Force Majeure and Hardship Clauses in International Commercial Contracts in View of the Practice of the ICC Court of Arbitration

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ICC ARBITRATION IS GENUINE *international* arbitration: The jurisdiction of the Court covers business disputes of an international character (Art.1(1) of its Rules)[1]; the arbitrators can be of any nationality (Art. 2), the parties are free to determine the law to be applied by the arbitrators to the merits of the dispute. In the absence of such determination by the parties, the arbitrators shall apply the law designated as the proper law by the rules of conflict which they deem appropriate (Art.13(3)). They shall have the power of an *amiable compositeur* only if the parties are agreed to give them such powers (Art.13 (4)). Finally, "in all cases the arbitrator[s] shall take account of the provisions of the contract and the relevant trade usages" (Art. 13 (5)).

This international character of ICC arbitration is also reflected by the statistics issued at the Court's 60th anniversary, in October last year[2]: While in 1977 arbitrators under ICC Rules were nationals of 20 different countries, by 1982 the arbitrators involved in ICC cases came from 30 different countries; the 1982 break-down of the origin of parties according to geographic areas showed that 54 per cent came from Western Europe, 10 per cent from European socialist countries,17 per cent from the Americas and Australia,10 per cent from Arab coun-

(...)

ICC arbitration is therefore practiced by arbitrators coming from all over the world, who have to apply a large spectrum of national laws from many legal systems. As a consequence, the members of most ICC arbitral tribunals have different legal backgrounds. This marks a fundamental contrast with national State courts, where all judges have the same legal education and essentially apply domestic law only. The same difference exists as regards domestic arbitrations or arbitration courts, which both prohibit foreigners from acting as arbitrators.

This observation does of course lead to the question as to whether the decisions of such international tribunals, as set up under ICC Arbitration Rules, arrive at results which are identical to those reached by the State courts the laws of which they apply, or whether there are variations. Assuming such variations might occur in the application of domestic laws by arbitral tribunals and the competent national courts in a given country, this will not affect the recognition and enforcement of an award even in that country, provided that domestic arbitral awards enjoy a privileged treatment and can only be set aside on limited substantive grounds, as for instance breach of (domestic) public order.

The same principle applies in any case for foreign awards to be enforced under the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.[3] Art. V (2) of

the Convention clearly limits the possibility for a member State to deny enforcement of a foreign award falling under the scope of the convention for substantive reasons only by providing that the recognition and enforcement of an arbitral award may be refused if

"(a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or

(b) The recognition or enforcement of the award would be contrary to the public policy of that country."

In a thorough study on the interpretation of the New York Convention, van den Berg[4] has revealed that court decisions which have so far been rendered on Art. V (2) show a very restrictive interpretation of the term "public policy". This restrictive approach of national courts in denying enforcement of foreign arbitral awards on public policy grounds gives in fact international arbitrators a "supplemental margin of discretion" in the interpretation of the applicable law, which goes beyond the powers available to national judges.

International arbitrators are, as a rule, chosen amongst others because of their familiarity with the rules and practices of the business underlying the dispute at stake. Their confirmation of court practice would thus be an indication that the law still meets the requirements of the trade in question. On the contrary, deviations - within the tolerable margin - may indicate that the applicable body of law lays behind the development of such trade.

I. DEFINITIONS

Force majeure and "hardship" are exceptions to the basic rule *pacta sunt servanda*. However, a clear distinction of the meaning of both terms in commercial practice is not always easy. There are indeed borderline cases, which cannot be labelled as falling in one or the other basket exclusively. practitioners of international arbitration will also agree that there is a great confusion as to the use of these two terms. Even in important international contracts, they are often inserted as synonyms.

Force majeure

As regards *force majeure*, it is often believed that this term is solely of a contractual nature, so that parties to a contract are free to stipulate that a certain event shall be regarded as *force majeure*, irrespective of the conditions which have to be met under the applicable law.

This view is for instance reflected in contract stipulations, which can often be found, that a determined event will be recognized as *force majeure* when a Chamber of Commerce or a similar organization issues a "*Force Majeure* Certificate ". In the interpretation of the parties, the presentation of such a certificate will release them from their contractual obligations. They are often subsequently surprised and disappointed to learn, through a decision of an arbitration court, that a Chamber of Commerce or other body can only certify that a specific event has taken place but that the arbitrators are bound to the qualifications of the applicable law.

One of the reasons for this confusion may be that Standard contracts, which are largely based on common law conceptions, are used by parties coming from different legal systems. Such is the case, for instance, of the Conditions of Contract (International) for Works of Civil Engineering Construction of FIDIC[5] which introduce expressions like "excepted risks'; "special risks'; "frustration" which have not always a strict equivalent in continental legal terminology.

The legal elements for the qualification of an event as *force majeure* (*vis maior*, act of God, etc.) are essentially the same in most legislations, and court decisions show a universal trend to a comparable restrictive interpretation. These elements are (i) that the event is of an external nature, (ii) that it could not be foreseen or prevented and (iii) that it renders performance of a contractual obligation impossible at all or for a certain time.

Hardship

This cannot be said for the term "hardship" in the meaning of an event that changes the contractual equilibrium between the rights and obligations of the parties in such a dramatic way that performance can become ruinous for one of them or cannot reasonably be expected. Although most legislations have rules to

cope with such situations (which roughly fall under the so-called *clausula rebus sic stantibus*), accepted solutions by national laws as well as court decisions and legal doctrine show a remarkable degree of variation.

One example among many others : Professor Strohbach, in a parallel study an the same subject[6], mentions para. 295 of the Gesetz über internationale Wirtschaftsvertrdge ("GIW") 1976[7] of the German Democratic Republic. This is a modern law, which takes into consideration the necessity to provide for adaptation to changing conditions during the performance of long term contracts. Its provisions primarily aim at an adaptation of the contract to the new situation and a continuation of the contractual relationship. Such a solution is not to be found in many other and often older laws : In the "model situation" there is not a long term contractual relationship requiring a continuous cooperation between the parties and even the re-negotiation of contractual provisions over a longer period of time, but a single transaction to be performed in the future, the execution of which becomes too onerous for one party due to changed circumstances. The logical legal solution to such a situation is rather the right of this party to be relieved of its obligations without having to bear the consequences of breach of contract. Although it is true that court decisions and legal doctrine have in most countries bridged the gap between unsatisfactory provisions of the law and the needs of modern contract practice, the results nevertheless differ largely from country to country.

ICC Proposed Model Clauses

As ICC work in the Field of legal standardization has always been influenced by the necessities of international trade reflected in the practice of its Court of Arbitration, its Commission an International Commercial Practice has set up a "*Force Majeure* and Hardship" working party with the mandate to draft model clauses which can be recommended to the business world to be incorporated in international contracts either as such or with amendments.

Its work is now about to be concluded. According to the last draft[8], two model clauses are foreseen:

1) a *Force Majeure* Clause, which lays down the conditions for release from liability when performance of a contractual obligation has become impossible; and
2) a Hardship Clause, which is intended to cover cases where unforeseen events so fundamentally alter the equilibrium of a contract that an excessive burden is placed on one of the parties. It is similar (but not identical) to the provisions of para. 295 (1) GIW mentioned above and the parties to the contract are required to attempt to nego-

tiate an adaptation of the contract. At that stage, they may agree to use the 1978 ICC Rules for Adaptation of Contracts[9], which provide the reference to a third person, operating under such Regulations. If no agreement can be reached, either party shall be free to initiate legal proceedings. This is a different solution to that foreseen in para. 295 (2) GIW, which provides that if no agreement can be reached the aggrieved party may terminate the agreement.

It is to be hoped that the new set of ICC Rules, when it has been finalized and recommended for use, will have a beneficial unifying effect in the field of *force majeure* and hardship clauses, thus contributing to increasing the forseeability for the parties of the consequences they have to face when either *force majeure* or hardship is claimed by one party.

II. CASES

Economic and political developments in recent years have brought about rapid changes in the economic environment as did armed conflicts and other political disturbances. One would therefore expect many noteworthy ICC arbitration cases dealing with force majeure and hardship issues. Surprisingly, this is not the case. As Professor Strohbach indicates[10], there have also been only a few cases before Arbitration Courts in CMEA countries.

The Secretariat of the ICC Court of Arbitration has been so kind as to investigate for the purpose of this study relevant awards which have been approved in the 1980-1982 period. While there was no suitable case in 1980, one case has been reported in 1981 and two cases in 1982. This is a very small percentage of the total awards which have been approved in these years (71 in 1980, 64 in 1981 and 74 in 1982).

But the previous years also show a seemingly similar picture. There are no statistics available. The only source are extracts of awards which have been published by the former Secretaries General of the Court of the ICC Court of Arbitration, Messrs. Thompson and Derains, in the *Journal du droit international* (1974-1980)[11], where altogether less than 10 cases falling in our category have been reported. It can be assumed that the actual number of cases where *force majeure* or hardship has been alleged by a party is probably higher but that the authors have picked out those cases which are of some legal interest and which can be regarded as examples of the present trend.

In Case 2546 (unpublished), an Austrian buyer of raw material requested compensation from an Israeli seller for non-delivery of a part of the contracted quantity after the outbreak of the Yom Kippur War in October 1973. The defendant had evoked *force majeure* on the grounds that the plant had been closed until

March 1974, and that transportation facilities, both within and from Israel had been in complete disarray. Alternatively, he alleged that further supply of raw material was to be excused in accordance with the general doctrine of frustration to supply the client with the additional quantity at old prices in view of the fact that market prices had dramatically gone up, would have meant : ". . . his selling the product at one third of its production cost...".

It was established that the defendant had invoked the contractual *force majeure* clause after the outbreak of war on October 8, 1973 but that shipments had been continued after that date. In January 1974, the defendant declared the outstanding balance of deliveries as cancelled in view of the *force majeure* situation and at the same time offered new deliveries at considerably higher prices.

The sole arbitrator, sitting in England under English law rejected both defences for the following reasons:

> "It was proved to my satisfaction that *force majeure*, in the shape of war, prevented fulfilment of the balance of the contract in the period from 8th October to 31st December 1973. The contract was thereupon extended, in the event, for two months. I did not find it proved that *force majeure* prevented fulfilment during January and February 1974. The evidence of that effect submitted on behalf of the Respondents did not, to my mind, give any satisfactory explanation of the offers to ship made early in January 1974 at a higher price. I concluded that the Respondents could and would have shipped the balance in January and February 1974, if the higher price had been agreed. Or at any rate the contrary was not proved. If I had not reached that conclusion on the facts, I would have rejected the Claimants' submission that the *force majeure* clause had no application to difficulties in production and applied only to difficulties in putting goods on board ship. (...) I also rejected the Respondents' submission that the contract was frustrated because the cost to them of performing it had considerably increased. No doubt it is possible that a contract may be frustrated through becoming more costly to perform; nor can it be

> said in my opinion that, as a matter of law, an increase in cost of 300 per cent for example would frustrate a contract but one of 200 per cent would not. My reasons for rejecting this submission were first, that there is little room for the doctrine of frustration to operate when a contract already has an elaborate *force majeure* clause; and secondly, that the Respondents' evidence in this area was so lacking in detail that I was quite unable to conclude that any fundamental hypothesis of the contract was no longer fulfilled."

This award clearly shows some trends which can also be found in other decisions rendered by international arbitrators, namely that war will only be accepted as *force majeure* if the hostilities have had a direct impact on the performance of the contract and that, in addition, performance has to be continued if it is possible, after a reasonable time. The argument that there is no room for the doctrine of frustration in cases where there is an elaborate *force majeure* clause confirms the reasoning of international arbitrators found in other ICC awards that businessmen are considered to be well aware of the risks which they take within the frame-

work of their business; consequently, they are held fully responsible for adverse results if they have failed to protect themselves in the contract.

Three Cases (2142[12], 2139[13], and 2138[14]) deal essentially with the same matter. After the expropriation of sources of raw materials in a developing country, the former owners threatened with attachment all products which would be sold by the state enterprise entrusted with the commercialization of the product after the expropriation. In the meantime, this enterprise had concluded a series of FOB contracts with different buyers. Some of them, after being informed of the threat, refused to take delivery under their contracts on the grounds of *force majeure*. In the proceedings, however, it could be proved that other buyers had regularly taken delivery of the product in question, and that no intervention by the former owners had evidently been made.

In all these cases the arbitrators rejected the existence of *force majeure* because the nationalization had already taken place before the new buyers had signed their contracts with the new distribution enterprises. The element of unforseeability was therefore lacking. In addition, in no case could proof be established that buyers were prevented from taking delivery of the product in question, as the claimant could demonstrate that such deliveries had actually been carried out without problems for other buyers.

One argument which often turns up in arbitration disputes by parties desirous of terminating a contract is that performance has become impossible due to exchange control or customs regulations. These questions are dealt with in Cases 2216[15] and 3093/3100[16] concerning exchange controls and in Case 3740, of 1981 (unpublished) on export controls.

In Cases 2216 and 3092/3100, buyers of crude oil refused to perform their contracts, arguing that they did not get the necessary authorizations to obtain foreign exchange. In addition, in Case 2216, the facts were that the prices for crude oil had actually gone down and the performance of the contract would have meant a substantial loss for the buyer

In both cases, it had been established during the proceedings that the pertinent exchange control legislation had been in force before the contracts had been concluded. The buyers were therefore fully aware of the fact that authorizations might not have been given for a specific transaction. In Case 2216, it could also be demonstrated that the buyer had probably even failed to undertake the necessary steps to obtain the required authorizations.

The arbitrators decided that the element of unforseeability was lacking. The pertinent exchange control legislation was already in force before the contracts

had been concluded, and it was regarded as the duty of the buyers to undertake the necessary steps to get the foreign exchange transfer permissions. As such had not been the case, they

were held responsible for breach of contract.

In case 3740 (unpublished), an Indian defendant refused to deliver a certain quantity of a commodity on the grounds that the government of India had requested him to meet domestic requirements in priority to export commitments. He informed the claimant thereof and asked to be relieved of his contractual obligation by virtue of a *force majeure* clause which they had stipulated.

The sole arbitrator concluded that the defendant had relied only an a confidential Person-to-Person letter, signed by an Under-Secretary of a Ministry, and that the decision to ban the export of the goods was not the subject of any export (control) amendment order published in the Official Gazette nor did it purport to have been made by the designated Minister of the Central Government. The arbitrator concluded:

> "In the premises such decision did not have the force of law, or consequentially, the effect of constituting *force majeure* within the meaning of clause ... of the letter dated ... "

This decision also shows a very strict standard : The arbitrator took a formal standpoint and did not take into consideration the administrative pressure which was probably exercised on the Indian party.

The same attitude can be found in decisions on the duration of a *force majeure* situation. In Case 1703[17], it had been established that the Party which had to set up a plant on a turn-key basis had to stop the work due to outbreak of hostilities. After the end of hostilities, this party refused to continue and finish the work on the grounds that its government had withdrawn the necessary export financing facilities, that it was not possible to obtain the necessary visas for its personnel and that its security could not be maintained.

The arbitrators, after having admitted *force majeure* for the duration of the hostilities and at least twenty days thereafter, came to the conclusion that for the following period one basic element for the qualification of a *force majeure* situation, namely irresistibility, was missing: The visas could have been obtained if the defendant had made the necessary efforts (a consulate of the country of the defendant had never been closed) and it would also have been possible to find alternative financial resources. The defendant had, in the view of the arbitrators, failed to declare his willingness to continue his work and to make the necessary efforts.

The same attitude is reflected in two other decisions where parties claimed *force majeure*. In Case 1782[18], a party which had to deliver trucks to an Arab country and to maintain them, had after delivery refused maintenance on the ground of *force majeure* because its employees, probably of Israeli origin, did not obtain the necessary visas. The arbitrators ruled that even if this allegation was correct, it did

not make performance impossible. The defendant could have made other arrangements in order to guarantee the servicing of the trucks.

In the same line is the decision in Case 3952, given in 1982 (unpublished), concerning a contract of delivery of crude oil. One party claimed *force majeure*, due to the fact that his own supplier had not delivered the necessary quantity of oil.

The arbitrators, after having declared that delivery of such a fungible product as crude oil was never impossible decided that if non-performance of a delivery obligation by a third supplier was to be qualified as *force majeure*, it must be expressly stipulated in the contract. It had been negligence an the part of the defendant not to assure other supplies. Moreover, a secondary motion that the shifting from one supplier to another would have caused high costs was not accepted as an excuse. The actual price difference of over one third of the market price was not enough to be recognized as hardship and relieve the seller from delivery.

CONCLUSION

The above-mentioned ICC cases clearly demonstrate the tendency for international arbitrators to interpret *force majeure* in a very restrictive way. The same Observation is true for "hardship": ICC arbitrators have only exceptionally admitted the application of the principle *rebus sic stantibus*. This restrictive approach is not only visible where French law is applicable[19] a law which is always quoted as an example of strict interpretation of the principle *pacta sunt servanda*, but also when other laws are applied.[20]

The conclusion to be drawn from this is that ICC arbitrators apply at least the same restrictive criteria for admission of *force majeure* or hardship as do courts in the country whose law they apply.

Footnotes

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1) *See Rules for the ICC Court of Arbitration*, ICC Doc. No. 291, 1980 ed., Paris. Unless otherwise stated, all mentioned articles refer to these rules.

2) *See ICC Arbitration, Factr and Figures*, October 1983, Paris.

3) Convention on the Recognition and Enforcement of Foreign Arbitral Awards, New York,10 June 1958, *U.N. Doc. E/Conf. 2619 Rev. 1 (1958).*

4) Albert Jan van den Berg, *The New York Arbitration Convention of 1958*, The Hague, 1981.

5) Conditions of Contract (International) for Works of Civil Engineering Construction, with forms of tender and agreement, March 1977.

6) Heinz Strohbach, "*Force Majeure* and Hardship Clauses in International Commercial Contracts and Arbitration; the East-German Approach",*1 J, Int. Arb.* 41, 42 (1984).

7) Dietrich Maskow and Hellmut Wagner, *Kommentar zum Gesetz über internationale Wirtfchaftsverträge - GIW - vom 5 Februar 1976*, pp. 414 *et seq*., Staatsverlag der DDR, Berlin 1978, 2nd edition Berlin 1983.

8) ICC Document No. 460-21/1, of October 26, 1983.

9) *Adaptation of Contracts*, ICC Doc. No. 326.

10) Strohbach, *op. cit., note 6 supra.*, pp. 39 *et seq.*

11) *1974.Journal du droit international [Clunet]* 876; (1975) 916; (1976) 968; (1977) 931; (1978) 976; (1979) 982; (1980) 949.

12) *1974 Clunet* 892.

13) *1975 Clunet* 929.

14) *1975 Clunet* 934.

15) 1975 , Clunet 917.

16) 1980 Clunet 951.

17) *1974 Clunet* 894.

18) *1975 Clunet* 923.

19) *e.g.* Case 2708, *1977 Clunet* 943.

20) *e.g.* Case 1512, 1974 *Clunet 905.*

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