SUPERVENING ILLEGALITY AND INTERNATIONAL COMMERCIAL ARBITRATION

by

LJILJANA BIUKOVIC

LL.B. The University of Belgrade, 1986
LL.M. The Central European University, Budapest, 1995

Faculty of Law

A THESIS SUBMITTED IN PARTIAL FULFILLMENT OF
THE REQUIREMENTS FOR THE DEGREE OF
MASTER OF LAWS

in

THE FACULTY OF GRADUATE STUDIES
(FACULTY OF LAW)

We accept this thesis as conforming
to the required standard

THE UNIVERSITY OF BRITISH COLUMBIA

November, 1995

© Ljiljana Biukovic, 1995
In presenting this thesis in partial fulfilment of the requirements for an advanced degree at the University of British Columbia, I agree that the Library shall make it freely available for reference and study. I further agree that permission for extensive copying of this thesis for scholarly purposes may be granted by the head of my department or by his or her representatives. It is understood that copying or publication of this thesis for financial gain shall not be allowed without my written permission.

Department of LAW

The University of British Columbia
Vancouver, Canada

Date 28 September 1995
ABSTRACT

This thesis examines states' influence—in the form of supervening illegality, or subsequent changes in legislation—on international commercial transactions. The topic will be examined with reference to the major world legal systems and international law and practice. A large number of international transactions are carried out under the complex terms of government intervention. However, from the present doctrinal concepts, statutory frameworks, and judicial and arbitral practice, it is possible to infer that no absolute protection from state and government intervention exists as such. The problem of frustration of contracts, as framed in all national jurisdictions and explained in fairly detailed legal theory, does not presently have any uniform remedy for parties in international trade.

The study begins with a brief comparative survey of the terminology that will be used in the thesis and then moves to related general principles and theories of contract law in civil and common law countries: party autonomy, public policy, force majeure, frustration, state immunity, state sovereignty, etc. Next, it examines the status of contractual parties in international transactions within the context of changed circumstances. The inquiry includes judicial and arbitral practice related to supervening illegality. Several countries' statutory frameworks with regard to force majeure, frustration, remedial modalities, and arbitration will be introduced as well. Finally, a wide variety of international trade contracts will be examined in order to illustrate present contract drafting techniques. In the conclusion, this thesis advocates efficient and equitable adjustment of contracts and allocation of risks of loss from nonperformance caused by supervening illegality. This would be based on careful drafting of force majeure and arbitration clauses. In order to protect and ensure their interests, parties are advised both on how to define the right to adjust or terminate the contract and on the circumstances under which they could rely on that right.
# TABLE OF CONTENTS

ABSTRACT ii

TABLE OF CONTENTS iii

ACKNOWLEDGMENT vi

INTRODUCTION 1

1. Scope of Study 1
2. Methodology 4

CHAPTER ONE: DEFINITIONS 6

1. AUTONOMY OF WILL 7

1.1. Autonomy of Will in Contract Law 8
1.2. Private International Law Concept 13

2. THE NOTION OF SUPERVENING ILLEGALITY 14

3. INTERNATIONAL TRANSACTIONS 17

3.1. Law Applicable to Contracts 18
3.2. The Nationality of Parties 20

i. Private Parties 20

ii. State or State-owned Company as a Party 21

The *Jordan v. Sojuznefteksport* Case 25

The *Rolimpex* Case 26

3.3. Arbitration Clause 33

Summary 35
CHAPTER TWO: FORMS OF LIMITATION OF PARTY AUTONOMY

2.1. Limitations by Government Acts
   i. Restrictions Against Trade With The Enemy
   ii. Export and Import Regulations
   iii. Expropriation

2.2. Acts of Governments as a Part of International Actions

2.3 The Rational for Supervening Government Acts

CHAPTER THREE: CONCEPTS OF SUPERVENING ILLEGALITY

3.1. The Common Law Doctrine of Frustration

3.2. The Concept of Impracticability

3.3. The Civil Law Doctrine of Force Majeure

3.4. International Rules on Frustration and Force Majeure

3.5. Application of Concepts

CHAPTER FOUR: CONSEQUENCES OF SUPERVENING ILLEGALITY AND REMEDIAL MODALITIES

4.1. Discharge or Adaptation of Contracts

4.2. Remedies and Allocation of Loss
CHAPTER FIVE: CONTRACTUAL REGULATION OF SUPERVENING ILLEGALITY

5.1. The Force Majeure Clause

5.2. Drafting of Force Majeure Clause

5.3. The Hardship Clause

5.4. The Arbitration Clause

CHAPTER SIX: CONCLUSION

BIBLIOGRAPHY
ACKNOWLEDGMENT

I wish to express my gratitude and admiration to the following persons without whose help this thesis could not have been written:

Professor Robert K. Paterson, my first supervisor, for his ideas, suggestions, patience and encouragement throughout the completion of this work.

Professor Joost Blom, my secondary reader, for his guidance and advice.

Special thanks to Professor Pitman B. Potter. Without his support and the support of the Graduate Committee of the Faculty of Law I would not have been able to make this thesis at the UBC.

I would also like to thank to the faculty and library staff for their time and energy, in particular to Lillian Ong and Francis Wong.

Finally, I am grateful to my husband for his constant support and understanding.
INTRODUCTION

1. Scope of Study

This thesis examines the influence of states and governments, in the form of supervening illegality, on contracts of international trade. The focus throughout will be on government interference in private relationships only after international contracts have been concluded. The purpose is to show how private parties can be protected from liability for non-performance caused by supervening illegality and to allocate losses fairly.

The conduct of international commerce is in general governed or controlled by two sets of rules—national and international. National rules relating to private commercial transactions are established by statutes (usually laws on contracts and foreign trade and investment enacted by legislatures); by regulations promulgated by governments and executive organs; and by court decisions, if the country is one of the common law tradition. Secondly, there is a set of international legal instruments in the form of international treaties that significantly affects private parties involved in international trade. The initial hypothesis of this thesis is that with national sets the "conflict" is between the principle of party autonomy and the perceived need to protection of public interest by the state. As for the international set of rules, the premise is that these treaties are advantageous for private parties in international trade because they have been established to promote international, rather than domestic, transactions, to create internationally uniform rules, and to assist international business. Reference is made here to the possibility of transforming this set of rules into a part of national legislation, probably a part of contract law.

Many authors would argue about the extent of state intervention and its impact on the autonomy of parties' wills. Some of them point to the different purposes and techniques of intervention: the protection of local manufacturers from international
competition, the development of new industries, the maintenance of adequate supplies of resources, and the protection of national security. Others conclude that state intervention is often utilized for political purposes, for the benefit of social order, for the protection of a weaker side, or for public policy objectives. Donald Harris and Denis Tallon emphasize modern American doctrine, whose starting point is "that we cannot separate a sphere of contractual freedom from the sphere of state intervention, because the law of contract is itself a form of state intervention to the extent that respect for agreements assumes state sanction." 

Notwithstanding these justifications for state intervention, the primary assumption of this study is that, at present, it is highly uncertain as to what extent international commerce is limited or only controlled (in the sense of 'regulated') by governments. Hardly any modern national legal system still follows the principles of trade liberalism and classical laissez-faire theory without any intervention in private arrangements. However, it should be noted that from a legal perspective, freedom of contract and freedom of foreign trade are usually seen as basic individual rights. Consequently, they represent fundamental constitutional values in most modern states. On the other hand, constitutional recognition of individual rights is linked to the precisely defined function of modern governments to protect and to promote the equal rights of

---

2For example Dapray Muir says that state intervention is based on the right to control foreign trade. He found that this intervention has been frequently in the form of restrictions imposed with respect to export and imports, depending on the economic and military circumstances; see D. Muir in Richard B. Lillich, ed., *Economic Coercion and International Economic Order* (Charlottesville: The Michie Company, 1976) at 23
individuals. The reality today is that the state itself participates in international trade, exercising its economic power based on fundamental constitutional principles. The fact that the regulatory power of government is determined by the constitutional principles of separation and limited delegation of powers, due process, and judicial protection of individual rights, does not necessarily mean that individuals will always be fully protected from excessive and controlling acts of the executive. In many areas of international trade, governments have achieved such regulatory power that restrictions may lead to the abuse of constitutional rights—such as restraint of the right of individuals to trade. Ever-increasing import restrictions, export barriers, licencing formalities, permit regimes, obligation to disclose business information, and other typical regulatory measures suggest that even though the principle of limited government power is recognized in modern constitutions, there is often a strong attempt on the part of executives to act beyond these limits. Whenever governments act in such a way, it may be possible to conclude that government measures are becoming restrictive. On the other hand, international organizations, such as the GATT and the WTO, attempt to provide a common institutional framework for international trade without government involvements and restrictions of import and export. Their main activities are aimed at reducing barriers to free trade and harmonizing national trade policies in order to improve the conduct of international trade.


7General Agreement on Tariffs and Trade (GATT) came into force on January 1, 1948. It is both a multilateral trade agreement and an institution that oversees the agreement’s operation. It creates a legal framework for trade relations between Member States and a forum for dispute resolution. In general, GATT promotes: reduction of tariffs and non-tariff barriers to trade, prohibition from using quotas on import and export (except for agricultural goods and fisheries), and harmonization and standardization of technical regulations of member states. The agreement establishing the World Trade Organization (WTO), coming-into-force in 1995 will become the successor to GATT. It strongly emphasizes on elimination of trade barriers in order to create a common institutional framework for free trade.
Although these regulatory functions of state and government are of the utmost importance, there is still a concern that the state's protection of individual rights may lead to limitations on individual autonomy. For these reasons, this thesis concentrates on supervening illegality as a correlation of these two interests and related principles: state interest, which necessarily connotes public benefit and public policy as triggering principles; and private interest, which connotes autonomy of will, and the freedom of the individual to act.

2. Methodology

This thesis will first attempt to elucidate the terminology and theoretical concepts surrounding supervening illegality, autonomy of will, frustration, and force majeure; and, their use in the context of international trade and international dispute resolution will be critically analyzed. The study will also provide selective examples of judicial and arbitral practice in the dispute resolution related to the issue of supervening illegality, touching upon international and national jurisprudence. Finally, this thesis will address the question of drafting contracts. This methodology is suggested in order to answer the question of how to ensure efficient protection of private parties from liability for non-performance caused by supervening illegality. This will involve comparing current regimes of protection as provided by national judicial and legislative practice, by international treaties, and by international contracts drafted by private parties themselves.

In Chapter 1, a brief outline of basic terms used in this paper will be presented. The historical overview of particular legal concepts is included in order to provide a deeper insight into the issues. In addition, the complexity of international trade necessitates a comparative survey of the legislative and judicial practices of common law and civil law countries. Indeed, such comparison will represent one of the major
methodological tools for the whole thesis. Next, particular practical problems involving contracts in international trade will be examined. First of all, the advantages and disadvantages of state involvement in contracts will be discussed. With respect to state standing in arbitral proceedings, the concepts of sovereign immunity and the Act of State doctrine will be taken into consideration.

Chapter 2 is concerned primarily with limitations of party autonomy in international trade. In this discussion, acts of governments are scrutinized from two perspectives: when those acts reflect domestic policy, and then, when they appears as a part of a broader international measure encouraged and recommended by the United Nations or some other international organization. The problem of frustration will be approached.

In Chapter 3, the problem of frustration will be approached. Theoretical perspectives presented will include concepts—such as impossibility, impracticability and force majeure—that prevail in the present international legal environment.

Chapter 4 deals with the consequences of non-performance of contracts from the moment of discharge by supervening illegality. Solutions provided by the laws of selected countries will be compared.

Chapter 5 provides a study of drafting techniques with respect to supervening events and arbitration clauses. Finally, in Chapter 6, conclusions drawn from the whole study will be presented.
CHAPTER ONE:
DEFINITIONS

Some preliminary distinctions should be drawn with respect to the basic terminology applied in the study.

For the purpose of this thesis, the notion of autonomy is analyzed as a concept of domestic law within the framework of two legal systems—the common law and the civil law. Taken as a principle of domestic law, autonomy of will constitutes the fundamental principle of contract law in the civil law system and the source of all contractual obligations of the parties. With respect to the common law system, the notion is set out as a freedom of contract, a decisive fact that gives the legal basis for contracts within the limits of public order.

Supervening illegality will be understood to mean subsequent changes in legislation, subsequent acts of governments or their administrative bodies, or "change in surrounding circumstances which have the effect of prohibiting performance by virtue of the previously existing law". A detailed outline of the forms of supervening illegality is provided in Chapter 1 (2. The Notion of Supervening Illegality). In this context, state intervention is taken as a broader notion which covers involvement of the state in commercial transactions and its regulatory activities and powers, including all preceding and subsequent changes in laws.

International business transactions will be defined for the purpose of this thesis as international contracts, or "contracts with elements in two or more nation-
states"\textsuperscript{9}, concluded between private parties exclusively or between private parties and states.

1. AUTONOMY OF WILL

Scholars and philosophers have labored for hundreds of years to categorize and define the principle of autonomy of will. Since almost all aspects of life are affected by the autonomy of will, the law itself simply could not be without its own perception of the notion. The basis of the development of all legal theories, including those regarding autonomy of will, can be found in various disciplines and sciences, above all in history, philosophy and sociology. Influential philosophical concepts on the autonomy of will developed from Aristotle's and Thomas Aquinas's metaphysical ideas about morality and the nature of things\textsuperscript{10}. In the philosophy of Kant, autonomy of will was introduced as an ethical category, promoting the ideas of duty and the value of the human person\textsuperscript{11}. Most of these philosophical ideas were brought together in 1789 in the famous legal document of the French revolution, the Declaration of the Rights of Man and the Citizen. ART. 4 of the Declaration states:

\textsuperscript{9}H. Smit, N.S. Galston & S.L. Levitsky, ed., \textit{International Contracts} (New York: Parker School of Foreign and Comparative Law, Columbia University, 1981) at 4
\textsuperscript{10}Summarizing scholastic concepts of contracts and philosophical ideas, James Gordley says; "Making a contract was an exercise of the virtue of liberality by which one another, or of the virtue of commutative justice by which one enriched another"; see J. Gordley, \textit{The Philosophical Origins of Modern Contract Doctrine} (Oxford: Clarendon Press, 1991)
\textsuperscript{11}For detailed explanation see J. Gordley, \textit{ibid.}; also G. Rouhette at D. Harris & D. Tallon, \textit{supra}, note 5; B. Nicholas, \textit{French Law of Contract} (London: Butterworths, 1982)
"Freedom consists in doing all which does not harm the other; therefore, the exercise of natural rights of each man has no other limits than those which ensure to the other members of society the enjoyment of these same rights." 12

John Stuart Mill based his conception of the autonomy or freedom of individuals on the social philosophy of utilitarianism. He wrote that the greater the individual freedom the greater and more varied human development is. 13

While those philosophical concepts offer a broad, non-legal definition of the autonomy of will as the personal or individual freedom to act without any limitations, the law chooses a more realistic approach: that there is no absolute autonomy or freedom in a modern society, only a limited one. In this respect, the development of the idea of autonomy of will in contract law can be presented.

1.1. Autonomy of Will in Contract Law

Some authors emphasize that autonomy of will is actually more a justification for the legal enforcement of contracts than merely a sort of expressed will of the parties 14. Others prefer to define autonomy of will as "the realization of the principle of individual autonomy that translates into the right of parties to contract with each other, thus as an aspect of individual liberty" 15.

12 H.J. Leibesny, Foreign Legal System: A Comparative Analysis (George Washington University, 1981) at 30
14 Ibid., at 697-708
Georges Rouhette explains that "[a]utonomous will means a will which determines its rules for itself: the contractual obligation has its source in the will of the parties who alone and freely created the contract and all its effect."\(^{16}\) Hence, the author says that "the will of parties is first of all the foundation of the contract"\(^{17}\) whereas "freedom is the heart of the contract"\(^{18}\). Autonomy of will is usually perceived as connected with freedom of contract, mainly in terms of a freedom to enter into a contract with a freely selected partner and freedom to fix the terms of contract\(^{19}\). The phrases are even sometimes seen as synonymous.

As well, the term autonomy of the will and will theory were paramount notions of seventeenth century French philosophy and legal doctrine. For example, Jean Domat discussed limitations to the autonomy of will and freedom of contract in his book "Les loix civiles dans leur ordre naturel 1689-1694". The French Civil Code (Code civil)\(^{20}\), influenced by Domat's ideas, uses the postulate of l'autonomie de volonté (autonomy of will) for an individual's freedom to choose. A confirmation of the influence of the autonomy of will theory and laissez-faire doctrine on the Code Civil is set out explicitly in ART. 1134.1, which provides that a contract has the force of law for the parties who concluded it.

In the eighteenth and nineteenth centuries, during the reign of natural law theory and the development of the philosophy of laissez-faire, the principle of the freedom of parties to contract became the central feature of classical contract law everywhere, including England. For common law judges of the nineteenth century the individual's freedom to contract was to be protected in a way that "the law should interfere with

\(^{17}\) Ibid.
\(^{18}\) Ibid.
\(^{19}\) Ibid.
people as little as possible"\(^{21}\). The best example of such a principle in a court decision is the statement of Jessel, M.R. in *Printing and Numerical Registering Co. v. Sampson*\(^{22}\) in 1875: "If there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily should be held sacred"\(^{23}\).

Obviously, it was believed that no external control from the legislature or the executive should occur once a contract had been mutually agreed upon. Professor Atiyah explains that from the middle of the nineteenth century it was claimed in England that the primary function of the law had come to be purely facultative and "the laws of contract became like the law of will, a device for enabling private individuals to make their own arrangements, and to summon the State to their aid to see that those arrangements were adhered to"\(^{24}\). In other words, there was a belief that the parties were the best judges of their own interests and that the only function of the law was to safeguard these.

This approach undoubtedly reflects the highly individualistic model of contract law firmly rooted in the *laissez-faire* idea and the liberal capitalism of a flourishing free market. This classical theory of autonomy of will and freedom of contract was accompanied by several others that appeared about the same time in common law countries: the equivalent theory, the bargain theory, and the interest theory. All of these were based on the similar principle of the sanctity of contract and the existence of the free market. It was further deemed that such a market was capable of imposing its own rules of the game only through the relationships and transactions of the parties at that market. The general bias in favour of the freedom of contract and the self-regulated market became

\(^{22}\)Printing and Numerical Registering Co. v. Sampson [1895] LR 19 Eq. 462, at 465
\(^{23}\)J. Swan & B.J. Reitter, *supra*, note 15, at 602
\(^{24}\)P. S. Atiyah, *supra*, note 13, at 408
scrutinized not later than 1850. Many authors marked that year as a starting point of the
decrease of freedom in contract.

Even a brief introduction to the concept of contract in former socialist
countries reveals how little attention was paid to the autonomy of the will of individuals.
The old socialist concept distinguished between two types of contracts. First in
importance were so-called economic contracts, which were more or less contracts
concluded in order to fulfill socialist plans in the economic sphere. They were concluded in
a form of administrative obligation imposed on state enterprises. The second were
contracts concluded between private parties, but outside the field of trade and commerce
in a strict sense. Some contracts were even required to be in a prescribed form and have a
prescribed content. The key characteristic of such contracts was an absolutely restricted
freedom of parties to determine their obligations. These contracts were one of the state's
instruments to organize and control the economy in all aspects. All these facts are usually
seen as evidence that the Western understanding of the contractual freedom of parties was
not even recognized in most of these countries.

Authors sometimes argue that the limitation of the autonomy of will is
necessary to maintain a system that is established for the benefit of the majority. Sidney
Fine, for example, explains that limitation of the autonomy of will was strongly supported
by the middle class majority, which wanted to return to pre-industrial "golden age"

25See P. S. Atiyah supra, note 13; also G. Gilmore, supra, note 3; also J. Gordley, supra, note 9
26G. Eörsi, Contract in the Socialist Economy, in A. Von Mehren ed., International
see also O.S. Ioffe, Soviet Civil Law (Dordrecht: Martinus Nijhoff Publishers, 1988) at
139-211
27See also G.H. Millholin, supra, note 3 at 279; M. Horwitz, The Transformation of
conditions. According to this line of reasoning, the state simply could not allow an individual to upset this system by its own individual acts.

As shown by this brief overview, limitation of autonomy of will is a common tendency in most countries, with a direct or an indirect intention to narrow the scope of autonomy. Moreover, it could be argued that the basic means of imposing limitations on the party's autonomy did not differ fundamentally in these two blocs. State intervention through so-called secondary legislation (such as export and import controls, exchange bans, etc.) and through laws and mandatory rules passed by legislatures, were traditionally used in both types of countries to restrict the individual's contractual freedoms.

Since increases in the importance of the notion of the autonomy of will and freedom to negotiate and to contract have always been followed by increases in tendencies toward direct or indirect control of the market, it could be assumed that the 'ideal' and 'pure' autonomy of will could never exist within a market. That pervasive influence of the state and government affects the individual's behavior and cannot be denied. In the name of social progress, states began to pass legislation directed against the individual's freedom to contract and thus slowly the natural rights of individuals, once a paramount principle, has replaced with the theory of common interest. The attendant increasing power of governments resulted in numerous limitations to the autonomy of individuals. First it became significant in the field of labour law (problems of monopolies, merging, restraint of trade) as well as in the growing interest in consumer protection and standard term of contracts. Richard Speidel notes that the American welfare state by 1900 sought to cure inequalities in contractual bargaining positions in areas such as antitrust, insurance, labour law, and transport. Professor Treitel also details how the content of numerous service

contracts was regulated in great detail by legislation, such as in the Rent Act\(^{30}\) and the Employment Protection (Consolidation) Act.\(^{31}\)

1.2. Private International Law

As previously mentioned, private international law defines party autonomy as both "the parties' right to choose the law which governs an international contract"\(^{32}\). The prevailing rule that the law applicable to the substance of a contract would be the one chosen by the parties themselves became of paramount importance in the nineteenth century, not only in legal theory, but also in court practice. The courts in the most important European capitalist countries (England, Germany, and France) looked at the express as well as the tacit choice of law by the parties. According to Ole Lando, England was the first country to establish the principle of reliance on the intention of the parties regarding the choice of law in international contracts\(^{33}\). In arriving at this solution, English legal scholars were greatly influenced and supported by \textit{laissez-faire} theory and the importance of party autonomy in the English law of contracts. In contracts, although France promoted the principle of party autonomy in the law of contracts, there recognition of the principle in private international law came late. One of the possible reasons for this is a long period of legal scholarly criticism in relation to the theory in contract law. The French courts, on the other hand, were more supportive of the principle, and since a 1910

\(^{30}\)Rent Act, 1977 s.44

\(^{31}\)Employment Protection (Consolidation) Act, 1978 s. 49


\(^{33}\)\textit{Ibid.} at 14
Court of Cassation decision\textsuperscript{34}, they have recognized that the law applicable to the contract is the one chosen by the parties to the contract.

In short, it should be noted that the notion of the autonomy of will in this thesis refers to a situation in which contracts are made freely and voluntarily by parties. That is, both parties contract with reference to their freely stated private interests. The aim of this discussion is to explore the relation between autonomy of will and supervening illegality as a very sophisticated interaction of private and public interest. In this context, contracts are a reflection of autonomous, private interest, whereas laws represent the public interest and state intervention.

2. THE NOTION OF SUPERVENING ILLEGALITY

Practitioners of international trade seek from the state certain guarantees that they will not be subject to disturbances by government activities. In other words, they need a stable legal framework for their transactions. On the other hand, states still prefer direct participation in international transactions. In short, parties to international transactions are often affected by sudden changes in policy, supervening prohibitions, or other acts of government that would disturb the performance of already concluded contracts.

It appears that the effects of supervening illegality, bearing characteristics of supervening events, are quite similar to the effects of frustration. However, in the matter of supervening illegality, the distinction should be made between the civil law approach, based on the Roman law concept of impossibility and force majeure, and the common law approach based on the concept of frustration\textsuperscript{35}. Although supervening

\textsuperscript{34} Cass. civ. 5 Dec. 1910, S. 1911 I. 129

\textsuperscript{35} See the discussion provided in Chapter Three: 1. Frustration of Contract
illegality does have some characteristics of a supervening unforeseeable event beyond the control of the parties, who do not bear any fault for its occurrence, it also differs from such a supervening event. Its *differentia specifica* in the majority of cases is that supervening illegality does not make performance physically impossible but only legally impossible. However, many would agree that supervening illegality is included in a doctrine of frustration of the contract, that could discharge a contract "if, after its formation, events occur making its performance impossible or illegal, and in certain analogous situations"\(^{36}\).

The contract in international trade, concluded in accordance with the law, may subsequently become unlawful by a change of law or act of government\(^{37}\). As already explained, this subsequent change of law or change in surrounding circumstances is defined as supervening illegality. When this happens, the contract will usually cease to be valid or enforceable and the parties will be discharged. Supervening illegality may have the effect of creating temporary illegality (causing delay in performance rather than frustration) or permanent impossibility of performance. It may be partial, frustrating only a part of performance, or absolute, frustrating the main purpose of a contract. As will be explained in the following chapters, numerous disputes related to supervening illegality come about as result of contracts being frustrated during war, when public policy considerations result in so-called "trading with the enemy" prohibitions\(^{38}\).

Indeed, very often a decision in cases of supervening illegality is based solely upon consideration of public policy. Professor Atiyah stressed that supervening

---


\(^{37}\)G.H. Treitel, *supra*, note 8, at 319, found that supervening illegality arises from a "change in the surrounding circumstances which has the effect of prohibiting performance by virtue of the previously existing law". According to this author, the surrounding circumstance is for example, the war that could break out.

\(^{38}\)See Chapter Three
illegality is "a more drastic way of expressing the public interest, and is therefore usually reserved for cases in which the public interest is more seriously infringed." Professor Treitel shares this opinion and characterizes supervening illegality as a case in which "the court is concerned, not merely with reaching a solution which may do justice between the contracting parties, but also with the public interest in seeing that the law is observed; and this public interest may sometimes outweigh the private interest of the parties." Sometimes, contemporary legislators have preferred immediate application of a law, foregoing any "transitional period". In such cases either the parties have to modify the content of their contract or it is be declared null and void. Here legislative intervention in the name of public policy prevails over the freedom of contract. For these reasons, the notion of public order and public policy is important and will be examined in Chapter 2 of this paper.

In summary, it should be noted that arbitral tribunals would examine all consequences of state intervention into contractual relations, but this will not necessarily result in relief being granted for non-performance of a contract. Case studies on that issue will be provided in Chapter 3 and 4 of this study.

It has been already suggested that for the purpose of this study state intervention is taken to mean every regulatory intervention of the state and its organs in trade. Such intervention is accepted as a fundamental function of the state. Accordingly, state regulatory powers are accepted as one of the components of government, which are defined and limited under the rule of law and national constitution of every modern country. On the other hand, supervening illegality represents only one modality of state intervention. This thesis will deal only with regulatory powers of governments and its agencies when they are used to change rules relating to international trade. The analysis will focus particularly on any intervention which has the characteristics of a supervening

39P.S. Atiyah, supra, note 21
40G.H. Treitel, supra, note 8, at 320
event. Thus, state intervention and supervening illegality in this thesis are more or less synonymous, even though the broader action does comprise the narrower.

Before scrutinizing cases of supervening illegality, however, a brief introductory overview on the formation and specific characteristics of international contracts should be presented.

3. INTERNATIONAL TRANSACTIONS

The notion of international transactions is briefly explained in the Introduction to this thesis. The essential considerations in the present context are that international transactions are carried out as contracts of a distinctive nature and that, therefore, supervening illegality may affect them in a different manner than it would purely domestic transactions.

The structure of contracts in international trade, as contracts with elements in two or more nation-states, can be distinguished from the structure of those in national trade. Diversity of both national laws and international rules, customs, and usages constitute some of the considerable elements that should be taken into account when a contract for international trade is to be concluded. Additional difficulty can be created by the fact that contractual parties are entities of different nationalities and sometimes of different legal natures. At the same time, thanks to the dynamic development of international trade practice, many new types of international contracts have been developed. Thus, parties are able to use not only standard contracts and the general conditions that correspond to the types of contracts concluded for the purpose of trade within national borders, but also a great variety of new contracts such as factoring, franchising, leasing, consulting engineering contracts, joint ventures, know-how contracts, computer-service contracts, and bank contracts, among others.
In light of the dynamic political and economic context of international commercial transactions, it is understandable that governments would be involved in contracts. A substantial amount of government intervention occurs in the principle of contract drafting. Further, governments often seek to extend their domestic trade laws to international transactions and to impose their standards on international relations. Many countries enact export and import controls, and foreign exchange and foreign investment acts, to name a few. However, these instances of governmental intervention can be unpredictable. Thus, coming back to the question of how supervening illegality affects international trade, the following issues must to be clarified: the law applicable to contracts, the state as a party to such contracts and the arbitration clause.

3.1. The Law Applicable to Contracts

Contracts in international trade presume the participation of parties domiciled and/or registered in different countries. When parties from different countries undertake international transactions, the legal framework of the transaction proves to be a sensitive issue that usually involves numerous difficulties. One of the first is the question of which law will govern the contract. In most cases, the answer would be the lex contractus, the national law of a given country, or the law which is to govern the contract according to the national conflict of laws rules. In short, the parties choose a particular, national system of law. The fact that parties are entitled to decide on the law which will govern the contract is not necessarily advantageous, especially if they are not certain about that law. Making a choice of law according to the principle of party autonomy does not completely eliminate uncertainty with respect to the set or rules that directly governs the contract. Moreover, there is always a risk that during the life of a contract this law can
change. The reality of supervening illegality confirms that the national law can be changed overnight.

For the party who has to obey the national law of another country, unfamiliarity with that legal system is not the only risk likely to impede the transaction. Indeed, it is followed by a large number of extraordinary events such as political, economic and social upheavals that go beyond the parties' intention at the moment of making the contract. Further, there are mandatory rules which they have to obey. Mandatory laws clearly limit their autonomy. If the contract is silent on the choice of law which will govern the contract, the issue will be decided in accordance with the conflict of laws rules.

Thus, it is possible to say that this typical unfamiliarity with the legal systems of other countries is able to diminish positive effects of the party autonomy principle, as the leading principle of international trade.

However, a contract can be governed by rules other than national laws, such as *lex mercatoria*, including rules of international treaties and conventions. By relying on some international treaty, such as the *United Nations Convention on Contracts for the International Sale of Goods*\(^{41}\), the risk of supervening illegality can be reduced, since changes to such multinational documents require longer procedures and are accompanied by more publicity than changes to national law.

---

3.2. The Nationality of Parties

Many issues can arise with respect to nationality of parties. The most basic of these is, of course, the question of who can be a party to a contract for international trade. It is generally accepted by all states that both private parties (individuals and/or private companies) and states or state-owned companies are by their national laws entitled to enter into international trade contracts. International contracts with foreign states or state enterprises call for special attention. The principal legal problem often concerns the consequences of having parties that differ not only in bargaining positions, but also in legal character or personality, involved in international trade. The issue becomes more complex in arbitration proceedings when the contract is frustrated by supervening illegality. In order to overcome some difficulties that may arise from contracts concluded between private entities and states, it is necessary to examine their standing in arbitral proceedings and the possibility of defining their rights in the contract itself.

i. Private Parties

When both parties are individuals or privately owned companies they can successfully use the defence of supervening illegality for non-performance if they are able to prove that their non-performance was caused by a government act that was passed after the signing of the contract, and if they could not have foreseen, nor prevented, the change. Practically, the contract would be dissolved because its performance would have become illegal by a subsequent act of the government.

As well, private parties are free to decide on dispute resolution. According to the principle of party autonomy, parties are free to choose the authority which will decide any dispute that arises from the contract. Moreover, they can refer a dispute to
national court or neutral arbitral tribunal. The only limit to arbitration is imposed by national laws with respect to the issue of arbitrability. For instance, some disputes, connected with domains in which the state has some strong vested interests and policies, cannot be decided by arbitration. In France, for instance, arbitration is excluded in all matters where ordre public is concerned. Furthermore, patents and trade marks issues are non-arbitrable in France, Italy, Brazil and the United States. Disputes relating employment are not arbitrable in Italy.

ii. State or State-owned Companies as Parties

Involvement of states in international commerce is not a recent phenomenon. However, it became prominent after World War II. First of all, the socialist countries started to control foreign trade through specific sets of rules and the establishment of state agencies and state enterprises, with monopolies on trade with other states. Furthermore, in many developing countries, the state's involvement was the most important method of strengthening their bargaining positions in negotiating contracts.

---


43 Article 2060 of the Code Civil: "One cannot submit to arbitration questions of status and capacity of persons, questions relative to divorce and separation, or questions respecting controversies that concern public entities or public establishments and more generally any matter that concerns the public order."

44 See R. David, *supra*, note 42, at 188

45 See ARTs. 806 and 808 of the Italian Code of Civil Procedure

46 The term state-enterprise is defined by K.-H. Böckstiegel as "any commercial enterprise predominantly owned or controlled by the state or by state institutions, with or without separate legal personality"; see K.-H. Böckstiegel, *Arbitration and State Enterprises: Survey on the National and International State of Law and Practice*, (Deventer: Kluwer Law and Taxation, 1984) at 14
with companies from developed countries. Private companies were still unable to reach an adequate level of technical and financial development to deal with other companies at the international market. Finally, in industrialized countries, where private companies prevail, state enterprises operate within particular industries, such as with government procurement or public utilities.

It is noteworthy that even in international trade contracts concluded with foreign states or state enterprises are formalized to a great extent, since the laws of the state usually impose special and strict sets of rules regarding the state as a contractual party. In addition, these contracts are usually performed within the territory of the contracting state. For these reasons, it is possible to conclude that the formation of international contracts which involve the state as a contracting party are from the very beginning restrictive. Moreover, the sensitive issue will be to comply with the supervening prohibition imposed by the state which is a party to the contract and a creator of the subsequent impossibility of performance. This issue will be scrutinized in Chapter 4, and especially in Chapter 4.1.

If state traders or governments are involved in international trade, disputes will generally be referred to arbitration. State traders and governments tend to want escape from the jurisdictional territory of another contracting party, even though they do not mind having their national courts authorized for dispute resolution. On the other hand, the private party will not like to have the dispute decided by the court of the state which is a party to the contract. State enterprises sometimes point to certain restrictions, imposed by their national laws, with respect to their participation in arbitration. As far as developed countries are concerned, there are no restrictions on state enterprises acting as private entities. In contrast, public entities⁴⁷ are not allowed to agree to arbitration in some

⁴⁷Note that the term "public entities" is here used to ascertain state, government, city, or public corporation, acting only in the form of jure imperii transactions, or as a public authorities, whereas the term "state enterprise" is understood as a private entity, acting in predominantly in the form of jure gestionis transactions
countries. For example, such restrictions exist in Belgium, France, and Luxembourg, but with some exceptions based on obligations derived from international treaties signed by the state or on specific permission given to the particular public entity.

State enterprises in former socialist bloc countries were obliged to refer their disputes to arbitration. It was the only forum for commercial disputes which arose from contracts signed by parties from socialist countries according to the Convention on Settlement by Arbitration of Civil Law Disputes Arising from Relations of Economic, Scientific and Technical Cooperation. Arbitration was the most common tribunal for dispute resolution when a contract was concluded with Western companies as well. As to dispute resolution by arbitration in Western countries, state enterprises established in the form of public entities were subject to restrictions in some countries, whereas those established in the form of private companies, wholly or partially owned by the state, were not.

Thus, it is possible to conclude that arbitrability of disputes between states and private parties is an issue regulated solely by national law. However, some international conventions on arbitration have made an attempt to provide a uniform solution to the problem. For example, the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (ISCID Convention) provides in

48 The Convention on Settlement by Arbitration of Civil Law Disputes Arising from Relations of Economic, Scientific and Technical Cooperation (Moscow Convention) was signed in 1972 by so-called COMECON or CMEA countries. CMEA countries were members of the Council for Mutual Economic Assistance: Bulgaria, Czechoslovakia, the German Democratic Republic, Hungary, Mongolia, Poland, Romania, and the Soviet Union. Cuba became the member state later.

49 For example in Belgium and Luxembourg the ban was absolute, whereas in France and Germany public entities could agree on arbitration if a permission is granted by a certain state authority. According to K.-H. Böckstiegel, supra, note 46, at 15, no restrictions seemed to exist in Austria, Australia, Canada, Great Britain, Italy, The Netherlands and Switzerland.

ART. 25(3) that "[c]onsent by a constituent subdivision or agency of a Contracting State (to arbitration) shall require the approval of that State unless that State notifies the Centre that no such approval is required". The European Convention on International Commercial Arbitration also provides a certain reservation for conclusion of arbitration agreement for "legal persons of public law to resort to arbitration". ART. II(1) imposes the general rule that States and international organizations have a right to submit a dispute to arbitration whereas ART. II(2) speaks of limits: "On signing, ratifying or acceding to this Convention any State shall be entitled to declare that it limits the above faculty to such conditions as may be stated in its declaration." Chapter 11 Section B of the North American Free Trade Agreement (NAFTA) establishes a mechanism for resolving disputes derived from investment contracts between a state, or state enterprise, and a private investor as a party to the treaty. Article 1116(1) of this treaty gives a private investor direct and mandatory access by to arbitration. Section B of Chapter 11 goes even further, providing detailed procedural rules with respect to arbitration.

With respect to supervening illegality, a state party's involvement in international contracts raises an important dilemma: whether a state party may be excused

52 ART. II of the European Convention on International Commercial Arbitration
53 The North American Free Trade Agreement (NAFTA) Chapter 11 Section B - Settlement of Disputes Between a Party and an Investor of Another Party
54 Article 1116: Claim by an Investor of a Party on Its Own Behalf:
1. An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under:
   (a) Section A or Article 1503(2) (State Enterprises), or
   (b) Article 1502(3)(a)(Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A, and that the investor has incurred loss or damage by reason of, or arising out of, that breach.
55 As to the procedural rules, the investors' choice is limited in ART. 1120(1) to ICSID Convention, Additional Facility Rules of ISCID and the UNCITRAL Arbitration Rules, whereas the choice of substantive law according to ART. 1131(1) is NAFTA or international law
from liability for non-performance by claiming that a change in its own law represents a
force majeure event. In other words, assuming that a state party is nothing but a state-
owned or state-controlled enterprise, can a supervening government act be understood as
a self-induced frustration (according to the common law tradition), or as a fault of a party
who failed to perform (according to the civil law tradition). Neither conception will bring
excuse from liability for non-performance of a state party. This issue was decided in two
cases involving contracts concluded between Western companies and state enterprises
from the socialist bloc. In 1958, when the USSR placed a ban on oil exports, the case
*Jordan Investments Ltd. v. Sojuzneftexport*\(^{56}\) came to the Foreign Trade Arbitration
Commission of the USSR Chamber of Commerce (FTAC). The 1974 case *Czarnikow Ltd.
v. Rolimpex*\(^{57}\), decided at first by arbitration in London and finally by the House of Lords,
resulted from the Polish government's ban on sugar exports. In both instances, government
acts frustrated already-concluded contracts. In both cases the force majeure defence was
accepted: arbitrations and courts held that acts of governments had the effect of force
majeure. It is significant that in both cases the defendants, using the act of state as force
majeure argument, were state enterprises from the former socialist bloc. However, the
forums that reached similar results were quite different.

**The Jordan v. Sojuznefteksport Case**

*Jordan Investments Ltd. v. Sojuznefteksport* resulted from the Soviet
Ministry of Foreign Trade's denial of an export licence for deliveries of fuel oil to Jordan
for 1956 through 1958. From 1954 to 1956 the Soviet state enterprise *Sojuznefteksport*

\(^{56}\) *Jordan Investment Ltd. (Israel) v. Sojuznefteksport*, (hereinafter *Jordan*) FTAC Award
(Moscow) 3. 7. 1958; published in English in 53 American Journal of International Law
(1959) 800

\(^{57}\) *Czarnikow Ltd. v. Centrala Handlu Zagraniczego Rolimpex* (hereinafter *Rolimpex*)
[1979] A.C. 351
and two Israeli companies had entered into several contracts for the annual export of fuel and crude oil for the period 1955 to 1958. One week after Israel, allied with France and Great Britain, attacked Egypt in 1956, the Soviet Ministry of Foreign Trade refused to grant export licenses for already concluded contracts. This act was a political decision made in accordance with the national interest of the Soviet state at the time. Jordan started an arbitration procedure in October 1957 before the FTAC in Moscow, pursuant to the arbitration clauses in the concluded contracts. The Soviet company answered by using the force majeure defence, saying that a government act had caused non-performance of the contracts and thus they should be regarded as cancelled. The company pointed out that the government decision was beyond its control. Jordan argued that the Soviet company, as an exporter, was obliged to obtain an export license. It further argued that the Soviet company itself was established by the Soviet government and that it had a monopoly on the export of fuel and crude oil. Being so closely connected with the government, the state enterprise could not claim that such an order represented force majeure. Obviously, to reach a decision the arbitral tribunal had to decide on the crucial issue of the close relationship between a Soviet company and the Soviet State. The FTAC found a solution in the Soviet law which said that such export-import enterprises were separate legal entities, entitled to acquire rights in property, and obligations in their own name, and that such entities would have standing before the courts. At the same time, they were a part of the state monopoly of a foreign state. Being a separate entity from the state, a state enterprise (even a government agency) could not affect governmental decision-making. Thus, the arbitration in Moscow rendered an award in favour of the Soviet exporter.

The Rolimpex Case

The 1979 C. Czarnikow Ltd. v. Centrala Handlu Zagranczego Rolimpex case reveals the issue of supervening illegality in a different environment. After so many
years of dealing with problems of illegality in the context of war, this case came as an
important case involving governmental interference with contracts. Supervening illegality
appeared as a result of a government act, or rather a decision on issuing a licence for
international transactions. The importance of the case is in the fact that the contract was
frustrated by an act of government and that the Polish defendant successfully used a force
majeure defence in an action for breach of contract. Before ascertaining the facts of the
case it should be noted that the Rolimpex case involved another issue behind the issue of
supervening illegality: the issue of governmental involvement in international trade
through companies which are wholly or partially owned or controlled by governments.

Another issue that was to be solved in the case, but had appeared as a problem in many
cases as early as the fifties and sixties, was in respect to export licenses and the nature of
the obligation on a seller's side to acquire this licence.

Rolimpex was a state export trading company which had a monopoly on
sugar and some other commodities. However, under Polish law, the company was deemed
a legal personality separate from the state and government. In 1974 the company was
authorized to export 200,000 metric tons of sugar. Rolimpex thus entered into two
contracts with an English company, Czarnikow, for the sale of 17,000 metric tons of
sugar. The contracts were governed by the rules of the London Refined Sugar
Association. A dispute arose when the Polish government imposed a ban on the export of
sugar and revoked export licences already granted in November 1974. The reason the
Minister of Foreign Trade and Shipping passed this decree was a bad agricultural season
(1974-1975) and, consequently, a lack of sugar for domestic consumption. Czarnikow
claimed damages for non-performance of the contracts by Rolimpex. After being decided
by arbitration which excused Rolimpex on grounds of force majeure, the case went to the
lower Courts in England and ended up before the House of Lords. The decision of the
House of Lords upheld the arbitrators' and the lower courts' decisions against Czarnikow's
appeal that Rolimpex was a state trading company and thus could not rely on government
intervention as a *force majeure* excuse for non-performance. The House of Lords further held that Rolimpex was not under any absolute obligation to obtain and maintain the license in force until delivery.

The *Rolimpex* case became the most criticized international law case in England during the seventies. Scholars lambasted the unsatisfactory examination of the relationship between the government and the company. The issue of the export licence requirement was posed as a question of the greatest importance for international trade. Arthur Hermann wrote that "[t]he doctrine laid down in Cubazucar and Rolimpex is masochistic, bad for business and contrary to the public interest" and that "[t]he Czarnikow doctrine enables the government, which makes a contract in the hope of making profits, to get out of the contract if the market turns against it, claiming political motives of economic necessity".

The *Rolimpex* case reveals the fact that a successful *force majeure* defence depends on the level of the separation between a state corporate entity and the state as its owner. Indeed, in all such cases a two-step analysis, proposed by Karl-Heinz Böcksteigel in his survey on state enterprises in arbitral proceedings, has to be undertaken by courts or arbitrators. The first step is, as in the *Rolimpex* case, is to ascertain the level of separation between a state and a state enterprise. An enterprise which is a separate legal entity is able to claim discharge of a contractual duty because of supervening illegality and interference of its state and government. This possibility could hardly be provided for the state itself because logically the state cannot intervene in its own business and claim supervening illegality. As previously mentioned, this will be understand in common law as self-induced frustration. At this point, suggests Böcksteigel, the second step can be taken: the precise character and influence of the government acts has to be determined by

---

60 See K.-H. Böcksteigel, *supra*, note 46, at 37 and 47-48
arbitrators in order to assess whether or not the state enacted a new law or regulation only to provide an excuse for a domestic defaulting enterprise\textsuperscript{61}. Here, it should be proven that the government's act is general in nature, applicable not only for one specific contract and relationship but for all of the same kind\textsuperscript{62}. Otherwise, it is hard to plead the excuse of force majeure. It is convenient to begin with the second step only after the issue of the nature of the legal entity of the enterprise has been settled.

These two issues were of concern to the arbitrators and the courts in the \textit{Rolimpex} case. Assessing the separability of the state trader from the state, the arbitrators and the English judges favoured the Polish company. The case revealed the question of legal entities as the most controversial one. The willingness of courts to ignore the complex issues of the separability of the enterprise from the state or government, and the

\textsuperscript{61} K. H.-Böcksteigel, \textit{supra}, note 46, at 47, first discusses the effects of administrative acts of state and concludes that:

"A1. Due to the presumption that a state will not have its executive organs act in the detriment of its own foreign trade organs, including state enterprises, administrative acts of state should in principle not be considered as force majeure.

A2. This presumption is not applied, however, if it can be seen prima-facie or can be proved by the state enterprise that the administrative act was caused by general considerations not connected with this contract or this sort of contract

A3. In spite of rule A2 the presumption under A1 is applicable again, if the private party proves that in its specific case the general considerations did not apply."

Hence, Böcksteigel examines the effects of the acts of state in the form of law and imposes the following rules:

"B1. If it is not a general law but a law for an individual case the same rule applies as under A.

B2. A general law, due to its per definitionem general character, will in principle have to be recognized as force majeure.

B3. Rule B2 does not apply, however, if the private enterprise supplies at least prima facie evidence that it was in the interest of the state not to fulfill its contractual obligations which was the motivation of the law."

It is not hard to foresee that the rule B3 would not benefit private enterprises in practice. To provide the arbitrators with \textit{prima facie} evidence that a subsequent change in law or subsequent act of government came only to provide a solid excuse for non-performance by the state would be \textit{probacio diabolica} for the private party.

\textsuperscript{62} In addition, see the discussion on Limitations by Acts of Government in Chapter 3.2; see also \textit{Settebello Ltd. v. Banco Total and Acores}, FT Comm LR, 21 June 1985
nature of the government acts are sometimes understood as consequences of the fact that courts themselves are nothing but the creation of states and that their judgments are reflections of state policy. Thus, the question of the independence of courts as tribunals cannot be avoided unless the parties decide to submit the dispute to an arbitrator or arbitrators. For that reason a dispute resolution clause in contracts of international trade calls for arbitration, whenever the parties are not compelled by mandatory rules to litigation in a particular country's court system. This chapter also discusses some advantages and disadvantages of the arbitration clause and arbitration as a method of dispute resolution.

However, it is possible to analyze these two cases in a different way as well. Government acts in the Jordan case differ from those of the Rolimpex case even though both cases involved denial of export licences. If we scrutinize the reasons for the denials we find that the Soviet government decided to ban the export of oil to Israel because Israel had attacked Egypt. The background to the decision is, in other words, completely political. On the other hand, the Polish government's act was taken in response to a problem of heavy rain and flooding beyond the control of the government itself.

As far as supervening illegality in court or arbitral proceedings is concerned, an additional problem could arise. According to the Act of State doctrine, courts are not allowed to examine validity of acts of foreign states in the way suggested by Karl-Heinz Böcksteigel as a second step in the analysis. For this reason, a private party as a litigant may not be able to obtain remedies for loss caused by a state party non-performance. In other words, when a private party is not able to attack the validity of the acts of a sovereign state it may be hard to prove that a change in the law constitutes self-

63 The Act of State doctrine is usually used as a defence in cases in which one of the parties is a state or state-owned enterprise. It prevents courts of one country from judging the acts of a foreign state that occur entirely within its own territory. The origins of this doctrine could be found in basic principles of public international law—the independence and sovereignty of states and the principle of sovereign immunity.
induced frustration. Under this line of thought, a state party can rely on a change in its own law and claim force majeure.

Finally, even if a state party cannot be protected from liability for non-performance caused by supervening illegality, a private party may not be able to obtain legal remedies for changes in the law of the state party. In brief, a state party can rely on the principle of sovereign immunity. The principle is based on the old Roman maxim *par in parem imperium non habet*, meaning that one state could not exercise jurisdiction over another state, and that one state could not be judged by courts of another state. The reason is that states are sovereign partners and that taking one of them before the court of another would automatically impair its sovereignty. It is important to notice that the concept of sovereign immunity includes immunity from suit and immunity from execution.

---

64 The concept of sovereign immunity originated as the theory of absolute immunity. Professor Schmitthoff, in his article *The Claim of Sovereign Immunity in the Law of International Trade*, (1958) 7 International and Comparative Law Quarterly 518, says that absolute immunity is based on dignity, equality and independence of foreign States. According to this theory, the state itself or its company involved in litigation, could always raise the plea of sovereign immunity (see cases *Chisholm v. Georgia*, 2 Dall. 419, 425 (U.S.) (1793); *United States v. Lee* (1882) 106 U.S. 196, 248; *Compania Naviera Vascongada v. ss. Cristina* [1938] A.C. 485). However this theory was abandoned when the theory of limited or restrictive sovereign immunity appeared. This theory allows a foreign sovereign to claim immunity before the courts of another state only if a dispute arises from transactions in which the state exercised its sovereign authority—administrative, legislative, or judicial. Thus, a distinction have to be make between two types of transactions involving sovereign states. Transactions *jure imperii*, as already explained, are acts of public authority, whereas transactions *jure gestionis* are commercial activities. Protection by the plea of sovereign immunity cannot be given when the state is involved in transactions *jure gestionis* because then the state acts almost as a private business person. However, even in a situation when the state is performing acts of public authority, it can expressly or by an arbitration clause waive sovereign immunity protection. Followers of the theory of limited immunity often insist that a foreign state entering into a commercial contract, which is by its nature a private law relation, implicitly waives sovereign immunity. Since the theory of limited or restrictive immunity is based on the assumption that the state is performing some activities, a problem might appear with respect to the activities of state enterprises (see case *Krajina v. Tass Agency* [1949] 2 All E.R. 247; also case *Czarnikow v. Rolimpex* [1979], A.C. 351; case *Baccus S.R.L. v. Servicio Nacional Del Trigo* [1956] 3 W.L.R. 948). Finally, there is the theory of denial of immunity, which is in practice even more restrictive than the theory of limited
Many common law states have passed laws on sovereign immunity in order to specify cases in which a foreign sovereign may enjoy immunity from litigation based on the principle of sovereign immunity and to specify cases in which no immunity is provided. Usually, these laws contain a list of exceptions concerning when the state can not rely on immunity. The United States, for example, enacted the Foreign Sovereign Immunity Act (FSIA) in 1976. In 1978 the State Immunity Act (SIA) was passed in Britain. In 1982 Canada passed the Foreign Sovereign Immunity Act. One international treaty governs the same issue: the European Convention on State Immunity (1972). On the other hand, immunity. According to this theory, a foreign sovereign is not entitled to immunity from legal process in the territory of another sovereign. Lord Denning supported the theory in his dissenting opinion in the case Rahimtoola v. Nizam of Hyderabad, [1957] 3 W.L.R. 884, 910: "It is more in keeping with the dignity of a foreign sovereign to submit himself to the rule of law than to claim to be above it, and his independence is better ensured by accepting the decision of a court of acknowledged impartiality than by arbitrarily rejecting their jurisdiction". Exceptions are usually limited to legislative, executive, and administrative acts of foreign states within their own territories and diplomatic activities.

65Foreign Sovereign Immunity Act (1976), 15 I.L.M. 1388-1392 (1976), Amendments to the FSIA (1988), 28 I.L.M. 397 (1989), Section 1605(a)(1) provides the general rule concerning judicial immunity of foreign sovereigns and the waiver of immunity before the US courts: "(a) A foreign state shall not be immune from the jurisdiction of courts of the United States or of the States in any case--(1) in which the foreign state has waived its immunity either explicitly or by implication, notwithstanding any withdrawal of the waiver which the foreign state may purport to effect except in accordance with the terms of the waiver."

66State Immunity Act (1978), 17 I.L.M. 1123-1129 (1978), Section 9 (1): "Where a State has agreed in writing to submit a dispute which has arisen, or may arise, to arbitration, the State is not immune as respects proceedings in the courts of the United Kingdom which relate to arbitration."


68European Convention on State Immunity and Additional Protocol (1972) Europ. T.S. No. 74 in 1987 the following states were party to this Convention: Austria, Belgium, Cyprus, Luxembourg, the Netherlands, Switzerland and the United Kingdom. Article 12 contains the rule on the waiver of sovereign immunity: "1. Where a Contracting State has agreed in writing to submit to arbitration a dispute which has arisen or may arise out of a civil or commercial matter, that State may not claim immunity from the jurisdiction of a court of another Contracting State on the territory of Contracting State according to the
civil law countries generally have not enacted particular laws on state immunity, but the same principle of limited sovereign immunity is practiced in the jurisprudence of the civilian courts.

In short, national and international rules on state immunity contain primarily rules on the waiver of sovereign immunity from being sued. As far as a private party's claim for legal remedies in cases of supervening illegality is concerned, the problem is still that a state party may rely on the state's immunity from execution and that may leave a private party without any possibility to cover its loss.

3.3. The Arbitration Clause

Not only for reasons of reduced costs and time, which are usually pointed as principal advantages of arbitral procedures, parties in international contracts are more likely to choose arbitration also because it offers the possibility of control over dispute resolution. The arbitration clause is facilitated by the principle of party autonomy, that with respect to arbitration parties are free to choose the law applicable to the merit of a dispute, free to constitute arbitration and to appoint arbitrators, and free to decide the place of arbitration and procedural rules. For all these reasons, party autonomy as a basic principle of international commercial arbitration should be understood as one of its biggest advantages. In contrast, when disputes appear before national courts, parties are limited by law of which the arbitration has taken or will take place, in respect of any proceedings relating to:
(a) the validity of interpretation of the arbitration agreement;
(b) the arbitration procedure;
(c) the setting aside of the award;
unless the arbitration agreement otherwise provides."
a set of national laws (substantial and procedural), and they must rely on the impartiality of judges of a national court.

In order to meet their need for the efficient, final, and binding determination of their disputes, parties should carefully consider the advantages offered by the principle of party autonomy. When appointing arbitrators, they should decide whether to refer their dispute to ad hoc or institutional arbitration. The prevailing practice is to choose institutional arbitration when one of the parties is a foreign state, government, or state enterprise. As to the appointment of the tribunal, the supremacy of the principle of party autonomy empowers parties to determine the scope of the jurisdiction of arbitrators. This is one of the most important elements of the arbitration clause. The jurisdiction of the arbitrators has to be clearly stated in order to enable the arbitrators to decide all disputes that could arise from the contract. As Chapter 6.2. of this thesis will explain, the parties should be aware of the fact that arbitrators can reach a just solution to a dispute only if they have enough authority conferred on them by the parties themselves. If they act beyond the scope of their jurisdiction in deciding a dispute, their award can not be enforced. In other words, the court of the enforcing country can reject the recognition and enforcement of the award on the ground set out in Article V (1)(c) of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention)\textsuperscript{69}.

The choice of law applicable to the merits of a dispute is very important to the outcome of a dispute, especially with respect to non-performance caused by supervening illegality. Some national laws have different concepts of the defense of non-performance based on doctrines of frustration, impossibility, impracticability, or force majeure. The possible outcomes are explained in Chapter 3.

\textsuperscript{69}Convention on the Recognition and Enforcement of Foreign Arbitral Awards, (The New York Convention), done at New York, on 10 June 1958, came into force on 7 June 1959, 330 U. N. T. S. 38 (1959), No. 4738
Finally, when choosing arbitration as a method of resolving disputes that arise from non-performance caused by supervening illegality, parties to international transactions rely on advantages provided by the New York Convention with respect to the possibilities of enforcement of foreign arbitral awards by national courts. Recent practice confirms that it is easier to enforce a foreign arbitral award than a foreign judgment. However, before scrutinizing the enforcement of awards, it is necessary to examine the importance of the choice of law by the parties with respect to the matter of supervening illegality. The next chapter provides an exhaustive survey of doctrinal and practical attempts to explain the legal nature and consequences of supervening illegality.

Summary

From the preliminary discussion and the case studies provided, two questions related to the effects of supervening illegality on international transactions still call for further discussion. The first of these concerns whether the choice of applicable law can help the parties in any way to avoid negative consequences brought by changes in law. In other words, which law should the parties choose as the applicable set of rules for their international contract? It is appropriate to note that there are at least two potential problems which the parties seeking protection from supervening illegality in international transactions have to consider. One of these concerns familiarity with national legal systems. Indeed, it has been already emphasized that most of the uncertainty that surrounds international trade derives from unfamiliarity with the legal framework of foreign transactions. Obviously then, this should be taken into consideration when the applicable law is to be determined. Furthermore, the parties should also be familiar with the whole business environment within which a particular national law operates. However, during the process of contract drafting and negotiating, the parties are often so focused upon the
minutiae of the contract—their specifics obligations—that they neglect these vital considerations.

The other problem concerns the stability of the legal system chosen as the set of rules applicable to the contract. This chapter suggested that a possible solution for these two problems could be found in the application of national laws or in the application of rules of international trade law, *lex mercatoria*. As previously discussed, the prospect of government intervention in private commercial transactions is inherent, on the grounds of fundamental constitutional principles, under the national laws of all modern states. The extremely wide range of justifications for government legislative intervention suggests both that familiarity with national laws is not easy to attain and that the stability of such laws is likewise unpredictable. On the other hand, a set of international rules is established by international business people themselves. It is widely acknowledged that such rules have been used and tested in commercial practice for many years. As already explained, international treaties and conventions, which represent to a great extent codifications of international customs and usage, are not subject to frequent and supervening changes. Their implementation by state signatories is usually pursuant to a long process that is open to public discussion. Hence, it is reasonable to assume that international traders can better tailor rules according to their own needs than state legislators. Finally, *lex mercatoria* is extremely supportive of contractual regulation of most disputes in international contracts and arbitration. In other words, *lex mercatoria* is more likely to support and give effect to the principle of party autonomy, than are national laws.

The second question that should be examined concerns the position of the state as a party in international contracts. From the perspective of a private party, the most important question is can the state, or the state enterprise, as a party legitimately override its contractual obligations in exercising its regulatory powers? Simply, can a state rely on changes in its own law to claim an excuse from liability for non-performance? The solution to this problem will obviously affect the ability of a private party to obtain remedies for
loss in cases in which a state party has failed to perform the contract because of changes in its own law. The complexity of this question has been illustrated in the cases of Rolimpex and Jordan, the evolution of doctrinal theories on state immunity and Acts of State, and, finally, the theory developed by Karl-Heinz Böcksteigel.

In short, when a state enterprise is a contractual party the test provided by Böcksteigel should be used, because it reveals not only the nature of such an entity (issue of separability from the state), but also the nature of a contract from the perspective of a state entity. If the state enterprise is a separate entity from the state, then the answer to above-question is positive—a state enterprise's contractual obligations are affected by supervening change in its own law and any supervening illegality excuses liability for non-performance. On the contrary, if the enterprise is treated as the state itself, it shouldn't be excusatory. Then, the problem with a state party relying on a change in its own law has to be examined in the light of doctrinal and judicial approaches towards supervening illegality in the major legal systems (frustration and force majeure). Chapter 3 will present such perspectives of supervening illegality.
CHAPTER TWO:
FORMS OF LIMITATION
OF PARTY AUTONOMY

Proceeding out of the above discussion on supervening illegality this chapter examines the most common forms of governmental limitations of party autonomy in international trade. First, supervening illegality will be considered as a consequence of government acts and changes in national legal frameworks (the national perspective). Second, supervening acts of government will be observed in the light of legislative measures proposed by international organizations (the international perspective). Then will follow an inquiry into the rationale for government intervention in international transactions and one into justifications for retention of regulatory powers by governments and administrative organs.

2.1. Limitations by Government Acts

When entering contracts, parties to international transactions usually assume the implicit risks of subsequent legislative changes in their own countries. However, besides an understanding of the risks of doing business at home, the international business environment requires knowledge of the numerous risks inherent in trade with a foreign contracting party—particularly with respect to policy or legislative changes in his host country or an intermediary third country which could be involved in performance. Most often, supervening illegality operates in the form of governmental
orders, regulations and decrees affecting the form of international contracts as much as they affect purely domestic trade contracts. For instance, international trade

69. All modern legal systems have imposed certain requirements regarding the form of a contract. Usually requirements regarding the form of a contract consists of an obligation to conclude a contract in written form or to obtain a sort of authentication or authorization by authorities. There are some reasons why formalism still prevails over the freedom of contract. Professor Treitel, supra, note 36, emphasized: certainty (written form can easily ascertain the content of a contract), cautionary effect (a longer time is provided for a party to think over whether it is going to enter into a contract in a form of a deed or in the form of an oral promise), protective function (especially good for a weaker party because it is evidence of the concluded contract) and channeling purpose (to help to make a distinction between different transactions). A. Von Mehren & J.R. Gordley, The Civil Law Systems (Boston: Little, Brown & Company, 1977) also emphasize the importance of a form for protection of parties, transaction, and a market as a whole. They say a form provides evidentiary security, discouraging transactions that are unfair and dangerous or simply promotes "channeling, cautionary, evidentiary and deterrent policies". More on limitations with respect to the form of contracts: L. Herbert, Foreign Legal System: A Comparative Analysis (George Washington University, 1981); A. Lewis, The Scope of Compulsory Contracts Proper, (1943) 43 Columbia Law Review 589; A. Lewis, Contracts of Adhesion and the Freedom of Contract; A Comparative Study in the Light of American and Foreign Law, (1962) 36 Tulane Law Review 481; A. Lewis, Principles of Contract and European Commercial Law, (Kent: Tudor Business Publishing Ltd, 1992)

70. According to the principle of autonomy of will, parties are free to choose the content of their contract. In other words, they are free to make a contract and to determine the rules of a contract. The problem usually arises when parties decide to write down their own conditions as 'their own law', but, at the same time, laws provide some elements that must be incorporated into a contract, or specify terms that must be expressly stated. Sometimes these obligations are imposed by custom or usage and they are considered as implied. Standard terms are the most common way of determining the content of a contract today and they can be drafted either by statutory provision (government and/or administrative bodies) or by some other associations (private parties). Sometimes parties simply do not stipulate some clauses or duties because these questions have already been regulated by the general law of contract. In these situations it is up to the court to apply rules relating to the contract in question. Not being expressly stated in a contract doesn't mean that they are of no importance for contractual parties, but simply that these clauses or duties do not depend on parties free will but on the law of contract. This means that if parties missed the opportunity to stipulate some clause according to their own interests then general rules would be applied. The problem of the contents of a contract is usually analyzed in common law through the analysis of express and implied terms of contract. The implied terms of contract could be divided into three groups: terms implied in facts which parties must have intended to include (something is so obvious that it does not have to be explained but it could be a subject of a test of "business efficacy"); terms implied in law
has been especially affected by prohibitions against trading with the enemy during wartime\textsuperscript{71}, import and export restrictions (including tariffs and non-tariff barriers, such as quotas, licence requirements, restrictions on the movement of capital, and price controls\textsuperscript{72}), or expropriation.

and obligatory for parties even though they did not intend to include them (usually have been put into statutory form and thus determined by rules of law) and terms implied by custom. More on content of contracts at: P. S. Atiyah, \textit{supra}, note 21; A. Von Mehren, \textit{A General View of Contract, International Encyclopedia of Comparative Law}, vol. 2, (The Hague: Tübingen and Martinus Nijhoff Publishers, 1982); G. H. Treitel, \textit{supra}, note 36; D. Yates & A.J. Hawkins, \textit{Standard Business Contracts: Exclusions and Related Devices} (London: Sweet & Maxwell, 1986). Soviet legislature created the so-called planned contracts which some state enterprises were obliged to conclude. The strict obligation regarding price and quality of products that are the subject matter of contract, conditions of delivery, etc., was directly imposed by an administrative decision. Enterprises were free to choose contractual parties but the contract had to fulfill conditions regarding above mentioned terms because it was necessary for achieving the plan imposed by the government. Not only did the government impose strict obligations regarding the conclusion of the contract but also the sole performance was supposed to be in a prescribed way. Since the only important thing was to act in accordance with state plans there was not much concern about loss suffered by one of the contractual parties but only about the loss on the side of the state. A party did not expect any profit or other benefit from concluding or performing contracts, but the state did. As a consequence, remedies were of minor importance to the state. Not being free to choose a contractual party or to stipulate clauses of contract enterprise as a party, it is even less free to stipulate a penalty clause for non-performance. State organs are here to decide upon penalty and sanctions (sometimes a combination of disciplinary and penalty sanctions), because every non-performance is contrary to public order. Soviet civil law (RSFSR Civil Code) imposed numerous limitations in regard to the content of a contract and provided different classification of these limits. Content was first of all limited by the fundamental principles of the Soviet communist morality and community values as defined in ART. 5 RSFSR Civil Code. It was then limited by the set of mandatory rules of Civil code and other related positive norms and laws, and finally, by the will of the contractual parties. The content of a contract was virtually determined by imposing obligations on parties to include some specific terms. However, the Soviet law did not speak about the implied or expressed terms but rather made a distinction between \textit{essential, usual and occasional} terms.

\textsuperscript{71}Ertel Bieber & Co. \textit{v. Rio Tinto Co.}, [1918] A.C. 260

\textsuperscript{72}Regulation can frustrate a contract by imposing a price as a mandatory element of a contract. That happened in 1988 in the case of \textit{Petrogas Processing Ltd. v. Westcoast Transmission Co.}, [1988] W.W.R. 699; affirmed on other grounds [1989] W.W.R. 272, when the federal and the provincial legislation of Canada introduced the new price of natural gas so that the buyer was not obliged to take the minimum quantity of natural gas.
i. Restrictions Against Trade With The Enemy

Wartime is a period in which the regulation of foreign trade will be influenced more by political reasons than economic ones. So-called situations of national emergency, such as a state of war or an economic crisis, are ideal moments for expansion of power by executives. Indeed, executive emergency power is often extended during wartime on the basis of constitutional provisions, for reasons of public policy. Not surprisingly, most countries passed their Trading with the Enemy Acts during World War I or World War II. To mention two, the United States passed the Trading with the Enemy Act in 1917, while the United Kingdom passed Trading with the Enemy Act in 1939. The idea behind such acts is the same—that those involved in trade with the enemy should be punished, because by doing so they cooperated with the enemy and thus supported the enemy's economy. Supervening illegality in the form of changes in laws, decrees, or regulations, appeared as a consequence of the outbreak of war; in other words the mere outbreak of war was not always the factor that made contracts physically impossible to perform.

Trading with the enemy legislation usually has the following consequences on international contracts. First, companies or persons from the territories designated as the enemy's territories became unacceptable contractual partners. As well, contracts could become impossible to perform when, for example, the place of performance became

---

74 Trading with the Enemy Act.
75 Trading with the Enemy Act (2 & 3 Geo. 6, c89) 1939
76 see *Porter v. Freudenberg* [1915] 1 K. B. 857
part of enemy territory\textsuperscript{77}, or performance of contracts involved carriage on enemy vessels\textsuperscript{78}.

With respect to the previous point, the 1943 case of \textit{Fibrosa Spolka Akcujna v. Fairbairn, Lawson, Combe Barbour, Ltd.}\textsuperscript{79} is one of the most famous cases involving supervening illegality as a result of the \textit{Trading with the Enemy Act}\textsuperscript{80}. Indeed, for many reasons numerous authors have cited the \textit{Fibrosa} case as a turning-point in judicial and legislative practice\textsuperscript{81}. In the context of this discussion, of importance is the Court's decision that despite the fact that physically the contract could have been performed, through a neutral country on a neutral ship or in neutral territory occupied by that time by the Russians, the contract was seen as frustrated, because the buyer's country and designated port had become enemy territory, due to its occupation by the Germans. Lord Atkin found that the declaration of a state of war had "caused an indefinite delay and the legal impossibility of delivery at the enemy-occupied port"\textsuperscript{82}. In this respect, The House of Lords strongly protected public interest by preventing any possibility of giving, directly or indirectly, any aid to the enemy. Most significantly, the House of Lords'

\begin{itemize}
\item \textsuperscript{77}see \textit{Esposito v. Bowden} (1857) 7 E. & B. 763; also \textit{Fibrosa} case, infra, note 159
\item \textsuperscript{78}see \textit{Duncan, Fox v. Schrempt & Bonke} [1915] 3 K. B. 355
\item \textsuperscript{79}\textit{Fibrosa Spolka Akcujna v. Fairbairn, Lawson, Combe Barbour, Ltd} (hereinafter \textit{Fibrosa}) [1943] A.C. 32 (June, 1942). In \textit{Fibrosa} case the facts were as follows. Fairbairn Ltd., a Leeds manufacturer of textile machinery made a contract with a Polish company Fibrosa in July 1939, for the supply of two sets of special machines. The parties agreed that delivery would be c.i.f. Gdynia, three or four months after they managed to settle all the details. Payment would be in London. The dispute arose immediately after Germany invaded Poland on September 1, 1939, and Great Britain reacted declaring war on Germany on September 3, 1939. As early as July 1939 Fibrosa paid Fairbairn £ 1000. The total price was determined at £ 1600. Fibrosa suggested that the port of delivery should be changed since Great Britain, on September 22, 1939, declared Poland to be enemy territory. Fairbairn held that the contract was frustrated upon the occupation of Gdynia, and did not want to return the money given by Fibrosa.
\item \textsuperscript{80}\textit{Trading with the Enemy Act} (2 & 3 Geo. 6, c. 89) 1939
\item \textsuperscript{81}See G.H. Treitel: \textit{Outline of the Law of Contract} (London: Butterworths, 1975); G.J. Webber, supra, note 73; also discussion on remedial modalities provided in Chapter 4 of this thesis
\item \textsuperscript{82}\textit{Fibrosa} case [1943] A.C. 32, at 50
\end{itemize}
decision, that Fairbairn should return the money to Fibrosa because of a total failure of consideration and consequent frustration of the contract, resulted in the passage of The Law Reform (Frustrated Contracts) Act in 1943, which changed the principles of frustration of contract with respect to remedial modalities.

In short, trade with the enemy statutes in general impose prohibitions for only a limited period, during wartime. Consequently, government authority is expanded for only a limited period as well. Supervening illegality in this form results in dissolution of the contract, since any further performance is illegal. Sanctions against infringement of these rules can be as severe as confiscation of the property of parties who fail to comply with them. Clearly, public policy considerations are the primary grounds for government intervention in such cases. Because of the requirement of strict compliance with public interests, supervening illegality in cases of trading with the enemy abrogates contracts regardless of contractual terms (even express terms) or the intention of parties.

For parties in international trade it is important to understand that the dissolution of a contract will not necessarily solve all problems derived from frustration of further performance. Frustration will not have negative effects with respect to rights acquired by parties before the supervening events that caused the dissolution. However, remedial claims related to non-acquired rights will not, in general, be successful. In short, cases involving trading with the enemy prohibitions confirm that in situations in which public interests prevail over private economic ones, the private interests of parties involved in international trade will be disregarded to a great extent.

83 Law Reform (Frustrated Contracts) Act, (6 & 7 Geo. 6, c.19) 1943
84 See discussion provided in Chapter 4 of this thesis
ii. Export and Import Regulations

Export and import regulations usually aim to affect private parties in international trade during periods of peace. In contrast to trading with the enemy prohibitions, these regulations are not based on extended or emergency executive powers, but on continuing executive powers. Moreover, the grounds for these restrictions are not primarily political in nature, but rather economic. Acts are justified by invoking far-reaching arguments about protection of domestic traders from unfair competition, prevention of severe market disruptions, or promotion of domestic products and industry. In other words "...a contract may be frustrated because subsequent to its conclusion the government has prohibited its performance, i.e., by placing an embargo on the exportation or importation of the goods sold... . The prohibition operates as a frustrating event only if it is final and extends to the whole time still available for the performing the contract."  

The most common forms of export and import regulations by supervening government acts are customs and tariff duties or fees, and so-called non-tariff barriers—quotas, licences, or other government restrictions such as exchange controls on currencies (for instance, multiple exchange rates or restrictions on the transfer of funds), or product safety and health standards (usually with respect to food or electrical appliances). However, this list is not exhaustive; moreover, governments regularly create new forms of import and export regulations. Because of the wide range of international practice with respect to licencing requirements, this thesis will focus on them. Their use is in contrast to the more uniform application of customs procedures, tariffs and quotas. For this reason, these three will be mentioned only in brief: numerous international treaties (such as GATT\textsuperscript{86}, or Maastricht Treaty\textsuperscript{87}) have already defined principles of free trade.

\textsuperscript{86}\textit{General Agreement on Tariffs and Trade (GATT), 1947, 55 U.N.T.S. 308}
\textsuperscript{87}\textit{Maastricht Treaty (the "Treaty on European Union") with effect from 1 November 1993, especially ARTs. 30, 34 and 36}
and determined which trade barriers can be imposed by states—especially in regard to customs procedures, tariffs and quotas.

In order to determine the so-called dutiable status of goods customs laws control the process of goods entering a country. For this purpose, customs legislation includes numerous rules related to the determination of value of goods being imported, their classification and their country of origin. Customs valuation procedures are subject to the GATT regime in order to eliminate any excessive practices by member states, which tend to impose burdensome custom clearance formalities and fees.\(^88\)

Tariffs are taxes levied according to the dutiable status of goods being brought into a country.\(^89\) GATT countries in numerous multilateral agreements have decided that tariffs on certain goods cannot exceed set levels. Unilateral modifications are allowed only with respect to goods specified in such agreements. In contrast to quotas, which limit or even ban the import of certain products (zero quotas), tariffs limit imports by levying a tax on the basis of the value of the imported good (\textit{ad valorem} tariffs) or the number of units imported (\textit{specific} tariffs).

Quotas operate in international trade as simple limits on the quantity of a certain good which may be imported into a country.\(^90\) All countries use this system in practice, but in certain situations only, in accordance with the GATT provisions\(^91\), and on

---

88 For example \textit{Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade}, (1979), GATT, 26 BISD 116 (1980), define the actual transaction price for purpose of import customs as the value of the goods, unless there are good reasons to doubt the reliability of the price.

89 P. Raworth, \textit{Legal Guide to International Business Transactions} (Toronto: Carswell, 1991) at 13: "[t]ariffs represent a discriminatory entry tax on imported goods, which reduces their competitiveness and in some instances may even prevent their commercialization".


91 See GATT, ARTs. XIII and XIX
a non-discriminatory basis. The rationale behind the system of quotas is the protection of domestic producers of certain goods, or sometimes health and safety reasons. For example, Canada employs quotas as a part of its import restraint programs. The Secretary of State for Foreign Affairs is authorized by the Export and Import Permits Act\textsuperscript{92} to issue import permits with respect to the import of goods on the Import Control List\textsuperscript{93}. In other words, there is a specific list of goods which are subject to limited import transactions. Foreign partners interested in exporting products to Canada have to be aware whether their goods are on the list, and if so, they must be aware of limits on the number of the good to be imported into Canada. Textile and clothing goods and some agricultural products have tended to dominate the list.

Supervening illegality with respect to tariffs, quotas, or custom duties is understood in this chapter as subsequent export and import regulation changes which appear, for instance, if the list of goods subject to limitations subsequently changes, if the limit on the volume of goods for import/export subsequently changes, or if the dutiable status of goods changes. However, in all these situations, changes will have limited scope in accordance with international treaties which govern transactions.

In contrast, licencing requirements are distinct cases of supervening illegality because they assume that at least one of the parties has a duty to obtain a certain document from a government or administrative organ in order make performance possible. Customs, quotas, or tariffs operate more as frameworks that limit foreign trade in quantity, quality, or in kind, rather than as pre-conditions to import or export transactions. Two situations can be distinguished. The first is where the obligation to obtain a licence existed at the time of contracting. Here, if the application for a licence has been rejected by the authorities, such an act of government or its agency will make performance legally

\textsuperscript{92}R.S.C. 1985, c. E-17
\textsuperscript{93}Ibid., s. 5 [am. 1970, c. 29 (2nd Supp.), s. 3; c. 32 (2nd Supp.), s. 1; 1974, c.9, s. 2; 1980-81-82-83, c. 82, s. 9; 1984, c. 25, s. 104]
impossible. The contract will be discharged and the party who failed to obtain a licence, because the fact that he acted with due diligence, will be excused for the reason of force majeure. In contrast, if the licence requirement did not exist at the time of entering into a contract, a question could arise as to whose duty it was to get it. Illustrative here was the case of *Brandt v. Morris*\(^9^4\) in which the court looked into the nature and type of the contract to determine which party was obliged to get the licence. The difference, then, between the two above forms of supervening illegality lay in whether the licence was refused, or only subsequently required.

With the former case, when the party's performance becomes subsequently impossible because of the failure to obtain the licence from authorities, it is important to consider whether the obligation to obtain the licence is defined in the contract as the obligation to act with due diligence (doing everything which is reasonable to do to get a licence), or as an absolute obligation of one party. In the first case, in order to be excused from failure to get the licence, the failing party must, obviously prove that he acted with due diligence in his attempt to get a license. Professor McElroy\(^9^5\) found that the rule here was established in the decision rendered in the case of *Anglo-Russian Merchant Traders and John Batt & Co.'s Arbitration*\(^9^6\) by Viscount Reading, C.J.: "[T]he implied obligation..."

---

\(^9^4\) *Brandt v. Morris*, [1917] 2 KB 784: the contract for sale of 60 tons of aniline oil was concluded by a company from Manchester and an American firm. The delivery was provided as f.o.b Manchester. There was no any prohibition or export licence requirement for aniline oil at the time of entering into contract. The court held that according to the rules governing the f.o.b. contract the obligation to get the licence was for the buyer since the buyer had to provide an effective ship, which by all means meant to obtain a licence to export, so that a ship could legally carry the goods.

\(^9^5\) R.G. McElroy, *supra*, note 73, at 36

\(^9^6\) *Anglo-Russian Merchant Traders and John Batt & Co.'s Arbitration* [1917], 2 KB 679; the case was result of the contract for the sale and delivery of aluminium concluded in London. The sale and delivery was to be at Vladivostok. It was known to both parties that aluminium could be exported from England only under the UK government's license. However, the application for licence was rejected, and the Court of Appeal held that the seller should be excused from performance.
is no higher than: the sellers shall use their best endeavors to obtain a permit."\textsuperscript{97} The same requirement was among the issues in \textit{Rolimpex} case.\textsuperscript{98} The House of Lords upheld the arbitrators' and the lower courts' decisions that rejection of an export licence by the Polish government constituted force majeure, because Rolimpex acted with due diligence even though it failed to obtain the licence. In contrast, if the obligation to obtain the licence was an absolute one, the failing party cannot be excused from liability for non-performance on the grounds of supervening illegality. In other words, supervening illegality in this case does not have the effect of force majeure or frustration events.

Moreover, arbitrators are not always willing to grant an excuse for non-performance on the basis of the force majeure or frustration defence when the export-import licence has been denied. As mentioned above, they will look carefully at the terms of the contract, they will try to define the standard of duty to obtain the licence, and they will investigate whether licencing requirements have appeared after the conclusion of a contract or not. For example, in a dispute between a French buyer and a Romanian seller\textsuperscript{99}, the arbitral tribunal decided on three subject matters, including the force majeure defence based on a cancellation of the export licence by the Romanian authorities. The contract was concluded for the delivery of a certain quantity of fuel by the Romanian company to the French company. The dispute arose when the price of oil changed and the Romanian seller refused to deliver the oil. He claimed that he was not obliged to deliver since the contract contained a clause, concerning unforeseeability of monetary parity, which allowed re-adaptation of the contract if both parties agreed to do so. Another reason for the cancellation of the delivery was because the Romanian authorities refused to grant the export licence to the seller. With respect to the latter reason, it is necessary to

\textsuperscript{97} R.G. McElroy, \textit{supra}, note 73, at. 37
\textsuperscript{99} Award made in case no. 2478 in 1974 by the arbitral tribunal sitting in Paris; also in ICCA Yearbook III, at 222
examine the reasoning of the arbitral tribunal. The tribunal confirmed that the cancellation of the export licence by the authorities in Romania was a case of force majeure, but also found that the Romanian seller failed to inform the French party of the occurrence of force majeure. Consequently, the tribunal decided that the seller's responsibility to pay damages was established.

Some contracts for international trade include so-called government approval clauses. Such clauses stipulate that obtaining appropriate approval from government is a pre-condition of contract formation. In other words, failure by one of the parties would not constitute a breach of performance; nor would refusal by government authorities to grant an approval constitute a supervening event of force majeure character. Simply, the contract would not become effective, because a condition precedent had not been fulfilled. If refusal of government to issue a licence or approval is included in a force majeure clause, any refusal will discharge the party required to secure such an approval. Finally, if the contract is completely silent on approval mechanisms, than the question of failure to obtain approval and discharge is decided by courts or arbitrators. They decide whether the failure can be interpreted within the doctrine of frustration or not. The preceding cases show that the solution is not always certain, and that parties to international transactions should not assume that a failure to obtain a licence generally discharges a contract.

iii. Expropriation

The party who fails to perform his contractual obligation because the goods that are the subject matter of the contract are taken by government will usually invoke a force majeure defence based on the act of expropriation100. In terms of

100See, for example cases Bailey v. De Crespigny (1869), L.R. 4 Q.B. 180; B.P. Exploration Co. Libya Ltd. v. Hunt (no.2), [1983] 1 A.C. 352 (H. L.)
international trade, expropriation—the seizure of a foreign-owned property by a host government—is considered one of political risks inherent in doing business in foreign countries. The term political risk covers the risks of nationalization, expropriation, and other restrictions such as "controls on exports and imports, controls on the movement of currency, restrictions on licensing and investment, and controls over physical property located within a country." In short, classic nationalization is the taking over of an entire industry or a natural resource by government, while classic expropriation is the taking of one plant or isolated individual property. Taking over property without any compensation for its owners is called confiscation.

The modern concept of political risk includes other acts of government that are not direct take-overs of property and investments, but that do nonetheless affect the transactions by making performance impossible or too burdensome for the parties involved. These acts usually come in the form of increases in tax rates or royalties, discriminatory taxation, complicated export and import licensing procedures, currency problems, price controls, or personnel restrictions such as forced employment of local managers, etc. The emphasis is here given to a gradual limitation of the owner's property rights. Such government acts are usually called creeping expropriation. For example,

---


103 For example, in case *Kursell v. Timber Operators Ltd.* [1927] 1 K.B. 298 a dispute arose when the Latvian state nationalized the forest in accordance with its new agrarian law and confiscated all the rights of vendors and purchasers in the forest; also case *Banco Nacional de Cuba v. Sabatino* 376 US 398 (1964) a dispute arose from the Cuban government's nationalization acts affecting an American property in Cuba

104 M. Litka, *International Dimensions of the Legal Environment of Business*, 2nd ed., (Boston: PWS-Kent Publishing Co., 1991) at 70, says that creeping expropriation "may take one of the following forms: 1. price control; 2. import and export restrictions; 3. legislation that affects managerial control over the multinational firm; 4. a change in the value of currency; 5. confiscatory taxation". He defined it as "series of action by host
expropriatory taxation was one of the issues in the case *Revere Copper and Brass, Inc. v. Overseas Private Investment Corporation*\(^{105}\). *Revere* is one of the numerous sixties and seventies cases which examined non-performance of contracts as result of political risks in the parties' countries.

Even though expropriation and nationalization are accepted as legitimate acts of a sovereign country\(^{106}\), current international law theory limits these rights

---

\(^{105}\) *Revere Copper and Brass, Inc. v. Overseas Private Investment Corporation*, (hereinafter *Revere*) (1978)17 International Legal Materials, 1321-1383. The *Revere* case resulted from the contract signed by Revere Jamaica Alumina (RJA), an American company from Maryland, a wholly-owned subsidiary of the Maryland corporation, Revere Brass and Copper (Revere), and the Government of Jamaica on March 10, 1967. It was an investment contract to finance the RJA's activities in Jamaica related to the mining of bauxite, and the construction of a plant to convert the bauxite to alumina. It was a long-term contract, that was supposed to remain in force for 25 years. The Government of Jamaica granted a lease to Revere, and according to this lease, Revere's subsidiary RJA obtained the right to mine bauxite in Jamaica. The RJA built the plant as provided by the contract. However, in 1972 the problems in continuing performance began. The government changed in accordance with the results of the election. A new government wanted to renegotiate the contract in order to get local participation in the exploitation of bauxite and to impose higher revenues. The old government had agreed on a 'no further tax clause' which was stipulated in the contract signed in 1967. However, the new government passed the Bauxite Act in 1974, changing the tax rate for bauxite. After that RJA closed the plant. In January 1976 RJA started proceedings in the Supreme Court of Jamaica against the Jamaican government claiming that the Government is responsible for the breach of the contract caused by the Bauxite Levy. In December 1976 Revere started arbitration proceedings against the Overseas Private Investment Corporation (OPIC), claiming a compensation under an insurance policy for the losses caused by the expropriatory action of the new government of Jamaica. The Arbitration rendered a decision that was different from that of the Jamaican Court. Contrary to the court, which held that the bauxite levy was not a breach of the agreement, the arbitrators decided in favour of Revere, and concluded that the bauxite levy was an expropriatory action as set out in Sec. 1.15 of the Contract of Guaranty which had been signed between Revere and OPIC.

\(^{106}\) According to the classical doctrine developed in Europe from the seventeenth century, taking or foreign property was forbidden and the state had a duty of restitution to foreign investors. This theory was completely in accordance with the fact that foreign investors were the most powerful colonial Western countries. However, traditional theory was criticized in the nineteenth century by Latin American professor Calvo (Calvo Doctrine)
significantly. Seizure of foreign property must not be discriminatory: that is, it seizure must not affect the assets of foreign entities only. Furthermore, it must be done for a public purpose. Finally, a country has to provide "prompt, adequate and effective" compensation to the foreign owners or investors. If no compensation is paid, than this taking of property is deemed confiscation. This applies also in the case of nationalization, which could be defined as expropriation of "all activities or properties in a certain sector of economy". Probably the most common problems with expropriation are those arising from long-term contracts, investments and building contracts, or contracts for the sale of land, when the act of expropriation would make a whole contract illegal. For example, in the Canadian case Oxford Realty Ltd. v. Annette the property was expropriated while the real estate agent was attempting to sell it on behalf of the owner. The court held that the contract had been frustrated by expropriation and for that reason the agent could not get any commission for his work.

Supervening illegality is more likely to frustrate contracts when one of the parties is from an economically less developed country or area. Such countries are usually who promoted nationalization as a legitimate action of a sovereign state within its own territory. Finally from the beginning of the twentieth century the traditional theory transformed into modern traditional theory, which does not deny the sovereign's right to nationalize foreign property but only if certain conditions are met (for public purpose, non discriminatory, just compensation).

107 These criteria appeared first in 1938 in the note addressed to the Mexican Revolutionary government by the US Secretary of State, Cordell Hull; see R. Schaffer, B. Earle & F. Agusti, supra, note 102, Chapter 15, at 414; they explain the meaning of the international law standard for compensation for foreign property as follows: "adequate" compensation meant fair market value as a going concern, including future earnings and intangibles, "prompt" meant as soon as reasonable; and "effective" meant cash or a commodity immediately available and freely convertible to cash; on application of the standard in international disputes see Iran-United States Claims Tribunal-Case Concerning Phelps Dodge Corp. and OPIC and Iran of 19 March 1986, 25 I.L.M. 619, 626-628 (1986); Case Concerning Sedco, Inc. and National Iranian Oil company and Iran of 27 March 1986, ibid. 629, 632-635

108 M. Litka, supra, note 104, at 68

considered by foreign investors as countries of the highest level of political risk. This risk involves the probability of strikes, revolutions, civil wars, changes of government, nationalization, expropriation, and other political or civil disturbances\textsuperscript{110}.

When supervening illegality appears in the form of nationalization, confiscation and classic expropriation, impossibility of performance of contractual obligation is both physical and legal. For instance, a party who has an obligation to export certain goods manufactured in his factory will become unable to perform his obligation if the factory becomes subject to expropriation (as well as confiscation or nationalization). This can be absolute physical impossibility, because a party cannot trade with goods which have been physically taken away from him. It is also legal impossibility, since there is a legal act preventing the party from further use of his property for the purpose of managing his own contractual obligations. Creeping expropriation is closer to the concept of economic impossibility or impracticability, because a party is still physically and legally able to perform or, more often, to continue the performance. However, after a creeping expropriation act is passed, this performance becomes burdensome and uneconomic for the performing party.

2.2. Acts of Governments as a Part of International Actions

It was emphasized in Chapter 1 of this thesis that performance of international trade contracts is affected by two sets of legal instruments. The first is a set

of national rules which creates a national legal framework for foreign trade. The second is a set of international legal instruments in the form of international treaties and documents, a set which sometimes becomes the pattern for treatment of foreign trade at the national level. In this part of the thesis reference will be made to cases of supervening illegality caused by supervening application of international law measures and standards by states. The survey will be focused on the most restrictive and extraordinary measures that can be imposed on foreign trade and private parties involved in these transactions. The use of embargoes by national governments has become frequent, especially due to the growing activities of the United Nations (UN) and numerous international organizations of global or regional character. This is another example of limitations imposed on private

---

111 For example, in response to the Security Council Resolution 418, 32 UN SCOR Res. & Docs. at 5, UN Doc. S/INF/33 (1977) which proposed economic sanctions against South Africa's regime based on violence, infringement of human rights and apartheid, the President of the US, Ronald Reagan, issued Executive Order 12,532 (50 Fed. Reg. 36,861) to ban all exports of computers and computer software, including other related technology to South Africa. The order involved some other measures, such as the restriction of nuclear export to South Africa, banned loans to the South African Government, and banned government export assistance to US firms operating in South Africa with more than twenty five employees which did not comply with the fair employment principles. In addition see the most recent overview of the international actions against the South Africa government by L.B. Sohn, Rights in Conflict; The United Nations and South Africa, (New York: Transnational Publishers Inc., 1994)

112 Contrary to the resolutions of the Security Council which are not directly binding on private parties, since they are not directly applicable, the regulations of the European Union have the effect of direct applicability. Pursuant to a meeting of the EU Council of Minister in August 4, 1990, the Council issued the Regulation 2340/90 (1990) P. J. L213/1(9 Aug.) on prevention of trade by the EC with Iraq and Kuwait. Immediately after the meeting of the EU Council of August 4, 1990, the Department of Trade (DTI) of the United Kingdom reacted issuing the Notice to Importers 2274 and explanatory note issued by DTI 5 August 1990 amending Open General Supply Licence of 4 December 1987 and existing rules on oil imports from Iraq and Kuwait. The DTI Notice came into force on August 6, 1990. In ARTs. 1 and 2. of the Regulation, the EU prohibited sale, supply, or promotion, of all commodities or products exported from or imported to Iraq and Kuwait. The prohibition included all contracts concluded, or partly carried out before August 7, 1990. The only exemption was provided for goods which were exported from Iraq and Kuwait before August 7, 1990, and non-financial services with respect to contracts concluded before August 8, if the execution had already commenced.
international transactions on the ground of public policy. Here, public policy objectives are formulated as the need to protect world peace and to maintain international order.

In brief, two types of international treaties can be distinguished. There are treaties which are directly applicable in signatory countries, as any other domestic law (self-executing treaties). For example, such treaties include the Warsaw Convention for the Unification of Certain Rules Relating to International Carriage by Air113, the Vienna Convention, or the directives of the European Union. Other international treaties have to be implemented by the national legislatures signatory countries (so-called executory, or non-self-executing treaties). For example, the Charter of the United Nations and the recommendations of the UN Security Council have to be put into force by national legislatures of member states.

Since Security Council economic sanctions resolutions are not directly effective and applicable, these economic sanctions are not directly binding on private companies and individuals of particular countries. In order to obtain binding power, they have to be implemented as national measures. The implementation could be done in two ways: by a legislative body in the form of statutes, or by the executive, in the form of directives, orders, or regulations. The implementation process is determined in every country by its own national law, and will not be further investigated, since it belongs to the field of public international law, rather than international trade law.

As for the effects of implementation of international measures by governments on private parties, economic sanctions in the form of embargoes will be considered. An embargo is a complete ban on trade with a certain state and its nationals, or a ban on certain types of transactions related to certain products. For instance, as a response to the UN proposal of imposing economic sanctions against Libya, US President Reagan imposed an embargo against the regime of General Gadafi. This embargo, invoked

---

113 *Warsaw Convention for the Unification of Certain Rules Relating to International Carriage by Air* (Warsaw Convention), (1929), CTS 1947, No. 15
under the International Emergency Economic Powers Act\textsuperscript{114}, included not only a freezing of all Libyan assets in the US, but also a ban on travel to that country by US citizens. The prohibition imposed on US citizens by the executive\textsuperscript{115} was one of issue of contention before the ICC arbitration in a dispute which arose in 1980 between The National Oil Corporation, a Libyan State company, and Libyan Sun Oil Company, an American entity. The two companies had entered into a twenty-year contract for oil exploration in Libya\textsuperscript{116}. Problems started when the American company, in December 1981, informed the Libyan partner that due to the US Government Passport Order, Sun Oil would suspend its performance and invoke the force majeure clause, assuming that the act created a situation of supervening illegality. However, the force majeure defence was rejected by arbitrators, because they found that the supervening order did not make performance absolutely impossible—the company was still able to send to Libya non-American employees from its subsidiaries outside the US.

2.3. The Rationale for Supervening Government Acts

It was explained in the Introduction that the primary assumption of this study is that limitation of private incentives by supervening acts of government reflects a "conflict" between two basic principles of every modern democratic state\textsuperscript{117}. One is the principle of freedom of the individual. It is often said that the scope of individual freedom is a reflection of the level of achieved democracy in a particular state. Another basic

\textsuperscript{114}International Emergency Economic Powers Act, 1977
\textsuperscript{115}The US Government Passport Order from the 9 of December 1981
\textsuperscript{116}ICC award No. 4462 of 1985; the case will be discussed later in Chapter 5, with respect to the interpretation of force majeure clause
\textsuperscript{117}See discussion provided in Chapter One: 1. Autonomy of Will (Sections 1.1.)
principle of the modern state is that of state sovereignty: every sovereign state has the power to define and promote its own values and to impose rules and mechanisms for the protection of these fundamental values. As explained earlier, modern democratic countries make efforts to limit the scope of direct state intervention in business, precisely defining, by constitutional principles, the function of government. Primarily, law-making power is vested in representative bodies (such as a Parliament or a legislature). Thus, the fundamentals of legal principles and contractual relations, including those related to international trade, in one state are imposed through a long democratic procedure by these paramount bodies with law-making power. On the other hand, secondary legislation (decrees, orders, regulations) is the result of the exercise of executive power. To ensure the state's concern and responsibility for the country and people over which its sovereignty extends, the constitutions of many countries place regulatory power relating to international trade in the hands of government. Delegation of power to executives is based on arguments that it is very useful to have an active government because of its flexibility and ability to act more quickly than lawmakers.

However, private parties may argue that regulatory intervention has to be re-examined, because it leads in practice to the limitation of party autonomy in international trade. On the other hand, however, governments respond that economic and public policy interests (in a "purely" political sense) have to be observed for the benefit of the majority, whereas private interests have to be determined according to the interests of the majority. Indeed, public policy is usually defined as a collection of principles which

---

See discussion provided in Chapter 1 of this thesis in Section 1.1.

When considering the legal nature of public policy, analytical clarity makes necessary some introductory remarks regarding the terminology. The term *public policy* will be used in the sense of the common law concept, whereas the term *public order* will be used in the sense of the civil law concept derived from the French law, originally named *l'ordre public*. Public order is generally recognized in all civil law countries, except Germany, where the concept exists, but the translation of the French term appears as *good morals* (ART. 328 of the Zivilprowessordnung (ZPO) of Code of Civil Procedure)
represents the foundation of a legally organized community and which have to be adhered to by the parties\textsuperscript{120}. The principle itself has operated by giving priority to public over private interests and its importance has been increasing constantly since the beginning of the nineteenth century\textsuperscript{121}.

\textsuperscript{120}S. Perovic, \textit{The Influence of Public Order on Validity of Contracts (Uticaj javnog poretka na punovaznost obligacionih ugovora)} (Belgrade: Arhiv za pravne i društvene nauke br. 3, 1983)

\textsuperscript{121}The notion of public order had been used for the first time in a modern legal sense in \textsc{ART. 6} of the French Code civil from 1804, as a possible limitation of the autonomy of will of parties. It is important to emphasize that public order was also widely accepted in the French courts. They decided that all contracts against public order were null and void. Even though it is usually assumed that public order encompasses only the basic principles of a legally organized community, the notion is very often connected with morality, or the necessity to protect the morality of society. For instance, \textsc{ART. 1133} of the French Code civil says that the \textit{causa} of the contract is illicit when it is contrary to \textit{l'ordre public} or \textit{bonnes moeurs}. According to the study of French law the main reason for the adoption of the principle of \textit{l'ordre public} in French law was (F.H.L. Lawson, A.E.Anton & L.N. Brown, \textit{Introduction to French Law} (Oxford: Clarendon Press, 1967) at 169) "to protect the State and its institutions on the one hand and the family on the other". Thus, the general principle of French law is the invalidity of all contracts contrary to public order or morality as described in "the three vital articles, \textsc{ART. 6} Code civil, which provides that private agreements cannot derogate from laws concerning public order and morality and \textsc{ART. 1131} and \textsc{ART. 1133}, the combined effect of which is to deny legal effect to an obligation whose cause is prohibited by law or contrary to public order or morality. In the common law countries, such as England and Canada, courts started to declare a contract invalid and illegal as early as from the eighteenth century (first in England and later in Canada). Friedman in his \textit{Law of Contract}, 2nd edition (Toronto: Carswell 1986) at 350 says that it was usually done "on the ground that its very nature, or purpose that is designed to achieve, whether directly or indirectly, contravenes the ends of society." Finally, he concludes that "such contracts offend the basis of legal order, which is found upon justice, legality and morality..". The former socialist countries of Eastern Europe and the USSR did not use the formulation of public policy and morality in the meaning of western legal systems. On the contrary, they introduced a great variety of new formulas such as \textit{principles and rules of socialist community, principles of the community in transition to communism, interests of working people}, etc. Differences in the fundamental principles of the capitalist and the socialist world simply required the existence of two different contents of a public policy. For example, \textsc{ART. 5} RSFSR Civil Code imposed the general rule or limitation with respect to what consists the basic values of the Soviet society.
Economic interests have been invoked as a basis for government intervention in international trade mainly in situations in which export and import regulations have to be imposed. For example, quotas, tariffs, and taxation are usually presented by governments as measures aimed at protection of domestic markets, promotion of domestic producers, and prevention against unfair competition from foreign competitors. On the other hand, protection of domestic goods or traders can lead to distortion of the international market. The Settebello case\textsuperscript{122} clearly illustrates both how far the practice of helping domestic traders can go and what means government can use in order to protect a domestic party who has failed to perform his obligation. Settebello ordered a tanker from the Portuguese state shipyards. The delivery was scheduled for 31 January 1978. The contract provided that if the shipyard delayed the delivery for more than 12 months, Settebello would have the right to rescind the contract. Despite several extensions, the Portuguese party did not deliver the tanker until the 30th of August 1982, at which time Settebello decided to start arbitration. Invoking rights provided in Article 6 of the contract, Settebello claimed the 11 million it had already paid. The Dutch arbitrators rejected the Portuguese defence, which was based on decree No. 119/82 passed by the Portuguese Government ten days before the cancellation date provided in the contract. The decree, tailored perfectly for that contract, prohibited cancellation clauses only for contracts governed by Portuguese law and only for delays in delivery. Moreover, arbitrators found that the decree was passed only in order to help the Portuguese party try to get out of the contract. The arbitrators rightly noted that the decree was never again invoked after the Settebello case. The award was rendered in favour of Settebello. It can be argued that the Settebello arbitrators acted in favour of free trade principles and promotion of international business, enforcing international standards and limits on national authorities and their decision-making powers. Indeed, in cases arising from

\textsuperscript{122}Settebello Ltd v. Banco Total and Acores, FT Comm LR, 21 June 1985
international contracts, it is noteworthy that not only international arbitrators, but also national judges have expressed preferences towards international standards.

Probably the most famous case is that of *Mitsubishi Motors v. Soler Chrysler-Plymouth*, in which the *American Safety* doctrine was put under scrutiny: the promotion of international commerce was seen as a higher priority than original protectionist agenda of the doctrine. Implicit in the issue of the arbitrability of antitrust claims of an international character was, in fact, not the mere application of the *Sherman Act* or the *Arbitration Act*, but rather the supremacy of international principles over national concerns. The same issue was considered in *Scherk v. Alberto-Culver Co.* and *The Bremen case*, where the Court observed: "The expansion of American business and industry will hardly be encouraged if, notwithstanding solemn contracts, we insist on a parochial concept that all disputes must be resolved under our laws and in our courts..." The Court of Appeals in *Scherk* agreed, emphasizing that a parochial approach taken by an American court would "damage the fabrics of international commerce and trade, and

---

124 Justice Blackmun says: "At the outset, we confess to some skepticism of certain aspects of the *American Safety* doctrine." 473 U.S. 614 (1985) at p.632. The said doctrine was established in *American Safety Equipment Corp. v. J. P. Maguire &Co.*, 391 F. 2nd 821 (1968) and it held that the legitimacy of application of national laws is "that pervasive public interest in enforcement of the antitrust laws, and the nature of the claims that arise in such cases, combine to make ... antitrust claims ... inappropriate for arbitration." *ibid.* at pp. 827-828
125 *Sherman Act* was the Act of 2 July 1890, c. 647, 26 Stat. 209 (1890), as amended, 15 U.S.C. §§1-7
129 *ibid.*, at 9
imperil the willingness and ability of businessmen to enter into international commercial agreements.\textsuperscript{130}

In short, the courts' reasoning in favour of expanding international trade, affirming that it is necessary for national courts to consider domestic policy in the context of international policy, confirms that economic interests and "purely" political interests can hardly be distinguished where the international public policy is concerned. Here, in order to promote both international trade and the economic interests of the US, courts observed international policy.

Perhaps the only instance in which international policy holds more to policy incentives than to economic ones is in the case of the embargo, or as noted earlier, prohibitions against trading with the enemy. In regard to the latter, public interest appeared as a projection of national interests accepted as the most important values and principles of an individual country at a certain moment (the breakout of war). It can be argued that during the two World Wars national policy protected by such acts were identical to international policy—Germany and its allies were considered enemies of the rest of the world. Likewise, the embargo obviously subordinates economic interests to political ones. When embargoes are proposed by the international community, public interest or public policy has a broad meaning and assumes a variety of general principles and interests acceptable to a majority of countries. These values are, for example, protection of world peace and security, ensurance of world welfare and prosperity, protection of children, or protection of human rights. As already explained, these international public policy values become, through the legal process of implementation into the domestic body of laws, a part of the public policy of a signatory state as national public policy. Generally, however, the priority of free trade for international organizations is more than obvious. Although the GATT documents have established a framework for

\textsuperscript{130}Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974) at 516-517
restrictive practices by member states, states can impose restrictions only within the limits determined by the GATT. As for embargo, limits have been established in Article XI, which bans many types of import restrictions and thus acts as a general prohibition of non-tariff barriers:

"1. No prohibitions or restrictions other than duties, taxes or other charges, whether made effective thorough quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or the exportation or sale for export of any product desired for the territory of any other contracting party."

Even though the article does not expressly mention the embargo, the article has been used as a basis for formal complaints in many cases in which one contracting party has imposed an embargo against the other contracting party. However, there are significant exemptions provided in Articles XX and XXI—restrictions on imports and exports can be imposed for a variety of health, safety, of security reasons, for instance. In short, the embargo can be imposed if an importing state finds that any further import of goods from another contracting party would jeopardize national security, protection of human health or protection of the environment.\(^\text{131}\)

\(^{131}\)For instance in the US/Mexico Tuna Embargo Dispute which arose in 1991, the US Customs Service acting under the Treasury Department put in place an embargo against Mexico for violation of the US Marine Mammal Protection Act (16 U.S.C. § 1361). Mexico filed a formal complain with the GATT based on prohibitions imposed by Article XI. On the other hand, the US answer was based on exemptions provided in Article XX (exemption from the obligations imposed in Article XI are related to health, safety, and conservation regulations of the importing country). Also, the provisions of Article XI were the basis for Nicaragua to request an investigatory panel of the GATT in 1985, when President Ronald Reagan imposed a comprehensive embargo on the government of Nicaragua, Exec. Order No. 12,513, 50 Fed. Reg. 18,829 (1985), based on the fact that Nicaragua's policies constituted an unusual and extraordinary threat to national security and foreign policy of the US. The President declared a national emergency and placed a total embargo on all trade with Nicaragua. In this case the US defence was the national
It is significant that even though the risks of supervening illegality in the form of expropriation or nationalization have been defined as political risks, governments use economic reasons as a justification for such practices. Expropriation will usually be explained on the basis of an increasing need of a country to have control over certain, usually foreign, industrial concerns. Nationalization will be promoted as an economically necessary take-over of a whole industrial field. However, even these actions of governments are limited by international customary law. For instance, from the nineteenth century and even into the 1950s in Latin America, the already-mentioned Calvo Doctrine was the leading justification for expropriation. This doctrine promoted national interests, obviously both economic and political, as a legitimate justification for take-overs of foreign property without compensation. Later, as a result of pressure from the United States and other Western countries, the doctrine was abandoned and "prompt, efficient, and adequate" compensation become an irrevocable principle in international security exception provided in Article XXI of the GATT ("measures ... necessary to protect essential security interests").

132 See discussion on compensation and expropriation in this Chapter, at p.78
133 The neglect of international minimum standard of treatment of foreigners and foreign-owned corporations by the Latin American states has been seen as a result of the historical conditions surrounding the development of these countries. Their natural resources were exploited by large foreign companies, especially during the nineteenth and the early twentieth centuries. On the other hand, the countries of Latin America were underdeveloped, with a number of social, economic, and political problems. After the new Latin American republics had been established in period after the 1930s, their governments used nationalization to restore their economies and to re-impose control over natural resources. The new policy was based on the Calvo Doctrine—first the "sovereign states, being free and independent, enjoy the right, on the basis of equality and freedom from interference of any sort by other states, whether it be by force or diplomacy", and second, "that aliens are not entitled to rights and privileges not accorded nationals, and that therefore they may seek redress for grievances only before the local authorities"; see the study of M.R. Garcia-Mora, The Calvo Clause in Latin American Constitutions and International Law, (1950) 33:4 Marquette Law Review 205, at 206-209. Garcia-Mora found that the so-called Calvo Clause has been incorporated in the constitutions of Mexico, Bolivia, Nicaragua, Cuba, Equador, Peru, and Venezuela with certain differences, but with the same idea—as a waiver of diplomatic protection of foreign entities and their property from any international claim.
business\textsuperscript{134}. Finally, some regional documents have gone even further. For instance, NAFTA's expropriation and compensation Article 1110 prohibits nationalization or expropriation of investments of foreign parties on the territories of the Parties to NAFTA—except for public purposes, on a non-discriminatory basis, in accordance with due process of law and certain minimum standards of treatment, and on payment of compensation. It seems, then, that these provisions amount to a repudiation of the Calvo Doctrine\textsuperscript{135}. Thus, it could be concluded that although economic interests can be used as grounds for government action in the form of supervening illegality, this use is strictly limited.

In short, in considering the importance of public policy to understanding the influence of state and government on private international transactions, an additional question must be put forward—how is public interest, which outweighs private interests of parties, determined in national laws and in international treaties? When national courts are to apply national public policy in deciding disputes in international contracts, they simply look into national laws. However, when courts and arbitrators have to rely on international public policy incentives (as in Mitsubishi) they will face some difficulties, foremost of which is simply the question "which public policy?". Usually public policy incentives, set out in international documents, include principles of free trade on a stable and predictable basis, non-discriminatory treatment, obligations of consultation and conciliation to avoid disputes on trade (GATT, NAFTA, Treaty of EU) and principles of protection of world welfare (the UN Charter\textsuperscript{136}). Thus, Pierre Lalîv advocates that public

\textsuperscript{134}See the explanation of "prompt, efficient and adequate" compensation in this Chapter, at 52, also see footnote 107

\textsuperscript{135}See also J. Daly: Has Mexico Crossed the Border on State Responsibility for Economic Injury to Aliens? Foreign Investment and the Calvo Clause in Mexico after the NAFTA, (1994) 25:3 St. Mary's Law Journal 1147

\textsuperscript{136}Charter of the United Nations 59 Stat. 1031, T.S. 933, 3 Bevans 1153: "We the people of the United Nations determined: to save succeeding generations from the scourge of war..., and to reaffirm faith in fundamental human rights..., and to establish conditions under which justice and respect for the obligations arising from treaties and other sources
policy be created at the international levels, taking into account the needs of international trade, in order to serve transnational interests. Finally, it can be argued that by ratification of international treaties such principles, which appear worthy of protection in a supranational perspective, become part of national public policy as well, at least for signatory countries.

The consequences of infringement of those public policy principles, national or international, are always the same. Contracts drafted or performed in defiance of public policy objectives are void fully or partially. Where there is already international consensus (e.g. a treaty) on measures that necessarily impair individual contractual freedom, the acts of a national court or legislature imposing such standards are inherently more likely to be seen as legitimate than such acts based purely on an individual national perception of public policy. Where the latter affects domestic transactions, it will be accorded more deference than where it applies to a situation like an international contract to which persons who are not nationals are party.

on international law can be maintained, and to promote social progress and better standards of life in larger freedom..."

"Governments may be overthrown, wars may break out, large areas of country may be devastated by natural disaster, but somehow traders find ways of establishing and continuing business relationships. The inventiveness of a scientist and engineer in matters physical is matched by the ingenuity of the trader in constantly developing new sales techniques, new instruments to accommodate more efficiently the requirements of the commercial community, new methods of surmounting hurdles thrown up by the law or actions of government." 138

International traders often face the problem of supervening illegality. In the Introduction to this thesis the notion of supervening illegality is defined as *subsequent changes in subordinate legislation, subsequent acts of governments or their administrative bodies, or changes in surrounding circumstances* 139. When supervening illegality occurs after the contract is concluded, the parties are prevented from further performance by impossibility that is legal rather than physical.

The situation in which any further performance becomes illegal can arise in all types of international trade contracts. Parties in such contracts are affected in different ways by supervening illegality. The party who owes the performance is interested in becoming excused of his obligation. In other words, he wants to avoid the consequences of the breach of his contractual duties. The other party is, however, more interested in remedial modalities which could substitute for the performance he was supposed to get, or which could cover damages he suffered because of non-performance. Essentially, he wants adjustments in performance more than mere discharge and termination of the contract. For

---

139 See explanation given by G.H. Treitel, *supra*, note 8, at 319; also footnote 37 of this thesis
these reasons, it is difficult for the parties to regulate their contractual obligations with respect to supervening illegality. Usually, they will try to find the legal concept that provides an adequate solution for such a situation.

The legal concepts related to supervening illegality appear to be a matter of great uncertainty and confusion, despite the fact that they belong to the same family within different legal systems; including the doctrines of frustration and impracticability in common law and the doctrine of force majeure in civil law. All these doctrines agree that the failure to perform contractual obligation arises for reasons which appear, beyond the control of parties, after the formation of contract. Essentially, supervening illegality is examined in the light of the "conflict" of two contract law principles—pacta sunt servanda (contracts must be observed) and rebus sic stantibus (changed circumstances). Despite these common grounds, the doctrines approached in this chapter tend to define differently the requirements for discharge of contracts. For instance, all concepts start from the assumption that the appearance of supervening illegality makes performance of the contract impossible. However, Professor Treitel maintains that this concept of impossibility derives from the civil law tradition; in his opinion, common law rejects this concept as such. He finds an explanation for this discrepancy in the fact that civil law provides enforced performance as the primary remedy for non-performance, whereas common law provides monetary compensation which "is never considered to be impossible". However, these two concepts in practice very often achieve similar results. For instance, the civil law remedy in the form of enforced performance will be changed for

---

141 See G.H. Treitel *supra*, note 8, at 1-3; when the author cites Holt, C. J. decision in the case Thornborow v. Whitacre [1706] 2 Ld. Raym. 1164, 1165: "[W]hen a man will for a valuable consideration undertake to do an impossible thing, though it cannot be performed, yet he shall answer in damages."
142 G. H. Treitel, *supra*, note 8, at 2
compensation in a case in which it becomes impossible to render such specific enforcement. This can happen when a person who has to render a specific service becomes unable to perform his obligation, or when a specific, identified thing (not of a generic kind) which is a subject matter of a contract, perishes. Along with this line of thought frustration and impossibility of performance are often used as synonyms or analogous terms. By a close examination of these concepts I intend to determine whether it is possible to establish one "uniform concept" for supervening illegality in international trade contracts by which parties can anticipate such situations.

For the purpose of this thesis the doctrine of frustration within English contract law theory is understood as an exception to the principle *pacta sunt servanda*, as a basis of discharge of contract whenever a supervening event occurs. The doctrine of impracticability will be understood in the American legal sense. The doctrine of force majeure, on the other hand, will be used as a civil law concept, derived from the French tradition, and as presently used in France, Germany, and the European Union. This discussion will, however, reveal that the background to the "conflict" of two legal systems is primarily a difference in understanding the principles of contract law whereas both achieve similar results with respect to supervening illegality. This survey aims to present doctrinal explanations of the legal nature of supervening illegality, examine the application of relevant concepts by courts and arbitrators, and evaluate the usefulness of such concepts to parties in international trade today.

3.1. The Common Law Doctrine of Frustration

The problem of supervening illegality has in common law countries usually been considered with reference to the doctrine of frustration. Traditionally, this doctrine constitutes an exception to the strict principle of contract law—*pacta sunt servanda* (contracts must be observed). In the English doctrine of frustration, when an unforeseen, subsequent event renders performance legally or physically impossible, both parties will be discharged from further performance of their contractual obligations. In a broader context, impossibility to perform can be seen as a part of the concept of breach of contract which gives the aggrieved party the right to claim damages.\(^\text{144}\)

The foundation of the doctrine of frustration was established on the basis of the principles of sanctity of contract and strict obligation. In the famous case of *Paradine v. Jane*\(^\text{145}\), it was held that the party had to perform the contract because he had promised to do so. Since the party guaranteed a specific outcome of the contract, he was liable for damages to another party if he failed to fulfill the promise.

Various common law theories developed with the reference the doctrine of frustration provide explanations for the discharge of a contract. The strict rule of *Paradine v. Jane* has been modified towards a more flexible concept that a radical subsequent change of circumstances calls for a significantly different solution, since the nature of the


\(^{145}\) *Paradine v. Jane*, K.B. (1647), Aelyn 26, 82 Eng. Rep. 897. The dispute arose from the contract for lease of the land for 21 year. Approximately six years from commencement of lease, the enemy's army attacked the land, and the tenant was deprived from the use of land for the following two years. Consequently, he assumed he should not pay the rent for the period he was unable to use the land. On contrary, the court found him obliged to pay the rent notwithstanding the supervening event which deprived the tenant from the property. The court held that the party was bound on the basis of the obligations created by his own contract. The decision thus made was the basis of the doctrine of the absolute contracts.
Contractual obligations have changed as well. One of the first of such modifications came with the theory of implied term, applied by Blackburn J. in the famous Taylor v. Caldwell case, in which the contract to perform a music concert was frustrated because fire destroyed the defendant's music hall. The Court found that the parties should be excused from performance which had become impossible because of the perishing of the thing (the music hall) without the fault of the defendant: "The contract is discharged because it impliedly provides that, in the events which have happened, it shall cease to bind." This impossibility is of a factual nature. Just solution theory does not explain when or why the contract should be discharged because of frustration, but rather offers a broad basis for courts to deviate from the general rule of absolute contractual obligation in order to achieve a just decision. The theory of foundation of the contract explains that a contract should be discharged when its foundation, as established by the parties, has disappeared. This theory does not represent a step beyond the theory of implied term, since the foundation of the contract is defined by elements of an implied term. Further, the theory of construction of the contract is based on the presumption that any subsequent event which brings "about change of circumstances is one of the risks which reasonable businessmen would put on the contractor seeking to avoid the contract." Finally, the theory of failure of consideration suggests that when the supervening event prevents one party from performing the obligation, both parties are discharged. The reason is that consideration of the contract has failed. Ultimately, however, despite the fact that scholars have made efforts to draw distinctions between these theories, they can hardly be distinguished in judicial practice.

146 See Lord Radcliffe's opinion in Davis Contractors Ltd v. Fareham Urban District Council, [1956], AC 696, 729
148 Ibid., at 833-834
In short, it was held that frustration would occur not only when the subject-matter of the contract disappeared, but also when it had been seized from the party (expropriation or requisition, for example), when the mere purpose of the contract had been frustrated (as in the case Krell v. Henry, explained in the following paragraph) or, finally, when the contract was frustrated by state or government acts (as in the Fibrosa case\textsuperscript{150}, when altered circumstances arose out of government activities at the beginning of World War II). It is also important that frustration in all these cases was related to subsequent events, those that occurred after the conclusion of contracts. If events were antecedent, or if impossibility existed at the time of the conclusion of contracts, the cases would have been covered by doctrine of mistake. In essence, subsequent events held as frustration discharge a contract, but antecedent events held as mistake make a contract void.

In addition, in cases in which subsequent event made the performance more difficult rather than impossible, the consequence is still the frustration of purpose. This rule is the one applied in Taylor v. Caldwell, but the principle was also established in the famous Coronation cases\textsuperscript{151}. In Krell v. Henry the court held that the contract to hire an apartment for a day to watch the coronation procession of King Edward VII was frustrated by the cancellation of the coronation. The court held that the defendant should be released from his obligation to hire the apartment and to pay the price because the purpose of the hiring was frustrated by the cancellation of the procession.

Despite the fact that cases of supervening illegality have been included in the common law concept of frustration, supervening illegality itself has never been of a particular interest among common law scholars. The application of the doctrine was obviously based on the assumption that subsequent changes in laws or other subsequent

\textsuperscript{150}see Chapter 4.1. of this paper

government acts have similar characteristics to any other supervening events which cause frustration (that is, events beyond the control of the parties, which make any further performance of the contract impossible). One of the first studies of this issue appeared in the 1940's. Writing about "discharge of an obligation for impossibility of performance, failure of consideration or frustration" Professor McElroy suggested "supervening legislation or executive action" as a reason for impossibility of performance and thus as an excuse for breach of contract. Here, he was the among first to distinguish between supervening illegality of the contract and the impossibility of performance. First, he pointed out that "an illegal contract (may) be possible of performance in fact". Second, he examined the effects of both illegality and impossibility and concluded that illegality discharges both parties, whereas impossibility may discharge only one of them. For instance, said Professor McElroy, in the case of goods perishing after a contract of sale is concluded, the question whether the seller would be discharged would depend upon whether the goods were "specific" or not. Whether the buyer would be discharged would depend upon whether there were a failure of consideration. Finally, he examined the courts' practice with respect to supervening illegality. According to his survey, "the court may raise the matter (of illegality) of its own motion and deny the plaintiff a remedy" even if the defendant has failed to plead illegality himself.

Beyond McElroy's writings, however, another characteristic of supervening illegality can be noted as well. This relates to the fact that supervening illegality often makes performance only more difficult or economically burdensome, but not absolutely impossible. The American concept of impracticability is often seen as the origin of the established solution for this aspect of supervening illegality in the common law.

---

152 McElroy, supra, note 73
153 Ibid., at Introduction xxx
154 Ibid.
155 Ibid., at Introduction xxxi
3.2. The Concept of Impracticability

The concept of impracticability has been adopted as a way to distinguish between simple *impracticability* and actual impossibility. In this context, impossibility exists when the performance becomes impossible for parties; whereas impracticability refers to performance becoming only much more difficult. In both situations, the outcome is the same—discharge of the contract by supervening events. Professor Treitel says that the American concept of impossibility includes "extreme and unreasonable difficulty, expense, injury or loss to one of the parties". Konrad Zweigert and Hein Kötz suggest that it is to be applied in situations in which the change in circumstances has rendered performance by the debtor very much more onerous or costly. The concept accepted in the Uniform Commercial Code (UCC) provides in §2-615 (a) an excuse for non-delivery because of impracticability:

"Delay in delivery or non-delivery in whole or in part by a seller who complies with paragraph (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made *impracticable* by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid."

The doctrine of impracticability extends the concept of impossibility by assuming that a financial or commercial hardship is sufficient to discharge a contract. Contracts can be frustrated by events such as extreme rises or falls in prices, shortages of raw material, embargoes, or similar situations in which a performance is still possible but commercially difficult for a party.

---

156G.H. Treitel, *supra*, note 36
Impracticability has also been accepted in the Restatement (2nd) of Contract from 1981\textsuperscript{157}. Explanation of the judicial application of the concept is formulated in the Empresa Exportadora de Azucar v. Industria Azucarera Nacional SA (The Playa Larga) case\textsuperscript{158}: the Court held that a contract for the delivery of sugar from Cuba to Chile has been frustrated by a change in the relationship between the two countries. Even though delivery was not absolutely impossible, it was found that the basis of discharge was that performance would cause extreme hardship for the seller.

It is significant that the English courts have no general affinity for the concept of impracticability as the Americans do have. Yet, the principle of discharge by impracticability or commercial impossibility has slowly been transforming in England. In many cases courts have not been willing to discharge a contract for reasons of inflation\textsuperscript{159} even though "extreme inflation may be capable of frustrating a contract"\textsuperscript{160}. In this line of thought Lord Simonds rendered the decision in one of the so-called Suez cases. In the case of Tsakiroglou & Co. v. Noble Thörl GmH,\textsuperscript{161} he practically rejected the concept

\textsuperscript{157}See §261 of the Restatement (2nd) of Contracts
\textsuperscript{158}In Empresa Exportadora de Azucar v. Industria Azucarera Nacional SA (hereinafter Playa Larga) [1983] 2 Lloyd's Rep. 171 (the Playa Larga dispute arose from the contract for sale of sugar concluded by one Cuban and one Chile company. Both parties were state-owned companies. At the time when the contract was concluded both countries were governed by the Marxist governments. However, the government changed in Chile and consequently diplomatic relations between countries were severed. Hence, the commercial relations immediately crashed as well.
\textsuperscript{159}British Movietonenews Ltd. v. London Cinemas [1952], A.C. 166, 185: sudden depreciation of currency does not frustrate a contract
\textsuperscript{160}National Carriers Ltd. v. Panalpina Northern Ltd [1981] A.C. 675, 712
\textsuperscript{161}Tsakiroglou & Co. v. Noble Thörl GmH, (1962), A.C. 93, 115, arose from the contract on sale of 300 tons of Sudanese groundnuts c.i.f. Hamburg. The contract was concluded on October 4, 1956 and the seller was obliged to ship the goods in Port Sudan in November/December 1956. Both parties expected shipment to be via Suez, but there was no express or implicit destination with respect to shipping in the contract itself. However, the Suez canal was suddenly closed on November 2, 1956, due to the war between Israel and Egypt. Accordingly, the seller should use another route to reach Hamburg-via the Cape of Good Hope. On contrary, he declared the contract at an end. The arbitrator decided that thus the seller was in breach and award damages in favour of the buyer. The award was upheld by the courts, including the House of Lords.
of impracticability by asserting that "an increase of expense is not a ground of frustration" and confirmed the classical English approach towards frustration caused by subsequent event. In some other cases, the courts came very close to the American concept. They advocated the possibility to discharge contracts in which performance became impracticable because it could be done only at an excessive or unreasonable cost\textsuperscript{162}, or became impracticable in a commercial sense\textsuperscript{163}. The House of Lords in \textit{Davis Contractors Ltd v. Fareham Urban District Council}\textsuperscript{164} made an important decision which brought closer the English and American approach towards impracticability. Lord Radcliffe viewed that "frustration occurs whenever the law recognizes that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract."\textsuperscript{165}

Even though these cases suggest that it is sometimes difficult to make a difference between the English doctrine of frustration and the American solution, there is still no clear-cut change in the position of English courts that impracticability in general could be considered as the only ground for discharge of contracts.

\textsuperscript{162}Moss v. Smith (1850) 9 C. B. 94
\textsuperscript{163}Horlock v. Beal, [1916] 1 A. C. 486, 492
\textsuperscript{164}Davis Contractors Ltd v. Fareham Urban District Council, [1956], A.C. 696, 729; the dispute arose from the contract to build 78 houses for a price of £94,000 in 8 months, when a labour shortage delayed performance to 22 months and increased costs to £115,000. The builder invoked as an argument for delay and increase in costs the change in circumstances—events which had discharged the contract. The House of Lords rejected the builders argument and held that the events were within the ordinary range of commercial probability, because they increased costs to less than 23 per cent. of the contract price and thus did not constitute the ground for the application of the doctrine of impracticability.
\textsuperscript{165}Ibid.
3.3. The Civil Law Doctrine of Force Majeure

Continental legal systems developed their concept of impossibility of performance from the old Roman law rule *impossibilium nulla obligatio est*\(^\text{166}\). The rule assumed that the contract would be void if at the time of formation the promised performance was objectively impossible. Both Germanic and Romanistic civil codes use this notion of impossibility\(^\text{167}\). In contrast, the notion of supervening illegality has been approached as the supervening event. That is, continental scholars and lawyers have drawn a distinction between cases of impossibility and cases of supervening events on chronological grounds: impossibility is an initial obstacle to perform, while supervening event is an obstacle to performance that appears after the conclusion of the contract. *As far as common law is concern, the difference between impossibility at the time of making the contract and subsequent impossibility caused by supervening events has been explained as a difference between two doctrines—the doctrine of mistake and doctrine of frustration\(^\text{168}\). Practically, subsequent events are seen as unforeseen changes in circumstances, set out as *clausula rebus sic stantibus\(^\text{169}\).

For the above reasons, the doctrine of force majeure is held as the most appropriate doctrinal explanation of supervening illegality. The concept of force majeure is based on the old Roman law concept of *vis major\(^\text{170}\) which provides an excuse for non-

---

\(^{166}\)Digesta, 50.17. lex 185

\(^{167}\)It should be noted, however, that German law makes distinction between two types of non-performance or breach of the contract, impossibility (initial, objective and subjective) and delay, whereas French law has a unitary conception of non-performance. For detailed explanation see K. Zweigert & H. Kötz, *supra*, note 149, at 177-207

\(^{168}\)See Chapter 3.1. The Common Law Doctrine of Frustration, at 69

\(^{169}\)Even though the concept was known in ancient Roman Law, K. Zweigert & H. Kötz, *supra*, note 149, at 211, write that it origins from the Glossators and the Middle Ages, later in works of Grotius and Pufendorf and that "it was accepted in the Codex Macimilianus bavaricus civilis of 1756 and then in the Prussian General Land Law of 1794".

\(^{170}\)The term refers to a superior power, irresistible force
performance caused by an event which is outside the control of the parties and which can not be foreseen nor avoided by exercise of due care. The modern usage was established by the definition given in ART. 1147 and ART. 1148 of the Code civil\textsuperscript{171}. French courts accept the concept of \textit{cas fortuit} or \textit{force majeure}, assuming that liability for non-performance of contract can be excluded if the cause is an external event that is \textit{imprévisible et irrésistible}. In other words, in France the concept can be successfully used as a defense for non-performance only when three conditions are observed: the event that caused non-performance must have been unforeseeable; impossibility caused by the event must be absolute; and non-performance must not be the fault of the party seeking to avoid performance.\textsuperscript{172} In this respect, it is important to note that the event must be an outside one. There must be no connection between the event and the party seeking an excuse. In other words, there will be no excuse for what is called self-induced frustration in common law. This is of crucial importance whenever supervening illegality occurs. If, for example, the state is party to a contract, a change of law or other regulation will not be considered as a force majeure event. As previously explained, the state cannot 'intervene' in its own contract. Accordingly, the state enterprise which is not a separate legal entity will not be excused for non-performance caused by supervening illegality.

The concept of force majeure has been modified by judicial practice, which has also started to excuse so-called hardship situations in which exceptional circumstances, have made performance too burdensome. Such situations, accepted in the doctrine of \textit{imprévision}, fundamentally differ from those of the classical force majeure which is, again, under French law "an irresistible and unforeseeable event which makes the

\textsuperscript{171}ART. 1148 Code civil: "There is no ground for damages and interest, when by consequences of a superior force or a fortuitous occurrence, the debtor has been prevented from giving or doing that to which he has bound himself, or has done that from which he was interdicted."

\textsuperscript{172}See M. Litka, \textit{supra}, note 104, at 102
performance of a contract impossible. Thus, the modified concept of force majeure broadens the definition of force majeure to include practical impossibility in addition to the more narrow classical sense (inevitability of the event, due care of performing party).

In contrast, the German concept of force majeure relies more on judicial practice than on doctrinal concepts of the law of contracts. Some practitioners in Germany, such as Jürgen Einmahl, Dr. Axel Epe, and Manfred Finken, have noted that the German understanding of the concept is derived more from international commercial practice than the domestic practice. It is noteworthy that the application of the German concept, as much as the French one, requires that the party who fails to perform the obligation has acted in good faith, so that he cannot be responsible for the event causing non-performance.

It was German judicial practice that, after World War I, introduced the concept of economic impossibility—an extension of the classical concept of the force majeure (Unmöglichkeit) through the new doctrine of Wegfall der Geschäftsgundlage. This concept was similar to the French doctrine of imprévision, the doctrine of rebus sic

---

173See A.H. Puelinckx, supra, note 140, at 53
176For detailed explanation see M. Kurkela, ed., Comparative Report on Force Majeure in Western Europe (Helsinki: The Union of the Finnish Lawyers Publishing Company Ltd., 1982), at 41-50
177§ 275(1) BGB
stantibus, or the American law notion of impracticability. In 1914 issues of supervening events were especially burdensome for German judicial practice when the German economy collapsed, partially because of the war and partially because of the global economic crisis. The Reichsgericht\(^{178}\) thus found a solution for cases of supervening events in the concept of economic impossibility, which was by nature almost identical to the American concept of impracticability\(^{179}\). In essence, the concept of economic impossibility enables a party to be released from a contractual obligation if a change of circumstances has made his obligation "too much to ask"\(^{180}\). In other words, economic impossibility is a situation in which performance is not literally impossible, but rather too burdensome to expect from a performing party.

3.4. International Rules on Frustration and Force Majeure

The United Nations Convention on Contracts for the International Sale of Goods (the Vienna Convention)\(^{181}\), the most important international treaty with respect to international transactions, refers to the issue of non-performance and force majeure only in ART. 79:

"(1) A party is not liable for a failure to perform any of his obligations if he proved 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."

\(^{178}\)Reichsgericht (RGZ)-German Imperial Court which decided civil matters cases  
\(^{179}\)See at 73 of this Chapter  
\(^{180}\)K. Zweigert & H. Kötz, \textit{supra}, note 149, at 213  
This concept gives rise to several concerns. First, it can be noted that the Vienna Convention does not in fact use terminology such as frustration or force majeure. According to the explanation set out in ART. 79(1), it is possible to assume that an unforeseeable impediment beyond the parties' control is a supervening event. That, after all, represents the foundation of the force majeure doctrine. Furthermore, the provision says nothing about the nature of the impediment nor its effects. Accordingly, the impediment could be an Act of God, acts of government (supervening illegality), earthquake, fire, flood, strike, war, revolution, embargo, and the like—events that are unforeseeable, unavoidable, or unpreventable. Finally, it is uncertain whether or not the provision also includes a situation of absolute objective impossibility, impracticability or economic impossibility.

It can be noted that ART. 79(1) deals with a partial exemption (exemption from liability in damages), whereas ART. 79(3) provides an exemption for a limited time, as long as an impediment is present. An ambiguous solution with respect to the discharge of a contract is set out in ART. 79(5), which gives to the party any right other than to claim damages. As far as such rights are concerned, obviously including the discharge, a party has to take into consideration provisions of ART 61(1)(a) which suggest further application of articles 62 to 65\(^\text{182}\).

Finally, the application of the Vienna Convention is limited to international contracts concluded between parties whose places of business are in different contracting

\(^{182}\)ART 61 (1): If the buyer fails to perform any of his obligations under the contract or this Convention, the seller may: (a) exercise the rights provided in articles 62 to 65;
ART. 62 : The seller may require the buyer to pay the price, take delivery or perform his other obligations, unless the seller has resorted to a remedy which is inconsistent with this requirement;
ART. 63(1): The seller may fix an additional period of time of reasonable length for performance by the buyer of his obligations;
See also ART. 64(1): which provides when the seller may declare contract avoided and
ART. 65: which provides that the seller may make the specification of the form, measurement or other features of the goods if the buyer fails to do so
As well, it is applicable unless contracting parties explicitly agree that it will not be.

As a unique and autonomous body of laws, European Union law (the EU law) is based on the most important principles of the common law and the civil law. Nevertheless, the concept of force majeure prevails in EU law, as a widely accepted practice in international contracts concluded between member states, as well as in contracts concluded with third countries. Force majeure within EU law is understood in a classical form of the civil law concept *impossibilium nulla obligatio*, as an exception from the principle *pacta sunt servanda*. This means that the force majeure concept consists of two elements—the objective and subjective. The objective element must be understood in the sense of "an extraordinary event beyond the influence of the person concerned". The second, subjective, element consists of "everything possible having been done by the person concerned, acting with care, prudence and diligence, in order to avoid the occurrence of that event".

The Court of Justice of the European communities, or the so-called The European Court, developed a specific test in cases related to a plea of force majeure due to supervening illegality. The cases related to force majeure heard by the Court consist of references from national courts for preliminary rulings on EU law, and actions by and against Member States. The former cases are initially those in which force majeure was plead before national courts by competent authorities of Member States when exporters or importers claimed damages for the authorities' non-performance. Then, national courts would asked the European Court for the opinion (reference) with respect to the issue. The later cases are those in which Member States invoked force majeure defence in order to justify the non-observance of Community obligations, most commonly non-

---

183 ART. 1(1)(a) of the Vienna Convention
185 Ibid.
implementation of the secondary EU legislation on time. In all these cases, not only other Member States but also individuals (private parties), even though prevented from appearing before the European Court, can be affected by the non-observance of the EU obligations.

In both situations the first step is to determine the definition of force majeure accepted by the court. Two above mentioned elements, the objective and subjective, are already recognized as standards. The second step relates to the legislative or regulatory context: different branches of law in the Union have different uses of the concept. However, supervening illegality has not been addressed as a specific issue in current judicial practice. Thus, one of the possible solutions for the parties in international trade is to trace patterns of the application of the concept of force created in national laws, predominantly in civil law countries, or to determine analogous patterns created with respect to related cases of supervening events.

3.5. Application of Concepts

The utility of these principal concepts related to supervening illegality is of the greatest importance for parties in international trade. Each of the three major doctrines presented in this chapter include legal impossibility, or supervening illegality, as a

---

The relative differences in approaches reflect the difficulty in reaching one, exclusive solution. Moreover, it is possible to conclude that the positions of common law and civil law are becoming closer.

The contemporary doctrine of frustration shares certain similarities in respect to the requirements for excuse from performance with the doctrine of force majeure. First, the supervening event must happen after the conclusion of the contract. Second, neither party must be responsible for its occurrence. As to the responsibility for non-performance, while French law speaks about lack of fault, German law uses the expression good faith, the English classical approach emphasizes that "reliance cannot be placed on self-induced frustration", and American law provides that impracticability will be a ground for discharge only if it occurs without the fault of the party claiming discharge.

Third, there is a tendency in both concepts of frustration and force majeure of emerging towards the American concept of impracticability. For instance, Professor Schmitthoff notes that English law developed a specific, distinctive test (called by Lord Sumner in Bank Line Ltd. v. Arthur Caper & Co. [1919] A. C. 435, 452 that the destruction of the res central to contract; supervening events beyond the control of the promisor, such as the death or disability of an essential party to the contract; and the supervening illegality of the contract; and the supervening illegality of the contract)." See also M.D. Aubrey, supra, note 143.

Compare, for example, the requirements provided by the doctrine of frustration at C.-J. Cheng, ed., Clive Schmitthoff's Selected Essays on International Trade Law, (Dordrecht: Martinus Nijhoff Publishers, 1988) at 255 ("an event has happened (i) after the conclusion of the contract, (ii) for which neither party is responsible, and (iii) which is regarded by the law as a valid excuse of performance") and A.H. Puelinckx, supra, note 140, on force majeure at 56 ("the event is irresistible; the event must be unforeseeable; the debtor is not at fault")

187 Compare, for example, J.D. Newman, Exchange Controls and Foreign Loan Defaults: Force Majeure as an Alternative Defence, 71 Iowa Law Review (1986) 1509, who includes into force majeure at p. 1517: "the destruction of the res central to contract; supervening events beyond the control of the promisor, such as the death or disability of an essential party to the contract; and the supervening illegality of the contract;

188 Compare, for example, the requirements provided by the doctrine of frustration at C.-J. Cheng, ed., Clive Schmitthoff's Selected Essays on International Trade Law, (Dordrecht: Martinus Nijhoff Publishers, 1988) at 255 ("an event has happened (i) after the conclusion of the contract, (ii) for which neither party is responsible, and (iii) which is regarded by the law as a valid excuse of performance") and A.H. Puelinckx, supra, note 140, on force majeure at 56 ("the event is irresistible; the event must be unforeseeable; the debtor is not at fault")


190 § § 261, 265 of The Restatement 2nd
Radcliffe, "the test of the changed significance of the obligation"191) in the case *Davis Contractors Ltd v. Fareham Urban District Council*192 which implicitly suggests that the concept of frustration could be understood as to cover cases of economic impossibility, in which the performance is still possible, but, because of occurrence of a subsequent event becomes commercially unsuitable. He also points out that the English doctrine "insists that there must be such a radical change of circumstances...that the foundation of the contract has gone and the contract, if kept alive would amount to a new and different contract from that originally concluded by the parties."193 Moreover, the additional concepts dealing with fundamental changes in circumstances have appeared in countries of the classical force majeure doctrine—imprévision in France, and Wegfall der Geschäftsgrundlage in Germany.

Finally, according to the doctrine of frustration, the most important consequence of a supervening event is to discharge the parties from their obligation. Discharge and termination occurred completely and automatically194 before the *Fibrosa* case and the enactment of the *Law Reform (Frustrated Contracts) Act*195 in England. In other words, 1943 saw the introduction of an adjustment of contractual obligation and restitution based on the principle of unjust enrichment196. As to the consequences defined by the doctrine of force majeure, a duality of systems is also in place. It has been explained that force majeure follows the classical principles of contract law—pacta sunt servanda and impossibilium nulla obligatio. As a result of balanced application of these principles, when the contract becomes absolutely impossible to perform because of an extraordinary irresistible event, the parties will be discharged from further performance and the contract

191See C. Schmitthoff in C.-J. Cheng, ed., supra, note 188, at 254-264
192*Davis Contractors Ltd v. Fareham Urban District Council*, [1956], A. C. 696, 729
194Lord Simon in *Joseph Constantine Steamship Line Ltd. v. Imperial Smelting Corporation Ltd.*, [1942] A.C. 154, 163;
195*Law Reform (Frustrated Contracts) Act*, (6 & 7 Geo. 6, c.19)
196For discussion on remedial modalities see Chapter 4 of the thesis
will be terminated. However, another system of rules has been introduced through judicial practice. It allows adaptation of contracts by courts (imprévision and Wegfall der Geschäftsgrundlage) whenever new external circumstances, including unforeseen changes of circumstances and economic impossibility, fundamentally upset the contract. In brief, adaptation of contract means a change of contractual provisions during the course of performance in accordance to a new situation. Apart from adaptation by judicial solutions, adjustment of contracts to changed circumstances can also be performed by operation of law (means provided in statutory provisions of national laws) or by means provided in contractual provisions themselves (for example, according to hardship clauses).

Even though this analysis suggest that legal theory has attempted to distinguish the concepts of frustration, force majeure, and impracticability, parties in international trade can expect in practice, ironically, the same outcomes (termination of contract and exemption for the debtor from liability for non-performance) regardless of which of them is applied. Yet, when the issue of adaptation arises, which falls within the practice of courts in both common law and civil law countries, differences between the concepts may become obvious. For instance, in common law countries the scope of adaptation of frustrated contracts has been limited by laws197. On the other hand, the doctrine of force majeure has been extended by imprévision and Wegfall der Geschäftsgrundlage—the scope of adaptation in practice depends on civil courts.

Closing this discussion on the applicability of these concepts of supervening illegality in international trade contracts, parties to such contracts should make their choice taking into consideration one additional element. That is, they should be familiar with the remedial modalities provided in civil law and common law countries accordingly. Moreover, the question whether the civil law or common law concept is

197 For example: in England, Law Reform (Frustrated Contracts) Act (6 & 7 Geo. 6, c. 19)1943; in British Columbia, Frustrated Contracts Act R.S.B.C., 1979, c.144
appropriate calls for analysis of courts' and arbitrators' practice. This aspect will be examined in Chapter 4 of this paper.

Finally, this summary of the doctrinal approach to supervening illegality requires another concept to be clarified. The *force majeure clause* will be explained in detail in Chapter 5. The broadest and the most general explanation of the force majeure clause is a clause that expressly stipulates the events in which parties agree to excuse non-performance. The term is of a contractual nature, indicating 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."\(^\text{198}\) It seems that force majeure clauses have been in use in English commercial contracts since the nineteenth century. *Yrazu and Another v. The Astral Shipping Company*\(^\text{199}\) appears to be the first reported case concerning a force majeure clause in English law. David Yates notes two cases from England as the cornerstones of the common law interpretation of force majeure\(^\text{200}\). He notes that in *Lebeaupin v. Crispin*\(^\text{201}\) force majeure included "all circumstances independent of the will of man and which it is not in his power to control, and such force majeure is sufficient to justify the non execution of a contract. Thus, war, inundation and epidemics are held as cases of force majeure. It has even been decided that a strike of workmen constitutes a force majeure."\(^\text{202}\) Moreover, McCardie J., in his decision in *Lebeaupin v. Crispin* included direct legislative or administrative interference among examples of what could be considered force majeure. In the second case emphasized by Yates, *Matsoukis v. Prietsman*\(^\text{203}\), it was held that force majeure covered not only Act of

---


199*Yrazu and Another v. The Astral Shipping Company* [1904] 20 T. L. R. 153


201*Lebeaupin v. Crispin* 2 K.B. 714 (1920) at 719

202Ibid.

203*Matsoukis v. Prietsman* 1 K.B. 681 (1915) at 687
God but also strikes and damages to machinery. Thus, it is possible to conclude that although the term force majeure is not part of English law, it has been so widely used by private parties in commercial contracting governing by English contract law than it has significantly effected the common law doctrine of frustration.

Another comparison could made this point. Since force majeure is usually related to absolute impossibility, especially in the civil law concept, it is hard to say if supervening illegality will always create such a result. Sometimes, a party would only have more difficulty in performing its contractual obligation because of a change in legislation. For example, a change in an export licencing regime does not necessarily prevent a party from exporting. It could, however, make his obligation more costly or cause delay. This is why some authors would rather speak about hardship than force majeure with respect to supervening illegality. This approach is based on the notion of hardship as a situation in which "the performance has become much more burdensome, but not impossible". Consequences of hardship would be "a fundamental change in the equilibrium of the contract". David Yates explains hardship as a real variation of force majeure. Finally, hardship would result in a change of the contractual aspects of performance, in modification or adjustment of a contract. As Yates points out, "[t]he object of a hardship clause is, by way of renegotiation, to convert the contractual relationship from one that is frozen at the point of formation into an evolutionary one". In contrast, force majeure would result in the discharge of the contract.

205 *Ibid.*, at 662
206 D. Yates, *supra*, note 200 at 188
CHAPTER FOUR:
CONSEQUENCES OF SUPERVENING ILLEGALITY
AND REMEDIAL MODALITIES

The preceding discussion explained that supervening illegality in international trade refers to situations in which subsequent changes in the applicable law make the performance of international contracts legally impossible. According to the common law doctrine of frustration and the civil law principles of force majeure, the primary consequence of such events is a discharge of contract. This chapter analyzes what principles determine the right to claim discharge when it becomes impossible to perform or to continue performance because of supervening illegality. Also, explored will be the legal consequences of discharge when one party has performed his obligation partially or entirely before the occurrence of a supervening event. Next, the question to be answered is whether parties can claim damages despite a discharge of contract. If so, what principles are applicable by courts and arbitrators? In short, what remedies are available to parties seeking to have courts or arbitrators allocate losses caused by supervening illegality?

In arriving at answers to the above questions, this chapter starts from the assumption that, despite the fact that international contracts (like domestic contracts) tend to be governed by the principle of autonomy of will—which enables the parties to address freely any legal issue in their contracts (including the issue of a discharge or termination of a contract and remedies for loss caused by non-performance)—such contracts are often silent on such issues. Thus, in the field of international trade the question of satisfactory allocation of the risk of loss is usually left to—national courts or arbitral tribunals. The next assumption concerns the specifics of international transactions. As mentioned in the Introduction to this thesis, international contracts transcend national boundaries. They are usually concluded in one country and executed in a different country or even in several
countries. Furthermore, international transactions usually involve a third party (agent, carrier, bank, to mention a few) in their performance. Finally, different legal systems can involve different frameworks for international transactions. Once the parties set up the specifics of performance and once they invest certain amounts of money in the preparation or commencement of transactions, they may not be willing to give up their contracts automatically when a supervening event occurs. Despite radical changes in circumstances, the parties may rather be interested in keeping their contracts alive. If so, they will be interested in mechanisms for an adequate adaptation of the terms of contracts, not in a mere discharge. Following these basic postulates, this chapter starts with an analysis of basic principles related to discharge and adaptation of contracts affected by supervening illegality as provided accordingly by the doctrines of frustration and force majeure.

4.1. Discharge or Adaptation of Contracts

As pointed out in Chapter 3 of this thesis, in English law supervening illegality is a problem considered with reference to the doctrine of frustration. Accordingly, the primary consequence of supervening changes in law will be the discharge of a frustrated contract. If all requirements are fulfilled, both parties will be discharged from further performance of their contractual obligations. In brief, requirements with respect to the nature of the supervening event itself are as follows. First, the event must be subsequent not antecedent, or in other words, it must occur after the conclusion of the contract. Second, it must be unforeseen. Third, supervening illegality means that the event must make performance legally impossible, but not necessarily physically impossible or

208 See the discussion in Chapter 3.1 The Common Law Doctrine of Frustration 69-73 and Chapter 3.5. Application of Concepts, at 82-87
impracticable. As far as the contractual parties are concerned, the most important requirement is that frustration must not be self-induced.

Assuming that the above requirements have been fulfilled, the general principle of frustration is that the parties will be automatically and totally discharged from their contractual obligations from the moment when their contract has become illegal. Automatic discharge means that from the moment supervening illegality occurs, the contract will be terminated and parties will not be obliged to carry out their performances any further. This means that discharge does not depend on the parties' choice: if the parties continue to behave as if the supervening event never happened, they will act illegally. In other words, their performance will be seen as an infringement of a new legal rule. The common law rule that frustration totally discharges contracts means that it affects performance of both parties. Both of them are wholly excused from further performance of their obligations.

Since the principle of automatic and total discharge on the grounds of frustration or force majeure operates only with regard to future obligations, the effect on the parties will depend on whether they have commenced performance before the occurrence of a supervening event or not. If not, discharge appears to be a just solution for both parties—it will simply put them into the positions they were in before entering the contract. However, if contractual provisions required one performance to begin before the other, discharge will significantly affect the party who fully or partially did perform his obligation. In short, discharge will cause loss to this party. Not only will discharge give an excuse for non-performance, but also significant benefits (in the form of the benefits of the other's performance) to another party.

Problems of one-sided performance and application of the doctrine of frustration have been discussed in English judicial practice a great deal, suggesting that automatic and total discharge might not be an adequate and just solution for all cases of frustration. Modification of such an approach can be illustrated with reference to two
famous English cases—*Krell v. Henry*\(^{209}\) and *Fibrosa* case\(^{210}\). In *Krell v. Henry* the defendant Mr. Henry paid the deposit of 25 l. toward the agreed rent of 75 l., to the plaintiff, Mr. Krell, according to their contract to hire a flat to watch the Coronation. However, after the deposit had been paid, the Coronation was cancelled. The Court decided that both parties were discharged. Yet, Mr. Henry's deposit was retained by Mr. Krell. The Court, which in the first instance discharged both parties from the contract, did not consider the deposit as a subject-matter for its judgment and so Mr. Henry received no remedy for this loss. Had Mr. Henry paid more than the deposit, his loss would have been even greater, one might conclude.

An even more obvious illustration of the early judicial practice in England is seen in another Coronation case, *Chandler v. Webster*\(^{211}\), in which the contract was almost identical to that of the *Krell v. Henry* case. The only difference was in the method of payment. In *Chandler v. Webster*, the contract provided for payment in advance, including the £100 deposit. The Court decided not only that would prepayment of the deposit remain with the renter, but also that the hirer had to pay the full amount because his obligation for payment was due before the event of discharge occurred. The grounds for the difference in judgments were found in the differences in the stipulated contractual obligations. In *Chandler v. Webster*, one party promised a full payment in advance, whereas in *Krell v. Henry* only a deposit was to be paid in advance. However, both cases confirmed that the courts applied the principle of absolute and total discharge.

In the *Fibrosa* case\(^{212}\), an English manufacturer agreed to sell machinery to a Polish partner. The parties stipulated c.i.f. Gdynia delivery, for the price of £4,800 to be

\(^{209}\) *Krell v. Henry* [1903] W. K.B. 740; see also discussion on the case provided in Chapter 3 of this thesis, at 71


\(^{211}\) *Chandler v. Webster* [1904] 1 K.B. 493

\(^{212}\) *Fibrosa* case, *supra*, note 210; see also *supra*, note 79 and the discussion in Chapter 2.1(i)
paid partially before delivery (£1,600) and partially upon delivery. However, the Polish buyer paid £1,000 only, instead of 1,600. The English seller never delivered the machinery, because of the German occupation of Gdynia and the commencement of World War II. The seller rightly maintained that the contract was frustrated by a supervening event, but at the same time the buyer claimed the right to recover money paid in advance. In contrast to the *Krell v. Henry* decision, The House of Lords reached a judgment in favour of the Polish buyer. The complexity of the decision was intensified by the fact that it was difficult to find a justification for, from a practical perspective, restitution as a remedy for the buyer. The appropriateness of such a decision was found in the principle of a total failure of consideration. The House of Lords held that the Polish buyer did not receive anything of what was agreed upon by the contract and thus he should be granted the right to restitution. Conversely, if even one part of the machinery had been delivered by the English manufacturer, restitution would have not been allowed.

The *Law Reform (Frustrated Contracts) Act 1943* confirmed the principle established by the judgment of Viscount Simon, L. C. that due to frustration and total failure of consideration the aggrieved party is entitled to claim prepaid money. Viscount Simon, L. C. himself called for a change of legislation in his speech. The Act governs all English contracts frustrated by supervening impossibility, supervening illegality, and change in vital circumstances. Indeed, it gives the courts power to adjust an already concluded contract between parties according to the court's sense of a just solution. This was a great improvement upon the common law. Professor Schmitthoff, interpreting section 3(2) of the *Law Reform (Frustrated Contracts) Act*, is of the opinion

---

213 *Law Reform (Frustrated Contracts) Act*, 1943, 6 & 7 Geo. 6, c.40
214 Viscount Simon L. C. in the *Fibrosa* case [1943] A.C. 32, at 49 stated: "[I]t must be for the legislature to decide whether provision should be made for an equitable apportionment of prepaid monies which have to be returned by the recipient in view of the frustration of the contract in respect of which they were paid."
that the Act "likewise applies in arbitration proceedings". The major principles with respect to the recovery of the prepaid money are that the aggrieved party has the right to claim recovery for money paid or payable to the other party before the discharge of the contract, but the court has the discretion to decide upon the claim and to determine a just solution.

The results of these two cases lead to an additional dilemma. Even though the rough justice reached in the Coronation cases can easily be criticized, it is uncertain whether the solution provided in the Fibrosa case and the English Law Reform (Frustrated Contracts) Act 1943 significantly improves the positions of the parties. From

---

215 See C. Schmitthoff, supra, note 188, ch. 20. "Frustration of International Contracts of Sale in English and Comparative Law", at 266.

216 Law Reform (Frustrated Contracts) Act 1943, section 1(2):

"All sums paid or payable to any party in pursuance of the contract before the time when the parties were so discharged ... shall, in the case of sums so paid, be recoverable from him as 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 so paid or payable incurred expenses before the time of discharge in, or for the purpose of, the performance of the contract, the court if it considers it just to do so having regard to all 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."

217 Law Reform (Frustrated Contracts) Act 1943, section 1(3):

"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 (other than a payment of money to which the law foregoing subsection applies) before the 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 perspective of a party who received money, there is a risk that the total restitution of
the received amount would result in a great loss. In the *Fibrosa* case, for example, the
English party could have had extra expenses in obtaining or producing the machinery. It
did not deliver the machinery because the outbreak of war frustrated this intention, but it
certainly prepared the machinery to be delivered. It could be argued that the buyer
suffered some loss, despite the fact that he would recover the money. The loss would be in
the mere fact that the buyer did not get the machinery he needed. Yet, from the
perspective of the aggrieved party, who had paid some money, there is always a risk that
the failure of consideration will not be total, and that the right to restitution will not be
granted.

Difficulties in legislative and judicial solutions with respect to discharge of
frustrated contracts and remedies suggest that another concept may be taken into
consideration. Specifically, the concept of adaptation or modification of the contractual
terms in response to the change in circumstances brought about by a supervening event
may provide an adequate solution, especially for cases of one-sided performance.
Adaptation has already been defined in this thesis as a change of contractual provisions in
accordance with a new situation during the course of performance. The Law Reform
(Frustrated Contracts) Act reveals that the English common law is very reluctant to apply
the concept, apart from situations where down payments were made before the contract
was frustrated. In essence, adaptation is limited to judicial revision of the terms of
restitutionary remedy. English courts would rather chose to assist parties in renegotiating
contracts or redetermining their obligations, than enjoy even limited power to change the
terms of contracts in changed circumstances.

---

219 See the discussion in Chapter 3.5. Application of Concepts.
The civil law concept of discharge in cases of force majeure applicable to supervening illegality has the same principal consequences as the above stated common law concept of discharge. According to the principle *impossibilium nulla obligatio*, the civil law provides that contracts, when they become legally impossible to perform, will be discharged and both parties will be excused from further performance. In France, for instance, courts have to annul the contract on the request of any one of the parties\(^2\) if the contract itself does not stipulate automatic annulment. The requirements for the application of the force majeure doctrine are that the supervening events must be external, unforeseeable, unavoidable, subsequent events, which have occurred without the fault of the party seeking an excuse and which have made contractual obligations impossible to perform.

It has already been mentioned that the traditional requirement of absolute and objective impossibility has been modified, by the concepts *imprévision* and *Wegfall der Geschäftsgrundlage*, to include unforeseen and uncontrollable events which make contracts economically impossible. However, the basic principles of contract adaptation by operation of law vary greatly among civil law countries\(^2\). In French law courts will generally adapt contracts to changed circumstances, usually in long-term contracts (adaptation of extraordinary cost increases). The concept is held to be appropriate in cases when so-called public contracts (concluded between private companies and public authorities in the public interest and subject to the administrative law) have to be adapted

---


\(^2\) Article 1184 Code Civil

to changed circumstances. Contract adaptation by courts is used to avoid an excessive economic loss suffered by a party supplying public services. In German law, the application is the most liberal: whenever contracts become impossible because of disappearance of the basis of contract, courts are empowered to adapt contractual terms. *Wegfall der Geschäftsgrundlage* has been used in judicial practice a great deal since it provides a solution for cases in which the parties' intentions and aims cannot be achieved by contracts because of radical changes in the surrounding circumstances.

---

223 During the period of dramatic political and economic crisis of World War I, the French government started to intervene frequently into the economic relations of private parties. *Fait du Prince*, or government's acts usually prohibiting some export contracts or rejecting export licences, appeared to be an obstacle of the force majeure nature. Even though these acts had effects of hardship, not of force majeure, the situation demanded an efficient and immediate solution in order to prevent serious economic disturbances. Some legal scholars proposed the extension of the force majeure principle to the cases thus occurred. The theory was named the *théorie de l'imprévision* and it was accepted only by the courts that dealt with the contracts concluded between the state and individuals, (Conseil d'Etat and Tribunaux Administratix). Since these contracts were governed by administrative law, not Code civil, the *théorie de l'imprévision* could be applied. As a result of its application, contracts that became burdensome could be modified by the court or even terminated. Unfortunately, the possibility to deal with the frustration caused by governmental intervention was rejected by civil courts. After World War II, French judges were also authorized by the Law of 23 April 1949 to decide whether to cancel contracts disrupted by economic difficulties and concluded before September 2, 1949. Thus the courts extended power included the discretion to determine damages as well, Accordingly, the French approach toward the adjustment of contracts has been modified in favour of judicial discretion.

224 J. Draetta, R. B. Lake & V. P. Nanda, supra, note 222, at 184

225 The German concept modified *clausula rebus sic stantibus* first through the assumption that if economical difficulties frustrate the contract, the parties could rescind it on the "lapse of contractual basis" (*Fortfall der Geschäftsgrundlage*) and later, adding the requirement of good faith in performance, to obtain the right to rescind the frustrated contract. It is noteworthy that after World War II, Germans faced for the second time in the century, the problems of frustrated contracts because of extraordinary economic change. Numerous cases of supervening illegality and impossibility of performance caused by the outbreak of the war, or prohibition by Nazi government's acts and decrees, opened an additional discussion after the collapse of the Nazi state. Furthermore, some other contracts became impossible due to the rapid nationalization and confiscation in East Germany. In certain classes of cases the impossibility of performance was caused by the devaluation of a nation's currency after the end of the war. The Germans found a solution
As far as cases of a one-sided performance are concerned, the civil law starts from the same position as the common law. Since force majeure affects contracts only from the moment of the occurrence of a supervening event, the parties are excused from all future performance. The civil law allows courts to decide on restitution in order to reimpose a just solution that requires loss to be shared, instead of being entirely borne by one side.

4.2. Remedies and Allocation of Loss

In situations of supervening illegality courts try to reach decisions which will leave the parties in the same position they had before the supervening illegality. Discharge has proven to be a just solution for cases in which parties have not commenced performance. Damages are not provided as a remedy for cases of supervening illegality because there is no responsibility for non-performance on the part of the party seeking to be excused from liability for non-performance. However, considering the situation in which only one of the parties has already partly or entirely performed his obligation before the discharge of the contract, a just solution implies that such a party cannot be left in a worse position than he was before the contract was concluded. Even though there is no fault on the part of another party, the mere fact that it is possible to conclude that one party would suffer a significant loss (because one received a performance while at the

for problems arising from international contracts. They granted the courts the power to assist in modifying the parties obligations with the Law of March 26, 1952, (Gesetz über die richterliche Vertragshilfe), thereby reducing or delaying debtors' payments in internal relations and in international contracts (for example, The London Agreement of February 1953-Vertragshilfe). The later act related to contracts concerning the delivery of goods or services that were concluded before World War II between Germans and non-Germans. The issue of these contracts was about prepaid money by foreign creditors to German parties. The solution included extending the power to adjust the contracts.
same time the performing party suffered a loss) suggests that some remedy has to be
determined. For instance, the French Code civil provides an obligation for each party to
return what was received under the contract before force majeure occurred\footnote{Article. 1183 Code Civil}. English law also provides that "[a]ll sums paid or payable to any party in pursuance of the contract before the time when the parties were so discharged ... shall, in the case of sums so paid, be recoverable..."\footnote{Section 1(2) of the Law Reform (Frustrated Contracts) Act 1943}

In general, restitution is based on principles of unjust enrichment—a benefit
conferred upon one party has to be returned to a party who performed, regardless of
whether the latter party suffered a loss because of performance or not. In the event of
supervening illegality, no national law provides rights to claim any other damages, such as
expenses and losses incurred before a subsequent event. Restitution seems to be accepted
as the most adequate remedy to restore the parties to their original positions and as the
fairest method of allocation of risk from loss. If governed by the restitution principles of
English law, the restitution would be decided in accordance with the judgment of the
Fibrosa case and related rules of section 1.(2) and (3) of the Law Reform (Frustrated
Contracts) Act\footnote{See also G.H. Treitel, supra, note 8.}. These rules rely on principles of unjust enrichment and determine that
restitution, even for partial performance, will be allowed in respect to benefits in money,
or "other than paid money"\footnote{See Section 1(3) of the Law Reform (Frustrated Contracts) Act 1943}, given according to the contract frustrated by the
supervening event.

A similar solution is provided in American law, in the Restatement of Law,
2nd. Contracts. The rule established in § 377 regulates a situation in which a party has
already performed in part his contractual duty before the supervening event\footnote{Restatement of the Law, 2nd. Contracts, § 377. Restitution in Cases of Impracticability, Frustration, Non-Occurrence of Condition or Disclaimer by Beneficiary:}. 

\begin{enumerate}
\item[226] Article. 1183 Code Civil
\item[227] Section 1(2) of the Law Reform (Frustrated Contracts) Act 1943
\item[228] See also G.H. Treitel, supra, note 8.
\item[229] See Section 1(3) of the Law Reform (Frustrated Contracts) Act 1943
\item[230] Restatement of the Law, 2nd. Contracts, § 377. Restitution in Cases of Impracticability, Frustration, Non-Occurrence of Condition or Disclaimer by Beneficiary:
\end{enumerate}
Specifically, "whether the court requires restitution of benefits conferred under a contract that proves impossible or frustrated depends on the parties' assumptions or, as courts often express it, the implied terms of the contracts"\(^ {231}\). It is noteworthy that the rule does not directly cover supervening illegality but rather other cases of frustration, such as supervening impracticability, frustration of purpose, or non-occurrence of a condition.

Contrary to the other provinces (which adopted the Canadian Uniform Frustrated Contracts Act based on the English Law Reform (Frustrated Contracts) Act 1943), British Columbia adopted its own Frustrated Contracts Act\(^ {232}\). Many scholars have pointed out the important changes introduced by the Act, mainly based on the principles of restitution\(^ {233}\). The B.C. Act, which applies to the sale of goods, provides a party with the right to restitution for "benefits created by his performance or part performance of the contract"\(^ {234}\). Here, benefit is defined as "something done in the fulfillment of contractual obligations, whether or not the person for whose benefit it was done received the benefit"\(^ {235}\). On the other hand, section 5(3) expressly provides that where restitution is required by the party who has conferred some benefits later destroyed by the supervening event, losses may be apportioned equally between the parties.

In international trade practice a decision on contract termination or adaptation and determination of appropriate remedies could often be the responsibility of arbitrators. However, according to current arbitration practice, parties are advised to

---


232 R.S.B.C., 1979, c.144


234 *The Frustrated Contracts Act of British Columbia* s. 5(1)

235 *The Frustrated Contracts Act of British Columbia* s. 5(4)
expressly contemplate adaptation to changed circumstances. In other words, as far as international arbitral dispute resolution is concerned, they should not rely on an implied principle of adaptation. For instance, the ICC Arbitration Rules\textsuperscript{236} concerning adaptation apply only in situations in which the parties expressly refer to them in the contract. In reaching the appropriate remedy in cases of contracts frustrated by supervening illegality, arbitration tribunals will sometimes be governed by the principles universally recognized in all legal systems and applicable by courts—the widely acknowledged "law of civilized nations". Accordingly, leading doctrines of frustration and force majeure will often be considered by arbitrators, who will try to reach a just solution resting on principles of unjust enrichment, equity and good faith (\textit{lex mercatoria}\textsuperscript{237}). The basic principles are still similar. From this survey on adaptation it appears that parties to international transactions should carefully draft their contracts in order to approach the problem in an adequate way. That is, in short, to include express terms on renegotiation to changed circumstances or to confer a mandate for adaptation upon arbitrators. If the contract is silent on these issues, adaptation will occur according to the applicable law and relating rules explained in this Chapter—with a resultant increase in uncertainty.

\textsuperscript{236}ICC, Rules of the ICC Court of Arbitration Pub. 477 (1988), 1 January 1988; also ICC, Rules for the Adaptation of Contracts, Pub. No. 326 (1978) is going to be replaced by new ones

CHAPTER FIVE:
CONTRACTUAL REGULATION
OF SUPERVENING ILLEGALITY

After the study (Chapters 2 and 3) of doctrinal concepts and statutory provisions in national laws on supervening illegality, this chapter attempts to answer the following questions. First, can the parties freely agree on a definition of supervening illegality, formulating their own list of supervening events? In addition, can they agree on different principles applicable to the rights to cancel or to modify the contract, and to claim damages or remedies other than those provided in national laws? In other words, can preliminary agreement about supervening illegality provide better protection of the parties' interests and offer a satisfactory way to allocate loss caused by supervening illegality?

This chapter, then, will explore some of the most common drafting techniques used by parties in order to determine cases of excuse for non-performance of contractual obligations and to allocate the risk of non-performance. Typically, the parties are interested in extending the list of frustration events which excuse them from liability for non-performance under national laws, or gives a basis for the adaptation of frustrated contracts to changed circumstances. In short, they are interested in drafting an appropriate force majeure clause or hardship clause. A force majeure clause will enable parties to terminate the contract before completion and to claim an excuse from liability for non-performance. A hardship clause will facilitate parties who want to modify the contract to changed circumstances or to renegotiate and continue with the performance. Along with the problem of drafting an appropriate clause, this chapter will examine cases in which arbitrators, not the parties, have decided upon the adaptation of international contracts.
5.1. The Force Majeure Clause

The concept of a force majeure clause is now currently in use in all national legal systems. It originated from the civil law system, or from French law, to be precise. As already mentioned, a force majeure clause is a contractual provision which in certain circumstances, allows a party who has an obligation to perform a contract, to terminate that contract before completion and be entirely exonerated from responsibility for non-fulfillment. It is a basic principle of contract law that parties can freely agree on any contractual terms, including those on exclusion of liability in cases of force majeure, unless such terms are against some supervening mandatory rules. In essence, the parties are allowed to define and enumerate force majeure events in their contracts, as well as to determine the legal consequences of these events. Practically, there is the possibility of extending or narrowing the types of events that would exclude liability for non-performance. Thus, some events which would not otherwise be considered as being within the ambit of force majeure could be given such effect. In other words, the parties may use a force majeure clause as a "waiver of modification of remedial rights which would otherwise be available upon a successful action for breach of contract." Force majeure clauses have been in use in English commercial contracts from the nineteenth and the beginning of the twentieth centuries. Yrazu and Another v. The Astral Shipping Company appears to be the first reported case concerning force majeure.

238 The expression *force majeure* is always written in French, notwithstanding the language of a contract itself, which is, according to U. Draetta, R. B. Lake & V.P. Nanda, supra, note 222, "due to the fact that in this area the international trade usages found their inspiration in the French legal tradition", at 92.
239 H. Strohbach, *supra*, note 175, at 40
241 Yrazu and Another v. The Astral Shipping Company [1904] 20 T. L. R. 153
majeure in English law. David Yates cites the cases *Lebeaupin v. Crispin*[^242] and *Matsoukis v. Prietsman*[^243] as the cornerstones of the common law interpretation of force majeure[^244]. In the former, force majeure included "all circumstances independent of the will of man and which it is not in his power to control, and such force majeure is sufficient to justify the non-execution of a contract. Thus, war, inundation and epidemics are the cases of force majeure. It has even been decided that a strike of workmen constitutes a force majeure."[^245] Moreover, McCardie J. pointed out in *Lebeaupin v. Crispin* that direct legislative or administrative interference could be considered force majeure[^246]. In *Matsoukis v. Prietsman*, the second case emphasized by Yates, it was held that force majeure covered not only Acts of God but also strikes and damage to machinery[^247]. In short, English courts have identified a wide range of force majeure events that may excuse non-performance. However, it has been accepted that the parties are also free to stipulate a force majeure clause and, thus, that they are free to define events which will exclude parties from liability for non-performance.

In other words, international business people and lawyers use force majeure clauses extensively as protection "from liability when (their) failure to perform results from a cause beyond (their) control."[^248] Not only can the parties rely on national law principles of force majeure, but they can also consider international trade practices and other aspects of the *lex mercatoria*. The prevailing practice in international trade is to formulate a detailed, non-exhaustive list of events that constitutes force majeure, even

[^242]: *Lebeaupin v. Crispin* [1920] 2 K.B. 714
[^243]: *Matsoukis v. Prietsman* [1915] 1 K.B. 681
[^244]: D. Yates, supra, note 200, at 195
[^245]: *Lebeaupin v. Crispin* [1920] 2 K.B. 714 at 719
[^246]: *ibid.*
[^247]: *Matsoukis v. Prietsman* [1915] 1 K.B. 681 at 687
though there is a tendency to draft force majeure clauses by referring only to events internationally regarded or normally recognized as force majeure.249

As far as supervening illegality is concerned, in the absence of a force majeure clause, a solution provided by mandatory rules of the applicable law will be relevant. Standard solutions, which call for the application of the doctrines of frustration and force majeure, have been analyzed in Chapter 2. However, when a force majeure clause is included in a contract, an additional question may appear. Since a force majeure clause may either extend or narrow the list of events which will excuse liability for non-performance, is it possible to assume that such clauses can be used in order to exclude supervening illegality as a frustrating or force majeure event altogether? In other words, can a force majeure clause exclude the operation of the civil law doctrine of force majeure or the common law doctrine of frustration? According to English judicial practice, whenever public policy has to be observed, it is not possible to exclude by terms of contract the effects of frustration by supervening illegality. Under this theory, regardless of the content of a force majeure clause, a contract will be discharged when supervening illegality occurs. Thus, in Ertel Bieber Co. v. Rio Tinto Co. Ltd250 the contract expressly provided that only the outbreak of war would suspend certain contractual obligations. However, The House of Lords decided according to public policy considerations, to discharge the contract. Specifically, The House of Lords held that suspension of contractual obligation would still imply trading with the enemy251. The court was of the

249See the discussion "The Practice of International Business Contracts Concerning Force Majeure" in U. Draetta, R. B. Lake & V.P. Nanda, supra, note 222, at 92-96; see also K.-H. Böckstiegel, "Hardship, Force Majeure and Special Risks Clauses in International Contracts" in N. Horn, ed., supra, note 220, at 168-169
251Lord Sumner explained why the suspension clause was held to be against public policy and void, obviously pointing out that every continuing communication with the enemy would be giving aid to the enemy economy during wartime. Lord Sumner asked: "If upon public grounds on the outbreak of war the law interferes with private executory contracts by dissolving them, how can it be proper to a subject for his private advantage to
same opinion when it explained, in the case of *Constantine Line v. Imperial Smelting Corporation*\(^{252}\), that discharge by supervening illegality, unlike frustration by supervening impossibility, is not dependent on the express terms and the surrounding circumstances of the contract\(^{253}\). Obviously, then, the importance of public policy incentives in cases of supervening illegality should not be disregarded, since it may distinguish supervening illegality from other cases of frustration or force majeure. In contrast, however, when a contract stipulates that the obtaining of an export licence is an absolute obligation of one contractual party, such an explicit obligation may exclude frustration by supervening illegality as a basis for discharge of a contract.

In some situations, the parties may even wish to provide for a extension period, in order to avoid automatic and total discharge of their contract. Indeed, it has been suggested that international trade prefers flexible solutions instead of clear-cut solutions, such as discharge. Thus, a detailed force majeure clause often embraces two solutions—first, an extension of the time for performance, and second, discharge of the contract, if a force majeure event continues to prevent performance beyond the end of the extended period.

Although the parties can, in general, freely stipulate a force majeure clause in their contracts, often they prefer to choose one of the numerous standard clauses provided by international treaties and organizations. It is significant that supervening illegality is not always explicitly included in a list of force majeure events.

 withdraw his contract from the operation of the law and claim to do what the law rejects, merely to suspend where the law dissolves?" See *ibid.*, at 286
\(252\)See *Constantine Line v. Imperial Smelting Corporation* [1942] A.C. 154
\(253\)Viscount Simon L.C. per curium in *Constantine Line v. Imperial Smelting Corporation* [1942] A.C. 154, at 163: "Discharge by supervening impossibility is not a common law rule of general application, like discharge by supervening illegality; whether the contract is terminated or not depends on its terms and the surrounding circumstances in each case."
The Vienna Convention\textsuperscript{254}, as already mentioned, does not use the term force majeure at all, nor does it give a list of force majeure events. However, it does clearly define three conditions which cause an exemption: the event has to be beyond the control of the party; it has to be unforeseeable, and finally, not only the event, but its consequences, should be unavoidable.

\textbf{Article 79.}

"(1) A party is not liable for a failure to perform any of his obligations if he proved 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."

In other words, the Convention covers supervening illegality even though it is not explicitly mentioned. The treaty, in fact, developed a concept of impediments, but it failed to provide a definition of the term, or a list of examples of impediments. It is usually interpreted very broadly in order to include both cases of absolute impossibility and cases in which the performance becomes too onerous because of changed circumstances\textsuperscript{255}. Thus, impediment is understood as including: war, blockade, fire, flood, earthquake, sabotage, government prohibition, or any other event which satisfies the three above requirements.

In practice, force majeure clauses do not necessarily share the same characteristics even if drafted by the same organization and based on the same concept. For instance, the force majeure clauses included in the United Nations Economic


\textsuperscript{255}J. Hannorld, \textit{Uniform Law for International Sales} (Deventer: Kluwer Law and Taxation Publishers, 1982) at 443
Commission for Europe's (E.C.E) contract models No. 188, 188A, and 1A for international business people involved in the supply of plants differ significantly.

Clause 10.1. (E.C.E. Contract No. 188);
Clause 25.1. (E.C.E Contract No. 188A)

"The following shall be considered as cases of relief if they intervene after the formulation of the contract and impede its performance: industrial disputes and any other circumstances (e.g., fire, mobilization, requisition, embargo, currency restrictions, insurrection, shortage of transport, general shortage of materials and restrictions in the use of power) when such other circumstances are beyond the control of parties."

Clause 19. (E.C.E Contract No. 1A)

"[W]here the fulfillment of the contract in whole or in part is rendered absolutely and permanently impossible by exceptional circumstances beyond the control of the parties and arising after the conclusion of the contract, the contract of the unfulfilled part thereof shall be cancelled but neither party shall be liable to pay damages."

It is obvious that two different methods are applied in preparing these clauses. The first model, as in contracts no. 188 and 188A, uses the older method of listing, applicable according to the so-called normative test. Listing can have the disadvantage of being exhaustive unless specified otherwise, but contract no 188 and 188A do alleviate this by

---


257 Professor Schmitthoff finds that two methods can be used in a regulation of force majeure clauses. The older test is the so-called normative and it rely on a list of events included into a force majeure clause, as a basis for courts' decision whether a particular event would be considered as a frustration event or not. A modern test is the so-called quantitative, which simply relies of the courts findings on whether a fundamentally different situation occurred because of supervening event, and whether such an event was unusual and beyond the control of the parties. See C. Schmitthoff, *supra*, note 188, *Frustration of International contracts of Sale in English and Comparative Law*, at 267.
stipulating that the list is non-exhaustive. In contrast, the clause in the contract no. 1A provides only general wording—exceptional circumstances beyond the control of the parties—adopting what is called the qualitative test\textsuperscript{258}. Here, it is obvious not only that the circumstances must be beyond the control of the parties, but also that the intervening circumstances must arise after the formation of the contract. Government activities are expressly included in the list provided by the first, older model of contracts, while they are omitted from the second, since no specific circumstance need be mentioned.

Finally, there are the typical force majeure clauses that have been progressively developed in international practice amongst traders in specific goods, often organized into some industry associations. For instance, contract no. 100 drafted by the Grain and Feed Trade Association (GAFTA)\textsuperscript{259} follows the concept of the E.C.E. clauses in contracts no. 180 and 180a.

Clause 22.

"[S]ellers shall not be responsible for delay in shipment of the goods... occasioned by any Act of God, strike, lockout, riot or civil commotion, combination of workmen, breakdown of machinery, fire of any cause comprehended in the term force majeure...."

Notwithstanding the above listing of force majeure events used by the GAFTA in its model clause, it could be concluded that international treaties and documents include among supervening events government interventions—such as export and import licences, nationalization, or embargoes. Further, a dominant tendency in contractual regulation of the force majeure clause in modern trade is to provide that supervening events should first cause a delay in the performance, only after which should there be a termination of the whole contract.

\textsuperscript{258}Ibid.
\textsuperscript{259}Taken from B. J. Cartoon, supra, note 248
5.2. Drafting of Force Majeure Clauses

Appropriate choice of drafting technique helps the parties both to define precisely the situations in which they can be discharged from further performance and to allocate risk of loss caused by non-performance. Assuming that the parties choose a force majeure clause in order to avoid a regime of supervening illegality provided for in the applicable law (primarily automatic and total discharge of contract) this thesis advocates the so-called two-step drafting method—first, it is necessary to specify events which constitute force majeure, and second, the legal consequences of non-performance have to be determined. The later step relates to the outcome of the contract itself and to the principles of allocation of loss.

In essence, the parties determine in the first step the specific events that constitute force majeure. As previously explained, two tests could be used when this first part of the clause is drafted. The normative test involves listing all events which possibly constitute force majeure\(^{260}\). The main characteristic of this older method is that events of force majeure are only those included in a list drafted by the parties themselves. Thus, the advantage is that the parties are free to put on a list even those events which the applicable law does not consider force majeure. On the other hand, the content of such a list depends greatly upon the parties' foreseeing certain events. However, it is always possible that something unpredictable prevents a performance, yet courts' and arbitrators' interpretation according to the normative test is likely to be strict and narrow, without application of the principle of the *ejusdem generis*\(^{261}\). In short, unpredictable events not on the list will not be considered force majeure. There is an exception, however: as already explained, supervening illegality is a unique situation because of related public policy considerations.

\(^{260}\)See C. Schmitthoff, at footnote 257

\(^{261}\)Under the rule *ejusdem generis* (of the same kind) the interpretation is given according to the assumption that the parties intended to include only events similar to the ones enumerated
Since courts and arbitrators always consider public policy in cases of supervening illegality, in such cases a contract can be discharged notwithstanding the express terms or the list of force majeure events which exclude supervening illegality.

An alternative to a listing supervening events is the qualitative test—only a short reference to the event is given (circumstances impeding a reasonable performance, circumstances generally recognized as force majeure, beyond the control of a party, or due to force majeure), and courts or arbitrators will have to resolve any uncertainty concerning the content of the clause under the proper law of the contract. For these reasons, parties should be aware of differences between the civil law concept of force majeure, and the common law doctrine of frustration. Preferably, they will have to take into consideration the prevailing judicial practice or interpretation of broadly formulated force majeure clauses, before starting to draft their own clause. In the many cases that have involved a broad and vague force majeure clause, courts and arbitrators have relied on solutions provided by national laws or legal doctrine (usually the classical concept, established on three conditions) instead of on the intentions of parties and the actual provisions of their contracts. This approach has been affirmed in many awards rendered by ICC arbitrators\(^{262}\). One such case has already been mentioned in Chapter 3—that case arose from a contract for oil exploration concluded between a Libyan and an American company\(^{263}\). In brief, the contract was expressed to be subject to Libyan law and included the ICC arbitration clause together with the following force majeure clause:

\[\text{Article 22.1.} \]

"Any failure or delay on the part of a Party in the performance of its obligations or duties hereunder shall be excused to the extent attributable to force majeure. Force majeure shall include, without limitation: Acts of


\(^{263}\)See Chapter 3, the ICC case no. 4462 of 1985
God, insurrection, riots, war, and any unforeseen circumstances and acts beyond the control of such Party”.

Problems arose when the American company, in December 1981, informed the Libyan partner that due to a US Government Passport Order from the 9th of December 1981, which prevented US citizens from travelling to Libya, Sun Oil would suspend its performance and invoke the force majeure clause. The next problem appeared only a few months later, in March 1982, when the US Government Regulation limiting exports to Libya was enacted. The Regulation covered all export of American technical equipment and data. Sun Oil informed the Libyan side that the licence for export of technical information was denied in June 1982 and that the company thus had to continue to invoke the force majeure clause. Finally, the Libyan company initiated ICC arbitration.

Even though it was held that the broad force majeure clause clearly included government orders and regulations as events that could excuse parties from performance\textsuperscript{264}, the arbitrators examined in depth not only the wording of the clause, but all conditions related to the nature of the supervening event and its effects on the contract. Primarily, the tribunal was concerned with the impossibility of performance as objective and absolute. Accordingly, the tribunal found that the Passport Order should not be interpreted to be an event of force majeure, because the American company was not obliged by any article of the contract to only send US citizens to Libya. Since the company had personnel with non-US passports, replacements could have been found. As for the Export Regulation, the arbitrators found, again, that the consequences could have been avoided. They explained that the prohibition against exporting technical equipment and data from the US to Libya did not constitute an absolute impossibility since the company had enough time to find somewhere else in the oil market an adequate substitute from other companies, even from its affiliated companies.

\textsuperscript{264}The case no. 4462 was published in Yearbook of ICCA XVI, 1991, at 54 and detailed analysis of a force majeure clause is given at 57-68
The above circumstances illustrate that two overriding factors may be added. Even if some of the events included in a force majeure clause occur, this does not automatically ensure that the force majeure clause will be operative. The arbitrator may examine whether the event really makes the obligations impossible to fulfill or not. Secondly, the arbitrators will carefully scrutinize the activities of the non-performing party, in order to make sure that the party did everything that a reasonable person would do to prevent the event from happening. In this case the arbitrators found that the answer to both questions was negative.

The second step is related to the consequences of the appearance of the force majeure event. International contracts are often complex, long-term transactions, involving significant investments in kind or/and in money, and parties will generally prefer to extend the period for performance than automatically terminate the contract whenever the supervening event occurs. Thus, they can draft an extension period, allowing a delay for a certain number of days or months, only after which should the contract be deemed terminated. As already mentioned, this drafting technique has already been widely accepted by international traders and their associations. However, the parties should draft this option carefully, not assuming that all supervening events will cause minor delays. In addition, the parties must precisely define their behavior during a delay period. First, the party who is seeking an extension period has to be obliged to give proper notice of the occurrence of a force majeure event. It is usually provided in international contracts that if proper notice is not provided, the party who failed to perform loses the right to rely on the force majeure clause. It has been already mentioned that the parties in the contract itself stipulate the degree of liability (absolute or only due diligence). Furthermore, the force majeure clause itself has to define the obligation of the delaying party to try to overcome force majeure. This usually involves such party in "taking all reasonable measures in order to continue performance". Second, the party that has received the notice should be obliged to restrain from any act that could make the event permanent. Professor Schmitthoff
defines this obligation simply, as the "general duty of the parties (reasonably) to co­operate to save and carry out the common venture of their contract."265. Such an allocation of obligations will simply make contractual parties responsible for keeping the contract alive, even when it has been temporarily delayed.

The above-mentioned second step in drafting a force majeure clause also includes a decision by the parties on the allocation of risk and the remedies to be made available for non-performance. The parties here have to formulate an answer to the question of what should be done after the excuse for non-performance is granted. From the analysis provided in Chapters 2 and 3, with respect to remedies for the breach of contracts caused by non-performance, if there is no commenced performance at all, the general rule is that the parties will be left in the positions they were at the time of frustration. However, the problem appears when one of the parties has entirely or partially performed its contractual obligations. Again, national laws and relevant doctrinal solutions suggest as a main remedy restitution, on the grounds of unjust enrichment. The question here is whether the parties may decide differently in their own contract. Is it possible to use a force majeure clause in order to define other legal consequences of supervening illegality? If so, what would be the remedies for the aggrieved party other than those provided under the general law? In arriving at the answer to this question it is necessary to emphasize that the force majeure clause provides an excuse from non-performance on the basis of lack of fault on behalf of the non-performing party. Accordingly, if there is fault, there could be damages for the aggrieved party. As to the costs and loss which may appear because of one-sided performance, force majeure clauses commonly used in international practice do not provide any specific remedy. More often, the question is addressed by special contractual clauses related to excepted risks or special risks.

265 See C. Schmitthoff, supra, note 85, at 275
In conclusion, the main advantage of a force majeure clause regulating supervening illegality is that it provides the possibility of avoiding automatic and total discharge of a contract. Instead, an extension period allows a contract to be kept alive. Furthermore, a force majeure clause allows the parties to give the effect of force majeure events to certain situations to which the applicable law does not apply the doctrine of frustration or force majeure. This includes situations in which performance may have not become absolutely impossible in a strict sense, but only burdensome or economically impracticable. In addition, the burden of proving the existence of supervening illegality is placed on the party who relies on it, as an excuse for non-performance. A further condition is the giving of proper notice to the other party upon the occurrence of supervening illegality. Failure to provide such notice will result in the force majeure clause being unavailable as an excuse. As well, the party seeking an excuse for non-performance is obliged to undertake every measure necessary to continue performance. This obligation should be seen as an explicit rejection of force majeure clause excuses in situations of self-induced non-performance. At the same time, the other party will have a separate obligation to co-operate. Finally, it should be noted that a force majeure clause is not traditionally used in international trade as a basis for renegotiation or adaptation of a contract to changed circumstances. Such solutions are provided for in so-called hardship clauses.

5.3. The Hardship Clause

As already explained, the hardship clause is a clause that adapts contractual obligations primarily according to changed circumstances.\textsuperscript{266} It is important to

\textsuperscript{266} For detailed discussion see U. Draetta, R. B. Lake & V. P. Nanda, \textit{supra}, note 222, at 195-207; D. Yates, \textit{supra}, note 200, at 186-188 and 207-209; H. Strohbach, \textit{supra}, note
notice that hardship clauses are usually used to cover cases that include events such as wars, embargoes, government acts, strikes, import or export prohibitions, and similar situations usually included in force majeure clauses. In addition, a hardship clause is useful in situations in which a supervening event is not absolutely unforeseeable, and performance is not absolutely impossible, but rather economically impractical. In brief, the two clauses differ significantly with respect to their effect on contracts—a force majeure clause terminates the contract and excuses the liability of a non-performing party, while a hardship clause adapts the contract. For these reasons, and especially in the light of the fact that some national laws impose strict requirements with respect to force majeure defences, a hardship clause should be considered as a proper solution for parties in international trade.

As far as the structure of hardship clauses is concerned, there are some similarities with force majeure clauses. First, a hardship clause consists of two parts. The first part provides a list of events or circumstances seen as hardship events. The second part defines the procedure when a stipulated event occurs. This procedure also includes two steps. Normally, the parties will first provide for renegotiation of the contract by the parties themselves; and only after failing to achieve a solution by this means, will they undertake the second step—adaptation to the changed circumstances. This latter step will


267Typical hardship clause provides: If during performance of this Contract there should arise economic, political or technical circumstances which were unforeseen by the parties and are beyond their control, and which make performance of the Contract so onerous (though not impossible) for one of the parties that the burden would exceed all the anticipatory provisions made by the parties at the time the Contract is signed, such affected party shall be entitled to equitable relief, and may request the revision of the Contract. The parties will discuss the matter, and if an amicable solution cannot be reached, the affected party may request arbitration of the matter in accordance with the arbitration clause of this Contract. See U. Draetta, R. B. Lake & V. P. Nanda, supra, note 222, at 194
usually involve a third party in the problem-solving procedure. This could be a court or an arbitrator. Since the applicable law sometimes does not allow courts to assist in adaptation, parties in international trade generally would rather address this issue through arbitration and choose as the applicable law, one that allows adaptation of contracts.

Hardship clauses are sometimes taken as being similar to force majeure clauses regarding rights and obligations imposed on contractual parties when a supervening event occurs. For example, hardship clauses should also contain an obligation on the part of a non-performing party to give proper notice to the other party and to prove that the hardship event will make the contract more onerous\textsuperscript{268}. The time limit provided for invoking a hardship clause should be fixed (some period after the appearance of a hardship event). As far as supervening illegality as a hardship event is concerned, the effects of a hardship clause are also limited by the rules of the applicable law. In other words, public policy considerations must be considered. It is hard to say whether all cases of supervention would allow for the renegotiation or adaptation of a contract instead of discharge. For instance, in the \textit{Fibrosa} case, when the supervening event was the trading with the enemy prohibition, the Court held that the contract had to be discharged, since the Polish territory was occupied by the Germans, who had already been declared enemies of England. Any suspension of the contract and renegotiation were held to constitute cooperation with the enemy.

In conclusion, it is debatable whether parties should decide to draft a hardship clause or a force majeure clause. Indeed, some authors—Ugo Draetta, Ralph

\textsuperscript{268} ICC Doc, No. 460/277 of June 28, 1982 provides the following hardship clause: "1. Should the occurrence of events not contemplated by the parties fundamentally alter the equilibrium of the present contract, thereby placing an excessive burden on one of the parties in the performance of its contractual obligations, that party shall be entitled to request a revision of the present contract. Such request shall be made to the other party within a reasonable time from the moment the requesting party becomes aware of the event and of its effect on the economy of the contract. The request shall indicate the grounds of revision. Failing such communication, the interested party shall be barred making any request under this clause."
Lake, Ved Nanda and Norbert Horn, to mention a few—find it difficult to distinguish between force majeure and hardship clauses in international trade. It appears from the above study of these two clauses that the difference in legal effects is the most important distinction—the force majeure primarily aiming to discharge the contract, while the hardship attempts to modify it. From the perspective of the allocation of loss, the force majeure clause provides an only limited remedy. Remedies are in fact limited to restitution. In hardship situations, on the other hand, not only can the original allocation of loss provided for in the contract be completely changed and voluntarily modified to new circumstances, but the allocation of contractual rights and duties can also be modified. Since such changes may occur, it should come as no surprise to learn that adaptation itself is usually referred to arbitrators. In that situation, an award rendered by arbitrators according to the rules of the applicable law will represent a settlement of a dispute. Aside from the applicable law a part of the basic framework for the arbitrators' jurisdiction will be the arbitration clause, which usually appears as alongside the hardship clause.

5.4. The Arbitration Clause

If the contract is silent on the issue of modification, a dilemma arises as to whether the arbitrators may adapt the contract according to changed circumstances. Undoubtedly, the authority to make a decision upon a dispute should be defined by the parties' agreement. However, when there is nothing in the contract or the arbitration clause about adaptation of the contract, the arbitrators will look for an answer in the law

\[269^U. Draetta, R. Lake & V. Nanda supra, note 222, at 178\]
\[270^N. Horn, supra, note 220, at 26\]
applicable to the contract, and probably in judicial practice and customary law as well. Because the relevant question here is whether the arbitration award produces an adaptation of the contract or an altogether new contract, which may no longer reflect the original intentions of the contracting parties, the original contract should specify the terms of the arbitration, so as to safeguard the interests of each party. The authority of arbitrators to decide on termination and a claim for damages is widely accepted, but the ability of arbitrators to adapt contracts is often constrained.

271 Most often arbitration clauses are silent on the rules of adaptation. They define scope of jurisdiction of arbitrators broadly, sometimes even vague. For instance, some institutional arbitration rules on arbitration define the rules of arbitrators as follow:

i. American Arbitration Association
"Any controversy or claim arising out of or relating to this agreement, or the breach thereof, shall be settled by arbitration in accordance with the Commercial Arbitration Rules and supplementary procedures for international commercial arbitration of the American Arbitration Association, and judgment upon the award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof."

ii. International Chamber of Commerce
"All disputes arising in connection with the present contract shall be finally settled under the Rules of [Conciliation and] Arbitration of the International Chamber of Commerce by one of more arbitrators appointed in accordance with the said Rules."

iii. International Centre for the Settlement of Investment Disputes
"The parties hereby consent to submit to the International Centre for Settlement of Investment Disputes any dispute relating to or arisen out of this Agreement for settlement by arbitration pursuant to the Convention on the Settlement of Investment Disputes between State and Nationals of Other States."

iv. London Court of International Arbitration
"Any dispute arising out of or in connection with this contract, including any question regarding its existence, validity or termination, shall be referred to and finally resolved by arbitration under the Rules of the London Court of International Arbitration, which Rules are deemed to be incorporated by reference into this clause."

v. UNCITRAL Arbitration Rules
"Any dispute, controversy or claim arising out or relating to this contract, to the breach, termination or invalidity thereof, shall be settled by arbitration in accordance with the UNCITRAL Arbitration Rules as at present in force."

In addition, the rules regarding adaptation of contracts as provided in national laws are explained in several occasions in this paper referring to theories of frustration, l'imprévision, Wegfall der Geschäftsgrundlage in the major common and civil law systems; see discussion in Chapter 3.2.(iii)
In order to avoid these controversies, the parties can always expressly provide in their contractual provisions for the adaptation principles that apply in case of a supervening event or changed circumstances. This has been proposed by many scholars and practitioners, who also suggest the application of the alternative solutions offered by international organizations\textsuperscript{272}. Proposed solutions include the mechanism for adaptation provided in the ICC Rules on the Regulation of Contractual Disputes\textsuperscript{273}. The principle is established in ART. 1. 2. and 3. of the ICC Rules that parties should entitle the third person (arbitrator or mediator) or a three-member board to modify the contract as they think appropriate.

In the absence of express provisions or even terms of reference on adaptation, the arbitrators will generally try to avoid disturbing the \textit{pacta sunt servanda} rule. They will decide within the framework of available remedial modalities, awarding restitution if possible. This might be a rigid solution and inappropriate in the case of some international contracts. Indeed a great concern of arbitrators with respect to the possibility of enforcement of the award should be observed as well. Without the clearly expressed intention of to handle adaptation through arbitral proceedings, arbitrators may found that any adaptation of a contract would be outside the scope of their mandate. Consequently, the recognition and enforcement of such an award may be refused\textsuperscript{274}.

\begin{footnotes}
\item[272] The most recent study on the issue is published by U. Draetta, R. B. Lake & V. P. Nanda, \emph{supra}, note 222.
\item[273] \emph{Adaptation of Contracts (Rules on the Regulation of Contractual Disputes)}, ICC Document No. 326 (1978).
\item[274] Article V(1)(d) of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) 1958: "1. Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that: (d) The composition of the arbitral authority of the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place"
\end{footnotes}
Some concerns with respect to adaptation of international contracts frustrated by supervening illegality derive from the public policy arguments attached to changes in laws and regulations. The mere fact that many legal scholars refer to the influence of public policy objectives in changed laws or surrounding circumstances suggests that arbitrators may also sometimes be reluctant to adapt contracts unless there is a strong justification to modify private relations according to new public interests. As a result of this perceived reluctance, it is not surprising that arbitrators usually limit their authority to adapt contracts to rendering restitutionary awards.

275See explanation provided by G. H. Treitel, supra, note 8, and footnote 37
Supervening illegality in the form of government intervention in private international commercial agreements remains an issue insufficiently addressed in legal theory. Within the context of the common law doctrine of frustration and the civil law doctrine of force majeure, supervening legal impossibility of performance has been taken as a basis for automatic and total discharge of a contract and as an excuse from liability for a non-performance of the parties. Aimed mainly at restoring the parties' bargaining positions to what they were before the supervening illegality, these concepts do not always support the economic interests of the parties in continued contractual relations because they do not allow for adaptation of the contract to new surrounding circumstances. Indeed, one of the most crucial problems in maintaining the equilibrium of the original contracts affected by supervening illegality (that is, the problem of remedy in the case of one-sided performance) is in practice based on only one widely recognized remedy—restitution on the grounds of unjust enrichment. This remedy should be observed as an attempt to maintained the original contract more than the new situation. But, the idea that neither party should be allowed to profit or to suffer a loss as a result of the supervening event may be observed to determine what is fair in the situation of the new surrounding circumstances. Then, the same idea may be a guidance to adaptation of the contract.

This thesis has examined supervening illegality in the context of international contracts. The reasons for a study of international contracts have been explained in the Introduction to the thesis—the greater degree of insecurity with respect to changes of business environment (political, social and economic disturbances). this insecurity owes its existence to a greater degree of variables: the nationality of the parties
especially the position of a state or a state-owned company as a party), the choice of law (national or international sets of rules as the applicable law), or the choice of forum for dispute resolution (courts or arbitrators). The basic premise was that a solution to the problem of supervening illegality is of great practical importance for international traders, for the emergence of a global world market, and for the establishment of widely recognized international sets of rules on international trade. Thus, the survey was primarily aimed at examining the advantages and disadvantages of principles, applied by courts or arbitrators, as provided within two frameworks—the traditional concepts of national laws (doctrines of frustration and force majeure), and the concepts of international treaties and contract models drafted by international organizations.

According to prevailing international practice and legal opinion, the appearance of supervening illegality in international trade leaves international business without a clear answer to the dilemma of termination or survival of the contract. Choosing the latter, the parties will be faced with the problems of adaptation of contracts to changed circumstances in accordance with the limited possibilities provided by the rules of applicable law and by public policy considerations which inevitably have to be observed whenever an issue of change in laws appears. Even though modern international contractual practice shows a strong preference for the survival of the contract (two-step procedure of the force majeure and hardship clause, providing extended delay periods or renegotiation before termination), it is still possible that a contract affected by supervening illegality will be discharged because of public policy considerations, despite the existence of express or implied contractual provisions. Indeed, many cases in this study illustrate that public interests usually outweigh private interests in international trade, whether these public interests are recognized as national or international public interests.

As Chapter 2 of this thesis illustrates, although supervening illegality as a ground for discharge of contracts on the basis of national or international public policy may represent different types of impossibility, the final effect on private contracts will
always be the same. Those public policy principles will necessarily impair individual contractual freedom and make private contracts fully or partially void.

Since the international transaction will be governed by the set of rules freely chosen by the contractual parties (national or international sets of rules) it is possible to conclude that this choice contributes a great deal to the stability of the contract as well. International sets of rules, the *lex mercatoria*, attempt to promote and enforce as general principles both *pacta sunt servanda* and *rebus sic stantibus*. These model rules promote negotiation in good faith to overcome all unforeseen difficulties, including supervening illegality. As far as supervening changes in international rules are concerned, it has been shown in this paper that they are rarely really "supervening" or unpredictable compared to the degree of unpredictability in regard to changes of national laws. Moreover, international treaties (such as the Vienna Convention, the New York Convention, or the Charter of the United Nations, to mention a few) and international organizations (the GATT or its successor, the WTO) encompassing in an autonomous body of rules international custom, general principles of law and arbitral practices, are aimed at establishing international economic relationships based on principles of cooperation and other recognized rules are constantly followed by the majority of countries. As a unique legal order, *lex mercatoria* has also become a source for national legislation and judicial practice as well. For all these reasons, this thesis advocates the application of internationally agreed rules as the most appropriate framework for international business people and their transactions, at least as far as effects of supervening illegality on contracts are concerned.
BIBLIOGRAPHY:

A. Books:

Böcksteigel K.-H. Arbitration and State Enterprises: Survey on the National and International State of Law and Practice (Deventer: Kluwer Law and Taxation, 1984);
Burrows A. S. Remedies for Torts and Breach of Contracts (London: Butterworth, 1987);
Boyle C. & Percy D.R. Contracts: Cases and Commentaries (Scarborough: Carswell, 1994);
Castel J.G., The Canadian Law and Practice of International Trade (Toronto: Edmond Montgomery Publications Ltd., 1991);
Christou R. International Agency, Distribution and Licensing Agreements, (London: Longman Group UK Ltd., 1986);
Craig W.L., International Chamber of Commerce Arbitration (New York: Oceana Publishers, 1985);
Park W.W. & Paulsson J. Arbitration in International Trade (Deventer: Kluwer Law and Taxation Publishers, 1986);
David R. Major Legal Systems in the World Today (London: Stevens, 1985);
Dobbs D.B. Domke on Commercial Arbitration (Illinois: Callaghan & Co., 1984);
Domke M.
Breach and Adaptation of International Contracts, An
Introduction to Lex Mercatoria (London: Butterworth, 1992);
United States Contract Law (New York: TN Juris Publications Inc., 1991);
Farmsworth on Contracts (Boston: Little Brown and Company, 1990);
Laissez Faire and the General Welfare State (Ann Arbor: University of Michigan Press, 1956);
Law of Contract, 2nd ed. (Scarborough: Carswell, 1986);
International Commercial Agreements, A Functional Primer on Drafting, Negotiating and Resolving Disputes (Deventer: Kluwer Law and Taxation Publishers, 1988);
The Death of Contract (Ohio: Ohio State University Press, 1974);
Commercial Law (Harmonsworth: Penguin Books, 1982);
Lex Mercatoria: Lectures (Deventer: Kluwer Law and Taxation Publishers, 1983);
The Philosophical Origins of Modern Contract Doctrine (Oxford: Claredon Press, 1991);
Contract Law Today (Oxford: Clarendon Press, 1989);
The Framework of Economic Activity (London: Macmillan, 1967);
National Constitutions and International Economic Law (Deventer: Kluwer Law and Taxation Publishers, 1993);
The Transnational Law of International Commercial Transactions, (Deventer: Kluwer Law and Taxation Publishers, 1982);
The Transformation of American Law, 1870-1960 (Oxford: Oxford University Press, 1992);
Soviet Civil Law (Dordrecht: Marinus Nijhoff Publishers, 1988);
Comparative Report on Force Majeure in Western Europe, (Helsinki: The Union of the Finnish Lawyers Publishing Company Ltd., 1982);
Introduction to French Law (Oxford: Clarendon Press, 1967);
<table>
<thead>
<tr>
<th>Author</th>
<th>Title and Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leibesny H.J.</td>
<td><em>Foreign Legal Systems: A Comparative Analysis</em> (George Washington University, 1981);</td>
</tr>
<tr>
<td>Lewis A.</td>
<td><em>Principles of Contract and European Commercial Law</em> (Kent: Tudor Business Publishing Ltd., 1992);</td>
</tr>
<tr>
<td>Lloyd D.</td>
<td><em>Public Policy, A Comparative Study in English and French Law,</em> (London: The Athlone Press, 1953);</td>
</tr>
<tr>
<td>McElroy R.G.</td>
<td><em>Impossibility of Performance</em> (Cambridge: Cambridge University Press, 1941);</td>
</tr>
<tr>
<td>McNair</td>
<td><em>Legal Effects of War,</em> 3rd ed., (Cambridge: Cambridge University Press, 1948);</td>
</tr>
<tr>
<td>Mehren von A.T. ed.</td>
<td><em>International Encyclopedia of Comparative Law,</em> vol. 7 (Tübinen: J.C.B. Mohr, 1981);</td>
</tr>
<tr>
<td>Nicholas B.</td>
<td><em>Canadian Regulation of International Trade and Investment</em> (Toronto: Carswell, 1986);</td>
</tr>
<tr>
<td>Paterson R.K.</td>
<td><em>International Trade and Investment Law in Canada,</em> (Scarborough: Carswell, 1994);</td>
</tr>
<tr>
<td>Redfern A. &amp;</td>
<td><em>Law and Practice of International Commercial Arbitration,</em> (London: Sweet &amp; Maxwell, 1986);</td>
</tr>
<tr>
<td>Hunter M.</td>
<td><em>ICCA Congress Series,</em> no. 3 (The Hague: Kluwer Law and Taxation Publishers, 1987);</td>
</tr>
<tr>
<td>Sanders P. ed.,</td>
<td><em>International Contracts and Conflicts of Laws</em> (London: Graham &amp; Trotman/Martinus Nijhoff, 1990);</td>
</tr>
<tr>
<td>Schmitthoff C.</td>
<td><em>International Contracts</em> (New York: Parker School of Foreign and Comparative Law, Columbia University, 1981);</td>
</tr>
<tr>
<td>Schmitthoff C.</td>
<td><em>Rights in Conflict; The United Nations and South Africa,</em> (New York: Transnational Publishers Inc., 1994);</td>
</tr>
<tr>
<td>N.S. Galston &amp;</td>
<td><em>Frustration and Force Majeure</em> (London: Sweet &amp; Maxwell, 1994);</td>
</tr>
<tr>
<td>S.L. Levitsky, ed.</td>
<td></td>
</tr>
<tr>
<td>Sohn L.B.</td>
<td></td>
</tr>
</tbody>
</table>
Treitel G.H. *Outline of the Law of Contract* (London: Butterworths, 1975);  
Vagts D.F. *Transnational Business Problems* (New York: The Foundation Press, 1986);  
Webber G. J. *The Effect of War on Contract*, (London: The Solicitors' Law Stationery Society, Ltd., 1946);  
Yiying S. *A Handbook on the Procedures of International Trade*, (Beijing, 1985);  

B. Articles:

Aubrey M.D. *Frustration Reconsidered—Some Comparative Aspects* (1963) 12 International and Comparative Law Quarterly 1165;  
Has Mexico Crossed the Border on State Responsibility for Economic Injury to Aliens? Foreign Investment and the Calvo Clause in Mexico After the NAFTA (1994) 25:3 St. Mary's Law Journal 1147;


The Calvo Clause in Latin American Constitutions and International Law (1950) 33:4 Marquette Law Review 205;


Frustration and Solution in German Law (1961) 10 American Journal of Comparative Law 348;


The Lex Mercatoria in International Commercial Arbitration (1985) 34 International Commercial Law Quarterly 747;


The Scope of Compulsory Contracts Proper (1943) 43 Columbia Law Review 589;


Lex Mercatoria: An Arbitrator's View (1990) 6 Arbitration International 133;


McNair
The General Principles of Law Recognized by Civilized Nations
[1954] British Yearbook of International Law 1;
Melis W.
Force Majeure and Hardship Clauses in International Commercial
Contracts in View of the Practice of the ICC Court of Arbitration
(1984) 1:3 Journal of International Arbitration 213;
Mustill, Lord
The New Lex Mercatoria: The First Twenty-Five Years (1988) 4
Arbitration International 99;
Myers J.J.
Government Influence on International Construction Contracts
(1985) 13 International Business Lawyer 105;
Newman J. D.
Exchange Controls and Foreign Loan Defaults: Force Majeure as
Perovic S.
The Influence of Public Order on Validity of Contracts (Uticaj
javnog poreta na punovaznost obligacionih ugovora), Arhiv za
pravne i društvene nauke br. 3, Beograd, 1983;
Puelinckx A.H.
Frustration, Force Majeure, Imprécision, Wegfall der
Geschäftsgundlage, Unmöglichkeit and Changed Circumstances;
A Comparative Study in English, French, German and Japanese
Law (1986) 3:3 Journal of International Arbitration 47;
Rapsomanikis M.
Frustration of Contract in International Trade Law and
Comparative Law, (1980) 18:3 Duquesne Law Review 551;
Schmitthoff C.
The Claim of Sovereign Immunity in the Law of International
Trade, (1958) 7 International and Comparative Law Quarterly 518;
Smith H.
Frustration of Contract: A Comparative Attempt at Consolidation,
(1958) 58:3 Columbia Law Review 287;
Speidel R.E.
An Essay on the Reported Death and Continued Vitality of
Stewart A.
The South Australian Frustrated Contracts Act (1992) 5:3 Journal
of Contract Law 220;
Stewart A. &
Carter J.W.
Frustrated Contracts and Statutory Adjustment: The Case For a
Strhohbach H.
Force Majeure and Hardship Clauses in International Commercial
Contracts and Arbitration: The East-German Approach (1984) 1:1
Journal of International Arbitration 39;
Thomas J.E.
Force Majeure: The Contextual Approach of the Court of Justice
White M. J.
Contract Breach and Contract Discharge Due to Impossibility: A
Wright M. E.
Changed Circumstances: Does the Outcome Remain the Same?
(1985) 59:3 Law Institute Journal 172;
Yates D.
Drafting Force Majeure and Related Clauses, (1991) 3:3 Journal
of Contract Law 186.
Table of Cases:

United Kingdom:

*Anglo-Russian Merchant Traders and John Batt & Co.'s (Londo) Ltd., Re* [1917] 2 K.B. 679

*Atkinson v. Ritchie* (1809) 10 East 530


*Bailey v. De Crespigny* (1869), L.R. 4 Q.B. 180


*B.P. Exploration Co. Lybia Ltd v. Hunt* (no. 2) [1983] 1 A.C. 352

*Brandt (H.O) & Co. v. Morris (H.N.),* [1917] 2 K.B. 784:

*British Movietonewns Ltd. v. London Cinemas* [1952], A.C. 166


*Chandler v. Webster* [1904] 1 KB 493

*Compania Naviera Vascongada v. ss. Cristina* [1938] A.C. 485

*Davis Contractors Ltd v. Fareham Urban District Council,* [1956], A.C. 696

*Duncan, Fox v. Schrempf & Bonke* [1915] 3 K.B. 355


*Esposito v. Bowden* (1857) 7 E. & B. 763

*Fibrosa Spolka Akcujna v. Fairbairn, Lawson, Combe Barbour, Ltd* [1943] A.C. 32

*Herne Bay Steamboat v. Hutton* [1903] 2 K.B. 683

*Horlock v. Beal* [1916] 1 A.C. 486

*Joseph Constantine Steamship Line Ltd. v. Imperial Smelting Corporation Ltd.* [1942] A. C. 154


*Krell v. Henry* [1903] 2 K.B. 740;

*Kursell v. Timber Operators Ltd* [1927] 1 K.B. 298

*Lebeaupin v. Crispin* [1920] 2 K.B. 714

*Matsoukis v. Prietsman* [1915] 1 K.B. 681


*National Carriers Ltd. v. Panalpina Northern Ltd* [1981] A.C. 675

*Nordenfelt v. Maxim Nordenfelt Co.* (1894) A.C. 535

*Paradine v. Jane* (1647), Aley 26

*Printing and Numerical Registering Co. v. Sampson* [1895] LR 19 Eq. 462

*Rahimtoola v. Nizam of Huderabad* [1957] 3 W.L.R. 884
Taylor v. Caldwell (1863) 3 B. & S. 826
Thornborow v. Whitacre [1706] 2 Ld. Raym. 1164
Tsakiroglou & Co. v. Noble Thörl GmgH, [1962], A.C. 93
Wilson v. Carnley [1908] I K. B. 729
Yrazy and Another v. The Astral Shipping Company [1904] 20 T.L.R. 153

2. United States:

Allied Bank International v. Banco Credito Agricola de Cartago, 757 F. 2nd 516, 522 (2nd Cir. 1985)
Chisholm v. Georgia, 2 Dall. 419, 425 (U.S.) (1793)
United States v. Lee (1882) 106 U.S. 196, 248
Revere Copper and Brass, Inc. v. Overseas Private Investment Corporation, 17 International Legal Materials (1978) 1321
Mitsubishi Motors v Soler Chrysler-Plymouth Inc. 473 U.S. 614 (1985)

3. Canada:

Oxford Realty Ltd. v. Annette (1961) O.W.N. 316 (Ont. H.C.)
Petrogas Processing Ltd. v. Westcouast Transmission Co (1988), 59 Alta. L.R.EU Case

4. European Union:

Dairyvale Foods Ltd. v. International Board for Agricultural Produce [1982], 3 C.M.L.R. 358
5. France:

F: Cass. civ. 4.12.1929, S 1931.1.49, DH 1930.50
F: Cass. civ. 5 Dec. 1910, S. 1911.I. 129
F: Cass. req. 22.1.1941, DA 1941. 163
Paris 12.5.1949, Gaz Pal 1949.2.48

6. Arbitration Awards:

ICCCase no. 2478 in 1974 by the arbitral tribunal sitting in Paris; also in ICCA Yearbook III
ICC award No. 4462
_Jordan Investment Ltd. v. Soijsneftexport_ decided in 1958 by the Foreign Trade Arbitration Commission of the USSR Chamber of Commerce
_Settebello Ltd v. Banco Total and Acores_, FT Comm LR, 21 June 1985

Table of Legislation:

Austrian Civil Code (Allgemeines Bürgerliches Gesetzbuch, ABGB), 1811
Empowment Protection (Consolidation) Act, 1978, s. 49 (U.K.)
Export and Import Permits Act, R.S.C. 1985 c. E-17
Frustrated Contracts Act, R.S.B.C., 1979, c.144
German Civil Code (Burgeliches Gesetzbuch BGB), 1896
Law Reform (Frustrated Contracts) Act, (6 & 7 Geo. 6, c.19) 1943
Rent Act, 1977, s.44 (U.K.)
Restatement (2nd) of Contracts
Russian Socialist Federated Soviet Republic (RSFSR) Civil Code, 1964
The United States Arbitration Act, Title 9, U.S.C §§ 1-14, as amended 3 September 1954 (68 Stat. 1233); Chapter 2 added 31 July 1970 (84. Stat. 692)
The United States Marine Mammal Protection Act 16 U.S.C. § 1361
Trading With the Enemy Act (2 & 3 Geo. 6, c.89) 1939
International Conventions:

General Agreement on Tariffs and Trade (GATT), 1947, 55 U.N.T.S. 308

The Convention on Settlement by Arbitration of Civil Law Disputes Arising from Relations of Economic, Scientific and Technical Cooperation (Moscow Convention) 1972


The Treaty on Eurpoean Union (Maastricht Treaty) with effect from 1 November 1993

The Warsaw Convention for the Unification of Certain Rules Relating to International Carriage by Air (Warsaw Convention), 1929, CTS 1947, No. 15