgyz Republic.

Chapter I gives an overview of the concept from the perspective of uniform law and different legal systems, specifically introducing a reader to US and German approaches and providing a brief history of the development of the doctrine of changed circumstances in the mentioned jurisdictions. Chapter II analyzes the constituting elements of the doctrine in the US, German, and Kyrgyz law. Finally, Chapter III examines the legal effects of the successful invocation of the doctrine in different jurisdictions. On the basis of the results of the study, the present work concludes with the note on the existing deficiencies of Kyrgyz rules on the doctrine of material change of circumstances to correspond the developments in German law, and recommendations for drafting hardship clauses.

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## Table of Contents

## Introduction

The long-living principle of *pacta sunt servanda* (the literal translation of which is "agreement must be kept") plays the crucial role in the contract law, securing each party entering into a contractual agreement by ensuring the performance of respective obligations of another party and promoting the predictability of contractual relationships. The principle establishes one of the cornerstones of the law of contract by proclaiming the sanctity of contracts, which means that parties that entered into an agreement must respect and fulfill their contractual promises according to the agreed terms.[1] In other words, parties must at any cost fulfill their obligations arising from a contract. *Pacta sunt servanda* provides for the performance of contracts in any circumstances, even if the events occurring after the parties entered into the contract have rendered performance to be much more burdensome that it was expected by the parties.[2] The strict approach of this rule originates from the view that "that once the risks have been allocated by the parties during the conclusion of the contract, they should, as a general rule, not be reallocated in a different manner later".[3]

Nowadays the principle of *pacta sunt servanda* may be found in substantive laws of almost all legal systems. For example, the rule of the sanctity of contracts was codified in many of civil codes,[4] generally having the following meaning: "lawfully formed contracts have the binding force as between the parties."[5] Even the jurisdictions, which do not manifestly provide statements regarding the principle of *pacta sunt servanda,* recognize the rule (usually in the form of judicial tradition).[6] However, sometimes the performance of contractual obligations (especially in long-term or



[1] Christoph Brunner, *Force Majeure and Hardship Under General Contract Principles: Exemption for Non-performance in International Arbitration*, (Kluwer Law International B.V., 2009) 1
[2] Rona Serozan, "General Report on the Effects of Financial Crises on the Binding Force of Contracts: Renegotiation, Rescission or Revision" in Başak Başoğlu. (ed.) *The Effects of Financial Crises on the Binding Force of Contracts - Renegotiation, Rescission or Revision* (Springer, 2016) 6
[3] Ibid
[4] Code Civil, Article 1103; Codice civile, Article 1372; Civil Code of the Russian Federation, Article 309
[5] Serozan, supra **Ошибка! Закладка не определена.**, 6
[6] Ibid

international contracts) becomes objectively impossible or may be exceptionally complicated by an unexpected turn of events. In such cases, parties may find themselves to be bound with a contract, the performance of which has become tremendously burdensome. Therefore, solutions are to be found in the form of exceptions to the principle of the sanctity of contracts. These exceptions are necessary to provide a defaulting party with relief in accordance with the general rule of good faith and fairness.[7] It should be noted, however, that it is a very difficult task to find a balance between the necessity of respecting the rule of the binding force of contract and the necessity of protecting parties with regard to the principles of good faith, fairness, and reasonableness in their performance of contracts.[8]

Various juridical concepts have evolved to allow the party to avoid the liability and terminate or adjust the contract in cases of the unexpected change of circumstances. In that vein, a party to a contract may be exempted from the liability for non-performance by invoking a relevant defense, either on the grounds of force majeure, hardship, frustration or any other excuse, available under the relevant substantive law. One of these exemptions is a so-called doctrine of changed circumstances, the concept of which contemplates a situation, where the agreed performance is still possible but becomes economically detrimental or worthless due to the material change of the underlying circumstances. The legal effects of hardship usually include adjustment (either through renegotiation or judicial interference), and termination of the contract.

It should be noted that the notion of hardship is frequently associated with the concept of impossibility of performance.[9] Indeed, one may easily confuse these two doctrines especially since both of them have almost identical requirements – non-fulfillment of contractual obligations due to a contingency beyond the promisor's control (which may also include situations of excessive onerosity



[7] Ibid
[8] Ibid
[9] Alejandro M. Garro, "Comparison between provisions of the CISG regarding exemption of liability for damages (Art. 79) and the counterpart provisions of the UNIDROIT Principles (Art. 7.1.7)" (2005) <http://cisgw3.law.pace.edu/cisg/principles/uni79.html> accessed 4 February 2019

of the performance). The hardship test does not employ any additional requirements, which are not covered by the force majeure.[10] The difference before these concepts lies in the scope of their application and their legal consequences. Whereas force majeure exempts an obligor from its obligation to perform and liability for non-performance (i.e. from paying damages), the doctrine of hardship allows courts either to terminate the contract or to adjust it so to preserve the initial balance. While some situations of the contractual unbalance fall exclusively under the doctrine of hardship (e.g. decrease of the value of the performance received by a party),[11] in other cases, for instance, in the event of an excessive increase in the cost of the performance, more accurate consideration is required.[12]

The subject matter of the present work, the doctrine of change in circumstances, available in various jurisdictions and legal instruments under different headings such as hardship, *Wegfall der Geschäftsgrundlage*, impracticability, *imprévision*, frustration of purpose, material change of circumstances, fundamental alteration of the equilibrium of the contract etc. (importantly, the doctrine does not necessarily mean the same thing in different legal systems, so some discrepancies need to be carefully examined). Such a variety of approaches has resulted in inconsistencies as to the way these doctrines are treated in different legal systems. Nevertheless, in spite of these differences, the very concept of the doctrine provides that hardship may arise due to an unexpected turn of events which results in disequilibrium of the contractual exchange between the parties. The present work is aimed to compare the rules on the doctrine of change in circumstances available under civil law and common law with the rules developed by Kyrgyz law on contracts. Common law is represented by US law,



[10] Bürgerliches Gesetzbuch ("BGB"), s 275 s313
[11] Brunner, supra note **Ошибка! Закладка не определена.**, p.222
[12] To simplify, the difference between the impossibility and hardship may be epitomized by the "ring in the lake" case, where seller agreed to sell and buyer agreed to buy a ring, which is to be delivered on the boat. During the transportation, the storm sank the boat and, subsequently, the ring. While it is technically possible to salvage the boat, to find and rescue the ring, the enormous costs of these operations would be extremely disproportionate to the price of the ring, i.e. the cost of performance would be totally disproportionate to the value of performance received. Thus, seller may request for discharge of its duty to perform and exemption from liability for non-performance.

which, contrary to English law, has developed the doctrine of impracticability. German law was selected due to the fact that it has developed one of the most comprehensive and flexible approaches towards the doctrine of change of circumstances among other civil law jurisdictions (e.g. it covers cases of objective and subjective impossibility, frustration of purpose, common mistake and hardship).[13] Unfortunately, in Kyrgyzstan, the doctrine on a material change of circumstances did not get the attention it deserves. To date, no publications in the Kyrgyz Republic have specifically dealt with the excuse for non-performance on the ground of material change of circumstances. Thus, the author tries to provide the first analysis of the doctrine under Kyrgyz law and shed some light on the practice of Kyrgyz courts in this respect.

The research will employ the methodology of comparative and critical analysis of relevant legislation, case law, doctrines and principles that are the focus of this study. Accordingly, the present thesis is divided into three chapters. Chapter I is devoted to provide a general overview of the doctrine on changed circumstances and explain the rationale behind the excuse for non-performance, focusing on its historical background in the mentioned jurisdictions and availability under uniform legal instruments. Chapter II is aimed to indicate and analyze the features of the doctrine, i.e. shade some light on the elements necessary to invoke the defense (e.g. material alteration of the contractual equilibrium, assumption of the risk, assumption of non-occurrence of the contingency). Chapter III is aimed to examine and compare the legal consequences of the invocation of the doctrine, i.e. reliefs available for the disadvantaged party as well as the emergence of duty to renegotiate the contract. The result of the research will contribute to knowledge by the virtue of developing recommendations for avoiding or curing deficiencies caused by Kyrgyz law on the doctrine of changed circumstances.



[13] Larry A. DiMatteo, "Contractual Excuse Under the CISG: Impediment, Hardship, and the Excuse Doctrines" (2015) 27 Pace Int'l L Rev 258, 264

## Chapter I. Conceptual Framework of Hardship

Common and civil law differently approach the issue of changed circumstances, particularly with respect to the doctrine of hardship. The subchapters below will provide the brief history of the development of the doctrine of changed circumstances in the context of two different legal systems: common law with the stress on the US approach, and civil law with the example of the German notion of the interference with the basis of the transaction. Additionally, the doctrine of hardship will be analyzed as a general principle of law in the context of uniform legal instruments, particularly the CISG and the UNIDROIT Principles. Being a part of Kyrgyz law on international sale of goods, the CISG represents a controversial issue as to the availability of the hardship defense under the framework of the Convention. Thus, with regard to the CISG, the present research will provide a brief overview of the possibility to invoke hardship excuse under Article 79 of the Convention. Accordingly, being a non-binding legal instrument, the UNIDROIT Principles reflect the general practice most suitable for international transactions and serve as an example of a *lex mercatoria*, which provides comprehensive protective mechanisms to all parties to the contracts.

### Common law approach – US law on the doctrine of impracticability

The modern doctrine of impracticability, which can be found in Section 2-615 of the Uniform Commercial Code, has originated from the doctrine of impossibility of an Anglo-American common law.[14] Initially, English courts denied any defenses for non-performance by relying on the doctrine of absolute liability provided under the mentioned principle of pacta sunt servanda.[15] Their position assumed that performance should be exactly as it was promised by the parties when they entered the contract.[16] If the promisor failed to fulfill his commitments, he would be held liable for the non-



[14] Aaron J. Wright, "Rendered Impracticable: Behavioral Economics and the Impracticability Doctrine" (2005) 26 Cardozo L Rev 2183, 2187; E. Allan Farnsworth, Julia L. Brickell, Stephen P. Chawaga, 'Relief for Mutual Mistake and Impracticability' (1981)1 J L & Com 1, 13

[15] Paula Walter, "Commercial Impracticability in Contracts" (1987) 61 St John's L Rev 225, 230

[16] E. Allan Farnsworth, *Contracts,* (Little, Brown, 1982) § 9.5; ibid 230-231

performance, irrespective of the reason for the non-performance. This principle of absolute liability was perfectly illustrated by the *Paradine v. Jane* case.[17] In this case, the landlord filed a suit against his tenant to recover unpaid rental payments. The tenant argued that he should be exempted from the duty to pay rent due to the fact that he had been unable to use the rented land because it had been occupied by the invading army. However, the court ruled that this defense was insufficient given that "[w]hen the party by his own contract creates a duty or charge upon himself, he is bound to make it good, if he may, notwithstanding any accident by inevitable necessity, because he might have provided against it by his contract".[18] Therefore, under the doctrine of absolute liability, a contract was binding on the parties even when they unexpectedly faced uncontrollable circumstances such as natural disasters, wars, death, etc.

After the strict application of the doctrine of absolute liability was recognized to be impracticable, courts have developed the theory of the implied condition.[19] The theory establishes that where the contract does not expressly provide for any relief from performance, under certain circumstances, an implied condition still may excuse a party.[20] The court in *Taylor v. Caldwell*,[21] a pivotal case in this matter, stated 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," thereby establishing the doctrine of impossibility in common law.[22] In this case, the continued existence of the music hall was an implied condition. Hence, the court excused the lessee from payment and the owner of the hall from paying damages for non-delivery.[23] It should be noted that the court did not entirely deny the



[17] *Paradine v. Jane* [1647] EWHC KB J5
[18] Ibid
[19] Walter, supra note 15 230
[20] Ibid
[21] *Taylor v Caldwell* [1863] EWHC QB J1: the case concerned an unexpected destruction of the music hall, which was rented for a series of scheduled performances
[22] Ibid
[23] Ibid

principle of absolute liability but rather reconfirmed it on its own terms, making it a "subject to compliance with implied terms".[24] The theory of the implied conditions was criticized for the "lack of a logical foundation".[25] Particularly, it was argued that the application of the theory is inevitably accompanied with speculation of the court, which is to determine what the parties would have provided had they foreseen the event.[26]

Nevertheless, the narrow interpretation of the *Taylor* was echoed in the so-called English coronation cases (most notably**,** in *Krell v. Henry*), which introduced the doctrine of frustration of purpose.[27] In *Krell*, the court ruled that the lessee of the rooms with a view of the King Edward VII's coronation procession was excused from the obligation to pay even if the rental of the rooms remained possible.[28] The court held that as the underlying purpose of the lease contract had been destroyed (specifically, the coronation was cancelled due to the King's unexpected illness), the lessee was excused from performance.[29] It should be noted, that despite some similar features, the doctrine of frustration of purpose is conceptually different from the doctrine of impossibility.[30] While the latter excuses parties from the performance which is objectively not possible, the frustration of purpose contemplates a situation where the supervening event alters the original set of circumstances to such an extent that the contract is not "wide enough to apply to the new situation."[31] Therefore, in case of frustration of purpose, the parties are discharged from performance because the whole transaction does not have any value.[32]As evidenced in *Taylor v. Caldwell* and coronation cases, the common law doctrine of impossibility required objective proof to excuse a party from performance of its contractual



[24] Walter, supra note 15, p.230
[25] Ibid
[26] Ibid
[27] Ibid
[28] *Krell v. Henry* [1903] 2 K.B. 740 (C.A.)
[29] Ibid
[30] Walter, supra note 15 231
[31] Ibid 232; see *Davis Contractors v. Fareham Urban Dist. Council* [1956] App. Cas. 696, 721
[32] Walter, supra note 15 232

obligations.[33] Thus, any objective possibility of successful performance would prevent a party from invoking the defense of impossibility. However, with the development of commercial trade in the twentieth century, some courts started interpreting the doctrine in the light of prevailing business practices of the time, particularly diminishing the importance of the requirement of objective proof of impossibility.[34] Therefore, a more relaxed approach gave rise to the doctrine of impracticability, which is also referred as the subjective view on impossibility.[35]

To date, English law rejects any defense based on the change of circumstances other than the invocation of the doctrine of impossibility and frustration of purpose.[36] The doctrine of frustration, which does not in principle cover situations of hardship, cannot effectively fulfill the gap created by the absence of hardship defense in English law. According to Treitel, "no English decision supports a rule of discharge by the virtue of impracticability".[37] Moreover, it appears that a number of decisions stand for the opposite and reject such pro-hardship approach.[38]

The US law while following the English approach, has developed the doctrine of impracticability, which is now embedded in the Uniform Commercial Code and the Restatement (Second) of Contracts. Initially, the concept of impracticability was introduced in the *Mineral Park Land v. Howard*, where the promisor failed to remove all the gravel necessary to fulfill a contract for the construction of a bridge.[39] The promisor claimed that even though there had been sufficient amount of gravel to fulfill the contract, the removal of the gravel remaining underwater would be much more expensive than obtaining the same amount of gravel from another source.[40] The court ruled in favor of the promisor by stretching the doctrine of impossibility to include hardship - "a thing is impossible



[33] Wright, supra note 14 2190
[34] Wright, supra note 14, 2190
[35] Ibid
[36] Brunner, supra note **Ошибка! Закладка не определена.**, p.408
[37] Guenter H Treitel, *Frustration and Force Majeure* (Sweet & Maxwell, 1994) para. 6-028
[38] Ibid, para. 6-028
[39] *Mineral Park Land Co. v. Howard*, 156 P. 458 (Cal. 1916)
[40] Ibid 460.

in legal contemplation when it is not practicable; and a thing is impracticable when it can only be done at an excessive and unreasonable cost".[41] In this case, for the first time, the court recognized exorbitant costs to be an impediment rendering the performance of the contract impossible. Therefore, US courts expanded the grounds on which the non-performing parties could have been excused so to meet the needs of commercial enterprises and provide justice in extreme cases. The urgent need in such an expansion was later confirmed by the drafters of the Uniform Commercial Code, who codified "the ever-shifting line, drawn by courts hopefully responsive to commercial practices and mores, [under] which the community's interest in having contracts enforced according to their terms is outweighed by the commercial senselessness of requiring performance."[42]

Later, the doctrine of impracticability was included to the Restatement (First) of Law on Contracts (notably, under the concept of impossibility) so to apply to other types of contracts. According to the First Restatement, impracticability occurs when an "extreme and unreasonable difficulty, expense, injury or loss involved."[43] The Restatement (Second) of the Law on Contracts also covers situations of impracticability, employing, however, the language of the UCC. The Second Restatement finds impracticability when costs of production increase "well beyond the normal range"[44] and provides for the discharge of the duty to perform.[45] Notably, unlike the UCC, the Second Restatement expressly provides for the discharge of duties under the doctrine of frustration of purpose.[46]



[41] Ibid 460
[42] Farnsworth, supra note 14, p.16
[43] Restatement (First) of Contracts § 454 (1932)
[44] Restatement (Second) of Contracts § 261, comment d (1981)
[45] Ibid
[46] Ibid § 265: "Where, after a contract is made, a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary"

**Civil law approach – German notion of *Wegfall der Geschäftsgrundlage***

Civil law systems have referred to the issue of unexpected change of circumstances under the doctrine of "*clausula rebus sic stantibus".*[47] This doctrine provides that the enforceability of a contract depends on the continued existence of the circumstances, which existed at the time of entering into the agreement.[48] Hence, the vast majority of civil law systems allows the discharge or adaptation of the contract only on the ground of *fundamental* change of circumstances.[49] This means that civil law systems stand for the principle that parties should bear the risk that performance may become more onerous than they expected at the time of the conclusion of the contract.[50]

It should be noted that the mere increase in the difficulty of performance cannot justify the non-performance and result in termination or adaptation of the contract. Civil law follows a stricter approach, imposing a higher threshold for defaulting parties by virtue of the wording of relevant provisions. For instance, the Italian Code requires a contract to become "excessively onerous" in order to allow a party requesting for dissolution of the contract.[51] On the other hand, a defense based on the material change of circumstances is still not provided by the French law of contracts, is available only in administrative law under the doctrine of "*imprevision".*[52] Therefore, French law on contracts exempts a defaulting party from the liability for non-performance only in cases where the excuse of force majeure is available. This means that the contracting parties may be excused only if the circumstances they rely upon satisfying strict requirements of force majeure, i.e. the party in breach



[47] Brunner supra note **Ошибка! Закладка не определена.**, p.401
[48] Ibid
[49] Ibid
[50] Codice civile, Article 1467: "In contracts with continuous or periodical execution or adjourned execution and in case that the obligation of one of the parties has become excessively onerous due to extraordinary and unpredictable events, the party who is obliged to such performance can demand the dissolution of the contract ... The dissolution cannot be demanded if the supervening onerosity is part of the normal risk of the contract…"; the Civil Code of the Russian Federation, article 451: "A material change of the circumstances, from which the parties have proceeded when concluding the contract, shall be the ground for its amendment or cancellation…. The change of the circumstances shall be recognized as material, if they have changed to such an extent that in case the parties could have wisely envisaged it, the contract would not have been concluded by them or would have been concluded on the significantly different terms."
[51] Ibid, Codice civile
[52] Brunner supra note **Ошибка! Закладка не определена.**, p.404

must prove that the performance of its contractual obligation is objectively impossible. However, even this restrictive position is expected to change slowly towards a more flexible approach so to allow parties to rely on the doctrine of hardship.[53]

German law provides one of the most extensive rules of excuse due to changed circumstances as it expressly recognizes and provides reliefs for different types of defenses: impossibility, frustration of purpose, common mistake, and hardship. In the context of the present research, the attention will be focused on the doctrine of hardship available under section 313 of the German Civil Code (*Bilrgerliches Gesetzbuch*, hereinafter "BGB").[54] This article covers the following situations: supervening events prevent the fulfillment of the purpose of the contract; the performance of the contract becomes 'impracticable' or the value of the performance changes materially; and mistake in basic assumptions.[55] Thus, it may be noted that contrary to English approach, German law considers the doctrine of frustration of purpose and shared mistake under the common heading of an "interference with the basis of the transaction." Originally, the German Civil Code had no specific provision to deal with a material change of circumstances (*Wegfall der Geschäftsgrundlage*).[56] At the time BGB was created, two different doctrines were applicable in cases of excessive onerosity of performance: the above-mentioned *clausula rebus sic stantibus* and the rule of *laesio enormis.*[57] According to the former, only a fundamental change of circumstances, which existed at the time of the formation of the contract, may excuse parties from fulfilling their contractual commitments.[58] The rule of *laesio enormis* allows a party to terminate the contract if the performances are initially grossly



[53] Ibid, p.405
[54] See also BGB §314, which puts a stress on the importance of the issue of the change of contractual equilibrium in long-term contracts
[55] BGB §313; Basil S Markesinis, Hannes Unberath, Angus Johnston, *The German Law of Contract: A Comparative Treatise* (2n edn, Hart Publishing 2006) 319
[56] Paul Oertmann, *Die Gescheftsgrundlage: Ein neuer Rechtsbegriff ('The Basis of the Transaction: a New Legal Concept')* (A. Deichert 1921) 37.
[57] Ewoud Hondius, Hans Christoph Grigoleit, *"Unexpected Circumstances in European Contract Law"* (Cambridge Universuty Press 2011) 61
[58] Ibid

disproportionate or become so after the conclusion of the contract.[59] Both doctrines had not been included in BGB as the authors of the Code intended to emphasize the importance of the principle of *pacta sunt servanda.*[60] Therefore, the first version of the BGB did not in any way limit the *pacta sunt servanda* in situations of the unforeseen change of circumstances and, specifically, in cases of hardship.

The wide application of sanctity of contracts turned out to be a big problem after World War I in cases of increased performance costs and monetary devaluations caused by the hyperinflation occurred in 1914-1923 when the value of the Deutsche Mark has dropped enormously, at some point being worth one billionth of its original value.[61] Due to the shortage of goods and extreme levels of inflation, fulfillment of contractual commitments was recognized to become too burdensome. Initially, the German courts tried to apply the doctrine of economic impossibility, according to which the debtor would have been discharged from the contractual obligations in case of radical change of the essence of performance (to the extent of rendering it something different from its original nature).[62] Later, the courts started applying the principle of *pacta sunt servanda* along with the principle of good faith (*Treu und Glauben*) in order to adjust contract to correspond to the real value of the money instead of terminating them.[63]

Section 313 of the BGB "*Störung der Geschäftsgrundlage"* ('interference with the basis of the contract') was inserted only in 2002 in the course of a comprehensive reform of German contract law.[64] The idea of the article was influenced by Paul Oertmann who defined the concept of *Geschäftsgrundlage* as the "underlying circumstances on which the parties' will to form a contract is



[59] Ibid
[60] Ibid
[61] Alexander Schramm, "The English and German Law on Change of Circumstances: An Examination of the English System and Potential Advantages of the German Model" (2018) 4 Anglo-Ger. L.J. 25, 38; Markesinis, supra note 55, 329
[62] Hondius, supra note 57, 62
[63] Ibid
[64] Brunner supra note **Ошибка! Закладка не определена.**, 405

based on".[65] The idea was initially supported by the courts of the German Reich, which based their decisions relying on Oertmann's theory of the basis of the contract.[66] The reform of 2002 finally incorporated the concept into the BGB. Notably, the drafters did not modify the rules developed by the German courts but rather codified the existing case law.

It should be noted that subsection 2 of §275 of the BGB covers a similar concept, under which the creditor is denied of demanding performance where the promisor's effort to perform would be grossly disproportionate to the creditor's interest in the performance.[67] While this provision seems to cover the issue of impracticability, the legislator emphasized that a "pure uneconomic bargain must not suffice".[68] Moreover, the requirement of "gross disproportionality" [69] must have an extraordinary effect so to amount to factual impossibility.[70] It is argued that the practical application of this concept is rather of a very limited nature.[71] A good illustration of such an extraordinary case would be the above-mentioned "ring in the lake" situation, which would be governed by §275(2) BGB).[72] In this scenario, the effort required to perform the contract (draining the lake and using a metal detector to find the ring) has changed to become grossly disproportionate to the value of the ring and, consequently, to the creditor's interest in the performance (which has remained unchanged).

**Uniform legal instruments**

Globalization trend and rapid development of industries in the twentieth century have increased the significance of international trade and, subsequently, created an urgent need in the



[65] Oertmann, supra note 56, 37; Brunner, supra note **Ошибка! Закладка не определена.**, 405
[66] Brunner, supra note **Ошибка! Закладка не определена.**, 405
[67] BGB §275(2)
[68] Schramm, supra note 61, 42
[69] Hondius, supra note 57, 62
[70] Schramm, supra note 61, 42
[71] Hannes Rosler, "Changed and Unforeseen Circumstances in German and International Contract Law" (2008) 5 Slovenian L Rev 47, 52
[72] BGB §275(2): "The debtor may refuse performance to the extent that performance requires expense and effort which, taking into account the subject matter of the obligation and the requirements of good faith, is grossly disproportionate to the interest in performance of the creditor"

unification of law, specifically of the law of contracts.[73] Since almost every international transaction needs to be expressed through a contract, the selection of the applicable law became one of the most important questions to be decided by parties when drafting the contract. While this issue can be resolved during the pre-contractual negotiations, in practice, there is always a risk that the party with strong leverage may impose its national law (which is preferred due to its more favorable conditions) to the other party.[74] Moreover, parties may fail to find an agreement on the choice of law. Even though the conflict of law rules may be applied to determine the law applicable, this may still result in a negative outcome at least for one of the parties, the one which will be dealing with an unfamiliar law of the other state. Such a party will be unable to properly calculate its risks and, therefore, properly make decisions. The international community found a solution to this problem in the form of harmonization and unification of private law by creating legal instruments of uniform applications. The most famous and widely used of these instruments are the United Nations Convention on Contracts for the International Sale of Goods ("CISG") and the UNIDROIT Principles of International Commercial Contracts ("UNIDROIT Principles" or "UPICC"). The UPICC is an example of a significant "soft law" instrument, representing the codified "set of model rules on the law of contract". The issue of the relations between the principle of *pacta sunt servanda* and excuses for non-performance of contractual obligations has been differently addressed in the mentioned legal instruments. Notably, the doctrine of changed circumstances experienced the most significant changes in these two instruments.



[73] Hüseyin Can Aksoy, *Impossibility in Modern Private Law* (Springer, Cham, 2014) 93
[74] Ibid

**CISG**

The CISG governs contracts for the international sales of goods between private businesses. Article 79 of the CISG, covering exemptions for non-performance, is often criticized for being one of the most controversial provisions of the Convention – "the Convention's least successful part of the half century of work".[75] While the article avoids terms, the understanding of which varies in different legal systems, the existing wording results in disputes among legal practitioners. One of the most challenging issues is the availability of hardship defense under the CISG. Article 79 provides for the exemption from the liability for non-performance if a party to a contract proves that such non-performance was caused by "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".[76]

The text of article 79, as well as all other provisions of the CISG, does not explicitly provide for the effects of hardship. Neither it expressly or impliedly excludes hardship defense from the scope of the CISG. Specifically, the main controversy arises around the interpretation of the term "impediment". An "impediment" represents an "external force that objectively interferes with the performance of the contract and renders performance impossible".[77] Arguably, a material change of circumstances, which makes the performance to be extremely difficult or impracticable, may qualify as an "impediment", especially as the wording of the provision does not expressly equate the term with an event which results in *absolute* impossibility of performance. Therefore, one may follow the approach of application of a so-called "limit of sacrifice" beyond which a defaulting party may not be expected to perform its contractual obligations.[78] In this case, the non-performing party must satisfy



[75] Yasutoshi Ishida, "CISG Article 79: Exemption of Performance, and Adaptation of Contract Through Interpretation of Reasonableness − Full of Sound and Fury, but Signifying Something" (2018) 30 Pace Int'l L. Rev. 331
[76] CISG, Article 79 (1)
[77] Dionysios Flambouras, "Comparative Remarks on CISG Article 79 & PECL Articles 6:111, 8:108" (May 2002) available at <http://cisgw3.law.pace.edu/cisg/text/peclcomp79.html> accessed 4 February 2019
[78] Ibid

the requirements imposed by the article 79 "four-prong test": 1) the impediment that resulted in non-performance was beyond the party's control, and the party could not reasonably be expected 2) to have taken the impediment into account at the time of entering the contract; 3) to have avoided it or its consequences; 4) to have overcome it or its consequences.[79]

Notably, the provision governing hardship cases was proposed to be included in CISG,[80] however, the proposal was denied.[81] The final wording of the article 79 was adopted to include the term "impediment" in response to the criticism of the Article 74 of the 1964 Uniform Law on International Sales ("ULIS"), under which a party "could escape liability when performance had become unexpectedly difficult for reasons beyond his control".[82] Therefore, it may be argued that the language of article 79 narrowed the scope of excuses from liability to exclude the notion of change of circumstances. Indeed, such rejection of the hardship provision was widely perceived as evidence of reluctance of the drafters to include the hardship cases into the scope of the Convention and, subsequently, unavailability of hardship defense under CISG.[83] On the other hand, some may argue that "such history evidences that the discussions were not conclusive on this question" and it is too early to completely reject availability of hardship under CISG.[84]

[79] Ishida, supra note 75, p.334

[80] The text of the article would be the following "If, as a result of special events which occurred after the conclusion of the contract and which could not have been foreseen by the parties, the performance of its stipulations results in excessive difficulties or threatens either party with considerable damage, any party so affected has a right to claim an adequate amendment of the contract or its termination" from John O. Honnold, *Documentary History Of The Uniform Law For International Sales: The Studies, Deliberations And Decisions That Led To The 1980 United Nations Convention With Introductions And Explanations* (Springer Netherlands, 1989) p.350

[81] Ishida, supra note 75, p.363

[82] Alejandro M. Garro, CISG-AC Opinion No. 7, "Exemption of Liability for Damages under Article 79 of the CISG" available at <https://www.cisg.law.pace.edu/cisg/CISG-AC-op7.html> accessed 4 February 2019

[83] Scott D. Slater, "Overcome by Hardship: The Inapplicability of The UNIDROIT Principles' Hardship Provisions to CISG" (1998) 12 FLA J INT'L L 231, 259-60; ibid: "As to the legislative history of Article 79, there is ample support for the proposition that the notion of "impediment" under Article 79 points to an insurmountable obstacle that is unrelated to the more flexible notions of hardship, impracticability, frustration, or the like…"

[84] Ishida, supra note 75, p.363; Garro, supra note **Ошибка! Закладка не определена.**: "legislative history is inconclusive to warrant the conclusion that CISG Article 79 cannot exempt a party to perform, in whole or in part, when the impediment is represented by a totally unexpected event that makes performance exceedingly difficult".

Another problem arises when one decides to settle hardship cases by recognizing the availability of hardship as a "governed-but-not-settled" gap, which is to be filled by some general principles or applicable law as provided in Article 7(2) of CISG.[85] This approach may lead to a situation where there is no alternative other than follow rules provided by applicable domestic law. It is argued by some scholars that such approach is less preferable than direct application of article 79 because "leaving the question to the conflict of law rules of the forum leads to a great diversity of potentially applicable legal doctrines (impracticability, frustration, imprévision, etc.)".[86] Hence, invocation of hardship excuse as provided by domestic law may highly contradict the very purpose of the Convention – uniformity of the law of sales and removal of legal barriers in international trade.[87] Therefore, an interpreter, in order to follow the core objectives of CISG, should probably find a way to address the issue of hardship within the means available under the text of the Convention.[88]

With regard to the effect of the invocation of article 79, one may notice that the provision provides only for the exemption from the liability for a failure to perform.[89] There are no rules under which a court or arbitral tribunals may "revise" or "adapt" the terms of the contract in order to adjust the agreement to changed circumstances and restore the equilibrium of the contract. However, some scholars claim that other legal effects may also be available in cases of hardship. For instance, it was proposed that "it would not be a deviation from the language of the Convention for [judges] to adapt the contract, […] particularly when they deal with an unexpected skyrocketing price beyond once-in-decade increase".[90] The underlying reason for such proposal is the preservation of the integrity of the Convention, and promotion of "uniformity in its application and the observance of good faith in



[85] CISG, Article 7(2)
[86] Supra note **Ошибка! Закладка не определена.**; Peter Schlechtriem, *Uniform Sales Law - The UN-Convention on Contracts for the International Sale of Goods* (Manz, Vienna: 1986), p.422: ""[i]t is imperative, in [his] opinion to treat radically changed circumstances as 'impediments' under Article 79 in exceptional cases in order to avoid the danger that courts will find a gap in the Convention and invoke domestic laws and their widely divergent solutions".
[87] See CISG, Preamble
[88] Garro, supra note 82
[89] CISG, Article 79(1)
[90] Ishida, supra note 75, p.380-381

international trade" as provided in Article 7(2) of the CISG.[91]Alternatively, one may infer that the language of article 79(5) of the CISG ("Nothing in this article prevents either party from exercising any right other than to claim damages under this Convention"[92]) may be used in order to allow courts or arbitrators to "determine what is owed to each other, thus "adapting" the terms of the contract to the changed circumstances".[93]

In 2009, the Belgian Supreme Court created a new approach towards the availability of hardship by applying the UNIDROIT Principles to fill the gap under article 7(2) of the CISG (even though the parties did not agree on the application of the UPICC) .[94] In the *Scafom* case, after the enormous increase in the cost of steel, the seller of steel tubing stopped making deliveries and requested for the adjustment of prices.[95] The Supreme Court used UNIDOROIT Principles as a "gap-filling" tool under article 7(2) of the CISG, which allows settling "governed-but-not-settled" issues by virtue of the general principles on which the Convention is based.[96] The rationale behind the application of the UPICC was based on the nature of the Principles as a restatement of internationally-recognized contract principles.[97] However, this decision was widely criticized in the legal community for various reasons. For example, it is argued that the CISG allows filling gaps with the principles to be found within *its* provisions, not from external sources.[98] Moreover, the application of the UPICC rules on hardship may be perceived as the imposition of the domestic civil law rules; therefore, one



[91] Ibid.
[92] CISG, Article 79(5)
[93] Garro, supra note 82, para.40
[94] *Scafom International BV & Orion Metal BVBA v. Exma CPI SA*, Cour de Cassation/Hof van Cassatie, Belgium, 19 June 2009, English translation available at <http://cisgw3.law.pace.edu/cases/090619b1.html> accessed 10 February 2019
[95] Ibid
[96] Ibid
[97] Ibid
[98] Harry M. Flechtner "The Exemption Provisions of the Sales Convention, Including Comments on "Hardship" Doctrine and the 19 June 2009 Decision of the Belgian Cassation Court" (2011) Belgrade Law Review, Year LIX 3, 84-101

may argue that in this particular case referencing the UNIDROIT Principles of civil law contradicts the purpose of the CISG as a balance between the civil and common law traditions.[99]

**UNIDROIT Principles**

The Principles is a document prepared by the Institute for the Unification of Private Law with the purpose of unification and harmonization of the law of commercial contracts.[100] The UPICC seek to establish common rules on contract law so to offer the best solution for the specific needs of cross-border commerce and consider approaches existing in different legal systems as to the doctrine of change of circumstances.[101] Moreover, the Principles try to avoid the issues created by the Vienna Convention by the intentional omission of the problem of hardship.[102] Therefore, prominent experts on contract law consider the solutions offered by the UNIDROIT to be better suited for specific needs of international trade than any previous agreements.[103]

Article 6.2.2 and 6.2.3 of the UPICC were drafted to cover the situation of hardship. Particularly, article 6.2.2 contains a definition of hardship, providing that the concept contemplates a situation "where the occurrence of events fundamentally alters the equilibrium of the contract".[104] The article does not define the extent of such alteration of the balance, however, the experts affirm that the unbalance should be of an extremely disproportionate nature so to create a serious disparity between the original and new situations.[105] Therefore, hardship defense cannot excuse a non-performing party if the change had to be included among normal business risks, which are usually assumed by the



[99] Tian Dai, "A Case Analysis of Scafom International BV v Lorraine Tubes S.A.S" (2016) 1 Perth International Law Journal, p.142
[100] Abdulkadir Guzeloglu, Tarik Kurban, "A Brief Overview of Unidroit Principles Of International Commercial Contracts (PICC)", available at <http://www.mondaq.com/turkey/x/648064/Contract+Law/A+Brief+Overview+Of+Unidroit+Principles+Of+International+Commercial+Contracts+PICC+2010> accessed 10 February 2019
[101] Elena Christine Zaccaria, "The Effects of Changed Circumstances in International Commercial Trade" (2005) 9 Int'l Trade & Bus L Rev 135, 168
[102] Ibid
[103] Zaccaria, supra note 101, 168
[104] UNIDRO1T Principles, article 6.2.2
[105] Zaccaria, supra note 101, 169

parties when they enter into the contract.[106] Nevertheless, it is difficult to determine the exact moment when the change of the equilibrium exceeds the area of a "normal risk." The provision specifies that such an alteration of the equilibrium occurs "either because the cost of a party's performance has increased or because the value of the performance a party receives has diminished".[107] Notably, the latter case may cover cases of frustration of purposes.[108] Also, the article provides the list of requirements, which should be fulfilled in order to rely on hardship under the UNIDROIT Principles:

> "(a) the events occur or become known to the disadvantaged party after the conclusion of the contract;
>
> (b) the events could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract;
>
> (c) the events are beyond the control of the disadvantaged party; and
>
> (d) the risk of the events was not assumed (both expressly or impliedly) by the disadvantaged party".[109]

All these requirements represent the general notion of hardship.[110] The rationale behind this approach is that the drafters of the UPICC have intended to create a basic principle, which could be referred to in different cases of gross unbalance, without being limited to specific situations.[111]

Article 6.2.3 of the UNIDROIT Principles covers the effects of the invocation of hardship excuse. The provision specifies that the non-performing parties have a right to request for renegotiation of the contract provided that such a request should be made "without undue delay and



[106] Ibid, Zaccaria
[107] UNIDRO1T Principles, article 6.2.2
[108] Brunner, supra note **Ошибка! Закладка не определена.**, p.41; UNIDROIT Principles, comment 2(b) on Article 6.2.2: 'The substantial decrease in the value or the total loss of any value of the performance may be due … to … the frustration of the purpose for which the performance was required (e.g. the effect of a prohibition to build on a plot of land acquired for building purposes or the effect of an export embargo on goods acquired with a view to their subsequent export)."
[109] UNIDRO1T Principles, article 6.2.2
[110] Zaccaria, supra note 101, p.170
[111] Ibid

shall indicate the grounds on which it is based".[112] However, the request for renegotiation cannot itself give a requesting party the right to suspend performance of the contract.[113] Such a party may suspend the performance only in extraordinary cases, therefore, it is prevented from the abuse of the right to request for renegotiation. Hence, such a request is a subject to the principle of good faith and the duty to co-operate, which are covered by the UPICC by virtue of articles 1.7 and 5.1.3.[114] Under these articles, the requesting party should honestly evaluate whether a hardship defense may be invoked and, if the answer is negative, it must not invoke the clause. Moreover, both parties should conduct their renegotiations in good faith so to reach an agreement. If the parties fail to do so, either party may resort to litigation or arbitration with the request for termination or adaptation of the contract.[115] It should be noted that the provision does not indicate how long a party should wait before resorting to any dispute resolution mechanism. Thus, it may be implied that the duration of the waiting period will depend on the particular circumstances of the case.

In addition, article 6.2.3 provides that a judge or an arbitrator, after confirming the grounds for invocation of hardship, decides whether it is reasonable to terminate the contract or to adapt it to restore the equilibrium as it was intended by the parties.[116] In the latter case, the powers of the court are not of an unlimited nature, particularly, a judge cannot rewrite the contract so to impose new obligations upon the parties. This means that the court may merely modify some clauses so to restore the balance and prevent injustice.[117] Moreover, the Official Comments recognize that the court is not limited with these two options and it has other alternatives such as directing the parties to renew their negotiations or confirming the terms of the contract in dispute in their original state.[118]



[112] UNIDRO1T Principles, article 6.2.3 (1)
[113] Ibid, article 6.2.3 (2)
[114] Ibid, comment 5 to article 6.2.3
[115] Ibid, article 6.2.3(3)
[116] Ibid, article 6.2.3(4)
[117] Zaccaria, supra note 101, p.171
[118] Ibid

To sum up, it may be said that the doctrine of hardship is generally accepted both in national and uniform law as an instrument of protecting disadvantaged parties from impracticable contracts caused by unexpected events. However, the extent of such acceptance differs from one case to another (e.g. English and American law). Moreover, as the very nature of hardship defense is practically the same in every legal instrument, the differences lie in the treatment of elements constituting hardship situation and the legal consequences of relying on the doctrine. This matter is to be discussed further.

## Chapter II. Elements of the Doctrine of Change in Circumstances

### US Doctrine of Impracticability

Section 2-615 of the UCC provides that

> "Except so far as a seller may have assumed a greater obligation… delay in delivery or non-delivery in whole or in part by a seller… is not a breach of his duty under a contract for sale if performance as agreed 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…".[119]

Therefore, section 2-615 expressly stipulates that in order to invoke the doctrine of impracticability a party in breach should prove that: (1) the supervening contingency rendered a performance "impracticable", (2) the non-occurrence of the contingency was the basic assumption of the contract; (3) the disadvantaged party did not assume the risk of this contingency's occurrence. It should be noted that while section 2-615 of the UCC expressly covers only performance of sellers, official comments reflect the intent of the drafters to extend the coverage to buyers who meet the requirement of the doctrine of impracticability.[120]

The requirement of the occurrence of the event rendering the performance impracticable is focused on the increased cost of the performance.[121] However, neither the section itself nor its official comments specify the degree to which the burden must increase in order to constitute the case of impracticability. It is affirmed, however, that additional expenses of performance, even if they are a result of an unforeseen contingency, do not give rise to a doctrine of impracticability.[122] Thus, if the performance merely becomes more expensive or even unprofitable, the disadvantaged party is not entitled to invoke the doctrine of impracticability. Indeed, US courts are reluctant to exempt a party



[119] UCC, Section 2-615(a)

[120] Official comment 9 to Sec.2-615 of the UCC:
> "Where the buyer's contract is in reasonable commercial understanding conditioned on a, definite and specific venture or assumption as, for instance, a war procurement sub-contract known to be based on a prime contract which is subject to termination, or a supply contract for a particular construction venture, the reason of the present section may well apply and entitle the buyer to the exemption."

[121] Farnsworth, supra note 14, p.16

[122] Ibid, p.18-19

from the duty to perform in cases where the performance merely becomes more expensive or unprofitable.[123] It may be implied that the event should make the performance extremely onerous and costly. This strict approach was confirmed by US case law. Moreover, in the *Publicker Industries* case, where the US court rejected the request for exemption providing that "[the court] is not aware of any cases where something less than a 100% cost increase has been held to make a seller's performance 'impracticable."[124] Obviously, this statement does not mean that anything below or above 100% increase in the cost of performance should be sufficient to deny or grant the excuse to requesting party. Nevertheless, this ruling shows the general approach of US judiciary towards the threshold of impracticability, which was left undefined by the legislature.

Furthermore, the courts are reluctant to excuse the performance in cases where a non-performing party still has alternative methods of performance.[125] For instance, in the series of so-called Suez cases, carries tried to invoke the doctrine of impracticability after the Suez Canal was closed so that they could not ship their goods. However, the courts consistently held that as long as the carriers had had alternative routes, their non-performance could not be excused.[126] Additionally, the courts ruled that even though the routing the vessels around Africa was more expensive, such a difference in the cost of performance was not sufficient to render performance impracticable.[127] The similar holding was reached in so-called OPEC cases, where the parties sought to excuse their performance due to the inflation caused by the OPEC oil crisis in the 1970s.[128] The inflation made many contracts unprofitable, however, US courts did not regard the resulting hardship as sufficiently onerous to excuse the parties from the performance of the contracts.[129]



[123] Jeff Ferriell, *Understanding Contracts* (LEXISNEXIS 2009) 686
[124] *Publicker Industries v. Union Carbide Corp.*, 17 U.C.C. Rep. Ser.989, reported by Treitel supra note 37, para.6-008
[125] Farnsworth, supra note 14, 16; Nancy Kim, "Mistakes, Changed Circumstances and Intent" (2008) 56 U Kan L Rev 473 (2008), 507
[126] Ibid Farnsworth, 16
[127] Ferriell, supra note 123, 686
[128] Ibid
[129] Ibid

The other element of the doctrine of impracticability is the basic assumption of the contract, which in a somewhat way resembles the theory of implied conditions (see *Taylor v. Caldwell* case). Both the UCC and the Restatement (Second) of Contracts employ the following wording of this requirement: "performance as agreed 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* (emphasis added)."[130] Even though the language of both legal instruments does not expressly require supervening events to be unforeseeable, it may be implied that the element of the "basic assumption" is a question of foreseeability.[131] Indeed, the disadvantaged party will not be able to rely on the doctrine of impracticability if the event, which renders the performance impracticable, was foreseeable enough to be within the scope of contemplation of the party, i.e. it could not assume that the event would not occur. This view is supported by the official comment no.1 to section 2-615 of the UCC, which provides that "[t]his section excuses a seller… where his performance has become commercially impracticable because of *unforeseen* supervening circumstances not within the contemplation of the parties at the time of contracting" (emphasis added).[132] It should be noted that since everything in the world has a slight possibility of occurrence and every risk may be considered as foreseeable, the doctrine of impracticability is a "contemplation doctrine". This means that the court determines the risks that parties should have reasonably included in the contract after the contingency has occurred and the dispute has arisen.[133] Otherwise, the doctrine would never have been applied and all contracts would be a subject to strict liability rules, if not an absolute liability.[134]

The third requirement necessary to establish the ground for invoking the doctrine of impracticability is that the party requesting for the excuse must not have assumed the risk that the



[130] UCC, Section 2-615; Restatement (Second) of Contracts § 261 (1981)
[131] Kim, supra note 125, 507
[132] UCC, Comment 1 to Section 2-615
[133] Wright, supra note 14, 2198
[134] Ibid

performance would become impracticable because of the particular event that occurred. Entering into any commercial transactions always implies the involvement of the assumption of the risk of occurrence of some unforeseen events. The question is whether the circumstances that have rendered performance excessively burdensome were within the scope of risks contemplated by the party requesting for an excuse. This element includes both expressed and implied assumption of such risk.[135] In case of the expressed assumption, a party, which expressly promises to fulfill its contractual obligations regardless of any event that may make the performance impracticable, will be bound by this promise. Warranties may serve as an example of such expressed promise where a party would be obliged to perform in spite of any added burden. A good illustration of contractual risk allocation may be found in construction contracts, particularly contracts on new construction and those for the renovation of existing buildings. In formers, the risk of destruction of the building is usually assumed by the development company, while the contract for renovation frequently impose such risk upon the owners who supposed to have the building insured. The case of implied assumption of the risk is, however, much more controversial. If the contract is silent on this matter, a court or an arbitral panel may infer such an assumption based on the following factors: a negative inference derived from the clause excusing the party's performance in case of other specified contingencies;[136] the party's knowledge and expertise; the general foreseeability of the event that made performance impracticable; or the fact that defaulting party was able to shift the risk of the occurrence of such an event.[137]

It is argued that the element of assumption of the risk may negatively affect the availability of relief under the doctrine of impracticability in fixed-price long-term contracts.[138] In such contracts, the parties are presumed to accept the risks pertained to the volatility of prices and currency



[135] Farnsworth, supra note 14, 21
[136] Moreover, the party may have assumed a risk that exceeds the 'default' risk so that the threshold test of the hardship exemption has been tacitly passed, see Brunner supra note **Ошибка! Закладка не определена.**, p.424
[137] Farnsworth, supra note 14, p.21
[138] Ferriell, supra note 123, p.688

fluctuations. For instance, in *Northern Indiana Public Service Co. v Carbon County Coal Co.* case, the court held that the disadvantaged party was aware of the fact that the electricity may be purchased at a cheaper price from other suppliers when it had entered into the long-term contractual relationships with its supplier.[139] According to the judgement, the buyer had assumed the risks related to such a possibility and cannot request for relief under the doctrine of impracticability: " if … the buyer forecasts the market incorrectly and therefore finds himself locked into a disadvantageous contract, he has only himself to blame and so cannot shift the risk back to the seller by invoking impossibility or related doctrines."[140]

In addition, section 2-615 and its official comments provide for additional prerequisites for invocation of the doctrine of impracticability. One of these requirements is the absence of faul**t** of the interested party, i.e. the party requesting for excuse must prove that it did not cause the event rendering the performance impracticable. This requirement is implied by the language of the section and explicitly provided by the case law.[141] For instance, in *Roth Steel Products v. Sharon Steel Corp,*[142] the court held that Sharon could not invoke the defense of impracticability because the defendant's failure to perform was a "result of its policy accepting far more purchase orders than it was capable of fulfilling [even though it knew that raw materials were in short supply] rather than a result of the existing shortage of raw materials."[143] Interestingly, this judgement expressly equates the absence of fault with the presence of events beyond the control of the disadvantaged party: "the unforeseeable event upon which excuse is predicated [should be a result of] factors beyond the party's control…If the factors which create the event are within the control of the party asserting commercial impracticability, then the inability to perform is the result of the party's conduct rather than the event



[139] *Northern Indiana Public Service Co. v Carbon County Coal Co* 799 F.2d 265 (7th Cir. 1986) reported in Ferriell, supra note 123, 688: ": a fixed-price contract is an explicit assignment of the risk of market price increases to the seller and the risk of market price decreases to the buyer."
[140] Ibid
[141] Farnsworth, supra note 14, p.20, ftn no.103
[142] *Roth Steel Products v. Sharon Steel Corp*, 705 F.2d 134 (6th Cir. 1983)
[143] Ibid at 36

itself."[144] Therefore, US courts may refuse to grant relief on the ground of impracticability not only in cases of negligence or willful misconduct [145] but also in cases in which the disadvantaged party fails to prove that the events causing the contingency were beyond its control.

Finally, the official comments to UCC require the interested party to demonstrate that it undertook reasonable steps to assure that the source of the good did not fail.[146] In this respect, the court in *Steel Industries, Inc. v. Interlink Metals & Chemicals, Inc*. case[147] affirmed the position of the UCC, ruling that the supplier of steel was not entitled to invoke the excuse of impracticability when faced with a shortage of supply from its own supplier. Specifically, the Russian supplier of raw material refused to continue deliveries at reduced prices; so, after contacting a number of other Russian companies to find out whether they could deliver the steel, the supplier refused to deliver steel to the manufacturer at the discounted prices. In spite of the supplier's attempts to prevent the increase in price, the court held that the supplier had failed to explore all reasonable means of fulfilling its contractual commitments by not looking for other sources of supply. Thus, it is the supplier who must bore the risk of its chosen supplier's nonperformance. This case reveals the very restrictive view of US courts on the applicability of the doctrine of impracticability.

**German Notion of the Interference with the Basis of the Transaction**

German law approach towards the doctrine of changed circumstances is based on the theory that since the circumstances have materially changed, the foundation of the transaction has been destroyed and the parties cannot be longer bound to their original commitments, i.e. under the new circumstances, continuing performing the contract in its original terms would constitute bad faith.[148] Thus, §313 of the BGB typically covers situations where the equivalence of the exchange has



[144] Ibid at 36
[145] Farnsworth, supra note 14, p.20
[146] Official Comment 5 to UCC. § 2-615: "There is no excuse under this section, however, unless the seller has employed all due measures to assure himself that his source will not fail."
[147] *Steel Industries, Inc. v. Interlink Metals & Chemicals, Inc*., 969 F. Supp. 1046(E. D. Mich.)
[148] The doctrine originated from §242 BGB, according to which the contract must be performed in good faith.

fundamentally altered and where one party's purpose as to the contractual subject matter is materially affected (i.e. frustration of purpose). Notably, §313 of the BGB extends the rules established in the first paragraph to the cases, in which the parties share a grave error as to the circumstances underlying the contract situations (i.e. cases of common mistake).[149] Thus, German law covers not only the change of circumstances that occurred after the conclusion of the contract but includes the pre-contractual events into the scope of the doctrine of changed circumstances. 314

The language of section 313(1) of the BGB provides that not every change of circumstances may be covered by this provision. In fact, the changed circumstances should have been the basis of the contractual relationships between the parties. §313(1) of the BGB does not define what constitutes the foundation of a contract. Thus, it is implied that the term "basis of the contract" is subject to judicial discretion.[150] However, it is generally accepted that the provision is applicable to the basic assumptions shared by the contracting parties at the time of entering into the agreement.[151] This means that even the assumption is held by one of the parties, the other party must recognize and not contest such an assumption. These basic assumptions may refer to present circumstances and future events. The test employed by German courts focuses on the factors which caused the parties to enter the contract.[152] Indeed, when the circumstances upon which the parties concluded the contract have materially changed, "the foundation of the transaction has been destroyed and the parties are no longer bound to their original contractual commitments."[153] Alternatively, after the destruction of the basis of the contract, performance in a way as it was agreed originally would constitute bad faith.[154] It should be noted that in spite of similarities with the doctrine of frustration of purpose under common



[149] BGB §313(2) expressly provides for cases of common mistake: "It is equivalent to a change of circumstances if material conceptions that have become the basis of the contract are found to be incorrect"
[150] It is argued that this term (as well as the term "fundamental change") should be used restrictively in order to preserve §313 of the BGB as a "last resort in exceptional circumstances", see Rosler, supra note 71, p.56
[151] Hondius, supra note 57, 182
[152] Andrew Hutchison, "Gap Filling to Address Changed Circumstances in Contract Law - When It Comes to Losses and Gains, Sharing is the Fair Solution" (2010) 21 Stellenbosch L Rev 414, 422
[153] Zaccaria, supra note 101, p.149
[154] Ibid

law, the general approach under German law is different. Particularly, as noted above, the basic assumptions as to the foundation of the transaction should be *shared* by the parties at the time of conclusion of the contract. Hence, generally, the destruction of one party's specific purpose for entering the contract will not entitle that party to invoke §313 of the BGB. Moreover, it is stated that "usually the party receiving the good or service bears the risk of achieving the intended purpose so that the purpose itself does not become the basis of the contract."[155]

The second requirement is that the change of circumstances, which became the basis of a contract, must be significant to the extent that had the parties foreseen such changes, they would not have entered into the contract in these terms.[156] Moreover, an aggrieved party must be unable to be kept by the contract under the changed circumstances.[157] This means that a mere increase in the cost or regular inflation will not suffice to grant an excuse under the *Geschäftsgrundlage*. Indeed, the practice shows that German courts are prone to apply this element of the doctrine extremely restrictively, expanding the requirement to include not only the test of foreseeability of the event but also duty to take preventive measures.[158] For instance, in one case it was held that the supplier was not entitled to be excused from performance due to the fact that he had failed to take precautionary measures (e.g. accumulating a reserve) when the emergence of the crisis had become apparent.[159] Thus, the decision confirmed that the doctrine cannot be applied when a change of circumstances was foreseeable for the disadvantaged party. Notably, nothing in the language of section 313 of the BGB gives a guideline as to the applicable test of foreseeability. Nevertheless, it may be applied that the general standard of reasonableness may be derived from the following words: "the parties would not



[155] Schramm, supra note 61, p.37
[156] BGB Section 313(1)
[157] BGB Section 313(1)
[158] Rosler, supra note 71, p.52
[159] Decision of 8 February 1978, Zeitschrifi firWirtschafts- und Bankrecht [WM] 1978, 322 reported in Rosler, supra note 71, p.52

have entered into the contract or would have entered into it with different contents if they had foreseen this change."[160]

§275(2) of the BGB covers a similar concept of practical impossibility, under which the obligor's performance may be excused on the ground of gross disproportionality.[161] However, contrary to the concept proposed by §313 of the BGB, in order to apply §275(2), the obligor must prove that the burden of performance is disproportionate compared to the other party's interest of the performance.[162] This means that the key issue is "whether the increased burden of performance is somehow reflected by a corresponding gain for the creditor."[163]

**Kyrgyz Law on Material Change of Circumstances**

The notion of hardship is contained in article 412 of the Civil Code of the Kyrgyz Republic ("CCKR") under the heading of the "Amendment and termination of the contract in connection with a material change in circumstances" (*izmenenie i rastorzhenie dogovora v sviazi s sushhestvennym izmeneniem obstoiatelstv*). This article defines such change as following:

> "A material change in circumstances, upon which the parties relied at the time of conclusion of a contract, shall be the ground for amendment or termination of the contract, unless otherwise provided by the contract or arising from its substance.
>
> Change in circumstances shall be deemed material, where the circumstances change to such an extent that the parties would not have entered into the contract, or have entered on the essentially different terms, had they reasonably foreseen such circumstances."[164]

Introduced in 1996 into the Civil Code of the Kyrgyz Republic, the provision on material change of circumstances was a completely new concept for Kyrgyz law. The previous version of the CCKR (specifically, the Civil Code of the Kirghiz Soviet Socialist Republic) lacked any provision



[160] BGB §313(1)
[161] BGB Section 275(2)
[162] BGB Section 275(2)
[163] Hondius, supra note 57,182
[164] The Civil Code of the Kyrgyz Republic, part 1 of 8 May, 1996 (hereinafter, "Civil Code of the Kyrgyz Republic"), article 412(1)

regarding the excuse for non-performance except for the impossibility to perform.[165] The rationale behind such absence of the doctrine of hardship in Kyrgyz law was the Soviet point of view that "in the socialist system the problem of changed circumstances is **..**of a small importance **...**it could not rise in the sphere of socialist economy and within the relations of socialist property."[166] Nevertheless, in 1996, after the collapse of the Soviet Union, Kyrgyz law introduced the doctrine of change of circumstances to the current version of the Civil Code as a way to respond to issues caused by the changes in the political setting and, particularly, by transition towards a market system, which resulted in economic instability.[167]

Nowadays, the doctrine allowing termination or adjustment of contracts is subject to the general principle of sanctity of contracts (i.e. contracts must be observed), which can be found in article 299 of the CCKR.[168] This means that the doctrine of material change of circumstances is an exception to this general rule and may be invoked only in extraordinary circumstances.[169] Article 412 of the CCKR provides that the changed circumstances should have been the circumstances, which the parties relied upon at the time of conclusion of the contract, i.e. facts underlying the contractual relationships.[170] In some way, this requirement echoes the doctrine of the "foundation of contractual relationships" provided §313 of the BGB. However, contrary to German law, the CCKR does not expressly indicate that the changed circumstances should have been the actual foundation of the transaction. Thus, the Civil Code of the Kyrgyz Republic neither expressly, nor impliedly covers the situation of the destruction of the purpose of the contract (i.e. article 412 does not apply to cases of



[165] Civil Code of the Kirghiz Soviet Socialist Republic (30 July 1964), article 238 of the Civil Code of the Kirghiz Soviet Socialist Republic (30 July 1964)
[166] Alexei G. Doudko, "Hardship in Contract: The Approach of the UNIDROIT Principles and Legal Developments in Russia" (2000) 5 Unif L Rev 483, 485; Mikhail Agarkov, 'On the Problem of Contractual Responsibility" in *The Problems of Soviet Civil Law* (Moscow, 1945) 144
[167] Doudko, supra note 166, p.485
[168] Civil Code of the Kyrgyz Republic, article 299: "Obligations should be enforced in a proper manner and within the established period in accordance with the terms of the contract and requirements of legislation, and in the event such terms and requirements are absent, in accordance with prevailing business practices and other usually provided requirements"
[169] Doudko, supra note 166, p.494
[170] Civil Code of the Kyrgyz Republic, article 412(1)

frustration of purpose). Therefore, it may be argued that the result of this approach is that 'buyers' in transactions are generally less protected than 'sellers'.

Interestingly, being verbatim of the relevant provision in the Civil Code of the Russian Federation,[171] article 412 of the CCKR does not stipulate that the change of circumstances should have been unforeseen for the disadvantaged party, thereby differing from Russian law.[172] Unfortunately, the drafting history of the Kyrgyz Civil Code gives no mention of any rationale behind this modification. Nevertheless, it may be argued that the foreseeability test is still required under article 412. Particularly, it is claimed that this provision implies this test under the element to be analyzed below – section 1 of the article provides that the material change of circumstances should have been unforeseen, otherwise the parties would not have entered into the contract at all.[173]

According to Article 412 of the CCKR, "a change of circumstances is considered **material** when the change is such that, had the parties reasonably foreseen it, they would not have been concluded the contract at all or would have been concluded it on significantly different terms".[174] Thus, by this particular wording Kyrgyz law has chosen to employ a subjective test to define changed circumstances (contrary to the approach of US doctrine of impracticability[175] and similar to the German language of section 313).[176] However, Kyrgyz approach towards the doctrine of change of circumstances does not rely solely on the fiction that the parties would not have concluded (or would have concluded on essentially different terms) had they foreseen changed circumstances. Article 412(2)(2) of the CCKR introduces an objective element to determine the magnitude of the change of circumstances. The provision specifies that the "performance of the contract without amending its



[171] Civil Code of the Russian Federation,article 451
[172] Ibid, article 451(2)(1): '[…] at the moment of concluding the contract, the parties have proceeded from the fact that no such change of the circumstances will take place"
[173] Civil Code of the Kyrgyz Republic, article 412(1)
[174] Civil Code of the Kyrgyz Republic, article 412(1)
[175] UCC, section 2-615 requires performance to become extremely burdensome
[176] BGB §313(1): "the parties would not have entered into the contract or would have entered into it with different contents had they foreseen this change"

terms must violate the existing balance of contract-related property interests of the parties and result in such damages for the interested party so it would to a significant degree be deprived of what it anticipated to get when entering into the contract."[177] Hence, the article provides for the fundamental alteration of contractual equilibrium similar to the UNIDROIT approach.[178] Yet, the CCKR does not contain any guidance as to how to determine the significance of the alteration. As a result, so far Kyrgyz courts have not succeeded in achieving a more or less consistent approach on how significant the deprivation of rights should be in order to grant a relief based on the doctrine of change or circumstances.

Moreover, the CCKR rules require the presence of the events beyond the control of the interested party.[179] Specifically, it expressly provides that the hardship "[should] have been caused by events which the interested party cannot overcome with the degree of care and caution required by the nature of the contract and business practices."[180] Therefore, Kyrgyz law introduces a more restrictive approach with a somewhat subjective element of determination the sufficient level of care and caution "required by the nature of the contract and business practices."[181] It is clear, however, that the requirement prevents a self-induced material change of circumstances from serving as the ground for invoking hardship excuse.

Finally, article 412(2)(3) of the CCKR stipulates that the aggrieved party may request for termination or adaptation of the contract only if did not expressly or implicitly assumed the risk of the changes in question.[182] This provision is intended to determine whether the change of circumstances



[177] Civil Code of the Kyrgyz Republic, article 412(2)(2)
[178] UNIDROIT Principles, article 6.2.2; however, Doudko supra note 166 provides that "in domestic practice, a 50% rate of distortion of equilibrium seems fairly low (*suggested by the UPICC*), especially for countries with an unstable political and economic situation, and it would seem to contradict the principle of the exceptional nature of changed circumstances."
[179] Civil Code of the Kyrgyz Republic, article 412(2)(1)
[180] Ibid
[181] Ibid
[182] Civil Code of the Kyrgyz Republic, article 412(2)(3): "the contract may be annulled, and on the grounds provided in point 4 of this Article it may be amended at the demand of the interested party where [the following condition is present]: … business practices or the substance of the contract do not indicate that the interested party shall bear the risk of the change of circumstances"

was beyond the aggrieved party's intentions and reasonable expectations at the time of entering into the contract. In that vein, the approach of Kyrgyz law echoes the doctrine of commercial impracticability developed in the United States, which also requires the interested party to prove that it did not assume the greater risk (obligation). The article specifies that such an assumption should be derived from either business customs or the contract itself.[183]

It should be noted that unlike German law, Kyrgyz doctrine on changed circumstances does not expressly cover the cases of a common mistake. The excuse for non-performance on the ground of the common mistake may be derived from the language of article 412, specifically from the wording "[m]aterial change in circumstances, upon which the parties relied in entering a contract…"[184] This phrase may indicate that if the facts underlying the conclusion of the contract turn out to be incorrect, the interested party will be entitled to request for relief under the doctrine of change of circumstances. Indeed, neither the article itself nor the official comments specify whether such change should occur after the conclusion of the contract. Thus, the issue of the availability of the excuse on the basis of a common mistake is still open and it is a subject to be clarified by Kyrgyz courts and arbitrators. Unfortunately, it would be unreasonable to assume that there is an extensive or consistent practice on article 412. Moreover, the official commentary to the CCKR is limited to the description of the concept and does not contain any relevant examples from Kyrgyz case law or scholarly works.

To sum up, it seems that the excuse available under article 412 of the CCKR requires the same basic elements required under US and German law: unexpected occurrence of the event fundamentally changing facts underlying the contract (in US law - rendering performance impracticable) and non-assumption of the risk of this event happening. In line with US law, article 412 provides for a stricter approach, imposing the obligation of proving the absence of fault of the disadvantaged party (presence the events beyond its control). However, Kyrgyz rules do not expressly oblige parties to the contract

[183] Ibid
[184] Civil Code of the Kyrgyz Republic, article 412(1)

to find alternative ways of performance but urge them to act with "sufficient level of care and caution." Moreover, as mentioned above, contrary to German and US law, Kyrgyz rules do not expressly cover the situations of common mistake or frustration of purpose. Thus, the question of the application of the excuse of changed circumstances will fall within the scope of judicial discretion. Since it is very difficult to speculate on the development of Kyrgyz practice in this respect, the interested parties are highly recommended to specifically stipulate the uncovered cases of changed circumstances in their contracts in order to be protected from the situations of hardship or, accordingly, from the unpredictable decisions of Kyrgyz courts.

## Chapter III. Legal Effects of the Doctrine of Change in Circumstances

Generally, the application of the doctrine of change of circumstances or related concepts entitles the disadvantaged party to request for either termination or adaptation of the contract. Whereas termination may be granted at a date and on terms fixed by the court or arbitral panel (or according to relevant laws or contractual provisions), the adaptation of the contract corresponds to the changed circumstances. It should be noted that the general practice does not allow retroactive adjustments as a way of dealing with the alteration of contractual equilibrium, i.e. the adjustments should be of a forward-looking character so to help parties to overcome changed circumstances.[185] This chapter will describe and analyze the approaches of US, German, and Kyrgyz law as to the legal consequences of invocation of the doctrine.

### US law (excuse from performance)

Under US law, the major remedy for the case of impracticability is an excuse from further performance.[186] Nevertheless, the drafters of the Uniform Commercial Code left some room for the possibility of adjustment of the contract, providing courts and arbitral panels with the possibility of "directing the controversy towards an "equitable adaptation" of the contract.[187] Particularly, official comment No. 6 to section 2-615 of the UCC provides that:

> "In situations in which neither sense nor justice is served by either answer when the issue is posed in flat terms of 'excuse' or 'no excuse', adjustment under the various provisions of this Article is necessary, especially the sections on good faith, on insecurity and assurance and on the reading of all provisions in the light of their purposes, and the general policy of this Act to use equitable principles in furtherance of commercial standards and good faith."[188]

[185] Frederick R. Fucci, "Hardship and Changed Circumstances as Grounds for Adjustment or Non-Performance of Contracts Practical Considerations in International Infrastructure Investment and Finance" (2006) available at <https://files.arnoldporter.com/hardship_excuse_article.pdf> accessed 15 March 2019

[186] Ibid, p.8; Rodrigo Momberg Uribe, "The effect of a change of circumstances on the binding force of contracts. Comparative Perspectives", PhD (2011) 177 available at <https://www.academia.edu/37850908/The_effect_of_a_change_of_circumstances_on_the_binding_force_of_contracts_Comparative_perspectives> accessed 15 March 2019

[187] Zaccaria, supra note 101, p.142

[188] As provided in Fucci, supra note 186, p.8

Interestingly, while this comment expresses the "general bias of the UCC drafters towards facilitating commercial transactions by applying greater flexibility in contract interpretation," it simultaneously putting an emphasis on the principle of good faith, which is a cornerstone of contract performance in civil law.[189] Other sections of Article 2 of the UCC in a somewhat way support the approach expressed in the official comments. For instance, section 2-302 permits courts to limit the application of specific provisions of the contract,[190] and section 2-716 authorizes courts to order specific performance in proper circumstances, where such an order would prevent injustice.[191] Correspondingly, several sections of the Restatement (Second) of Contracts provide that in exceptional circumstances, the courts may adjust the contract to equitably distribute the losses between the parties.[192] However, it is argued that allowing a judicial allocation of losses, section 2-615 and its official comments, in fact, provide little guidance as to how to adapt the contract so to actually reflect the changed circumstances.[193] Indeed, case law shows that US judges feel compelled to excuse disadvantaged parties from further performance rather than to adjust the contracts.[194] Thus, the general practice is that an excuse for nonperformance is "either granted or emphatically denied."[195]

Since US courts are extremely reluctant to allow interference with relationships between the parties by means of adjusting contractual terms, to date, there is just one significant case in which a court held that an increase in the cost of performance was sufficient to modify the terms of the contract. This case is the *Aluminum Company of America (ALCOA) v. Essex Group, Inc.*[196] This case involved a long-term contract, under which Essex undertook to deliver alumina to ALCOA, which, in turn, would convert it to molten aluminum to return it to Essex for further processing. However, ALCOA's



[189] Ibid
[190] UCC, section 2-302(1)
[191] UCC, section §2-716(1)
[192] See Restatement (2nd) of Contracts §158(2), §204, §272(2) (1982)
[193] Momberg, supra note 186, p.178
[194] Ibid
[195] Ibid
[196] *Aluminum Co. of America v. Essex Group, Inc.*, 499 F. Supp. 53, 58 (W.D. Pa.1980)

production costs associated with the performance of a contract rose 600% from 1968 to 1978 due to the 1973 oil embargo. Even though the contract contained a flexible price adjustment formula, the increase in non-labor production costs were grossly disproportionate. In fact, ALCOA lost $3 million in 1977, more than $8 million in 1978 and was expecting to lose about $75 million in total until the end of the contract. In its claim, ALCOA requested for excuse from performance or, alternatively, for of the adaptation of the contract, specifically, adjustment of the price index to reflect actual production costs. The court ruled on the adaptation of the contract. The relief took the form of an adjustment of the contractual terms by the virtue of substituting the agreed price adjustment scheme with a new one established by the court in order to allocate the losses and risks created by the unexpected turn of events and reduce the losses of ALCOA. The court provided that the decision was in line with the "general policy of the UCC to use equitable principles in furtherance of commercial standards and good faith."[197] Indeed, in the absence of such an approach, businessmen would be unwilling to ever enter into long-term contracts, which are usually vulnerable to different contingencies.

Notably, in the ALCOA decision, the court stressed the significance of the parties' failure to reach an agreement on the adaptation of the contract.[198] Thus, the court implied the duty of renegotiation that should precede the intervention of the court, which, according to the ruling, is the "last resort" for the parties. Moreover, the court stated that the possibility of judicial intervention can serve as "a desirable practical incentive for businessmen to negotiate their own resolution to problems which arise in the life of long term contracts."[199] Without a doubt, an agreement reached after the good faith negotiations between the parties would be much more satisfactory for them than any decision rendered by a judge. Nevertheless, it should be noted that this truly revolutionary judgement



[197] Fucci, supra note 186, p.8
[198] Supra note 196 at 91-92
[199] Ibid

never came into effect because it had been appealed and, subsequently, the parties had settled before the case was heard.

**German approach (Pro-adaptation)**

Firstly, it is important to note that section 313 does not predetermine the effects of the application of the doctrine of changed circumstances in each individual case. Indeed, it is significant as a symbol of a power of the judiciary to step in and amend the terms of the contract in accordance to changed circumstances so to "correct a disturbance of the foundation of the contract."[200]

§313(1) of the BGB provides that parties can request for adaptation of the contract by the courts.[201] It should be noted that initially, German courts did not recognize their power to interfere with the contractual relationships of the parties. In fact, German courts were reluctant to "adjust the relations between the parties… in order to mitigate the hardships of the war."[202] However, in the 1920s courts relaxed their approach by invoking the principle of good faith: "the first and the noblest task of the judge is to satisfy in his decisions the imperative demands of life and to allow himself in this respect to be guided by the experiences of life."[203] The court provided for the three-prong test to allow the adjustment of the contract: both parties must desire for the continuation of their contractual relationship; a modification of the contract must be possible; an adjustment must take place only in cases of a substantial change of circumstances.[204] Even though this approach was not immediately favored by the contemporaries, "the dam was breached." The landmark judgement of 1923 confirmed the approach of the court in RGZ 100, 129, emphasizing that "adjustment and not the termination of the contract is the logical reaction to the crisis."[205] Since that, many decisions on the radical change of circumstances have expressed their position that they do not intervene contractual relationships



[200] Markesinis, supra note 55, p.324
[201] BGB §313(1)
[202] Markesinis, supra note 55, p.336
[203] *RGZ 100, 129, case no.96* reported in Markesinis, supra note 55, p.336
[204] Markesinis, supra note 55, p.336
[205] *RGZ 107, 78, case no.99* reported in Markesinis, supra note 55, p.337-338

between the parties but rather help them to reach the natural result of a contractual relationship based on the principle of good faith.[206] The approach of favoring adjustment of the contract over termination was statutorily reflected in section 313 of the BGB.

§313 makes the adjustment of the contract available on the basis of the principle of freedom of contract, which, in German law, is focused on giving effect to the parties' will and intentions.[207] Such will assumes upholding the contract's original equilibrium and the preservation of the contract itself.[208] It should be noted that upholding the equilibrium means that the terms of the contract may be modified to the extent that the allocation of risks and benefits expected by the parties at the time of entering into the contract will remain practically the same.[209] Preservation of the contract, in turn, is not limited to the strict principle of *pacta sunt servanda*, which aims at the continuation of the contractual obligations as precisely defined by the original contract. German law on the change of circumstances stands for the preservation of general contractual relationships, regardless of the specific terms of the contract.[210] In other words, in situations of hardship where the performance of contractual commitments is still objectively possible, a modification that would preserve the contract is the best option.[211] Hence, section 313 of the BGB focuses primarily on the preservation of the parties' proportional exchange of duties, not on upholding specific contractual terms.

The third paragraph of §313 of the BGB stipulates that the contract may be terminated, however, the termination is available only in circumstances, where a "gap-filling" in the form of the adaptation of the contract is impossible or unreasonable for one party.[212] Impossibility assumes



[206] Markesinis, supra note 55, p.338
[207] Schramm, supra note 61, p.51
[208] Ibid
[209] Ibid
[210] Ibid
[211] DiMatteo, supra note 13, 263; Theo Rauh "Legal Consequences of Force Majeure under German, Swiss, English and United States' Law" (1996) 25 Denv J Int'l L & Pol'y 151, 153
[212] BGB §313(3): "If adaptation of the contract is not possible or one party cannot reasonably be expected to accept it, the disadvantaged party may withdraw from the contract. In the case of continuing obligations, the right to terminate takes the place of the right to withdraw"

situations where the modified contract would be illegal, useless, or impossible to perform.[213] The element of unreasonableness implies situations where adaptation of the contract would lead to intolerable results according to the principle of good faith.[214] Therefore, under German law, termination of the contact is a measure of an exceptional nature. This approach reflects the intention of the legislature to preserve the contractual relationship between the parties by all available means.

It should be noted that German law does not expressly require parties to renegotiate the contract before resorting to the court. Nevertheless, the German Federal Supreme Court and some legal scholars state that the duty of preliminary negotiations exists in a sense that the claim for the adjustment or termination of the contract implies that the aggrieved party has submitted the request for renegotiation, which has turned out to be rejected.[215] This position, however, has not found wide acceptance among legal commentators who argue that the duty of cooperative negotiations cannot and should not be imposed by the law.[216]

**Kyrgyz law (Pro-termination)**

Article 412 of the CCKR expressly provides for two reliefs: upon the request of the interested party, courts may either terminate or adjust the contract. The element of the request of the interested party (a court cannot invoke the excuse on its own) follows from the rule of the parties' autonomy and the extraordinary character of the reliefs sought. The article imposes an additional requirement for resorting to a court - the aggrieved party may request for the termination or adjustment of the contract only after the failure of the negotiations with the other party.[217] This means that before applying to a court, the interested party must seek to reach an agreement with the other party. Unfortunately, unlike,



[213] Schramm, supra note 61, p.40
[214] Ibid
[215] Ibid
[216] Brunner supra note **Ошибка! Закладка не определена.**, p.481
[217] Civil Code of the Kyrgyz Republic, Article 412(2): "If the parties fail to reach an agreement to make the contract consistent with the materially changed circumstances or to annul the same, the contract may be annulled [or] it may be amended at the demand of the interested party…"

for instance, the UPICC[218] or Principles of European Contract Law,[219] Kyrgyz law does not regulate the negotiation process. The wording of article 412 does not specify any requirements that would help to understand whether the situation of failure of negotiations took place. Thus, the situation, where the aggrieved party may be deprived of reliefs provided under the doctrine of material change of circumstances due to bad faith negotiations, are common to business practice. It may be only implied that such a requirement assumes that the other party must have expressly rejected a proposal to adjust or terminate the contract or have failed to reply within the period specified in the proposal or any other relevant document, statute, or business practice.

According to article 412 of the CCKR, the main method of court's interference in cases of a material change of circumstances is the termination of the contract. In this case, the court determines the consequences of such termination, with consideration given to the "need for fair allocation among the parties of the expenses borne by them in connection with the performance of the contract."[220]

The Civil Code specifies that the contract may be modified only in exceptional circumstances, particularly, when "termination of a contract would contradict public interests or result in damage to the parties far exceeding the costs necessary for the execution of the contract on revised terms."[221] The rationale behind this approach is the attempt to avoid situations where the parties would be tied together in a hostile relationship. Moreover, this position may be based on the premise that the right to modify the contractual terms entails an inherent danger that courts may excessively use such power so to rewrite the contract contrary to the interest of the parties. However, such a strict approach seems to limit the court's right to opt for the remedy most appropriate to the circumstances of the case, creating additional legal barriers to the power of the judiciary to adjust the contracts. It should be



[218] UNIDROIT Principles, comment 5 on article 6.2.3 of the expressly provides that the re-negotiation process is subject to the principles of good faith and duty of cooperation

[219] Principles of European Contract Law, article 6.1.1.1(2) of the stipulates the duty of both parties to renegotiate the contract: "the parties are bound to enter into negotiation with a view to adapting the contract or terminating it"

[220] Civil Code of the Kyrgyz Republic, Article 412(3)

[221] Civil Code of the Kyrgyz Republic, Article 412(4)

noted that adaptation is not meant to impose a practically new contract or new obligations upon the parties. The adaptation of the contract should be predictable and closely related to the original contractual terms. The restrictive language of section 4 of article 412 of the CCKR seems to be the reason that the available case law on the subject contains just one case, where the court modified the contract by eliminating of the contractual provisions.[222] However, even this decision was later dismissed by the Supreme Court of the Kyrgyz Republic.

Finally, should be noted that according to the general rule expressed in article 414 of the CCKR, the obligations are considered amended or terminated by a court from the time the decision on termination or amendment of the contract enters into legal force.[223] However, application of this general rule in the specific case of a material change of circumstances may be inappropriate because it substantially limits "flexibility of the court's termination remedy," especially comparing it to the situation where a court may terminate the contract at a date and on terms fixed.[224]

With respect to the legal effects of the application of the doctrine of hardship, Kyrgyz law differs from the approaches established under US and German law, which accordingly provide for the reliefs of excuse from further performance and adaptation of the contract. Even though the language of each rule is flexible enough to allow adaptation, termination or excuse from performance, whichever is requested, the legal practice of each country confirms the approach codified in the legal instruments of the respective jurisdiction. The result of the research conducted in this section of the thesis is that the German approach is the one that perfectly balances the principles of the sanctity of contracts and good faith. Indeed, German rules appropriately protect parties from the situation of hardship while preserving their contractual relationships, albeit in modified terms. Therefore, the



[222] The Ruling of the Supreme Court of the Kyrgyz Republic from 9 April 2013, no.ED-*000173/12 MO*
[223] Civil Code of the Kyrgyz Republic , article 414(3)
[224] Doudko, supra note 166, p.506

author would recommend parties to the contract to include a comprehensive tool for adjusting (or terminating, if desirable) contractual terms.

## Conclusion

Different approaches towards the legal doctrine of changed circumstances exist in different jurisdictions and their judicial practice. US doctrine of impracticability, German concept of the interference with the foundation of the transaction, and Kyrgyz notion on the material change of circumstances perfectly illustrate the variety of the treatment of situations of hardship. It was established that Kyrgyz rules on the doctrine of changed circumstances contain certain deficiencies, which should be either amended or specifically considered by the parties at the time of conclusion of their contract. For instance, Kyrgyz approach is silent on the matters of frustration of purpose, common mistake, allocation of losses, etc. The Civil Code of the Kyrgyz Republic contains a very restrictive approach towards the possibility of adjustment of the contracts in cases of hardship, thereby limiting the effect of the principle of *pacta sunt servanda.* Moreover, a big concern is the absence of the consistent approach of the judiciary (evidenced by the very limited number of available decisions on the subject) as well as the lack of any scholarly work that would help to interpret article 412 of the Civil Code of the Kyrgyz Republic.

The author would like to conclude with the following remarks on drafting the contracts subject to Kyrgyz law: parties are highly encouraged to define standards invoking the excuse of hardship (stricter or more liberal, whichever desirable), to cover situations of the frustration of contractual purpose and common mistake. Furthermore, it is very important to include clauses dealing with the desirable effect of the application of the doctrine. Such clauses may vary: adjustment schemes, strict provisions on termination (although, it is not necessarily important in the existing pro-annulment approach), imposition of the duty to renegotiate the terms of the contract, etc. Parties are recommended to take into consideration the following factors: the level of inflation, the nature of the transactions in question, currency fluctuations, political stability, if applicable. The list is not exhaustive since the circumstances in every single case are to determine the needs of the parties.

Finally, the author recommends the parties to appoint a third-party adjustment mechanism so to avoid the court intervening their contractual relationships.

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