

GAP FILLING TO ADDRESS CHANGED CIRCUMSTANCES IN CONTRACT LAW – WHEN IT COMES TO LOSSES AND GAINS, SHARING IS THE FAIR SOLUTION

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1 The nature of the problem

The problem of changed circumstances arises when the factors on which contracting parties had based their consensus are fundamentally changed. This upsets the equilibrium of contractual exchange, since performance now becomes more onerous for one of the parties. The result will usually be a loss for one party and possibly even a windfall gain for the other. This issue of changed circumstances, or hardship, as it is often referred to, is dealt with by many leading Western legal systems. Countries such as Germany and the Netherlands deal with this problem in terms of their civil codes.¹ English law has the doctrine of frustration, as does the US, although discharge is far more readily permitted in the latter jurisdiction.² In the realm of international trade there are rules on hardship contained in the Unidroit Principles of International Commercial Contracts (“PICC”), as well as in the Principles of European Contract Law (“PECL”) and the Draft Common Frame of Reference (“DCFR”).³ Comparative study thus reveals that this is a widely acknowledged problem and that leading legal systems address it with their own idiosyncratic rules.

The position is different in South Africa, however. South Africa has a mixed legal system, in that it is based on a mixture of seventeenth century Roman Dutch law in the civilian tradition as well as significant tracts of English law, and also recognises the doctrine of precedent, so that these sources have

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¹ German Civil Code § 313 (*Störung der Geschäftsgrundlage* which means “interference with the basis of the transaction”); Civil Code of the Netherlands art 6:258. Other European civil law countries such as Italy, Spain, Greece, Portugal and Austria have similar provisions in their civil codes. Notable exceptions are France, Belgium and Luxembourg. See generally Lando & Beale *Principles of European Contract Law I & II* (2000) 328.

² A succinct summary of the English approach can be found in *J Lauritzen AS v Wijsmuller BV* [1990] 1 Lloyd’s Rep 1 8 (“The Super Servant Two”). For the US approach see § 2-615 of the Uniform Commercial Code and §§ 261-272 of the Second Restatement of Contracts. A good authority on both jurisdictions is Treitel *Frustration and Force Majeure* (2004).

³ Hardship is dealt with in the Unidroit Principles of International Commercial Contracts (“PICC”) art 6.2.1-6.2.; the Principles of European Contract Law (“PECL”) at art 6:111; the Draft Common Frame of Reference (“DCFR”) Book III art 1:110.

been updated by decisions of our courts over the years.⁴ South African law recognises discharge of a contract based on impossibility,⁵ but does not as a general principle address any change of circumstances which falls short of this.⁶ Comparatively our country thus lags behind other nations, in that it fails to make provision for a widely acknowledged problem. What lessons can South Africa learn from comparative study in this field and is there a solution to this problem which is appropriate to the specific requirements of the South African situation?

The first question to be addressed is a normative one, however. What is the underlying justification for having rules on changed circumstances and do these types of considerations apply in the South African context?

2 The requirement of good faith

The inclusion of the doctrine of *Störung der Geschäftsgrundlage* under the 2002 amendments to the *Bürgerliches Gesetzbuch* (“BGB”) codified the law which had arisen from academic theory and had been adopted by multiple decisions of the German courts.⁷ In its original form the doctrine was known as *Wegfall der Geschäftsgrundlage* (collapse of the foundation of the transaction) and its application was based on the general good faith provision of the BGB, which appears at § 242.⁸ This good faith basis of a change of circumstances doctrine is not unique to German law. The Dutch civil code makes the operation of its change of circumstances provision dependent upon a finding by a court that this is what “reasonableness and fairness” require.⁹ Even in the English common law, with its hesitancy to recognise good faith as an independent ground for intervention in contracts,¹⁰ the doctrine of

⁴ See generally, Zimmermann ““Double Cross”: Comparing Scots and South African Law” in Zimmermann, Visser & Reid (eds) *Mixed Legal Systems in Comparative Perspective* (2004) 1.

⁵ *Peters, Flamman and Co v Kokstad Municipality* 1919 AD 427 434; *Transnet Ltd t/a National Ports Authority v Owner of MV Snow Crystal* 2008 4 SA 111 (SCA) para 28; Van der Merwe, Van Huyssteen, Reinecke & Lubbe *Contract – General Principles* 3 ed (2007) 541; Christie *The Law of Contract in South Africa* (2006) 472.

⁶ *Hersman v Shapiro* 1926 TPD 367 at 375 - 377; *Transnet Ltd t/a National Ports Authority v Owner of MV Snow Crystal* 2008 4 SA 111 (SCA) para 28; Van der Merwe et al *Contract* 542; Christie *Law of Contract* 93, 472-473. It should be noted, however, that in the context of credit agreements, the Legislature is moving in the direction of recognising subjective impossibility of performance (or impracticability) in limited circumstances. Under s 86 of the National Credit Act 34 of 2005 a consumer may apply to a debt counsellor to be declared over-indebted. According to this section, headed “application for debt review”, a consumer may approach a debt counsellor to be declared over-indebted and his debt may be reviewed, based on his or her subjective financial position. This presents an opportunity to renegotiate a contract which has become subjectively impossible or more difficult for a debtor to perform and evidences a shift by the Legislature in the direction of allowing discharge or renegotiation of contracts struck by changed circumstances.

⁷ Markesinis, Unberath & Johnston *The German Law of Contract* (2006) 324; Lorenz “Contract Modification as a Result of Change of Circumstances” in Beatson & Friedmann (eds) *Good Faith and Fault in Contract Law* (1995) 357 370.

⁸ Markesinis et al *German Law of Contract* 322-324.

⁹ *Burgerlijk Wetboek* (“BW”) art 6:258. The formula is expressed in the original as *redelijkheid en billijkheid*. The quoted translation is taken from Warendorf, Thomas & Curry-Summer *The Civil Code of the Netherlands* (2009) 714.

¹⁰ See Brownsword “Positive, Negative, Neutral: The Reception of Good Faith in English Contract Law” in Brownsword, Hird & Howells (eds) *Good Faith in Contract – Concept and Context* (1999) 13. Brownsword identifies positive, negative and neutral views in respect of the role of good faith in English law, but notes that the majority of English lawyers favour the negative or neutral view (25).

frustration has been developed to achieve a “just and reasonable result” and “to do what is reasonable and fair”.¹¹ Indeed what emerges clearly from comparative study of rules on changed circumstances is that they have a common normative basis in what might loosely be described as a desire to do what is fair.

Consider the argument of Fried, who asserts that in an instance of frustration a gap-filling process, which seeks to make provision for the results of the occurrence of an unforeseen event, must take place.¹² In the process of apportioning losses and gains, Fried argues, the principle of sharing pertains.¹³ Another way of expressing this view might be that it is not *just*¹⁴ to hold a party bound to a contract after a frustrating event, “because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract.”¹⁵ The result of enforcing the promise would be to apportion the unforeseen losses or gains to one party alone. This would not be fair, since the burden of a change occasioned by an unforeseen event would be allocated by chance. It is for this reason that rules which address the problem of changed circumstances are generally grounded in good faith.

In the South African jurisdiction, Van Huyssteen and Van der Merwe argued in 1990 for the problem of changed circumstances to be addressed based on the demands of good faith:

“In a system of contracts based on bona fides, a contractant should be entitled to proper conduct on the part of his co-contractant. ...A change in circumstances surrounding a contract could then result in a refusal to enforce the contract or a specific term if insistence on its enforcement in spite of the changed circumstances is objectively not in good faith when the relationship between the contractants is considered.”¹⁶

Good faith is a far more contentious topic in South Africa than this extract suggests, however. In 1988 the Appellate Division (as the Supreme Court of Appeal was then known) buried the *exceptio doli generalis*, a Roman law mechanism which had been adopted in certain earlier decisions to outlaw bad faith conduct, in its *Bank of Lisbon and South African Ltd v De Ornelas* decision.¹⁷ Although Roman Dutch law had a strong grounding in good

¹¹ *The Super Servant Two* [1990] 1 Lloyd’s Rep 1 8.

¹² Fried *Contract as Promise* (1981) 69-70.

¹³ 69-70.

¹⁴ The concepts of “justice” and “fairness” will be used interchangeably in this paper. The reason for this approach is the connection drawn between these terms in *Barkhuizen v Napier* 2007 5 SA 323 (CC). In this judgment Ngcobo J stated that “[n]otions of fairness, justice and equity, and reasonableness cannot be separated from public policy” (para 51). Later the same judge stated that “[t]he concepts of justice, reasonableness and fairness constitute good faith” (para 80). It would therefore appear that the Constitutional Court views these terms as interlinked, perhaps even as synonyms importing the same general idea.

¹⁵ *Davis Contractors Ltd v Fareham Urban District Council* 1956 AC 696 729.

¹⁶ Van Huyssteen & Van der Merwe “Good Faith in Contract: Proper Behaviour amidst Changing Circumstances” 1990 *Stell LR* 244 248-249.

¹⁷ 1988 3 SA 580 (A) 607A-B. On the *exceptio doli* and its relationship with the doctrine of good faith in South African law see Zimmermann “Good Faith and Equity” in Zimmermann & Visser (eds) *Southern Cross* (1996) 217 217-236; Hutchison “Good Faith in the South African Law of Contract” in Brownsword, Hird & Howells (eds) *Good Faith in Contract: Concept and Context* (1999) 213 213-222.

faith,¹⁸ the exact status of this doctrine in modern South African law was left in considerable doubt following this case. While good faith was an underlying value of South African contract law ensuring fair performance through *inter alia* playing a role in the interpretation of contracts, it had never been an independent device capable of being directly invoked.¹⁹ This had been the role which the *exceptio doli generalis* played, giving an outlet to the good faith principle.²⁰

Soon after, however, the Appellate Division held that public policy required “the doing of simple justice between man and man.”²¹ Thus the concept of fairness in contracting was revived under the banner of public policy. Lubbe advocated equating this aspect of public policy with the concept of good faith²² and this eventually received the approval of a dissenting judge in the Supreme Court of Appeal.²³ This development was cut short by a decision of the SCA in 2002, however.²⁴ In *Brisley v Drotzky*, the majority cited the following passage by Dale Hutchison:

“[G]ood faith may be regarded as an ethical value or controlling principle based on community standards of decency and fairness that underlies and informs the substantive law of contract. It finds expression in various technical rules and doctrines, defines their form, content and field of application and provides them with a moral and theoretical foundation. Good faith thus has a creative, a controlling and a legitimating or explanatory function. It is not, however, the only value or principle that underlies the law of contract; nor, perhaps, even the most important one.”²⁵

This statement was confirmed by subsequent decisions of the SCA and that was where the matter stood for several years. In 2007 the Constitutional Court had occasion to pronounce on the issue of fairness in contracting. In *Barkhuizen v Napier*²⁶ (“*Barkhuizen*”) a clause in a standard form contract placing a time limit on when an action could be brought under that contract was challenged on the basis of the constitutional right of access to the courts.²⁷ This raised the question whether the Constitutional Court should develop the common law of contract to give effect to constitutional rights. The majority held that a constitutional challenge to a term of a contract must be brought under the banner of public policy, a concept informed by the rights

¹⁸ Zimmermann “Good Faith and Equity” in *Southern Cross* 220.

¹⁹ See for example: *Paddock Motors (Pty) Ltd v Igesund* 1976 3 SA 16 (A); *Tuckers Land and Development Corporation (Pty) Ltd v Hovis* 1980 1 SA 645 (A); *Brisley v Drotzky* 2002 4 SA 1 (SCA) para 22. See also Zimmermann “Good Faith and Equity” in *Southern Cross* 240; Barnard-Naudé “‘Oh what a tangled web we weave...’ Hegemony, Freedom of Contract, Good Faith and Transformation – Towards a Politics of Friendship in the Politics of Contract” 2008 *Constitutional Court Review* 155 176.

²⁰ See, generally, Zimmermann “Good Faith and Equity” in *Southern Cross*; Hutchison “Good Faith in the South African Law of Contract” in *Good Faith in Contract*.

²¹ *Sasfin v Beukes* 1989 1 SA 1 (A) 9E-G.

²² Lubbe “Bona Fides, Billikheid en die Openbare Belang in die Suid-Afrikaanse Kontraktereg” 1990 *Stell LR* 7 20-21.

²³ *Eerste Nasionale Bank van Suidelike Afrika Bpk v Saayman NO* 1997 4 SA 302 (SCA).

²⁴ *Brisley v Drotzky* 2002 4 SA 1 (SCA). Confirmed in *Afrox Healthcare Bpk v Strydom* 2002 6 SA 21 (SCA); *South African Forestry Co Ltd v York Timbers Ltd* 2005 3 SA 323 (SCA) para 27.

²⁵ *Brisley v Drotzky* 2002 4 SA 1 (SCA) para 22. This quotation is taken from Hutchison “Non-variation Clauses in Contract: Any Escape from the *Shifren* Straitjacket?” 2001 *SALJ* 720 743-744.

²⁶ 2007 5 SA 323 (CC).

²⁷ S 34 of the Constitution of the Republic of South Africa, 1996. *Barkhuizen v Napier* 2007 5 SA 323 (CC) para 1.

in the Bill of Rights.²⁸ Of course there was a conflict here between the right to freedom of contract, which was also protected by public policy and the competing value of fairness in contracting.²⁹ Ncgobo J ultimately held that the concept of contractual certainty had to be limited in the interests of fairness in contracting.³⁰ As far as the concept of good faith went the Constitutional Court left its status open,³¹ but clearly chose to frame its decision in the language of public policy.³²

What emerges from this decision is that the issue of fairness in contracting is waxing in South Africa. While good faith as discussed in the older cases may no longer be a viable avenue for redress, some have argued that the difference between the new public policy based value of fairness and the old concept of good faith is simply one of semantics.³³ For present purposes this means that the inequity which would result from apportioning losses and gains consequent upon an unforeseen change of circumstances by chance is now against public policy and the newly entrenched requirements of fairness. Thus the argument of Van Huyssteen and Van der Merwe has been affirmed, but the appropriate terminology for the ground of redress is fairness in contracting, rather than good faith. This is a possible means of addressing the problem of changed circumstances as argued for here, but the use of a simple discretion to discharge contracts based on grounds of fairness does not seem entirely satisfactory.

Brand has offered a different, narrower interpretation of the *Barkhuizen* judgment:

“If we have learnt anything from what happened in the past in South African courts, it is this: imprecise and nebulous statements about the role of good faith, fairness and equity, which would permit idiosyncratic decision-making on the basis of what a particular judge regards as fair and equitable are dangerous. They lead to uncertainty and a dramatic increase in often pointless litigation and unnecessary appeals.”³⁴

The problem with using the concept of fairness in contracting to provide redress in situations of changed circumstances is that it is a “nebulous” concept and leaves the question of whether to award redress entirely at the discretion of the presiding judge. This sentiment was echoed in a more recent pronouncement on the ambit of fairness in this context by Harms DP in a unanimous judgment of the Supreme Court of Appeal.³⁵ In *Bredenkamp v Standard Bank of South Africa Ltd* the Supreme Court of Appeal restricted the notion of fairness as set down in *Barkhuizen* with the statement that there

²⁸ *Barkhuizen v Napier* 2007 5 SA 323 (CC) para 29.

²⁹ Para 57.

³⁰ Para 70.

³¹ Paras 79-83.

³² Compare the argument of Glover “Lazarus in the Constitutional Court: An Exhumation of the *exceptio doli generalis*?” 2007 *SALJ* 449-456 who makes the point that the Constitutional Court deliberately chose to ground its doctrine of fairness in public policy rather than good faith.

³³ Barnard-Naudé 2008 *Constitutional Court Review* 195-196.

³⁴ Brand “The Role of Good Faith, Equity and Fairness in the South African Law of Contract: The Influence of the Common Law and the Constitution” 2009 *SALJ* 89-90. Compare the statements of the majority of the SCA in *Brisley v Drotosky* 2002 4 SA 1 (SCA) para 24. Brand JA was a signatory of the majority decision in *Brisley*.

³⁵ *Bredenkamp v Standard Bank of SA Ltd* 2010 4 SA 468 (SCA) para 54.

is no over-arching requirement of fairness in the enforcement of contractual provisions “if no public policy consideration found in the Constitution or elsewhere is implicated.”³⁶ This means that the evaluation of contractual equity must remain focused around public policy and that an outlet for fairness should still be sought in the technical rules of contractual doctrine.

In the context of hardship something more concrete is thus required, preferably in the form of a rule which can set guidelines for the exercise of judicial discretion in appropriate situations. The South African Law Commission (“SALC”) had proposed in a 1998 report that the problem of changed circumstances be addressed by enacting legislation which would incorporate rules similar to what is today article 6:111 of the Principles of European Contract Law.³⁷ This suggested legislative provision was included as a clause in a Bill granting courts the power to revise contracts on good faith grounds.³⁸ The Bill was never enacted, however, and the momentum gained by Project 47 has largely been superseded by the enactment of the Consumer Protection Act 68 of 2008, since this statute outlaws unfair contract terms, albeit in a consumer context.³⁹ While it is possible that the Consumer Protection Act could be brought to bear on the present problem, this is a tenuous argument⁴⁰ and more specific rules on changed circumstances are necessary in South Africa.

3 A new rule to deal with changed circumstances in South Africa

The new rule on changed circumstances should be introduced by the judiciary as a common law doctrine and should not take the form of legislation. The legislative arm of government has hesitated to enact legislation in this area, although it has been tabled for more than ten years.⁴¹ While this may be attributable to the controversial nature of the good faith doctrine – as evidenced by the opinion of Brand quoted above as well as the line of cases starting with *Brisley v Drotsky* – it appears that Parliament has failed to address this issue properly. Furthermore, rather than attempting to capture a change of circumstances doctrine in an immutable statute, a common law rule can be developed and adapted over time and is not constrained by the prescriptive meaning of statutory language. The *Barkhuizen* decision outlined above evidences a shift in thinking with regard to fairness in contracting and

³⁶ Para 50.

³⁷ South African Law Commission *Unreasonable Stipulation in Contracts and the Rectification of Contracts Project 47 Report* (1998) 186-191.

³⁸ Bill on the Control of Unreasonableness, Unconscionableness or Oppressiveness in Contracts or Terms. Attached as “Annexure A” to the SA Law Commission *Unreasonable Stipulation in Contracts and the Rectification of Contracts Report* 208.

³⁹ See Chapter 2 Part G of the Consumer Protection Act.

⁴⁰ Immediate objections to this proposal are that the Consumer Protection Act does not apply to contracts where the State or a juristic person with an income over a prescribed amount is the consumer. See s 5(2) (a)-(b) of the Consumer Protection Act.

⁴¹ The exception in this regard is the process of debt review under the National Credit Act as described in n 6 above.

it is thus arguably at common law that the developments in this regard are taking place.

If the need for such a rule is accepted, the next question to arise is what content should the rule have? What categories of changed circumstances would trigger its operation and what would be the threshold test a change in circumstances would have to meet in order to invoke a remedy? Comparative solutions to these problems are myriad, as the few examples given in the introduction show.

As to the categories which would invoke redress, this paper will adopt the terminology used in the United States jurisdiction. Thus discharge should be granted for situations of impracticability, which occurs when performance becomes significantly more difficult or expensive, including a situation of actual impossibility of performance.⁴² This type of change in circumstances typically afflicts the supplier of goods or services.⁴³ Market related increases in expense, or increased difficulty in supply due to industrial action or crop failure might be foreseeable events, against which a prudent businessperson would take precautions, but if such an event were to prove unforeseeable it would no longer be fair to hold the disadvantaged party bound to the contract. It is for this reason that impracticability is a ground for discharge in the US, provided the threshold test of the event being sufficiently unforeseeable is met. Redress is also permitted in other jurisdictions such as Germany and the Netherlands, where any change of circumstances can justify the application of the relevant civil code provisions, provided the threshold test is met.⁴⁴ English law does not permit redress on this ground,⁴⁵ but this view seems to be isolated in the light of comparative study.

For South Africa to allow redress in a situation of impracticability would not be entirely foreign to our law. Although objective impossibility has always been the required threshold for discharge, certain authorities have always maintained that this is a “pragmatic” standard and depends on factors such as practical and economic expediency and fairness.⁴⁶ For illustration of this point consider the statement in *Moss v Smith*:

“A man may be said to have lost a shilling when he had dropped it in deep water, though it might be possible by some very expensive contrivance to recover it.”⁴⁷

If discharge is to be allowed where the cost of performance to the supplier has increased, then the converse situation where the value of the performance

⁴² See the Uniform Commercial Code § 2-615; the Second Restatement of Contracts § 261. The doctrine of impracticability in the US is usually traced back to the decision in *Mineral Park Land Co v Howard* 156 P 458 (1916). See Treitel *Frustration and Force Majeure* 263.

⁴³ Second Restatement of Contracts § 261, official comment (d); Treitel *Frustration and Force Majeure* 309.

⁴⁴ In Germany the test is whether the parties would not have entered into the contract or would have entered on different terms if they had foreseen the change (§ 313(1)), whereas in the Netherlands the test is whether “reasonableness and fairness” require that a party can no longer be held bound to a contract in unmodified form.

⁴⁵ *Tennants (Lancashire) Ltd v CS Wilson & Co Ltd* [1917] AC 495 510; *British Movietonews Ltd v London and District Cinemas Ltd* [1952] AC 166 185; Treitel *Frustration and Force Majeure* 290-291.

⁴⁶ Van der Merwe et al *Contract* 188. See also De Wet & Van Wyk *Kontraktereg* (1992) 85-86; Hutchison & Pretorius (eds) *The Law of Contract in South Africa* (2009) 382.

⁴⁷ *Moss v Smith* 1859 9 CB 94 103. De Wet & Van Wyk *Kontraktereg* 85-86 give a similar example of a valuable marble statue, which is lost beneath the ocean when the ship carrying it sinks.

to the recipient has decreased should likewise be considered. This situation is generally referred to as frustration of the purpose of the contract. Obviously such purpose must be commonly held by both parties and must be the foundation on which the contract is built. These further requirements mean that discharge for frustration of purpose is difficult to invoke. Perhaps the most famous instance of discharge on this ground is the English case of *Krell v Henry*⁴⁸ (“*Krell*”). There, a room overlooking Pall Mall in London had been hired by the defendant from which to watch the coronation procession of King Edward VII on 26 June 1902. A specially increased rate was charged for the hire of the room and it was to be used only during the day of the coronation and not during the night. It was thus clear that the common purpose of both parties was to hire a flat to view the procession. When this event was cancelled on 24 June, due to the sudden illness of the king, the lessee, Henry, refused to proceed with the contract. Krell sued for the outstanding rental, but was unsuccessful. The court held that the contract had been discharged by the collapse of its foundation.⁴⁹

The concept of frustration of purpose is not known by that name in South Africa, but there have been similar cases where a commonly held supposition about the occurrence of a future event has failed to materialise.⁵⁰ Although there is authority in case law that this type of supposition can void a contract,⁵¹ this has been expressly overruled by the Supreme Court of Appeal in *Van Reenen Steel (Pty) Ltd v Smith NO*⁵² (“*Van Reenen Steel*”). The merits of the specific device of the supposition *in futuro* aside, the conservative approach to changed circumstances applied by the SCA in *Van Reenen Steel* should not preclude development in this area given the new shift toward fairness in contracting. The concern of the courts that discharge should not be permitted too readily due to the failure of a motivating factor to materialise is relevant and, as Treitel notes with regard to the English jurisdiction, *Krell* is the only true case where discharge on the ground of frustration of purpose has ever been allowed.⁵³

Thus the availability of a frustration of purpose type defence should be limited by a strict threshold test, but to have no possibility of discharge on this ground would not be fair to the contracting parties. If performance has truly become worthless to the recipient, then to make him bear this loss alone and to permit what might (as in *Krell's* case) then be a windfall gain to the supplier would be unfair.⁵⁴

What should be clear by this point is that the problem of changed circumstances brings two opposing concepts into conflict. On the one hand

⁴⁸ [1903] 2 KB 740.

⁴⁹ 754.

⁵⁰ *Williams v Evans* 1978 1 SA 1170 (C); *Hare's Brickfields Ltd v Cape Town City Council* 1985 1 SA 769 (C); *Sonarep (SA) (Pty) Ltd v Motorcraft (Pty) Ltd* 1981 1 SA 889 (N); *Van Reenen Steel (Pty) Ltd v Smith NO* 2002 4 SA 264 (SCA).

⁵¹ *Williams v Evans* 1978 1 SA 1170 (C) 1174G-H; *Osman v Standard Bank National Credit Corporation* 1985 2 SA 378 (C) 386C.

⁵² *Van Reenen Steel (Pty) Ltd v Smith NO* 2002 4 SA 264 (SCA) para 8.

⁵³ Treitel *Frustration and Force Majeure* 346. The US jurisdiction is slightly more lax in this regard, see *Doherty v Monroe Eckstein Brewing Co* 191 NYS 59 (1921); *Industrial Development and Land Co v Goldschmidt* 206 P 134 (1922); *20th Century Lites v Goodman* 149 P 2d 88 (1944).

⁵⁴ This would occur if the procession was rescheduled for a later date and Krell was allowed to let out his room at an enhanced price for a second time.

there is the very real need to preserve contractual sanctity and not to permit discharge too readily. On the other there is the requirement of fairness, which requires that contractual certainty be limited where strict enforcement of an agreement would lead to injustice. Both these values are said to be protected by public policy in South Africa⁵⁵ and both need to be weighed against each other in exercising discretion as to whether to allow discharge on the ground of changed circumstances. It is this fine balancing act which makes the threshold test as to when to permit redress for changed circumstances so important.

In formulating a common law rule in this vein for South Africa, regard should be had to comparative law. The English use a simple test as to whether there has been a “radical change in the obligation” in deciding whether to permit discharge under the doctrine of frustration.⁵⁶ The contract is construed before and after the relevant change to see whether there has been a sufficiently significant change in the nature of the obligation.⁵⁷

In the United States, the Second Restatement of Contracts asks whether there has been “the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made”.⁵⁸ A similar test is applied in Germany, where the court must answer the question whether “circumstances which became the basis of a contract have significantly changed since the contract was entered into and if the parties would not have entered into the contract or would have entered into it with different contents if they had foreseen this change”.⁵⁹ This type of test focuses on the motivating factors which caused the parties to enter the contract and asks whether there has been a significant change in these circumstances.

The Dutch approach shies away from formulating any sort of guidelines in this regard, other than simply to declare that a court may modify a contract “on the basis of unforeseen circumstances of such a nature that the other party, according to standards of reasonableness and fairness, may not expect the contract to be maintained in unmodified form.”⁶⁰ This is perhaps the most obvious conferral of discretion on the judiciary to do as it sees fit in a particular case, although there is a similar exercise of discretion in the other examples shown above. If South Africa’s rule is to be based in considerations of fairness, clearly a large dose of judicial discretion is going to be required to resolve a given case too. It is for this reason that a common law rule is preferable to a statutory instrument, since it can invoke the best elements of all the leading foreign law models. With this in mind, perhaps it is advisable to turn, as the SALC did, to supranational model rules, which are drafted with the intention of creating a generally applicable, ideal solution.

⁵⁵ *Barkhuizen v Napier* 2007 5 SA 323 (CC) para 57.

⁵⁶ *Davis Contractors v Fareham Urban District Council* [1956] AC 696 729. It should be noted that “frustration” is a blanket term in English law and refers to discharge for changed circumstances in general.

⁵⁷ McKendrick “Discharge by Frustration” in Beale (ed) *Chitty on Contracts I* (2008) 1479 1487.

⁵⁸ Compare the wording of the Second Restatement of Contracts §§ 261, 265.

⁵⁹ § 313(1). Translation taken from the website for the *Bundesministerium der Justiz* www.gesetze-im-internet.de/englisch_bgb (accessed 05-08-2010).

⁶⁰ Civil Code of the Netherlands art 6:258(1). Translation taken from Warendorf et al *Civil Code of the Netherlands* 714.

The PECL rules, favoured by the SALC, use a vague standard of whether an obligation has become “excessively onerous” to determine whether redress for changed circumstances is permitted.⁶¹ If the change has simply made the obligation “more onerous” then discharge is not allowed.⁶² The intention is clearly to emphasise the importance of contractual certainty, while still allowing for discharge in extreme circumstances. The SALC does not give any motivation as to why it selected this particular article for its draft Bill, which leaves a reader in the dark as to why the equivalent provision in the Unidroit Principles of International Commercial Contracts, for example, was overlooked.

The PICC provision is noticeably similar to that of the PECL, but there are certain important differences. Article 6.2.2 of the PICC reads as follows:

“There is hardship where the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of a party’s performance has increased or because the value of the performance a party receives has diminished, and

- (a) the events occur or become known to the disadvantaged party after the conclusion of the contract;
- (b) the events could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract;
- (c) the events are beyond the control of the disadvantaged party; and
- (d) the risk of the events was not assumed by the disadvantaged party.”⁶³

The PICC formula does a good job of specifying to parties and to judicial officers exactly what the criteria for redress are. Rather than a subjective notion of what is “excessively onerous”, the PICC requires a shift in the reciprocal values of performance under that contract (fundamental alteration of the equilibrium of the contract). The list of checkpoints (a) to (d) is also more comprehensive than the list to be found in the equivalent PECL formulation⁶⁴ with the inclusion of a new ground (c) that the events be beyond the control of the disadvantaged party. If the provisions of these model rules are to be subjected to purposive interpretation, however, it is likely that an adjudicator would focus on their similarities in effect, rather than differences in semantics. Particularly since this paper advocates a common law solution, a South African judge adopting this approach might pragmatically state that a threshold test should be that there has been a fundamental alteration in the equilibrium of the contract, which is to be judged with reference to whether performance has become excessively onerous for one party.

⁶¹ PECL art 6:111(2). This standard is taken from the equivalent provision in art 1467 of the Italian Civil Code.

⁶² PECL art 6:111(1).

⁶³ PICC art 6.2.2.

⁶⁴ PECL art 6:111(2) reads as follows:

“If, however, performance of the contract becomes excessively onerous because of a change of circumstances, the parties are bound to enter into negotiations with a view to adapting the contract or ending it, provided that:

- (a) the change of circumstances occurred after the time of conclusion of the contract,
- (b) the possibility of a change of circumstances was not one which could reasonably have been taken into account at the time of conclusion of the contract, and
- (c) the risk of the change of circumstances is not one which, according to the contract, the party affected should be required to bear”.

As far as the individual criteria (a) to (d) go, a major difference between these model rules and for example German or Dutch law, is that the frustrating event must have occurred after the conclusion of the contract (criterion (a)).⁶⁵ In the South African context the PICC approach is preferable, since the law of common mistake is sufficiently developed to deal with a change in circumstances which occurs prior to the contract's conclusion.⁶⁶ Criterion (b) requires that the frustrating event should not have been reasonably foreseeable at the time of contracting, which is an eminently sensible requirement and will limit the instances in which relief is available. Criteria (c) and (d) rule that the frustrating event should neither have been self-created nor should a contracting party have assumed the risk of its occurrence. Again, these rules on the assumption of risk are already largely present in the South African law of supervening impossibility and to transpose them to the realm of changed circumstances would be a logical adjustment.⁶⁷

As should by now be apparent, the argument advanced here is that the generality of the PICC formulation makes it the ideal model on which South African courts can base a new rule to deal with changed circumstances. This formulation synthesises the best of the various municipal doctrines, while avoiding idiosyncrasies such as the lack of a doctrine of common mistake in German law.⁶⁸ For the sake of completeness, attention should also be paid to the third major international set of model rules, the Draft Common Frame of Reference, which represents the latest attempt to establish a model law for the whole of Europe.⁶⁹ The DCFR deals with changed circumstances in Book III at article 1:110, with the threshold test that performance must have become "so onerous because of an exceptional change of circumstances that it is manifestly unjust to hold the debtor to the obligation".⁷⁰ Again there is the emphasis on contractual certainty, so that obligations which are simply "more onerous" to perform remain binding.⁷¹ Although, as in the equivalent PECL and PICC provisions, there are further limitations to this test at article 1:110(3), the result is largely the same. The major changes in the DCFR formula involve the inclusion of a requirement that the change be "exceptional", as well as the exchange of the "excessively onerous" standard for one of "manifest injustice". However, again these differences are minor. Thus while the DCFR formulation adds further weight to the provisions of the PICC formulation through their reiteration, the PICC formula is better. A judge who disagrees

⁶⁵ Markesinis et al *German Law of Contract* 346-347 explain that German law does not deal with common mistake in the BGB and that this class of cases therefore falls to be dealt with under the German Civil Code § 313. Hartkamp & Tillema *Contract Law in the Netherlands* (1995) 125-126 note that the distinction between common mistake and frustration is not drawn in BW art 6:258, where discharge on the ground of changed circumstances is permitted for both situations.

⁶⁶ The leading South African case on common mistake is *Dickinson Motors (Pty) Ltd v Oberholzer* 1952 1 SA 443 (A). See also *Van Reenen Steel v Smith* NO 2002 4 SA 264 (SCA) para 9.

⁶⁷ *Transnet Ltd v/a National Ports Authority v Owner of MV Snow Crystal* 2008 4 SA 111 (SCA) para 28; Van der Merwe et al *Contract* 543-544; Christie *Law of Contract* 475.

⁶⁸ Markesinis et al *German Law of Contract* 346-347.

⁶⁹ Von Bar & Clive *Principles, Definitions and Model Rules of European Private Law I* (2009) 2.

⁷⁰ DCFR III 1:110(2).

⁷¹ DCFR III 1:110(1).

with this approach in South Africa could read all three formulations together and adopt the emergent purpose of these provisions, which is clearly the same.

Thus whether a change in circumstances results in increased expense of performance for the supplier or decreased value of the performance to the recipient, redress should be permitted, provided the change meets the threshold of sufficient weightiness. This threshold test is different in different jurisdictions, but the best approach seems to be that of the international model rules of contracting. The aggregate approach of the PICC, the PECL and the DCFR should thus be adopted as the new common law rule in South Africa. Once the rule has been formulated, however, the important question arises as to what remedies will be available under this new rule.

4 Remedies consequent upon a finding that there has been a fundamental change in circumstances

The favoured procedure of all three systems of model rules mentioned above following the occurrence of a frustrating event is for the disadvantaged party to request renegotiations.⁷² Should this prove unsuccessful, a court may discharge or modify the contract. This type of situation is based on the good faith regime which governs proceedings under all three systems of model rules.⁷³ As official comment C to the DCFR provision notes, a party to a contract is entitled to request renegotiation of that contract as a matter of course; the interesting feature of these rules is that judicial intervention is made conditional upon there already having been a good faith attempt to reach settlement. A similar approach is taken in both the PECL and the PICC, although the PECL threatens a damages award for a failure to respond to a request to renegotiate.⁷⁴ In the South African jurisdiction a leading contract authority has opined that this type of approach is unlikely to be successful, due to the centrality of the value of contractual certainty.⁷⁵ This view extends also to the alternative of judicial adaptation.⁷⁶ It is time to revisit this issue, since the importance attached to fairness in contracting is changing and in any event this approach is not as greatly at variance with South African law as one might think.

As noted above, it has always been an option for a South African party to request renegotiation. Freedom of contract allows for this. What has changed, however, is that whereas in the past the non-disadvantaged party could have stood on its rights under the letter of the contract and refused to budge, today this should be considered unfair, provided the change in circumstances was sufficiently fundamental. Thus a court when faced with this type of dispute should first of all apply the threshold test as to the severity of the effect of the frustrating event as discussed above and if the change is found to meet this test, then the court is faced with two alternatives: either discharge the

⁷² PICC art 6.2.3; PECL art 6:111(2)-111(3); DCFR III 1:110(2)-110(3).

⁷³ The PICC contains a good faith provision in art 1.7 and art 5.1.3 creates a duty to co-operate. The PECL art 1:201 contains a general good faith provision, as does the DCFR III 1:103.

⁷⁴ For criticism of the PECL approach see comment C to DCFR III 1:110.

⁷⁵ Christie "Our Law of Contract and the Modern Lex Mercatoria" in Glover (ed) *Essays in Honour of AJ Kerr* (2006) 59-73.

⁷⁶ 73.

contract or modify it. Discharge would be the classic remedy and is favoured in common law countries⁷⁷ as well as South Africa⁷⁸ as the correct approach to a situation of impossibility at present. This is not the ideal solution, however, and gives rise to all sorts of enrichment difficulties.⁷⁹ Discharge should thus be the outcome of last resort, since this is an all-or-nothing approach.

There are circumstances, however, where this will be the unavoidable outcome. Markesinis gives the example from German law of a dispute decided in 1976 concerning the transfer of a professional football player from one club to another.⁸⁰ This player had, unbeknown to both clubs involved, accepted a bribe to lose a game before the time of transfer. The Bundesgerichtshof held that the actions of the player had made him “worthless” to both clubs, and upset the fundamental basis of the transaction. Due to the circumstances of the case, revision of the contract under the doctrine of *Wegfall der Geschäftsgrundlage* was not possible and hence the agreement was discharged and the return of the transfer fee was ordered. If discharge is the unavoidable outcome of a case, this remedy must be enforced.

Contract modification should also not be dismissed too quickly in the South African context, indeed it occurs already in certain contexts, as alien as this remedy may appear to some commentators.⁸¹ Consider the problem of partial enforcement of restraint of trade agreements. In *National Chemsearch (SA) Pty Ltd v Borrowman*⁸² (“*National Chemsearch*”) Botha J held that under appropriately limited circumstances, a judge could formulate a new agreement for the parties which partially enforced the restraining provision.⁸³ This approach did away with the so-called “blue pencil test”, which relied upon the severability of the offending portions.⁸⁴ The *National Chemsearch* approach of contractual adaptation was confirmed by the Appellate Division in *Magna Alloys and Research (SA) (Pty) Ltd v Ellis*.⁸⁵ While this is simply a limitation of a too-widely worded provision, rather than a whole new contract, it does evidence a willingness on the part of the courts to achieve justice by contract modification.⁸⁶

Obviously contract modification would also be an order of last resort and a negotiated settlement would be the ultimate goal of proceedings. The notorious court-ordered adjustment of the contract in the US case of *Aluminum Co of*

⁷⁷ For English law see *The Super Servant Two* [1990] 1 Lloyd’s Rep 1 8; McKendrick “Discharge by Frustration” in *Chitty on Contracts* 1522. For US law see UCC § 2-615; Second Restatement of Contracts § 261; Nehf “Impossibility” in Perillo (ed) *Corbin on Contracts 14* (2001) 5.

⁷⁸ For authority see n 5 above.

⁷⁹ In the English jurisdiction the Law Reform (Frustrated Contracts) Act 1943 had to be enacted to address this problem. In South Africa this issue is dealt with by the common law, see *Kudu Granite Operations (Pty) Ltd v Caterna Ltd* 2003 5 SA 193 (SCA); Christie *The Law of Contract* 472.

⁸⁰ BGH NJW 1976, 565 as cited in Markesinis et al *The German Law of Contract* 347.

⁸¹ Christie “Our Law of Contract and the Modern Lex Mercatoria” in *Essays in Honour of AJ Kerr* 73.

⁸² 1979 3 SA 1092 (T).

⁸³ 1116D-1117G.

⁸⁴ See the discussion in *Roffey v Catterall Edwards & Goudré (Pty) Ltd* 1977 4 SA 494 (N) 507C-D.

⁸⁵ 1984 4 SA 874 (A) 896E. See also *CTP Ltd v Argus Holdings Ltd* 1995 4 SA 774 (A) 787E-F.

⁸⁶ It should be noted that explicit contract modification would be against established precedent in South Africa, where the courts have been reluctant in the past to make an entirely new agreement for the parties. See for example *Southernport Developments (Pty) Ltd v Transnet Ltd* 2005 2 SA 202 (SCA) para 17. Comparative law indicates that this is out of line with international trends, and is evidence of an old-fashioned approach which takes contractual certainty as its only goal.

*America v Essex Group, Inc*⁸⁷ should bear witness to the danger of too liberal an application of this remedy. There a carefully negotiated pricing mechanism was abandoned by the court in favour of its own mechanism,⁸⁸ a decision which Dawson has described as “grotesque”.⁸⁹ The caution of the relevant comment in the Draft Common Frame of Reference bears directly on this point:

“Any modification must only be such, however, as will make the obligation reasonable and equitable in the new circumstances. It would not be reasonable and equitable if the effect of the court’s order were to introduce a new hardship or injustice.”⁹⁰

Ideally it should be the parties to the contract themselves who arrive at some type of settlement and perhaps a court could enforce some sort of duty to renegotiate in good faith on the parties as an intermediate step to actually modifying the contract itself. This type of duty was enforced by the Supreme Court of Appeal in *Southernport Developments (Pty) Ltd v Transnet Ltd*⁹¹ (“*Southernport Developments*”). This case was slightly different to the present scenario, in that the duty to renegotiate had been established in the parties’ own contract and was enforceable at the instance of an arbitrator. The duty to renegotiate following a change of circumstances would, however, be based on a common law rule, or an *ex lege* term of the contract, which means that the connection between *Southernport Developments* and the present argument is fairly concrete.⁹² A court could add mettle to this duty to renegotiate by making a temporary order advising the parties what it thinks would be a just outcome to their dispute and then sending them away to attempt to reach a settlement before a return date. This would avoid the type of outcome as evidenced in *Alcoa v Essex Group*⁹³ above and would provide a basis for reaching agreement.

In sum, renegotiation is the best means of equitably solving disputes following a change of circumstances. Fairness in contracting requires that the non-disadvantaged party entertain a request to renegotiate by its counterpart. An attempt at renegotiation should be a condition precedent for access to the courts to resolve a dispute involving a frustrated contract. If, however, no resolution can be reached by the parties, then court intervention is necessary. The circumstances of the case will determine whether adaptation or discharge is more appropriate as a remedy. The court should seek to do what is fair and not to impose new hardship on the parties by its ultimate order.

5 Conclusion

There has been an important shift in emphasis in South African contract law, away from black letter contractual certainty and towards fairness in

⁸⁷ 499 F Supp 53 (1980).

⁸⁸ 80.

⁸⁹ Dawson “Judicial Revision of Frustrated Contracts: The United States” 1984 64 *BUL Rev* 1 26.

⁹⁰ Comment E to DCFR III 1:110.

⁹¹ 2005 2 SA 202 (SCA) para 17.

⁹² It should be noted, however, that in this case the court was emphasising the fact that it was not creating a new agreement for the parties (*Southernport Developments (Pty) Ltd v Transnet Ltd* 2005 2 SA 202 (SCA) para 17).

⁹³ 499 F Supp 53 (1980).

contracting. This shift has the authority of the Constitutional Court behind it and the mandate which the *Barkhuizen* case places on all future courts must be given effect to. One such area, which has traditionally been ignored in the South African jurisdiction, is the problem of changed circumstances. To place the burden of a frustrating event on one party alone is simply not fair and some sort of sharing of losses and gains must take place.

To allow the hardship problem to be addressed on equitable grounds alone is not satisfactory, however. There is too much scope left for the discretion of an individual judge and there are no guidelines in place to give him or her direction. Thus while fairness in contracting demands that this problem be addressed, a discretion based on fairness alone is not the final solution. Rather this should underlie the introduction a new set of rules to deal with changed circumstances.

Provided a threshold test is met, remedies would then be available in South African law to address any situation of hardship. This threshold test is best formulated in the form of a common law rule which will ask whether there has been a fundamental alteration in the equilibrium of the contract due to an exceptional change in circumstances, so that performance has become excessively onerous for one party. Further requirements are that the hardship should have occurred after the conclusion of the contract, should not have been foreseeable at the time of contracting and should not have been self-created or within the sphere of a party's assumed risk.

If a party believes hardship is present in its case, it is entitled to request renegotiation of the contract and the opposing party is bound by the prevailing climate of fairness in contracting to entertain such a request. Should all attempts at self-resolution fail, discharge or renegotiation may be awarded by a court. This will ensure that gaps in contracts created by the occurrence of unforeseeable contingencies are addressed in a fair manner. This also vindicates the basic approach advocated by Fried that losses and gains consequent upon frustration be shared.⁹⁴ This apportionment of the burden caused by a change of circumstances shows the concern for one's fellow human being necessary to do simple justice between people.

SUMMARY

South African law does not make provision for the impact of fundamentally changed circumstances on a contract if the change does not result in objective impossibility. This is not in line with most other leading legal systems around the world, as well as with the foremost bodies of supranational contract law rules, such as the Unidroit Principles. When a situation of hardship arises, this creates a gap in a contract, which the parties did not foresee and which the law should fill. Ideally resultant losses and gains should be equitably split between the parties. The development of notions of fairness in contracting has reached a point where public policy could require that a situation of changed circumstances be addressed, to achieve a fair result *inter partes*. This normative principle should underlie the adoption of new rules to deal with hardship in South Africa, which could be based on best international practice as gleaned from comparative study.

⁹⁴ Fried *Contract as Promise* 69-70 (cited above).