suspected of harming the employer by omitting to charge relatives for the goods bought at the market where she worked. Her employer confronted her and faced her with the decision to sign a contract in which she would undertake to make good the damage caused or be reported to the authorities. This, the court held, did not constitute coercion. (See already, RGZ 110, 382, 385.)

In cases in which the dismissal of an employee is threatened, the *Bundesarbeitsgericht* has developed the rule that the threat is legitimate if a 'reasonable' employer had considered dismissal; eg, BAG NZA 2002, 731. If that were the case, then the employee is not entitled to rescind a contract of termination (*Aufhebungsvertrag*) entered into under the influence of the threat for coercion. While it is not necessary that the dismissal would have been upheld by a court *ex post* (eg, BAG NJW 1997, 676), overall, the test applied is strict and, crucially, difficult to predict; for criticism, see eg, Hromadka, EWiR 1998, 251, 252 and Benecke, RdA 2004, 147, who object that this test creates insecurity. (See also, for a summary of the case law, BAG NZA 2004, 597, case no 84, discussed in section 2 on consumer rights, p 274.)

English law, likewise, recognises a category of 'illegitimate' threats, which fall short of threats to act unlawfully and yet are threats to do something 'wrongful' (such as blackmail) or threats which are held to be contrary to public policy (eg, the practice of 'blacking' ships by trade unions: compare the situation at the time of *The Universe Sentinel* [1983] 1 AC 366 with that when the series of cases on *The Evia Luck* was decided: see *Dimskal Shipping Co SA v International Transport Workers' Federation ('The Evia Luck (No 1)')* [1986] 2 Lloyd's Rep 165 and *Dimskal Shipping Co SA v International Transport Workers' Federation ('The Evia Luck (No 2)')* [1989] 1 Lloyd's Rep 166; [1990] 1 Lloyd's Rep 319 and [1992] 2 AC 152). For example, in *The Universe Sentinel* (cited above) Lord Scarman made it clear that '[d]uress can, of course, exist even if the threat is one of lawful action: whether it does so depends on the nature of the demand. Blackmail is often a demand supported by a threat to do what is lawful, eg, to report criminal conduct to the police' (at 401. See, also, Lord Diplock, at 385). The key question will thus be whether or not the relevant demand is 'unwarranted' and given the basic position discussed in the next paragraph, it seems that this will rarely be held to be the case. A possible example is the case of *Norreys v Zeffert* [1939] 2 All ER 187, where a threat was made to notify trade protection societies and the defendant's social club of his default on moneys owed under certain bets. Atkinson J (*obiter*, having ruled that there was no agreement in any case) drew a distinction (in assessing whether there as consideration for an agreement to pay off those debts) between threats carried out in the lawful furtherance of the creditor's business and those that merely intended to injure the debtor in order to induce payment of money. Thus, one might characterise the threat to inform his social club and the trade protection societies as illegitimate and the demand is not one to enforce a legal debt, as the gaming contract is illegal and unenforceable in a court (unless a new promise to pay can be extracted and supported by valid consideration).

Nevertheless, it must be remembered that the basic position is that it will not normally be duress to threaten to do something that one has the right to do. For a recent discussion, see the case of *CTN Cash & Carry Ltd v Gallagher Ltd* [1994] 4 All ER 714, especially at pp 718–19: to quote Beatson's summary, 'as a general rule the determination of when socially objectionable conduct which is not itself unlawful should be penalized is for the legislature rather than the judiciary' (*Anson's Law of Contract*, p 283).

7

The Doctrine of the Foundation of the Transaction

1. INTRODUCTORY REMARKS

This German term of *Wegfall der Geschäftsgrundlage* or, more accurately, of *Störung der Geschäftsgrundlage* includes three main types of situations: (a) cases where the purpose of the contract cannot be fulfilled because of the occurrence of subsequent unforeseen events; (b) cases where the performance, though strictly possible, has become 'impracticable' or where the value of the counter-performance has significantly changed; and (c) mistake in shared basic assumptions. The foundation may never have existed; it may have been shattered; or it may have totally collapsed. Though different terms are used for these situations, it is by no means obvious that they should entail different consequences. Indeed, they are treated in the same way in German law. This marks a fundamental difference from the position under English law, which proceeds on the assumption that mistake rules apply if a common misapprehension is present at the day of entry into the contract, while the doctrine of frustration takes effect where events have occurred *after* the conclusion of the contract which make performance illegal, impossible, or radically different from what the parties contemplated when making the contract. In German law both cases are discussed under the common name of a 'disturbance of the foundation of the transaction' (*Störung der Geschäftsgrundlage*). Note however that cases where the performance has strictly and literally become impossible are (and have traditionally been) expressly dealt with in the Code under the heading of impossibility (§ 275 I BGB). Moreover, certain cases of 'practical' or 'personal' impossibility, which had previously been discussed as examples of frustration, are now assimilated to the law of impossibility in § 275 II and III BGB respectively. Likewise, illegality is—traditionally—governed by a special rule in § 134 BGB (discussed in chapter 5, p 240). The term 'frustration' thus has a different breadth from that of the doctrine of the foundation of the transaction and should therefore be avoided when discussing German law.

The concept of the foundation of the transaction occupies middle ground between interpretation, setting the contract aside on the basis of mistaken assumptions and irregularities of performance. Indeed, the concept assumes characteristics of each of these three devices. This is why we have devoted a separate chapter to it in this book.

2. THEORETICAL EXPLANATIONS

Cohn, 'Frustration of Contract in German Law' (1946) 28 *J Comp Leg & Int L* 15; Dawson, 'The Effects of Inflation on Private Contracts: Germany' 33 (1934) *Michigan L Rev* 171–238; Dawson, 'Judicial Revision of Frustrated Contracts' (1982) *Juridical Review*; Dawson, 'Judicial Revision of Frustrated Contracts: Germany' (1983) 63 *Boston University L Rev* 1039; Ebke, 'Legal Implications of Germany's Reunification' (1990) 24 *Int Lawyer* 1130; Hay, 'Frustration and its Solution in German Law' 10 *The Amer J Comp L* 345 (1961); Kegel, 'Empfiehlt es sich, den Einfluß grundlegender Veränderungen des Wirtschaftslebens auf Verträge gesetzlich zu regeln und in welchem Sinn? (Geschäftsgrundlage, Vertragshilfe, Leistungsverweigerungsrecht)' *Gutachten für den 40. Deutschen Juristentag*, I (1953) 135 (a comparative study which also reproduces summaries of the forty-two decisions published after the end of the Second World War); Kegel, Rupp and Zweigert, *Die Einwirkung des Krieges auf Verträge* (1941); Köhler, 'Die Lehre von der Geschäftsgrundlage als Lehre von der Riskiobefreiung' in *50 Jahre Bundesgerichtshof* (2000) vol 1, 295; Larenz, *Geschäftsgrundlage und Vertragserfüllung* (3rd edn, 1963); von Mehren and Gordley, *The Civil Law System* (2nd edn, 1976), pp 1038 *et seq*; Oertmann, *Die Geschäftsgrundlage* (1921); Philippe, *Changement de circonstances et boulversement de l'economie contractuelle* (1986); Nussbaum, *Money in the Law* (revised edn, 1950) (excellent on the socio-economic background of the post-First World War period); Schmidt-Rimpler, 'Zum Problem der Geschäftsgrundlage' *Festschrift für H.C. Nipperdey zum 60 Geburstag* (1955) 1; Simon, *Der Wegfall der Lehre von der Geschäftsgrundlage* (1988); Treitel, *Unmöglichkeit, Impracticability und Frustration im Anglo-Amerikanischen Recht* (1991); Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (1990), especially pp 579–82. Special emphasis must be given to: W Lorenz, 'Contract Modifications as a Result of Change of Circumstances' in Beatson and Friedmann (eds), *Good Faith and Fault in Contract Law* (1995), p 357 (on which we have drawn freely).

If the circumstances in which a contract was concluded change after its conclusion, the ensuing legal difficulties bring into relief a clash between important contract values. The first is the principle of *pacta sunt servanda* and the certainty which this brings to legal transactions. Against this may stand the vaguer idea of fairness, often advanced behind the opaque Latin motto: *clausula rebus sic stantibus* (the historical, but not theological, foundations of which—which go back to Thomas Aquinas's *Summa Theologica*—are fully discussed by Pfaff, 'Die Clausel Rebus Sic Stantibus in der Doctrine und der Osterreichischen Gesetzgebung' in *Festschrift Unger*, pp 223–354 (1898). See also, Voirin, *De l'imprevision dans les rapports de droit prive* (1922)).

Throughout the nineteenth century, German states and jurists were divided as to which of these ideas deserved to take precedence. (For a comparative summary, see Schmitz, '*Clausula rebus sic stantibus*' in *Rechtsvergleichendes Handwörterbuch* I (1929), p 634.) For instance, the 1863 Civil Code of Saxony, in its § 864, took the view which had then come to prevail in Germany and ruled out any one-sided withdrawal from the contract because 'the circumstances under which the contract was made [had] changed or performance or counter performance [had] become disproportionate.' The earlier Prussian Code of 1794 had, on the other hand, provided a more detailed regulation (as was in keeping with its massive size) as well as a general provision—§ 378 I, 5—which stated that if '. . .an unforeseen change [of circumstances] makes it impossible to achieve the final aim pursued by the parties as expressed in the contract or inferable from the nature of the transaction, then each of them may withdraw from the unperformed contract.' (Likewise, see the *Codex Maximilaneus Bavaricus* of 1756, part 4, chapter 15.)

At first the importance of personalities played the decisive role in this area; later events of broader historical significance also played their part in influencing the development of the law. The personality to whom we refer was that of Bernhard Windscheid, arguably the most influential of the Pandectists of the nineteenth century and chief draftsman of the first version of the Civil Code. Now Windscheid had, as far back as 1850, written a monograph entitled '*Die Lehre des römischen Rechts von der Voraussetzung*'; and much of that thinking later found its way into his influential treatise on civil law (*Pandekten*, II (8th edn by Kipp, 1900)). Not surprisingly therefore the thesis came to the fore when Windscheid had his chance to draft the Code.

At its simplest, the theory posited that promisors usually assume that the intended legal consequences will occur only in certain circumstances. This assumption however about the continued existence of a certain state of affairs, has not been made a term of the contract. If the promisee had been in a position to realise that this 'presupposition' (*Voraussetzung*) had crucially influenced the will of the promisor, then the latter should not be held to his promise if this basic assumption (presupposition) was subsequently falsified. This comes close to saying that the contract itself was concluded under a condition (*Bedingung*) that the assumed state of affairs would remain unaltered for the period of the contract; and that is why Windscheid described this assumption as an 'inchoate condition' (*unentwickelte Bedingung*). The theory thus became known as the 'theory of presupposition' (*Lehre von der Voraussetzung*).

Those who were concerned with the security of commercial dealings struck back against this theory. The unilateral motives of one party, even if recognised by the other, could not be treated like conditions unless they had been incorporated into the contract. To do otherwise would allow one party to pass on his contractual risks to the other; and both legal certainty and commercial dealings would be impaired. Anyway, it was thought that the courts had other means at their disposal to cope with such cases since they could, where this seemed just and equitable for them to do so, imply a reservation of a right to terminate (*Vorbehalt eines Rücktrittsrechts*).

Doubts of this kind won the day, especially since Windscheid was not re-appointed as a member of the Second Commission that (partly) re-drafted the projected Code. But in an article published in volume 78 of the *Archiv für die civilistische Praxis* ((1892) 161, 197), he replied to Lenel's earlier objections (published in AcP 74, 213 *et seq* (1888)), retorting that the problem could not be brushed aside. 'The theory of tacit presupposition,' he argued, 'will, time and again, claim recognition. Thrown out by the door, it will always re-enter through the window.' He was right about the need to deal with the problem; less right about the fate of his theory. (Though Lenel returned to the fray again in AcP, 79, pp 49–107 (1899) with an article entitled 'Nochmals die Lehre von der Voraussetzung'.)

The 'Economic Consequences of the Peace' treaty (to borrow the title from John Maynard Keynes's famous book), signed at Versailles in 1919, led to the case law of

the 1920s, described in the next section. The problem was thus back, the calm confidence of the nineteenth century having been shattered by a war that put an end to three empires—the Russian, the Austrian and the Ottoman—besides ruining Germany. Inevitably, the courts were forced to solve the new problem in a pragmatic way; but they needed a theory with which to justify their work. Oertmann obliged with a book entitled *Die Geschäftsgrundlage; Ein neuer Rechtsbegriff* ('The Basis of the Transaction: A new Legal Concept') but not before having had one last attempt to redefine the notion of impossibility (see his 'Der Einfluß von Herstellungsverteurungen auf die Lieferpflicht' JW 1920, 476). The new theory appeared just as inflation was about to take off and enter its last and deadliest phase. Oertmann thus looked as if he was going to be luckier than his father in law (Windscheid).

The basis of the transaction, according to this theory, is the 'assumption made by one party which has become obvious to and acquiesced in by the other' that certain circumstances which they regard as important are either extant or will come about, even though this assumption was not expressed in their declarations exchanged when making the contract. (Oertmann, *Die Geschäftsgrundlage; Ein neuer Rechtsbegriff*, at 37.) This distinguishes Oertmann's theory from Windscheid's doctrine, for it is not sufficient that the assumption belied by the future course of events was privately entertained by the party to whose disadvantage things have worked out; it must have been manifested by him 'during the process of the formation of the contract' and 'acquiesced in by the other party.' Thus, in essence, Oertmann had shifted from the hopes and expectations of the parties (stressed by his father in law) to the obvious effects which the changed circumstances had had on the transaction. (For a detailed comparison of Oertmann's theory with that of Windscheid (as well as the older doctrine of *clausula rebus sic stantibus*), see: Locher, 'Geschäftsgrundlage und Geschäftszweck' in 121 AcP, 1 (1923).)

Oertmann's theory, though an improvement on Windscheid's, is not without its difficulties. A typical, if somewhat outdated example given in German books, talks of the father of the bride who buys furniture for his daughter's new household. Disaster then strikes in the form of the cancellation of the wedding. Everyone, including Oertmann, agrees that it would be absurd to argue that the contract of sale disappears with the cancelled wedding. But why is this not so? The better answer is because this is not within the sphere of the seller's contractual risk. Oertmann's theory also fails to provide an answer to all those cases where, at the time when the contract was made, the parties did not foresee the alteration of circumstances. The most that can be said here is that the parties regarded the continuation of the present circumstances as self-evident. This however means that the theory excludes any assumptions about the future course of events; and this means that, in the end, we are back to the old theory of *clausula rebus sic stantibus* and the view that what matters is that the situation remains as it was at the time of conclusion of the contract.

A theory which has had the express or tacit support of scores of decisions of the *Bundesgerichtshof* cannot easily be brushed aside, even if the criticisms levelled against it are weighty. Yet as Werner Lorenz (among others) has argued, 'a perusal of these cases leaves the reader with the impression that these citations are mere ornaments' ('Contract Modifications as a Result of Change of Circumstances' at 370). Every result thus seems, on closer analysis, to turn on the facts of each case (as we shall try

to show in the next sub-section). Moreover, the weight to be attached to such supervening events is not the same in all types of contract. The allocation of risk, inherent in each type of contract, seems to be the most important element in these crucial cases, turning on the 'collapse of the underlying element of the transaction.' It is also worth noting that in English law in the closely related area of 'failure of consideration' as a ground for restitution, this point concerning the allocation of risk as between the parties has been a key element in deciding exactly what was the basis of the transfer and whether this has failed sufficiently to entitle one party to claim restitution of any benefits already conferred. (For further details, see Virgo, *The Principles of the Law of Restitution* (1999), chapter 12.) Fuller discussion of this area does not seem appropriate in this context although one should note that the restitutionary principles can only come into play once any contract has been set aside. This leads to issues of electing between suing for breach of contract and rescinding the contract and then claiming a restitutionary remedy. This should not obscure the fact that, even once set aside, the contract, its terms and context, may be vital in assessing the availability and extent of any restitutionary claim (see *The Principles of the Law of Restitution*, pp 323–4).

This point concerning risk allocation will be found in most of the cases reproduced in translated form; and, according to Schmidt, it has become the common denominator of the case law since the decision of the *Bundesgerichtshof* of 1978 (BGH JZ 1978, 235, consolidating a trend which started with BGH NJW 1958, 297: *Staudinger*-Schmidt, § 242, Rn. 946). In this context it is perhaps also interesting to note that Treitel, who has written extensively on the subject both from the point of view of English and comparative law, shows equal scepticism about the utility of the search for the 'so-called theoretical or juristic basis of the doctrine of frustration' (*The Law of Contract*, p 920). To say, in a book on German law, that too much attention should thus not be wasted on theories, may sound heretical (especially since the post-Second World War period has seen no abatement to the Germanic ability (and predilection) to theorise; but with such powerful (and Anglo-German) authority backing such scepticism, the common lawyer may contemplate the thought, albeit with bated breath.

3. THE INITIAL APPROACH AND THE PRESENT POSITION OF THE BGB

There are (or used to be) a number of areas which the BGB left unregulated. One of them is the topic Anglo-American lawyers call frustration (subject to the reservations noted about this term, above). Yet it would be wrong to say that the Code (initially) totally ignored the problems raised by an unexpected change in circumstances. We thus find individual provisions, scattered in both the general and special part of the law of obligations, which deal with precisely such problems. We thus already referred to the rules of impossibility (§ 275 BGB) and illegality (§ 134 BGB) which would cover such cases as *Taylor v Caldwell* (1863) 3 B & S 826, ie the case of subsequent impossibility for which neither party is responsible, or *The Fibrosa* case [1943] AC 32. Here, then are two important English cases the facts of which have found an answer in the original text of the BGB. But there are other provisions which are narrower in scope, though the drafting commissioners of the Code made it clear that these exceptions

were *not* meant to reflect the existence of a general principle. (See *Motive*, vol I, pp 248–9; *Protokolle*, vol II, pp 690–1.)

Further, § 321 BGB provides an important right to the contractor who has to perform his obligation first. For such a person is entitled to refuse such performance until an appropriate security is given if, after the conclusion of the contract, there has been a significant deterioration in the financial position of his co-contractor which endangers the claim for counter-performance. Likewise, § 490 BGB allows the person who has promised to make a loan to revoke his promise if a serious deterioration in the financial position of the borrower endangers the repayment of the loan. § 779 BGB deals with a slightly different factual situation, namely one in which the agreeing parties have entered into a compromise (*Vergleich*) on the basis of a commonly believed state of affairs which turns out to be wrong. Analogous situations in English law would, probably, be handled as cases of common mistake (see the recent case of *Grains & Fourrages SA v Huyton* [1997] 1 Lloyd's Rep 628 (above, chapter 6, p 279), concerning a common and fundamental mistake as to the basis on which the contract terms were rectified). Finally, even though § 138 BGB conceives of usury in broad terms (which in some respects bring the German notion close to the English treatment of undue influence), its utility in the kind of cases we are considering in this chapter is limited since it can only alleviate hardships which arose before the making of the contract. It is readily observable that these isolated rules did not cover the bulk of cases discussed by Oertmann. Despite this cautious attitude of the BGB, the courts have—in what could be called a 'revolution'—developed their own general principles as to when a change of circumstances is relevant and based them on the general clause of good faith in § 242 BGB. This function of general clauses in allowing reform of the law through judicial decision-making has been highlighted in chapter 1.

The major reform of the German Code of 2002 eventually supplied an all-encompassing statutory basis for the doctrine of the foundation of the transaction in § 313 BGB. (For a short but useful treatment of this aspect of the reform, see Lorenz/Riehm, *Lehrbuch zum neuen Schuldrecht* (2002), Rn. 388 *et seq*.) This provision attempts to capture the basic tenets of the doctrine as developed by academics and applied by the courts in an abstract yet flexible way. It was thus not the intention of the legislator to change the previous (case) law. (See preparatory works, *BT-Drucks*. 14/6040, pp 374–5.)

It is important to stress from the outset that § 313 BGB is open-textured and does not pre-determine the result of the application of the doctrine to individual cases. Its importance is of more symbolic nature and lies, first, in validating the introduction of the doctrine into German law by the courts, and secondly, in empowering the courts to step in and change the terms of the contract where they think it necessary to correct a 'disturbance' of the foundation of the contract. On closer examination, the provision leaves ample room for policy considerations when allocating the risk of the occurrence of unforeseen circumstances. In order to understand the field of application of this provision, it is therefore necessary to review the landmarks of the development of the doctrine of the foundation of the transaction. In the following we will give a brief conceptual outline of the doctrine and subsequently illustrate how this position of German law was developed step-by-step by the courts.

Paragraph 313 BGB differentiates conceptually but not as to the legal consequences between the so-called 'objective' and the 'subjective' foundation of the transaction.

§ 313 I BGB defines the *objective* foundation of a contract thus: 'If the circumstances which have become the foundation of the contract have seriously altered after the conclusion of the contract and if the parties would not have concluded the contract, or would have concluded it with a different content if they had foreseen this alteration, then adaptation of the contract can be demanded in so far as adherence to the unaltered contract cannot be expected of one party taking into consideration all the circumstances of the individual case and in particular the contractual or statutory division of risk.' Whether the objective foundation of the contract needs to be in the contemplation of the parties, at least insofar as they have regarded it as self-evident (eg, BGHZ 131, 209, 215), is subject to some controversy. The issue may be left open here since the courts do not actually inquire whether the parties did regard the circumstance in question as self-evident.

In § 313 II BGB, the *subjective* foundation of the transaction is treated in exactly the same way as the objective basis of the transaction. It is derived from the horizon of expectations of the parties and concerns the case that essential assumptions of the parties which have become the foundation of the contract turn out to be wrong.

The *legal consequences* of a disturbance of the foundation of the transaction are laid down in § 313 III BGB. In the first place, an adaptation of the contract is required. Only where such a 'gap-filling' exercise is not possible, may the disadvantaged party withdraw from the contract. The disadvantaged party is thus granted a right to have the contract terms adapted or, in exceptional cases, a right to terminate the contract. Long-term contracts are terminated with consequences only for the future; in respect of all other contracts a reversal of any performance of the contract hitherto also takes place (under § 346 BGB).

The *contractual distribution of risk* is central to the application of the provision. The contractual risk-allocation is determined by reference, first, to the contract terms themselves and, second, in the absence of an express stipulation, by reference to general contract law principles. Ultimately this is a decision taken on the basis of policy considerations. It is difficult to state many general principles used in defining what is seen as the foundation of a transaction. The application of the doctrine depends on the facts of the individual case. As a result, it is even more important to understand the historical development of this area.

There is one insight, however, which underpins the doctrine of the foundation of the transaction and which should be emphasised at this stage. The doctrine of *pacta sunt servanda* requires that a subsequent change of the terms of a contract must be restricted to extreme cases. Only where it cannot reasonably be asked of one party (*unzumutbar*) to bear the risk of a subsequent change of events, or to bear the risk of certain assumptions as to the state of affairs when entering into the contract, does the doctrine of the foundation of the transaction come into play.

As a general rule, in all three major lines of cases which have emerged over the years the debtor is required to stick to the terms of the contract. The three *main* groups of cases are: an imbalance between performance and counter-performance, the frustration of the purpose of the contract and common mistake.

First, the mere fact that performance has become more burdensome than anticipated does not as a general rule entitle the promisor to back out of the contract. (This is also the basic starting point in the English law of frustration: see eg, *Davis Contractors Ltd* v *Fareham Urban District Council* [1956] AC 696, especially at 729.)

However, if the value of the counter-performance consisting in the payment of a sum of money has changed, the courts tend to show more sympathy with the debtor and adapt the contract to the value at the time of entry into the contract.

Turning to the second main group of cases, likewise, it is only in exceptional cases that courts will step in and allow the debtor to invoke a change of circumstance in relation to the intended use of the object of the contract. Generally speaking, every party to a contract is taken to assume the risk that he will be able to make a profitable or otherwise satisfactory use of the object of the contract.

Thirdly, in relation to the subjective basis of the transaction, it does not suffice that, for instance, the basis of the calculation of the price has been made known to the other party. Other circumstances are required to justify transferring the risk of an erroneous calculation of the price to the other party. In the subsections below we will give illustrations for all three of these lines of cases. It may be useful first, however, to explore the origins of the doctrine.

4. THE CAUSE OF THE REVOLUTION

The origins of the courts' preoccupation with the effects of a change of circumstances, but not yet the cause of the revolution, can be found in those cases which attempted (often successfully) to enlarge the notion of impossibility regulated by the Code. The illustrations here show the courts starting with a notion found in the Code (objective, subsequent impossibility), to which the debtor's subsequent 'inability' is assimilated and extending it to economic impossibility (sometimes with the help of § 242 BGB) on the grounds that to decide otherwise would be 'asking too much of the debtor' (*dem Schuldner unzumutbar*). This has, with the latest major reform, become law in § 275 II and III BGB. These groups of cases thus form a convenient bridge to the more adventurous case law we shall encounter in the next subsection.

The first of these cases dealt with subsequent impossibility concerning generic goods. Here, the governing rule used to be found in § 279 BGB, which stated that 'if a debt described by class is owed, and so long as delivery of this class of object is possible, the debtor is responsible for his inability to deliver, even though no fault may be imputed to him.' The same rule is now contained in § 276 I 1 BGB (under the heading of '*Beschaffungsrisiko*'). In RGZ 57,116, the defendant had agreed to sell the plaintiff flour produced in accordance with his own mill's secret recipe. Before the goods could be delivered, the mill was destroyed by fire but not before 2000 tons of this flour had left the mill, destined for another customer. In the light of this last-mentioned fact, it was not possible to maintain that such merchandise of this kind was no longer available. If § 276 I 1 (ex § 279) BGB were to be applied literally, the seller could always repurchase this flour from his other customer or, arguably, find similar flour in a distant market. Nevertheless, *aided* by § 242 BGB, the *Reichsgericht* took the view that the debtor is relieved where the fortuitous event has rendered performance so difficult that commercial men would regard such extraordinary difficulty as amounting to 'impossibility'. (Some earlier decisions, dealing with almost identical facts, had also absolved such 'innocent' debtors on the grounds that the accidental destruction of their mills made the performance of their contractual obligations 'essentially different.' Their inability to deliver the promised flour, while their mill was being rebuilt, was thus seen as amounting to 'impossibility' and not as 'delay'. See, for instance, RGZ 42, 114, 115.) On this point, compare the discussion of the well known English case of *Taylor v Caldwell* by Fuller and Eisenberg (*Basic Contract Law*, 3rd edn, p 801): the music hall could have been rebuilt in time to perform the contract, but it would have been so expensive that no reasonable businessman could be expected to pay out such sums in those circumstances. This reasoning is a nice parallel with the flour mill case discussed above (albeit not concerning bulk sales of generic goods), showing that 'impossibility' is a more relative term than it might appear at first sight (see further, Treitel, *The Law of Contract*, pp 880–1).

However, subsequent case law on bulk sales of generic goods showed that the courts were not automatically going to consider price increases, even when they exceeded 100 per cent of the originally agreed price, as constituting 'economic impossibility' leading to the absolution of the debtor. RGZ 88, 172, is one of a number of cases involving the sale of tin just before the First World War. The subsequent outbreak of hostilities sent the price of tin shooting up by some 200–300 per cent, but the *availability* of the goods was otherwise unaffected. In refusing to release the sellers (defendants) from their contractual duties, the courts took various factors into account, including the fact that these sellers were experienced wholesalers accustomed to price fluctuations. In the case in question, the court also felt that if the seller were released, the effect on retailers, who were more cautious in calculating resale prices, would have been disastrous because the percentage of price increases in their resale contracts would be much lower. The result might then be that such retailers would not have been able to plead 'economic impossibility'. The court thus held (at 177) that '. . . for such transactions the principle holds good that the seller will never be released as long as such goods are still being sold and bought on the market and are available in sufficient quantity for the performance of the contract. What the situation would be if only a few parcels of goods could be obtained by a fantastic offer or from a single supplier at an exorbitant price need not now be decided.' The final result was thus that the plaintiff (buyer) of the tin was allowed to claim the difference between the contract price of the tin and the amount he had to pay to another seller in order to obtain a substitute delivery. (For another 'tin' case, see RGZ 92, 322 and 95, 41.)

After the First World War, the case law shifted its ground somewhat on the basis of a new distinction. Were the generic goods in the wholesale contract in question available on a world market or was the debtor unable to choose between different suppliers? In the second situation, there could be cases where it would be 'utterly ruinous' (*geradezu ruinös*) to the seller to insist that he must perform at the originally stipulated price. For a time the idea of economic ruination held out some appeal and led to the so-called 'defence of ruination' (*Einrede der Existenzvernichtung*) being successfully pleaded in a number of cases. Thus, in RGZ 100, 134, the *Reichsgericht* was faced with an action brought against the sole distributor of Opel motorcars in Southern Germany who had entered into contracts to sell cars on the basis of the 1919 price list. Because of the hyperinflation that affected Germany after the end of the War (see next section), the price of the cars had increased very considerably when the contract had to be performed. The court stressed that sellers should carry the risk of price increases just as buyers should carry the risk of a fall in prices. In this case, however, the court took the view that the supplier had entered into a large number of such contracts and

that their fulfilment at the originally stipulated price would be totally ruinous to him. (For further illustrations, see RGZ 101, 79; 102, 98; 102, 272.) By now, however, inflation was here to stay, and indeed the signs were that matters were going to get worse; and the defence of ruination was also increasingly criticised as failing to provide sure guidance for courts when deciding whether to intervene in cases concerning such contracts. Another Division of the *Reichsgericht* thus wondered whether this defence led to an unfair distinction between wealthy and impecunious or badly organised debtors, the latter categories too easily attracting the sympathy of the courts (RGZ 103, 177, 178); and by the end of 1921, when the movement of prices had become even more pronounced, this theory was abandoned (RGZ 103, 177; and for criticisms, see: Locher, 'Geschäftsgrundlage und Geschäftszweck' 121 AcP, 93 (1923)).

By this time jurists had also come to realise that all attempts to 'enlarge' the codal notion of impossibility suffered from two major flaws. The first, obvious to the reader from what has already been said, stemmed from the vagueness of the notion of 'economic impossibility', however one tried to define it. The second was linked to the fact that the pleas of impossibility, if accepted by the courts, resulted in the contract in question automatically being discharged; and a number of disputes soon made it clear that in many instances this was not the wish of either party to the affected contract! The search thus started for another theory which would make the answer turn more openly on the disproportionality between performance and counter-performance brought about by the unexpected turn of events, and which would also allow the parties to keep the contractual bond alive through mutually advantageous adjustments. The theories of Oertmann and Krückmann (enunciated in an important article published in 1918 in 116 *Archiv für civilistische Praxis*, 157 and based on the idea that proportionality between performances is of the essence in synallagmatic contracts) were to perform this function. These theoretical underpinnings arrived not a moment too soon. For the type of case that was now coming before the courts was different; and the economic imbalance, resulting from the galloping inflation, much larger (while in some instances also posing a direct challenge to statutory law). So we must turn our attention to this aspect of the case law and then look at the casuistry of the courts.

When Windscheid predicted in 1892 that the drafters of the Code were too optimistic in their belief that they could make do without a legal theory for changed circumstances he was right; but he could not have foreseen the events which brought this topic to the fore just after the end of the First World War.

The political events are well known. The victors of the war, largely under pressure from the French (on whose soil much of the war had been fought), demanded severe economic reparations from the defeated Germany, coupled with the 'occupation' of the German industrial zone in the Ruhr as a guarantee that these huge sums of economic atonement would be paid. In human terms, the demand was understandable; in economic and political ones, it proved a disaster. A disaster in social and economic terms for Germany, but ultimately for the rest of Europe as well. For the internal dislocation in Germany provided, eventually, the ideal conditions for the rise of the National Socialist movement which capitalised on the frustration induced in the German people, first by the hyperinflation of the 1920s and then the American-led deflation of the 1930s. If this appears easy to assert with the benefit of hindsight, one

must not forget the handful of brilliant individuals (such as John Maynard Keynes) who foresaw much of this at the time but were unable to stem the tide of events.

These catastrophic consequences followed, indeed with a ferocity and a rapidity that may well be unique in world history. They certainly give the German law of 'frustration' a sense of uniqueness which contrasts sharply with the more 'commercial crises' that provided the staple diet of the English courts. (It is interesting, for instance, to note that we have been unable to find a German Suez case: for the English cases see eg, *Tsakiroglou & Co Ltd v Noblee Thorl GmbH* [1962] AC 93 and Treitel, *The Law of Contract*, pp 879–80.) Certainly, England never experienced inflation of this kind; and one may be permitted to speculate that if it ever did, its attachment to nominalism would fall by the wayside as it did in Germany. (Lord Denning's views in *Staffordshire Area Health Authority v South Staffordshire Waterworks Co* [1978] 1 WLR 1387, accord with this hypothesis; and their force is not diminished by the fact that in his country the great judge's views have, often, met with suspicion or rejection.)

Be that as it may, in Germany, at the beginning of the First World War, one gold mark had an internal purchasing power of RM1.05. By the end of the war, the figure was RM2.62 (somewhat higher than the rise that occurred in the US but lower than that found in France); and it had risen to 36.7 RM by 1922. But one year later—1923—the rise became steep: 2,785 RM had the purchasing power of 1 RM of 1914. Then in May of that year prices literally went berserk, so that by the end of that year the mark had a trillionth of its 1914 value (1,200,400,000,000 RM equalled one 1914 RM). One can look at these figures in a different way. At the beginning of the war 4.2 RM bought one US dollar. By the end of the war, the mark stood at 7.43 to the dollar; and by the early Autumn of 1923 98,860,000 marks in order to purchase one US dollar. After that date, quotations were in billions of marks to the dollar.

In the light of the above economic developments, the calls for legislative intervention were very loud; but the problem was not easily soluble. Influential financiers, among them Schacht in an important book entitled *The Stabilization of the Mark* (1927), expressed serious doubts about the economic advisability of these revalorisation moves. Others thought that the social inequities of this situation required urgent action whatever the merits of purely financial arguments. Foreign creditors were also proving intransigent, thwarting the Reichsbank's attempts to stabilise the mark. (The financial aspects of the crisis are thoroughly discussed by Elster, *Von der Mark zur Reichsmark* (1928) who provides many interesting figures about the collapse of the German currency. For a discussion in English see: Graham, *Exchange, Prices, and Production in Hyper Inflation: Germany, 1920–1923* (1930).)

To this financial debate another one of a political/legal nature was soon to be added. Could the courts take matters into their hands when the legislator was unable and or unwilling to act? The outcry that followed in some quarters after the *Reichsgericht's* decision of 1923 (discussed in this section) was published, led the President of the Association of Judges of the *Reichsgericht* to issue a stern statement to the press. Some extracts deserve to be quoted in full since they give an idea of how extreme the tone of the debate had become:

> No one will criticize the Reichsgericht for having too quickly and without mature reflection given up the principle that mark equals mark . . . the cautious way in which the decision [of 1923] is reasoned shows how fully the senate was aware of its responsibility in view of the

> significance of the decision. When the highest court of the Reich, after careful consideration of the arguments for and against, has come to such a decision, it believes that it can expect that the government will not set aside the view taken by the court by fiat (*Machtspruch*) of the legislator. The decision is grounded on the great concept of good faith which rules our legal life, and supported by the recognition that to continue to hold to the notion that mark equals mark would lead to a great deal of injustice, unbearable in a State based on justice (*Rechtsstaat*) . . . the concept of good faith stands outside of individual statutes, outside of particular provisions of the positive law. No legal order that deserves this honourable name can exist without this fundamental principle. Consequently, the legislator cannot by his fiat frustrate a result that good faith imperatively requires. (Statement of 8 January 1924, translated by von Mehren and Gordley, pp 1090–1.)

(For a fuller discussion see Kübler, 'Der deutsche Richter und das demokratische Gesetz' in AcP 162 (1963), pp 114–5.)

The statement elicited a prompt response from the Reich's Minister of Justice. Overall, it was more restrained in tone. In it he first claimed that the judge's reaction was based on newspaper reports about contemplated government action which had not yet been decided. But he then took particular objection to the judge's notion that the court's decision could not be altered by legislative action. He concluded thus,

> . . . it would lead to a dissolution of the legal order and to a fatal dislocation of the governmental framework if a court claimed the right not to apply a law that had been enacted by the constitutionally required procedures because a majority of [the court's] members believe that the law is not in accord with the general moral law. . . .

In constitutional terms this must have surely been right.

Yet the courts were also right to take note of the fact that by this time the collapse of the mark in the foreign exchanges was largely the result of foreign perceptions and attitudes, something which gave them the opportunity to adopt a different optic towards the problems confronting them. The most important consequences followed from this realisation that the problem was no longer one of rising prices but of depreciation in the value of money. For, as Professor Dawson observed (33 *Michigan Law Rev* 171 at 190 (1934)):

> A gross inadequacy of price could then be ascribed, not to the general disruption of economic life from which all Germans suffered alike, but to a change in the standard of value selected by the parties in the particular case. The creditor in a money obligation might fairly be required to forego the substance of his claim for the sake of the national interest or to preserve the sanctity and certainty of contract. It was quite another thing to require that he bear the risk of blind and capricious changes in the purchasing power of money.

Seen in this light, the 1923 decision acquires a certain aura of inevitability.

Two years later the dispute was brought to an end by the enactment of a statute (the *Aufwertungsgesetz*—Law of Revalorisation of 15 July 1925, superseding temporary legislation enacted on 14 February 1924) which adopted the court's ratio and allowed owners of land to extinguish their mortgages by paying a sum amounting to 25 per cent of the value of the mortgage in gold marks.

Yet the 1925 Act only applied to some transactions—mainly mortgages of land and negotiable bonds; and it allowed fixed adjustments to be made which varied according to their type or nature. (For instance, 25 per cent for debts secured by mortgage; 15 per cent for negotiable bonds; for most banks and insurance companies, partial

receiverships were employed; bonds of government agencies received nothing etc. Clearly, these percentages meant that claims were, in large part, wiped out.) This approach did not please everyone (cf, for instance, Oertmann's views in *Die Aufwertungsfrage* (1924), pp 72–4); but the contrary decision to leave every possible transaction to be adjusted by the courts would have entailed huge delays and prolonged uncertainty. The Act (and a number of hotly contested government decrees) further excluded from the courts all public obligations of the Reich—a decision which obviously had an important effect on the country's public debt. Additionally, and perhaps most importantly from the point of view of private law, §§ 10 and 63 of the Act listed the bulk of the transactions (which included all synallagmatic contracts, payments for maintenance and support, etc) for which the adjustment and revalorisation was to be made 'according to general provisions of law.' So the 1923 decision retained a large area of application; it also ushered in a host of other problems. In what follows we discuss some of these difficulties. The precise way that each was solved must be sought in more specialised works, since it would be of little use to go into them in a book of this kind. (For a brief account in English see 'The Effects of Inflation on Private Contracts: Germany' 33 *Michigan L Rev* 171, 213–38 (1934).)

First, in effect the decision declared a 1909 Act of the German legislature (which had made the *Reichsmark* legal tender) no longer to be in force. Writing in 1934, Professor Dawson suggested '[t]hat a court of law could do so much [as was done by the Decision of 1923] is proof of the courage and imaginative insight of the German judiciary.' And he continued (33 *Michigan L Rev* 171, 238 (1934)):

> Seldom in history has there been a revolution in judicial thinking so complete, in the short space of four or five years. In retrospect it seems plain that every available resource of legal science was applied to relieve the mounting burden of intolerable injustice, to preserve what was left of order in the midst of universal collapse, and finally to reconstruct those values that the wreck had not wholly destroyed.

That the decision showed courage is beyond doubt; but Professor Dawson also might well have been right to add (as he did in an article written in 1983 (93 *Boston University L Rev* 1085 that the judges, who by that time were increasingly recruited from the middle classes which 'had suffered severely during the inflation,' might have been showing through their decisions their growing impatience with the 'political leadership that the Weimar Republic had installed—popularly elected, leftist in tendencies, and more and more helpless to cope with the array of interconnected and insoluble problems that piled up after the war.'

Secondly, the revalorisation that was proposed came to cover not only contracts not yet executed, but those—going back to 1922—which had been 'closed' through performance, compromise, litigation or otherwise. Coupled with the next point, this meant that a huge number of cases had to be resolved by trial judges and other administrative officials who were charged with the task of adjusting all such contracts. Professor Nussbaum, among others, has described the effects of this measure. He wrote:

> In his budget of 1926, the Prussian Minister of Finance mentioned that it had been necessary as a result of revaluation to appoint more than three thousand officials, permanent and auxiliary, to the Prussian courts. A figure of five thousand for all of Germany is probably not an exaggeration. Litigation, as if to imitate the scale of depreciation, rose to millions of cases.

Three reporter systems were created for evaluation cases alone; the *Reichsgericht* itself rendered considerably more than two thousand judgments on revaluation during a period of about ten years. Nearly half of them reversed the decision of the lower appellate courts, thus evidencing the bewilderment of the judiciary (Nussbaum, *Money in the Law*, pp 206–11).

The above was largely the result of the third consequence of the 1923 decision; and here again it deviated (for reasons which are not entirely clear) from the firmly-held principle expressed by the *Reichsgericht* only eight years earlier (RGZ 86, 397, 398, case no 95, cited with approval two years later by RGZ 90, 374, 375) that '[b]y the provisions of positive law the power is not conferred on the judge to re-adjust contracts for the purpose of alleviating the hardships of war.' Thus the possibility of merely discharging the parties (and ordering restitution where this was necessary) was ignored, the German courts moving increasingly (and with strengthened conviction since the second World War period) towards the position that contracts whose foundations were destroyed by unexpected events or discoveries would be revised and not terminated since 'in law it is a basic premise that contracts should be performed.' (BGH JZ 1952, 145, 146. Many other cases adopted this stance. For instance: BGH NJW 1953, 1585; NJW 1958, 785; NJW 1969, 233; BGHZ 58, 355; BGH NJW 1984, 1746, case no 106.) The 'claim for adjustment' (*Ausgleichsanspruch* on which see Hedemann, *Reichsgericht und Wirtschaftsrecht* (1929), especially 312 *et seq*) thus became an essential feature of this litigation.

How burdensome if not impossible was this task, which was now placed on the shoulders of the trial judge, can be seen from the 1923 decision itself, which allowed the owner mortgagor to pay off his loan (and remove the mortgage) by ordering him to pay the mortgagee/lender a supplementary amount. The instructions to the trial judge as to how this supplement should be calculated included the order 'to take into account not only the increase in the value of the land—measured according to paper marks . . . but also the other circumstances of the case such as the economic strength of the debtor and the nature of the land (ie, whether it was agricultural, industrial or urban). Also the charges, especially of a public character which burden the land must be taken into account.' And if that seems a Sisyphean task, consider the trial judge who had to comply with the instructions of the *Bundesgerichtshof* in the Volkswagen case decided in 1952.

The facts of this strange decision can be abridged as follows. Just before the beginning of the second World War the two plaintiffs, along with a further 336,000 other potential purchasers, made small payments to the DAF (*Deutsche Arbeitsfront*, an entity set up by the Nazi regime as a substitute for all former labour trade unions). The DAF acted as a sort of 'trustee' for the defendant, which was a car manufacturer that had the full backing of the Nazi apparatus in its effort to produce 'the people's car'. The money, prepaid through savings books made available for this purpose, was deposited by the DAF in a Berlin bank. The potential purchaser, known as a *Volkswagensparer*, would typically purchase stamps which would be stuck in a book and, when the requisite amount had been gathered, he could exchange the book for a car. When war broke out, the car factory was first turned to military purposes, and subsequently was largely (but not entirely) destroyed by Allied bombing. The series of disasters was then completed by the Russians entering Berlin before the Americans and confiscating the said DAF account. After the war had come to an end, and the dust—literally—had began to settle, the plaintiffs sought the delivery of their cars

(and were willing to pay for them whatever price was assessed by the court). Their action was dismissed on the ground that the foundations of their contracts had been totally destroyed by the aforementioned events.

The *Bundesgerichtshof* disagreed, starting from the premise (mentioned above) that contracts once entered into must be enforced. The *Bundesgerichtshof* thus ordered the trial judge to find out how many of the other 336,000 prospective purchasers wished (and were able) to proceed with the purchase of their cars, as well as answers to a host of other questions. And, as if all this were not enough, the defendant firm was to be instructed to produce the maximum possible number of cars in order to ensure that this performance was not pushed too much into the future while ensuring that all new customers were also fully satisfied. Professor Dawson has observed that 'the trial judge to whom the case was returned must have had the sensation that he was wandering lonely as a cloud among the daffodils as he set about performing these multifarious tasks' (93 *Boston University L Rev*, 1085 (1983)). Professor Larenz, more Germanically and prosaically, wondered whether such an order required of the judge resources which he simply did not have at his disposal. No wonder then that in recent times academics, relying on judicial hints, have encouraged the idea of the parties being placed under a duty to renegotiate their dispute and only if they fail to reach an agreement to be allowed to have recourse to a court of law. (See, for instance, Eidenmüller, 'Neuverhandlungspflichten bei Wegfall der Geschäfsgrundlage' ZIP 1995, 1063 *et seq*, essentially reviewing Nelle's more wide-ranging *Neuverhandlungspflichten* (1993/4).)

But such attempts failed in the early 1920s, when the courts came increasingly under very heavy pressure of litigation, not least because the interests of the parties can be so diametrically opposed. One wonders, therefore, what might make such attempts succeed today, especially when the case law under this heading has, if anything, decreased in volume compared with the 1920s. In any event, rather than invent new duties to negotiate and, *faute de mieux*, hang them on the peg of § 242, one might well try to abandon the whole predilection for 'adjustment' and try to shift the judges towards the idea of termination (plus rights under the rules of unjustified enrichment). Professor Dawson was thus at his most convincing when he asked 'why should such a monumental, unmanageable task be undertaken at all?' (93 *Boston University L Rev*, 1086 (1983)) This preference to 'reconstruct' the contract rather than to 'dismantle' it rested in the first instance on the premise (established in the 1920s) that, since a contingency had occurred for which the contract had not provided, a court must step in and fill the gap. Few persons, even among the more sceptical authors, have been willing to admit that the conclusion had no connection whatever with the premise.

In comparative terms, the result of the above was that, at least in this respect, the German doctrine of 'frustration' is closer to the English equitable doctrine to order rectification in the case of a contract entered into by mistake than to the English law of frustration. For in the latter case the contract comes to an end automatically and without the court having any powers to adjust the parties' obligations except for certain restitutionary consequences. (See *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32, and now the extended rights given by the Law Reform (Frustrated Contracts) Act 1943. On this see: *BP Exploration (Libya) Ltd* v *Hunt* [1979] 1 WLR 783, affd [1983] 2 AC 352.) Contrary attempts, made by Lord Denning in *British Movietonews Ltd v London and District Cinemas* [1951] 1 KB 190, were emphatically turned down on appeal by the House of Lords in [1952] AC 166;

and the same position seems to prevail in the US, even though one does find the odd case where judges have displayed the Germanic tendency to redraw the contract for the parties. (Thus see, the inconclusive case of *Aluminum Co of America v Essex Group Inc* 499 FSupp 53, 1980.) It should also be noted that, in English law, the relatively restrictive approach to the frustration of contracts has led to the development of an extensive and sophisticated practice of including *force majeure* clauses, particularly in standard form contracts. These clauses have a number of benefits for the parties: they can be triggered off even where the relevant event would not have amounted to frustration in the strict sense and the remedies provided under such clauses can be made more flexible than the total discharge of the contract (eg, suspending performance until the effect of the event has subsided, granting extra time to perform or providing further remuneration for performance that has become more onerous). (See generally, Treitel, *Frustration and Force Majeure* (1994) and McKendrick, *Force Majeure and Frustration of Contract* (1994).)

If the English story is much less dramatic than the German, it is not without its difficulties. Major adjustment of the strict English approach to the consequences of the frustration of a contract came in the form of legislative intervention in 1943 in the form of the Law Reform (Frustrated Contracts) Act. At common law, the result of frustration was to bring the contract to an end automatically and immediately (*Hirji Mulji v Cheong Yue Steamship Co Ltd* [1926] AC 497), with the result that all future obligations were discharged (*Appleby v Myers* (1867) LR 2 CP 651: obligation to pay for the partial erection of machinery was discharged when the premises and the machinery were destroyed by fire, because payment was to be made on completion of the work). Equally, obligations already accrued prior to the frustrating event remained in place (*Chandler v Webster* [1904] 1 KB 493), although the development of the law of restitution since the *Fibrosa* case (*cited above*) has allowed recovery of moneys paid over where there has been a 'total failure of consideration' (in the sense that none of the performance, for which the payment had been made, has actually been received). Even this last common law development left certain difficulties unanswered. For the requirement that such a failure of consideration be 'total' meant that receipt of any part of the performance could render the *Fibrosa* type of claim inapplicable. Further, the party that was thus forced to return such payments might have incurred preparatory expenses or left with goods now worthless due to the failure of the contract, neither of which it could claim against that sum to be repaid. It was such problems that the 1943 Act aimed to resolve and we provide a brief summary of the Act here.

Section 1(2) of the Act concerns the restitution of money paid. It basically embodies the *Fibrosa* position, but makes clear that the requirement of 'total' failure of consideration need not be satisfied to recover any payments made. The proviso to section 1(2) goes further, however, allowing any expenses incurred 'in, or for the purpose of, performing the contract' to be set off against any such repayments 'if [the court] considers it just to do so having regard to all the circumstances of the case.' Indeed, a claim can be made for such expenses under section 1(2) *even if no payments were made the other way* under the contract, *so long as* some payment was due to be paid in advance. Meanwhile, section 1(3) concerns the restitution of any 'valuable benefit' in kind, which again can be set off against any repayments to be made if the court considers that it is just to do so in the circumstances. The application of section 1(3)

requires that the relevant benefit first be identified and valued and then the court must assess how much the party providing that benefit should be awarded (*per* Robert Goff J (as he then was) in *BP Exploration (Libya) Ltd v Hunt* [1979] 1 WLR 783). For analysis of the detailed operation of these provisions, see Beatson, *Anson's Law of Contract*, pp 558–62; Treitel, *The Law of Contract*, pp 913–17; Burrows, *The Law of Restitution* (2nd edn, 2002), pp 361–72 and Virgo, *The Principles of the Law of Restitution* (1999), pp 376–88.

A detailed analysis of the Act cannot be undertaken here; rather we wish to highlight certain issues raised by the operation of the Act.

First, we must note that the Act does not apply where a provision of the contract excludes it: section 2(3). This is consistent with the point made above concerning the allocation of risks by the parties: where this has been made explicitly, the courts will not intervene simply if one party has made a bad bargain.

Secondly, and interestingly from a comparative perspective in the light of the foregoing discussion, it may be asked whether the Act aims at a general apportionment of the loss suffered by the parties as a result of the frustrating event. In the first major case on the matter, the court held that the 'fundamental principle underlying the Act . . . is prevention of the unjust enrichment of either party to the contract at the other's expense' and not more general loss apportionment (*per* Robert Goff J in *BP Exploration (Libya) Ltd v Hunt* [1979] 1 WLR 783, at 799–800). This approach has been criticised by some. See, for example, McKendrick, 'Frustration, Restitution and Loss Apportionment' in Burrows (ed), *Essays on the Law of Restitution* (1991), p 147, on the basis that it is particularly difficult to distinguish between those actions in reliance on the contract that create a benefit and those that do not. Others, however, point out that the part-performer can more easily assess the risks involved and obtain insurance (Posner and Rosenfield, 'Impossibility and Related Doctrines in Contract Law: An Economic Analysis' (1977) 6 *Jo Leg Stud* 83, 112 ff) or suggest that such an approach would be contrary to 'the basic individualistic tradition of contract law whereby contracting parties are viewed as pursuing their own self interest and taking their own risk.' (Burrows, *The Law of Restitution*, p 365. More generally see Virgo, *The Principles of the Law of Restitution*, pp 373–90 (especially 388–90).)

The most recent case on the matter engaged in a detailed discussion of section 1(2) of the Act and in particular of the proviso thereto. (See *Gamerco SA v ICM/Fair Warning Agency Ltd* [1995] 1 WLR 1226 (noted by Clark [1996] *LMCLQ* 170)). In that case, Garland J concluded that section 1(2) was not merely a statutory formulation of the defence of change of position (on which see *Lipkin Gorman Ltd v Karpnale* [1991] 2 AC 548) but rather encompassed a broad discretion for the court to do what was just in all the circumstances, which could include some measure of loss apportionment (subject to the conditions of section 1(2)). It seems that it is accepted that some level of loss apportionment is thus possible under section 1(2), (thus Burrows, *The Law of Restitution*, pp 363–5), alongside a limited change of position defence. This is however a far cry from the legislation adopted in other Commonwealth jurisdictions which allows full loss apportionment to deal with frustrated contracts. (See, for instance, the Frustrated Contracts Act 1974 (British Columbia), the Frustrated Contracts Act 1978 (New South Wales) and the Frustrated Contracts Act 1988 (South Australia), helpfully discussed by Stewart and Carter, 'Frustrated Contracts and Statutory Adjustment: The Case for a Reappraisal' [1992] *CLJ* 66 (especially 79ff).

This is not the place to attempt to resolve this involved debate. Nevertheless, these points are highlighted to show that the effects of the common law and the various statutory interventions that have sought to improve the position have not been blind to arguments based on loss apportionment, although how far these interventions have dealt successfully with the issues raised is another matter, particularly when discussing the UK's 1943 Act.

5. ADJUSTING PERFORMANCE AND COUNTER-PERFORMANCE: A CLOSER LOOK

Outside the area of bulk sales where, as we have noted, some experiments were carried out with the notion of economic ruination, the attitude of the German courts remained reserved, initially at any rate. After all, the oracles of the law came from a background that had taught them that important legal changes come from the legislature, guided by the informed mind of trained jurists. Not surprisingly, therefore, the first rumblings of discontent with the economic consequences of a prolonged war fell on unsympathetic ears.

RGZ 86, 397, case no 95, is as good an example as any. There the defendant gave the plaintiff in 1913 the option to hire his circus. Because of the war, the takings at the gate were diminished; and the plaintiff tried to get out of his agreement. The court replied sternly that according to the law 'the judge is not empowered to adjust the relations between the parties . . . in order to mitigate the hardships of war.'

Five years later, in RGZ 100, 129, case no 96, the first signs of weakening appeared. The plaintiff, who in 1915 had let industrial premises to the defendant, was also expected to supply steam for the purposes of the business. By 1920, the cost for this had gone up considerably; and the plaintiff sought extra money, or at least a declaration that he had to supply steam only at a reasonable price. The *Reichsgericht* first referred to its earlier, harsher law (of which RGZ 99, 258, is particularly noteworthy since it (a) dealt with very similar facts and (b) was decided a mere three months before the present case) and then trumpeted the retreat from the positivistic positions of earlier years. 'The first and noblest task of the judge,' said the court, 'is to satisfy in his decisions the imperative demands of life and to allow himself in this respect to be guided by the experiences of life.' The case must be read carefully, not only for its disregard for strict legal analysis in favour of 'fairness', but because it contains the seeds of the new approach (criticised above), namely that the courts will not only terminate the contractual relationship, but will adjust it provided that three conditions are satisfied: first, both parties must wish to continue with the contractual relationship; secondly, an adjustment for both parties must be possible; and thirdly, such an endeavour will be undertaken only in the case of a 'very exceptional transformation of circumstances.' As repeatedly stated so far, the first of these features was, in one sense at least, the most important since both parties were unwilling to accept the one remedy (discharge of the contract), which the hitherto favoured theory of 'impossibility' would allow.

The new approach did not find immediate favour with all the divisions of the *Reichsgericht*. (At that time there were seven, though two years later that had risen to

thirteen. For a disapproving decision see, for instance, RGZ 103, 170, 177.) Yet the dam was breached; and RGZ 103, 328, case no 97, unequivocally confirmed the new trend, for the first time also alluding to Oertmann's theory rather than using the more emotional language of the earlier decision. The court at least made the pretence that it was applying a scientific theory emanating from a professor of the University of Göttingen, a comforting refuge for most German judges. But as we have already noted and Kegel has pointed out, the decision ultimately hinges on the court's distribution of risk on the basis of policy considerations: the risk of currency depreciation, following a lost war, is not one which can be allocated to one party or the other but must be born by both, ie the population at large. The road for the revalorisation (*Aufwertung*) decisions was now wide open; and not a moment too soon, for by the Spring of 1923 inflation had entered its most virulent stage.

The facts of that landmark case (RGZ 107, 78, case no 99) were simple; and the policy question it had to answer was how could one achieve an equitable distribution of the currency risks in a currency market which found itself in great turmoil. But it also had to confront two difficulties which had not figured so prominently in the earlier case law. The first was the language of the private bargain which left no room for judicial intervention; the second the unequivocal and forbidding wording of the statute which adopted the principle of nominalism. The litigation arose because the owner of land (mortgagor) tried to pay off his lender (mortgagee) with old marks. The mortgagee refused to surrender the mortgage unless and until he was paid a properly revalued sum. The language of the Supreme Court has none of the emotive tone of the earlier case (RGZ 100, 129, case no 96); nor does it show any traces of the politically provocative stance found in the subsequent press announcement of the presiding judge—no doubt because it was conscious of the significance of its decision. But the opinion did contain a number of very important points, which had been foreshadowed in the earlier cases and have been maintained intact ever since (in addition, of course, to invoking the Oertmann theory).

The first point was that such interventions would only be undertaken in cases involving the most serious of disruptions. The 1920 decision had thus ruled that 'only very special and quite exceptional transformation and change of circumstances . . . can bring about the result outlined above [revalorisation]. The fact alone that a subsequent change in the conditions is not foreseeable and could not be foreseen does not suffice.' The 1923 decision justified its abandonment of 'nominalism' by stressing the fact that 'this principle must be disregarded . . . if as a result of an especially heavy depreciation of legal tender, not foreseen at the time when the currency regulation was passed [ie,1 June (1909)], it would lead to results which can no longer be reconciled with § 242 BGB.'

This point was well made in a post-Second World War case (the facts of which can be found below: BGH NJW 1959, 2203–4, case no 102). There the *Bundesgerichtshof* stated:

> One of the stated requirements for the application of the theory of the collapse of the basis of the transaction . . . is that the intervening change be of critical nature and affect the interest of the parties to a significant degree. Not every adverse modification of the prior relationship of equivalence, unforeseen by the parties at the time of the contract, justifies a departure from the principle that contracts must be adhered to (*pacta sunt servanda*). What is really required is such a fundamental and radical change in the relevant circumstances that it would be an intolerable result, quite inconsistent with law and justice, to hold the party to the contract.

The 1923 case, RGZ 107, 78, case no 99, also re-emphasised a point that we made earlier, namely that these cases do not purport to lay down a general rule which will be applied mechanically in each subsequent decision. Thus the court stressed that 'it will be necessary to determine in each case and in accordance with the principle of good faith what degree of monetary depreciation is necessary before a creditor's claim must be revalued.' Indeed, earlier in its opinion the court had expressly stated that no general principles can be established requiring the revalorisation of every mortgage claim as such, nor that they must all be revalorised to the same extent.' (This last point, however, was abandoned by the 1925 legislation which set fixed amount of revalorisation for the various typed of transaction for which it provided.)

The third point implicitly confirmed by this landmark case was that adjustment, and not termination of the contract, was the logical reaction to this crisis. This preferred option seemed to follow from the principle enunciated many times since that 'in law one must start from the premise that contracts are to be performed'; and a number of subsequent decisions have stressed their belief that they do not regard themselves as intervening in these cases but merely helping bring about the natural result of the contract. (See, for instance, BGH JZ 1952, 145 and note by Kegel.) That this, however, does not necessarily follow from abstract contractual logic can be seen by looking at other legal systems which have not followed the German approach. A number of cases, which are noted below, make one wonder whether this approach is in many cases at least preferable to a simple termination of the contract followed by an application of the rules of unjust enrichment, if any. But whatever the merits of the 'adjust' rather than 'dissolve' approach, let us stay with it for a moment and see what forms this adjustment took in practice.

More often than not, the adjustment took the form of increasing the amount of the performance in order to provide the equivalent of the counter-performance which had already been rendered. One thus assumes that in the 1923 case the mortgagor would have been made to pay a higher amount in exchange for the removal of the mortgage from the *Grundbuch* (the German equivalent of the Land Registry.) (See, for instance, BGH DB 1958, 1325.) Indeed, as already stated, the Revalorisation Act made this equal 25 per cent of the mortgage in gold marks. Even with the sum of revalorisation fixed (from 1925 onwards) to 25 per cent of the mortgage, other difficulties arose in practice. Here are two of the variations that confronted the courts.

In the first variant, cases arose in which the *vendor* (mortgagor) of land undertook, as part of his obligations of sale, to extinguish any mortgages which existed on the sold land. If he did this before the transfer to the purchaser, but the lender/mortgagee had been paid with worthless money, he could demand the reinstatement of the mortgage in the Land Registry. This revival of the mortgage, however, had the consequence that the vendor could no longer be said to have transferred the land to his purchaser, free of all encumbrances (*lastenfrei*), as he is obliged to do under § 439 II (now § 442 II) BGB. This meant that he thus had to pay off the mortgage for a second time and, what is more, in hard currency—a sum which invariably exceeded the purchase money. The *Reichsgericht* held that in such cases good faith required that the vendor of the land be granted a contribution claim (*Ausgleichsanspruch*) against the purchaser, so that the purchaser was thus obliged to contribute to the cost of paying off the mortgage. The size of this contribution, invariably left to the lower courts to assess, was determined by a variety of circumstances, though it must be added that a

purchaser unwilling to go along with such an arrangement was allowed to terminate the contract of sale.

The second variation on this theme involved the reverse situation. Here the purchasers of land were again asked to make increased payment to the vendors in cases where, as a result of altered circumstances, *they* (and not the vendors as in the preceding example), were relieved of obligations under the contract of sale. This situation was, for instance, brought about where the purchase price was less than it would otherwise have been because the purchaser had expressly undertaken to pay any mortgages that burdened the land.

This factual variant was litigated after the Second World War as a result of a series of crucial economic decisions taken in the summer of 1948 by the German civilian leadership (of the 'Allied-occupied' Germany). The decision of 23 June 1948 in particular gave rise to this problem by introducing new currency legislation which allowed Reichsmarks already in circulation to be exchanged for the new DM at a rate of 10 RM for DM1. The measure (and the freeing of price controls, also taken at the time) put Germany on the path of its astonishing post-war economic recovery. But it also meant that purchasers, in cases like the one just described, ended up with a windfall at the expense, one could say, of vendors for they were able to pay off mortgage-secured debts at one tenth of their value. Once again therefore a judicial order was thus made that the amount 'saved' by the purchasers should be paid to the vendor. (See BGH MDR 1959, 564. Purchasers might make other such savings, for instance when they assumed tax obligations related to the land which turned out to have been grossly over-estimated by the parties.) Overall, the amazing—to an outsider at least—feature of this case law is not only its volume, but more the fact that 'adjustments' were ordered where the purchasers had made benefits of something in the order of 10 per cent of their total obligations. (See on this, Rothe, 'Lastenausgleichkslauseln im Grundstücksverkehr' DB 1963, 1527.)

In the cases just mentioned, the adjustment took the form of an added or *increased* amount which had to be paid by one of the parties to another. Alternatively, the value of the contractual performance could be *decreased* or scaled down, or the time of performance altered, eg, extended. (BGH MDR 1953, 282, case no 101; BGH NJW 1958, 785.) The sugar beet case offers the best-known example.

There, two major landowners in post-Second World War East Germany (before it was defeated by the Russians) dealt in sugar beets. One—the seller/plaintiff—grew them on his land; the other—the defendant—extracted the sugar from them and then sold it. On one occasion, and after the extraction had taken place, the plaintiff demanded the sale price but before the case could be decided, the defendant's land was confiscated by the Russians. At first instance, the action for the price was dismissed, the lower court in effect taking the view that the defendant had lost enough and should not be asked to pay damages in the circumstances. The *Bundesgerichtshof* took a different view. Good faith applied to this case; and it required that the defendant pay something—the lower court would have to determine the amount—though not the entire contract price.

The possibility of *substituting* a different subject matter (rather than increasing or decreasing the obligations) was, on the other hand, very rarely ordered. Thus, in 1971 the Court of Appeal of Karlsruhe decided (JZ 1972, 120) that a contract to deliver over a long period of time coal from certain mines which were closed down (because

of their high costs) could not be substituted by an offer by the seller to deliver coal of similar quality but coming from other mines. Yet in another case, the promise to supply alternating electrical current was substituted without hesitation by an obligation to provide direct current. (BGH NJW 1954, 1323.)

The decision of the Court of Appeal of Karlsruhe looks decidedly odd in the light of a decision handed down by the *Bundesgerichtshof* some ten years earlier. The facts of this unusual case were as follows.

A city dweller, who wished to live in the country, was offered the possibility of a lease on which the defendant/builder was to erect for him a pre-fabricated house. When, to the surprise of both contracting parties, the local authority declined to give building permission, the plaintiff sought to recover his down-payment to the builder, The latter however was able to offer to build the house on another plot of land, located nearby, which had the same characteristics as the first plot (view, clean air etc) but belonged to another landowner who however was willing to lease it to the plaintiff for the same rent. The BGH was of the view that if these assertions could be proved, then the substitute performance should be allowed to go ahead.

Cases where the contract has been entirely terminated seem rare, though on many occasions the courts have not denied the fact that 'good faith may also require the total release from contractual liabilities' (see, for instance, BGH MDR 1953, 282, 283, case no 101). One case where this happened, since no other solution was available to the court, is the case discussed below concerning the transfer of a football player who, prior to the transfer and unbeknown to the selling and buying clubs, had accepted a bribe to lose a game (BGH NJW 1976, 565, case no 105). Surprisingly however the highest court failed to reach this result—termination—in the so-called *Volkswagen* case, discussed above, which would appear to have offered the ideal kind of facts for such an answer. There, termination coupled with restitution of the sum paid—perhaps adjusted to take into account of the effects of war—would have been the most practicable solution given that the basis of that particular transaction had been so dramatically destroyed by the intervening war and the subsequent Russian occupation of Berlin.

No exclusive list of the types of cases that have been caught by § 242 BGB can be given here; even the large German treatises content themselves with giving illustrations. So we shall mention only two more.

The first concerned contracts which had linked payment to the gold standard or to currencies such as the English pound which were tied to gold. Through this device, they had found salvation from the ravages of the inflation of the 1920s. Yet the American-led deflation of 1930 led to the abandonment of the gold standard and a new round of decisions, often provoked by sellers asking for an increment (*Ausgleichsanspruch*) toward the loss attributable to devaluation (usually in the order of 20 or 30 per cent). Where the claims were accepted, they were accompanied by the usual request to the trial judge to investigate a number of relevant points (eg, had the seller in his capacity as importer of the merchandise taken advantage of the devalued pound? Was the buyer an exporter, and if so did he suffer any losses from the diminished value of the foreign currency? See, RGZ 112, 329, 333–4. See also, RGZ 119, 133 (sale of land); RGZ 147, 286 (sale of cotton) pegged to the American dollar leading to a loss of 13 cents to a dollar).

The second group of cases present a somewhat unique feature, namely that the hardship was solely one-sided. These were obligations to make periodic payments of

money for another's support, typically concerning pensions. In such cases, the person entitled to be paid could not be expected to pay anything more. This type of case really called for only one type of reaction: upward adjustment. This indeed happened in the 1920s; but in the post-Second World War period, the *Bundesgerichtshof* showed itself to be remarkably slow in taking the same steps. The fact that living costs had not experienced catastrophic increases was at best a partial reason, since we have noted that in other contexts the courts had been willing to intervene in circumstances where the change in the situation was anything but enormous. It is more likely that judges—like everyone else—had become aware that by the mid-1960s the total cost of pensions ran into billions of marks and that thus a decision in one pension case, though limited (in the light of what we have already said) 'to its particular facts' would, inevitably, extend over a very wide range of similar transactions the features of which would be 'virtually indistinguishable' (Stötter, 'Der Wegfall der Geschäftsgrundlage wegen Kaufkraftminderung bei Gehalts-und Ruhegeldvereinbarungen' DB 1966, 809). But in 1973 the *Bundesgerichtshof* decided to bite the bullet and authorise an upward adjustment to prevent 'unbearable' injustice (BGHZ 61, 31, case no 104). The decision was controversial at the time; but it also contains interesting *dicta* and it thus deserves a closer look.

The action in that case was brought by the plaintiff who became the defendant company's director in 1935. He was employed at a very high salary and that salary formed the basis for generous calculations for his retirement pension, which he took in 1951. During the next decade the cost of living in the Federal Republic of Germany rose by approximately 1per cent per annum but then, from 1960 onwards, it started a steep rise so that by 1971 it had reached approximately 54 per cent (which amounted to an internal devaluation of about 35 per cent). The plaintiff's demand for an adjustment was accepted by the *Bundesgerichtshof*, which referred to its earlier reluctance to take such a step but also to some recent decisions of the Federal Labour Court which had, more recently, blazed the trail in this respect. Such an adjustment of the pension would be made out of the profits of the enterprise, which the pensioner had helped create; and would also represent an appropriate reward for his long loyalty towards the company. The Federal Labour Court had added that,

> [t]hese services had been rendered by the pensioner in advance, trusting that he could plan the later stages of his life on the basis of a maintenance promised to him. If this expectation should be disappointed as a result of the depreciation of the currency, a pensioner would have no longer the means of bargaining for an adjustment, contrary to the sections of the population whose income would have kept up with the increase in prices.

Naturally, the court repeated the usual ritual of sending the case down to the trial judge to do all the hard work; and for good measure added the standard statement that every case turned on its facts. Nevertheless, it also contained two very interesting strands of thought, which must be mentioned briefly.

First, the court stated that in future cases one should not rush to the courts but first try to explore the possibility of a negotiated agreement between the parties concerned. (A view which, as we have seen, has since gained some support among certain academics and also accords with the current trend in the UK to encourage negotiation, alternative dispute resolution and settlement out of court: see the recent reforms of English Civil Procedure, treated in Andrews, *English Civil Procedure* (2003).) If

that failed, then the employer should be expected to put forward his own, reasonable proposals; and only if they failed to meet with the agreement of the pensioner should the possibility of a court action be entertained. In this respect, the court noted that such a practice had indeed become fairly widespread in the world of business.

The court then stressed in various forms that the plaintiff's high earnings should in no way be held against him in this process. 'The extent of the rise in prices should be the standard for fixing the extent of the adjustment,' reasoned the court and 'no attention should be given in principle to any other aspects of the pensioner's assets or income, except, perhaps possibly to any increase in income arising from any statutory insurance.' On the other hand, the profitability of the enterprise and the 'principle of equality of treatment' might well be relevant considerations for the calculations of the trial judge.

6. FRUSTRATION OF PURPOSE

We have stressed from the outset of this chapter that the German term *Störung der Geschäftsgrundlage* covers a variety of legal problems which in other systems—eg, English law-would be handled by a variety of different concepts. So far we have concentrated on altered circumstances which have destroyed (*Erschütterung*) the balance between the performances of the parties or made the foundation disappear (*Wegfall*). In this section we shall concentrate briefly in the remaining two major headings: the 'frustration' of the common purpose of the contract and mistake as to basic assumptions (*Fehlen der Geschäftsgrundlage*). Cases of literal or physical impossibility (*Unmöglichkeit)* will, of course, be discussed in greater detail in chapter 9, section 3, p 406. Three preliminary notes of warning are however necessary.

First, as Palmer has observed about American law (but which, we believe, also holds some truth for German and English law as well) '[t]here is a marked similarity between mistake in basic assumptions, impossibility, and frustration of purpose' (*Treatise on Restitution*, II, § 7.2 (1978)). This leads us to the second warning. Differentiations may be possible at a theoretical level; but in practice, the results may well be very similar whichever road one chooses to go down. Finally, and in view of the above, it does not really matter where one treats this last subject of mistake as to present facts: under the heading of mistake (which is what common lawyers would prefer to do) or 'changed circumstances' which currently is the preferred approach in Germany.

Turning then to our first kind of problem, we note that debtors are not, normally, excused if the occurrence of events has frustrated their assumptions about the profitability of their transaction (see, eg, *Davis Contractors Ltd v Fareham Urban District Council* [1956] AC 696). In such cases the normal rule is that the risk falls on them. This fundamental principle is not expressly laid down in the BGB but presupposed by a number of more specific provisions. Thus, § 537 I BGB states that the lessee is not exempt from paying the rent if he is for a personal reason unable to use the rented object. Likewise, § 649 BGB entitles the employer under a contract for work and materials to terminate the contract if he no longer requires its performance; however, the contractor remains entitled to the counter-performance subject to any

savings he made because he did not actually carry out the contract. The case law confirms the validity of this risk-allocation but occasionally distributes the risk of being able to use the object of the contract otherwise.

Thus, in one case, the *Bundesgerichtshof* stated that 'the risk of being unable to dispose of the [purchased] goods normally falls within the purchaser's area of risk' (BGH NJW 1984, 1746, 1747, case no 106); and in another case it added that,

> in a contract for the production and sale of goods, the intention of the person placing the order to forward the . . . products to a particular client does not render this purpose of concluding the contract a basis of the transaction which affects both parties. Reasons of contractual certainty require that in principle each party must bear the risk that the purposes intended by him in concluding the contract cannot be achieved (BGH MDR 1953, 282, 283, case no 101).

In appropriate circumstances, however, both parties may understand the purpose for which the contract was concluded; and future failure of this purpose may make the contract worthless for the party now seeking relief. Four cases illustrate this; and their similarity with the *Krell v Henry* type of situation [1903] 2 KB 740 has been discussed *ad nauseam* by German jurists (eg, Larenz, *Schuldrecht I* (14th edn, 1987), § 21 II 1). If they have one thing in common, it is that they show that the German courts seem if anything more willing than the English to intervene and adjust the contract. The cases also show a strong preference for doing this through the notion of 'frustration' rather than impossibility or mistake, perhaps because this gives them more room to manoeuvre and fine-tune the contractual obligations. Whether they should be doing this is, as we have seen, another matter.

In the first case (OLG Bremen NJW 1953, 1393, case no 100), the plaintiff hired a sports hall from the defendant for a special appearance of a well-known singer. The rent was to be 15 per cent of the profit but not less than DM1500, this last amount to be paid at the time of conclusion of the contract. When the singer fell ill and the performance was cancelled, the plaintiff demanded the return of the money paid. The Court of Appeal of Bremen held that he was entitled to it. For this was not a simple hiring of a hall, but a hiring of a hall for a specific purpose which was known to the other party and had become the foundation of the transaction.

A year later the *Bundesgerichtshof* itself had occasion to confirm this approach in another case (BGH MDR 1953, 282; '*Bohrhammerfall*' or pneumatic drill case, case no 101). The case has been criticised, mainly on the grounds that it paid too much attention to vague ideas of equity rather than looking at the proper distribution of risks; but for present purposes it provides an illustration of how 'frustration of purposes' can work in practice.

In that case the defendant, who did business in West Berlin, ordered six hundred drill hammers, which the plaintiff knew were destined to be used in mines in East Germany. By the time the plaintiff accepted the order and started production, the (first) Berlin blockade had already been brought into effect. The plaintiff asked for payment of the contract price. The defendant refused, pleading that (at that time) he could no longer dispose of them in the East (and, apparently, not easily even in the West since the drills were of an out-dated type). Though the court took the view that neither the defendant's order nor the plaintiff's letter of acceptance stated that the validity of the order depended on the possibility of delivery in the eastern zone, such

delivery had nevertheless become the basis of the transaction 'since both parties shared the assumption that delivery of the drills to the east zone would become possible in the foreseeable future.' In the court's view it was immaterial whether the basis of the transaction had disappeared after the conclusion of the contract, or whether it did not exist at the time when the contract was concluded, since the legal consequences were in both cases, the same: the transaction was not invalid; but had to be adapted to the actual situation in accordance with the dictates of § 242 BGB. The defendant thus had to pay for the drills which had already been completed (even though he could not ship them to the East) but was relieved of all liability for the remainder.

The third (and chronologically most recent) case on this kind of 'frustration' related to the performance of a music band at a carnival event which was cancelled as a result of the Gulf War. The Oberlandesgericht of Karlsruhe (NJW 1992, 3176) did not even discuss impossibility, but relied on the doctrine of *Wegfall der Geschäftsgrundlage* in order to relieve the music band from liability.

Arguably, the fourth case is the most important in this series. It arose out of the fall of the Shah and the advent of the regime of the ayatollahs in Iran. The full and complicated facts can be found in the translation reproduced below. (See BGH NJW 1984, 1746, case no 106.) Here suffice it to say that the dispute concerned the shipping of German beer to Iran, some of which arrived in a damaged state. A compromise was then reached by the parties which provided, inter alia, that the plaintiff would (a) be allowed to get his next consignment of beer at two-thirds of the original price per case and (b) would be paid the sum of DM20,000 as compensation for the damaged beer when he put in his next order for beer. However, the advent of the fundamentalist regime in Iran made such further orders impossible; and without them the amount promised as damages also failed to reach the plaintiff. His attempt to secure a new compromise having failed, he then tried to claim the full loss originally sustained by him as a result of the defective consignment.

The *Bundesgerichtshof* started with the by now customary dictum that a 'change in circumstances does not make contracts disappear *in toto* [but that, on the contrary,] the general rule is that they should be maintained.' It then addressed the crux of the matter with the following statement:

> It is true that in commercial matters the risk of being unable to dispose of the goods normally falls within the purchaser's area of the risk; but the court below was right to point out that this was not a contract of sale but a transaction by which the defendant was to compensate the plaintiff for its losses. There is nothing to suggest that if the compensation envisaged by the compromise failed to materialise, the parties intended the loss to be borne by the plaintiff alone.

The court thus accepted that the best way out of this impasse was to order the defendant to pay half of the profit which the plaintiff would have made if the compromise agreement had not been disturbed by the events in Iran.

This case, unlike the previous one, not only offers a good illustration of 'frustrated purpose' litigation, it also represents a good example of a decision applying the more legalistic approach which currently prevails among German courts. This, as already stated at the beginning of this section, pays more attention to the allocation of risk which the contract and the surrounding circumstances dictate than to the vaguer,

equitable grounds which figured so prominently in the earlier case law. Indeed, this approach which was confirmed by the *Bundesgerichtshof* in its decision of 8 February 1978 (BGH JZ 1978, 235), has provided constant guidance ever since. In 1972 the defendant, an oil importer, agreed to supply the plaintiff oil by instalments at an agreed price. At the time when the contract was made the price of oil was approximately DM100 per ton. After the Yom Kippur War in October 1973, the price of oil, which had been steadily rising during the preceding months, rose further and reached DM600 per ton. At this stage, the defendant informed the plaintiff that he would only supply him with further oil at an adjusted price. The plaintiff refused to consent to this proposal and, on the contrary, warned him that he would treat any interruption in supply as amounting to a breach of contract. This indeed occurred, and the plaintiff claimed from the defendant the amount he had to pay to obtain his oil from another source.

The *Bundesgerichtshof* accepted the claim as well founded. True, it admitted that in synallagmatic contracts the starting assumption was that performance and counter-performance were of equivalent value. Yet the contract and its surrounding circumstances might indicate how the parties intended to delimit their respective spheres of risk. The fact that this was a fixed price term indicated that the defendant was willing to assume the risk of price fluctuations. To the argument that, even if this were so, the assumption was limited to 'normal' fluctuations and not to increases of the kind experienced here, the court's view was that the defendant should have realised that further price increases were imminent and could have absorbed their effect by stockpiling oil while its price was still at manageable levels. In view of the paramount importance of the principle *pacta sunt servanda*, the defence of the collapse of the underlying basis of the transaction would not be permitted; and it should be limited to those cases where it was 'indispensable for avoiding intolerable results, irreconcilable with law and justice.'

This disinclination to be easily carried away by the *Geschäftsgrundlage* theory has been confirmed repeatedly since 1978, the emphasis having shifted to the objectively ascertained 'allocation of risks.' BGH NJW 1977, 2262 brings this point out clearly.

There builders who sold family homes also offered to supply them with direct heating produced by their own power station nearby. The prices would be determined by tariffs charged by the public utility of this community. Soon after the contract was concluded, the builders discovered that they had made a bad bargain since the public utility in question did not shift the full burden of the price increase of coal and oil on to its customers (since it was able to make up for these rising costs in another way). The *Bundesgerichtshof* insisted that the builders could not escape their contractual undertakings even though they were losing nearly DM60,000 per annum. This was a bad bargain, and it could not be pleaded as being due to changed circumstances because the circumstances causing these losses were clearly within the builder's sphere of risk. Besides, reasoned the court, the enterprise was large enough to absorb such losses! (In the same vein, see: BGH NJW 1978, 2390; BGHZ 74, 370.)

Yet it would be wrong to pronounce the traditional 'equitable' approach to intervention to be dead in the German courts. On the contrary, given the slightest sign of a return to a genuinely unusual and abnormal situation, the courts will revive the old theory. This indeed occurred after the reunification of Germany when the old West swallowed up a bankrupt East. The planned economy regime which prevailed in the

latter thus meant that, in appropriate circumstances, the contractual allocation of risk approach which had come to prevail in the West, had to be modified when litigation emanating from the East reached the courts. The decision of the *Bundesgerichtshof* of 14 October 1992 (NJW 1993, 259, case no 107) shows this. Its reading should cause no difficulties to the reader; but what the translated extracts do not do is reproduce the economic adjustment engineered by the court. Since it is not without interest, nor indeed is it beyond criticism, a few words on this aspect of the case alone may not be out of place.

The case involved a buyer (defendant) and a seller (plaintiff), of a machine originally acquired from Austria, both parties operating in the state-controlled economy of communist (former) East Germany. The two Germanys agreed to unite in 1989 and the currency of East Germany ceased to exist in July 1990. East German marks (for brevity: EDM) were converted into West German marks (WDM) at a rate of 2:1. The purchase price of the sold object was 1.3 EDM; and before the disappearance of the EDM, the plaintiff had paid (through state credits) 400,000 EDM. The BGH took the view that the two parties should share the cost; and here is how it worked it out.

1.7 EDM (purchase price) minus 400,000 EDM (deposit) left 1.3 EDM unpaid. Exchanged for WDM, this meant 650,000 WDM, half of which– ie, 325,000 WDM—should be paid by the defendant (buyer). This may sound as very much less that the originally agreed purchase price of 1.7 EDM, but in fact it may have been too generous to the plaintiff (seller). For the 1.7 EDM were based on an unrealistically inflated price of EDM and the Austrian Schilling (from where, it will be remembered, the sold object was originally acquired). If one used the WDM /Schilling market exchange rate, the purchase price would have been 380,000 WDM.

Now, it will be recalled that the plaintiff was allowed to claim 325,000 WDM; and he was allowed to keep the deposit already received (which was 400,000 EDM or, at a 2:1 exchange rate, 200,000 WDM.) This means that the plaintiff (seller) ended up with a total of 525,000 WDM for a machine which, realistically priced, was worth 380,000 WDM. That 525,000 WDM sum covered the plaintiff's costs and left a profit of about 40 per cent. That the court should have used its 'adjusting' powers under § 242 BGB is understandable, and arguably fair; that it should have been so generous to the plaintiff is more open to doubt. But then such injustices are bound to occur when one expects judges to act not only as judges, but also as businessmen and accountants!

7. COMMON MISTAKE

In this group of cases we are faced with a mistake as to an extant fact which is shared by both parties at the inception of the contract. (The English case of *Griffith v Brymer* (1903) 19 TLR 434, illustrates the kind of factual problem with which we are here concerned. In that case, it will be remembered, a room was hired to watch the coronation parade of King Edward VII at a time when, unbeknown to both parties, the parade had already been cancelled. Thus, in one case the parties expressly assumed that the stipulated rent of land would equal the peacetime rent, but it did not.) Since the German § 119 BGB does not apply to this kind of mistake, any insistence to pay the stipulated rent would have to be determined by good faith, which in turn could be

invoked only if the common assumption of the parties had become the foundation of the contract. (See, OLG München, MDR 1950, 672. See, also, BGHZ 25, 390, 392.) Cases 103 and 105 provide two further interesting illustrations.

In the first case (BGHZ 37, 44, case no 103) the plaintiff agreed in 1959 to sell land to the defendant in exchange for a series of 'building' obligations assumed by the latter. Both parties were aware of planning difficulties since the plots in question had not yet been subjected to building regulations, but believed that these difficulties could, in part at least, be overcome soon. This however had not happened by the time of the trial (1967); and the prognosis was uncertain. The plaintiff thus asked for the plots to be reconveyed to him and for a declaration to be made that the arrangement was invalid. The court agreed, adding that 'where the contacting parties know of the existence of an impediment but assumed mistakenly that it could be removed . . . a mutual mistake has occurred, the legal consequences of which are not to be determined by § 306 BGB. Instead, they must be considered from the aspect as to whether the basis of the transaction has disappeared (§ 242 BGB). It is thus necessary to examine whether and to what extent, as a result of unforeseen delay in fixing the date of performance, the situation as seen originally by he contracting parties has been changed so fundamentally that according to good faith the contract can no longer be executed in the manner envisaged at the beginning.'

The next case (BGH NJW 1976, 565, case no 105) is, in fact, more interesting since here we find one of the rare examples in which 'adjustment' meant termination of the contractual bond. Here the dispute arose as a result of one football club 'transferring to another one of its players who, unbeknown to both parties had, before the transaction was agreed, accepted bribes to 'lose' a game. The *Bundesgerichtshof* agreed with the lower courts that,

> not every disturbance of the basis of the transaction is significant. In view of the paramount importance in the law of contracts of the principle that they must be carried out, reliance on the fundamental disturbance of the basis of a transaction is only admissible in exceptional cases and only if it appears imperative in order to avoid an unbearable result which cannot be reconciled with the demands of law and justice.

Bribery in cases such as this was a very serious matter which had clearly falsified the common assumptions of the parties. This clearly was also not one of the cases where one could say that the plaintiff buyer club had assumed the risk of an event such as this occurring. (For good measure, the *Bundesgerichtshof* also pointed out that the defendant club had to bear the risk which originated in its sphere of influence.) The event had further made the player 'worthless' for both parties to the contract and so, in the instant case, no modification was possible other than to order the complete rescission of the transaction followed by the return of the transfer fee.

See also, the famous '*Roubles case*', RGZ 105, 406, case no 98. In this case the plaintiff lent the defendant 30,000 Russian roubles in return for two promissory notes whereby the defendant undertook to pay the plaintiff 7500 marks. It was found that the parties assumed that a rouble was equivalent to 25 pfennigs and neither party was aware that the value of the rouble was much lower at the time. The court solved the case on the basis of § 119 I BGB. However, the assumption of a declaration mistake seems artificial. There are better, alternative explanations of this case. See for instance, Medicus, *Allgemeiner Teil*, Rn. 758, who suggests that the case should have

been solved on the basis of interpretation: the correct exchange rate was agreed by the parties. In any event, the case can be solved on the basis of the doctrine of the foundation of the transaction; in this sense: Larenz and Wolf, *Allgemeiner Teil*, Rn. 64. The *Reichsgericht* however must have felt unease in applying this newly developed doctrine and preferred to (over-) stretch existing rules.

8

The Performance of a Contract

1. INTRODUCTORY REMARKS

The section of the BGB dealing with the 'extinction of obligations' (*Erlöschen der Schuldverhältnisse*) enumerates four different ways of extinguishing a debt, 'performance' (*Erfüllung*) being the normal way in which this result is achieved (§§ 362–71). Paragraph 362 I BGB states the general rule that an obligation owed to the creditor comes to an end if the debtor performs it. The remaining three ways are substitutes for performance (*Erfüllungssurogate*). They are: deposit (*Hinterlegung*, §§ 372–86), set-off (*Aufrechnung*, §§ 387–96) and release (*Erlaß*, § 397). The manner in which an obligation is performed raises a number of questions. In this chapter we will limit our observations to three main points: the relationship between performance and counter-performance (below, section 2); time and place of performance (below, section 3); and performance through third parties (below, section 4). In actual legal practice the most important among the 'substitutes' for performance is set-off which will be discussed in the remainder of the chapter (below, section 5). At the same time, the conditions of performance determine the background against which irregularities of performance must be understood, so these conditions form a key thread that runs through this and the next two chapters.

2. PLEA OF UNPERFORMED CONTRACT (*EINREDE DES NICHTERFÜLLTEN VERTRAGES*)

Brox, *Die Einrede des nichterfüllten Vertrages beim Kauf* (1948); Bydlinski, 'Die Einrede des nichterfüllten Vertrages in Dauerschuldverhältnissen' in *Festschrift für Steinwenter* (1958) 140; Jahr, 'Die Einrede des bürgerlichen Rechts' JuS 1964, 125, 218, 293; Keller, 'Das Zurückbehaltungsrecht nach § 273 BGB' JuS 1982, 665; Kirn, 'Leistungspflichten im gegenseitigen Vertrag' JZ 1969, 325.

(a) Classification of Contracts

Before discussing the problems which in German law are regulated by §§ 320–2 BGB, it may be helpful to recall briefly the classification of contracts.

In common law systems the most significant classification is that which distinguishes between, on the one hand, offers in which the offeror seeks to obtain a promise, ie an obligation of the offeree in exchange for his own promise (bilateral or