THE EFFECTS OF CHANGED CIRCUMSTANCES IN INTERNATIONAL COMMERCIAL TRADE

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Introduction

When parties reach an agreement, they commit themselves to a certain line of future behaviour and to the performance of a particular obligation. This commitment has its origin in the belief that if promissors were allowed to escape their contractual obligations whenever any circumstance arose that altered the economic equilibrium of the agreement, certainty of law would collapse and the ‘decline of faith in contract’ would be inevitable.

Thus, it can well be understood why the principle of sanctity of a contract, or pacta sunt servanda, that makes the contract binding and establishes the allocation of risk once and for all is recognised by international practitioners as one of the fundamental rules of contract law. It is present in common law, civil law and Islamic law systems and thus assumes the value of a transnational principle to be included in the context of lex mercatoria.
However, a rigorous application of the *pacta sunt servanda* principle can lead to harmful effects on the viability of a contract. Indeed, in long-term contracts, circumstances may arise which make performance of the contract excessively onerous for one of the parties, fundamentally altering the economic equilibrium and resulting in an unfair advantage for the other party. This situation of gross disparity is better known as *hardship*.

The risk of hardship is virtually inevitable in the field of international trade, as the economic and political context is subject to continual flux and rapid change. A great number of factors may intervene, such as an alteration in the political situation of a nation, an unexpected price rise in raw materials\(^6\) or a sudden depreciation of currency. Naturally, the longer the contract lasts, the greater the risk that circumstances may change. As international contracts generally last a long time this risk is ever present.

Therefore, in the event of any unpredicted circumstances arising, rather than maintaining the contract in its original terms and adhering to a rigorous application of the *pacta sunt servanda* principle, the parties are likely to be more concerned with restoring the contractual equilibrium so as to safeguard their mutual interests and ensure that their commercial relationship remains lasting and productive.\(^7\)

Nonetheless, national legal systems are reluctant to respond to this need; so much so that hardship did not find expression in the United Nations Convention on Contracts for the International Sales of Goods (better known as CISG or the Vienna Convention).

The Unidroit Principles, on the other hand, although not of a binding nature, do deal with hardship under Articles 6.2.2 and 6.2.3. These principles establish not only rules shared by most existing legal systems, but also rules more suited to the requirements of international commercial trade.

The aim of this paper is to examine this complex scenario and the limited tools available to international practitioners for the purposes of dealing with situations of hardship. There will also be an attempt to determine what benefits the Unidroit Principles could confer in the long term, contributing to overcome the difficulties without jeopardising the stability and safety of international trade agreements.

\(^6\) For example, the worrying effects of the uncontrolled rise in crude oil prices that periodically unbalances the world economy.

The effects of hardship on the contract

The need to keep the contract alive

The vast increase in economic activity and the growing global market have had strong repercussions on contracts. Indeed, while international trade was once essentially based on the import and export of goods, it now includes the exchange of services, the transfer of technology and the creation of joint ventures to set up economic operations.

This situation has made contractual relationships ever more complex and difficult to manage. As these complex contracts are intended to last, permanent cooperation between the parties is essential. A new contractual spirit has been described, giving rise to what Professor Macneil has defined as relational contracts.8 The contracts are designed by providing for negotiation between the parties to cope with the new situations that may come about during the course of the performance of the contract.

Therefore, it is in the interests of both parties to keep the contract alive even when unforeseen circumstances have altered the economic equilibrium, i.e., in situations of hardship. This can be achieved through forms of adaptation to prevent premature termination of a contract on which the parties have already spent considerable time and money, and which was intended to be advantageous for both of them.

There are a number of different reasons, of both a political and economic nature, justifying this desire to maintain the agreement. One example of this desire is the so-called cascade or pyramid contract commonly used in the crude oil or natural gas sectors. These contracts provide for the different phases such as prospecting, extracting, carrying, processing and distributing, necessary for the exploitation of specific resources. As each contract links up with the other, it can easily be seen that a total or partial failure of one party to perform any one of these contracts because of supervening unforeseen circumstances will have serious repercussions on all the other linked contracts.9

It should be borne in mind that negotiations to reach a new agreement would be very long and costly, especially in contracts that provide for specific resources where a contractual partner would be hard to replace. Long-term collaboration can create a cordial, trusting relationship as well as reciprocal exchanges of know-how that would again be very difficult to rebuild with a new contractor.10

For these reasons, when a situation of hardship arises, rather than maintaining the contract in its original terms or choosing a premature termination of the contract, it is desirable for international practitioners to continue their commercial relationship, re-establishing the contractual equilibrium between the parties.11

10 Ibid, 328.
The inadequacy of the solutions offered by domestic legal systems

Different approaches

The solutions provided by domestic law for situations of hardship are inadequate since they not only differ from one nation to another, obliging parties to operate in a sort of ‘juridical Babel’, but have proved to be little suited to the new needs of commercial trade.

Common law systems, for the most part, do not generally give relief to a party nor provide for a revision of the terms of the contract when performance has become extremely costly, arguing that a party might have made provision for such an event in the contract. On the other hand, some civil law countries such as Germany and Italy, which were subjected to wartime economic instability, found it necessary to introduce into their legal systems concepts such as Wegfall der Geschäftsgrundlage and Eccessiva Onerosità Sopravvenuta which, although now applied in a very restricted manner, provide for the adaptation or termination of the contract in situations in which the economic equilibrium between the parties has radically changed.

This does not mean that there is a clear and radical distinction between common law and civil law systems, nor that the systems of civil law provide better or more adequate solutions than that of common law countries. The reality is quite diverse and complex as even countries belonging to the same legal system have acquired very different legal attitudes, mainly deriving from each country’s individual tradition and judicial culture. Moreover, even those countries that have proven to be more sensitive to situations of hardship demonstrate remarkably wide differences of approach.

The following sections will analyse the approaches of the American, Australian, English, and Italian legal systems to situations of changed circumstances highlighting their differences and their limits.

Sacco ‘termination kills the contract, instead renegotiations should be able to cure it’.

15 See paragraph 313 of Bürgerliches Gesetzbuch (BGB) and Article 1467 Codice Civile. Among the civil law countries also Algeria, Argentina, Brazil, Egypt, Ethiopia, Greece, Hungary, Mexico, Portugal, Spain, Switzerland and the Netherlands provide for situations of hardship. However, French contract law and Belgian law only provide relief for situations in which the performance of the contract has become impossible (force majeure).
16 AH Puelinckx, ‘Frustration, hardship, force majeure, imprévision, Wegfall der Geschäftsgrundlage, Unmöglichkeit, changed circumstances’ (1986) 3 (2) Journal of...
The doctrine of frustration

The *pacta sunt servanda* principle is applied with great firmness by the English legal system. This inflexibility is normally justified by citing *Paradine v Jane*,17 when the King’s Bench held that a party committed to a contractual obligation is bound to perform it even when objectively unable to do so. This was later mitigated, at the end of the 19th century, when English law began to elaborate the concept of frustration. Indeed, in the case of *Taylor v Caldwell*,18 it was established that when performance of a contract depends on the continued existence of a given person or thing, then an implied condition is present, the absence of which will be considered by both parties as an excuse for non-performance.19 However, apart from such situations where it is impossible to honour the contract, it is interesting to analyse how English law has dealt with the hypothesis whereby performance of the obligation, although possible, would be commercially sterile.20

In the so-called Coronation cases,21 flats had been let to allow royalists to watch the royal procession pass from a vantage position on the balconies during the coronation ceremony of King Edward VII. When the ceremony was postponed because of the King’s illness, the contract was recognised to have been frustrated because the underlying assumptions and aims of the contracting parties on which the contract had been based no longer applied, leading to a situation of *frustration of purpose*. The judges ruled that the agreement had been reached for the sole purpose, known to both parties, of watching the coronation ceremony. Indeed, the price paid to rent each of the flats was exceedingly high, precisely because of the specific use to which it was to be put.22

In more recent developments of the doctrine of frustration, the criterion applied is that of a *radical change of circumstances*. Lord Radcliffe gave a fitting definition of such a situation in the case of *Davis Contractors Ltd v Fareham Urban District Council*.23

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17 *Paradine v Jane* (1647) Aleyt 26; 82 ER 897.
18 *Taylor v Caldwell* 3 B & S 826; 122 ER 309.
21 See eg *Krell v Henry* [1903] 2 KB 740.
23 *Davis Contractors Ltd v Fareham Urban District Council* [1956] AC 696.
Frustration occurs when the law recognises that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which the performance is called for would render it a thing radically different from that which was undertaken by the contract.24

In other words, the changed circumstances must be such as to alter the substance of the contract, causing it to take on the character of a new contract quite unlike the one agreed by the parties.25

This also seems to be the interpretation followed by Australian law. In the case of Codelfa Construction Pty Ltd v State Rail Authority of New South Wales,26 the Supreme Federal Court followed the same line of reasoning as Lord Radcliffe. In this case, a construction company (Codelfa) had undertaken to build a tunnel for the New South Wales State Railway. The contract had been drawn up in such a way as to emphasise that time was of the essence in the performance of the contract. However, the noise created by the construction works was such that the nearby inhabitants had obtained a court injunction to prevent Codelfa from working during certain hours of the day. The contract was thus recognised to have been frustrated, because the injunction had precluded its performance within the time and working schedule specified. Again, a radically different situation from the one agreed upon had come into being.27

However, even by applying the criterion of a ‘radical change of circumstances’, it is still difficult to reconcile the doctrine of frustration with situations of hardship. In the case of Viscount Simon in British Movietonews Ltd v London and District Cinemas Ltd,28 it was ruled that an exceptional increase or drop in price, sudden devaluation of the currency, unexpected obstacle to performance or other impediment, has no effect on the agreement made between the parties. Indeed, in this case, the contract was considered to be frustrated not because performance had become excessively onerous but because new circumstances had made performance an entirely ‘different thing’ from that which was originally agreed upon.29

This line of reasoning was confirmed in the so called Suez Canal cases that were filed after the sudden closure of the Suez Canal caused by the Arab-Israeli war.30 In these cases, although shipping costs underwent a dramatic increase as the ships had to circumnavigate the southern tip of Africa, English judges rejected the plea of

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26 Codelfa Construction Pty Ltd v State Rail Authority of New South Wales (1982) 149 CLR 337.
28 British Movietonews Ltd v London and District Cinemas Ltd [1952] AC 166.
frustration, ruling that the event had not rendered performance radically different from what had been agreed upon. The only case in which the plea of frustration was granted was that of the Société Franco Tunisienne d’Armement v Sidermar SpA. In this case the judge was oriented by a clause in the contract which made express reference to passage through the Suez Canal.

From the above, it is clear that the very rigid position adopted by English law makes it essential to forecast all those conditions which could give rise to controversy and to include details and specifications of the courses of action. However, even in cases when all the elements required to invoke the doctrine of frustration are present, the question arises as to what effects this will have on the contract. The English system offers only a fixed alternative maintenance of the contract in its original form, obliging one of the parties to bear the greater sacrifice caused by changed circumstances or else a premature termination of the contract. Indeed, under English law, the court has no power to adapt the contract to changed circumstances. This principle is based on a decision made by the House of Lords in 1952, according to which the function of the court is not to make a contract for the parties, but to interpret the contract made by them.

34 British Movietonews Ltd v London and District Cinemas Ltd [1952] AC 166.
The inability of judges to adapt the contract is considered by Professor Schmitthoff as a ‘serious defect of English law’, as this rule is in direct contrast with any modern system of trade law.

Other leading scholars have pronounced similar opinions. For example, Professor Treitel and Professor Atiyah argue that, from a practical point of view, ending the contractual relationship does not seem any more satisfactory than allowing it to continue unaltered, and that a compromise is often the best solution. Thus, it seems clear that while part of the English literature has recognised to some extent that it may be useful to try to save the contract rather than terminate it, English law continues to adopt a very rigid stance.

**Commercial impracticability**

There is greater flexibility in the North-American system than in the English one when dealing with situations of changed circumstances. Apart from recognising the termination of the contract in the presence of an objective impediment to its performance, the North-American approach adopts a more liberal view both of the concept of hardship and of the means for obtaining renegotiation of the contract in such a condition.

The American doctrine of commercial impracticability was first proposed in 1916 in the case of *Mineral Park Land Company v PA Howard*. The defendant had reached an agreement to haul gravel and earth from the claimant’s land to the site of construction of a bridge. However, at a certain stage, work had to be stopped because the rest of the earth and gravel was underwater and could only be removed at a far greater cost (10 times) than the sum agreed upon in the contract. The judges ruled in favour of the defendant, judging that ‘a thing is impossible 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’.

In 1932 this principle was stated in s 454 of the Restatement (First) of the Law on Contracts, which refers to a situation entailing ‘…not only strict impossibility but impracticability because of extreme and unreasonable difficulty, expense, injury or loss involved’. This concept was later also included in s 281 of the Restatement (Second) of the Law on Contracts (1981), according to which the doctrine of impracticability can be invoked in a situation involving any abnormal price rise that creates extreme or unreasonable difficulty.

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36 Ibid.
41 Restatement (First) of Contracts s 454 (1932).
Confirming the interest in regulating situations where a supervening event has made performance economically untenable, s 2–615 of the Uniform Commercial Code (UCC) summarised the notion of commercial impracticability, stating that ‘... delay in delivery or non-delivery in whole or in part by a seller ... is not a breach of his duty under a contract of 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 ...’. In other words, the application of s 2–615 of the UCC relies on the following requirements:

(i) occurrence of an unforeseen event which made performance of the contract impracticable;
(ii) the non-occurrence of the event was a basic assumption upon which the parties had based their agreement; and
(iii) the impracticability had resulted without the fault of the party seeking to be excused.

Clearly, the nature of an unforeseen event is very difficult to define and therefore much is left to the discretion of the judges. For instance, in the cases following the US’s entry into the Second World War after the attack on Pearl Harbour, the judges rejected pleas for termination of contracts, deciding that the event was foreseeable, despite the fact that the Japanese attack had taken the American armed forces entirely by surprise. In some of the Suez Canal cases, too, closing of the canal was judged to be foreseeable, even if this move had not been planned by the Egyptian government but was decided on the basis of the developments of the war. In Professor Perillo’s view, the judges’ decisions in these cases were strongly conditioned by consideration of the drastic consequences that would have ensued if the pleas had been supported, since thousands of contracts would then have been bound to be dissolved. Indeed, Professor Perillo feels that ‘it is no accident that the court is more willing to find an excuse where the supervening event has drastic consequences only for one contract or a small number of contracts than where the supervening event affects an enormous number of transactions’.

42 Although s 2–615 refers to the seller, it applies also to the buyer.
46 Ibid.
Furthermore, there is also a tendency among American courts to consider that when no express provisions have been made for a particular event, the party most affected has implicitly accepted the risk involved.48 Even when the parties have prudently included in the contract a clause which deals with changed circumstances, if this is inadequate to deal with the consequences of the event (which have turned out to be more serious than envisaged), American judges prefer to observe the *pacta sunt servanda* principle and deny application of *impracticability* to the case in question.49 Indeed, the very fact that there has been agreement between the parties to include a clause in the contract gives the judge greater leeway to base his ruling on the allocation of the contractual risk. That is why contracting parties are tending to *excogitate* more and more elaborate, sophisticated clauses to endeavour to cover all the possible contingencies, although a certain measure of risk will still inevitably be present with regard to future events.

In a few limited cases, such as that of the *Transatlantic Financing Corporation v United States of America*,50 it was held that ‘foreseeability or even recognition of a risk does not necessarily prove its allocation’,51 since parties are not always able to provide for all known contingencies, sometimes through lack of agreement but often simply because they are too busy.

In the official comment to s 2–615 of the UCC,52 it is made clear that a mere price rise is not sufficient to invoke *commercial impracticability*. The rise must be shown to be *extreme and unreasonable*, and in some cases the supervening circumstance must be such as fundamentally to change the nature of the performance agreed upon. Despite the intention to provide an answer to situations of hardship (revealed both in the Restatement and in the UCC) the American courts tend to interpret the concept of *impracticability* in a very narrow sense.53

This can be justified to some extent by the fact that, since the Second World War, the US has enjoyed greater economic stability than such nations as Italy and Germany, which had to adopt a more flexible attitude, as will be discussed below.54

However, the American approach is certainly more flexible than the English approach, not only as regards situations of hardship but also in providing judges with the possibility of directing the controversy towards an ‘equitable adaptation’ or renegotiation of the contract. Although the American legal system normally

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48 See eg *Eastern Air Lines v McDonnell Douglas Corp* 532 F 2d 957 (5th Cir, 1976) in which the court stated: ‘because the purpose of a contract is to place the reasonable risk of performance on the promisor, he is presumed, in the absence of evidence to the contrary, to have agreed to bear any loss occasioned by any event which was foreseeable at the time of contracting.’

49 See eg *Publiker Industries Inc v Union Carbide Corp*. 17 UCC Rep 989 (Dist Ct ED Pa 1975).


52 UCC s 2–615, Comment 4.

53 See eg *US v Wegematic Corporation* 360 F 2d 674 (2nd Cir, 1966); *Eastern Air Lines v Gulf Oil Corp* 415 F Supp 429 (SD Fla 1976); *Missouri Public Service Company v Peabody Coal Company* 583 SW 2d 721 (Mo Ct App 1979); *Northern Illinois Gas Co v Energy Co-operative Inc* 38 UCC Rep Serv 1222 (Ill App Ct 1984).

tends towards termination of the contract, in situations where the original agreement can be shown to have become impracticable, in a few cases American judges seem to have been able to intervene personally, directing the revision of the terms of the contract.

A significant statement is made in the official comment to s 2-615 of the UCC, which refers expressly to adaptation:

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 the furtherance of commercial standards and good faith.55

Three cases in point clearly illustrate this approach. The first56 was that of the Atlas Corporation, which had agreed to supply uranium to the Ioxa Electric Light and Power Corporation for a period of four years. Shortly after the conclusion of the contract, a series of economic factors57 had brought about a drastic increase in the costs for uranium production, casting uranium producers into grave difficulties. Atlas registered a plea for equitable adjustment of the price, on the basis of s 2-615 of the UCC. The court denied the existence of grounds for impracticability, as the claimant had not established an adequate standard for revising and altering the price. However, although the judges rejected application of s 2-615, they did not exclude a priori that a price adjustment could be made ope iudicis.

In the case of Florida Power & Light Co v Westinghouse Electric Corp,58 although the judge denied exemption from responsibility according to s 2-615 of the UCC, he stated his willingness to take part in the transactions that would follow. In this case, he viewed the controversy as ‘business problems, to be settled as business problems by businessmen’.

Finally, in the case of Aluminium Company of America (ALCOA) v Essex Group Inc,59 Judge Teitelbaum showed his intention of taking a greater part in the settlement. According to the contract concluded in 1967, ALCOA had agreed to transform a certain quantity of raw materials into aluminium, for a period of 16 years. The price per pound was established by applying a complex index-linked formula. After 1973, the problems for uranium producers described above caused the price to rise above the index. ALCOA proved during the hearings that it had already suffered a loss of $12,000,000 and that unless the price was adjusted, the total loss for the remaining contractual period would have amounted to $75,000,000. The judge ruled that termination of the contract was not an answer and personally

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55 UCC s 2 – 615, Comment 6.
57 The crude oil embargo by the Arab countries and OPEC cartel; new, unforeseen federal regulations to control and protect the environment; a sudden shortage of uranium.
worked out a new mechanism for calculating the price, thus starting the trend
towards what has been called ‘forms of surgical reconstruction of the contract’. In
the decision, the judge showed that it is necessary first of all to allow the parties to
renegotiate the terms of a contract and only if they are unable to come to an
agreement must the court undertake adaptation by legal settlement. According to
Judge Teitelbaum, this solution should encourage parties to solve the many
problems that may occur during long-term contracts without the intervention of a
third party. Indeed, a solution reached after renegotiation by means of a friendly
agreement between the parties would be more acceptable than any decision
imposed by the court: ‘only a rule which permits a judicial action of the kind the
court has taken in this case will provide a desirable practical incentive for
businessmen to negotiate their own resolution to problems which arise in the life of
long term contracts’.

Part of the American literature was highly critical of this decision, considering it to
have introduced worrying implications. Professor Dawson, for example,
describes the Alcoa decision as ‘grotesque’, as ‘a lonely monument on a bleak
landscape’ and as ‘the frustrated venture of a single trial judge whose fancy was
unusually free’.

Indeed, according to these scholars, the main risk is that ‘if the other courts adopt
the Alcoa test, contracts – especially long-term ones – will become markedly less
secure. And there will be little basis upon which parties might ascertain in advance
which contracts are vulnerable to reformation or avoidance’. This fear was shared
by later courts which chose not to take Judge Teitelbaum’s position, making the
Alcoa judgment an isolated case.

In order to circumvent the impasse and encourage parties to reach a new
agreement, scholars have occasionally suggested that changed circumstances may
place a party under an obligation to revise the contract. The basis of this duty is
the principle of good faith, stated in s 1–203 of the UCC and also mentioned in
Comment 6 of s 2–615. According to this line of reasoning, refusal to modify the
contract in cases of changed circumstances would be in contrast with the duty to
perform the contract in good faith.

However, courts have not been receptive to this suggestion. In Bermingham’s view:

the courts to date have refused to read official comment 6 to impose a duty to negotiate
good faith modifications under drastically changed circumstances. The result is that the
parties are left with the rigid ‘excuse’ or ‘no excuse’ alternatives which, it has been
suggested, the UCC was intended to mitigate.

60 F Macario, *Adeguamento e rinegoziazione nei contratti a lungo termine* (Naples: Jovene Editore,
1996) 252.
61 *Aluminium Company of America (ALCOA) v Essex Group Inc* 499 F Supp 53 (WD Pa 1980), 92.
62 F Macario, *Adeguamento e rinegoziazione nei contratti a lungo termine* (Naples: Jovene Editore,
1996) 252 (footnote 37) cites Dawson.
63 F Macario, *Adeguamento e rinegoziazione nei contratti a lungo termine* (Naples Jovene Editore,
1996) 252 (footnote 37) cites Sirianni.
64 JP Bermingham, ‘Extending good faith: does the UCC impose a duty of good faith negotiation
under changed circumstances?’, (1987), 61(2) *St John’s Law Review* 223.
In *LC Williams Oil Co Inc v Exxon Corporation*, the court rejected the argument ‘that Exxon was under a good faith obligation to modify the existing contract terms when William’s circumstances changed’.

To conclude, although American law has proved to be more flexible than English law, it seems clear that common law systems apply a certain rigour to the question of hardship and of its effects on contracts.

**Eccessiva onerosità sopravvenuta and Article 1467 of the Italian Civil Code**

Unlike English and American law, the Italian Civil Code explicitly provides for situations of hardship.

Already by 1942 the inflexibility of the *pacta sunt servanda* principle had been mitigated by the introduction into the Civil Code of exemption to perform a contract in cases of *eccessiva onerosità sopravvenuta*, ie in cases in which, although possible, the performance of the contract would require strong financial sacrifice from one of the parties. Indeed, according to article 1467 of the Italian Civil Code ‘... if extraordinary and unforeseeable events make the performance of one of the parties excessively onerous, the party who owes such performance can demand dissolution of the contract ...’ Such a consequence cannot be demanded if the supervening hardship is part of the normal area of risk of the contract. Furthermore, ‘the party against whom dissolution is demanded can avoid it by offering to modify equitably the conditions of the contract’ (*reductio ad equitatem* or return to equity).

Many legal systems have based the doctrine of excessive hardship on Article 1467 of the Italian Civil Code so as to create a system based on better compliance with the changing needs of the economy. However, the innovative character of the Italian provision on hardship does not exclude the existence of difficulties when applying Article 1467 of the Italian Civil Code.

Problems may occur when trying to interpret what is meant by the normal area of risk of the contract. The most recent approach seems to have abandoned the attempt to define this concept once and for all, as the normal risk depends on the type of agreement made by the parties. Indeed, each type of contract, together with its clauses, expresses a particular allocation of the risks agreed on between the parties. In addition, the market sector involved may affect the level of acceptable risk. Trading in some raw materials, for instance, or charterparty, are sectors which

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68 Article 1467(1) Italian Civil Code.
69 Article 1467(2) Italian Civil Code.
70 Article 1467(3) Italian Civil Code.
71 See eg the systems of Greece, Egypt, Hungary, Ethiopia, Portugal and Algeria.
feature rapid fluctuations, even over short periods, of up to 200% or more. Thus, in such sectors, abrupt alterations must be considered the norm and not grounds for excessive hardship, whereas similar fluctuations in other sectors would undoubtedly be grounds for dissolution of the contract.73

As to its effects, Article 1467 of the Italian Civil Code provides for a premature termination of the contract if the disadvantaged party should advance this request in court. This effect does not operate automatically as the judge must establish whether performance of the contract is truly excessively onerous.74

However, the party who would benefit from the situation of hardship is granted the power to avoid termination of the contract by offering an equitable renegotiation (reductio ad equitatem), such as supplementing the price, for instance. This offer cannot be advanced by the disadvantaged party (even if it is in his/her interest to ensure continuation of the contractual relationship), as it is a request expressly reserved to ‘the party against whom dissolution is demanded’.75

It should be borne in mind that a reductio ad equitatem or is not meant to re-establish the contractual equilibrium between the parties but only to eliminate the disproportion exceeding that of the normal area of risk inherent in the contract. Thus, if the offer is accepted, the disadvantaged party will in any case suffer the negative consequences of the changed circumstances, within the limits of normal tolerability.76 This line was confirmed in 1992 by the Italian Court of Cassation which stated that: ‘[A]n offer of adaptation can be considered equitable if it brings the contract to a situation that had it existed at the time of the conclusion of the contract, the disadvantaged party would not have had the right to ask for termination.’77

Furthermore, the offer must be presented in clear and precise terms, as the judge has to limit his/her assessment to whether it is a consonant offer, but in many cases cannot change it.78 However, the Italian Court of Cassation recently allowed the judge’s intervention in the adaptation process by stating that if the offer is inadequate, the judge may determine an equitable revision of the contract.79 According to the court, this decision ensures a better safeguard of the disadvantaged party, while respecting the principle that only the party who would benefit from the changed circumstances can propose a reductio ad equitatem.80

74 This means that premature termination of the contract depends both on the choice of the disadvantaged party and on the judge’s decision.
75 Article 1467(3) Italian Civil Code.
There have been attempts among the literature\textsuperscript{81} to allow the disadvantaged party to preserve continuation of the contractual relationship. Indeed, the interest in keeping the contract alive has led part of the literature to suggest that a situation of excessive onerosity places both parties under a duty to adapt the contract to the changed circumstances. Once again, the basis of this duty is the principle of good faith, stated in Articles 1366 and 1375 of the Italian Civil Code.\textsuperscript{82} However, no court has followed this line of reasoning, as it is feared that the concept of good faith is too vague and thus leaves too much space to the discretion of the judge.

This fear could easily be overcome by taking into consideration the German concept of the Wegfall der Geschäftsgrundlage (ie ‘disappearance of the basis of the transaction’).\textsuperscript{83} According to this theory, when the circumstances have radically changed, the foundation of the transaction has been destroyed and the parties are no longer bound to their original contractual commitments. Indeed, under these new circumstances, performance of the contract in its original terms would constitute bad faith. Thus, the judge has the power to adapt the contract to the changed circumstances and may consider a premature termination only in the event that there is no reason to keep the contract alive. The basis of the doctrine of the Wegfall der Geschäftsgrundlage originated from paragraph 242 BGB,\textsuperscript{84} which requires that the contract must be performed in good faith.

With the recent reform of the German Civil Code, this doctrine was codified in paragraph 313 Bürgerliches Gesetzbuch (BGB).\textsuperscript{85} This codification confirms the importance given to good faith in cases of changed circumstances, although the concept of the Wegfall der Geschäftsgrundlage is now only accepted by German courts in a very restricted manner, compared to those early of strong inflation after both World Wars.

\textit{International commercial trade in situations of hardship}

\textit{The hardship clause and the adaptation of the contract}

The inadequate solutions of domestic law have resulted in the principle of freedom of contract being invoked and in the insertion of an appropriate clause known as the hardship clause, which enables contracting parties to pursue their agreement by means of continual adaptation of the contract to changing circumstances.

\begin{itemize}
\item \textsuperscript{81} R Sacco and G De Nova, Il Contratto (2nd edn, Turin: Utet, 1993) 685–86; P Gallo, ‘Eccessiva onerosità sopravvenuta e problemi di gestione del contratto in diritto comparato’ (1991) VII, sez civ, Digesto IV 244; Criscuolo, 71–79.
\item \textsuperscript{82} According to Article 1366 of the Italian Civil Code ‘the contract shall be interpreted according to good faith’. Furthermore, Article 1375 states: ‘the contract shall be performed according to good faith.’
\item \textsuperscript{84} Paragraph s 242 Bürgerliches Gesetzbuch (BGB).
\item \textsuperscript{85} Paragraph 313 Bürgerliches Gesetzbuch (BGB).
\end{itemize}
The formulation of this clause varies from one contract to another because it is essential to adapt it to the particular sector and the type of performance specified. However, there are some general features that characterise these clauses and the aims they embody. First of all, insertion of this clause is an explicit demonstration that the contracting parties are willing to undertake revision of the contract, if unpredicted circumstances make performance of the contract excessively onerous for either one of the parties.86

Analysis of the hardship clause demonstrates that it is subdivided into two parts: in the first part, the contracting parties specify the circumstances governing the operation of the clause and, in the second part, they indicate what effects such circumstances will have on the agreement.

In the first part, dealing with the events, the clause refers to changes in circumstances that must necessarily have occurred after the conclusion of the contract, and which must have been unforeseeable at the time the contract was concluded.

Indeed, it is not easy to identify this characteristic since in the abstract all events are equally foreseeable or unforeseeable. According to Professor Fontaine, the fact that a hardship clause has been inserted in the contract implies that the parties are aware of the risk of future events overthrowing the equitable balance of interests.87 In practice, however, contracting parties cannot predict if or when any event could occur and what degree of influence it could have on the balance and it is for this

86 A distinction must be drawn between the hardship clause and that of force majeure, when an unexpected, irrevocable event beyond the control of the disadvantaged party makes performance of the contract absolutely impossible. Instead, a hardship situation arises when a sudden change of circumstances irreversibly alters the economic balance of the contract and thus makes the performance by one of the parties excessively onerous or non-economically viable, even if it is still objectively possible. In principle, this distinction seems clear enough but in practice the two concepts tend to overlap. In fact, it is common practice in international trade agreements to give a much wider reading to the notion of force majeure than would classically have been adopted. In many cases, such clauses include not only events that would make performance of the contract impossible but also circumstances that would hinder its normal execution and thus make it ‘practically impossible’, in other words not objectively but subjectively, economically impossible or ‘exorbitant’ from an industrial or commercial standpoint, U Draetta, Il Diritto dei Contratti Internazionali – La Patologia dei Contratti (Padua: Cedam, 1988) 43 and 85–86 fn 14. Clearly, from this viewpoint, the force majeure clause becomes very difficult to distinguish from the hardship clause. Confirming the comparable nature of the practical application of the two concepts, it is a fact that in the latter hypothesis, force majeure acts not only as a factor that exempts the disadvantaged party from performance of the contract (a typical effect of this clause) but even as a factor that determines an adaptation of the contract. This progressive convergence applies both to the nature of the events and their effects on the international contract, and thus makes any true demarcation between the two types of clauses extremely fine. For this reason, some experts regard it as preferable, for the sake of greater simplicity and efficacy, to include only a single clause in the contract that aims to deal with any problems concerning fundamental changes in circumstances. For an analysis of this distinction, see eg U Draetta, Il Diritto dei Contratti Internazionali – La Patologia dei Contratti (Padua: Cedam, 1988) 85–87; PJM Declercq, ‘Modern analysis of the legal effect of force majeure clauses in situations of commercial impracticability, (1995) 15 Journal of Law and Commerce 246; J Rimke, Force majeure and hardship: Application in international trade practice – with specific regard to the CISG and the UNIDROIT Principles of International Commercial Contracts? (1998) Face Law School Institute of International Commercial Law http://cisgw3.law.pace.edu/ciegl/biblio/rimke.html.

very reason that they choose to insert such a clause. In view of the risk that this
criterion of unpredictability might restrict the application of the clause, in some
cases the contracting parties simply require the events to be ‘against the will of the
parties’ or ‘beyond the sphere of control’ of the disadvantaged party.88

An analysis of the circumstances is often indicated only in general terms, so as to
widen its application to include as many cases as possible. Formulae such as the
following are commonly observed: ‘in the case of a serious occurrence of a political,
economic or financial nature’, or ‘if the economic or monetary situation were to
develop’, or else ‘if significant variations in the situation or evident changes in the
economic conditions arise’.89 There are also some very vague expressions used, such
as ‘all those circumstances that might endanger the good outcome of the contract’ or
‘for any bona fide cause the revenue accruing ... for this transaction is insufficient to
meet the costs’.90 Nevertheless, these latter are relatively rare because their excessive
range of application could too easily allow one of the parties to take extreme
advantage.91

In practice, much more specific clauses are also frequently included, which list all
the events that could arise in a given business sector.92 For example, the following
hypothesis ‘if the production of steel deriving from haematite sources should reach
20% of the total production of steelworks x’ or ‘in the case of new import or export
laws’, or ‘if ordinary crude oil delivered to its destination should increase by more
than 6 francs per ton with respect to the original price’.93 However, it is more

88 Ibid, 258.
89 Ibid, 259.
90 A Frignani, ‘La hardship clause nei contratti internazionali e le tecniche di allocazione dei
rischi negli ordinamenti di civil law e di common law’ (1979) Rivista di Diritto Civile 702; M,
92 The use of ‘specific’ hardship clauses makes it sometimes difficult to distinguish these clauses
from the so-called ‘indexation clauses’ (clauses about floating currency rates, price revisions,
devaluation etc), which provide for automatic changes in price according to fluctuations in
various reference indexes, and thus protect the parties from well-defined events such as
inflation, currency devaluation and unfavourable trends in exchange rates. Unlike these
clauses, the hardship clause does not determine automatic adaptation but requires the parties
to commit themselves to the renegotiation of the contractual conditions and/or to the
intervention of a third party to solve the problem, and therefore always leaves some margin
of doubt as to the ultimate fate of the contract. Moreover, while indexation clauses become
operative in well-defined circumstances such as those listed above, and do not apply except
in such specific cases, the hardship clause is a general purpose tool that can cope with a vast
range of situations that the parties could not have foreseen. Unfortunately, in practice the
demarcation line is not always very clear, as in some cases even hardship clauses include a list
of specific events that could have to do with such circumstances as currency devaluation or a
sudden rise in costs. This has caused some experts to enquire whether such specifications are
in fact compatible with the requirement that the event be unforeseeable which, as analysed
below, is an essential characteristic of the hardship clause. For an analysis see M Fontaine, ‘Les
Droit International (Clunet) 794–814, 797; W Den Haerynck, ‘Drafting hardship clauses in
international contracts’, in Campbell (ed), Structuring International Contracts (The Hague:
Patologia dei Contratti (Padua: Cedam, 1988), 84.
common to find clauses in which circumstances are described in general terms with specific hypotheses indicated only as examples. This aims to avoid both disagreements between the parties as to what circumstances should be included in the list and the risk of overlooking any specific event.94

The hardship clause, in any event, applies only to circumstances that overthrow the balance of the contract. The criteria used to establish this event are variously formulated and can be based on objective or subjective parameters. In the first case, to describe hardship suffered by one of the parties and hence the tilting of the balance, such expressions as ‘the breakdown of the economic equilibrium of the contract, that could not be foreseen by the parties when the contract was concluded’ or ‘substantial and disproportionate prejudice’, ‘substantial economic hardship’, ‘obvious hardship’ are used.95 In the second case, instead, subjective clauses can replace the above objective ones, such as inequity or unfairness which deal with the minimum degree of unbalance of the contract.96

The most delicate part of this phase is the question of how to assess whether hardship is present. The clause often contains an obligation on the part of the disadvantaged party to notify the other party of the existence of a hardship condition. The failure to notify may, dependent on the requisite time requirement, result in the expiration of the right to invoke the clause.97 It triggers a consultation mechanism between the parties to ascertain the existence of such a condition. This is not always easy as the criteria used in the clause are often imprecise. There is also a risk that when the disadvantaged party invokes the clause the other party, who would benefit from the altered situation, will try to evade renegotiation.98 As a result, if the parties fail to reach an agreement about the effective existence of a

96 Expressions as ‘unfairness or substantial and disproportionate prejudice to the interest of either’ or ‘undue hardship or inequity’ can be frequently found in international contracts. See M Fontaine, ‘Les clauses de hardship’, (1976) Dir Prat Comm Int 265.
97 In a contract for the supply of crude oil the hardship clause stated: ‘The party who considers that the conditions set forth in section 13–2 are met, shall give notice thereof to the other party by registered letter, return receipt requested, which will specify the date and nature of the event or events which caused the change alleged by it, an evaluation of the hardship which is or will be suffered and the proposal made by it to remedy that change. Any notice given more than 12 months after the date of occurrence of the event(s) which caused the change alleged by the party giving the notice shall be of no effect’; B Oppetit, ‘L’adaptation des contrats internationaux aux changements de circonstance: la clause de hardship’, (1974) 101 Journal de Droit International (Clunet) 794–814, 814.
hardship situation, the clause itself provides for intervention by a third party, or arbitrator, to decide the question. If the third party considers the conditions of the clause to be fulfilled, the parties are obliged to renegotiate the contract whereas if the judgment is negative the contract will continue its course unaltered.99

The most interesting aspect of the hardship clause – as it is innovative in comparison with national provisions – lies in the second part of the clause, dealing with the legal consequences deriving from ascertainment of a hardship situation. Experience has shown that in some cases the effects of such situations are not permanent and this has induced the parties to provide for temporary suspension of performance of the contract. However, if after a certain period of time the situation still has not stabilised, the parties will then have to decide whether to terminate or to renegotiate the contract.

Apart from the latter hypothesis, revision of the contract may be the basis, as Professor Frignani says, the ‘clou’100 of the whole structure.101 Adaptation of the contract is first left to an agreement between the parties who must try to find an acceptable solution for them both and, above all, try to restore the original balance. Such formulae as the following are often used: ‘the disadvantaged party has the right to ask the other party to participate in a joint examination of the position, to determine whether revision of the contractual terms is necessary and if so, what revision is suitable in the circumstances’.102

The criteria guiding adaptation contained in the clauses are variously formulated and can be subjective, objective or mixed. Objective criteria include: ‘adjusting the price to a certain level’, or ‘reinstating the parties in an equilibrium comparable to that existing at the moment of the conclusion of the contract’.103 Subjective criteria rely on general principles, such as equity, good faith, loyalty and correctness and aim to favour adequate remedies and to facilitate adaptation of the contract.104 Finally, mixed criteria include a combination of subjective and objective criteria. The notion of equity or other such criteria has aroused some perplexity and, indeed, perturbs some experts, who maintain that such references make the clause dangerously imprecise, as they deal with muted, vague concepts and could therefore generate uncertainty. This objection has been countered by the argument that these are in any case criteria that are normally used in commercial practice and that they avoid too precise a list of adaptation criteria that could be insufficient to meet the future case. In any event, in unforeseeable changed circumstances, the

99 In the hardship clause of a contract for the supply of natural gas, the parties established: ‘If the seller(s) and the buyer(s) have not agreed on a mutually acceptable solution within 60 days after the notice requesting a meeting under the provisions of this section 13–9, either party may request the matter to be submitted to arbitration in accordance with section 11–3. For an analysis, see B Oppetit, ‘L’adaptation des contrats internationaux aux changements de circonstance: la clause de hardship”, (1974) 101 Journal de Droit International (Clunet) 794–814, 812–13.
100 ‘Clou’ is a French expression for ‘highlight’ or ‘chief attraction’.
101 A Frignani, ‘La hardship clause nei contratti internazionali e le tecniche di alocazione dei rischi negli ordinamenti di civil law e di common law’ (1979) Rivista di Diritto Civile 705.
102 Ibid.
contract cannot contain adequate indications so it will be necessary for the parties to renegotiate the contract on what could be described as good faith criteria.\textsuperscript{105} In this context, equity is the most meaningful criterion, as it is linked to the idea of justice.

At this stage, it is necessary to consider what will happen if the parties, despite negotiations, are unable to come to an agreement. It should be borne in mind that the parties are obliged to negotiate but not necessarily to reach an agreement.\textsuperscript{106} The obligation is fulfilled if they have met and conducted such negotiations in good faith, whereas there is failure to observe the obligation if one of the parties refuses to renegotiate or does not conduct such negotiations in good faith, honouring the duty to co-operate.

The contracting parties may, however, fail to reach an agreement despite honouring the above obligation, without this failure being imputed to the fault of one of the parties. In this case the obligation to renegotiate has not been breached and the agreement will continue to stand in its original form, unless the parties have provided for the effects of such a failure.

This is confirmed by the Award No 2478\textsuperscript{107} concerning a contract for supply of crude oil, in which the parties had stipulated the obligation to renegotiate if the rates of exchange were to change. As oil prices increased, one of the parties claimed that this rise should be assimilated within the concept of a change in the monetary balance and that there was therefore an obligation to renegotiate the agreement. When this failed, the disadvantaged party demanded to be discharged from the obligation to perform the contract. The arbitrators, instead, concluded that a price rise was not equivalent to a change in the currency balance and that this circumstance did not therefore give rise to an obligation to renegotiate. Moreover, they stressed that the obligation would in any case have been only that of negotiating in good faith and that failure to reach an agreement would not have resulted in termination of the contract unless explicitly stated in the agreement.

If the wish to deal with situations determining an altered economic balance induces the parties to introduce a specific hardship clause, the latter will be totally useless unless the consequences of failure to reach an agreement are also established. This was confirmed by Professor Schmitthoff when he stated that ‘a hardship clause without sanctions is hardly worth the paper on which it is written’.\textsuperscript{108} In fact, it is not always easy to demonstrate bad faith on the part of one of the contractors,\textsuperscript{109} and in any case, persistent disagreement even after loyal renegotiation is a real possibility.\textsuperscript{110}

\textsuperscript{107} Arbitral Award No 2478, 1975 in Clunet, 1975, 925.
In most cases, for this reason, the parties prefer to stipulate what effects failure to reach an agreement may have on the contract. Sometimes, however, parties provide for termination of the contract or for suspension for a given period of time.111 Mostly, however, the decision is delegated to a judge or arbitrator with expertise in the specific field, or to a third party expressly named in the contract, who may be designated as an ‘arbitrator’, an ‘expert’, a ‘conciliator’, a ‘referee’ or an ‘intervener’. This third party has the task of ascertaining the existence of the requirements for revision of the contract and in the affirmative case, of proceeding to undertake this adaptation.112 All these effects have been described by Professor Schmitthoff as ‘sanctions’, to highlight their function not only of offering alternative solutions, but also of encouraging the contracting parties to solve the hardship problem among themselves, by means of a friendly agreement. This remedy would in any case be preferable to the extreme remedy of bringing the contract to a premature end, or even of accepting the more or less imposed decision of a judge or arbitrator, that will certainly not facilitate future co-operation between the contracting parties: ‘no court or arbitrator in the world, at least in international business transactions, can render an award that could serve as the legal basis for a complex future co-operation against the will of one of the parties.’113

However, as mentioned above, there are many cases where, in spite of the parties’ efforts, an amicable agreement cannot be reached and thus the intervention of a third person may be necessary. In this event, it should be borne in mind that the third person, no matter whether this figure is defined as arbitrator, expert or conciliator is called on to carry out an entirely new function in comparison with the classical function of settling disputes stricto sensu. In some cases, this new function may simply be that of filling in supervening gaps; in others, of ascertaining the existence of a situation of hardship. However, in others still, it will extend to cover complete renegotiation of the agreement, intervening in the revision process to restore the original balance of the agreement in the face of supervening circumstances.

111 In this case expressions such as the following are normally used: ‘If an agreement is not reached within a reasonable time, each party can claim the termination of the contract’; M Fontaine, ‘Les clauses de hardship’, (1976) Dir Prat Comm Int 272.
112 The wording used in commercial practice normally varies according to the type of contract involved. For example in a contract for the supply of natural gas, already mentioned above, it was held: ‘If the Seller(s) and the Buyer(s) have not agreed on a mutually acceptable solution...the arbitrators shall determine whether the aforesaid occurrence has happened, and if so what adjustments, if any, in the said price or in other terms and conditions should be made...having due regard for the interest of the other party, and any revised prices or other conditions so determined by said arbitrators shall take effect on the date when notice of arbitration was first given’; see B Oppetit, ‘L’adaptation des contrats internationaux aux changements de circonstance: la clause de hardship’, (1974) 101 Journal de Droit International (Clunet) 794–814, 812. In other circumstances parties can decide to use different expressions, such as: ‘the matter may be referred to by the other party for the determination by an expert;’ see M Fontaine, ‘Les clauses de hardship’, (1976) Dir Prat Comm Int 274.
In reference to these new functions one can raise the question on whether the third person who adapts the contract can be defined as arbitrator. The terminology used in contractual practice is of no help, as it does not always cast light on this point, since the third party is variously referred to as an arbitrator, expert, conciliator, referee or intervener. The literature has often argued that in the strict sense of the term adaptation is not arbitration: ‘an arbitrator is supposed to solve legal disputes, ie disputes over existing rights and duties. The person who adapts contract terms, merely rearranges the contractual relationship on behalf of the parties.’

Indeed, there are many legal systems where it is stated that neither courts nor arbitrators have any power to adapt a contract. An example that immediately comes to mind is the English approach, already analysed above. In short, according to English law ‘the function of the court is not to make a contract for the parties, but to interpret the contract made by them’. This limitation was later extended to arbitrators, creating serious drawbacks in situations where the parties are unable amicably to establish a new equilibrium acceptable to both. In fact, even if the parties intend to continue their contractual relationship, the arbitrator, being in a similar position as a judge, has no power to adapt the contract and mediate between the opposing interests, as a kind of ‘peacemaker’. Professor Schmitthoff argued in 1980 that this inability of the judge or arbitrator to adapt the contract is a ‘serious defect of English law’ and that a solution must be found, as this rule is in direct contrast with any modern system of commercial law. More than 20 years have passed since this statement was made but no changes have yet been introduced into English law.

However, the general situation is not so clear as it would appear to be on the surface. In fact, under other legal systems, the German, the Dutch and the Japanese, for example, judges and arbitrators are empowered to adapt a contract to unforeseen circumstances. Thus, it is very difficult to identify a single solution in order to establish the degree of power the parties possess to allow an arbitrator to adjust the terms of the contract.

The difficulty in reconciling the third person indicated in hardship clauses with any similar figure in national legal systems has prompted the International Chamber of Commerce (ICC) to draw up specific rules regulating contractual relationships. The purpose of these rules is to enable the parties to call upon a third person, who is not an arbitrator, to adapt the contract. According to these rules the parties can demand the Standing Committee for the Regulation of Contractual Relations to appoint a third person, who will either formulate a recommendation...

115 British Movietonews Ltd v London and District Cinemas Ltd [1952] AC 166.
116 According to English law an arbitrator cannot act as amiable compositeur or be appointed to decide ex aequo et bono.
119 The Standing Committee was introduced by the ICC, in accordance with ‘The Rules for the Regulation of Contractual Relations’, which were published in ICC Doc 326.
or take a decision depending on the choice made by the parties. If the parties simply request an opinion, then the only legal requirement is that the parties weigh it up in all good faith. If, instead, the parties recognise the power of a third person to take a binding decision, then the resulting decision will automatically become part of the contract, which is considered to be an expression of the will of the contracting parties. In any case, the ICC has expressly stated that if the parties believe that they can safely choose arbitration without any risk of the decision not being accepted by the legal system where adaptation will take place; the parties still have the option to refer to the standard arbitration clause and to the ICC rules of arbitration.

Although innovative, this initiative has not been successful, as the Standing Committee has not once been called upon to act.120 In spite of its lack of success, the Standing Committee for the Regulation of Contractual Relations was nevertheless mentioned in another document published by the ICC in 1985. This document was drafted to provide all the possible remedies to a hardship situation and it laid out what were then suitable guidelines for the drawing up of a hardship clause to be drafted into the contract.121

The first part of the document defined the situation, which could lead to negotiation between those parties who aimed to revise the contract. If no agreement could be reached, the second part of the ICC clause proposed options which needed to be put into effect within a time-limit of 90 days from the request for revision made by the disadvantaged party and which the parties were able to develop, adapting them to their own specific needs. This document suggested as a first option that the contract be left to stand in its original terms. A second option was that of recourse to an arbitrator or judge to obtain suitable adaptation of the contract. Otherwise as a third and forth option, the parties could refer to the Standing Committee for the Regulation of Contractual Relations122 in order to obtain the appointment of a third person, who according to the parties’ will, is entitled to express an opinion or give a binding decision. The choice of any of these options was conditioned by each specific case but also by the willingness of the contracting parties to submit to the adaptation of their agreement by a third party.123

More recently, the ICC revised this document and in January 2003 published a new hardship clause which greatly differs from the previous one.124 Indeed, the 2003 clause no longer offers four options in above para???, alternative options but provides one only formulation with clear alternative

120 http://www.iccbo.org.
121 ICC Doc 421. One must consider that in the opening part of the document it was established that the hardship clause, unlike that of force majeure, was not meant to be a standard clause. Therefore, being presented by the ICC only as a ‘drafting suggestion’, it cannot be incorporated into the contract by mere reference.
122 ICC Doc 326
123 Obviously, in these cases the remedy may be unwelcome, especially to the party not injured by the changed circumstances, and the parties may be unwilling to subscribe a priori to the risk of having to submit to a ruling to their disadvantage. However, it is equally true that such a solution allows contracting parties to undertake long-term commitments with greater confidence, in a political and economic world subject to continual change.
124 In January 2003 new force majeure and hardship clauses were adopted by the ICC and published in doc 650. Both clauses apply to any contract which incorporates them either expressly or by reference.
consequences, namely negotiation or termination. In cases of excessive onerousness the new clause places upon the parties a duty to negotiate alternative contractual terms and if no agreement can be reached within a reasonable time, the party invoking the clause can terminate the contract. In this new document the drafters decided to make no reference to the intervention of courts or arbitrators as it was felt that the ICC clause should encourage the parties to find solution amongst themselves or through the general dispute resolution clause in the contract.

During the seminar that officially presented this clause to international practitioners, Professor Debattista explained the reason for this decision. His opinion was that:

... a special dispute resolution provision for hardship cases co-existing with a general dispute resolution clause might cause unnecessary and undesirable confusion. Thus, [where no agreement is reached], either because the performing party fails to offer alternative terms or because the non performing party fails unreasonably to accept them, then the likelihood is that a claim will be made, either for termination brought by the party invoking the clause or for breach of contract brought by the other party. That claim would go to arbitration or litigation under the general dispute resolution terms in the contract, for example, by reference to any of the dispute resolution services provided by the ICC.  

The limits of the hardship clause

The possibility that the hardship clause may constitute an attempt ‘to delocalise the contract’ has been underlined in the literature. Indeed, the inclusion of this clause can be seen as an intention to avoid, on this matter, the application of the relative national law that should be applicable, according to the rules of international private law.

The choice to free the contract from national constraints requires the parties to set out the precise contractual agreement in very clear and exhaustive terms. Nevertheless, some difficulties will persist with regard to hardship clauses, as the parties are not always able to assess what may happen during performance of a long-term contract and, in any case, may not have the patience or time to evaluate all the eventualities while drawing up the contract.

Indeed, one problem that lawyers have to grapple with during negotiation is the drafting of a hardship clause that can be considered legally satisfactory. This is, in part, due to the pressure which a lawyer is normally subjected to during such negotiations. In fact, on reaching an agreement, the parties’ main interest is to settle the economic aspects of the contract and leave the legal provisions, which may be considered by the parties as an unpleasant but unavoidable part of the negotiation, to be hurriedly discussed at the end of the negotiating process.

125 Seminar on force majeure and hardship held in Paris on 8 April 2003.
126 Paper presented by Professor Debattista, draftsman-in chief of the new ICC clauses during the seminar on force majeure and hardship held in Paris in April 2003.
127 A Frignani, ‘La hardship clause nei contratti internazionali e le tecniche di allocazione dei rischi negli ordinamenti di civil law e di common law’ (1979) Rivista di Diritto Civile 709.
The fact that non-lawyers tend to underestimate the importance of hardship clauses, ie what such clauses mean in terms of money, seems to confirm Professor Böckstiegel’s comment on lawyers and their part in stipulating contracts: ‘in the beginning (during contract negotiations) there are too few lawyers involved, and at the end (in case of dispute) too many’. This statement must be interpreted in the sense that ‘in the beginning, legal considerations are often not given adequate importance and, at the end, they are given too much importance, thus sometimes stopping the parties from settling the dispute amicably’. Certainly, the wording used in a contract is usually the main obstacle when attempting to reach an amicable solution if a hardship situation arises. Moreover, during the stipulation of the contract it is often very difficult to draw up a hardship clause that will satisfy both parties and therefore the result is usually the fruit of a compromise reached after interminable negotiations, which in any case tends to place the stronger party in a more privileged position.

After having mentioned some of the many difficulties encountered by both contracting parties and lawyers, the situation remains that however much attention may be given to writing up a contract or whatever clauses may be inserted, ‘the absolutely perfect clause suited to all circumstances and acceptable to all parties from the views of their very differing interests does not exist’. Nevertheless, it can be said that a careful, correct negotiation process can solve some difficulties, while others will inevitably continue to arise in view of the uncertainty surrounding forecasts of the future.

The approach of arbitrators in situations of hardship

At this stage, a brief analysis should be made of the approach of arbitrators when the parties have failed to include a hardship clause in the contract or, if included, it is too limited to be able to deal with the consequences of a particular event. In these cases, arbitrators tend to reject the plea for adaptation of the contract, on the basis of presumed professional expertise. In short, it is held that failure to include a hardship clause indicates the parties’ intention to accept the risks implicit in changing circumstances.

Many cases have been judged in this manner. In ICC Award No 1512, the arbitrator stated that as a general rule, one should be particularly reluctant to grant relief in situations of hardship, especially when the intent of the parties has been clearly expressed. Moreover, ‘caution is especially called for in international transactions where it is generally much less likely that the parties have been

128 Ibid, 161.
129 Ibid, 165.
130 Ibid, 165.
132 Ibid, 161.
unaware of the risk of a remote contingency or unable to formulate it precisely’.\textsuperscript{135}

More recently, it was ruled in ICC Award No 8873,\textsuperscript{136} that the obligation to adapt
the contract through the intervention of a third party applies only to exceptional
circumstances, and cannot be enforced unless by inclusion in the contract of a clause
minutely detailing the circumstances that could justify a hardship situation and the
entailing consequences.

The arbitral position is even stricter when the parties have included in the
contract a clause which turns out to be inadequate for the supervening
circumstances. In these cases the general attitude of arbitrators is to interpret the
hardship clause very strictly. Therefore, a clause mentioning specific changes must
be interpreted as meaning that no other changes should be taken into account. In
the already mentioned Award No 2478,\textsuperscript{137} involving a contract for supply of crude
oil, the parties had inserted a hardship clause on currency exchange rates. When an
increase in oil prices occurred, the arbitrators stated that a price rise was not
equivalent to a change in the currency balance. Therefore, there was no obligation to
negotiate because the circumstances that had occurred were not included in the
hardship clause. Similarly, in ICC Award No 5953,\textsuperscript{138} the parties had included a
clause which allowed the revision of the purchase price every six months. Despite
the existence of such a clause the arbitrator excluded interim adaptations because of
changed circumstances.

At this point it seems that in a situation of changed circumstances arbitrators
tend only to consider what was expressly stated in the contract, assuming that the
parties have implicitly accepted the risk of any supervening event not expressly
mentioned. One can argue that this line of reasoning could be in contrast with
common practice. According to some experts,\textsuperscript{139} the frequent use of hardship
clauses in long-term contracts has created a custom that leads to the belief that such
a clause is implied in the contract even if not expressly mentioned by the parties.
However, the lack of uniformity in negotiating hardship clauses, makes it difficult
to accept this position. There is such a variety of clauses which differ from each
other, according to the circumstances involved, to the different sectors in which the
parties operate and to the type of contract concerned that it could be difficult to base
a customary principle on them.\textsuperscript{140}

\textsuperscript{135} ICC Award No 1512 of 1971, Jarvin and Derains, Collection of ICC Arbitral Awards (1990), 3.
\textsuperscript{136} ICC Award No 8873 of 1997, Bulletin de la Cour International d’Arbitrage de la ICC, 10(2), 1999,
81; in support of this statement, see also ICC Award No 9029 of 1998, Bulletin de la Cour
International d’Arbitrage de la ICC, 10(2), 1999, 91. It should be born in mind that in both cases
the disadvantaged party invoked Articles 6.2.2/6.2.3 of the UNIDROIT Principles as the
expression of lex mercatoria.
\textsuperscript{137} Arbitral Award No 2478 of 1975 Clunet 1975, 925.
\textsuperscript{138} ICC Award No 5953 of 1989 Clunet 1990, 1056.
\textsuperscript{139} See eg U Draetta, Il Diritto dei Contratti Internazionali – La Patologia dei Contratti (Padua:
\textsuperscript{140} H van Houtte. ‘Changed circumstances and “pacta sunt servanda” in Institute of
International Business Law and Practice, Transnational Rules in International Commercial
In addition, even if the position of arbitrators does not seem to recognise the principle of adaptation to changed circumstances, it does not seem to be totally against such a solution or in favour of too rigid an application of the *pacta sunt servanda* principle. In some cases interpretative tools such as the non-aleatory character of long-term contracts, the need to preserve an economic balance among the reciprocal performance requirements, equity and good faith have acted in favour of adaptation of the contract.

Of course, it would be easier to obtain such a solution if the arbitrator was vested with the power of *amiable compositeur*, who is entitled to avoid the strict provisions of the contract and decide on the grounds of equity. Thus, in this case, only an arbitrator can grant relief or modify the terms of the contract whenever he or she feels it fair to restore the balance between the parties, having been altered by a change in circumstances. This is confirmed in the case involving the *Société européenne d’études et d’entreprises* and the former Yugoslav Government,\(^\text{141}\) in which the arbitrators, acting as *amiables compositeurs*, despite the lack of explicit adaptation clauses, granted relief because of the depreciation of the Yugoslav dinar. The arbitrators held that the contract stipulated between the parties was not at all aleatory because, at the moment the agreement was reached, the intention of the parties was clearly to stipulate economically equivalent prestations. Thus, as a consequence of this statement, it was held that:

\[...\text{as regards an international contract concluded without speculative intention, it ought to be admitted, as it has been judged, that the devaluation guarantee was meant by the parties, save express Convention; furthermore it would be contrary to good faith, that the Government of a State, who has ordered and received services would refuse to pay the actual value and should intend to derive a profit from the considerable devaluation of the payment currency.}\]

However, similar decisions can be found also in cases in which arbitrators did not act as *amiables compositeurs*. For example, in ICC Award No 2291,\(^\text{142}\) it was held on the basis of the *lex mercatoria* that the reciprocal performances are founded on a profit balance and that any subversion of this balance should lead to revision of the contract. Thus, ‘in most international contracts, the price is established on the basis of the circumstances existing when the agreement was reached and it will be revised according to the different events that occurred during the performance of the contract’\(^\text{143}\).

Under certain conditions, the principle of good faith could be applied to prevent a party from claiming performance as originally agreed when such a claim would be abusive in the light of the new circumstances that have occurred. This was the solution of the ICC in the Award No 3267, dedicated under the Swiss law.\(^\text{144}\)

Similarly, in ICC Award No 4761,\(^\text{145}\) it was decided that insistence on performance of the contractual obligations regardless of changed circumstances is contrary to the

\(^{141}\) Arbitral Award 2 July of 1956, *Clunet* 1959, 1074.

\(^{142}\) ICC Award No 2291 of 1975, *Clunet* 1976, 989; see also ICC Award No 1512 of 1971, *Clunet* 1974, 905.

\(^{143}\) ICC Award No 2291 of 1975, *Clunet*, 1976, 989.


principle of good faith, if the economic basis has substantially altered. In this case the arbitrators referred to Article 657, comma 4 of the Libyan Civil Code (the law applicable to the case in question) and ruled that the refusal by one of the parties to undertake negotiations to revise the contract, despite having admitted that the price needed to be changed, was contrary to the principle of good faith.

This legal approach certainly requires further consideration, but seems up to now to have been backed up only by sporadic, isolated decisions. However, this attitude demonstrates the arbitral tendency to evaluate each situation according to the circumstances of the case and also on the basis of the interpretative tools outlined above. This is clearly confirmed in the ICC Award No 1512, in which it was stated that international practitioners would apply the concept of changed circumstances as an excuse for non-performance ‘where compelling reasons justify it, having regard not only to the fundamental character of the changes, but also to the particular type of the contract involved, to the requirements of fairness and equity and to all circumstances of the case’.146

The CISG and the UNIDROIT Principles

*Article 79 of the United Nations Convention on Contracts for the International Sales of Goods*

The difficulty of evaluating hardship situations is confirmed by analysis of Article 79 of the United Nations Convention on Contracts for the International Sales of Goods (CISG) which aims to establish uniform provisions, exclusively addressing the issue of international contracts for the sale of goods.147

Since the CISG was intended to be a binding instrument, the negotiations among the participating states were inevitably very arduous. The need to find common ground among the different legal traditions has resulted not only in exclusion from the uniform provisions of some aspects of the contract148 but also in offering rules expressed in ambiguous terms, reflecting the general desire to reach a compromise and to leave matters more or less undecided.149 Foremost among the latter is Article 79, which deals with changed circumstances and is one of the most controversial points of the Convention, being the result of a very difficult and long negotiation.

According to the first sub-paragraph of this Article:

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147 The Convention is applicable to all the signatory states which numbered a total of 58 in 2002.
148 According to Article 4, the CISG governs only the formation of the contract of sale and the rights and obligations of the seller and the buyer arising from such a contract. Questions which are not expressly settled in the Convention are to be settled in conformity with the general principles or, as a last resort, by referring to the domestic law applicable by virtue of the rules of private international law – Article 7(2).
a party is not liable for a failure to perform any of his obligations if he proves that the
failure was due to 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.

It seems clear that the intention when drawing up the Convention was to avoid any
mention of existing concepts in the various national legal systems, such as force
majeure, imprévision, Unmöglichkeit, Wegfall der Geschäftsgrundlage, frustration or
impracticability. The draftsmen’s purpose was to express a single, independent rule
that could be shared by the various nations taking part in the Convention. This
explains the use of ‘elastic words’ like impediment or exemptions, the latter term
being the one used in the heading of s IV that includes this article.

Although the Convention aims to provide uniform provisions regarding
international contracts for selling goods, it is apparent that the attempt to find a
solution to the question of unpredicted changed circumstances was hedged with
difficulty. The difference among the various legal systems on this issue made
negotiations extremely long and laborious. Unfortunately, the result was the use of
so vague and ambiguous a ‘formula’ that ample space is left for discussion and
different interpretations. Therefore, the aim of the Convention, stated in Article
7(1) CISG to be that of promoting uniform application at international level,
certainly cannot be said to have been achieved.

One of the more controversial points is whether hardship should be included
among the causes of exemption referred to in Article 79 of the CISG. According to
prevalent opinion, it should not, since this provision was intended to cover only
situations in which performance has become impossible or unreasonably difficult.
Indeed a careful analysis of the negotiations that culminated in Article 79 of the
CISG shows that the participants intended to follow a rigorous selection method
and exclude any hypothesis of hardship.

150 B Nicholas, ‘Impracticability and impossibility in the United Nations Convention on
Contracts for the International Sale of Goods’, in NM Galston and Smit (eds), International
York: Matthew Bender, 1984) s5.02/5-5.

151 B Nicholas, ‘Impracticability and impossibility in the United Nations Convention on
Contracts for the International Sale of Goods’, in NM Galston and Smit (eds), International
York: Matthew Bender, 1984) s 5.01/5-1; P Gillies and G Moens, International Trade and

152 According to Article 7(1) of the CISG In the interpretation of the Convention regard is to be
had to its international character and to the need to promote uniformity in its application and
the observance of good faith in international trade”. See eg MJ Bonell, ‘I Principi UNIDROIT
dei contratti internazionali: un approccio nuovo alla disciplina dei contratti internazionali’, in
MJ Bonell and F Bonelli (eds), Contratti Commerciali Internazionali e Principi UNIDROIT
(Milan: Giuffrè, 1997), 65-95.

153 According to Professor Tallon, the Convention appears to refer to a very restrictive concept:
‘more flexible ... than that of traditional force majeure but stricter than frustration and
impracticability’, D Tallon, CM Bianca, MJ Bonell et al, Commentary on the International Sales
Law – The 1980 Vienna Sales Convention (Milan: Giuffrè, 1987) 592. See also P Gillies and G
Moens, International Trade and Business: Law, Policy and Ethics (Sydney: Cavendish
From the beginning of the preliminary sessions, lively discussion had arisen on the terminology to be used in Article 79 of the CISG as it was considered that the use of the generic term ‘circumstances’ might make it easy for the party claiming hardship to evade responsibility. The discussion resulted, after various proposals had been presented by the delegates of the participating nations, in the use of the term ‘impediment’ and thus excluding any connection to changed circumstances and hardship.

Furthermore, while the third sub-paragraph of this Article, dealing with temporary impediment, was being drawn up, a proposal was presented by the delegation from Norway. They proposed to integrate the text with an additional clause whereby the non-performing party would be exempted on a permanent basis if, after resolution of the impediment, the circumstances had so changed that insistence on performance would be manifestly unreasonable. Despite support from other delegations, including the English, American and Italian representatives, the proposal was rejected for fear, as expressed by the French delegate, that the theory of imprévision or frustration of purpose might gain a footing in the Convention.

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154 This discussion arose as the term circumstances had been used in Article 74 of the Uniform Law for International Sales (ULIS) adopted by the 1964 Hague Conference. Indeed, Article 79 of the CISG has often been considered as a revision of Article 74 of the Uniform Law of the International Sale of Goods adopted by the 1964 Hague Conference; see U Draetta, Il Diritto dei Contratti Internazionali – La Patologia dei Contratti (Padua: Cedam, 1988) 47; P Schlechtriem, Commentary on the UN Convention on the International Sales of Goods (G Thomas (trans)) (London: Oxford University Press, 1998) 603.

155 During the preparation of ULIS, a discussion started on a choice between two words: ‘obstacle’ and ‘circumstances’. A ‘Civil Law’ group, led by the Federal Republic of Germany, was against the use of the word ‘obstacle’, arguing that this term, if introduced, would reduce the chances of applying Article 74. At the insistence of this group, the ‘obstacle’ concept was eliminated and the term ‘circumstances’ was introduced. Thus, Article 74(1) ULIS states as follows: ‘Where one of the parties has not performed one of his obligations, he shall not be liable for such non-performance if he can prove that it was due to circumstances which according to the intention of the parties at the time of the conclusion of the contract, he was not bound to take into account or to avoid or to overcome; ‘in the absence of any expression of the intention of the parties, regard shall be had to what reasonable persons in the same situation would have intended’. With this wording, grounds for an excuse were not limited to physical or legal impossibility, or to circumstances where performance had been radically changed, but might extend to situations in which performance had become unexpectedly onerous. See JO Honnold, Uniform Law for International Sales Under the 1980 United Nations Convention (3rd edn, The Hague: Kluwer Law International, 1999) 477–78; MJ Bonell, ‘Force majeure e hardship nel diritto uniforme della vendita internazionale, (1990), Diritto del Commercio Internazionale 547–48.

156 For an analysis of the different alternatives presented during the drafting of this Article, see Stoll in P Schlechtriem, Commentary on the UN Convention on the International Sales of Goods (G Thomas (trans)) (London: Oxford University Press, 1998) 601–03.

157 According to Article 79(3) of the CISG ‘the exemption provided by this article has effect for the period during which the impediment exists’.

158 Up to 2004 Great Britain is not among the signatory states.

This demonstrates that the ultimate intention of those drawing up the Convention was to regulate the question of the causes of exemption in a very precise fashion, deliberately restricting as far as possible the field of application of Article 79 of the CISG. Indeed, the aim was to exclude the possibility of international practitioners to apply Article 7(2) CISG, claiming that there were gaps in the uniform law and hence of having recourse to the law applicable by virtue of the rules of private international law. Such a solution would be a severe threat to the uniformity of the law, as the various nations adopt different stances on the question.

However, the Convention does not make it clear what is meant by 'an impediment beyond [the parties'] control', thus leading some authors to interpret Article 79 of the CISG in a number of ways.

Indeed, Professor Schlechtriem considers that there must be a limit to the sacrifice required, beyond which, performance of the contract by the disadvantaged party could not be expected to be carried out, in view of the substantial economic unbalance that has developed. In extreme cases, in which an unreasonable increase in costs of performance has occurred, the disadvantaged party should be entitled to ask to be released from the obligations incurred by the contract or to ask for its renegotiation to adapt to the changed circumstances. This conclusion is based on the principle of good faith, whose observance in international trade is stressed as being important in Article 7(1) of the Convention.

Such an interpretation of Article 79 of the CISG seems to go beyond the draftsmen's intentions, considering that another question concerning this Convention is whether Article 7(1) CISG introduces a general principle of good faith. It is quite clear that in interpreting Article 79 of the CISG Professor Schlechtriem is strongly influenced by the German concept of Wegfall der Geschafsgrundlage and by the principle of Treu und Glauben, stated in Article 242 of the BGB.

Professor Tallon considers the latter solution to be unacceptable, as the principle of good faith cannot be used to interpret an express decision of the Convention. In

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160 One must recall that the CISG only refers to international contracts for sale of goods which are by virtue of their very nature short-term contracts. Therefore the CISG was not a suitable tool to deal with situations of changed circumstances; A Frignani, 'Le clausole di hardship', in U Draetta and C Vaccà (eds), Inadempimento, Adattamento, Arbitrato. Patologie dei Contratti e Rimedi (Milan: Egea, 1992) 350.


his view, Article 79 of the CISG constituted an ‘intermediate solution’ that would engender both correctness and confidence in contractual relationships.\(^{164}\)

The attitude adopted by Professor Bonell is different to that of Professor Tallon, as he considers a restricted interpretation of Article 79 of the CISG to be unjustified. The use of the term ‘impediment’, in his opinion, does not imply that there was any intention to limit the number of possible causes of exemption merely to those where it is absolutely impossible to perform the contract. The fact that the ‘impediment’ must be such that the debtor ‘could not reasonably be expected … to have avoided or overcome it or its consequences’ shows that, at least in principle, the possibility should be entertained that performance has become so onerous that it would be unreasonable to enforce it.\(^{165}\)

The delicate issue of the ill-defined borders between objectively impossible situations and hardship cases does not seem to have been fully elucidated even in recent case law, for example in a 1993 decision of the Tribunale di Monza.\(^{166}\) The case concerned the sale of a certain quantity of ferrochrome by an Italian company to a Swedish company. The selling company had pleaded termination of the contract for excessive supervening hardship, caused by a marked increase in the price of ferrochrome on the international market. As an international contract for selling goods was involved, the court had first to face the problem of application of the Vienna Convention.\(^{167}\) The decision, which has been much criticised by the doctrine, was to exclude any possible reference to the uniform law, but nevertheless the court attempted to establish what solution would have been adopted if the CISG had been applied. In fact, the Tribunale di Monza ruled that Article 79 of the CISG does not regulate the question of hardship but only that of releasing parties from obligations that have become impossible owing to an unforeseen change in circumstances. The latter hypothesis is equivalent to *force majeure*, dealt with in Article 1463 of the Italian Codice Civile. The reasoning behind this decision has given rise to considerable controversy, showing once more how divided opinions are on this issue.

Further lack of certainty and clarity is recognised when trying to identify the effects of pleas for exemption, as set out in the convention. No express declaration has been made regarding what should happen to the contract after the impediment has occurred. However, the fifth sub-paragraph of Article 79 of the CISG establishes that no provision in this Article prevents one or the other party from adopting any

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\(^{164}\) If the notion of good faith were to be regarded as the legal basis of the theory of *imprévision*, harmony would be jeopardised and the aim of the Convention, as stated in Article 7(1), would not be attained. See D Tallon, CM Bianca, MJ Bonell *et al*, Commentary on the International Sales Law – The 1980 Vienna Sales Convention (Milan: Giuffrè, 1987) 594.


other remedy apart from the payment of damages. This means that in cases of non-
performance for causes that are not attributable to the debtor, the creditor would
only lose the right to ask for damages, but would be free to choose between
termination of the contract and the request for pursuance of the agreement
unchanged. It seems clear, however, that if it is impossible to carry out the
obligation, this cannot be required of the debtor.

The problem arises instead in those cases where performance has not become
absolutely impossible but only beyond the bounds of reasonableness, as in Article
79(1) of the CISG. It seems absurd to expect the contract to continue to be
considered valid for an indefinite period. That is why some authors have suggested
subordinating the problem to regulation by the national law, to be applied
according to the norms of international private law. Finally, in cases of hardship,
those who support the application of Article 79 of the CISG consider there to be no
doubt that the effects can only be those provided for. Hence, it would be impossible
to request revision of the contract to adapt it to the changed circumstances except in
the case of inclusion of a hardship clause. However, part of the literature believes
that an adaptation of the contract to changed circumstances may be possible by
applying the principle of good faith stated in Article 7(1) of the CISG.

In conclusion, this section has attempted to show that Article 79 of the CISG is
not clear and leaves ample space for contrasting interpretations, being the result of a
compromise among those nations taking part in the negotiations. This cannot be
considered satisfactory, as it may allow international practitioners to interpret the
provision according to the direction of their own legal system, thus going against
the criterion of uniformity that was the underlying aim of the Convention stated in
Article 7(1) of the CISG.

It is easy to understand, however, why those who drew up the Convention
encountered such difficulty in dealing with so controversial an issue as unforeseen
changes in circumstances, and the great effort made to impose some uniformity and
find an adequate solution cannot but be appreciated. Perhaps the binding nature of
the Convention could not allow for any more definite wording than the one agreed
upon at the time.

168 In drafting Article 79 the Federal Republic of Germany proposed to exclude expressly the
possibility of claiming the performance of the contract in such a situation. The request was not
granted for the fear that it would release the promissor from the duty to do everything
possible to overcome the supervening impediment.

169 MJ Bonell, ‘Force majeure e hardship nel diritto uniforme della vendita internazionale’,
(1990), Diritto del Commercio Internazionale 565; B Nicholas, ‘Impracticability and impossibility
Galston and Smit (eds), International Sales: the United Nations Convention on Contracts for
the International Sale of Goods (New York: Matthew Bender, 1984) s 5.03/5–21; D Tallon, CM

170 MJ Bonell, ‘Force majeure e hardship nel diritto uniforme della vendita internazionale’,
(1990), Diritto del Commercio Internazionale 570.

171 Stoll in P Schlechtriem, Commentary on the UN Convention on the International Sales of
Goods (G Thomas (trans)) (London: Oxford University Press, 1998) 618; P Schlechtriem, Good
Faith in German Law and in International Uniform Laws, http://soi.cnr.it/~crolcs/crdcs/
frames24.html. AQ again this website doesn’t work - please supply???
**Definition and effects of hardship in the UNIDROIT Principles**

It is in this complex scenario that the Principles of International Commercial Contracts were published by Unidroit (International Institute for the Unification of Private Law)\(^{172}\) in 1994, with the aim of solving some of the problems discussed above by means of an approach based also on the American Restatement but which was entirely new in the context of international trade law.\(^{173}\)

The Unidroit Principles seek to establish rules that are common to most of the existing legal systems and also offer the best solutions to the specific needs of international trade. Thus, faced with particularly complex problems reflecting irreconcilable differences, instead of accepting compromises revealed by omissions and ambiguous wording (like those in the Vienna Convention), the concept of *better rules* was adopted, featuring innovative solutions better suited to the requirements of the international market. This was possible since the Principles are not binding in nature; therefore they will be applied in practice by reason of their persuasive value only.

Clearly, it is not yet possible to regard the Unidroit Principles *in toto* as the expression of modern *lex mercatoria*. Each single Article needs to be analysed to verify its correspondence to general principles or usages of trade, but despite the fact that for the moment, some Articles express opinions shared only by a minority, the solutions offered are considered better suited to specific trade needs than any previous agreements.\(^{174}\)

Articles 6.2.2 and 6.2.3, for example, were drafted so as to encourage correct trade relationships, protecting the party from situation of hardship. The sixth chapter, which deals with the *performance* of the contract, starts the section on hardship by stressing the principle whereby each party is bound to perform its obligations even if these have become excessively onerous.\(^{175}\) However, although sacrosanct, this obligation is not absolute. The principle cannot be applied in situations where circumstances have substantially altered the balance of the contractual agreement. This emphasises the exceptional nature of hardship, defined as a provision ‘to correct’ the *pacta sunt servanda* principle.\(^ {176}\)

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175 Article 6.2.1 UNIDROIT Principles.

According to Article 6.2.2, hardship must be invoked only ‘where the occurrence of events fundamentally alters the equilibrium of the contract’. A first possibility is a substantial increase in the cost of performance for one of the parties. The second hypothesis is that of a marked reduction in the value of the performance a party receives, including such cases as when circumstances have made this performance unsuitable for the purpose for which it was intended.

Clearly, in both cases there is reference to a performance that is still possible but whose economic advantage has suffered a reversal due to a substantial alteration in circumstances. However, the Article does not specify the extent of the unbalance between the parties. The experts are unanimous in declaring that this refers to an extremely serious disparity between the original and the new conditions, described by legal scholars as a ‘fundamental’ or ‘really serious’ change.

For hardship situation to be present, Article 6.2.2 of the Unidroit Principles specifies further requirements:

(i) the event must be ‘beyond the control of the disadvantaged party’;

(ii) it must occur or become known to the disadvantaged party after the conclusion of the contract and could not reasonably have been taken into account at that time;

177 Article 6.2.2 UNIDROIT Principles.
178 For example, a substantial increase in the cost of performance can be due to a dramatic rise in the price of the raw materials necessary for the production of the goods or the rendering of the services. For an analysis, see the Commentary to the UNIDROIT Principles at 147.
179 For example, the effect of a prohibition to build on a land site acquired for building purposes or the effect of an export embargo on goods acquired with a view to the subsequent export. See M Fontaine, ‘Les dispositions relatives au hardship et à la force majeure’, in MJ Bonell and F Bonelli, Contratti Commerciali Internazionali e Principi UNIDROIT (Milan: Giuffrè, 1997) 188.
182 H van Houtte. ‘Changed circumstances and “pacta sunt servanda” in Institute of International Business Law and Practice, Transnational Rules in International Commercial Arbitration’ (Paris: International Chamber of Commerce, 1993) 16. This means that hardship cannot be invoked if the changed circumstances are included among the ‘normal’ economic risks tacitly accepted by any party when reaching an agreement. It is difficult to identify the precise limit beyond which the economic unbalance must be considered to have exceeded the ‘normal’ area of risk. In the Principles, there is an official comment whereby if the performance can be precisely evaluated in monetary terms, an alteration of 50% or more of the cost or value of performance is very likely to be considered a ‘substantial’ alteration. Thus, the Principles have endeavoured to maintain an objective approach, relying on a precise measurement whereas a personal opinion has no value, as the parties are not legally required to specify the presence of certain conditions in their agreement. Official Commentary of the UNIDROIT Principles, 160. No arbitral award is known of where arbitrators have granted relief merely because the costs of performance have increased by 50% compared to what has been agreed in the contract.
183 Art. 6.2.2 (c) UNIDROIT Principles.
184 Art. 6.2.2 (a) UNIDROIT Principles.
185 Art. 6.2.2 (b) UNIDROIT Principles.
(iii) the event that has caused the contractual unbalance must not be among the risks tacitly accepted by the disadvantaged party, which include not only those expressly accepted but all those inherent in the nature of the agreement.186

All these conditions clearly demonstrate the generic nature of the hardship notion.187 No description is given of the events that could give rise to an unbalance, nor precise definition of what is meant by ‘fundamental’ alteration of the equilibrium. The reason for this is that the drafters of the UNIDROIT Principles aimed to ratify a basic principle to serve as a reference in situations of severe economic unbalance, without limiting the application context to a few specific cases. Indeed, there is no reason why the Article should not provide the contracting parties with support in drawing up their hardship clause, by means of adaptation of the provisions to the particular elements pertaining to their own field.188

As to the effects of a hardship situation on the contract, Article 6.2.3 of the UNIDROIT Principles provides a valuable contribution to international practitioners since it not only includes conditions with are normally inserted in hardship clauses but it also considers issues that frequently give rise to problems in contractual practice.

The opening sub-paragraph of the Article first recognises that the disadvantaged party is entitled to request renegotiation of the contract.189 Unlike hardship clauses, which often fail to specify this issue, the Principles provide that such a request is made to the other party ‘without undue delay’ and indicates ‘the grounds on which it is made’.

However, if no agreement can be reached the disadvantaged party has no right to suspend performance of the contract. This drastic step can be taken only in extraordinary circumstances, confirming the exceptional nature of hardship situations and the intention to prevent possible abuse of the right to apply for renegotiation.190

Indeed, the request for renegotiation by the disadvantaged party and the conduct of both parties during the renegotiation process are subject to the principle of good faith and to the duty to co-operate, which are respectively stated in Articles 1.7191 and 5.3192 of the UNIDROIT Principles. This means, first, that the disadvantaged

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186 Art. 6.2.2 (d) UNIDROIT Principles.
189 Article 6.2.3 (1): ‘In case of hardship the disadvantaged party is entitled to request renegotiations. The request shall be made without undue delay and shall indicate the grounds on which it is based’.
191 Article 1.7 (1) UNIDROIT Principles: ‘Each party must act in accordance with good faith and fair dealing in international trade’.
192 Article 5.3 UNIDROIT Principles: ‘Each party shall co-operate with the other party when such co-operation may reasonably be expected for the performance of that party’s obligations’.
party is required to evaluate honestly whether a hardship situation has truly arisen and not to invoke the clause purely for tactical reasons. Secondly, both parties are obliged to assume a constructive attitude during renegotiation, avoiding any attempt to obstruct the process and reciprocally supplying one another with all information required to reach an equitable solution.

If the parties are unable to reach an agreement within a reasonable time, the third sub-paragraph of Article 6.2.3 of the UNIDROIT Principles rules that either party may resort to the court or to an arbitrator who, after verifying the existence of a hardship situation, will decide whether it is reasonable to terminate the contract or to adapt it in order to restore the original balance.

Some doubt arises as to what the criterion of reasonableness, which should characterise the third party’s decision, refers to. In other words, should this decision be confined to the choice between termination and adaptation of the contract or could the third party even adopt some other solution. The official comment suggests that other choices could be made, indicating as other alternatives the possibility of inviting the parties to renew their negotiations and try once more to come to an agreement, or else of leaving the contract in its original terms. However, if the aim is that of finding a solution to a hardship situation, the latter solution is obviously unsatisfactory. Indeed, if the original terms of the contract are to be left unaltered, the party not adversely affected by the changed circumstances would be encouraged not to reach an agreement during the renegotiation process; thus the whole purpose of the Unidroit provisions would fail.

This purpose is also reinforced by Article 6.3 of the Principles of European Contract Law that has marked affinities with Articles 6.2.2 and 6.2.3 of the UNIDROIT Principles.

However, unlike the Unidroit Principles, Article 6.3 attributes to the contracting parties a true obligation to renegotiate and provides for the Award of damages if the other party refuses to renegotiate or does not conduct this phase in all good faith. This provision is of fundamental importance as it provides a real incentive for the contracting parties to reach an amicable agreement, which is surely a preferable solution to any decision imposed by a third party.193

As in the Unidroit Principles, under Article 6.3, failure to reach an agreement results, extrema ratio, in the intervention by a judge who must decide whether to terminate the contract or modify it. In the latter case, the comment to these Principles argues that there is a limit to the judge’s power of adaptation, whereby some clauses can be modified but not to the extent of rewriting the whole contract.194 This means that the adaptation must not consist of the imposition of a new contract but merely of some form of restoration of the original balance. If this is not possible, the only solution is for the judge to terminate the contract.

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194 Ibid, 326–27.
Articles 6.2.2 and 6.2.3 of the UNIDROIT Principles: holy grail or wholly useless?

Although only a short time has elapsed since the UNIDROIT Principles were published, many arbitral awards have already made express reference to them. Indeed, it is noteworthy that one of the first decisions in which reference to the Principles was made concerns hardship and the rules stated in Articles 6.2.2 and 6.2.3.

This was a case decided by the arbitral court of Berlin in 1992 and it concerned a contract for the supply of machinery to a financial company based in the German Democratic Republic from a company based in Eastern Europe.195 With the unification of Germany and the consequent opening of markets to the West, the machinery lost its value for the German importer, who invoked hardship for a substantial change in circumstances in comparison with the original contractual conditions. The arbitral court of Berlin decided in favour of the German importer and, to support its decision, expressly referred to Articles 6.2.2 and 6.2.3 of the UNIDROIT Principles. According to the arbitral court the principle whereby a substantial alteration in the contractual balance can lead to termination or adaptation of the contract is gaining progressively greater acceptance in international commercial trade.

A similar approach was adopted in ICC Award No 8486, which concerned a contract for the sale of goods by a Dutch company to a Turkish company.196 In deciding whether the buyer could be relieved from his obligation to pay the price on the grounds of exchange rate fluctuations in his country, the arbitral tribunal stressed the exceptional nature of hardship which requires a substantial alteration in the original contractual balance, not a mere increase in the cost of performance as in the instant case. To support the ruling the arbitral tribunal referred not only to Article 6.2.58 of the new Dutch Civil Code (the law governing the contract) but also to Article 6.2.1 of the UNIDROIT Principles. This is even more important when one considers that the new Dutch Civil Code was inspired by the Principles.

In both the above cases, the arbitrators referred to the UNIDROIT Principles to demonstrate that the solution offered by the national law governing the contract was in conformity with the international standard.

Of course, Articles 6.2.2 and 6.2.3 can also be applied if the parties have made express reference to the UNIDROIT Principles as the law governing the contract. However, there have not yet been any awards in which this has been the case.

An important issue to be considered is the possibility of invoking Articles 6.2.2 and 6.2.3 as expressions of lex mercatoria. In this way, the disadvantaged party could


ask for renegotiation regardless of whether a suitable hardship clause had been
included in the contract or whether the UNIDROIT Principles have been chosen by
the parties as the law governing the contract.

At present, this seems to be somewhat difficult to enforce. Indeed, as mentioned
above, the UNIDROIT Principles establish not only rules that are accepted in most
legal systems but also better rules, more suited to the needs of international trade.

Articles 6.2.2 and 6.2.3 of the UNIDROIT Principles need be seen in this light, as
the draftsmen seem to have wished to improve current practice, introducing general
rules which safeguard the disadvantaged party against unforeseen circumstances
and which could overthrow the contractual balance, even in the absence of a
hardship clause. Clearly, as they are not binding, unless there is express reference to
the Principles in the contract, Articles 6.2.2 and 6.2.3 can be applied only as general
principles recognised in international trade or as an expression of lex mercatoria.

Such a conclusion does not seem justified, or at any rate seems premature, in the
light of two recent arbitral awards.197 The first was a contract between a French
company and a Spanish company to build a road in Algeria.198 When the political
situation deteriorated in Algeria and the French company suffered delay and
considerable difficulty in performing the contract, the French company invoked
Articles 6.2.2 and 6.2.3 as general principles applicable to international trade, since
no specific hardship clause had been included in the contract. The arbitrator rejected
this plea, arguing that the obligation to restore the contractual balance is an
exceptional principle, accepted in international practice only when the parties have
included in the contract an express clause which establishes in detail what
situations constitute hardship. Hence the arbitrator excluded the possibility of
taking into account Articles 6.2.2 and 6.2.3 of the UNIDROIT Principles as an
expression of common practice in international trade and considered them, on the
contrary, to be rules that do not at present correspond to international practice and
can therefore be applied only if there is express reference to this effect in the contract
in question.

The other recent award199 provided confirmation of this view, as the court stated
that although the UNIDROIT Principles are a set of rules that are theoretically
suited as a basis for future lex mercatoria, there is not at present any possibility of
referring to their provisions (and specifically of Articles 6.2.2 and 6.2.3) as the
equivalent of current trade usage in international practice.

Criticism of these Articles by legal experts has not been lacking. Although
Professor Bortolotti appreciates the valuable contribution afforded by the
UNIDROIT Principles to the construction of a ‘transnational legal system’, he fears

that if the disadvantaged party is allowed the right to obtain adaptation of the contract, this may encourage all sorts of pretexts to change the agreement after it has been signed and therefore jeopardise the parties’ faith in the contract. Indeed, Professor Bortolotti argues that if the UNIDROIT Principles were to be adopted, Articles 6.2.2 and 6.2.3 should be expressly excluded in favour of a hardship clause, which should detail as precisely as possible the basis for recognition of such a condition and its consequences.\(^\text{200}\) The true problem, according to Professor Bortolotti, is that these \textit{better rules} introduced in the UNIDROIT Principles do not correspond to the criteria of correct contractual practice that the business world believes should regulate international trade, as they leave too much space for uncertainty and possible abuse. From this point of view, he feels that it is a pity that the draftsmen of the Principles did not resist the temptation to introduce such \textit{better rules}, instead of restating those which correspond to the standards prevailing in international trade.\(^\text{201}\)

\textbf{Conclusions}

This paper has attempted to demonstrate that an unforeseen change in circumstances is an inevitable risk in international trade, and that there is a need to restore the balance of the original contract and so ensure the continuation of business relationships to the mutual advantage of both parties.

In spite of this need, trade practice has shown how inadequate the tools presently available to international practitioners are to deal with such circumstances. The use of a hardship clause is not entirely satisfactory, as it requires the parties to provide ‘certain and well-defined solutions for uncertain and undefined situations’.\(^\text{202}\) Indeed, it is certainly not possible for the parties to foresee every single contingency that could arise in the future and, in any case, their desire to conclude the agreement and start the \textit{business} often causes them to underestimate the importance of giving due care and attention to drafting a suitable clause in order to avoid conflict when a situation of hardship arises.

Moreover, there is a general tendency on the part of judges and arbitrators\(^\text{203}\) to reject the plea for adaptation of the contract when no hardship clause has been inserted or even when it has been inserted, but is not adequate to deal with the consequences of a given event. On the other hand, on the basis of factors such as the non-aleatory nature of long-term contracts, equity and good faith, there have also been cases\(^\text{204}\) where the decision has been in favour of an adaptation of the contract.


despite the absence of a hardship clause. This orientation shows that there is also an arbitral tendency to judge each case on its own merits and identify the best solution according to the interpretative elements discussed above.²⁰⁵ Although only sporadic decisions have upheld this approach, it does indicate the real possibility that in practice there may be a shift towards a more liberal interpretation in the future.

In this scenario, Articles 6.2.2 and 6.2.3 of the UNIDROIT principles may constitute a useful tool and could contribute to provide guidelines for operators in the field of international trade. Indeed, although it is still premature to consider Articles 6.2.2 and 6.2.3 of the Unidroit Principles as an expression of *lex mercatoria*, it is not just to describe them as pure utopia either, or as excessively innovative rules that might jeopardise the safety of international trade agreements.

There seems to be no reason why the UNIDROIT Principles should have been limited to a mere statement of rules common to most existing legal systems. The fact that the solution adopted was that of offering a non-binding tool that could be applied in practice only if considered persuasive was presumably judged to be the best way to try to bring the legal approach closer to the new needs of international trade.

In conclusion, the work undertaken by the draftsmen of the UNIDROIT Principles in a field such as hardship where there is still strong controversy can be considered an important move forward from a rigid application of the maxim *pacta sunt servanda* and a first success in an area where the CISG failed.

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