Denver Journal of International Law & Policy

Volume 25
Number 1 *Fall*

Article 8

January 1996

Legal Consequences of Force Majeure under German, Swiss, English and United States' Law

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Keywords

Contracts, States, Industry, Petroleum, Islamic Law, Obligations

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I. INTRODUCTION

Long-term contracts, whether for the turnkey construction of a plant, the construction of works or installations, or for the periodic supply of goods, frequently face the problem that the economic,[1] political[2] and/or natural[3] surroundings change far more than the parties contemplated or expected when they signed the contract. This is especially true for long-term construction contracts where a European or North-American contractor agrees to perform construction work in a third world country. Here, subsequent events which render the performance of the contractor's obligation radically different from what was originally contemplated occur much more often than in a domestic contract. The possible risks in the performance of such a long-term contract are so numerous that they cannot reasonably be considered when the contract is signed.

In view of these imponderable risks, the parties often agree to add a Force Majeure Clause. These clauses are worded much like the following:

> In the Contract "force majeure" shall mean any occurrence outside the control of the parties preventing or delaying their performance of the contract.
>
> Force majeure shall mean extraordinary events independent of the Parties' will that cannot be foreseen or averted by them even with due diligence, being beyond their control and preventing the Contracting Party/or Parties/ from fulfilling the obligation(s) undertaken in this Contract.
>
> The expression "force majeure" shall mean circumstances which were beyond the control of the party concerned exercising the standard care of a reasonable and prudent operator.

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1. *E.g.*, inflation, increase in the price of raw materials.
2. *E.g.*, civil unrest, revolution, war.
3. *E.g.*, flood, earthquakes, storms.

Most clauses of this type require four essential criteria for an event to qualify as Force Majeure:

1) the event must be external;

2) it must render the performance radically different from that originally contemplated;

3) it must have been unforeseeable (objective standard) or at least unforeseen (subjective standard); and

4) its occurrence must be beyond the control of the party concerned.

These criteria are also required by the definition of Force Majeure under most national legal systems.[4] In this respect the term Force Majeure is described as "Wegfall der Geschäftsgrundlage" (destruction of the basis of the contract-Germany and Switzerland), "frustration" (England) and "impracticability" (United States).

Parties often, however, pay less attention to Force Majeure clauses. These clauses are generally included under "Miscellaneous" and their wording as well as their structure is not as detailed and accurate as they should be. Quite frequently, the contractual Force Majeure Clause broadly articulates the definition of a Force Majeure event without delineating the legal consequences to follow the occurrence of a Force Majeure event. To remedy this omission, the parties would have to insert detailed and lengthy provisions dealing with the effect of a Force Majeure event on the contractual duties already and still to be performed, provisions responding to questions such as: on what basis is work already performed to be calculated if such work is of no further use for the employer? can the contractor claim compensation for investments already made but not yet visible for the employer? etc. Instead of dealing with these complicated questions, the parties hope that a Force Majeure event will not happen and leave the determination of its effects to the applicable law — to the principles developed in each of the jurisdictions with respect to Wegfall der Geschäftsgrundlage, frustration or impracticability.

This note will examine the effects of Force Majeure clauses under German, Swiss, English and American law, and how these effects greatly differ. The legal consequences of a recognized Force Majeure vary from a judicial adjustment for the altered circumstances to a division of loss to annulment of the contract.

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4. *Cf.* THEO RAUH, LEISTUNGSERSCHWERUNGEN IM SCHULDVERTRAG (1992) (dealing with English, US-American, German and French Law as well as with the CISG and International Arbitration).

II. PRESERVATION OF THE CONTRACT UNDER MODIFIED CONDITIONS

A. *Alteration of the Contract by the Court*

1. Germany

Under German law, not every destruction of the basis of the transaction results in per se legal consequences. The principle of *pacta sunt servanda* may only be breached if it is in general unreasonable to expect the obligor to fulfill the contract. In *Machine Games*,[5] the Federal Supreme Court stated that the destruction of the basis of the transaction only has legal consequences where called for given the totality of circumstances and where necessary in order to avoid results which are intolerable and in general incompatible with law and justice. Consequently, "unreasonableness" has a double function: in addition to determining whether the basis of the transaction has been destroyed, it serves to determine the legal consequences.[6]

If the relationship between the parties largely breaks down, then a modification of the contract for the changed circumstances is to be considered first. The primacy of adjustment follows from the principle of *pacta sunt servanda*, since an adjustment encroaches less severely on the contract. In this respect, the contractual relationship as such is maintained. Modifying the contract to the changed circumstances should ensure that continuing the contract is reasonable for both parties.[7] Contract modification, because of its flexibility, is particularly suited to taking individual circumstances into account,[8] and every possible restructuring of the contract can, in principle, be achieved. The following types are possible:

- comprehensive reform of the contractual relationship, which can go so far as to replace the original obligation with a completely new one.[9]
- partial restructuring of the contractual relationship[10]
- partial preservation of the contract[11]
- alteration of the contractual obligation[12]
- increase in the amount payable[13]

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5. BGH 20.31967.WM 1967 (561) (F.R.G.).

6. KARL LARENZ, GESCHAFTSGRUNDLAGE UND VERTRAGSERFULLUNG: DIE BEDEUTUNG "VERANDERTER UMSTANDE" IM ZIVILRECHT (3d ed. 1963).

7. VOLKER EMMERICH, DAS RECHT DER LEISTUNGSSTORUNGEN 321 (1984).

8. BGHNJW 1972 (580) (F.R.G).

9. BGHJZ 1952, 145 (146) (F.R.G.).

10. BGHNJW 1953, 1585 (1586) (F.R.G.).

11. LM § 242 Nr.12 Bürgerliches Gesetzbuch (BGB).

12. BGHNJW 1954, 1323 (supply of alternative current instead of direct current) (F.R.G.).

13. BGHZ 1991, 32 (36) (F.R.G.).

- grant of additional equalization claim[14]
- reduction of the contractual performance[15]
- postponement of performance[16]

2. Switzerland

a. Basic Admissibility of an Alteration of the Contract

A modification of the contract aligns it to the new circumstances. The contractual relationship as such is maintained. Scholarly opinion concerning judicial contract modification is very different from that concerning annulment. The older textbooks, in general, apply the principle *clausula rebus sic stantibus* and reject contract modification. Some authors would only permit an alteration of the contract if the contracting parties wished or appeared to desire to preserve the contract.[17]

More recent commentaries, however, express no reservations about granting the judge competence to alter the contract. In principle, they acknowledge the alteration of the contract.[18] In one of its fundamental decisions, the Federal Court, based on the principles enshrined in Art. 373(2) Law of Obligations, allowed judicial alteration of the contract instead of annulment. The Federal Court continues to strictly adhere to this practice.[19]

b. Restrictions on Alteration of the Contract

As with contract dissolution, in a case of contract alteration the principle of private autonomy requires that the judge take into account the parties' agreements concerning the consequence of adjustment. If neither party wishes to continue the contract with altered contents or if both parties request that the contract be dissolved, even with different effects, then the judge must dissolve the contract. In long-term and economically significant contracts, the parties normally have a greater interest in preserving than in dissolving the contract.[20] Weighing the interests of the parties, the judge will focus on the particular concrete facts of the case, for example, on new offers of contracts.

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14. RG 21.6. 1933, RGZ 141, 212, 217

15. LM § 242 Nr.33 BGB (F.R.G.).

16. LM § 284 Nr.2 BGB (F.R.G.).

17. JACQUES BISCHOFF, VERTRAGSRISIKO UND CLAUSULA REBUS SIC STANTIBUS: RISIKOZUORDNUNG IN VERTRAGEN BEI VERANDERTEN VERHALTNISSEN 233 (1983).

18. PETER JÄGGI & PETER GAUCH, ZÜRCHER KOMMENTAR, OBLIGATIONENRECHT, 3 Aufl. (3d ed.) no. 635/636 to § 18 Law of Obligations (1980); PIERRE TERCIER, *La clausula rebus sic stantibus en droit suisse des obligations*, 127 JOURNAL DES TRIBUNAUX 194, 210 (1979).

19. BundesGerichts Entscheidungen [BGE] 97 II 398; BGE 68 II 173 (Switz).

20. BISCHOFF, *supra* note 17, at 234.

c. Possibilities for Alteration

(i). Alteration of the Content of the Contract

The first possibility for altering the contract is to restructure the content of the contract. The judge has a number of options. The judge may postpone the date on which performance is due, order payment by installments, authorize partial performance, delete an agreement to pay interest, or redetermine the place of performance.[21] Adjustments of the contract increasing one party's obligation or reducing the other party's obligation are of great significance in practice. For example, the Federal Court settled the grossly disproportionate lease obligations resulting from an extraordinary increase in the price of coal by appropriately increasing the interest rate.[22]

The Federal Court also raised the contractual obligations in a case involving the reevaluation of debts in German Marks. Both pecuniary obligations and obligations in kind may be reduced (in so far as they do not involve specific goods). In order to meet changed economic conditions, the rent in a lease for operating a restaurant on ships on Lake Lucerne was reduced from Swiss Francs 40,000 to Swiss Francs 17,000.[23] Obligations for performances in kind can also be adjusted for altered circumstances by reducing the quantity of goods owed while the counter-performance remains unchanged.[24]

(ii). Alteration of the Duration of the Contract

The judge may also shorten or lengthen the duration of the contract.[25] Such adjustment may be required if the restoration of normal circumstances (e.g., conclusion of a peace treaty, removal of an export prohibition) can be expected shortly and the obligor could then perform the contract after an appropriate extension of the contract.[26]

3. Anglo-American Law

a. Common Law

Both English and American[27] common law give the judge abso-

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21. JÄGGI & GAUCH, *supra* note 18, at no. 635 to art. 18 Law of Obligations.
22. BGE 47 II 318 (Switz).
23. BGE 48 II 252 (Switz).
24. BGE 47 II 454 (Switz).
25. JÄGGI & GAUCH, *supra* note 18, at nos. 573/574, 635/636 to art. 18 Law of Obligations.
26. BGE 44 II 526-27 (Switz.) (contract was extended for six months).
27. EWAN MCKENDRICK, *Frustration and Force Majeure-Their Relationship and A Comparative Assessment*, *in* FORCE MAJEURE AND FRUSTRATION OF CONTRACT 38 (1991).

lutely no power to alter legal rights with respect to a concluded contract. In *British Movietonews Ltd. v. London & Dist. Cinemas Ltd.*,[28] the Court of Appeals made its only attempt to override this principle. In this case, the defendants (cinema owners) had agreed to obtain films exclusively from the plaintiffs, (wholesale film distributors) for the period when a statutory instrument was in force. This statutory instrument had been passed in 1943 under the Emergency Powers (Defence) Act 1939. Its purpose was the preservation of public life during the war by allocating the few available films evenly.

At the end of the war, however, this Statutory Instrument was not repealed, but was simply included in another statute (Supplies and Services [Transitional Powers] Act 1945). In this context the Statutory Instrument had a completely different purpose, serving to protect Sterling currency against film imports from countries with hard currency[29]. Based on this change of purpose, the defendants pled frustration since they had concluded the original contract on completely different grounds — shortage of films during war — which no longer existed.

Lord Denning believed that the court only had the power to adjust a contract to the changed situation if the contract could be interpreted as recognizing such an intent by the parties. However, he never addressed the question of whether an essential change of the original content of the obligation had arisen:

> In these frustration cases, the court really exercises a qualifying power—a power to qualify the absolute, literal or wide terms of the contract-in order to do what is just and reasonable in the new situation. The court qualifies the literal meaning of the words so as to bring them into accord with the contemplated scope of the contract. Even if the contract is absolute in its terms, nevertheless, if it is not absolute in intent, it will not be held absolute in effect.[30]

This statement was rejected, on one hand, because it made the criterion of radical change of the obligation superfluous and, on the other hand, it would introduce the principle of *clausula rebus sic stantibus* into English contract law.[31] Therefore, it is not surprising that Lord Denning's statement caused some concern in the House of Lords and Lord Denning's decision was overturned.[32] Viscount Simon held

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28. 2 All E.R. 390 (1950).

29. Clive Schmitthoff, *Frustration of International Contracts in English and Comparative Law, in* INTERNATIONAL ASSOCIATION OF LEGAL SCIENCE: SOME PROBLEMS OF NON-PERFORMANCE AND FORCE MAJEURE IN INTERNATIONAL CONTRACTS OF SALE 126, 135 (1961).

30. British Movietonews Ltd. v. London & Dist. Cinemas Ltd., 2 All E.R. 390, 395 (1950).

31. Schmitthoff, *supra* note 29, at 136.

32. British Movietonews, Ltd. v. London & Dist. Cinemas, Ltd., 2 All E.R. 617 (1951).

that the requirements for frustration were not fulfilled:

> The suggestion that an uncontemplated turn of events is enough to enable a court to substitute its notion of what is just and reasonable . . . leads to some misunderstanding.[33] Though the legislative authority behind the words of the order is altered, the words themselves mean the same thing. This is not a case in which there has been a vital change of the law.[34]

Consequently, the only legal effect which comes into question is the annulment of the contract.

b. Uniform Commercial Code § 2-615

Uniform Commercial Code § 2-615 does not make any express provision for the legal effects; it is evident from Comment 6 that this provision however does not exclude the possibility of adjustment:[35]

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

All the same, the overwhelming majority of decisions continue to proceed on the assumption that there are generally the two alternatives of preservation and annulment.

The first case in which the contract was adjusted was the *ALCOA* case.[36] ALCOA had entered into a long-term supply contract for the conversion of minerals into aluminum (toll conversion service contract). The contract contained a price adjustment clause, whereby the parties chose the wholesale price index for industrial goods as an objective measure for the alteration of non-operation related production costs. However, when OPEC began to raise the price of crude oil in 1973 and, in addition, unexpected environmental protection measures greatly increased ALCOA's electricity costs, the rate of increase of the non-operation related production costs considerably exceeded the rate of increase of the index.

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33. *Id.* at 625.

34. *Id.* at 623.

35. *See also* RESTATEMENT (SECOND) OF CONTRACTS § 272(2) (1981) ("In any cases governed by the rules stated in this Chapter, if those rules . . . will not avoid injustice, the court may grant relief on such terms as justice requires including protection of the parties' reliance interests.").

36. Aluminum Co. of America v. Essex Group, Inc., 499 F. Supp. 53 (1980) [hereinafter ALCOA].

ALCOA stated that the parties had proceeded on the assumption that the wholesale index was to be an objective measure of ALCOA's non-operation related production costs. It further stated that the mutual error on this fundamental consideration led to a significant imbalance in the mutual obligations and required-on the basis of a total loss for ALCOA of US $ 75,000,000-an alteration of the contract. In absolute figures the price increase was 500%.

After the court affirmed the existence of Force Majeure, it refused to terminate the contract since this would give the plaintiff's business an unexpected profit, because ALCOA could only conclude a contract on increased present prices. The court further stated that the completion of a long-term contract required a careful examination of the circumstances of the contract, the intent of the parties and the supervening event.

The court, no doubt impressed by the huge sum involved, admitted that in certain cases terminating the contract was the only appropriate option. The court further stated that if the defendant wished to secure a long-term supply of aluminum at a price which still allowed it to make a profit and if the plaintiff had a continuing interest in the contract based on its desire for the full use of its production capacities, then both parties had the same interest in a long-term relationship. The court held that an adjustment was the suitable legal remedy since it came closest to the intentions and expectations of the parties and avoided inequities.[37]

On the basis of its superior expert knowledge the court even considered itself more able than the parties themselves to adjust the contract. The court declared that it possessed "information from hindsight far superior to that which the parties had when they made their contract."[38] After considering the original contract and the expectations of the parties, the court drafted the following price clause:

> For the duration of the contract the price for each pound of aluminum converted by ALCOA shall be the lesser of the current Price A or Price B indicated below. Price A shall be the contract ceiling price computed periodically as specified in the contract. Price B shall be the greater of the current Price B1 or B2. Price B1 shall be the price specified in the contract, computed according to the terms of the contract. Price B2 shall be that price which yields ALCOA a profit of one cent per pound of aluminum converted.[39]

In addition, the court fixed the invoice arrangements and rules for mutual provisions of information (in part for up to two years after

37. *Id.* at 78.
38. *Id.* at 91.
39. *Id.* at 80.

expiration of the contract).[40]

There are several approving comments[41] on the *ALCOA* decision. Supporters of judicial adjustment consider it a decisive step toward allowing judicial changes of contractual duties according to fairness[42] and flexibility.

B. *Allocation of Loss*

1. Germany

In some German cases a division of the loss comes into question as a legal consequence of the disappearance of the basis of the transaction.[43] The assumption underlying the basic principle of determination of loss is that the loss resulting from the contractual breakdown is to be appropriately fixed and allocated between the parties with consideration given to the interests of both parties,[44] their economic circumstances[45] and the originally expected profits.[46]

In a case which occurred under the equalization of burdens legislation,[47] a seller who had sold a war-damaged piece of land with a house for the price of DM 8,000. demanded compensation from the purchaser in the amount of DM 10,000, which was granted to him by the competent equalization of burdens authority for the property. The Federal Supreme Court held that an equal division of the respective advantages and disadvantages between the two contracting partners was appropriate.[48] The court granted the plaintiff DM 5,000 because the grant of such a claim for equalization would always be possible when the continued enforcement of the contract would lead to a result which was intolerable and no longer compatible with law and equity. An equal allocation of the loss is, by no means, a rigid principle; rather, all the circumstances of the case must be considered and valued to achieve an equitable and just equalization. This includes considering whether or not one of the parties has accepted a greater risk. Consequently, every possibility of allocation is open to the court.[49]

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40. *Id.*

41. Michael N. Zundel, *Equitable Reformation of Long-term Contracts-The "New Spirit" of ALCOA*, 1982 UTAH L. REV. 985, 1001; *see also* J.G. Ryan, Note, *UCC § 2-615, Excusing the Impracticable*, 60 B.U. L. REV. 575, 596 (1980).

42. Zundel, *supra* note 41, at 1000.

43. GERHARD KEGEL ET AL., DIE EINWIRKUNG DES KRIEGES AUF VERTRAGE IN DER RECHTSPRECHUNG DEUTSCHLANDS, FRANKREICHS, ENGLANDS UND DER VEREINIGTEN STAATEN VON AMERIKA 127 (1941).

44. *Id.* at 403.

45. OLG Nuremberg, 29.4.1971, RdL 1971, 322, 323.

46. KEGEL, *supra* note 43, at 127.

47. BGH LM No. 41 to § 242 Bürgerliches Gesetzbuch [BGB].

48. *See also* BGH 8.2.18.1984, NJW 1984, 1746, 1747; BGH 23.11.1989, NJW 1990, 572, 573.

49. *See* OLG Nuremberg, *supra* note 45, at 322-23. "An allocation as to 2/3 and

2. Anglo-American law

Due to the general reluctance of Anglo-American courts to adjust the contract, it is not surprising that in only one case has the court allocated the loss. The *National Presto Case*[50] was based on a mutual error of the parties concerning the level of further contractual costs and not on impracticability.

There are many opinions on impracticability which also demand an allocation of the loss in cases of commercial impracticability.[51] The reason given is that it is equitable that both parties, having landed in a losing situation without any fault, should share the loss. Both parties would probably have profited if the contract had been properly implemented; therefore, why should they not then also bear the losses?[52]

C. *Pro-rata Performance*

Where a seller has concluded several contracts for the delivery of specific goods and the supply of those goods subsequently becomes restricted, the restriction frustrates the seller's ability to fulfil all his obligations to supply. The question then becomes how to distribute the remaining goods.

1. United States of America

Both the Common Law[53] and the Uniform Commercial Code § 2-615 provide for the allocation of available goods[54] instead of dissolving one contract because of impracticability and declaring the other contracts capable of being fully performed. There is, however, no fixed allocation standard, so that the seller has some room for discretion in the distribution.[55]

In the *Atlantic Richfield*[56] cases, an oil company was forced to limit supplies to its customers because of a gasoline shortage in the

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1/3 is the appropriate legal result." *Id.*

50. National Presto Indus. v. United States, 338 F.2d 99 (Ct. Cl. 1964).

51. Glanville L. Williams, *The End of Chandler v. Webster*, 6 MOD. L. REV. (1942) 46, 50 (1942).

52. *Id.*

53. *See* Acme Mfg. v. Arminius Chem. Co., 264 F. 27 (4th Cir. 1920); *See also* Yuba v. Mattoon, 325 P.2d 162 (Cal. App. 1958); Amsden Lumber Co. v. Stanton, 294 P. 853 (Kan. 1931).

54. *See* Intermar, Inc. v. Atlantic Richfield Co., 364 F. Supp. 82 (D. Pa. 1973); *See also* Mansfield Propane Gas Co. v. Folger Gas Co., 231 Ga. 868 (Sup. Ct. 1974); Terry v. Atlantic Richfield Co., 72 Cal. App. 3d. 962 (1977).

55. J. White, *Allocation of Scarce Goods Under Sec. 2-615 UCC: A Comparison of Some Rival Models*, 12 U. MICH. J.L. REF. 503 (1978).

56. Terry v. Atlantic Richfield Co., 72 Cal. App. 3d. 962 (1977); Intermar, Inc. v. Atlantic Richfield Co., 364 F. Supp. 82 (D. Pa. 1973).

United States and the United Kingdom arising out of the oil crisis and because of a state regulation requiring the company to keep certain amounts in storage. In order to guarantee an equal supply to all customers the following distribution scheme was applied:

> Until further notice, our sales of gasoline to you will be limited to (104%) of our sales to you during the comparable calendar month of 1972, except in those cases where a different basis is approved due to such factors as the lack of 1972 sales history or the occurrence of a material intervening event.[57]

Where no comparable figures for 1972 existed, the consumption of the individual petrol station was estimated by the suppliers based on such details as size and position. Two petrol station tenants took action against this. The plaintiff in the first case argued that, although no comparable figures were available for 1972, the value estimated by the suppliers was far too low[58] and was done deliberately to drive him from the market. The second plaintiff claimed an inequitable hardship since the petrol station had only opened in 1971 and the current turnover was much higher.[59] In both cases the courts upheld the allocation formula. On the basis of the UCC § 2-615 (b) requirement that the allocation be fair and reasonable, the focus of the inquiry was on whether unequal treatment or discrimination in comparison with the other petrol station tenants was evident. "The fact that plaintiff, under the allocation formula, receives less than its marketing needs is the result of its lack of sales history in 1972 rather than the result of any arbitrary and discriminatory conduct by the defendant."[60] Consequently, whether better and more exact methods for calculating the comparison standard existed was irrelevant. What mattered was that both the disadvantages and the advantages of the allocation formula were shared equally amongst the customers. These principles of pro-rata performance are applied in the same way when the contract contains a Force Majeure clause.

2. Germany

German law also allows a pro-rata performance in cases where the basis of the transaction is destroyed.[61] When the seller of specific restricted goods encounters difficulties in obtaining these goods with-

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57. Intermar, Inc. v. Atlantic Richfield Co., 364 F. Supp. 82 (D. Pa. 1973). Intermar, *supra* note 54, at 90.

58. *Id.*

59. Terry, 72 Cal. App. 3d at 962.

60. *Intermar*, 364 F.Supp. at fn 54; *See also Terry* 72 Cal. App. 3d at fn 54, at 968. "The statutory demand for a fair and reasonable allocation denotes a collective quality characterizing the supplier's treatment of his customers as a group. . . . All dealers were treated alike." *Id.*

61. RG 3.2.1914, RGZ 84, 125; RG 22.10.1920, RGZ 100, 134.

out any fault on his part, and when these difficulties constitute an unreasonable demand on him such that he can no longer comply with his obligations, then he may reduce the supply to his customers proportionately. At the same time, he is exempted from claims for damages under § 242 of the German Civil Code.

In the *Sugarbeet Seeds* case,[62] the Supreme Court of the German Reich[63] permitted a seller, who had sold a specific amount of sugarbeet seeds for several years in advance, to allocate the seeds proportionately amongst all purchasers when events of nature reduced the harvest so that there were no longer sufficient supplies. The Federal Supreme Court said that in these cases, the seller's obligees represent a group of equally entitled persons who find themselves in a group with a common interest. The court added that it would be against the principles of good faith if one purchaser received more at the expense of the others Since the court stressed that the claimants enjoyed equal contractual rights and belonged to a group entitled to raise the claim, only those claimants who have concluded a contract with the obligor, and not his regular customers, will benefit from the pro-rata allocation.

3. England

While legal writers support the principles existing in the United States for pro-rata performance,[64] English case law has not developed any fixed precedents in this respect.

In the decision *The Super Servant Two,*[65] Dillon L.J. dealt with this problem and rejected the remedy of pro-rata performance for frustration. He reasoned that the contract is terminated with the occurrence of the contractual breakdown. He stated that the party relying on this could not subsequently incur an obligation to make an appropriate allocation. It therefore follows that the obligor is either completely discharged or must completely perform his contractual duties.

The problems this rule creates are made clear by the *Super-Servant-Two* case. If the defendant had only named one ship in the contract, then he would have been discharged from performance. The same would be true if both ships had sunk. With the sinking of only one ship he can, even as a matter of fact, only fulfil one part of the contract; but this is not considered a sufficient excuse. Accordingly, it would have been better for the defendant in this case if both ships had sunk.[66]

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62. RGZ 84, 129.

63. Now called the "Federal Supreme Court".

64. A. H. Hudson, *Prorating in the English Law of Frustrated Contracts*, 31 MOD. L. REV. 535, 543 (1968).

65. [1990] 1 Ll. L.R. 1, 13-14

66. Ewan McKendrick, *Self-Induced Frustration and Force Majeure Clauses*, 1989 LL.M.C.L.Q. 3, 6.

In contrast, the principle of pro-rata performance has been applied in contracts with exemption clauses. In *Tennants, Ltd. v. Wilson & Co. Ltd*,.[67] the Force Majeure clause provided that the seller can suspend its supplies when particular Force Majeure events occur. When the seller, who obtained chemicals from Germany and resold them in England, was no longer able to perform due to the outbreak of the First World War, one of the purchasers nevertheless sued for specific performance. The House of Lords dismissed the claim and allowed a pro-rata performance to be effected because, according to the Court, the seller was either obligated to all of his contracting partners in the same way or was obligated to none of them. Therefore, the chronological sequence of the contracts was irrelevant.[68]

There is, however, uncertainty as to how the allocation is to be carried out. In general, no specific method is required; rather, the Courts allow the seller a measure of discretion in light of the individual circumstances of each case. The only requirement is that a reasonable allocation be used in the particular case.[69] Accordingly, an equal treatment of all contracting partners is not absolutely necessary. The means of allocation can also take into account when the contracts were concluded.[70] Moreover, allocation can also be done solely on a mathematically equal basis without taking into account the content and the scope of the contracts.[71]

III. ANNULMENT OF THE CONTRACT

Whereas a termination of all contractual duties is seen as the last option in both German and Swiss law, this is the primary remedy in Anglo-American law. Accordingly, the requirements for an annulment of the contract are different.

One consequence of contract annulment is the reversal of performances already effected. In this respect there are significant differences, in particular in English law, on the question of which services performed are to be reimbursed. This ultimately led to the passing of the Law Reform (Frustrated Contracts) Act 1943.

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67. Tenants Ltd. v. Wilson & Co. Ltd., [1917] A.C. 495.

68. *Id.* at 512.

69. Intertradex S.A. v. Lesieur-Tourteaux S.A.R.L., [1977] 2 Ll. L.R. 146, 155 (Donaldson, J.).

70. *Id.*

71. Bremer Handelsgesellschaft mbH v. Continental Grain Co., [1983] 1 Ll. L.R. 269, 281.

A. *Requirements for Contract Annulment*

1. Anglo-American law

Both English and American law, in the event of significant frustration, only annul the contract at the time of frustration: "[f]rustration brings the contract to an end forthwith, without more and automatically."[72] The rationale for this is that the resulting contractual certainty should make cases of frustration predictable.

2. Germany

In German law, contract annulment replaces contract adjustment where the adjustment alone is insufficient to avoid a result incompatible with the principle of good faith and where this aim can only be achieved by discharging the aggrieved party from the contract. This occurs when the adjustment of the transaction leads to an obligation on one or both parties which can no longer be justified.

In the *Vigogne*[73] spinning case, one partner in a commercial partnership had entered into an obligation in favor of a third party in a preliminary contract, whereby, after the termination of the partnership agreement and in the course of the distribution of the partnership assets he would purchase a certain piece of property and sell it to the third party at a fixed price. During the distribution of the partnership assets inflation forced the partner to pay a much higher price than that fixed in the preliminary contract. On this basis, he refused to perform because the high rate of inflation had frustrated the fulfillment of the contract.

The Supreme Court examined whether or not the contract could be preserved with altered conditions.[74] The Court said that the obligor could only be discharged from his obligations if further performance of the contract would significantly contravene the principle of good faith and continue to bind the obligor either because the factual situation would not permit an adjustment or because the obligee refused to consent to an adjustment.[75]

3. Switzerland

a. The Acceptance of Contract Annulment

Textbooks and case law regard contract annulment as the usual

72. J. Lauritzen A.S. v. Wijsmuller B.V., [1990] 1 Ll, L.R. 1, 8.
73. RG 3.2.1922, RGZ 103, 328.
74. RGZ 103, 333, 334.
75. *See also* RG 12.5.1928, RGZ 121, 141.

legal consequence[76] of the application of the principle *clausula rebus sic stantibus*.[77] This is the normal reaction to determining that a contract is unenforceable because of events following conclusion. The rules for interpretation of statutory gaps allow the judge to annul the contract by creating a rule in accordance with Art. 1 (2) of the Swiss Civil Code, which gives the aggrieved party a right to give notice of termination or to annul the contract directly.[78]

b. Restrictions on Annulment of the Contract

The judge's fundamental freedom to create an adjustment rule to annul the contract is restricted by the wishes of the parties. This is the case, when one party has already accepted the unfavorable effects of altering the contract "by agreeing to the appropriate adjustment of the contract."[79] The other contracting party cannot then in good faith refuse to continue performance of the contract. Therefore, the judge cannot annul the contract by formulating a rule under Art. 1 (2) of the Swiss Civil Code. In addition, the principle of private autonomy prohibits an annulment of the contract where both parties agree to the preservation of the contract,[80] but cannot agree on the means of preserving the contract. The judge must then adjust the contents of the contract to the changed circumstances with the greatest possible adherence to its binding nature as determined by the parties.

Accordingly, the question of the legal effect of annulling the contract arises when 1) the intent of the parties regarding the preservation and continuation of the contract cannot be determined, 2) the parties wish to annul the contract, but the further consequences (*e.g.*, damages) are in dispute, or 3) one party needs to continue the contract but is not prepared to accept the risk.

B. *Reversal of performances already made*

If the Courts acknowledge the existence of significant Force Majeure, which leads to an annulment of the contract, then they must decide which of the performances already made need to be reversed.

1. England

76. BISCHOFF, *supra* note 17, at 230.
77. JÄGGI & GAUCH, *supra* note 18, at no. 635 on § 18 Law of Obligations.
78. *Id.*
79. BISCHOFF, *supra* note 17, at 230.
80. *See also* BGE 47 II 319, (Switz.).

a. Common Law

On the basis of annulment of the contract *ex nunc* at common law the parties cannot only keep the benefits already received, but they can also maintain their claims to obligations which became due before the frustration. At this point, any obligations not yet due can no longer be claimed.

Chandler v. Webster[81] is the leading case for this rigid rule. On the occasion of the coronation of King Edward VII, a room with a view over the coronation procession was rented. The contract provided that the tenant was to pay the whole rental of £ 141 before the procession took place. After he had only paid £ 100, the whole event was postponed.

Because the contract had only been annulled upon the occurrence of the frustrating event, the Court, relying on the tenant's duty of advance performance, decided that the tenant was under an obligation to pay the remaining sum. Thus, all debts owed before the occurrence of the event remain: the loss lies where it falls. This was justified on the grounds that the seller, despite being released from performance, still had the burden of preparing for performance and consequently had also to perform work which could be reimbursed. Because of the burdens of preparation, the court did not find a total failure of consideration, which would have led to the conclusion that no valid contract had existed. Accordingly, it is inappropriate to explain this case on the basis of the principle of consideration.[82]

Although the Court in *Chandler* based its opinion for a termination *ex nunc* on old precedents, this decision has been criticized many times as inequitable.[83] It forces a debtor to continue paying, although he can expect no counter-performance. Furthermore, the debtor has no possibility of obtaining a refund for payments already made or of receiving compensation. In contrast, an obligor who has to perform in kind can obtain substantial advantages with this arrangement under certain circumstances. If the performance, as in the coronation case, can be rendered later, then he obtains a double renumeration for his performance.

It took 38 years, however, before this decision was overturned by the *Fibrosa* case.[84] This case involved a British company that had entered into an obligation in July, 1939, to deliver machines to a Polish

81. [1904] 1 K.B. 493.

82. ERNST RABEL, DAS RECHT DES WARENVERKAUFS, Vol. I, 369 n.5 (1964).

83. R.G. McElroy, Glanville L. Williams, *The Coronation Cases-II*, 5 MOD. L. REV. 1, (1941).

84. Fibrosa Spolka Akcyjna v. Fairbain Lawson Combe Barbour Ltd., [1943] A.C. 32

company. A third of the total price of £ 4800 was paid in advance. The German occupation of Poland made it impossible for the English supplier to deliver, thus, frustrating the contract. The House of Lords decided that the Polish plaintiff could demand his advance payment because the absolute failure of performance by the English company constituted a total failure of consideration.[85] This means that the plaintiff, if he has received no counter-performance at all so that no contract was performed, can demand advance payments back under a quasi-contract theory.[86]

Since the Court, however, only allowed recovery in cases of a total failure of consideration, the principle laid down in *Chandler* will continue to apply with all of its disadvantages for common law cases in which only a small counter-performance is effected.[87] The Court saw the inequity in cases where one party has already incurred expenses in reliance on the implementation of the contract;[88] it therefore requested that Parliament pass a law to eliminate these inequities.[89] The Law Reform (Frustrated Contracts) Act 1943 accomplished that purpose.[90]

b. Law Reform (Frustrated Contracts) Act 1943 (L.R.F.C.A.)

The most important sections of this Act provide:

> Section 1
>
> (1) All sums paid or payable to any party in pursuance of the contract before the time when the parties were so discharged[91] shall, in the case of sums so paid, be recoverable from him as the money received by him for the use of the party by whom the sums were paid, and, in the case of sums so payable, cease to be so payable:
>
> Provided that, if the party to whom the sums were paid or payable incurred expenses before the time of discharge in, or for the purpose of, the performance of the contract, the court may, if it considers it just to do so having regard to all the circumstances of the case, allow him to retain or, as the case may be, recover the whole or any part of the sums so paid or payable, not being an amount in excess of the expenses so incurred.
>
> (2) Where any party to the contract has, by reason of anything done by any other party thereto in, or for the purpose of, the performance of the contract, obtained a valuable benefit[92] before the

85. *Id.* at 48.

86. A. Goodhart, *Mistake and Frustration in English Contract Law*, in: FS für A. Simonius 99, 105 (1955).

87. SIR ROBERT GOFF & GARETH JONES, THE LAW OF RESTITUTION 366 (1978).

88. Chandler, [1904] 1 K.B. 493 at 49, 55.

89. *Id.* at 50, 57.

90. RAUH, *supra* note 4, at 137.

91. In this Act it is referred to as "the time of discharge."

92. This excludes a payment of money to which the last foregoing subsection ap-

> time of discharge, there shall be recoverable from him by the said other party such sum (if any), not exceeding the value of the said benefit to the party obtaining it, as the court considers just, having regard to all the circumstances of the case and, in particular,
>
> (a) the amount of any expenses incurred before the time of discharge by the benefited party in, or for the purpose of, the performance of the contract, including any sums paid or payable by him to any other party in pursuance of the contract and retained or recoverable by that party under the last foregoing subsection, and
>
> (b) the effect, in relation to the said benefit, of the circumstances giving rise to the frustration of the contract.

The *Fibrosa* decision is contained in § 1(2), which provides for recovery of advance payments. The statute, however, goes further by allowing a claim for a reversal of performances already made, where only partial failure of consideration exists.[93]

Section 1(3), which in contrast to § 1(2) provides for the reimbursement of non-pecuniary amounts, was the subject of extensive discussion in B.P. Exploration Co. (Libya) Ltd. v. Hunt,[94] so far the only opinion on the L.R.F.C.A. The very complex facts are as follows: In December 1957, the Libyan government granted the defendant a license to search for and extract crude oil from a certain area of the desert. Since Mr. Hunt did not have sufficient resources to invest in such a large area, he concluded a company agreement with the plaintiffs, designated as a farm-in-agreement. The contract provided that the costs for the exploration and development of the license area and the extraction should be borne equally by the parties. Also, the oil extracted would be divided equally among the parties.

In accordance with the contract, the plaintiff advanced the initial costs for development. The defendant was to reimburse this money after extraction of the oil had begun by transferring crude oil from his share of the amount extracted. B.P. was thereby to receive "reimbursement oil"[95] for the share of the costs of the search for oil, which were to be borne by Hunt until B.P had recovered 125% of its initial expenditure. This covered B.P.'s risk in the event no oil was discovered. Ultimately, oil was extracted starting in 1967. The new Libyan government, under Gaddafi, expropriated the plaintiff in 1971 and the defendant two years later, declaring the oil industry nationalized. In response, B.P. sued based on frustration and demanded repayment of a sum to be equitably determined by the Court in accordance with section 1 (3) L.R.F.C.A.

Sir Robert Goff, who felt that the main purpose of the law was to

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plies.

93. GOFF & JONES, *supra* note 87, at 565.

94. B.P. Exploration Co. v. Hunt, [1979] 1 W.L.R. 783.

95. To be taken at the rate of three-eighths of Mr. Hunt's share.

avoid the unjust enrichment of one of the parties,[96] took a two-step approach. First, he determined and measured the benefit received and measured it in monetary terms. He, thereby, interpreted the central concept of § 1(3)-valuable benefit-in such a way that only the end-product of the services performed and received by the other party, and not the services themselves, was to be considered in assessing the benefit. He based his view on the fact that § 1 (3) did not put the plaintiff's performance on an equal footing with the defendant's benefit, but distinguished between the two.[97]

The focus on the end-product alone has, however, brought criticism.[98] In particular, according to this opinion, there can be no valuable benefit in those cases where no end-product has been produced. If, for example, a house was destroyed by fire shortly before its completion, the contractor would receive nothing.[99] Consequently, all performances made must be taken into consideration when evaluating the benefit. This argument was irrelevant in this situation, since Mr. Hunt received a benefit. This benefit consisted of the value of the crude oil he received and the compensation paid by the Libyan government.[100] This amounted to almost $85,000,000.00.

Sir Robert Goff next determined a sum which appeared equitable, but which was independent of the valuable benefit and was not to be in excess of that amount. In this respect, all the circumstances of the case were considered.[101] Accordingly, the judge regarded a sum which appeared equitable and which at the same time signified a benefit for the defendant as the appropriate value for the plaintiff's performance.[102] Since part of the money had already gone to B.P. in the form of oil, Sir Robert Goff set the remaining sum at $35,000,000.00.

2. United States of America

In contrast to English law, American law allows the interests of the parties to be balanced on the basis of the rights and obligations accrued before the failure of the contract: "[a] party whose duty of performance does not arise or is discharged as a result of impracticability of performance, frustration of purpose . . . is entitled to restitution for any benefit that he has conferred on the other party . . . ."[103]

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96. BP Exploration Co. v. Hunt, *supra* note 94, at 799.

97. *Id.* at 783.

98. A.M. Haycroft & D.M. Waksman, *Frustration and Restitution*, J. BUS. L. 207, 218-21 (1984).

99. G.H. TREITEL, THE LAW OF CONTRACT 689 (1983).

100. This had to be taken into consideration on the basis of § 1(3)(b).

101. J. Baker, *Frustration and Unjust Enrichment*, C.L.J. 266, 269 (1979).

102. *B.P. Exploration Co.* at fn 94.

103. RESTATEMENT (SECOND) OF CONTRACTS § 377 (1981).

In *Butterfield v. Byron*,[104] a contractor was obligated to co-operate in the construction of a house. Part of the cost was to be paid in advance and the rest was due when the house was completed. The building, however, burned down shortly before completion and further performance of the contract was frustrated. The Court distanced itself from the English decisions[105] and held that the contractor was entitled to receive full compensation for the performances already made, even if payment was not due when the contract was frustrated. The Court stated, "[i]n such a case defendant can recover for work and material done and furnished on an implied assumption at the contract rate."[106] While recovery of damages for performances effected in advance is allowed,[107] recovery of the loss incurred for reliance on a promise to perform is not permitted.[108]

3. Germany

In German law, the settlement of an annulled contract depends on the method of the contract's annulment. If the aggrieved party has a right to terminate on notice, then the annulment of the contract only takes place when the basis of the transaction has been destroyed.[109] If the aggrieved party has a right of rescision, the reversal of the contract is effected in accordance with the law of unjust enrichment.[110] When the contract is annulled without a legal declaration, it is necessary to differentiate between the types of contracts.

4. Switzerland (Annulment *ex nunc*)

Case law has yet to answer the question of whether the annulment arrangement constructed by the judge should have legal effects *ex tunc* or *ex nunc*. The opinions represented in legal literature are contradictory. Neither theoretical nor practical considerations support the consequences of annulment with effect *ex tunc*. If the application of the principle *clausula rebus sic stantibus* leads to the premature termination of the contract, it requires that the contract was valid when the events after the conclusion of the contract occurred, "and there can

104. Butterfield v. Byron, 27 N.E. 667 (Mass. 1891).

105. *Id.* at 668.

106. *Id.* at 669.

107. Alabama Football, Inc. v. L.C. Greenwood, 452 F.Supp. 1191, 1196-97 (D. Pa. 1978); West v. People's First Nat'l Bank & Trust Co., 106 A. 2d 427 (Pa. 1954); Baer v. United States Lines Co., 43 N.Y.S. 2d 212 (App. Term 1943) (Stating that performances due before the breakdown of the contract are no longer recoverable). Alfred Marks Realty Co. v. Churchills, 153 N.Y.S. 264, 265 (App. Term. 1915); Alfred Marks Realty Co. v. Hotel Hermitage Co., 156 N.Y.S. 179 (App. Term. 1915);

108. Carroll v. Bowerstock, 164 P. 143 (Kan. 1917); E. ALLAN FARNSWORTH, CONTRACTS 704 (1982).

109. BGH 21.11.1968, NJW 1969, 233, 234; BGH 12.6.1987, BGHZ 101, 143, 150

110. BGH 25.10.1989, BGHZ 109, 139, 144; LARENZ, *supra* note 6, at 186.

therefore never be a question of terminating it with effect ex tunc."[111] In addition, the question of premature annulment of the contract is important when performance of the typical continuing obligation has already commenced and the reversal of the transaction therefore presents difficulties. The contract can only then be terminated with effect *ex nunc*.

IV. CONCLUSION

This article has shown that the effects of Force Majeure events vary greatly. Even within a particular national legal system, the outcome of a Force Majeure event cannot be determined with certainty, and with the exception of English law the options for the courts are broad.

The impossibility of determining the legal effect of a Force Majeure event leads to great risk for the parties concerned. Given the uncertainty as to future events, their effects on the parties and their legal consequences, both parties bear this risk. It is, therefore, highly advisable that an appropriate clause which deals with the effects of Force Majeure events be inserted into the contract. As a good example of the possible wording of such a clause, the Force Majeure Clause proposed by the ICC is cited. After having stated what will be regarded as a Force Majeure event, this clause goes on to deal with the effects of a Force Majeure event:

> Effects of grounds of relief
>
> 6. A ground of relief under this clause relieves the failing party from damages, penalties and other contractual sanctions, except from duty to pay interest on money owing as long as and to the extent that the ground subsists.
>
> 7. Further it postpones the time for performance, for such period as may be reasonable, thereby excluding the other party s right, if any, to terminate or rescind the contract. In determining what is a reasonable period, regard shall be had to the failing party's ability to resume performance, and the other party's interest in receiving performance despite the delay. Pending resumption of performance by the failing party the other party may suspend his own performance.
>
> 8. If the ground of relief subsist for more than such period as the parties provide [the applicable period to be specified here by the parties], or in the absence of such provision for longer than a reasonable period, either party shall be entitled to terminate the contract with notice.
>
> 9. Each party may retain what he has received from the performance of the contract carried out prior to the termination. Each party must account to the other for any unjust enrichment result-

111. BISCHOFF, *supra* note 17, at 231.

ing from such performance. The payment of the final balance shall be made without delay.