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THE EFFECT OF CHANGE IN CIRCUMSTANCES ON THE PERFORMANCE OF CONTRACT

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Annotation. *The authors of this article use systemic, comparative and historical methods to review the most representative legal systems – French, English and German – and analyse how these legal systems deal with the effects of change in circumstances on the performance of a contract. The authors also discuss solutions adopted by scholar groups working on supranational contract law (soft law) instruments, namely, UNIDROIT Principles of International Commercial Contracts and Principles of European Contract Law, stressing that these sets of principles have significantly affected Lithuanian contract law provisions on changed circumstances. The authors concisely evaluate the case law of the Supreme Court of Lithuania on the application of the provisions on change in circumstances and their effect on the performance of a contract.*

Keywords: *pacta sunt servanda, rebus sic stantibus, hardship, changed circumstances, UNIDROIT principles of international commercial contracts, principles of European contract law.*

Introduction

A contract that is formed in accordance with the provisions of laws and is valid has the force of law between its parties (*pacta sunt servanda*). This principle derives from canon law and has been established in most legal systems. However, the principle of *pacta sunt servanda* is not absolute. Sometimes, strict application of this principle may lead to infringements on justice, reasonableness, and good faith. Therefore, legal theory and practice aim for compromise between *pacta sunt servanda* and another principle also derived from canon law – the clausula of *rebus sic stantibus* – which states that contracts are binding only so long as and to the extent that matters remain the same as they were at the time of the contract coming into force. Because of different legal traditions and historical circumstances, a variety of limits on the principle of *pacta sunt servanda* have been established in different states. Most legislators have introduced provisions into their national laws regulating exoneration from the performance of a contract where performance becomes impossible because of objective circumstances (e.g., *force majeure*). A more complicated case is when due to supervening events the performance of the contract becomes more cumbersome for one of the parties, though performance still remains possible. The main focus of this article is the latter case–the legal institute of changed circumstances. Various terms have been used to describe this legal doctrine: *Wegfall der Geschäftsgrundlage* in Germany, *imprévision* in France (established in administrative law only), *frustration of contract* in England (only partly covering the hardship situation), *impracticability* in the US. Meanwhile, the UNIDROIT Principles of International Commercial Contracts do not use any of these national terms and instead introduce the relatively new concept of hardship, which is now used in both, the English and the French versions of the UNIDROIT Principles, even if it has no legal meaning in England.[1] Nevertheless, the greatest problem for the concept of hardship is not in the terminology but in the different approaches that the legislator and the courts may take in dealing with it. The main problems are the criteria for the recognition of hardship, the question of whether the judge may revise/amend/terminate the contract in case of hardship and if yes, on what terms. It should be noted that some states and international conventions (e.g., the Vienna Sales Convention[2]), do not regulate the question of changed circumstances at all.

The legal institute of changed circumstances has not been analysed in Lithuanian legal doctrine with the exception of professor Mikelėnas who discussed this issue in his comparative study on contract law.[3] Therefore, such research is particularly relevant and needed. The main purpose of this article is to examine the most important features of the changed circumstances legal institute in the most representative legal systems–the

1 Tallon D. Hardship. In Hartkamp, A., *et al. Towards a European Civil Code*. Third Fully Revised and Expanded Edition. The Hague/London/Boston: Aspen Publishers, 2004, p. 500.

2 United Nations Convention on Contracts for the International Sale of Goods (1980). [interactive] [accessed 06-05-2009]. <http://www.uncitral.org/pdf/english/texts/sales/cisg/CISG.pdf>.

3 Mikelėnas, V. *Sutarčių teisė. Bendrieji sutarčių teisės klausimai: lyginamoji studija*. [Mikelenas, V. *Contract law. General Questions on Contract Law: a Comparative Study*]. Vilnius: Justitia, 1996.

French, the English and the German. In the opinion of the authors of this article, such a comparative survey is essential for the understanding of the legal roots of this institute and in trying to foresee its future developments. Comparative law is precisely the tool for the interpretation of Article 6.204 of the Civil Code of the Republic of Lithuania[4] (the Civil Code), which is the Lithuanian equivalent of what is known worldwide as the legal institute of changed circumstances.

1. The Regulation of Changed Circumstances in States with Different Legal Traditions

1.1. France

The French Civil Code does not establish any specific rules or guidance for situations where the performance of a contract becomes more cumbersome because of changed circumstances. The French courts are famous for their extremely strict attitude towards the observance of *pacta sunt servanda*. A party may be exonerated from the performance of a contract only in the case of superior force (*force majeure*), an accidental event (*cas fortuit*), or an external cause (*cause étrangère*). In legal doctrine, these three concepts are used interchangeably – to define a situation where the performance of a contract is impossible due to some objective circumstances. Almost all attempts by the French civil courts to expand the limits of the *force majeure* doctrine and apply it to cases of more cumbersome performance have failed. The French Supreme court (*Cour de cassation*) remains devoted to its classical approach – to exonerate the debtor from the performance of contract only in cases when such performance becomes impossible due to unforeseeable, unavoidable and uncontrollable events (war, natural disaster, embargo, strikes, riots, criminal offence, etc.). As a classical example of the strict *Cour de cassation* position – which is still prevalent today – legal doctrine often refers to *Canal de Craponne* case. In this case, the parties concluded a contract in 1567 for the provision of a garden's irrigation services. The contract had been in force for over 300 years, and the fixed fee for the irrigation services had gradually become absolutely inadequate and could not cover the service provider's costs spent for the maintenance of the irrigation canals. Therefore, the Aix Court of Appeals adapted the fee to the changed economic environment, namely, increased it. However, in 1876 *Cour de cassation* annulled the decision of the Court of Appeals referring to Article 1134 of the French Civil Code, which establishes the principle of *pacta sunt servanda*. *Cour de cassation* stated that "Since article 1134 is a general and absolute text, it is not for the courts, however just their decision may seem to them, to take account of time and circumstances in order to modify contracts made by the parties".[5] Such strict approach by *Cour de cassation* has largely remained unchanged

4 Lietuvos Respublikos civilinis kodeksas. *Valstybės žinios*. 2000, Nr. 74 – 2262, su vėlesniais pakeitimais ir papildymais. [The Civil Code of the Republic of Lithuania. Official Gazette. 2000, No. 74 – 2262, with further amendments and supplements].

5 Lamberterie, I. D. The Effect of Changes in Circumstances on Long-Term Contracts: French Report. In Harris, D.; Tallon, D.; *Contract Law Today: Anglo-French Comparisons*. Oxford: Clarendon Press, 1989, p. 228–229.

until the present day: the court's right to modify the contract or fill-in its gaps cannot be justified by application of principles of justice, good faith or customary law; no changes in economic environment whatsoever may confer the right upon the judge to terminate a contract or change its terms and thus the creditor in any occasion retains the right to demand specific performance from the debtor even in the case that such performance becomes very cumbersome, short of impossibility (*force majeure*).[6] Some authors identify historical reasons of such a strict approach. Since the French Revolution, the French courts suffer from a lack of trust in society and certain resistance to the proactive role of the judge, including the possibility to modify a contract.[7]

Despite the rigorous case law of the French civil courts with respect to the performance of contract, the French administrative court of last resort (*Conseil d'Etat*) has not followed this direction and developed its own distinct and much more flexible jurisprudence on the basis of *imprévision* (unforeseen circumstances) doctrine. The most cited court decision (*Gaz de Bordeaux* case) dates back to 1916. In 1904, the city of Bordeaux entered into a concession agreement with a private company for the supply of gas and electricity to a major part of the city for a period of 30 years. After the outbreak of World War I, the price of coal increased from roughly 35 to 117 francs francs per ton; therefore, the private company attempted to increase the fixed price of gas stipulated in the agreement. Although this claim was rejected in the court of first instance, *Conseil d'Etat* granted it. The court explained that due to the war, the coal prices had risen dramatically and hence the gas tariff stipulated in the agreement was not adequate in the changed economic circumstances. Accordingly, the private company was entitled to compensation from the city of Bordeaux.[8] Such actions of *Conseil d'Etat* may be interpreted as modification of the contract. The *Gaz de Bordeaux* case became a precedent for a number of subsequent cases in administrative courts. There may be reasons for greater flexibility in the administrative courts: they mainly deal with claims related to public services contracts, concession agreements and other arrangements which entail public interest. A public contract, if hampered, delayed or even paralysed because of changed economic circumstances, usually creates calamities for a substantial number of citizens. Therefore, administrative courts are more willing to apply the doctrine of *imprévision.*[9] On the other hand, civil courts mainly deal with disputes between private individuals or companies and thus reject the doctrine of *imprévision*, giving preference to the principles of party autonomy and *pacta sunt servanda*. Even so, French civil courts sometimes apply special legal constructions which allow for the modification of a contract without applying the *imprévision* doctrine. For example, a judge may take into account all the

6 Schmidt-Szalewski, J. *France. International Encyclopaedia of Laws: Contracts*. Vol. 3. The Hague/London/New York: Kluwer Law International, 1999, p. 221.

7 Karampatzos, A. Supervening Hardship as Subdivision of the General Frustration Rule: A Comparative Analysis with Reference to Anglo-American, German, French and Greek Law. *European Review of Private Law.* 2005, 2: 144.

8 Bell, J.; Boyron, S.; Whittaker, S. *Principles of French Law.* Oxford: Oxford University Press, 1998, p. 199.

9 Dadomo, C.; Farran, S. *French Substantive Law: Key Elements.* London: Sweet & Maxwell, 1997, p. 48–49.

terms of the contract as well as the factual circumstances, and interpret the contract as containing implied terms pertinent to changed circumstances. In addition, the arbitrators are not obliged to follow the strict case law of the French Supreme Court. Thus, in arbitral proceedings, there is a higher degree of tolerance for contract modification and its adaptation to a changed economic environment.[10] Moreover, the French legal tradition has afforded a certain role to the legislator: special laws have been promulgated establishing rules for contract modification (in cases of lease for commercial premises, bankruptcy, annuities, etc.).

The strict approach of the French courts encourages parties to include special adaptation clauses in their contract which allow for contract modification. For example, contracts may include indexation clauses based on inflation or stock exchange index which allow for automatic recalculation of the contract price when the index fluctuates to a certain degree. Another type of adaptation clauses–called hardship clauses–oblige the parties to renegotiate the contract if special circumstances mentioned in the hardship clause occur. Opinions on indexation and hardship clauses are ambivalent. On the one hand, the parties get an opportunity to independently stipulate their rights and duties in case of changed circumstances and there is no need for the interference of a third party (e.g., a court). On the other hand, adaptation clauses are often unable to foresee all possible scenarios of changed circumstances, and an ill-prepared adaptation clause may bring the parties into a deadlock. Accordingly, in the opinion of the authors of this article, certain statutory regulation regarding changed circumstances is indeed necessary. Later in this article, we shall take note of how drafters of international commercial instruments have also decided to not leave these issues solely to the autonomy of the parties and the self-regulation of the market, but have rather devised certain provisions for dealing with such problems.

1.2. England

Until the middle of nineteenth century, the absolute sanctity of contract prevailed in England. The most famous case in this respect, *Paradine v. Jane* dates back to the seventeenth century. In this case, a tenant who was sued for non-payment of rent pleaded that he had been evicted and kept out of possession by an alien army and thus refused to pay the rent. The court ruled that "where the law creates a duty or charge and the party is disabled to perform it and hath no remedy over, there the law will excuse him... but when the party of 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".[11] This rigid position was only mollified 200 years later, after the courts developed the doctrine of frustration of contract. The doctrine was established in 1863 based on the *Taylor v. Caldwell* case. In this case, the defendants had agreed to permit the plaintiffs to use a music hall for concerts on four

10 Schmidt-Szalewski, J., p. 221.

11 Beale, H. G. *Chitty on Contracts: Twenty-Ninth Edition. Volume I: General Principles.* London: Sweet & Maxwell, 2004, p. 1312–1313.

nights. After the conclusion of the contract, and before the first day on which a concert was to be performed, the music hall was destroyed by fire for which neither of the parties was responsible. The plaintiffs sued for damages to cover their incurred costs. The court rejected the claim on the basis that a condition was implied in the contract that the impossibility of performance arising from the perishing of the person or thing shall excuse the performance.[12] In its early development, the doctrine of frustration was confined to physical disappearance of the subject matter of the contract. However, the scope of the doctrine was soon extended to similar cases such as frustration of purpose of the contract. In the famous "coronation case" – *Krell v. Henry* – the defendant agreed in writing to rent rooms in the plaintiff's apartment to observe the coronation procession of King Edward VII. Due to unexpected illness of the King, the coronation was cancelled a few days before its commencement. The defendant refused to pay the balance of the agreed rent and the court upheld his refusal on the grounds that "the Coronation procession was the foundation of this contract and that the non-happening of it prevented the performance of the contract".[13] The court even ignored the fact that the rent contract did not make any direct reference to the coronation procession (though this could be deduced from relevant circumstances).

The *Krell v. Henry* precedent provided legal grounds for the systemic branch of the frustration doctrine – the frustration of purpose. The frustration of purpose is proof that the English approach is more flexible than the French *force majeure* legal doctrine. However, despite the acknowledgement of the frustration doctrine, English law retains a relatively strict attitude towards the legal institute of changed circumstances. Hardship, financial loss or other inconvenience involved in performing the contract or delay which is within the commercial risk undertaken by the parties, has been treated by English courts as insufficient to frustrate particular contracts.[14] In the *Davis Contractors Ltd. v. Fareham Urban District Council* case, the plaintiffs contracted to build 78 houses for the defendants at a fixed price, the work to be completed in eight months. Due to unforeseen lack of labour, bad weather and other reasons the work took 22 months to complete and cost was 17,000 pounds higher than initially calculated. The contractors claimed that shortage of labour had frustrated the contract and thus sought additional compensation on the basis of unjust enrichment. However, the House of Lords held that there was no frustration and dismissed the claim. Lord Radcliffe explained that "it is not hardship or inconvenience or material loss itself which calls the principle of frustration into play. There must be as well such a change in the significance of the obligation that the thing undertaken would, if performed, be a different thing from that contracted for".[15] English courts also rejected the doctrine of frustration in the famous Suez Canal cases, where the closure of the Suez Canal because of war led to arguing that contracts for the sale of goods had been frustrated. The courts held that the blockage of the canal did not make the situation fundamentally different and that the sellers had to consider

12 Marsh, P. D. V. *Comparative Contract Law: England, France, Germany.* Gower, 1994, p. 318.

13 Beale, H. G., p. 1327–1328.

14 *Ibid.*, p. 1322–1323.

15 Beale, H., *et al. Cases, Materials and Text on Contract Law.* Oregon: Hart Publishing, 2002, p. 617–619.

alternative though more expensive and time consuming routes.[16] Nevertheless, it must be noted that there are examples in English case law where courts applied the doctrine of frustration in cases of drastic increase of the contract price. In the *Staffordshire Area Health Authority v. Staffordshire Staffs Waterworks Co* case, there was a situation under scrutiny where a contract for the supply of water was concluded in 1919. A waterworks company agreed to provide a hospital "at all times hereafter" with water at fixed prices, which later were affected by the inflation. Thus, in 1975, the contractor sought rescission of the contract as the actual performance costs were many times higher than the fixed fee stipulated in the contract. The court held that "the situation has changed so radically since the contract was made 50 years ago that the term 'at all times hereafter' ceases to bind: and it is open to the court to hold that the contract is determined by reasonable notice".[17] The court allowed the parties to discharge the contract and the parties later concluded a new contract with renewed provisions. It is obvious that the facts in the *Staffordshire* case are similar to the earlier discussed French case of *Canal de Craponne.* However, the Court of Appeals demonstrated a higher degree of flexibility than *Cour de cassation* as the former discharged the parties from their contractual obligations whereas the latter refused to do so.

Despite examples where fundamentally changed circumstances have provided sufficient grounds for English courts to release the parties from their contractual obligations, English courts are generally reluctant to interpret the doctrine of frustration broadly. Contrary to US courts, English courts do not recognize the doctrine of commercial impracticability, whereas the doctrine of frustration of purpose has mostly been applied by English courts to consumer contracts but not to commercial contracts. These conclusions are drawn based on a review of various English court cases where the parties sought to prove the existence of frustration under different factual circumstances. The English courts' position may be partly explained by the fact that English law does not recognize a general duty of good faith in contractual relations between the parties. Some authors assert that the broader application of the principles of good faith and justice would allow English courts to interpret the doctrine of frustration in a more flexible way–covering not only cases of impossibility of performance but also instances of commercial impracticability and hardship.[18]

It is very important to stress that English courts traditionally do not have the right to change the terms of a contract, even after application of the doctrine of frustration. Attempts to interpret this rigid position in a more flexible way have faced resistance from the highest judicial authority in England–the House of Lords. In case of frustration, the contract always comes to an end and the courts do not have the right to modify the rights and duties of the parties, except for purposes of restitution. As in France, such stringent

16 Mikelenas, V., p. 426. Only in two Suez Canal cases frustration was successfully applied, however, these decisions were later subject to appeals and have been quashed in the higher judicial instances. See: Treitel, G. H. *Frustration and force majeure.* London: Sweet & Maxwell, 1994, p. 50.

17 Beale, H., *et al.,* p. 621–623.

18 Mc Kendrick, E. *Force Majeure and Frustration of Contract.* Second Edition. London/New York/Hamburg/Hong Kong: Lloyd's of London Press Ltd., 1995, p. 330.

jurisprudence has encouraged parties to be more attentive in the preparation of special adaptation clauses and inclusion of such clauses into contracts. However, as mentioned above, such practice also has certain inherent deficiencies.

1.3. Germany

Approach of German law to the legal institute of changed circumstances is the most flexible and the most interesting from the academic perspective. Until the beginning of World War I, German courts had a very strict attitude towards the modification of contracts due to changed circumstances. Traditional German contract law only acknowledged the legal doctrine of impossibility (*Unmöglichkeit*). However, the economic consequences of World War I and particularly the shocking hyperinflation compelled German courts to look for more flexible solutions, especially in cases where tremendous monetary depreciation made the performance of contracts completely impossible. Unfortunately, there were no statutory provisions allowing the courts to modify contracts due to the changed circumstances as the drafters of the 1896 German Civil Code (*Bürgerliches Gesetzbuch*) decided not to include the respective provisions into the code. In their first encounters with the necessity to adapt contracts, German courts attempted to broadly apply the legal doctrine of impossibility (*Unmöglichkeit*), but such attempts were subject to harsh criticism.[19] Thus, the courts had to find a certain theoretical foundation which could serve as a legal basis for the modification of contracts. A legal doctrine was chosen for this purpose. In the middle of the nineteenth century, professor Windscheid–a famous German scholar and the head of the working group preparing the first draft of *Bürgerliches Gesetzbuch*–had developed a new version of the old *rebus sic stantibus* doctrine suggesting that parties conclude a contract on the assumption that "the desired legal effect should exist only under certain circumstances".[20] Without this assumption, the contract lacks its material foundation and thus the interested party is entitled to terminate the contract. Even though this theory by professor Windscheid was criticized and rejected from implementation in the *Bürgerliches Gesetzbuch,* it was revived after World War I by professor Oertmann. This scholar developed a theory of the collapse of the foundation of a contract, *Wegfall der Geschäfstgrundlage***.** Based on this theory, the party's expectations with respect to the contract's performance and related circumstances must coincide with the other party's expectations or the other party must be clearly informed about such expectations. Unlike Windscheid's, this theory required that the parties' vision (expectations) for the future performance of the contract be mutual, not unilateral. Such mutual understanding of the parties was called foundation of the contract, *Geschäfstgrundlage*. If the circumstances under which the contract was concluded change fundamentally and deviate from the primary status of the contract, the foundation of the contract collapses and the court is entitled to exonerate the parties

19 Markesinis, B. S.; Unberath, H.; Johnston, A. *The German Law of Contract: A Comparative Treatise.* Second edition. Oxford and Portland, Oregon: Hart Publishing, 2006, p. 328.

20 Zweigert, K.; Kötz H. *Lyginamosios teisės įvadas*. [Zweigert, K.; Kötz H. Introduction to Comparative Law]. Vilnius: Eugrimas, 2001, p. 439.

from the performance of the contract or may change its terms thus restoring a just contractual equilibrium.[21] The contract may be amended or terminated because of changed circumstances if these circumstances were unforeseeable and none of the parties assumed the risk for their emergence. Professor Oertmann's theory of contractual foundation was soon adopted by German courts–the courts made reference to this doctrine in the reasoning parts of their decisions. There were many decisions where the courts modified the price in the agreements as well as other terms and conditions. In one of its precedent decisions, the Court of the German Empire (*Reichsgericht*) stated: "the collapse of the German currency is so major <...> the courts must be creative and deliver a judgement which accords with equity. The guiding principle must be that an equitable adjustment of the interests at stake must be made".[22] The flexibility of the German courts is also explained by the fact that judges at that time were mostly recruited from the middle class, who had suffered severely during the inflation, and because of personal experience they were willing to solve problems arising from inflation through their decisions.[23]

After the World War II, Germany suffered from a variety of problems, such as division of the country, vast demolition of buildings, emigration of its citizens, and detrimental economic consequences. Similarly to the inter-war period, the legislator contributed little towards the resolution of the problem of changed circumstances, and the main role was again played by the courts. The courts again used the doctrine of *Wegfall der Geschäfstgrundlage* and applied it together with the principle of good faith. For example, in the famous "drill hammers" case (1953) the defendant–a company established in West Berlin–placed an order to the plaintiff to deliver 600 drill hammers. The plaintiff knew that the drill hammers were to be used in the mines of the German Democratic Republic. Meanwhile, the so-called "Berlin Blockade" ensued; therefore, it became impossible to deliver the drill hammers to the German Democratic Republic. The plaintiff had already manufactured more than one third of the drill hammers but the defendant neither wanted to accept them nor to pay for them. The dispute was submitted to the court. The German Federal Court of Justice–*Bundesgerichtshof*–ruled that each party must bear the risk of the disappearance of the subjective purpose of the contract. The parties had agreed on the manufacture and delivery of drill hammers to East Germany, however, this basis for the transaction had failed. *Bundesgerichtshof* further ruled that "if in a contract for the delivery and payment of a series of objects, all the individual claims arising out of the contractual relationship are in issue, the court must adapt the entire contractual relationship as a unit to the factual situation, unless a complete release from all obligations is indicated. This adaptation may lead to a modification, especially a reduction, of the individual claims, or to a partial maintenance of the contract in accordance with the exis-

21 Markesinis, B. S.; Unberath, H.; Johnston, *op. cit*., p. 321–323. More about the doctrine of *Wegfall der Geschäfstgrundlage* see: Foster, N. G.; Sule, S. *German Legal System & Laws*. Oxford: Oxford University Press, 2003, p. 420 – 421.; Dannemann, G. *The German Law of Obligations. The Law of Contracts and Restitution: A Comparative Introduction.* Vol. I. Oxford: Clarendon Press, 1997, p. 31–32.; Ebke, W. F.; Finkin, M. W. *Introduction to German Law.* The Hague/London/Boston: Kluwer Law International, 1996, p. 181.

22 Beale, H., *et al.*, p. 633.

23 Markesinis, B. S.; Unberath, H.; Johnston, A., *op cit*, p. 331.

ting terms of the contract coupled with the elimination of far-reaching obligations".[24] Accordingly, the defendant was obliged to pay the cost of work representing only one fourth of the amount due.

After German reunification, the doctrine of *Wegfall der Geschäfstgrundlage* was renewed and has been successfully applied in numerous decisions in parallel with the principle of good faith. Not until 2002–after the completion of the reform of German law of obligations – was the doctrine of contractual foundation codified in Paragraph 313 of the German Civil Code.[25] This provision attempted to capture the basic features of the doctrine as developed by academics and applied by the courts in an abstract yet flexible way.[26] The first part of Paragraph 313 establishes that if circumstances upon which a contract was based have materially changed after conclusion of the contract and if the parties would not have concluded the contract or would have done so upon different terms if they had foreseen that change, adaptation of the contract may be claimed in so far as, having regard to all the circumstances of the specific case, in particular the contractual or statutory allocation of risk, it cannot reasonably be expected that a party should continue to be bound by the contract in its unaltered form (objective aspect of the doctrine). The same rules apply in case material assumptions that have become the basis of the contract subsequently turn out to be incorrect (Part 2 of Paragraph 313, subjective aspect of the doctrine). Part 3 of Paragraph 313 sets forth that if adaptation of the contract is not possible or cannot reasonably be imposed on one party, the disadvantaged party may terminate the contract.[27] It must be noted that no revolutionary changes have occurred in the jurisprudence upon the statutory establishment of the contractual foundation doctrine because the doctrine was codified based on the already developed jurisprudence. In any case, the courts were given the opportunity to officially ground their decisions on the statutory provisions dedicated particularly to the legal institute of changed circumstances.

1.4. A Comparative Summary

A review of the French, English and German legal systems confirms the initial assumption that these three legal systems are distinct and have chosen different approaches to the legal problems of changed circumstances. The French legal system represents the most inflexible approach as its civil courts are under no circumstances – with the exception of *force majeure* – allowed to modify or terminate a contract or exonerate parties from the performance of the contract/liability for non-performance because of

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24 Case No. BGH MDR 1953, 282 I. Civil Senate (16 January 1953). Translated German Cases and Materials under the direction of professors P. Schlechtriem, B. Markesinis and S. Lorenz, translated by Mrs Irene Snook, copyright professor B. S. Markesinis [interactive] [accessed 04-04-2009]. <http://www.utexas.edu/law/academics/centers/transnational/work_new/german/case.php?id=945>.

25 Rosler, H. Hardship in German Codified Private Law – In Comparative Perspective to English, French and International Contract Law. *European Review of Private Law.* 2007, 3: 485.

26 Markesinis, B. S.; Unberath, H.; Johnston, A., p. 324.

27 German Civil Code - Bürgerliches Gesetzbuch. The English translation by Geoffrey Thomas and Gerhard Dannemann. [interactive] [accessed 04-05-2009]. < http://www.iuscomp.org/gla/statutes/BGB.htm>.

changed circumstances. English law acknowledges the doctrine of frustration, which also primarily focuses on the impossibility of performance. However, this doctrine creates more space than the French approach as the doctrine of frustration also covers the "frustration of purpose" situation where performance remains possible but is no longer meaningful. The frustration doctrine has also been applied to cases where impracticability of the performance was confirmed by justifying the non-performance of a contract. German law went even further when the courts adopted flexible academic doctrines and acknowledged the right to modify contracts because of changed circumstances; later this right of the courts was codified. One of the main differences between English and French law on the one side and German law on the other is that in case of frustration of contract, a contract is always discharged (in case of *force majeure*, a contract is also usually terminated unless the judge opts for a temporary suspension) whereas under German law the priority is always given to adjustment rather than termination. It must be however noted, that the attitude of German courts is not frivolous. The principle of *pacta sunt servanda* under any occasion remains the main yardstick for the regulation of contractual relations between parties. The German courts resort to modifying a contract only under truly exceptional circumstances and after thorough assessment of all relevant circumstances.

The authors of the article have also reviewed a number of other jurisdictions and have concluded that most states have followed a more flexible (German) approach and established special changed circumstances provisions in their national legislations. Such provisions exist (naturally, to unequal degrees) in Italy[28], the Netherlands[29], Greece[30], Russia[31], Spain[32], Portugal[33], Austria[34], some of the Scandinavian countries[35], Lithuania, partly–in the United States[36] (this country acknowledges the doctrine of commercial impracticability), and a number of other states. The legal institute of changed circumstances (hardship) has also been introduced into the UNIDROIT Principles of International Commercial Contracts and into the Principles of European Contract Law. These

28 See: Lena, J. S.; Mattei, U. *Introduction to Italian Law*. The Hague/London/New York: Kluwer Law International, 2002, p. 278–283.

29 See: Hartkamp, A. The UNIDROIT Principles for International Commercial Contracts and the New Dutch Civil Code. *CJHB. Brunner-bundel opstellen, op 15 april 1994 aangeboden aan professor mr. C. J. H. Brunner ter gelegenheid van zijn vijfenzestigste verjaardag*. Deventer: Kluwer, 1994, p. 133–134.

30 See: Papanikolou, P. Rebus sic stantibus und Vertragskorrektur auf Grund veränderter Umstände im griechischen Recht. *European Review of Private Law*. 1998, 3: 303–317.

31 See: Doudko, A.G. Hardship in Contract: The Approach of the UNIDROIT Principles and Legal Developments in Russia. *Uniform Law Review*. 2000, 3: 483–507.

32 See: Merino-Blanco, E. *Spanish Law and Spanish Legal System*. London: Sweet & Maxwell, 2006, p. 246–251.

33 See: Monteiro, A. P.; Gomes, J. Rebus Sic Stantibus – Hardship Clauses in Portuguese Law. *European Review of Private Law*. 1998, 3: 319–332.

34 Tallon D., p. 501.

35 Nielsen, R. *Contract Law in Denmark*. The Hague/London/Boston: Kluwer Law International, 1997, p. 132

36 See: Farnsworth, E. A. *Farnsworth on Contracts.* Vol. 2. Third edition. New York, N.Y. – Aspen, 2004, p. 624–681.

soft law codifications will be discussed in the subsequent chapter of this article. However, Belgium[37] and Luxembourg[38] have adopted a negative approach towards the legal institute of changed circumstances: national legislations of these states do not provide possibilities to amend or terminate a contract on the basis of changed circumstances or other hardships.

2. The Regulation of Change in Circumstances under the UNIDROIT Principles and the Principles of European Contract Law

Articles 6.2.1–6.2.3 of the UNIDROIT Principles of International Commercial Contracts[39] (the UNIDROIT Principles) regulate the legal institute of changed circumstances (as mentioned above, UNIDROIT Principles hereby use a special notion of "hardship"). Meanwhile, the Principles of European Contract Law[40] (PECL) do not use the notion of "hardship" but rather "change of circumstances" (Article 6.111). The UNIDROIT Principles and PECL regulate the legal institute of changed circumstances in a very similar way because the working groups of both instruments have worked in close cooperation and many of the members were the same in both groups. One of the main differences worth mentioning is that Article 6.2.2 of the UNIDROIT Principles also acknowledges hardship with respect to events that have occurred before the conclusion of the contract but became known after the events occurred, whereas Article 6.111 of PECL recognizes hardship only with respect to events subsequent to the conclusion of the contract, the prior ones being dealt with under the rule on mistakes (Article 4:103 of PECL)[41]. Another difference between the two legal instruments is that the UNIDROIT Principles stipulate an additional condition for the application of hardship: "the events are beyond the control of the disadvantaged party" (Article 6.2.2, point c). While the PECL do not explicitly establish this particular requirement, a systemic and logical analysis of PECL reveals that an identical requirement is also established by the PECL. Due to the limited scope of this article and since the UNIDROIT Principles and PECL are very similar sets of rules, the authors will hereafter refer to the UNIDROIT Principles (the legal institute of hardship) only.

Article 6.2.1 of the UNIDROIT Principles establishes a general rule on the application of hardship: "where the performance of a contract becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligations subject to the fol-

37 Lando, O.; Beale, H. *Principles of European Contract Law*. Full Text of Part I and II combined. The Hague/London/Boston: Kluwer Law International, 2000, p. 328.

38 *Ibid*.

39 *Principles of International Commercial Contracts*. International Institute for the Unification of Private Law (UNIDROIT). Rome, 2004.

40 Lando, O.; Beale, H., *op. cit.*, p. 322–328.

41 Tallon, D., p. 503.

lowing provisions on hardship".[42] Thus, the very first provision on hardship stresses the importance of *pacta sunt servanda* and does not entitle the parties to suspend/terminate the performance of a contract every time the circumstances change and the performance becomes more onerous. Article 6.2.2 of the UNIDROIT Principles further provides a definition of hardship–such an occurrence of events which fundamentally alters the equilibrium of the contract either because the cost of a party's performance has increased or because the value of the performance a party receives has diminished provided that:

(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 by the disadvantaged party.[43]

To determine whether an alteration of the equilibrium is fundamental, the UNIDROIT Principles employ two objective criteria: an increase of the performance cost or a decrease of the performance value. In the first instance, the affected party is usually the one to perform the non-monetary obligation, e.g., due to a rise in prices of the materials or equipment necessary to perform an installation job. With respect to the second instance–decrease in the value of the performance–the commentary of the UNIDROIT Principles provides two main examples: drastic changes in market conditions or frustration of purpose.[44] It is thus clear that the drafters of the UNIDROIT Principles consider "frustration of purpose" to be an inherent part of the hardship legal institute, which confirms the earlier conclusion of this article that frustration of contract (same as under English law) covers not only instances of impossibility of contract but also instances of more cumbersome performance, including the disappearance of purpose.

Article 6.2.3 of the UNIDROIT Principles establishes the legal implications of a hardship. A two-level system is introduced. The first level stresses communication: in a case of hardship, the party is entitled to request renegotiations. The request must be submitted timely–right after the occurrence of the event–and must be motivated. Having entered the renegotiations, the parties must intend to reach an agreement, must observe the principle of good faith, and may not use the renegotiations as a pure tactical manoeuvre.[45] If the parties fail to reach an agreement within a reasonable time, either party may resort to the court. If the court approves a hardship, it may, if reasonable:

(a) terminate the contract at a date and on terms to be fixed; or

(b) adapt the contract with a view to restoring its equilibrium.[46]

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42 *Principles of International Commercial Contracts*, p. 42.

43 *Ibid.*, p. 183.

44 *Principles of International Commercial Contracts*, *op. cit.*, p. 184–185.

45 Bonell, M. J. *An International Restatement of Contract Law. The UNIDROIT Principles of International Commercial Contracts.* Third Edition. Ardsley, New York: Transnational Publishers, Inc., 2005, p. 119–120.

46 *Principles of International Commercial Contracts*, p. 188.

A linguistic analysis of Article 6.2.3 of the UNIDROIT Principles reveals that the court has discretion to choose the applicable remedy–adaptation or termination. Such discretion is also confirmed in legal doctrine.[47] The more complicated question is which of these remedies the court should give preference to. The commentary of the PECL explicitly states that the primary aim should be to preserve the contract.[48] However, the commentary of the UNIDROIT Principles does not clearly establish such preference. Nevertheless, a systemic analysis of the UNIDROIT Principles demonstrates that *favor contractus* is one of the most important principles at the foundation of this unified contract law instrument. The UNIDROIT Principles contain many provisions which are aimed at preserving contractual relationships, and a hardship by its legal nature undoubtedly falls within the category of such provisions. Such interpretation was also confirmed in the legal doctrine prepared by professor Bonell, who was the Chairman of the Working Group for the preparation of the first edition of the UNIDROIT Principles.[49]

It should also be noted that if the court approves hardship and nevertheless decides to terminate the contract, the court is entitled to determine the date and the terms of such termination. Consequently, the court has wide discretion in resolving various related questions such as distribution of costs, restitution, compensation, etc.

3. Regulation of Changed Circumstances under Lithuanian Law

Under Lithuanian law, the legal institute of changed circumstances (hardship) is established in Article 6.204 of the Civil Code–"Performance of contractual obligations upon a change of circumstances". This Article basically reiterates Articles 6.2.1–6.2.3 of the UNIDROIT Principles. Thus, in Lithuania, questions related to hardship are solved under rules analogous to the ones established under the UNIDROIT Principles. It should also be mentioned that some specific provisions on hardship have been included in Part 4 of Book 6 of the Lithuanian Civil Code which addresses nominate contracts. For example, Part 6 of Article 6.653 of the Civil Code sets forth that in the event that the price increases for materials or equipment, or for services rendered to an independent contractor by a third party, and the independent contractor is not able to predict such an increase at the time when the contract was concluded, the independent contractor should have the right to demand an increase in the established price of the work or to terminate the contract in accordance with the provisions established in Article 6.204 of the Code. Similarly, Part 2 of Article 6.685 of the Civil Code provides that the independent contractor should have the right to demand a revision of the price of the contract if for reasons beyond his control the actual price of the work has increased by more than

47 Perillo, J. M. *Force Majeure and Hardship under the UNIDROIT Principles of International Commercial Contracts* [interactive]. [accessed 04-05-2009]. <http://www.cisg.law.pace.edu/cisg/biblio/perillo3.html, p. 131>.

48 Lando, O.; Beale, H., p. 326.

49 Bonell, M. J., p.117–124.

fifteen per cent (Article 6.204 of the Civil Code). Hereby the legislator clarified the abstract wording of Article 6.204 – "the cost of performance has essentially increased" – by specifying the exact percentage. It could be argued whether an increase in construction costs by 15% always constitutes hardship because the contractor often profits even after such increase in costs. In the opinion of the authors of this article, the courts should analyse each case individually and take into account the criteria specified in Article 6.204 of the Civil Code when determining whether the particular increase in costs constitutes hardship.

In Lithuania, there have been numerous attempts by parties to base their claims or objections on the provisions regulating changed circumstances. However, the lower courts have usually refused to recognize hardship as the conditions defined in Part 2 of Article 6.204 have not been fulfilled.[50] As of today, there is a lack of jurisprudence explicated by the Supreme Court of Lithuania (the Supreme Court) which could provide clarification on the contents of Article 6.204. There was only one case where the Supreme Court approved hardship.[51] In this case, the parties had concluded a lease agreement for commercial premises for a period of eight years. The agreement was concluded at the time when the Lithuanian currency (litas, LTL) was pegged to the US dollar (USD), the exchange rate being 1 USD: 4 LTL. One year later, the national currency was pegged to the euro and the exchange rate between the litas and the US dollar changed significantly. Therefore, the value of the performance or the money the lessor received had also declined. Since the parties did not include in their contract any specific provisions dealing with such changed circumstances, the dispute was resorted to courts. The Supreme Court approved the decisions of the lower courts, which modified the contract so that it would reflect the changed circumstances and contractual equilibrium could be restored.

Conclusions

1. Different approaches towards the legal institute of changed circumstances exist in different states and the jurisprudence of their courts. The legal systems of France, England and Germany are most representative in this respect and best illustrate these differences. France represents a negative, strict approach, England – intermediate (partly covers the legal institute of changed circumstances) whereas Germany represents a positive, flexible approach.

2. Most European states (including Lithuania) have opted for a more flexible model and their national legislations have established special provisions which deal with the legal institute of changed circumstances. Such solutions have also been introduced

50 Decision of the Supreme Court of Lithuania *G. B. v. „Ūkio banko investicinė grupė"* (2003) No. 3K-3-612. Decision of the Supreme Court of Lithuania; *„Sauliaus vaistinė" v. Panevėžio teritorinė ligonių kasa"* (2005) No. 3K-3-414. Decision of the Supreme Court of Lithuania; *UAB „Akmenės energija" v. AB „Lietuvos dujos"* (2007) No. 3K-3-477 etc.

51 Decision of the Supreme Court of Lithuania *B. R. v. UAB „Sauluva",* 2006, No. 3K-3-296.

by the UNIDROIT Principles of International Commercial Contracts and the Principles of European Contract Law.

3. The UNIDROIT Principles establish certain conditions which must be proven when appealing to provisions regulating the legal institute of changed circumstances. Renegotiations are compulsory, and only upon failure to reach an agreement the court or other third party is entitled to interfere. The court has discretion to choose the legal remedy (adaptation or termination). A systemic analysis of the UNIDROIT Principles reveals that the court should give preference to the preservation of contractual relations.

4. The provisions of the Civil Code of the Republic of Lithuania which regulate the legal institute of changed circumstances reiterate the rules established in the UNIDROIT Principles. However, the precise contents of this legal institute are not yet clear as court jurisprudence in this area is still under development.

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APLINKYBIŲ PASIKEITIMO ĮTAKA SUTARTIES VYKDYMUI

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Santrauka. *Teisėtai sudaryta ir galiojanti sutartis jos šalims turi įstatymo galią (pacta sunt servanda). Šis principas yra įtvirtintas daugelio valstybių sutarčių teisėje. Tačiau sutarčių privalomumo principas nėra absoliutus, nes tam tikrais atvejais beatodairiškas jo laikymasis galėtų reikšti protingumo, sąžiningumo ir teisingumo principų pažeidimą. Todėl šiuolaikinė civilinės teisės teorija ir praktika ieško kompromiso tarp klasikinio pacta sunt servanda principo ir kito, taip pat kanonų teisėje suformuoto principo – clausula rebus sic stantibus, kuris reiškia, kad sutarties sąlygos saisto šalis tol, kol sutarties sudarymo metu buvusios aplinkybės išlieka nepakitusios. Šis reiškinys – iš esmės pasikeitusių aplinkybių teisinis institutas, atskirose teisinėse sistemose turi skirtingą terminologiją ir taikymo sąlygas, o atskirų valstybių įstatymai ir jurisprudencija labai nevienodai sprendžia klausimus, koks turėtų būti teismų vaidmuo reguliuojant šalių sutartinius santykius, ar teismas turi teisę pakeisti sutarties sąlygas ir kaip turėtų būti sprendžiami nuostolių atlyginimo klausimai, kai vienai iš šalių dėl iš esmės pasikeitusių aplinkybių labai pasunkėja sutarties vykdymas.*

Šio straipsnio autoriai atliko lyginamąją–istorinę iš esmės pasikeitusių aplinkybių instituto analizę bei aptarė Lietuvoje pritaikytą šios problemos sprendimo būdą. Lietuvos teisės doktrinoje iš esmės pasikeitusių aplinkybių institutas iki šiol beveik nebuvo analizuotas, todėl tokio pobūdžio mokslinių tyrimų aktualumas yra neabejotinas. Šiame straipsnyje buvo išnagrinėtos skiriamuosius bruožus nagrinėjamoje srityje turinčios Prancūzijos, Anglijos ir Vokietijos teisės sistemos. Nustatyta, kad Prancūzija atstovauja negatyviajam-griežtajam požiūriui, Anglija – tarpiniam (iš dalies apima iš esmės pasikeitusių aplinkybių institutą), tuo tarpu Vokietija atstovauja pozityviajam-lankčiajam požiūriui. Daugelis Europos valstybių (įskaitant Lietuvą) pasirinko lankstesnį modelį ir savo nacionaliniuose įstatymuose įtvirtino iš esmės pasikeitusių aplinkybių institutą reglamentuojančias nuostatas. Tokį variantą pasirinko ir UNIDROIT tarptautinių komercinių sutarčių principų bei Europos sutarčių teisės principų rengėjai. Straipsnio autoriai taip pat konstatavo, kad Lietuvos Respublikos civilinio kodekso nuostatos, reglamentuojančios iš esmės pasikeitusių aplinkybių institutą, iš esmės pakartoja UNIDROIT principų nuostatas, tačiau šio instituto turinys Lietuvos teismų praktikoje nėra iki galo atskleistas dėl negausios teismų praktikos.

***Reikšminiai žodžiai**: pacta sunt servanda, rebus sic stantibus, sutartinių įsipareigojimų vykdymas pasikeitus aplinkybėms, UNIDROIT tarptautinių komercinių sutarčių principai, Europos sutarčių teisės principai.*

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