Hardship in Bulgarian Law

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Abstract: The article deals with the legal treatment of hardship (change of circumstances) in Bulgarian law trying to show where it stands in comparison with other legislations (Germany, England, USA) and international legal instruments (Unidroit Principles on International Commercial Contracts and Principles of European Contract Law). An overall picture of the different approaches to hardship is concisely presented. Hardship prerequisites and effects are analyzed with a stress on specific problems identified in some recent Bulgarian court decisions. Attention is drawn to certain concepts and reasoning in other legal systems that may be helpful to Bulgarian theory and practice when dealing with hardship cases.

Keywords: hardship; change of circumstances, onerous performance; disequilibrium of the contract; unforeseeable event

1. Introduction

The word "hardship" is a widely recognized legal term for what is known as imprévision in France, Wegfall der Geschäftsgrundlage in Germany, frustration in England and impracticality in USA. They all refer to events occurring after conclusion of the contract with shattering effect on what once seemed feasible and motivated the parties to engage in the contract. Here comes hyperinflation, embargo, economic crisis, political distress, wartimes or other supervening events which make performance extremely onerous, far in excess of what could have been reasonably anticipated by the parties at the time the contract was made. Such unexpected events may distort the balance of the contractual obligations and make

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AUDJ, vol. VII, no. 1, pp. 126-138

them grossly disproportional. In such situations hardship rules come to play in order to adapt or terminate the contract.

The concept of hardship is always handled with care as it might be dangerous to the principle of sanctity of contracts. *Pacta sund servanda* requires the parties have to perform as promised, no matter whether at a loss or with efforts or at expense greatly exceeding what was estimated and irrespective of the fact that what is to be received under the contract is needed or wanted no more. Therefore hardship is allowed in exclusively limited and exceptional cases[1].

2. Hardship in Comparative Perspective

There are various legal approaches to hardship. We will briefly go through them in order to outline the Bulgarian law understating of hardship.

In some jurisdictions (France and Belgium, for example), hardship is not legally acknowledged. The sanctity of contracts is never challenged and even radical changes of the contract obligations are tolerated for the sake of legal certainty.

In other countries the leading principle of sanctity of contracts is limited by and weighed against the fundamental principle of good faith. As supervening events disrupt dramatically the economic base of the contract, it ceases to be binding. In this context insisting the other party to perform what was originally agreed appear to be in violation of the good faith principle.

The link between good faith and hardship is obvious in Bulgarian law. Under the heading ”Economic onerosity”, art. 307 of the Bulgarian Commercial Code states that the court may modify or terminate the contract entirely or partially if circumstances have come into existence, which the parties could not and were not obliged to foresee and keeping the contract intact would be contrary to fairness and good faith. Close to that is the hardship definition in art. 258 (1) of the Netherlands Civil code.

A different pattern of hardship definitions can be found in article 6.2.2. of the Unidroit Principles “Hardship” and article 6:111 of the Principles of European contract law (PECL)”Change of circumstances”. The definitions are quite similar and both of them reflect situations where the equilibrium of the contract is

[1] The exceptional character of hardship is explicitly stated in art. 451 (4) of the Civil Code of the Russian Federation.

fundamentally altered and performance becomes excessively onerous due to changed circumstances. It is clear from the definitions that the contract misbalance results from increase in the cost of performance or decrease in the value of performance. Further, the change occurred after conclusion of the contract due to events which could not reasonably have been taken into account at the time of the conclusion and which are beyond the control of the disadvantaged party. In order to meet the hardship test it is additionally required that the risk of the events was not assumed by the disadvantaged party or is not a risk which, according to the contract, the party affected should be required to bear. In case of hardship the court may terminate the contract at a date and on terms to be determined by the court or adapt the contract with a view to restoring its equilibrium. [art. 6.2.3. (4)].

Another specific approach to hardship is provided by Section 313 of the German Civil Code which states "*if 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, adaptation of the contract may be demanded to the extent that, taking account of all the circumstances of the specific case, in particular the contractual or statutory distribution of risk, one of the parties cannot reasonably be expected to uphold the contract without alteration*" (Rösler, 2007, p. 489)

The understanding of the German law is based on the notion of fundamental circumstances defined as "*perceptions of one party, discernable to and not objected to by the other party, of the existence, present or future of certain circumstances that form the basis for their willingness to conduct*". (Rösler, 2007, p. 488)

Anglo-American law as usual seems to stand for its own. US law employs two concepts close to hardship - impracticability and frustration. English law on the other hand does not have rules on hardship but deals with frustration.

Impracticability deals with cases where changed circumstances lead to radical rise in the cost of performance, while frustration deals with cases where changed circumstances lead to radical drop in the value of counter performance (Schwartz, 2009, pp. 13-14). Both of them serve as an excuse for the contracting parties to perform.

According to article 2-615 U.C.C. performance is made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption

on which the contract was made. In the same way, § 261 of Restatement (Second) "Impracticability" allows discharge if a "basic assumption" on which the contract was entered into has proved to be untrue.

Frustration is present where the supervening events make performance physically or legally impossible or possible only in a way quite different from what was originally contemplated by the parties (Schwartz, 2009, pp. 13-14).

Following the above, few things deserve to be mentioned. Although the concepts of impracticality and frustration may look peculiar and remote they have their parallels as impracticality corresponds to onerous performance due to increase in the cost of performance and frustration covers decrease of the value of performance.

Part of the legislations, among them Bulgaria, Unidroit Principles and PECL are interested in changed circumstances resulting in disparity between performance and counter-performance. Another group of legislations, mainly Germany and USA, apply a more qualified approach and are interested in changes which affect such circumstances in particular which have become the basis of the contract. Hardship concept for this second group rests on assumptions made by the parties at the time of signing the contract[1].

Bulgarian hardship rules contain subjective criteria - good faith. Other definitions of hardship, including those of Unidroit and PECL apply only objective criteria – fundamental change of the contract equilibrium, onerous performance, rise in costs, decrease in value.

3. Prerequisites for Hardship

3.1. Unforeseeable Event

The first threshold a hardship case has to meet is that changed circumstances were unforeseeable. The majority of cases brought in Bulgarian courts failed to meet this criterion. Thus the court held that the party being a farmer could and had to predict unfavourable climate changes and insure against them[2]; transition from planned to market economy suggested that severe economic distress was possible and change

[1] Concerning the importance of assumptions for unexpected circumstances cases (Eisenberg, 2009).

[2] Decision № 76/16.01.2009 of the Russe District Court, confirmed by the Veliko Tarnovo Appellate Court.

in the general government policy was not to be unexpected[1]; dealing with a subcontractor readily makes the contractor aware of possible failure on part of the subcontractor to perform his obligation[2]. The range of circumstances that can be foreseen depends on the peculiarities of the given case. The long term of the contract extends the type and gravity of foreseeable contingencies. The same is true when dealing with a country with unstable political climate. Further, a contract for raw materials of constant demand, volatile prices and scarce resources calls for prudence and demands more vigilance on the respective party to make allowance for probable unfavourable changes.

It may seem that what happened once makes the parties beware so that everything is possible and thus foreseeable. But this is an extreme that ruins the very idea of hardship. Foresee ability is not whatever could be figured out as possible but rather what could reasonably be expected. And the test is objective. Any negligence to estimate possible risks would prevent the party to invoke hardship (Kalaidjiev, 2001, p. 280).

Hardship rules may lead to illusionary comfort for ready rescue available in case dramatic changes happen after the contract conclusion. The parties must be active to consider in advance possible dangers that may threaten somehow their interest in the contract and provide against such risks. This not being done, the party is deemed to have accepted the risk[3].

In unexpected circumstance cases it is often to hear about sharp rise, dramatic increase, extraordinary drop, exorbitant prices, etc. Is hardship present in case the event itself was expected but the degree of the change turned out to be beyond probability? This is the case with inflation as a normal business risk to account for but a rocketing hyperinflation could not commonly be figured out and reasonably expected. Thus the requirement of events being unpredictable has to be interpreted

[1] Decision № 566/20.05.2005 of the Bulgarian Supreme Cassation Court.

[2] Decision № 1589/20.05.2005 of the Sofia Appellate Court.

[3] In Transatlantic Financing Corp. v. United States (1966) the court stated that "*the circumstances surrounding this contract indicate that the risk of the Canal's closure may be deemed to have been allocated to Transatlantic. We know or may safely assume that the parties were aware, as were most commercial men with interests affected by the Suez situation… that the Canal might become dangerous area.*"

in a way to encompass situations of unexpected degree or dimension of the change although the event causing the change is foreseeable[1].

3.2. Disruption of the Contract Equilibrium

Although the heading of art. 307 of the Bulgarian Commercial Act is "Economic onerosity" the text says nothing about disproportion of performance and counter performance. Yet, the rule specifies that keeping the contract as it is would be contrary to fairness. Bulgarian legal doctrine interprets this to mean excessively onerous performance for one of the parties and fundamentally altered contract equilibrium (Gerdjikov, 2000, p. 45) (Kalaidjiev, 2001, p. 280). Usually, sharp rise in the prices of raw materials and inflation are given as examples but they have never been regarded and explored as different types of reasons for the contract disequilibrium.

Unidroit Principles and PECL distinguish increase of the cost of performance and diminished value of counter performance as two different groups of reasons for the contract disequilibrium. American law has its corresponding notions of impracticality and frustration.

Increase of the cost of performance refers to increase of the costs the party has to incur in order to perform its obligation. This is valid only for non-monetary obligations as far as no excuse or impediment for performance of monetary obligations is ever allowed no matter how hard, onerous or ruinous it may be for the debtor[2]. Increased costs usually suggest increased prices of raw materials, electricity and other expenses. They may be due as well to governmental or international regulations, restrictions or new environmental requirements[3].

The manifestations of diminished value of counter performance, on the other hand, depend on the type of obligation. If counter performance is a monetary obligation this will typically be the case of inflation[4] or fluctuations of the exchange rate. If

[1] This is presented as "magnitude-centered assumptions" (Eisenberg, 2009).

[2] Art. 81 (2) of the Bulgarian Law on Contracts and Obligations.

[3] The commentary of the Unidroit Principles give an example with new safety regulations requiring far more expensive production procedures. Unidroit principles of international commercial contracts, Rome, 2004, p. 185.

[4] A lease contract in Lithuania was concluded when the Lithuanian currency was pegged to the US dollar. A year after, the national currency was pegged to the Euro and the value lessor

counter performance is a non monetary obligation, decrease in the value of received performance implies lost interest in counter performance because the principle purpose in making the contract is frustrated (Schwartz, 2009, p. 18). Unidroit Principles give two examples - a prohibition to build on a plot of land acquired for building purposes or the effect of an embargo on goods acquires with a view to their subsequent export[1].

The world economic crisis starting at the end of 2008 led to collapse of the mortgage and respectively real estate market triggering prices and leases sharply downwards. There are few court decisions about leases of mall premises where lessees demanded termination of the lease agreements due to crisis. Courts confirmed the crisis was an unforeseen event. Further, on the question of performance becoming more onerous, Bulgarian courts developed two types of reasoning.

In one of the cases court said hardship would be present if due to unforeseen events the rent agreed in the contract and the market rent rates for identical properties differ significantly so that the lessee is paying in excess for what he receives from the lessor[2].

The court held no hardship is present in the particular case because lessee failed to prove overall sharp drop of the rents payable for identical properties. Lessee presented evidence only for few small amount rental decreases in renegotiated lease contract, not all of them for identical premises.

In another decision with similar facts the court said hardship is present as the sudden drop in the number of clients visiting the mall because of the crisis reduced consumption is an event the parties could not and had not to take into account which made lessee's performance excessively onerous[3]. Therefore the court decided for the plaintiff and terminated the lease contract.

These examples show that without a clear understanding about the meaning and forms of onerous performance the courts manage identical cases in a different way. Difference in the rent due under the contract and the market rent levels after the

receiveddeclined significantly. The Supreme Court modified the contract to restore the equilibrium. Baranauskas & Zapolskis, 2009, p. 211).

[1] Unidroit principles of international commercial contracts, Rome, 2004, p. 185.

[2] Decision № 192/18.11.2010 of the Varna Appellate Court.

[3] Decision of the Varna Appellate Court, Commercial case No 10/2010.

crisis cannot in itself prove contract disequilibrium unless increased costs of performance or diminished value of counter performance are present for the particular contract. Substantial drop in rent rates does not stand either for increased costs either of performance or for lost value of counter performance. Change in the market level of rents turns the contract into a bad bargain which is a normal business risk for the lessee[1].

The other reasoning that reduced consumption makes lessee earn less as seller and harder to pay the rent also does not presents a case of increased costs or diminished value. What is more, no relation exists between the lease and the sales. It cannot be claimed that the lease contract was made on the assumption that demand and sales of the goods to be sold in the premises would remain at certain levels. The risk of change in demand for the goods to be sold in the premises is entire assumed by the lessee.

In a third case before the arbitration court a franchisee brought a suit to terminate a franchise agreement for real estate agency services due to the fact that following the economic crisis the real estate business suffered a tremendous drop[2]. Court said equivalence is not affected as franchisee is still authorized to use the same industrial property rights as before. Court added also that the fact that the plaintiff does not make an income out of dealings with third parties does not result in disequilibrium of the franchise agreement. So court rejected the hardship claim. Counter performance remaining unchanged after the crisis is not an argument that contract equilibrium stays intact as the test is whether counter performance lost value for the debtor. One could possibly claim that due to the crisis, real estate business became less attractive and the franchise for real estate services lost part of its appeal and value.

This reasoning would be wrong as lost value is to be understood as frustration of purpose and no such result is obvious in the case with the franchise agreement. In contrast to the relation between lease of a shop and revenues from sales in the shop, a franchise payment for real estate agency and revenues from the real estate agency activity are more closely connected. But the franchise agreement had a clause for

[1] In the case of sale-purchase agreements where after the decline of apartment prices buyers still have payments due to sellers, mostly construction companies, hardship could not be invoked as lower estate prices do not make buyer's performance more onerous but lead to a missed chance to buy at lower price.

[2] Decision of 15.07.2009 of the Bulgarian Trade and Industry Chamber case № 91/2009.

firm monthly franchise payment regardless of the monthly revenues of the franchise activity. This clearly shows allocation and assumption of the risk of unworthy franchise business by the franchisee.

It is obvious that Bulgarian law needs more discussion on the notion of contract disequilibrium in hardship cases, especially about possibility to have decreased value of counter performance.

3.3. Before Performance

Changed circumstances should have occurred after the conclusion of the contract. Hardship can play only before performance. But if the party is in delay and hardship event occurs, the default party will not be able to resort to hardship.

Termination or amendment of the contract can be requested only before performance. The party claiming that the contract has become excessively onerous for her has to invoke hardship before performing its obligation. Following this rule it seems that the party will not be entitled to claim hardship if she has already performed its obligation and changed circumstances occur afterwards although the other party has not performed its obligation yet. On the other hand, acceptance of counter performance after hardship events occurred may bar the party to invoke hardship although she has not performed its obligation yet.

3.4. Beyond Control

Hardship can arise only if the events are beyond the control of the disadvantaged party. Although the court did not so qualify its reasoning, unfair competition cannot be a hardship event as the party has rights under the law to fight against it and therefore it is within its control[1].

3.5. Allocation of the Risk

Hardship requires that the risk of the events was not assumed by the disadvantaged party. It is not a prerequisite under the Bulgarian law but many jurisdictions require that the aggrieved party had not assumed the risk of the unexpected circumstances.

[1] Decision № 566/20.05.2005 of the Bulgarian Supreme Cassation Court.

Risk allocation may be explicit but moreover it will come implicitly out of the type and nature of the contract or out of commercial practice and usages. Financial difficulties, impediments, accidents that fall within the normal business risk cannot count as hardship[1]. It is possible to have statutory allocation as in the case of production contracts where the law itself states that any changes in the price of labour or materials will be calculated in the contractor's remuneration[2]. Sale contracts for generic goods readily indicate the risks seller will have to bear. The same is true for contracts for trade in securities and other financial instruments which often have an element of speculation or are subject to the fluctuations of stock exchanges.

In the Bulgarian court cases mentioned above the court didn't pay attention and didn't take into consideration the risk allocation made in the contract. Thus, the agreements for lease of mall premises expressly provided that lessee cannot terminate the contract during the first three years. The franchise agreement arranged a firm minimal franchise payment irrespective of the monthly revenues. In another case money were lent and had to be given back through delivery of wheat[3]. If this was impossible the party had to give back the money plus a default interest. Later, the farmer claimed he cannot deliver the wheat because of unexpected summer drought. He further claimed that in the given case keeping the contract clause for liquidated damages would be contrary to fairness and good faith. The court rejected the claim as the summer drought impaired only a small portion of the farmer's production and it was proved that the farmer in fact sold his production to a third party at a price above that agreed in the contract. However, the court didn't note that the stipulation of the two possibilities for repaying the money implies that the parties figured out bad weather could prevent wheat production and this risk was placed on the farmer.

It became clear from what was said above about foresee ability that a reasonably foreseeable event not mentioned and arranged in the contract means this risk was assumed by the respective party. When discussing the second major prerequisite

[1] As noted in ICC case 8486 of 1996 "*The rising of the private manufacturing sector and the connected fall in the price [of the product] described herein, as well as the general trade situation in Turkey, only concern the economic frame of the Turkish market and thus fall within the risk sphere of the defendant*".

[2] Art. 266 (2) of the Bulgarian Law on obligations and contracts.

[3] Decision № 76/16.01.2009 of the Russe District Court, confirmed by the Veliko Tarnovo Appellate Court.

for hardship, namely disequilibrium of the contract, we came across arguments about risk allocation. This is to show the importance of the risk allocation in hardship cases, which actually turns to be the leading criteria and the heart of changed circumstances. This criterion is not taken into account in Bulgarian law, which prevents proper analysis of hardship cases.

Hardship is similar to force majeure as it also is a non-fault excuse for non-performance. It poses the same legal question as force majeure – who will bear the risk of unexpected events. The answer is the party which explicitly or implicitly assumed the risk or according to the nature of the contract or commercial usage was required to bear or was able to foresee the occurrence of the event and did not make any provision against it. This shows that hardship cases call for risk centred analysis.

4. Effects of Hardship

Bulgarian law as many other jurisdictions empower courts to amend or terminate the contract in case of changed circumstances. This can be done solely upon explicit request on part of the disadvantaged party. The court cannot rule termination when amendment was opted for.

As no retroactive action is provided for by the law in case of hardship, Bulgarian theory and practice draw a conclusion that contract termination takes effect only for the future (Gerdjikov, 2008, pp. 56-57)[1]. This seems right for contracts with continuous or periodic performance but hardship is not restricted to that type of contracts. In certain cases *ex tunc* effect will better suit the needs looked for with the rules on hardship. Apart from that, force majeure and hardship are non-fault reasons for discharge of the contract, which is an argument that their consequences should be similar. In this respect Unidroit Principles and PECL more accurately provide that the court will terminate the contract at a date and on terms to be fixed. Article 313 (3) BGB explicitly arranges retroactive termination of the contract (Rösler, 2007, p. 490).

In contrast, the effect of frustration in English law is automatic release of the contract. Impracticability in American law, on its turn, results in discharge of the

[1] Decision № 1694/11.11.2002 of the Bulgarian Supreme Cassation Court; Decision of 3.07.2008 of the Bulgarian Trade and Industry Chamber case № 196/2007.

aggrieved party from its obligation to perform. Thus no possibility for amendment of the contract is given to the court due to the understanding that court should not get involved and substitute parties' will. It is also expected that upon termination the parties will renegotiate, i.e. adapt the contract for themselves (Rösler, 2007, p. 507).

Bulgarian law is silent whether the parties have to look for amiable solution before going to court. No such requirement and no obligation on the parties to negotiate are placed by the law. Unidroit Principles provide that the disadvantaged party is entitled to request negotiations (art. 6.2.3). According to PECL the parties are bound to enter into negotiations (art. 6:111 (2). But even in the latter case refusal to start negotiations, conducting or breaking negotiations contrary to good faith and fair dealing does not entitle the other party to discharge the contract but gives only right to compensation for damages suffered (art. 6:111 (3).

Neither the request for negotiations, nor the court claim entitles the respective party to withhold performance. Possible negative consequences for breach of contract obviously will not induce the party to perform as performance is an impediment to the hardship claim.

5. Conclusions

Bulgarian law still lacks clear and comprehensive idea of the nature and implications of the legal institute of hardship. Among other things, three issues deserve special attention and priority – disequilibrium of the contract, particularly the case of the so called "frustration of purpose", risk allocation and effect of the termination of the contract in case of hardship. Other legal systems and international acts may be helpful in drawing attention to certain hardship specifics and may offer possible solutions.

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