

**Fundamental change of circumstances
and
the principle of *causa finalis***

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Declaration

I, the undersigned, hereby declare that the work contained in this thesis is my own original work and that I have not previously in its entirety or in part submitted it at any university for a degree.

Signature:

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Summary

On the basis of a comparative analysis of the case law in Germany, England and South Africa dealing with fundamental change of circumstances, it is submitted that the underlying principle of this problem area is the idea of frustration of the contractual purpose (*causa finalis*). The problem of fundamental change of circumstances is directly connected with basic issues of legal theory such as the dichotomy between legal certainty and substantive justice, the role and limits of interpretation, the concretisation of principles, the adjudication of interests and the problem of value-judgements in the law which are of immediate influence on the understanding of the problem by judges and legal commentators. A broad perspective on the topic is necessarily indicated hereby.

The thesis therefore starts off with an account of the role of purpose (*causa finalis*) in the history of legal philosophy, with a focus on developments in Germany. The continuing relevance of Aristotelian-Thomistic legal thinking is emphasized. The German and English case law dealing with fundamental change of circumstances is analyzed in an analogous manner. An account of the history and development of the doctrines dealing specifically with fundamental change of circumstances is given: the *clausula rebus sic stantibus* of the *ius commune*, the doctrine of *Wegfall der Geschäftsgrundlage* in Germany and the doctrine of frustration of contract and common mistake in England. The crucial elements of the approach of the courts are restated. The positions of the two most influential German legal authors involved on opposite sides of the debate concerning the doctrine of *Wegfall der Geschäftsgrundlage* are discussed. At the end of the discussion of English case law, the approach of the English courts is compared with that of their German counterparts, providing a basis for the development of the author's understanding of the concept *causa finalis*.

Notwithstanding the fact that South African law does not recognize a doctrine dealing specifically with fundamental change of circumstances, and in spite of *dicta* to the effect that the English doctrine of frustration of contract is not part of South African law, it is submitted that the doctrine of frustration of contract has nevertheless strongly influenced the South African law of supervening impossibility and supposition, and has arguably become part and parcel of it. Likewise, cases of frustration of the contractual purpose due to a fundamental change of circumstances have been dealt with by means of other doctrinal devices such as common mistake. It is submitted, finally, that the famous and controversial issue of the role of *causa* in South African law should be reconsidered, since it may contribute to the understanding of the notion of contract, and assist in overcoming the current doctrinal crisis of the theory of contract.

Opsomming

Aan die hand van 'n vergelykende analise van die regspraak in Duitsland, Engeland en Suid-Afrika betreffende fundamentele verandering van omstandighede, word ter oorweging gegee dat die beginsel onderliggend aan hierdie probleemgebied te vind is in die gedagte van verydeling van die kontraksoogmerk. Die probleem van fundamentele verandering van omstandighede staan in onmiddellike verband met basiese vrae van die regsteorie, onder andere die teenstelling tussen regsekerheid en substantiewe geregtigheid, die rol en perke van uitleg, die konkretisering van beginsels, die opweging van belange en die probleem van waarde-oordele in juridiese verband wat almal inspeel op die hantering van die probleem deur regters en kommentatore. Met die oog hierop is 'n breë invalshoek op die ondersoekveld gebiedend.

Die ondersoek neem derhalwe as vertrekpunt 'n oorsig oor die rol van oogmerk (*causa finalis*) in die geskiedenis van die regsfilosofie met 'n besondere klem op ontwikkelinge in Duitsland. Die deurlopende belang van Aristoteliaans-Thomistiese denkwyses word beklemtoon. Die Duitse en Engelse regspraak betreffende fundamentele verandering van omstandighede word op 'n eenvormige grondslag ontleed. 'n Oorsig van die geskiedenis van leerstukke wat spesifiek verband hou met fundamentele verandering van omstandighede word aangepak, te wete die sg *clausula rebus sic stantibus* van die *ius commune* en die leerstuk van *Wegfall der Geschäftsgrundlage* in Duitsland en die leerstuk van *frustration of contract* en *common mistake* in Engeland. Die kernaspek van die benadering van die howe word uitgespel. Die botsende standpunte van twee van die mees invloedryke Duitse denkers in die teoretiese debat bied 'n breë konseptuele raamwerk vir die uiteindelijke vergelyking van die Engelse regspraak met die van die Duitse howe en die ontwikkeling van 'n eie standpunt aangaande die begrip *causa finalis*.

Die Suid-Afrikaanse reg erken nie in soveel woorde dat veranderende omstandighede as sodanig die bestaan van 'n kontrak raak nie, en in die besonder word die Engelsregtelike leerstuk van *frustration of contract* in vele regterlike *dicta* verwerp. Die ondersoek na die Suid-Afrikaanse respraak lei egter tot die gevolgtrekking dat die Suid-Afrikaanse reg aangaande onmoontlikwording van prestasie en die veronderstelling inderdaad in wesenlike opsigte deur die leerstuk van *frustration* beïnvloed is. Verydeling van die kontraksoogmerk ten gevolge van veranderende omstandighede geniet ook juridiese erkenning deur middel van ander juridiese meganismes soos die leerstuk van gemeenskaplike dwaling. Die slotsom van die behandeling van die Suid-Afrikaanse reg is dat die berugte en omstrede rol van *causa* in die Suid-Afrikaanse Kontraktereg herwaardering verg.

Expression of thanks

First of all I would like to express my gratitude to Professor G F Lubbe for agreeing to be my Supervisor and for his great patience and support during the unusual lengthy period of completion of this thesis. This period finally stretched from eight fabulous months in South Africa to my marriage, the birth of our first two children, the completion of my articles in Germany, my second state exam and the first year of practice as a lawyer. During the whole time, the subject of this thesis has lost nothing of its fascination for me and I greatly appreciate having had the time to investigate it a little deeper. I apologise to any prospective reader for the unusual length of this manuscript and I hope going over parts of it will be worth while. I also want to thank my wife Friederike for accepting that numerous evenings, weekends and holidays have been sacrificed. I dedicate the thesis to my daughter Luise, my "little South African".

Finally, I am deeply grateful for having had the chance to come to South Africa and experience this fascinating and beautiful country, feel at least some of its hopes and fears, joys and sorrows. Thanks also to Professor Reinhard Zimmermann, Regensburg, for giving the inspiration for my wish to go to South Africa. I am now one of many people I know who will always carry this country in their heart.

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Introduction

As a matter of course, contracts are made to settle the terms of agreements and to keep the parties bound thereto - *pacta sunt servanda*. But it is equally a matter of course that agreements and contracts develop out of certain circumstances and in contrast to the fixation of the agreement in the contract, those circumstances can naturally never be finally settled. Life goes on and is characterised by continual change.

Obviously, most of these changes have no bearing upon the contract, for the very reason for the conclusion of the contract was to protect the agreement from change. But sometimes circumstances which are vital for the agreement change in such a fundamental manner as to put the contract under considerable strain. Beyond a certain degree of strain it becomes questionable whether adherence to the contract still makes sense. After all, the principle of *pacta sunt servanda* is not an end in itself.

The crucial methodological problem in relation to the problem of changed circumstances is how to justify the intervention into the contract, and where to draw the line in view of the infinite range of possible factual situations. There are as many potential cases as possible circumstances and there is no general pattern of fundamental change of circumstances. This is what makes it especially difficult for the law to deal with the problem of changed circumstances since it is bound to lay down abstract rules for the sake of legal certainty.

Thus, one of the most important determinants of any response to the problem of fundamental change of circumstances, which gave rise to the doctrines of *clausula rebus sic stantibus* of the *ius commune*,¹ the doctrine of *Wegfall der Geschäftsgrundlage* in Germany² and the doctrine of frustration of contract in England,³ is the classic dichotomy between the goal of legal certainty and the ideal of substantive justice in the individual case.

There is much dispute on just how far one may or has to go: Where are the borders required by legal certainty? What are the limits of interpretation? How does the process of concretisation of general principles take place? Which are the standards to employ in this concretisation? The position of jurists in view of the abovementioned doctrines depends to a great extent on the stance taken on these fundamental issues. Connected with this is the question whether a distinctive legal device is really

¹Part II § 1.

²Part II § 2.

³Part III.

necessary for the resolution of this problem, or whether established rules of law and the normal rules of interpretation are sufficient to cope with problematic cases. Preconceived opinions shape every author's understanding of the role of the established rules of law, the role of interpretation, the role of *bona fides* and the role of purpose (or *causa*) in the law. This understanding, in turn, shapes the individual author's opinion on the contours of each doctrine. The opinions oscillate between two poles: the negative pole denies that doctrines regarding the effect of changed circumstances have any justification and claims that a solution must and can always be found in other established rules of law, whereas the positive pole acknowledges the doctrines as evidence of a general principle and a means of filling gaps in the law, based on judge-made law and the demands of substantive justice. These poles are personified in a characteristic manner by two of Germany's most influential legal scholars: Werner Flume and Karl Larenz.¹

All three doctrines referred to above have developed out of a specific practical need which had to be satisfied by the courts. Yet the question remains whether the other established rules of law and the inherited rules of interpretation can deal with the problem more effectively and reasonably (e.g. without a resort to fictions). Do they really offer more legal certainty, more foreseeability, and more precision? Or do they only veil the inevitable process of evaluative judgement (*Wertung*) more than they rationalise it? Do the three abovementioned doctrines not, in the end, - understood correctly in the light of a more fundamental enquiry into the far-reaching methodological and even philosophical questions entailed by the topic - make the solution of the specific problem of fundamental change of circumstances more rational, predictable, precise? If so, it would be better to persist with them and to improve them with reference to the results of a broad historical analysis of the methodological and philosophical premises of the law. When the decisions of the cases in question are not only based on purely equitable reasoning but also on intelligible and refined rules derived from a clear principle firmly rooted in legal history and theory, then the imperative of legal certainty should be satisfied.

The decisive question raised by the problem of fundamental change of circumstances is under what conditions may the principle of *pacta sunt servanda* be set aside? Under what circumstances is it justified to dissolve a contract? Which changes influence the binding character of a contract and which don't? What is the decisive aspect that may question the validity of a contract? The question for the abstract principle involved in cases of fundamental change of circumstances can only be answered with recourse to the nature, the essence of the concept of contract and the nature of law itself. Therefore, the answer to the problem of fundamental change of circumstances depends directly on the theory of contract itself.

¹Part II § 3.

The formulations used in the context of *clausula*, *Geschäftsgrundlage*, and frustration of contract are in the final analysis all directed towards the same crucial point: the change of circumstances is held to touch on the "nature" of the contract, its "foundation" or "basis", it makes the contract "radically different", it obstructs the "purpose" of the transaction, the "common object" of the parties.¹ The formulations employed show that the problem finally can be reduced to the question as to what determines the nature, what makes up the essence of a contract. What is the "basis", the "foundation" of a contract? Simply the autonomous will of the parties? Or rather the inherent ethical premises of the legal system? When does a contract become "radically different" compared to before the change of circumstances? What is the "purpose" of a contract? Can there be something like "the" purpose of a contract? How can the purpose or the foundation of the contract be determined? These questions cannot simply be answered with reference to the facts of the individual case by means of interpretation since they touch directly on our understanding of contract in general. Recourse to legal philosophy and methodology is therefore indispensable.

Due to this perception the thesis starts off with a short account of the understanding of law in general in the history of legal philosophy - which in turn determines the understanding of contract in particular - in order to supply the necessary background to appreciate the dimension and implications of the problem in issue here.

The account focuses to a certain extent on the role of purpose in the law because it is submitted in this thesis that the basic principle governing cases of fundamental change of circumstances and underlying the doctrines of *clausula rebus sic stantibus*, *Wegfall der Geschäftsgrundlage* and frustration of contract is that of frustration of the contractual purpose (*causa finalis*). The role of purpose is an underestimated but crucial element of our understanding of contract and of law in general. The essence or nature of a contract - and therefore its "foundation" or "basis" - can only be determined by taking into account the contractual purpose, that is the end for the sake of which the contract was entered and to which it was designed to constitute the means. If that purpose is frustrated by a fundamental change of circumstances, the contract fundamentally changes its significance, it becomes "radically different". In the Aristotelian-Thomistic tradition, the contractual purpose - on the abstract level - is considered to be either commutative justice (in a broad sense) or liberality.

The first part of the thesis therefore describes the impact of the Aristotelian-Thomistic philosophy of essences linked to ends (*causa finalis*) on the law of contract, its decline in the Age of Enlightenment (Hobbes, Locke, Hume, Kant) and the consequences of that decline for the legal theory of the 19th century (Savigny, Puchta, Windscheid), as well as the development toward a "renaissance" of

¹See especially Part II § 2.1, Part III § 1.1.2.

Aristotelian-Thomistic ideas in the modern German *Wertungsjurisprudenz* (Larenz) and legal ontology (Kaufmann) which was made possible through the renewed interest in the role of purpose in the law beginning with Ihering and the overcoming of the positivistic concept of science by Neo-Kantianism (Rickert, Stammler, Radbruch) and phenomenology (Husserl).

Before the background of the philosophical developments, the second part of the thesis describes the rise and fall of the *clausula rebus sic stantibus*, the answer of the *ius commune* to the problem of fundamental change of circumstances, and the emergence of its modern German counterpart, the doctrine of *Wegfall der Geschäftsgrundlage*.¹ The contemporary approach of the German courts towards the doctrine is analyzed and the discussion concerning the doctrine in German legal science is reflected by describing the position of the most influential opponents concerning this subject, Werner Flume and Karl Larenz.² It is argued that the position of Karl Larenz is convincing since it is based firmly on a clear understanding and evaluation of the philosophical and methodological implications of the problem of fundamental change of circumstances. On the basis of the discussion of the philosophical background, the historical development of the doctrine, its treatment by German courts and the exposition of the topic by Karl Larenz, it is argued that the cases of *Wegfall der Geschäftsgrundlage* may well be categorised and evaluated on the basis of the principle of frustration of the contractual purpose (*causa finalis*).³

Essentially the same path of investigation is followed in the third part of the thesis, dealing with fundamental change of circumstances in English law. An account of the development of the doctrine of frustration of contract is given and the characteristic but crucial confusion concerning the decisive underlying principle is highlighted.⁴ The close relationship between the common law treatment of frustration of contract and common mistake is emphasized.⁵ The similar treatment of the relevant cases and the fact that common mistake is considered an instance of the doctrine of *Wegfall der Geschäftsgrundlage* in Germany bears witness that the same underlying principle is concerned. The analysis of the approach of English courts towards the doctrine of frustration of contract shows that essentially the same criteria are employed by both English and German courts when applying the respective doctrines.⁶ The respective decisive criteria, "radical change of the obligation" and "Unzumutbarkeit", are different insofar as they reveal a characteristic difference in the approach of the legal traditions of the two countries (English law focuses on the contract, German law focuses on

¹Part II § 1.

²Part II §§ 2 and 3.

³Part II § 4.

⁴Part III §§ 1.1.1. and 1.1.2.

⁵Part III § 1.2.

⁶Part III § 2.

the aggrieved party), but on the other hand not so far from each other concerning the basic underlying principle. Consequently - and not surprisingly - the English cases of frustration of contract and common mistake can be categorised and analyzed the same way as it was done with the German cases.¹ An assessment of similarities and differences between the English and the German approach concludes this part of the thesis.²

Before coming to the role of fundamental change of circumstances in the South African law of contract, the results of the foregoing parts of the thesis are concentrated in a restatement and analysis of *causa finalis* as the informing underlying principle of the doctrines of *Wegfall der Geschäftsgrundlage* and frustration of contract.³

Finally, the way South African contract law deals with fundamental change of circumstances is analyzed from the perspective developed in the earlier parts of the thesis. It is argued that the predominant view among South African courts and legal scholars that South African law does not accommodate any kind of frustration doctrine and that the notion of *causa* has no role to play in contract law - and should accordingly be ousted completely - is incorrect in this rigid generality.⁴ Several aspects of the South African law of contract dealing with cases of fundamental change of circumstances are analyzed and it is argued that the principle of *causa finalis* can be regarded as the decisive aspect of the cases discussed.⁵

The study of the nature, the history and development of *clausula rebus sic stantibus*, *Wegfall der Geschäftsgrundlage* and frustration of contract may prove to be an illustrative factor in the search for a coherent theory of contract in order to stop the current doctrinal crisis and continuing disintegration of Private Law.⁶

¹Part III § 3.

²Part III § 4.

³Part IV.

⁴Part V §§ 2.5., 3 at the end.

⁵Part V §§ 2.1. - 2.3., 3.

⁶On this see Gordley *Philosophical Origins of Modern Contract Doctrine*, 8,9; in general: Grant Gilmore *The Death of Contract* 1974 102. From a German perspective: Wolfgang Zöllner "Zivilrechtswissenschaft und Zivilrecht im ausgehenden 20. Jahrhundert" *AcP* 188 (1988) 92; Arthur Kaufmann "Die 'Ipsa Res Iusta'" *I. Festschrift Larenz* 1973 (Kaufmann also expressly refers to Thomas Aquinas and Aristotle); Joachim Hruschka "Vorpositives Recht als Gegenstand und Aufgabe der Rechtswissenschaft" *Juristenzeitung* 1992 429sqq.

Part I: Change of circumstances in legal philosophy: the role of purpose in the law

1. Aristotelian-Thomistic philosophy

According to Aristotle, the world is made up of individual things, called "substances", e.g. people, animals, plants and things. He further identifies two major kinds of order in the world: the order of part to whole and the order of means (causes) to ends (effects), the first being based on the second. The essence of any substance is determined by its four basic causes: efficient cause (*causa efficiens*, which brings a thing into being, e.g. the parents of an animal or human being), substantial form (*causa formalis*), matter (*causa materialis*), and the "final cause" or "end" (*causa finalis*), which is the purpose of the thing's existence, e.g. for a flower to grow and blossom. The essence of a thing is therefore linked (also) to the purpose, or end, of its existence. By understanding the causes of a thing one can formulate a definition, thus capturing its essence. Matter and form were considered as internal causes (*causae intrinsecae*) and efficient and final cause as external causes (*causae extrinsecae*). The *causa efficiens* could be further subdivided into *causa factiva*, which necessarily brought about a certain effect, and *causa impulsiva*, which did not bring about an effect necessarily but gave an impulse into its direction. The concept of *causa finalis* proved to be the most fertile for the use of the lawyers. All events consist of causes and effects. All effects depend on causes. These causes can be proximate (*causa proxima*) or remote (*causa remota*). But the effect can only be established if the cause is sufficient therefore (*causa sufficiens*). Man too, has an ultimate end, a *causa finalis*: he is designed to live a fully human life by fostering and developing his natural assets accorded him by creation. The tool to reach that end is the most significant of all the assets given to man: the human reason. Through it, man is able to understand the ends of his actions and the contribution they make to his ultimate end. Means (causes) to that end (effect) are above all the human virtues, which form the main subject of Aristotle's *Nicomachean Ethics*. The specific virtues that became especially influential on medieval contract doctrine and thus also on the doctrine of *causa* were the aristotelian virtues of promise - keeping, liberality and commutative justice.

Thomas Aquinas (1224-1274) was the first to apply this broad approach to particular - and also legal - human actions, such as promise-keeping and marriage, by examining the moral lawfulness of human actions. He went beyond Aristotle's discussion of virtue and described a moral law, a "natural law", that governs the keeping of promises, thereby christianizing Aristotle. He perceived that because the essence of a thing is defined by its end, legal actions, like all actions, were also required to have the final cause in the sense of being the means to a particular end and in serving this end (designed by the acting individuals) had to correspond to the underlying virtues that were by definition best suited to attain the parties' envisaged end. These were, again, either liberality - giving or doing something for

purely benevolent reasons to the right people, the right amounts at the right time without expecting something in return - or commutative justice - that is expecting something of equal value in return. The corresponding virtues assured that there could be no arbitrary cause, they defined the acceptable causes on which in turn the enforcement of the obligation depended. A cause not corresponding to either of the virtues would not have served the end of the obligation which was also not left entirely to the parties, but had to correspond to the ultimate end (= final cause) of man.¹ In that case, the *causa* was not *sufficiens* and could therefore not reach its effect (the ultimate end): "*cessante causa cessat effectus*"² - the obligation could not be enforced.

To put it more specifically, the effect of changing circumstances can represent, in Aristotelian-thomistic terminology, an involuntariness of the 2nd degree: According to Aristotle and later Thomas Aquinas, man acts through reason and will. Reason is the capacity to understand the ends of one's actions and the contribution they make to the ultimate end of man.³ Will is the capacity to choose for the sake of this end.⁴ This is the crucial point of thomistic understanding of contract law. Contracts had to correspond to the will of the parties, but to the will as it was understood according to Thomas and Aristotle. First of all, a party had to understand the *essentialia* of the specific contract, the elements which made up its "essence" (as opposed to the *accidental*ia).⁵ If these essentials were not understood, the contract would not be binding. One could speak of an involuntariness in the 1st degree. But, according to Thomas, even if the party was clear about all the essentials, circumstances might arise under which the party would still not be bound. The source for this position is Aristotle's theory of equity in the *Nicomachean Ethics* Book V, chapter 10: as a matter of equity, a law should not be applied if the law-giver had not meant it to be applied under the given circumstances. Since Thomas saw promises as laws of the parties, he transferred this rule to promises and thereby to contracts: contracts are not binding under circumstances under which the contracting party did not intend to be bound.⁶ This, of course, is too general and Thomas differentiated further: if circumstances become onerous but the end of a contracting party is still attainable, that party is kept bound. If, on the other hand, the envisaged end is unattainable because of the change of circumstances, then these circumstances are outside the commitment of the party and the contract is not binding because of, as one could say, involuntariness in the 2nd degree, meaning that there is no involuntariness in the literal sense but in the sense that the will which led to the formation of the

¹for a detailed account: Gordley 17sq. and 49sq.

²Thomas Aquinas *Summa theologia* Suppl. Qu. 55 art. 2 n. 1.

³*Nicomachean Ethics* Book I chapter 7 and 9.

⁴*Nicomachean Ethics* Book II chapter 2 and 4.

⁵*Summa theologia* Suppl. q. 51, a. 2, ad 7.

⁶*Summa theologia* II-II, q. 88, a. 10; q. 89, a. 9; q. 120, a. 1.

contract corresponds no more to the originally envisaged end.¹ If the envisaged end (*causa finalis*) cannot be attained by means of the contract, then the contract lacks a *causa*. Since the reason for the enforcement of contracts is that the parties enter it in order to achieve a certain end, a "good cause" or *causa sufficiens*, thereby giving the contract its *causa*, there is no point in enforcing it. Furthermore, as described above, contracts, as being means to ends, were regarded as an exercise of the underlying virtues (in the case of exchange the virtue of commutative justice, demanding equality in exchange), the exercise of which was perceived as being the means best suited to achieve the parties' envisaged aims just as they were - and because they were - best suited for the achievement of man's ultimate end. Therefore, the contracts had to conform to these virtues.

This concept, however, only makes sense, if the will of the party is not treated separately from the *causa* (as being the end, aim or purpose of the will) but in close relationship with it. When will and purpose were divorced later on, beginning with the natural lawyers and culminating in the time of the 19th century pandectists, this concept could not work anymore and legal tools like the *clausula rebus sic stantibus* were to be increasingly criticised and eventually abolished. One of the main reasons for this was the fact that once Thomistic-Aristotelian philosophy was challenged by more modern philosophers, the understanding of its basic ideas and concepts slowly faded into oblivion, often leaving the jurists with legal rules which they could not explain anymore and therefore tended to restrict and eventually abolish.² The Aristotelian metaphysics of essences linked to ends was especially attacked by later philosophers who challenged the legitimacy of speaking both of essences and an ultimate end of man.³

One nevertheless feels reminded today of these Aristotelian-Thomistic concepts when observing the modern German remedy of *Wegfall der Geschäftsgrundlage*. The *Geschäftsgrundlage* (basis of the transaction) reminds one of the *causa* and the two main reasons for granting the remedy, frustration of purpose (*Zweckstörung*) and frustration of equality in exchange (*Äquivalenzstörung*), seem very familiar after contemplating the doctrine of *causa*, since they today lead to the collapse (*Wegfall*) of the *Geschäftsgrundlage*, just as they used to rob the contract of its *causa* in the Middle Ages.

¹see for details: Gordley *Philosophical Origins* 86-87.

²Larenz *Geschäftsgrundlage und Vertragserfüllung* 3rd ed. 1963 12 fn. 20 at the bottom.

³see for details: Gordley *Philosophical Origins* 23sq. and 113sq.

2. The decline of Aristotelian-Thomistic philosophy

The philosophy of Aristotle and Thomas Aquinas became largely discredited by modern philosophical movements starting with nominalism and voluntarism and then especially in the Age of Enlightenment as a result of the thought of Descartes, Hobbes, Locke and Hume.

This development originated in the great intellectual and philosophical struggle which called into question the whole medieval perception of the world (*Universalienstreit*): the question of what was at the origin of reality, what comes first (and must therefore be the basis for all reasoning): the *universalia* (the abstract, general, the idea of a thing) or the *realia* (the concrete, empiric)?

The medieval perception of the world rested on the assumption that the *realia* derived from the *universalia*, that at the base and origin of every concrete thing was the abstract idea of that thing by which it was determined, which determined its essence. Thus one could define the order of the world by tracing back all concrete things to their original ideas and all things inevitably had to behave according to those ideas since they determined their essences. This was also the starting point of Aristotelian-Thomistic philosophy. Scholars, however, increasingly turned away from the abstract ideas to study the concrete things of the world right before their eyes and, observing their diversity, became more and more sceptical about the validity of the abstract ideas.

John Duns Scotus (1265-1308) said that man possesses not a single form (or essence) but a number of distinct "formalities". Matter, life, animality, rationality, intellect, will, - all are distinct formalities. For Thomas, they are united in a single form because, for example, rationality is a certain realization of the potentialities of animality and animality in turn a realization of the potentialities of being alive. Scotus objected that this means describing purely in terms of potentiality something that is supposed really to exist. Therefore, an entity is like a series of transparencies overlaid to form a picture, each transparency being incomplete without the others. But the transparencies are not parts with separate functions, one cannot study them as Aristotle and Thomas did. Consequently, Scotus discussed contract by decomposing it into a cluster of conceptually distinct elements. Since they exist independently from each other, they cannot be defined or explained in terms of their end or function. The analysis is conceptual, but no longer teleological.

William of Ockham (1280-1349) went even further. He said that individual things have neither essential forms nor formalities. To him, concepts such as "man" were merely "intellections", "cognitions".¹ Nevertheless, Ockham claimed that a "demonstrative moral science" could "deduce

¹William of Ockham *Expositio super primum librum Perihermenias* cap. I in *Traditio* 4 (1946), 323.

conclusions syllogistically” from principles known either ”of themselves” (*per se*) or ”through experience” (*per experientiam*).¹ Ockham's views influenced Descartes, who asked how he could prove to himself that the objects around him really existed. He might be dreaming or the victim of illusions.² According to Descartes therefore, one could prove nothing about the outside world on the basis of perceptions alone.

Hobbes and Locke concluded that one ought not make assertions about the outside world that went beyond one's experience. To be meaningful, the words we use should refer to an experience or a combination of experiences.³ Therefore, according to Hobbes and Locke, the fundamental terms of Aristotelian metaphysics such as substantial form, nature, essence, and final cause or end were meaningless, human thought proceeds not by abstracting the essence of an object, but by grouping experiences together. This perception was reinforced by the impression which the physical discoveries of Galileo and later Newton made on their contemporaries. Their method stressed experimental observation and mathematics, the new science described its objects without regard to their substantial form or end. Locke called the experiences themselves ”simple ideas”, the combination of them ”complex ideas”.⁴ Human thought would therefore have to be explained without using the concept of essence, morality without using the concept of the end of man. Moral Philosophy needed a new basis since one could no longer speak of activities that contribute to the end of man or the virtues that make such activities possible. Experiences can be agreeable or disagreeable. Hobbes spoke of these feelings as ”appetite” and ”aversion”. Locke spoke of the ”pursuit of pleasure” and ”avoidance of pain”. He redefined good, happiness and obligation in terms of the pursuit of pleasure: ”What has an aptness to produce pleasure in us is that we call good, and what is apt to produce pain in us we call evil”.⁵ But from that point of view, it seems one could have no obligation except to pursue pleasure and avoid pain in any way one could. Hobbes and Locke tried to avoid this conclusion by describing society as a contract in which each person limits the ways he pursues pleasure and avoids pain in order to benefit from the limitations assumed by others.⁶ Both rejected the idea of ultimate essences and an ultimate standard of contract. Yet, people were supposed to be bound by a contract even when they could get away with violating it. Hobbes and Locke maintained that one could formulate definitions even in a world without essences and derive the necessary rules as consequences from these definitions. A contract by definition was binding.

¹William of Ockham *Quodlibeta* ii q. 14.

²Descartes *Méditations* méd. I in *Oeuvres* (Paris, 1967), ii. 404-13.

³Locke *Essay on human understanding* II. i. 2 (in: *The works of John Locke*, London, 1823); Hobbes, *Leviathan*, (Cambridge, 1935), I. i at I; I. iv at 18-20.

⁴Hobbes, *supra*, I. i at 1; I. iv at 18-20; I. v at 21-2; Locke, *supra*, II. ii. 1; xii. 1.

⁵Locke *supra* II. xxi. 54; similarly Hobbes *supra* I. vi at 30.

⁶Locke, *Two Treatises of Government*, II. viii. 95; Hobbes, *supra*, II. xvii at 119.

The obligations of those entering into a contract follow from its definition by deductive logic. But now, consequentially, definitions had to be reached in a way different from how Aristotle and Thomas Aquinas had defined things. Locke tried to explain how one could formulate definitions in his *Essay on Human Understanding*. Definitions were "complex ideas" which were made by combining "simple ideas". The simple ideas were combined either because they were observed to "go constantly [logically, necessarily] together" or "very arbitrarily...without patterns or reference to any real existence". Definitions of moral ideas such as "government" or "contract" were not made in the first way. One did not define contract to entail an obligation because one observed by experience that the persons who made contracts also happened to be bound by obligations. Therefore, definitions of moral ideas were made by combining simple ideas arbitrarily. If that is so, however, it seems that the conclusions drawn from these definitions were equally arbitrary. Locke himself observed the dilemma: if "moral knowledge be placed in the contemplation of our own moral ideas" and these "be of our own making", will there not be "a confusion of virtues and vices, if everyone may make what ideas of them he pleases"?¹ The answer he tries to give sounds already like a partial retreat: "complex ideas ...depend on the mind and are made by it with great liberty, yet they are not made at random, and jumbled together without any reason at all. Though these complex ideas be not always copied from nature, yet they are always suited to the end for which abstract ideas are made".² Locke's answer, however, presupposed that simple ideas were related in some way that did not depend on the arbitrary choice of the definer. To whose or what "end", however, are some definitions more suited than others? One could no longer speak of an ultimate end of man but only of the different and conflicting ends of individuals.

David Hume recognized that this answer was not satisfactory and was willing to face the intellectual consequences. He concluded that morality could not rest on reason because it could not be deduced from observing reality. "Reason is the discovery of truth and falsehood". Truth or falsehood depended either on "real existence and matter of fact" or on "real relations of ideas", of which there are four kinds: relation by resemblance, by quantity, by quality or by contrariety. None of them has anything to do with law and morals. Therefore, statements about morality were statements about feelings for which no reasons could be given.³ But how then explain why a contract should be binding? Hume resorted to a historical argument: the feeling that one is bound by a contract must have developed in societies so small that contracts would be kept out of self-interest alone, since, if a person violated his contract, others would immediately lose their motive for co-operating with him. When societies became larger, people were already accustomed to seeing contracts kept, and so they

¹Locke, *supra*, IV. iv. 9.

²Locke, *supra*, III. v. 7.

³Hume, *A Treatise of Human Nature*, (London, 1886), book 3, pt. 1, sect. 1, at ii. 236, 240.

felt displeasure at seeing them violated even when they were not the ones to suffer.¹ In a similar way, the jurists of the 19th century, especially the "Historical school of law" explained law primarily as something that had developed historically but did not concern themselves with explaining why to abide by those rules in terms of virtues and morality, at least not in a manner which influenced their account of the law in detail, apart from some general statements in introductory parts. In the end, Hume's explanation gives a person no genuine reason whatever to abide by a contract.²

Thus, Hume pronounced in a most radical manner the apparently inevitable separation of the "Is" and the "Ought" and the dilemma that resulted from it - especially crucial for the field of the law - which has marked philosophical and legal thought until today. It was perceived that the Ought can not be deduced from the Is, both are separated by a seemingly unbridgeable gap. Morality and ethics are outside of and unconnected with empiric reality. From this perception developed the tendency to keep morality and ethics out of the field of scientific reasoning, which came to be seen as the only legitimate form of human reasoning. Jurisprudence - considered as a legal science - was no exception to this approach. Legal doctrine and moral philosophy were to be strictly kept apart.³ The jurists of the 19th century did not deny values but did not see them as an object of their science, claiming that one could explain law without making philosophical commitments. For that reason too, the jurists of the 19th and 20th century rejected the natural law, because it built essentially on an Aristotelian-Thomistic foundation and had been in fact founded by the late scholastics and later "secularized" by Grotius and his successors by taking over Thomistic concepts without explaining them in terms of Thomistic-Aristotelian philosophy. The jurists of the 19th century only took over the systematical achievements of the natural lawyers and their scholastic predecessors because that served their scientific aim. This development was also the root for philosophical and legal positivism.

3. Kant (1724 - 1804)

Kant built his philosophy on Hume's perception of the separation of the Is and the Ought, aiming at formulating and drawing consequences from its implications. The Is is described empirically by physics. The Ought therefore can only be described by metaphysics. Since the Ought is strictly separated from the Is, there is no empirical evidence for it. The source of metaphysics can therefore,

¹Hume, *supra*, book 3, pt. 2, sect. 2, at ii. 262-4, 270-2.

²this is a summary of the account of the development given by Gordley, *Philosophical Origins, supra*, 23sq., 113sq.

³This development took place in the whole western hemisphere. See Gordley, *Philosophical Origins, supra*, 214sq. A good example for the attitude of the 19th century jurists is Sir Frederick Pollock's article "The nature of jurisprudence considered in relation to some recent contributions to legal science" in F. Pollock, *Essays in Jurisprudence and Ethics*, London 1882, I at 19-20.

according to Kant, be only in human reason, since it is the mediating factor between the individual (subject) and the empirical outside world (object). Reason, in turn, leads the individual to the realization of the categorical imperative, in which alone the Ought can be firmly rooted. Since ethical rules can only come from reason, their existence can only be *a priori*, without cause or end, for causes and ends are empirical facts. Kant interprets the dilemma in a positive way: since ethical rules do not exist independently of human reason and have no causes or ends in the empirical world, this fact constitutes the overwhelming dignity of the individual who also has no cause or end in the empirical world but constitutes an end in himself. He can therefore never be a means to an end other than the end in himself. He is always a subject and may never be reduced to an object or a means to an end other than himself. This fact demands that the freedom of every individual must be respected and this perception of the individual is the basis of the categorical imperative.¹ Kant thus established an autonomous ethic, which consequently had to be totally disconnected from the Is - the empirical world.

According to Kant, law is part of the Ought since it demands obedience to certain rules, but it has to be strictly separated from ethics. These two form different categories. Law has primarily to do with force and aims at the general public. It is restricted to the good conduct which is ensured by the use of force. Ethics, on the other hand, aim at the individual and ask to be obeyed voluntarily, according to the categorical imperative. Whether legal rules are just or unjust is determined by their conformity to ethical rules, but nevertheless ethics are not part of law. Ethics, in turn, are rooted in reason in the manner described above.

Kant defines the law as the means to balance the free will of the individuals:

”...der Inbegriff der Bedingungen, unter denen die Willkür des einen mit der Willkür des anderen nach einem allgemeinen Gesetze der Freiheit zusammen vereinigt werden kann”.²

From the separation of the Is and the Ought follows the irrelevance of ends or purposes (as empirical facts) for the law: Kant stresses that the law aims only at the relationship between the free wills of the individuals, not at the relationship of free will and wishes - and thus ends, purposes - which would be the content of the will. The law should not judge the content of the free will but only the form of the relationship of the free will of individuals because otherwise it would impose ends and purposes on the individual and make him an object of these ends which is incompatible with the dignity and the

¹Fikentscher, *Methoden des Rechts*, vol. III, 1976, pp. 19,22,23.

²Fikentscher, *supra*, 26.

freedom of the individual.¹ Since the law is part of the Ought, it is totally disconnected from the Is and therefore may not tie the individual to ends which are empirical facts and therefore parts of the Is. The Is does not determine the Ought and thus empirical ends and purposes may not determine the judgement of acts of individuals. Kant sees the law as an enforceable Ought resulting from a purposeless morality.² The law itself, just like the individual, is without purpose or end but constitutes an end in itself.

Kant's approach to law is therefore formalistic.³ Ethics are not inherent in the law but a totally different category. Kant's account of the law and his radical separation of law and philosophy and ethics is one of the landmarks in the development of legal positivism. The law to him is "pure Ought" for which the empirical Is is irrelevant. Ethics are not totally irrelevant but are not part of the law. They form a different category outside the law. Although Kant acknowledges that legal rules should correspond to ethical rules in some way, he does not specify how this should occur. The interplay between law and philosophy remains largely obscure. The important question of how to control the law, by what standards to measure the law, the whole question of evaluative judgement (*Wertungsfrage*) in the law, is neglected. The importance of philosophy not only as a general basis but also to provide concrete standards to measure the law, is underestimated. The law becomes an independent organism which largely explains itself. The connection to ethics is loose and continues to loosen in the course of the century. The ethical foundation of the law remains abstract, in very general terms, without concrete consequences for individual legal rules. The respect for the freedom and dignity of the individual alone does not provide useful guidelines for individual legal rules and neither does the categorical imperative, which can be interpreted in various ways as soon as it comes to detailed problems.⁴

It could be argued that it was not Kant's primary concern to work out all concrete consequences of his philosophy for the law and that it would have been the task of lawyers to integrate Kant's autonomous ethic based on reason alone into the law. Yet this did not happen, and perhaps it would not have been very successful anyway. The Kantian ethics remained in the background and the jurists of the time, above all Savigny, only took over Kant's formalistic and individualistic (and thus subjective) approach to law, regarding it as an autonomous organism, free of any purpose or end, whose content is nothing but the positive legal rules themselves as inherited from history. Ethics are part of philosophy, separate from the law, and therefore not within their field of study.¹ These jurists accepted Kant's ethics of freedom and dignity of the individual as a - somewhat remote - basis but did

¹Fikentscher, *supra*, 25.

²Fikentscher, *supra*, 29.

³Fikentscher, *supra*, 29.

⁴Fikentscher, *supra*, 30,31.

not concern themselves with it any further. They did not analyse Kant's ethical concepts in order to derive specific conclusions for the law.² When Savigny discussed the effect of mistake, fraud and duress on a declaration of will, he said:

"We in the area of law are not at all occupied with the speculative difficulties of the concept of freedom. For us, freedom is based simply on the appearance (*Erscheinung*), that is, on the capacity, of making a choice among several alternatives".³

Philosophers like Kant, as well as jurists like Savigny were all responding to the common problem of how to explain law and morality after the collapse of the Aristotelian philosophical tradition. But while the separation of the Is and the Ought led philosophers to search for the possibility of morality without being able to discover a moral order outside the human will, it led the jurists to abandon philosophy as a whole and to restrict themselves entirely to their "positive" subject matter, purging Aristotelian concepts from it, borrowing little from new philosophers and without drawing consequences from these borrowings to fill in the gaps left by the older concepts. They wanted to explain the law without making philosophical commitments.⁴

4. Savigny (1779 - 1861)

Savigny adopted the distinction between the Is and the Ought and Kant's rejection of everything empirical, especially empirical ends and purposes. On that basis, he distinguished "empirical legal reality" and the "real law" which are not the same thing but separated along the line of the separation of the Is and the Ought. The "real law" to him, like to Kant, led an autonomous, independent existence.⁵ Savigny saw it as the task of a legal "science" to reveal the "inner unity" of the law, the "real law", that is the system. The historical inheritance of legal texts and rules, identified by Savigny almost exclusively as the Roman law as it was received and accepted by the *Volksgeist* of the German people provided the raw material from which this system was to be derived. That was the programme of the *Historische Rechtsschule*, founded by Savigny. The new legal science was to pursue this task without commitment to any kind of natural law or philosophy, since these did not provide legitimate explanations of the law and - as far as ethics are concerned - were not part of the law as such.⁶

¹Fikentscher, *supra*, 26.

²Gordley, *Philosophical Origins*, 225,226,227. He describes this as "secular agnosticism" of the jurists.

³Savigny, *System des heutigen Römischen Rechts*, Berlin 1840, iii, §114, 102.

⁴Gordley, *supra*, 228.

⁵Savigny, *System I*, 54, Fikentscher, *supra* 26.

⁶Savigny's "Frühschrift", notes from a seminar in 1802/03, published by Wesenberg in 1951, 50.

Savigny's approach was thus purely historical and systematical.¹ The historical element of Savigny's approach, on the other hand, should not be overestimated. He regarded history as the raw material of his systematic studies, as a complete body of inheritance, a "closed shop", which contained the law as a whole that had to be revealed by historical exegesis. It has been said that Savigny stood with his back turned to the future. In his eyes, history ended in the present. He did not see history as an ongoing, dynamic process and thus did not see the law as a process open to the future.² To him, the law as a whole was contained in the sources, his subject matter, to which one had to stick as closely as possible.

Savigny also built on Kant's subjective approach and his concept of freedom and dignity of the individual, which he placed into the centre of his system of the law: Savigny is the father of the modern concept of private autonomy, the bearer of which is Kant's moral and perfectly free individual. From Kant's definition of the law as the formal relationship and balance of the free will of the individuals, Savigny developed the will-theory, which marked the legal science of the 19th century.

Savigny, again, like Kant, rejected specific ends or purposes in the law as detrimental to the original freedom and dignity of the individual.³ Such purposes would turn the individual as natural subject into the object of outward forces. The individual represented an end in itself only and the self-fulfillment of the individual was the only end which the law should recognise, no further end was to be pursued by the law. Savigny was therefore sceptical about the legitimacy and usefulness of imposed political and economic ends in legislation.

To criticise and reject the imposition of outward ends and purposes on free individuals suits philosophy very well but is bound to encounter difficulties in the field of the law. What was no problem for Kant became a problem for Savigny. To free the law of all kinds of specific ends and purposes and thus evaluative standards (*Wertungsmaßstäbe*), made it difficult to reach justified evaluative judgements (*Wertungen*) in countless legal questions. The availability of evaluative standards is indispensable for the work of a jurist. These standards had to come from somewhere. As pointed out above, Savigny rejected philosophy as the source for such evaluative standards in the law. In his effort to "positivize" the law, he turned to the given historical inheritance of legal texts and rules, especially the "pure" Roman law, as it was embraced and evaluated by the *Volksgeist*. This was to be henceforth the only subject matter of legal science and meant to replace the illegitimate concern with ends and purposes. This meant that the historical school of law mainly reproduced evaluative

¹Fikentscher, *supra*, 61 sqq.

²Fikentscher, *supra*, 55 sqq.

³Fikentscher, *supra*, 39.

judgements made by the ancient roman jurists as they were contained in the sources and applied them to modern problems. One could say that the whole approach of the historical school of law was mainly reproductive and interpretative.¹ Of course, this subject matter, the historical legal sources, is limited: the law of a society of so long ago, did not provide evaluative judgements directly applicable to modern legal issues. At that point, the dilemma produced by the radical separation of the Is and the Ought and the illegitimacy of establishing rules based on the observance of the empirical world and thus empirical ends and purposes implicit therein, became inevitable. These "gaps", made visible by the emergence of new problems for which no historically legitimised solution is offered (as part of the "real law" to be extracted from the historical subject matter), usually call for an amendment of the law by recourse to the underlying ends and controlling values of the law. But this procedure was not tenable in Savigny's time, since underlying ends and controlling values were considered illegitimate and at least not part of the law. But since the need for evaluative standards is inevitable, another way had to be found. This basic need thus inevitably resulted in a selective and eclectic use of the historical subject matter. The sources were interpreted to meet modern needs and aims. Their role was more and more to provide historical arguments for modern solutions. But these arguments were presented as if they constituted the only historically legitimate solution, the unique solution which the "real" law demanded. One has even spoken about a new "natural law" contained in and extracted from the *Volksgeist*, which had to provide for the basic need for evaluative standards concerning modern legal problems.² It seems that Savigny was not - as he had claimed - quite able to avoid commitment to any kind of natural law whatsoever. The means to at least partly introduce and at the same time (unconsciously) veil, the discovery and use of evaluative standards and thus ends and purposes guiding the law, was Savigny's use of the philosophical concept of *Anschauung* (contemplation).³

This required the jurist to establish the specific functions of the legal institutions by means of contemplation, taking into account the individuality, concrete appearance and organic development and functioning of these institutions as they emerge from history - and not only to deal with them by means of systematical, deductive and conceptual logic, inherited from Kant. By means of *Anschauung*, one could "reveal" characteristics of legal institutions which related to values,

¹Fikentscher, *supra*, 75 sqq.

²Fikentscher, *supra*, 40, with references.

³Against Kant's deductive, logical way of cognition, the philosopher Herder developed the concept of *Anschauung* (contemplation). He emphasized that in order to understand the essence of a thing, its whole being as such, in its very wholeness and individuality, one could not only proceed purely deductively, logically in the abstract because deduction and abstraction always involves moving away, distancing oneself from the original object. In order to account for individuality, one should not decompose objects logically into their parts and attributes in order to form abstract concepts but try to encompass with one glance all that constitutes the object in its individuality and wholeness; see Fikentscher, *supra*, 41, 70.

evaluative standards or ends and purposes. But because of the reproductive and interpretative approach, and the belief that the "real" law as such was in its completeness contained in the sources, and could be unambiguously extracted from them, the results of the *Anschauung* were pronounced authoritatively and were binding. The term *Anschauung* implied that one was simply observing an objective, unambiguous fact so that the process of evaluative judgement (*Wertung*) of the interpreter was thereby obscured. The results of *Anschauung* had to be accepted and could not be questioned. The process of evaluative judgement, contained (and hidden) in the *Anschauung* was therefore unconscious and uncontrollable. The concept of *Anschauung* was designed to avoid the shortcomings of a purely systematical and conceptual approach, but the price was a serious loss of justification and verification. Savigny's use of history could at some point even be called "historical metaphysics".¹

In accordance with his basic historical-systematical and logical-conceptual approach to law, Savigny states four "elements" of interpretation: grammatical, logical, historical and systematical interpretation.² But, being sceptical about all kinds of ends and purposes in the law, Savigny, following Kant, basically rejected teleological interpretation, which searched for the reason (end or purpose) of the rule (and which is the most important element of interpretation in today's German jurisprudence). The end, or reason of the rule (*Grund des Gesetzes*), as Savigny calls it, does not, he argues, become part of the content of the rule itself, the interpreter would only add it in an artificial way.³ The reason, or purpose, may therefore not be treated as a legal rule itself. Only what the legislator actually stated is relevant and not his motives or ends. The approach of the jurist to the law had to be, as mentioned above, purely reproductive and not creative, since law could not be "created", but was believed to be complete and entirely contained in the sources and the statutes. While Savigny held a very strict point of view on this issue in his earlier years, he later on adopted a slightly less positivistic attitude in his *System*. He still emphasizes that the reason of the rule is not part of the rule itself, but, he says, that reason (or end or purpose) may be used in the interpretation of the rule, although only cautiously.⁴ In the framework of the historical element of the interpretation, one may also ask for the specific reason that moved the legislator to adopt a certain rule, but only when the term used by the rule was actually ambiguous.⁵ Savigny's remarks on the further development or amendment of the law (*Rechtsfortbildung*), are few and show again that in principle he believed the law to be already complete and that "gaps" should be filled in exclusively by interpretation of and drawing analogies from existing legal institutions.⁶ But the subject of further development of the law

¹Fikentscher, *supra*, 77.

²Fikentscher, *supra*, 67.

³Savigny, *System I*, 40.

⁴Savigny, *System I*, 218, 220.

⁵Savigny, *System I*, 228, 233.

⁶Larenz, *supra*, 13.

agenda by the Roman sources themselves, because the Roman law itself represents the best example of an always dynamically developing legal system, constantly generating new rules from older ones.¹ Savigny observed:

”Die Römer haben von der Ergänzung des Rechts durch Analogie sehr richtige Ansichten, nur unterscheiden sie in der Anwendung derselben nicht überall die Fortbildung des Rechts von der reinen Auslegung”.²

Obviously, for the Romans, there was only a fluid boundary between interpretation and further development of the law. The demarcation of, and the fluid transition from interpretation to further development of the law remains one of the most important issues of discussion in German legal science today.

5. Puchta (1789-1846)

The works of Puchta mark the climax of the Historical School of Law and the so-called conceptual jurisprudence, which is characterised by the belief, that legal concepts can be deduced from each other and thereby form a coherent system of law. Puchta developed the so-called "pyramid of concepts". The pyramid of concepts meant that the highest concept (the subjective right - *subjektives Recht*) determined the content of all the concepts following from it. But where does the content of the highest concept come from? If determined by the more special (and thus theoretically lower) concepts, the argument would be circular. Instead, the ethical essence of the highest concept was the Kantian concept of the perfectly free and dignified individual. But descending down the concepts of the pyramid, the ethical content becomes necessarily less and less concrete or obvious, and finally fades into oblivion, since the lower concepts are only considered in terms of their logical-systematic position within the pyramid and not with reference to their particular ends or functions in the framework of the legal system. Kantian ethics serve as a starting point for the development of a purely logical and systematic approach, but quickly lose relevance in the unfolding of it.³ The inner unity and coherence of the law is not constituted by such ethical or political ends or purposes of the law but the relationship and unity of the conceptual elements (*Begriffselemente*) within the law. The

¹Fikentscher, *supra*, 58.

²Savigny, *System I*, 294.

³Larenz, *supra*, 23,24.

intriguing aspect of this approach was the image of a legal system ruled by logical necessity, albeit at the price of the neglect of ethical-teleological and sociological relations.¹

Puchta's exclusive emphasis on the deductive-conceptual method founded the kind of legal formalism that dominated legal science for a considerable period and against which Rudolph von Ihering militated unsuccessfully for a long time. Wieacker characterised this process as the final alienation of legal science from the social, political and moral reality of the law. This remoteness and separation of the legal science from reality, using scientific methods but focusing on the "pure Ought" as the exclusive subject, was the reason that the counter-reaction, when it did come, did not originate in philosophy but in the empirical sciences, especially sociology which emphasized the role of social reality in the law.

6. Windscheid (1817 - 1892)

Windscheid moved away from the concept of the *Volksgeist* as the primary source of the law into the direction of a statutory legal positivism (*Gesetzespositivismus*), which identified as the primary source of the law the statutes and thus the will of the legislator.² In his interpretation of the subjective will of the personified legislator, Windscheid introduced the strong psychological approach to the law that henceforth characterised legal science in a marked manner. Windscheid has been portrayed as an adherent of a rationalistic legal positivism, alleviated by an idealistic belief in human reason inherited from Kant.³

The "will", to Windscheid, is no more an ethical category, as it was for Kant and to some extent also for Savigny and Puchta, but a psychological notion. The legal concepts are not deduced from ethics but defined psychologically. This approach soon encounters difficulties: a subjective right may exist independently from the actual will of its bearer. Windscheid dismisses the problem by emphasizing the will of the legislator, who accords these rights to the individual. The decision whether an individual wills the exercise of that right or not is left up to him. Because the will of the individual is only relevant as regards the possibility of exercising the right Windscheid prefers the notion of a "claim" (*Anspruch*) above the term subjective right. This process illustrates the continuing erosion of

¹Larenz, *supra*, 32.

²This is attributed to the influence of Hegel's positivism vis-à-vis the state and its laws which was the basis of Julius Stahl's criticism of the concept of the *Volksgeist*: the common conviction of the people about a legal issue did not yet constitute the law, the law only gets its binding force when that conviction is positivised by the state in the form of statutes. See Fikentscher, *supra*, 94sqq.

³Larenz, *supra*, 30: "Es ist ein durch den Glauben an die Vernunft gemilderter, rationalistischer Gesetzes-positivismus".

the original meaning and inherent sense of the legal concepts necessarily entailed by the purely formalistic-logical-conceptual approach. The concepts derived by formal deduction remain at the surface of the legal rule, its inner sense, while its core is almost totally eliminated. In a formal-logical sense, the system is coherent, but the essential spiritual substance is missing and only implicitly presupposed by Windscheid.¹

But for Windscheid also, the question of evaluative judgement (*Wertungsfrage*) was inevitable. He was forced to find back doors for and make concessions to, questions of evaluative judgement and veiled it with logical-conceptual formulations, as for example was the case with his doctrine of *Voraussetzung*.² There is in Windscheid's thought an almost imperceptible transition from an empirical-psychological to a normative concept of will. Windscheid has regard not only to the actual will of the parties or the legislator, but also the "reasonable" will. Although he expressly rejected interpretation on the basis of a presumed objective reasonableness, he presumed the legislator or the parties to a contract to generally will reasonably, only slightly veiling it by means of arguments of a seemingly psychological kind. Windscheid, like all jurists, remains sensitive to the equity of the result:

"Endlich ist auch auf den Wert des Resultats Rücksicht zu nehmen, insofern nämlich angenommen werden kann, daß der Gesetzgeber eher etwas Bedeutendes, Angemessenes, als etwas Leeres und Unpassendes hat sagen wollen".³

It is also the duty of interpretation

"hinter dem Sinn, welchen der Gesetzgeber hat ausdrücken wollen, dessen *eigentlichen* Gedanken hervorzuziehen".⁴

Interpretation should thus not stop at the empirical will but ask furthermore for the "real" will, the reasonable will. This approach obviously tends to establish fictions in order to reach equitable results on the basis of an obscured and unconscious evaluative judgement (*Wertung*). Windscheid still regards this as interpretation, without realising that he has left the confines of the enquiry into an empirical will. The same happens with respect to the filling in gaps in the law (*Lückenfüllung*): Gaps

¹Larenz, *supra*, 33,34.

²see Part II 1.2.

³Windscheid, *Lehrbuch der Pandekten*, 7th ed 52.

⁴Windscheid, *supra*, 54.

should be filled "aus dem Geiste des Rechtsganzen".¹ But such comments only make sense if one assumes that there is an objective coherence of meaning, an inherent reasonableness in the law from which one can deduce evaluative standards for problematic legal issues, although this does not fit well with Windscheid's psychologism and legal positivism.² This inconsistency and even self-contradiction between a positivistic and empiric approach on the surface and a fundamental belief in the inherent reasonableness of the law at a deeper level, does not seem to have come to Windscheid's attention, probably because he was more concerned with "practical" dogmatical issues than with the consistency of legal theory.

7. Ihering (1818 - 1890)

Apart from his considerable dogmatic achievements, the most famous among them being the doctrine of *culpa in contrahendo*, Ihering took a great interest in legal theory and his work was of enormous influence on the development of this field. He was one of the first after Kant who sought to bridge the gap between the Is and the Ought and he was the first to reintroduce the topic of ends and purposes (*Zweck*) to the law. He aimed at the renewal of the law by asking a new question: What is the specific use of the law, what specific task is it supposed to serve? This question that had seemed to be illegitimate after Kant, now returned with renewed force.

Ihering started off on the basis of the *Begriffsjurisprudenz* and tried to develop it further in the form of his "natural-historical method" (*naturhistorische Methode*) which resulted in a total exaggeration of the technical, logical-deductive approach. When Ihering realized the artificiality, superficiality and arbitrary constructionism of that approach, its deficiency in concrete meaning and content and the extent to which it had lost touch with the real life of society, he turned away from the external, purely technical side of the law. His interest shifted to the internal operations of the law, the exploration of the dynamic forces behind the *ongoing* development of the law to which one had to turn in order to understand the essential meaning and content of the legal rules. He did not regard history as something static, given or inherited, like Savigny and his successors had done, but as a dynamic, ongoing process continuing into the future. This fundamental difference to earlier jurists led him to concern himself much more with the problem of the further development or amendment of the law (*Rechtsfortbildung*).

¹Windscheid, *supra*, 58.

²Larenz, *supra*, 32.

Ihering changed the direction and emphasis of his research to what he regarded as the real driving force behind the development of the law: the *Zweck* (end, purpose). He came to the conclusion that to understand the law as such requires understanding of how ends and purposes work in the law. This is why the "*Geist*" was never completed. He set out to investigate the working of the *Zweck* in his book *Der Zweck im Recht*, but never managed to make this entirely clear or to establish a coherent, clear-cut, unambiguous concept of *Zweck*. He was influenced by and borrowed heavily from the *Zeitgeist* of his time, especially the teachings of Darwin. He often used these for purely illustrative purposes, without having a full knowledge of them, or being truly committed to them. This resulted in differing interpretations of his understanding of *Zweck* and of his work and approach as a whole by modern scholars such as, for example, Larenz, Wieacker and Fikentscher. But notwithstanding the fact that Ihering did not make his understanding of *Zweck* entirely clear, his thoughts and his new approach have generated an enormous influence on the development of legal theory. This was mostly due to the fact that he clearly saw the deficiencies of the traditional approach and by boldly entering new grounds, determined the direction of the future development in legal theory.

The reasons for the binding force of the legal rules are to be found in their content rather than in their logical relationships.¹ Upon realizing this, Ihering's interest shifted drastically towards the content of the rules and the reasons why such contents acquired binding force by being expressed as legal rules:

"Daß die Befriedigung, welche die Jurisprudenz dem bloßen Verstande gewährt, nicht das höchste ist, ist mir je länger je mehr klar geworden, und ich habe die Spuren der Überschätzung der logischen Seite des Rechts, welche die erste Auflage an sich trug, möglichst zu tilgen gesucht. Über dem bloß Formalen der juristischen Logik steht als Höheres und Höchstes die substantielle Idee der Gerechtigkeit und Sittlichkeit, und eine Vertiefung in sie, d.h. wie sie in den einzelnen Rechtsinstituten und Rechtssätzen zum Ausdruck und zur Verwirklichung gelangt, ist nach meinem Dafürhalten die schönste und erhabenste Aufgabe, welche die Wissenschaft sich stellen kann".²

At first, Ihering realized that the content and meaning not only of the legal rules but also of the legal concepts themselves changed during the course of history.³ But then the belief that basic legal concepts represented elements, or basic juristic bodies, from which all legal rules could be deduced by combination and construction, became questionable. Ihering realizes that logical necessity had nothing to do with the nature of the binding force of legal rules.

¹Larenz, *supra*, 29.

²Ihering, *Geist des römischen Rechts auf den verschiedenen Stufen seiner Entwicklung*, vol II, 2, 361, footnote 506a.

³Ihering, *supra*, vol. IV, 1864, 305.

He observes that the sources of the Roman legal rules are to be found in psychological, practical, ethical and historical reasons. He sees that the legal science of his time is, albeit unacknowledged, strongly influenced by the fairness of the result reached in the individual case.¹ Ihering thus calls for a more pragmatic approach to the law, he asks for the "practical value" (*Lebenswert*) of the jurisprudence. This practical value, he believes, is best achieved in serving the inherent ends and purposes of the law as such and the particular legal rules. With this idea in mind, Ihering wrote his book *Der Zweck im Recht*, which was first published in 1877:

"Der Grundgedanke des gegenwärtigen Werkes besteht darin, daß der Zweck der Schöpfer des gesamten Rechts ist, daß es keinen Rechtssatz gibt, der nicht einem Zweck, das ist einem praktischen Motiv, seinen Ursprung verdankt".²

The purpose defines the origin and the aim of the law, both are inseparably connected. This makes the purpose the creator of the law and in order to understand and assess the law correctly, one has to consider its inherent purpose. Ihering's significance lies in choosing a whole new point of view, but this step marks only the beginning of a whole new path, raising more new questions than it answers. What is the origin of that purpose, what is its specific nature and way of functioning within the legal system? Ihering did not succeed in clarifying these aspects. His account of the *Zweck* is multi-faceted and ambiguous, influenced by popular philosophical ideas of his time, to which he had turned to in his effort to find new paths in the development of the law: Comte's sociological positivism, Jeremy Bentham's utilitarianism, and Darwin's natural selection. This is why Wieacker and Larenz saw Ihering's concept of *Zweck* as purely naturalistic - positivistic. Since the Middle Ages, one could not speak anymore of ultimate, objective ends/purposes of man like Aristotle and Thomas Aquinas had done, but only of ends or purposes of individuals or society at large. This is what Ihering did. To him, society works through mutual promotion of the interests of all its members and this is where the purposes of the law must come from.³

In the work of Ihering, the beginning of a shift of emphasis from the pure Ought (like in the case of the conceptual jurisprudence) to the Is, to social reality makes itself felt. Scholars realised that they had moved too far away from empiric reality and wanted to correct this deviation. The result was a strong, sometimes exaggerated emphasis on sociology. But the mere shift from the pure Ought to the pure Is in trying to find the source of the law did, and does not solve the dilemma of the division of Is

¹Ihering, *supra*, 315.

²Ihering, *Der Zweck im Recht*, vol. I, viii.

³Ihering, *Der Zweck im Recht*, vol. I, 462.

and Ought. The gap itself had to be bridged, the relationship of the two poles also required re-evaluation. Wieacker and Larenz have said that Ihering's shift to social reality, to the Is - his legal naturalism - represented only the inevitable second stage of legal positivism after the legal formalism of the conceptual jurisprudence in the search for the surrogates of the transcendent ideal which had been discredited by the division of Is and Ought.¹ According to Wieacker Ihering, although he had not read Darwin, was strongly influenced by the popular version of Darwin's theories of descent and selection, to the extent that he used these to explain the development of the law.² Larenz wrote that since Ihering did not elaborate any kind of hierarchy or value-system among the purposes of society, he was the first scholar to totally relativize all standards of the law. But Larenz also acknowledges that Ihering was not yet aware of the inherent dangers of popular social darwinism, notably of the abuse of power by the "fittest" who define what is good for society.³

Fikentscher takes a more positive stance on Ihering's concept of purpose, claiming that it was multi-dimensional and consciously comprised not only a historical and a social element, but also an ethical element.⁴ According to him, Ihering's purpose was not arbitrary. Instead, because Ihering's basic interest was the pursuit of justice, he always as a matter of course had in mind the just cause. Fikentscher points to several remarks in Ihering's work which also have been remarked on by Wieacker: Ihering views the human spirit as a means of checking and evaluating his own development in terms of his ethical standards.⁵ In addition to Ihering's remark about the whole purpose of his book "Der Zweck im Recht" cited above,⁶ Ihering also states in his introduction to the *Zweck*:

"...die Annahme eines von Gott gesetzten Zweckes in der Welt oder des göttlichen Zweckgedankens verträgt sich nach meinem Dafürhalten vollkommen mit der Statuierung des strengsten Kausalitätsgesetzes".⁷

Ihering always insisted that man has the freedom and capacity to choose.

From such remarks, Fikentscher concludes that Ihering had a concept of purpose very close to Aristotle: that every legal institution had a purpose in the sense of a *causa finalis* and that Ihering's motto should have read: the *just* purpose is the creator of the law.¹

¹Wieacker, *A History of Private Law in Europe* (transl. by Tony Weir), 357.

²Wieacker, "Ihering und der Darwinismus", *Festschrift Larenz I*, 63sqq..

³Larenz, *Methodenlehre*, 52.

⁴Fikentscher, *Methoden des Rechts* vol III 230sq. 238.

⁵especially in his Viennese lecture on legal intuition (*Rechtsgefühl*).

⁶*Geist, supra*, II, 2, 361, footnote 506a.

⁷Ihering, Introduction to *Der Zweck im Recht*, VIII, IX.

Wieacker is more reserved about these aspects. Although acknowledging that one should always be cautious when studying intellectual influences,² he considers these remarks as "relapses" into a moral indeterminism, reservations inconsistent with the rest of Ihering's teachings and which created contradictions eventually responsible for Ihering's inability to work out a coherent concept of purpose.³

Maybe it was at that time too much to ask of a scholar even of Ihering's stature. His great accomplishment was nevertheless that he boldly entered entirely new paths in order to find out how the law actually works. He emphasized the importance of social reality for the jurisprudence and re-introduced the finalistic point of view. His ideas generated enormous influence on his successors who tried to work out the consequences of his many insights. He even influenced the work of Roscoe Pound in the United States and, through him, Benjamin Cardozo.⁴

8. The *Interessenjurisprudenz*

Ihering's turn to a pragmatic jurisprudence, orientated at the social reality, was the starting point for the so-called jurisprudence of interests, advocated by Philipp Heck,⁵ Heinrich Stoll⁶ and Rudolf Müller-Erzbach.⁷

The jurisprudence of interests regarded jurisprudence primarily as a means for the protection of (legal) interests. Legal rules, said Heck, result from a competition of interests, be they of material, national, religious or ethical nature.⁸ These interests must be made visible and taken into consideration as the basis for the interpretation of the law. Like Ihering, Heck relinquished the search for the psychological will of the historical legislator in favor of the forces of society behind the development of the law. Heck's method of interpretation is a "research of historical interests", which he elaborated as the "*genetische Interessentheorie*" (genetic theory of interests). In this respect, he remained true to the positivistic concept of science by describing the law purely causally in terms of

¹Fikentscher, *Methoden des Rechts* III, p. 276.

²Wieacker, "Ihering und der Darwinismus", *supra*, 91.

³Wieacker, "Ihering und der Darwinismus" 78,79,84.

⁴Fikentscher, *Methoden des Rechts* III, p. 268.

⁵"Gesetzesauslegung und Interessenjurisprudenz", *Archiv für die civilistische Praxis (AcP)* 112; *Das Problem der Rechtsgewinnung*, 1912.

⁶"Begriff und Konstruktion in der Lehre der Interessenjurisprudenz", *Festschrift für Heck, Rümelin und A.B. Schmidt*, 1931 60.

⁷*Die Hinwendung der Rechtswissenschaft zum Leben*, 1939; *Die Rechtswissenschaft im Umbau*, 1950.

⁸Heck, "Gesetzesauslegung", *supra*, 60.

the interests present in society. But he and his colleagues naturally observed that the legislator did not simply codify the interests present in society but favoured some above others by means of an evaluative judgement (*Werturteil, Wertung*). Not all interests merit the same protection by the law. Every single legal rule contains

”mittelbar ein Werturteil über die ihm zugrundeliegenden Interessengegensätze”.¹

The legislator makes such evaluative judgements in order to make society conform to a certain social ideal.² The notion of *Wertung*, which was to become the central element of the future *Wertungsjurisprudenz* (evaluative jurisprudence) which was to succeed the jurisprudence of interests, did not fit in well with a positivistic explanation of the law. Heck and his colleagues stuck to positivism by explaining the phenomenon of evaluative judgement as yet another basic interest, as idealistic interests, ”decision interests” (*Entscheidungsinteressen*) which consisted of fundamental interests of the community, such as legal certainty or equity that determine the evaluative judgement.³ Thus, the concept of interest, just like Ihering’s concept of purpose, became multi-dimensional, being cause but also object and at the same time standard, of an evaluative judgement. The reason was, again, that scholars consciously or subconsciously wanted to remain true to the positivistic concept of science that sought to explain the law objectively by reference to its causes without judging its content, which seemed illegitimate. Heck and his colleagues treated the evaluative judgements of the legislator like phenomena of the natural world which could be treated and described in the same way as the natural or logical sciences described their respective subject matters: as clearly and unequivocally causally determined. But evaluative judgements belong to another category altogether since they involve conscious choices based on certain ideals and standards, they are not determined by unequivocal natural causes. There was as yet no understanding that legal science is not to be understood with reference to the positivistic concept of science.⁴

Heck and his colleagues nevertheless strongly moved in direction of a positivistic concept of science when they analyzed the underlying evaluative judgements of the law and advised the judge to follow their pattern and re-produce them in his decisions. They also made another step into this direction by applying this procedure to fill in ”gaps” in the law (*Gesetzeslücken*) and encouraging the judge to develop the law further (*Rechtsfortbildung*) under the guidance of the fundamental evaluative judgements of the legislator. Heck emphasizes that the law never entails a clear solution for every

¹Stoll, *Festschrift für Heck* etc., 67.

²Heck, ”Gesetzesauslegung”, *supra*, 41.

³Heck, ”Gesetzesauslegung”, *supra*, 232, footnote 357.

⁴Larenz, *Methodenlehre*, 57sqq.

possible case. To him, the problem of the further development of the law is the centrepiece of legal methodology.¹ He rejects the method of conceptual jurisprudence, that is the deduction of logically new concepts from already established general legal concepts, and calls instead for an "evaluative creation of a norm" (*wertende Gebotsbildung*).² He realizes that the perception of a gap in the law in itself entails an evaluative judgement about the content of the law, since such gaps are not obvious. To fill in such gaps, one has to identify and analyse the underlying interests involved and then to rate them, that is, to make an evaluative judgement developed from and guided by evaluative judgements already present in the law. If the constellation of the interests in a given case equals that in a case provided for by the law, an analogy can be employed, if the situation is not similar, the law has to be interpreted restrictively. In this way, the law has to be amended according to the given evaluative judgements.³

The jurisprudence of interests has had an enormous impact in German legal science, especially insofar as it introduced the weighing of interests as the means of evaluating a given case appropriately. German jurisprudence and judicial organs became more conscious of their methods. The jurisprudence of interests is the direct progenitor of the *Wertungsjurisprudenz* (evaluative jurisprudence), the predominant methodological approach in modern German jurisprudence. The *Wertungsjurisprudenz* developed after the positivistic concept of science was finally abandoned because of the influence of Neo-Kantianism and legal phenomenology.¹

9. Neo-Kantianism

Neo-Kantianism brought the first great challenge to the positivistic concept of science, which would accept as scientific only the method of the natural sciences based on experience or the strictly logical methodology of mathematics and geometry. But these methods could not satisfactorily deal with disciplines within the sphere of the humanities, such as history, philosophy, theology and jurisprudence. Eventually, it became questionable whether the methods of the "exact" natural sciences could adequately account for the whole of reality, as experienced by humans.

In 1902, the philosopher Heinrich Rickert pointed out that it is impossible to portray reality as a whole, in its vast diversity and complexity. Every attempt to investigate reality, entails a conscious or unconscious decision to approach the enquiry in a certain way, and our perception of reality depends

¹Heck, *Das Problem der Rechtsgewinnung*, 7.

²Heck, "Gesetzesauslegung", *supra* 100.

³Heck, *Das Problem der Rechtsgewinnung*, 36.

entirely on the approach we choose to adopt. We always regard reality with certain conceptual pre-conditions, because we have somehow to digest the information from outside in order that reality might make sense to us. Our perception of reality is necessarily always the result of a process of digestion and transformation of information in our mind, of our conceptualisation (*Begriffsbildung*). In that process, our mind is always selective, depending on the aim of our research because it would be impossible and useless to try to take into account the whole of reality at the same time - the selection and digestion of information is a necessary and inevitable aspect of human thought. This naturally also applies to the natural sciences. They too, due to their aim to discover the general laws that govern nature, have to use selection and simplification-generalization to uncover these general laws, and in that process have to move more and more away from the individual item to description of nature in general. This process of selection and digestion in the mind, natural to all human thought, is determined by basic pre-conceived criteria which Rickert identifies as "values". These determine our approach to reality. They make us consider something as "important" or "relevant". Without such values, there could not be any reason to concern oneself with the phenomena of reality. Everything we study, we put into relation to these values just by the way we approach them. Rickert points out that this does not mean that we immediately judge the object of our studies, the values simply determine our general approach. By developing this notion of value-related or teleological conceptualisation - *teleologische Begriffs-bildung*,² Rickert introduced the notion of "value" into the theory of knowledge and identified it as an epistemological *a priori* of all sciences.

Since any one studying a certain subject normally wishes to attract the interest of other people, the enquirer will let himself be guided by values generally shared in his community. These values are thus to a certain extent, empiric facts. Although these values may change and are thus to a certain extent arbitrary, their mere existence as values suggests the existence of an "absolute" value of some kind, even though it only exists reflected in the factual values:

"...das schließt die überempirische Voraussetzung ein, daß irgendwelche Werte unbedingt gelten, zu denen die menschlichen Werte in einem bestimmten Verhältnis stehen".³

For Rickert, the term "culture" is of central importance. To him, culture in its broadest sense means everything that has meaning and significance (*Sinn und Bedeutung*) through its relatedness to basic

¹Larenz, *Methodenlehre*, 64, 89sq.

²Rickert, *Die Grenzen der naturwissenschaftlichen Begriffsbildung*, 371sq.

³Rickert, *supra*, 640.

values for the human being who acknowledges these values as such.¹ Rickert divides the sciences into the natural sciences, which are free of specific values and meaning, and the cultural sciences (*Kulturwissenschaften*) whose very nature is its concern with values and meaning. Natural sciences "perceive" (*wahrnehmen*), cultural sciences aim at "understanding" (*verstehen*). The natural sciences aim at that part of the Is which is pure perception, independent from, and not concerned with meaning and values, the cultural sciences aim at that part of the Is which is determined by just that: values and meaning.²

Consequentially, the philosopher Emil Lask saw jurisprudence as an "empiric cultural science" which studies the meaning of norms resulting from their relation to acknowledged values and purposes. He called that the "value- and purpose-orientated method of the jurisprudence" (*wert- und zweckbeziehende Methode der Jurisprudenz*).³

Like Rickert, Rudolf Stammler distinguished two different ways of thinking: while Rickert spoke of "perceiving" and "understanding", Stammler called it "perceiving" (*wahrnehmen*) and "willing" (*wollen*). The first way, or form, of thinking deals with its object in terms of cause and effect (*causa effectus*), the second in terms of means for purposes (*causa finalis*). Both ways of thinking are of equal methodological value. There are natural sciences and "purposive sciences" (*Zweckwissenschaften*), of which the legal science is one. Its concepts and terms are therefore completely independent from the concepts of the natural sciences.

Ihering had already called the purpose "the creator of the law", but he studied the individual purposes and the purposes of society as a natural phenomenon in the way the natural sciences would do. His purpose was sociological. Stammler's purpose is not sociological but methodological, a characteristic trait of legal thinking. Stammler's approach was largely systematical and analytical. He sees the subject matter of law basically as a given, which only has to be brought into the correct form by application, but without changes or additions in its content. This, to him, would be illegitimate: he sees the task of the legal science as being primarily reproductive, not creative. Nevertheless, there is an important creative element in his doctrine of the correct law - *Richtiges Recht*. Stammler said that all thinking - and thus also legal thinking - is measured against the final requirement of correctness (*Richtigkeit*). The distinction between correct and incorrect is the basic feature of how we evaluate the results of our thinking. Correctness is achieved when all possible thoughts are in perfect coherence and harmony with each other. A legal rule is therefore correct when it fits into the body of

¹Larenz, *Methodenlehre*, 102.

²Rickert, *Kulturwissenschaft und Naturwissenschaft*, 20.

³Emil Lask, "Rechtsphilosophie", *Festschrift für Kuno Fischer*, 1905 316.

the law in general in perfect harmony without any contradiction. The correct law represents a "social ideal", its aim is that all social conduct should be brought into a harmonious order.¹ Stammler does not mean that there is an existing "ideal law", a kind of natural law: he emphasizes that all law depends on its empirical matter and is therefore necessarily "positive" in nature. There is no correct law in general as such, there is only the positive law that is partly correct and partly incorrect, but always aiming at and striving for correctness. The idea of the correct law is nothing but a guideline, a measure, a standard for the evaluation of the law just as for every other kind of human thinking. The law always represents an effort to be correct law.² Stammler has defined "principles of the correct law", but their nature is purely methodical, they are not legal rules themselves, only guidelines.³ The legal rules themselves can only be taken from the empiric matter of the law.

Gustav Radbruch built on the works of Rickert and Lask and moved away from Stammler's purely formal analysis of the thought structures of the "value-related" sciences to study the content and the interrelationship of the determining values. He thus moved from a more formal to a more "material" value-philosophy.⁴ Radbruch picked up on Rickert's understanding of culture and defined it as:

"die Gegebenheit, die die Bedeutung, den Sinn hat, Werte zu verwirklichen".

Thus, the law is

"[die] Gegebenheit, die den Sinn hat, die Rechtsidee zu verwirklichen".⁵

An "idea" in Kantian terminology means a final, not further deducible value. The central value of the law is therefore the idea of the law, which is nothing else but justice and the law thus must always serve and strive for justice.⁶ The law is not necessarily always just but it is always required to be just, it always stands under the requirement of justice (*unter der Anforderung der Gerechtigkeit*), it is orientated towards that ideal. While for Stammler, the idea of the law represented only a guideline, an evaluative standard of the law, it is for Radbruch a constitutive element of the positive law itself, the basic principle of positive law. Law, to Radbruch, is not just formed matter but a meaningful reality related to values and therefore the positive law necessarily needs a central point of orientation. While Stammler restricted the use of the guidelines of correct law to cases where the formed, positive

¹Stammler, *Die Lehre von dem Richtigen Recht*, 1926 141.

²Stammler, *supra*, 57.

³Stammler, *supra*, 153.

⁴Larenz, *Methodenlehre* 104

⁵Radbruch, *Rechtsphilosophie*, 1932 4.

⁶Radbruch, *supra*, 30,32.

law did not provide answers, Radbruch wants the idea of the law to determine the interpretation of the positive law and even more so also the further development of the law. Interpretation wants to clarify the inner meaning of a legal rule. In order to do this, it has to take into account the underlying purpose and the basic idea of the law at which the rule is aimed. This methodology necessarily blurs the border between interpretation and the further development of the law.¹

Radbruch partly rehabilitates juristic constructionism. He says that what Ihering and the adherents of the jurisprudence of interests found lacking in the conceptual jurisprudence was that it made juristic constructions in the wrong way - only by means of abstractions based entirely on formalistic logic (formalistic, or "categorical", construction). The true juristic construction is "teleological construction", whose aim is

"...die Zwecke der einzelnen Rechtsinstitute als Mittel zu höheren und immer höheren Zwecken und letzten Endes zu einem höchsten Zwecke alles Rechts zu begreifen und darzustellen".²

10. Legal phenomenology - Gerhart Husserl

Legal phenomenology was based on the philosophical phenomenology of Edmund Husserl and the philosophical ontology of Nicolai Hartmann.³ One of the most important scholars to apply the ideas of these philosophers to the law was Gerhart Husserl. The phenomenologists were also of the view that the idea of the law and guiding values were not only tools of the digesting mind, not only epistemological categories, but part of reality, part of the outside world itself and a decisive element of the subject of thinking itself. The principles *a priori* should not be understood as simply "forming activity of the mind", but as the immanent structure of the essence of the subject.⁴

Gerhart Husserl sought to clarify the interaction of the positive law and the *a priori* principles in the law. He portrays the relationship as that of potentiality and reality, the positive legal rules are realizations of the *a priori* potentialities.⁵ Legal rules can vary in their content, but they cannot totally move away from the *a priori* potentialities, for then they would lose all meaning for failing to conform to the idea of the law. The content of legal rules, therefore, is not arbitrary as legal positivism had claimed. This approach reminds one of the potentialities of Aristotle and Thomas

¹Radbruch, *supra*, 111.

²Radbruch, *Einführung in die Rechtswissenschaft*, 1952 246.

³e.g. *Das Problem des geistigen Seins*, 3rd ed., 1962; *Zur Grundlegung der Ontologie*, 1948; *Ethik*, 4th ed., 1962.

⁴Welzel, *Naturalismus und Wertphilosophie im Strafrecht*, 1935 44.

⁵G.Husserl, *Der Rechtsgegenstand*, 1933, IV.

Aquinas, which had been criticised by Duns Scotus. The binding nature of the *a priori* principles is different from that of the positive legal rules though, their nature is teleological, whereas the positive legal rules derive their binding force primarily through their normative nature. They are not statements of cognition but statements of will. The principles *a priori* represent a timeless "core of meaning" (*Sinneskern*), legal truths, but do not of themselves have normative power.¹ This makes clear that legal phenomenology does not head towards a new natural law but to the discovery of the eternal "core of meaning" within the positive law. The "core of meaning" means that there are similar traits to the legal institutions of all legal systems no matter how varied they may be, that determine their essence by being the condition of their possibility. Without such traits, these institutions would be meaningless. Consequentially, the positive law is a concretisation of the principles *a priori* and naturally this concretisation may vary considerably. Yet, the principles *a priori* cannot have normative power themselves, they need the concretisation through the positive law, otherwise they would be too general to apply in specific situations. These principles *a priori* remind one of the "*Universalia*" of the philosophy of the Middle Ages, which were the basis of Thomistic legal thinking and of the concept of *causa finalis*.

The nature of the positive law is its normativity, its destination to be enforced, also against the will of the individual. This normative nature is no less "real" than the manifestations of nature itself, it therefore does not have to be reduced to sociology or psychology but requires to be seen and studied as a phenomenon in itself with methods appropriate to its proper nature. Furthermore, in the positive law is also historical nature. It is part of history and thus subject to change, it shares in the "time-structure of historicity" (*Zeitstruktur der Geschichtlichkeit*).² The law cannot be simply a body of unchanging verbally formulated sentences, its authority depends entirely on the meaning of these sentences and different times can understand this differently. Husserl points out that a legal rule can only exert its normative power by being applied to a specific case by the judge, which represents a further, and final, step of concretisation. Through the judge, the *Zeitgeist* will necessarily influence the process of concretisation.³

The consequence is that although the historical "will of the legislator" does play a role in the interpretation in legal materials, it is not decisive. The law has to respond to the problems of the present, and to this end it is legitimate and necessary that the law must be interpreted according to the understanding of its era. Interpretation therefore, is a constant process which continually develops the idea expressed in a legal rule into the future. The result is - although the words of the law might not

¹Husserl, *Recht und Zeit*, 1955, 14.

²Husserl, *Recht und Zeit*, 21sq.

³Husserl, *supra*, 23.

have changed - "today's law" which may well differ from "yesterday's law": It is the product of the combined forces of legislation, jurisdiction, legal science and the "silent forces" of public intercourse.¹

11. The *Wertungsjurisprudenz* - Karl Larenz

The aim of the jurisprudence of interests to identify the interests underlying legal rules led to the question, how such interests were to be evaluated and thus ranked. The jurisprudence of interests saw interests at the same time as causal factors, the subjects of and the standards of evaluation. The adherents of the so-called evaluative jurisprudence (*Wertungsjurisprudenz*) distinguished these elements and made the evaluation of the interests their prime methodological concern. Overcoming the rigid rule of the positivistic concept of science through Neo-Kantianism and phenomenology was a prerequisite for a new understanding of the role of values (and thus purpose) in the law. The *Wertungsjurisprudenz* has become the predominant methodological approach in German legal science and among the judiciary.² One of its most influential exponents was Karl Larenz.

Larenz saw the nature of the legal order essentially as the product of the dialectical relationship of law (*Recht*) and justice (*Gerechtigkeit*), because the binding character of the law is only justified by its inherent (finalistic) focus on justice, the idea of the law. Larenz further emphasizes the spiritual nature of the law which cannot adequately be dealt with by the positivistic concept of science. The science of law has to develop its own methods suited to its subject. Since the subject's nature is teleological, "structures and relations of meaning" (*Sinnstrukturen und Sinnzusammenhänge*), based on values and value-judgements, jurisprudence has to develop objective, scientific (in the non-positivistic sense) methods of "value-orientated thinking" (*wertorientiertes Denken*). Since the law is always orientated towards certain values which serve as its basis and from which the law derives its essential meaning, the methods for its deeper understanding and further development must be equally value-orientated.

The law aims at the realization of the original idea of the law, which is justice itself. Justice is the ultimate value towards which the law is directed, it is "the meaning-*a priori* of all law". Its function is to provide the source of meaning and thus the justification of the normative character of the law, but also to control the law: whatever is incompatible with justice must be - in the end - regarded as

¹Husserl, *supra*, 58, 60.

²Larenz, *Methodenlehre*, 9, 10.

unlawful and therefore not part of the law. The focus on the ideal of justice is therefore, according to Larenz, constitutive for the law as such. He consequently defines the law as an

”order of human relationships under the requirement of justice” (*eine Ordnung zwischenmenschlicher Beziehungen unter der Anforderung der Gerechtigkeit*).¹

The law cannot deny this requirement without ceasing to be law.²

Larenz’ methodological enquiries centre on the following key-issues: interpretation, filling-in gaps in the law (*Lückenfüllung*) and the further development or amendment of the law (*Rechtsfortbildung*).

Through interpretation, the judge extracts basic value-judgements from the positive law which are needed to develop and justify the value-judgement in the individual case. The rules of the positive law are two-dimensional: they point to certain basic objective values such as, above all, justice, promise-keeping, protection of faith, honesty, but also represent the first step of concretisation of these values through the ”legal conscience” (*Rechtsbewußtsein*) of society and thus indicate how these values are understood and treated by the historical society of the legislator.

The filling in of gaps is required when the law is perceived to be incomplete. The perception of a gap presupposes teleological thinking: a gap can only be assumed to exist when something is missing which should be there in order for the law to make sense.³ This presupposes that the law has a certain comprehensible plan. Therefore, one speaks of a ”gap adverse to the plan” (*planwidrige Lücke*). To close a gap, Larenz proposes a resort to the methods of analogy, teleological reduction and (rarely and only under strict requirements) teleological extension. Gaps must be filled according to the ”immanent teleology” of the law, which consists not only of the intentions and value-judgements of the historical legislator but also of objective legal purposes and principles common to the legal system as a whole. Larenz describes the filling in of gaps also as ”*gesetzesimmanente Rechtsfortbildung*” (further development of the law within the written law) because it remains within the original intentions (plan) of the positive law.⁴

The next step is the *gesetzesübersteigende Rechtsfortbildung* (further development surmounting the -written - law). That means that the positive (written) law is developed beyond its original plan,

¹Larenz, *Methodenlehre*, 355.

²see the section on Radbruch, § 9 above.

³see the sections on Heck, § 8 above.

⁴Larenz, *Methodenlehre*, p. 354sqq.

beyond the legislator's original intentions in a manner which transcends the "immanent teleology" of the positive (written) law. But, Larenz insists, this development has to remain within the confines of the legal system as a whole, that is its basic principles and constitutional value-order, and must be justified by these principles.¹ Larenz describes this development as *extra legem - intra ius*. He accepts such a further development of the law in only three instances: 1. a compelling need in the legal intercourse (*unabweisbares Bedürfnis des Rechtsverkehrs*), 2. with regard to the "nature of things" (*Natur der Sache*); 3. with regard to an ethical principle (*mit Rücksicht auf ein rechtsethisches Prinzip*).²

Larenz does not deny the fact, that the differences between the three steps are gradual and that there are no clear boundaries between them.³ But exactly because of that it is all the more important that the judge must be conscious of exactly what he is doing. Since he moves more and more away from the solid ground of the positive law, the requirements for the justification of his results must accordingly become more strict and well defined. It is the most important aim of legal methodology to define objective, apprehensible criteria for the justification of (inevitable) further development of the law.

12. Legal ontology - Arthur Kaufmann

Kaufmann's hermeneutical ontology of the law can be regarded as the culmination of the attempts of Neo-Kantianism and Phenomenology to bridge the gap between Is and Ought after Kant. This in turn was the prerequisite for the renaissance of Aristotelian-thomistic ideas in the understanding of the nature and essence of law.

Kaufmann transcends the evaluative jurisprudence, which still accepts a certain dualism between value and reality, insofar as he builds his theories on a universal ontology in which values and reality are conceived as being essentially connected to each other.

To Kaufmann, this legal ontology, based on a hermeneutical understanding of the law in the tradition of Schleiermacher, Dilthey, Heidegger and Gadamer, represents the desired "third path", midway between the poles of natural law and legal positivism.

¹see Radbruch's teleological construction.

²Larenz, *Methodenlehre*, 402sq.

³Larenz, *Methodenlehre*, 351. See also the sections on Savigny and Radbruch, §§ 4 and 9 above.

The separation of Is and Ought, the realization that the Ought does not follow naturally from the Is and is not part of it, sooner or later had to bring about a crisis in the law, since law belongs to both spheres. Although the law constitutes an Ought which is based on the Is, the connection between the two spheres had seemingly been decisively severed. That meant that the *why* of the law remained unanswered. It could apparently not be the topic of scientific discussion anymore, since "reality" was understood as consisting of empirical facts only, verified through experience. The *why* of the law, its inherent meaning, essence, underlying values, virtues and morals - its justification, did not fall into that category. In consequence, law could not be justified anymore, but only described. The result was a heavy emphasis on the formal aspects of the law - its outward appearance. The only justification of the law now possible was formalistic and - in the end - arbitrary: force and history. In order to persuade, the Ought of the law could not be justified without constant reference to the Is. Detailed rules could not be based on Kant's abstract reasoning. His categorical imperative was too abstract and remote from daily legal problems, it was no alternative to Aristotle's ideas in the law.¹ But the jurists of the day did not even attempt to find a new philosophical basis for their teachings.

But if the question as to the *why*, the source of the binding character of the law, remains unanswered for a long time, the law inevitably runs into difficulties. The law establishes an Ought and the source and justification of the Ought must be clear. If it isn't, the law cannot remain coherent and consistent, it loses its persuasive force, on which its efficacy depends much more than on outer force. The *why* cannot be answered only with reference to formalities, but only with reference to its substance, its binding force depends on its substance, not its form.² This fact has consequences for - and might even determine - the working of the detailed rules of the law in everyday practice, which cannot be independent from the *why* of the law. A philosophy of substance is indispensable for the law. Without a coherent theory of law, there cannot be a coherent set of detailed rules. If the nature of the law is not understood properly, the rules cannot work or be handled properly. The formal aspects do not really account for the nature, the essence, the operation of the law. That question and with it the question of the relationship between Is and Ought had to be posed anew. This development in fact started with Ihering, who sought the substance of the law in a totally new way. In the meantime, the understanding of what constitutes "reality" had changed and became more differentiated through the results of Neo-Kantianism, Neo-Hegelianism and especially Phenomenology. These insights were finally, after due time, also received in the field of the law.

¹This view is shared by Fikentscher, *Methoden des Rechts*, *supra*, 30,31; Kaufmann, *Grundprobleme der Rechtsphilosophie*, 1994, 158; Gordley, *Philosophical Origins*, *supra*, 232 sqq.

²Kaufmann, *Grundprobleme der Rechtsphilosophie*, 1994, 137.

A new concept of the law was needed, which said something about the specific "reality" of the law and about its substance, its essence. Thus, one was back to the old problem of *Universalia*, the question of the relationship between the general and the singular, the abstract and the concrete, and - in close correspondence to that - the relationship between the Is and the Ought.¹

Law has to do with Is and Ought. Is and Ought cannot be said to have no relationship with each other. The Ought (or: values) is orientated towards the Is (and *vice versa*), it is not an end in itself, entirely on its own. It is always something real, an "Is" which "ought" to be something or in a certain way. The Ought relates to the Is as an evaluative standard and in this particular sense it has to do with "essence". The Ought can be described as the gap between the Is and the essence which has to be bridged. The essence is not disconnected with the Is, it is the foundation, the basis of the Is. In the intellectual world of Thomas Aquinas and Aristotle, the Is was the reality of the essence - the Ought was immanent in the Is, after the separation of Is and Ought, the Is was only the reality of empirical facts. For Thomas Aquinas, man was supposed to be good. To be good meant the realization of the essence of being human and to be bad meant to miss the essence of being human and to deny one's potential.

In the same way as Aristotle and Thomas Aquinas did, Kaufmann points out that since the law is a tool to serve humanity, the nature, or essence (or understanding), of the law must correspond to the nature (or understanding) of man.

The nature (or essence) of man cannot be reduced merely to his empirical existence. He is more than a heap of flesh. He is *person* in the ontological sense - that is the entity of *relations* which man has to other humans or things. Person is not substance but relation. Only through his relations can man live up to his full potential, become a full personality. Man's personal relations are the subject matter of the law and law is always only legitimised in that it gives everybody what is due to him: *suum cuique tribuere*. This is characteristic for all forms of order: the nature/essence of order is relation. Thomas Aquinas already saw that: "*Ordo non est substantia, sed relatio*".² What is needed is not an ontology of substance, but an ontology of relation, to describe the "reality", the essence of the law.

The subject matter of the law is the relation between Is and Ought itself. The law wants to bring Is and Ought into correspondence, as Edgar Bodenheimer put it: "Law is a bridge between Is and Ought".³ Unity in relation means analogy, as Thomas Aquinas said.¹ Analogy is unity of two

¹Kaufmann, *Analogie und Natur der Sache*, 1982, 55.

²*Summa theologica*, I, 116, 2.

³E. Bodenheimer, *Ratio iuris*, Vol.1, No.2 July 1988, 137 sqq.

essentially different things, neither identity nor difference, but both: unity of identity and difference,² dialectical identity³. Not identical but "similar".

For Kaufmann, analogy becomes the crucial concept to describe the essence of the law: the law is not a unity of norms but a unity of relations, a relation-unity - law is essentially analogous:

"Das Recht ist ursprünglich analog".⁴

The law is only "real" where Ought (rule) and Is (case) are assimilated:

"Recht ist die Entsprechung von Sollen und Sein".⁵

The idea of the law, the principles and even statutes and rules are only potentialities of the law. What the law needs to become full reality is the concretisation in the concrete case - when the Is meets and merges with the Ought. The assimilation of Is and Ought is brought about by way of analogy (in a broad sense). What is needed to create a unity of two different things is to find a *tertium comparationis* which both have in common, a mediator between Is and Ought. This *tertium*, Kaufmann says, is the "meaning" ("*Sinn*"), in which the idea of law, the rule and the case - all three levels of concretisation - can be identical (identity of meaning-relationship: "*Identität des Sinnverhältnisses*"). Thus, the teleological identity is the place where reality (Is) and value (Ought) are assimilated.⁶ The *telos* is an *Universale*, neither *ante rem* nor *post rem* but *in re*, an Ought within the Is.

The similarity and the relatedness of things is not something which exists only in the mind of the spectator but something which lies in the nature/essence of the things themselves. Just as the abstract is real in analogous form in the concrete thing, the *telos* is real in analogous form in concrete cases, that is, human undertakings. Kaufmann says that Is and Ought are "structurally interwoven":

"Die Frage Engischs: 'Wo hört denn die Seinsstruktur auf und wo setzt der Wertgesichtspunkt ein?' ist im Grunde unbeantwortbar, weil es in der Wirklichkeit keine

¹*Summa theologica* I, 13, 5; *Quaestiones disputate de veritate*, Ed. Edith Stein, Vol.I, 1952, 75.

²Heidegger, *Identität und Differenz*, 2nd ed., 1957, p.10.

³Hegel, *Sämtliche Werke* (Ed. Glockner), 3rd ed., Vol. II, p. 525sq. (*Phänomenologie des Geistes*).

⁴Kaufmann, *Analogie und Natur der Sache*, 19.

⁵Kaufmann, *Analogie und Natur der Sache*, 18.

⁶Kaufmann, *Analogie und Natur der Sache*, 44.

Grenze zwischen beiden gibt. Wertfreie Lebenssachverhalte und vom Sein gelöste Werte sind reine Gedankengebilde, aber keine Realitäten."¹

Kaufmann identifies "meaning"/*telos* with the *Natur der Sache* and *Typus*, but "meaning" always also refers to purpose/*causa finalis*. The *causa finalis* is thus the *Universale in re*, the mediator between Is and Ought. Basically, "meaning", purpose, *Natur der Sache* and *Typus* eventually refer to the same phenomenon, they are all situated on the teleological level.

Kaufmann's understanding of the essence of the specific reality of the law determines also his understanding of the working of the three levels of concretisation in the law (the idea of law - principles and rules - individual and concrete case), which he calls the levels of realization of the law (*Stufenbau der Rechtsverwirklichung*). The nature of this process of concretisation is neither merely deductive (deducing concrete rules from abstract concepts) nor merely inductive (establishing abstract rules from concrete cases by way of generalisation). Deduction cannot do without elements of the Is, induction cannot do without evaluative elements of the Ought. Rather, this process is in its nature like all human reasoning - hermeneutical. The direction of concretisation is neither linear from top to bottom nor linear from bottom to top - it develops from and in both directions and rather in the form of a spiral (the hermeneutical circle). Concretisation is in its nature dialectical between deduction and induction - it is analogous. Aristotle had already described the nature of analogy as mixed deductive-inductive.² That means that no level of concretisation is dispensable, neither can represent the specific reality of the law on its own, only all three levels, seen together, make up the specific nature, the reality of the law, in the ongoing process of assimilation from both directions.³ The idea of the law is only a potentiality without the concretisation in rules and decisions, the rules and principles need the idea of law to derive their content from in order that the content will not be arbitrary, a case cannot be decided without a rule to measure it against. Kaufmann refers to Gustav Radbruch, who had already recognised the relational character of the law and the role of the *telos* as mediator between Is and Ought in his classic definition of the law: law is

"die Wirklichkeit, die den Sinn hat, der Gerechtigkeit zu dienen"⁴ (the reality, whose purpose it is to serve justice - the idea of the law).

¹Kaufmann, *Analogie und Natur der Sache*, 46.

²Aristotle, *Erste Analytik* II, 24; *Rhetorik* I, 1357b.

³Kaufmann, *Grundprobleme der Rechtsphilosophie*, 135.

⁴Radbruch, *Rechtsphilosophie*, 9th ed. 1983 119.

Since all law is directed towards the idea of law, that is justice, the essence of justice requires specification. Again, Kaufmann refers to Radbruch and to Aristotle.

The idea of law, he says, is and must be derived from the idea of man, law is a reflection of man. Kaufmann sees the nature of man as threefold:

formal : man as an autonomous being who shapes his world - and consequently the law.

functional: man as a heteronomous being - in being subject to the law.

substantive (content): man constitutes an end/purpose in itself, he is his own purpose -

Man therefore is the concrete, substantive, historical purpose of the law.

Justice consequently also has three features/principles:

A formal principle: equality.

A functional principle: legal certainty (*Rechtssicherheit*).

A substantive principle, which determines the content: Purposiveness/practicability (*Zweckmäßigkeit*) - equity.

Justice is always therefore form, function and substance at the same time. The three sides (or demands) of justice may conflict with each other, but this conflict of justice with itself ("*Konflikt der Gerechtigkeit mit sich selbst*"¹) is necessarily rooted in the nature of justice itself. It is inevitable and needs to be resolved in every case anew.

Purpose or *causa finalis* is therefore the substantive principle of justice, an integral part of the idea of law. Not the only one, but a crucial one.

Kaufmann emphasizes the continuing relevance of Aristotle's ideas about commutative and distributive justice and the relationship between justice and equity for the discussion about law and justice. Aristotle too, saw justice as something proportional, relational, analogous, in need of an evaluative standard, a *tertium comparationis*, a mediator:

"Auch heute noch bildet das 5. Buch der 'Nikomachischen Ethik' des Aristoteles den Ausgangspunkt aller ernsthaften Überlegungen zur Gerechtigkeitsfrage. Kern der Gerechtigkeit ist, so hat schon er gelehrt, die Gleichheit. Aber während noch viel Spätere

¹Radbruch, *Vorschule der Rechtsphilosophie*, 3rd ed. 1965 32sqq.

(z.B. Kant) die Gerechtigkeit als eine formale und numerische verstanden haben ..., hat Aristoteles sie sehr viel angemessener als eine proportionale, geometrische, analogische erkannt. Das Gleiche ist ein Mittleres und sonach die Gerechtigkeit das Proportionale. Proportion aber verlangt ein Maß, Analogie ein tertium comparationis. Aristoteles nannte dieses Maßgebende die 'Würdigkeit'. Es ist klar, daß damit der Angelpunkt, aber auch die ganze Problematik der Gerechtigkeitsfrage angesprochen ist."¹

According to Radbruch, purpose (*causa finalis*) determines the substance, the content of justice. The question is what serves the *bonum commune*. Radbruch makes no difference between purpose and value.² The source for the purpose, or purposes is the ethics. The problem here is and always will be to determine what is the best for all. It is the old question of the highest good, or value. Aristotle and Thomas Aquinas saw happiness as man's highest good, his ultimate end. This value may be universal but its decisive handicap is that the more concrete it becomes, the more relative it becomes. For every individual concrete happiness is something different. The same applies in the final analysis to e.g. the general principles of law or the basic rights of the individual. All these topics and values are useful and necessary points of orientation, but not universally decisive at the concrete level. Later philosophers have no more been able to solve the problem and this situation has led to the rise of procedural ethics.³

Kaufmann acknowledges that in times of widespread value-relativism, the procedure is the necessary and crucial element to reach consensus about values, which in turn influence the law. But, he urges, consensus alone is not a sufficient criterion for the "truth" or "correctness" of the law. What is needed is not simply consensus, but convergence (*Konvergenz* - a process similar to the assimilation described above). Procedure cannot be an end in itself, it needs a subject matter and the procedure must always be oriented towards its subject matter. Here again, the result of the procedure is not and cannot be determined by the procedure as such but by the relation between the procedure and its subject matter. Consensus must always mean consensus in relation to a specific subject matter. Truth or correctness develops not *through* the procedure, but *in* the procedure. Again, it may never be forgotten, that form alone does not suffice, only form in relation to substance creates justified and dependable result.⁴

¹Kaufmann, *Grundprobleme der Rechtsphilosophie*, 144.

²Kaufmann, *Grundprobleme der Rechtsphilosophie*, 153. In contrast, e.g. to Max Weber, who distinguishes purpose-rationality and value-rationality.

³Kaufmann, *Grundprobleme der Rechtsphilosophie*, 156sqq.

⁴Kaufmann, *Grundprobleme der Rechtsphilosophie*, 216, 217.

Part II: Germany

1. The *clausula rebus sic stantibus* of the *ius commune* and the development of the doctrine of *Wegfall der Geschäftsgrundlage* in Germany

1.1. History of the *clausula rebus sic stantibus*¹

The ancient Roman lawyers did not have a specific concept dealing with changing circumstances in general. The first scholars who deal with changing circumstances concerning promises are Cicero (106-43 BC) and Seneca the Younger (4-65 AD). In his *De officiis*, Cicero stated the example of a lawyer, who had promised to assist somebody in court but could not be reproached for not doing so, because his son became deadly ill.² The other famous example holds that one should not return a borrowed sword to somebody who has in the meantime become insane:

”*Si gladium quis apud te sana mente deposuerit, repetat insaniens, reddere peccatum sit, officium non reddere*”.³

Seneca stated more generally, that circumstances had to remain the same in order to keep somebody to his promise:

”*Omnia esse debent eadem, quae fuerunt, cum promitterem, ut promittentis fidem teneas...*”.⁴

Cicero's example of the sword was taken up by St. Augustine in his *Enarrationes in Psalmos*, V, 7, which was in turn incorporated in the *Decretum Gratiani*.⁵ In the 13th century, the canonist Johannes Teutonicus added a gloss to this text that seemingly became the starting point of the *clausula* doctrine of the *ius commune*:

¹For a general account on the *clausula* see: Pfaff, "Die Clausel: Rebus sic stantibus in der Doktrin und der österreichischen Gesetzgebung", in: *Festschrift für Joseph Unger* (1898); Fritze, "Clausula rebus sic stantibus" (1900) 17 *Archiv für Bürgerliches Recht* 29 sqq.; Beck-Mannagetta, "Die clausula rebus sic stantibus und die Geschäftsgrundlage in der Dogmengeschichte", in: *La formazione storica*, vol. III, 1263 sqq.

²*De officiis*, 3, X- 30.

³*De officiis*, 3, XXV- 95.

⁴*De beneficiis*, Lib. IV, XXXV, 3.

⁵*Secunda Pars*, Causa XXII, Quaest. II, c. 14.

”...semper subintelligentur haec conditio, si res in eodem statu manserit”.¹

Here already, we have the concept of an implied condition that the circumstances will remain the same.

This assumption ran parallel with Thomas Aquinas’ view in moral theology, that breach of a promise is not a sin,

”si sint mutatae conditiones personarum et negotiorum”.²

In the civil law, the thread was taken up by the greatest of the glossators, Accursius, in his gloss to the passage in the Digest D. 12, 4, 8, § Quod Servius.

The passage referred to a man who reclaimed the money he donated with a view to a marriage of two people of whom one turned out to be a minor and thus incapable of marrying. The Digest denied the claim of *condictio ob causam datorum*, because the couple could still marry in the future and thus the purpose of the donation had not failed yet. Accursius found that the possibility of future marriage had to be circumscribed more specifically, and that in particular the possibility of marriage to a person other than the one the donator had in mind, had to be excluded. To achieve this, he stated that reclaiming the money was not possible under the condition that the original circumstances remained the same:

”...rebus sic se habentibus”.³

The commentator Bartolus de Saxoferrato takes over this view⁴ and further specifies the significance of *rebus sic se habentibus*. He also puts the specific legal act of *renuntiatio* - renunciation of pleas under the condition of *rebus sic se habentibus* and supports a retroactive reduction of paid rents if circumstances had changed to the extent that the tenant could not make any profit.⁵ Accursius and Bartolus use the term *rebus sic se habentibus* as a rule of interpretation, they do not yet speak express of an implied or tacit condition, but the underlying idea is the same.

¹gl. Furens, ad C. 22, q. 2, c. 14.

²*Summa theologiae*, Secunda Secundae, q. 110, art. 3, ad quintum.

³*Glossa Ordinaria*, p. 358 (Augustae Taurinorum 1968).

⁴*Commentaria*, D. 12, 4, 8, § Quod Servius, 3.

⁵*Commentaria* D. 12, 4, 8, fol. 42 r^o, col.2 ; Quaestiones Aureae (Venetiae 1450), quaest.4, fol.12 v^o. col. 2.

Bartolus's pupil Baldus de Ubaldis (1327 - 1400) proceeded by providing this rule with a philosophical explanation and enlarging its range of application.

Baldus' lively interest in philosophy - in that time consisting largely of the philosophy of Aristotle - considerably exceeded that of his predecessors, and his unprecedented willingness to use it in the field of the law marks the culmination of Aristotelian influence on the law. Baldus believed that moral philosophy was the mother of law.¹ He accordingly saw jurisprudence as a part of moral philosophy and held that the rules of moral philosophy should also be applicable in law. This was the widely held view in his time which was later repudiated by philosophers like Hobbes, Locke, Rousseau and Kant who challenged and eventually dismissed the moral philosophy of the Middle Ages that was based on Aristotle and Thomas Aquinas.² The more the scholastic philosophy declined, the more Baldus' philosophical argumentation was criticised as being "unscientific". This criticism which began during the Middle Ages, intensified in the 16th and 17th century and continued during the time of the 19th century pandectists. Savigny saw the age of the commentators as a period of decline of the scientific legal method due to - as he thought it - the superficial and formalistic use of popular philosophical and dialectic notions.³ This judgement is not generally adhered to today.⁴ Baldus' approach and the criticism which it drew highlights the at all times important question of the relationship between law and philosophy. Baldus held that since philosophy explained the general foundations of human reason and cognition, it should also explain the foundations of legal reasoning. It is recognized today, that the great contribution of Baldus was that he, while leaving the scattered and disparate rules of the law unaltered, provided them with a coherent concept, a homogeneous understanding, a rationale in an effort to harmonize them. The means to do this was the Aristotelian philosophy. From this basis, he proceeded to draw specific methodological and dogmatic consequences and thus introduced new lines of argument which became the motor of the further legal development.⁵ The lesson Baldus learned and passed on is that a coherent concept of the law, provided by philosophy, is an important prerequisite for the explanation and the further development and improvement of the law.⁶

The most significant example of Baldus' reception of Aristotle was the famous doctrine of *causa*. He harmonized the civil lawyers' concept of *pacta vestita* ("*ex nudo pactu non oritur actio*"), meaning

¹*Commentaria D.* 1, 1, 1, 2.

²Part I §§ 2,3.

³Savigny, *Geschichte des römischen Rechts im Mittelalter* VI, 2nd ed. 1850, p. 6sq.

⁴Horn, "Philosophie in der Jurisprudenz der Kommentatoren", in: 1 *Ius Commune*, 105, with references.

⁵Horn, *supra*, 147, 148

⁶this argument has been taken up by James Gordley in *The Philosophical Origins of Modern Contract Doctrine*, see the Introduction, § 1.

that only certain enumerated contracts were actionable, and the canon lawyers' concept that all agreements, thus also *pacta nuda*, should give rise to an action because promises should always be kept according to christian teachings.¹

In formulating the doctrine of *causa*, Baldus drew strongly from Aristotle's ideas about the four basic causes of the substances that make up the world. These ideas had been "christianized" and applied to moral law by Thomas Aquinas and were in turn digested by the canonists.²

Baldus handled the doctrine of *causa* in a way that shows that he was not thinking of any arbitrary causes, but was distinguishing according to the requirements of liberality and commutative justice - liberality meaning more than giving without receiving, exchange meaning more than giving and also receiving, the doctrine of *causa* therefore not being a tautology.³ Baldus held that when a party gives out of liberality, he does not use his substance badly and the other party is not enriched unjustifiably.⁴ He also stated that a notarial document in which a promise was made, had to mention the *causa*, otherwise one had to presume that the contract was made out of foolishness rather than liberality.⁵ Equally, he stated that an unjust price violated natural equity.⁶ Baldus' successors, on the other hand, soon began to simply talk of *causa gratuita* or *causa onerosa*.

The Roman lawyers did not have a special concept of *causa*. The word *causa* was used in relation to innominate real contracts in D. 2,14,7,2 and 4, and in relation to the stipulation in D.44,4,2,3, D.22,3,25,4, and C.4,30,13. The term did not have a coherent meaning and related only to the special circumstances of the specific contracts.

The Glossators wanted to harmonize these texts by concluding that this *causa* was to be equated with the *iusta causa traditionis* in the case of the passing of ownership. Therefore, the *causa* of a stipulation had to be a *negotium antecedens* (in the case of innominate real contracts a *datio vel factum*) which had to be expressed in the contract. Without this *causa*, the contract could not beget an action.

¹for details see Söllner, "Die causa im Konditionen- und Vertragsrecht des Mittelalters bei den Glossatoren, Kommentatoren und Kanonisten", *Zeitschrift der Savigny-Stiftung für Rechtsgeschichte Rom.Abt.* 77 (1960), 182sq.; Zimmermann, *Law of Obligations*, 549sq.; Gordley, *Philosophical Origins*, 49sq.

²Part I § 1.

³Gordley, *Philosophical Origins*, 55.

⁴Baldus, *In Decretalium volumen commentaria* to X.1.4.11, no. 30.

⁵*Commentaria* C. 4,30, 13, no. 14.

⁶*Commentaria* C. 4, 44, 2, no. 18.

With the newly acquired Aristotelian understanding of *causa*, Baldus proceeded to bridge the gap between legist and canonist contract doctrine by saying that *causa* could not be taken as only referring to a *negotium antecedens* but to every *causa extrinseca* (that is either *causa finalis* or *efficiens*). Thus, even a *causa impulsiva*, a reasonable motive, could be sufficient (*causa sufficiens*) to give rise to an action. If that was the basic reason why contracts are binding, the same had to apply to *pacta nuda*.¹

On the other hand, a reasonable *causa* was also considered a requirement for any contract to beget an action. If the contract lacked a *causa*, an error had to be presumed and no action could result from it. This was the decisive argument to make the *pacta nuda* actionable because the doctrine of *pacta vestita* was mainly justified with the argument that the formal requirements of these *pacta* protected those who were inexperienced and careless in handling their affairs from entering unconscionable or foolish contracts. If the party had to act on the basis of a sufficient *causa* (*causa sufficiens*), this *causa* had the same effect as a *vestmentum*. Though the concept of *pacta vestimenta* was still continued to be used also by Baldus, it had lost its reason and slowly faded into oblivion.

The consequence of the *causa* doctrine for the notion of *rebus sic se habentibus* and the ensuing doctrine of *clausula rebus sic stantibus* was profound: if an obligation constituted a means to an end, circumstances could arise in which that means would no longer be appropriate or fair in relation to the end so that the parties would have to be released from the obligation.²

The doctrine of *causa* explains why the very same authors who established the rule of *pacta sunt servanda* (ie that all *pacta* were regarded as binding and giving rise to an action provided they had a sufficient *causa*) also developed its exception, the *clausula rebus sic stantibus*. *Pacta sunt servanda* and *clausula rebus sic stantibus* are in fact twin concepts, springing from the same underlying notion.

Baldus also enlarged the range of application of *rebus sic se habentibus* by applying it to all kinds of *promissiones* - unilateral promises that could only be enforced when reinforced by an oath - though he does not give specific reasons for it.³

Under the later commentators, the range of application of the doctrine *rebus sic stantibus* was steadily enlarged with the development reaching its peak with Jason de Mayno (1435 - 1519). By this time, the

¹Baldus, *Commentaria in Decretales*, I, De Pactis, n. 14.

²*Commentaria* D. 12, 4, 8 pr., fol.364 r^o, col 2.

³*Commentaria* D. 12, 4, 8 pr., fol. 364 r^o, col 2.

notion of *rebus sic se habentibus* was applied not only to all sorts of contracts, but also to testaments, oaths, and also privileges and statutes.

During the 16th century also, the term *rebus sic se habentibus* was gradually replaced by the term *rebus sic stantibus*, the change being one of terminology only. The uncertainty about whether *rebus sic stantibus* was to be dealt with as an *exceptio*, a *conditio* or a *tacita clausula*, was settled in favour of the concept of an implied *clausula*. Philippus Decius (1454 - 1535) could therefore sum up the development by stating that the *clausula rebus sic stantibus* had become a general rule of law:

*”Et est regula communis, quod verba contractus et statuti intelliguntur rebus sic stantibus ideo ex causa supervenienti contraveniri potest.”*¹

At this stage, however, the view developed that the range of application of the doctrine had become too extended and that the *clausula*'s requirements were lacking precision to an intolerable extent. There was no agreement on the requirements for the operation of the doctrine and the *clausula* seemed to have become a collective term for a heterogeneous group of cases which permitted rescission and revocation of contracts.² The universal application of the *clausula* was seen as a considerable threat to legal certainty because all obligations are, to a greater or lesser extent, subject to changing circumstances.

At this point began the long process of the restriction and finally the abolition of the *clausula*.

The first scholar to criticise the *clausula* was Andreas Alciatus (1492 - 1550) who, as a general rule, wanted to restrict it to unilateral obligations. The application to bilateral obligations was to be permitted only in four instances: when the parties made their promise under a basic misconception, when the performance claimed runs against the nature of the contract, when rescission or revocation is allowed by statute, and - most importantly - when circumstances arise which the parties had not negotiated on.³

One of the main reasons for the decline of the *clausula* was the fact that the currency of the Aristotelian-Thomistic philosophical ideas of means to ends (final causes) had already been on the retreat for some time.⁴ This is particularly obvious in the treatment of changing circumstances by

¹*Consilia*, 1512, cons. 335, n. 4, 367.

²Köbler, *Die "clausula rebus sic stantibus" als allgemeiner Rechtsgrundsatz* 1990 31.

³Alciatus: *Tractatus de orationibus*, Tom. 6, 1, 3, n. 36, fol. 308 v°, and *Tractatus de praesumptionibus*.

⁴Part I § 2.

Hugo Grotius (1583 - 1645). It still reveals the influence of the doctrine of *causa* but Grotius adopts the argument of *causa* in a different manner, which was to influence successive generations of lawyers:

”But the way to find the natural truth is opened to us by a principle concerning the force and efficacy of statutes which is universally accepted. If a statute is founded on a presumption as to some fact and the fact is really otherwise, then the statute is not binding for the entire foundation of the statute fails if the truth of the fact fails. When a statute is founded on such, a presumption is to be gathered from its matter, words and circumstances. Similarly, therefore, we say that if a promise is founded on a presumption as to some fact that is really otherwise by nature the promise has no force because the promisor does not consent except on a certain condition which in reality is not met”.¹

Grotius uses the *tacita conditio (clausula)* but restricts it: the *status rerum* at the time of the conclusion of the obligation must be included in the ”unique reason” of the obligation. The *tacita conditio* will only come into effect, if the change of circumstance obstructs this unique reason. Grotius defines this reason as

”the unique and efficacious cause which moved the promisor”,

without which the promise becomes unjust and useless. The words of the promise should be extended beyond their literal meaning to include cases within that unique reason.² Furthermore, Grotius restricted the application of the *clausula* to executory contracts (though he did not restrict it to private law) and stated as a major requirement that performance had become intolerable - or excessively onerous - to the party.³

But Grotius did not explain his unique reason by talking about means to ends or final causes, derived from man`s ultimate end or cause. He also does not explain how the unique reason differs from the concept of *causa* or, if at all, from a presumption on which a promise is founded.⁴ He derives the unique reason solely from the interpretation of the intentions or wills of the parties: this is apparent from the fact that the failure of the unique reason, the *cessatio rationis*, is one of three examples Grotius gives of *defectus voluntatis originarius*, which renders an obligation unenforceable.

¹Grotius, *De iure belli ac pacis*, (Leiden, 1939), II. xi. 6.

²*De iure belli ac pacis*, I. 1, c. 21, § 20. 2.

³*De iure belli ac pacis*, I. 1, c. 16, § 27, p. 199.

⁴Gordley, *Philosophical Origins*, 91.

Heinrich von Cocceji (1644 - 1719) expressly identified Grotius' *tacita conditio si res maneat quo sunt loco* with the *clausula rebus sic stantibus*. Though he accepted the *clausula* as a general rule,¹ he did not accept every change of circumstances as sufficient but differentiated according to the relevance of the change of the original status. He distinguished *status mutatio substantialum* and *status mutatio accidentium* - substantial and non-substantial change of circumstances. A change of the former kind would activate the *clausula*, the latter not. He further distinguished between the express addition of the *clausula* to the obligation and its mere implication. In the latter case the *clausula* would only come into effect when the change was unforeseeable.

Augustinus von Leyser (1683 - 1752) opposed the mainstream legal science of his time in this respect and advocated the retention of the *clausula* in the field of contract law.² According to Leyser the consent to the contract depends on its underlying *causa* and if this is frustrated by changing circumstances, the consent is rendered invalid because the parties' consent related to another situation. Remarkably enough, Leyser is one of the last to utilise the argument of *causa*. Leyser admitted that there had been an abuse of the *clausula* concept, but contended that the threat to legal certainty could be addressed if three basic requirements were met: the change in circumstances had to be substantial so as to render performance intolerable for one party, the change must not be attributable to the fault of the affected party, and the change should have been unforeseeable for the affected party.

Leyser furthermore improved on Grotius by pointing out that a contract may not only have one "unique reason" or one cause, but several, and that changing circumstances may frustrate one or several causes but not necessarily all of them. To deal with this situation, Leyser advocated the idea of merely adjusting the contract to the new circumstances instead of dissolving it in an all-or-nothing fashion. The adjustment, in turn, should be left to the discretion of the judge whom Leyser regarded as best suited to ensure equitable results and watch over the fulfilment of the requirements of the *clausula*.

The criticism of the majority of contemporary scholars notwithstanding, the *clausula* was incorporated in different ways in the 18th century codifications. These codifications nevertheless reflect the move towards the restriction and eventual abolition of the *clausula* as a general rule.

The Bavarian *Codex Maximilianeus Bavaricus Civilis*, promulgated in 1756, formulated the *clausula* as a general rule along the line proposed by Leyser. The *clausula* is stated to be tacitly implied in all obligations, but in order for it to come into effect, the change must not be attributable to the fault of

¹Cocceji, *Disputatio De Clausula Rebus sic stantibus* (1699).

²*Meditationes ad Pandectas*, 1717 (Lipsia 1741), spec. 40, § 4, p. 411.

the affected party, must have been unforeseeable and so considerable that performance has become intolerable for the affected party.¹

The Prussian General Land Law (ALR), promulgated in 1794, still retains the *clausula* as a general rule, but the formulation already seeks its restriction as far as possible. During the drafting process Carl Gottlieb Suarez (1746 - 1798) sought, against considerable resistance, to retain the *clausula* as a general rule. He warned that the unconditional enforcement of all contracts would in many cases lead to inequitable results. He conceded, on the other hand, the possibility that the *clausula* might be abused and stressed the need for precise rules of application.² As a result it was provided that:

”Außer dem Fall einer wirklichen Unmöglichkeit, kann wegen veränderter Umstände die Erfüllung eines Vertrages in der Regel nicht verweigert werden.” (§ 377, I, 5 ALR)

”Wird jedoch durch eine solche unvorhergesehene Veränderung die Erreichung des ausdrücklich erklärten, oder aus der Natur des Geschäfts sich ergebenden Endzweckes beider Theile unmöglich gemacht, so kann jeder derselben von dem noch nicht erfüllten Vertrag wieder abgehen.”

(§ 378, I, 5 ALR)

§ 380, I, 5 ALR gave one party the right of unilateral withdrawal from the contract, if

”... durch die Veränderung der Umstände nur der ausdrücklich erklärte oder sich von selbst verstehende Zweck des einen Theils ganz vereitelt wurde.”

§ 381, I, 5 ALR, in turn, required the withdrawing party to compensate the other, if the change fell within his sphere.³

The provisions thus confine the effect of the *clausula* to the thwarting of the contractual purpose, but not any purpose - only the purpose expressly agreed upon or which self-evidently arose from the very nature of the contract. Any other kind of change or any other kind of purpose is considered part of the parties' consciously assumed risk.

¹§ 12, IV, 15.

²Köbler, *Die "clausula rebus sic stantibus" als allgemeiner Rechtsgrundsatz* 47.

³cited from Köbler *supra* 48.

Apart from these provisions, the idea of the *clausula* was incorporated in a number of narrowly circumscribed special provisions, mostly relating to long-term obligations.¹

The French Code Civil, promulgated in 1803, and the Land Law of the German state of Baden, promulgated in 1809 which almost literally repeated the Code Civil, were the first codifications to totally deny a general rule of *rebus sic stantibus*. Art. 1134 c.c. and Bad.LR states authoritatively:

”Rechtmäßig abgeschlossene Verträge gelten als Gesetze unter denjenigen, die sie geschlossen haben. Nur mit ihrer gegenseitigen Einwilligung oder aus Ursachen, welche das Gesetz billiget, lassen sie sich widerrufen.”²

The idea of the *clausula* as a qualification of contractual liability is restricted to a number of special provisions, such as donation and lending.³

The pandectist Anton Friedrich Justus Thibaut expressively rejected the *clausula*: contracts are to be fulfilled as long as there is no impossibility of so doing.⁴ Friedrich Carl von Savigny does not even mention the *clausula* and restricts the rescission of contracts to cases of duress, fraud, mistake and impossibility.⁵ This is typical of most of the pandectist authors who deal with change of circumstances only in respect of the few cases such as donation discussed by the Roman lawyers.

Bernhard Windscheid, while rejecting the *clausula* itself,⁶ tried to accommodate change of circumstances by way of his doctrine of contractual assumption⁷. This amounted to another attempt to bridge the gap between a legal transaction and reality, individual will and the facts of the case. In spite of the doctrine of mistake which held errors in motive to be generally irrelevant, Windscheid wanted to make certain motives legally relevant. This he sought to do by portraying some assumptions as ”undeveloped conditions”, in the sense that they were not made into express conditions because certain circumstances were assumed as a matter of course. Because it did not prevent the obligation from coming into being, the ”assumption” was not a condition in the strict sense but it amounted to a ”self-restriction of the will”. If the assumption was not met, the legal consequences might well correspond to the ”real will” (”wirklicher Wille”) but not to the ”actual will” (”eigentlicher Wille”)

¹Köbler, *supra*, 49 sqq.

²cited from Köbler, *supra* 55.

³Köbler, *supra*, 55 sqq.

⁴*System des Pandectenrechts*, 1803, § 201.

⁵Savigny, *Das Obligationenrecht als Theil des heutigen Römischen Rechts*, vol. 2 (1853) § 81.

⁶*Lehrbuch des Pandektenrechts*, vol. I, § 98.

⁷*Die Lehre des römischen Rechts von der Voraussetzung*, 1850.

of the party. The distinction between the "assumption" and the legally irrelevant motive was found in the requirement that the assumption should have been recognizable for the other party at the time of the formation of the contract. Because it entailed a purely subjective approach, this theory drew much contemporary criticism. It sought reservations in the minds of the parties about factual constellations which the parties had ordinarily not consciously thought of, let alone made into a condition of contracting. But at the same time Windscheid attempted consistently to adhere to the will-theory, thus revealing one of its weaknesses.¹ It was furthermore criticised for being unable to distinguish the contractual assumption in a precise way from a condition or a legally irrelevant motive.²

The development in respect of the doctrine of *Voraussetzung* nevertheless shows that there was by the end of the 19th century a slight tendency to relax the rigid rejection of the *clausula* in order to reach reasonable and fair results where an inflexible rule of *pacta sunt servanda* produced obvious injustice. The problem was, however, to justify a deviation from the strict rule while adhering to the 19th century will-theory. On the basis of Aristotelian-Thomistic philosophy, there was no conflict between interpreting the will of the parties and asking what was fair and reasonable, since promises constituted means to contemplated ends, and circumstances could therefore necessarily arise in which the adherence to the means would no longer be reasonable or fair. Windscheid himself drew the conclusion that if thrown out of the door, the idea of the *clausula* would always re-enter through the window.³ The idea at the root of the *clausula* is simply too closely connected with fundamental questions about the law to be ignored.

This slight tendency towards a more benevolent view of the *clausula* failed to influence the codification of the BGB. Windscheid's doctrine of the assumption was rejected as posing a threat to the security of legal intercourse, mainly because of Lenel's criticism that the doctrine could not sufficiently distinguish assumption and irrelevant motive.⁴ The BGB does not contain a general rule relating to change of circumstances, the idea of the *clausula* is only contained in some special provisions which do not permit generalisation.⁵ The most general rule concerning change of circumstances states that a party obliged to perform in advance may refuse to do so, if the counter-

¹Köbler, *supra* 66, 67; Gordley, *supra*, 185.

²Lenel in *AcP* 74, 213 sqq.

³Windscheid, "Die Voraussetzung" in *AcP* 78, 197.

⁴*Protokolle* II 2, p. 690.

⁵confirmed by the *Reichsgericht* in: RGZ 50, pp. 255, 257 (11.4.1902); RGZ 60, pp. 56, 58 (28.1.1905); RGZ 65, pp. 185, 188 (16.2.1907); RGZ 86, pp. 397, 398 (4.5.1915); RGZ 99, pp. 258, 259 (8.7.1920); RGZ 100, pp. 130, 131 (21.9.1920).

performance is endangered due to a deterioration of the other party's financial integrity.¹ Other provisions dealing with change of circumstances turn on special circumstances pertinent to donation², lending³ and long-term contracts like rent⁴, custody⁵, service⁶, mandate⁷ and association⁸.

1.2. The development of the doctrine of *Wegfall der Geschäftsgrundlage* (lapse of the underlying basis of the transaction)

As early as 1889 and 1898, two decisions of the *Reichsgericht*, although not expressly taking up Windscheid's arguments, inclined in a direction away from the mainstream of pandectism.⁹ Both decisions concerned mills which had been destroyed by fire, and in issue was whether the miller remained obliged to deliver the meal when the mills were rebuilt after several months. According to the general rule, this result was to be expected in the absence of a real impossibility of performance. The court nevertheless made an exception in these two cases, arguing that circumstances had in the meantime changed in such an unforeseeable way so as to impair or thwart the original purpose of the transaction, and thus to change its original content.

Soon after the promulgation of the BGB on the 1st of January 1900, the need to relax the strict rule of *pacta sunt servanda* in certain cases began to make itself felt. Although the *Reichsgericht* strictly rejected a general *clausula*-rule until the end of the First World War, it made exceptions in cases unsatisfactorily dealt with by the Code. This was done by constructing analogies to §§ 321, 610 BGB and by holding that the rejection of a general *clausula*-rule did not exclude its application in exceptional cases. These cases all concerned credit agreements, maintenance contracts and long-term contracts based on special considerations of trust¹⁰.

¹§ 321 BGB. The rule is reflected in § 610 BGB which permits the revocation of a promise of loan if the claim for repayment is endangered by the decline of the promisee's financial position. The same applies to § 775 Nrs 1,2, which gives the surety who has acted on the debtor's orders a right to claim release if the debtor's financial position has deteriorated.

²§§ 519, 528, 530 BGB.

³§ 605 Nr. 1 BGB.

⁴§ 570 BGB.

⁵§ 696 BGB.

⁶§ 626, 627 BGB.

⁷§ 671 BGB.

⁸§ 712, 723 BGB.

⁹See the decision of the 12.7.1889, *Seuffert's Archiv*, vol. 45, p. 114; and that of 6.7.1898, RGZ 42, p. 114.

¹⁰RGZ 60, p.56,60 (28.1.1905); RGZ 65, p. 37,38 (22.12.1906); RGZ 65, p. 185,188 (16.2.1907); RGZ 78, p. 385,389 (27.2.1912); RGZ 78, p. 421,424 (27.12.1912); RGZ 79, p. 156,161 (27.3.1912).(Cited after Köbler, p. 90).

In legal science, some authors argued for the recognition of a general *clausula*-rule, dogmatically justifying such a development by once again making it a problem of interpretation with reference to §§ 133, 157 BGB.¹ Contracts were to be interpreted to reflect what Erich Kaufmann called the "spirit" of the agreement. This approach was also, as was the case with Windscheid, criticised for proposing to interpret a non-existent will: the parties ordinarily do not think possible changes of circumstances but take the continuation of existing circumstances for granted. This line of argument, furthermore, brought the risk of supplementary interpretation under § 157 BGB going beyond the actual content of the contract and resulting in a fiction of intention.

This approach to interpretation, however, revealed the renewed tendency towards a more objective approach to a change of circumstances and its consequences for the contract. References to the "spirit" of the agreement are not far removed from the "nature" or "essence" or "purpose" of the contract and a perhaps unconscious return to Aristotelian and Thomistic legal thinking.²

Stahl, for instance, wanted to re-establish a doctrine of *clausula* independent of the will of the parties, which would come into effect whenever the "nature" of a contract was frustrated.³ The *Reichsgericht* also justified some of its exceptional references to the idea of the *clausula* by referring to the "nature" of the contract.⁴

Erich Kaufmann took a similar line in the field of international law.⁵ He distinguished an "empiric will" from the "effective will" ("*Wirkungswille*") which is directed towards everything corresponding to the nature of the type of contract and which ensures the attainment of the "essential purpose" ("*Wesenszweck*") of the contract. The obligation of every party to a contract is limited to what is reasonable for that party according to his will, understood as an effective will, directed towards an end.⁶ Today, the *clausula rebus sic stantibus* is an integral part of international law. Kaufmann's views did not, however, have an impact in the field of private law.

A general change of attitude towards the *clausula* was therefore not decisively inspired by legal reasoning. Instead the political and economic crisis resulting from the First World War and continuing

¹Namely Endemann, *Lehrbuch des bürgerlichen Rechts*, vol. I, 1899, § 63, p.19, §106, p. 16, § 184, p. 27; Dernburg, *Bürgerliches Recht*, vol. II, § 93, p. 10, § 111; Bindewald, *Rechtsgeschichtliche Darstellung der Clausula rebus sic stantibus und ihre Stellung im BGB* (Diss. 1901), p. 30sqq.; Artur Kaufmann, *Die Klausel: rebus sic stantibus* (Diss. 1907), 12.

²Köbler, *supra* 91.

³*Die sogenannte clausula rebus sic stantibus*, 1909, 20, 53sqq.

⁴e.g. RGZ 60, 56, 59.

⁵Erich Kaufmann, *Das Wesen des Völkerrechts und die clausula rebus sic stantibus*, 1911.

⁶Erich Kaufmann, *supra*, 110.

into the era of the Weimar Republic, virtually left the courts no choice but to resort to remedies similar to the *clausula*.

During the war, the *Reichsgericht* persisted in its rejection of the *clausula*. In a decision of the 3rd of July 1917,¹ the court reaffirmed that it did not have a power to relieve the parties from the hardships imposed on them by the war. But in a decision of the 8th of July 1920,² the same court recognized that, even though it was not so in the case before it, the principle of *pacta sunt servanda* might under certain circumstances conflict with the principle of good faith and equity. This would be the case where as a result of a change of circumstances, the performance due under the contract was in truth different from that contemplated by the parties at the formation of the contract.

The first breakthrough came with the decision of the 21st September 1920 dealing with the readjustment of rent.³ In this decision the court recognized generally that supervening economic crises could in certain cases result in an "economic impossibility". The court drew an analogy with § 325 BGB (regarding impossibility), based on the idea that although it might be still possible for the party to perform, it might in the changed circumstances be unreasonable for her to do so. This idea had developed from the assumption in the cases of 1889, 1898 and 1917 that change of circumstances might alter the content or purpose of a contract in such a way as to make the due performance an *aliud* compared to what the parties originally had in mind. The court now openly accepted that this was a revival of the *clausula*. It stated further that the ruling opinion up to then

"... ist durch die Erfahrungen überholt, die der Senat im weiteren Verlauf des Krieges und insbesondere durch dessen ungeahnte Umwälzung aller wirtschaftlichen Verhältnisse gemacht hat. Diese Verhältnisse erfordern unbedingt ein Eingreifen des Richters in bestehende Vertragsverhältnisse dann, wenn anders nicht ein Treu und Glauben und jedem Gebot von Gerechtigkeit und Billigkeit hohnsprechender, einfach nicht zu ertragender Zustand geschaffen werden soll."⁴

The court stated three conditions for judicial intervention: that both parties desire to maintain the contract, the change of circumstances must be "exceptional" and that the assessment of the parties' interests should lead to a division of the disadvantage. But this was still only a partial acknowledgement of the *clausula*, based on the principle of good faith and equity and the notion of

¹RGZ 90, 374.

²RGZ 99, 258.

³RGZ 100, 129.

⁴RGZ 100, 132.

reasonableness. Although this approach initially required that the change of circumstances should entail the ruin of the party upon execution of the contract, this requirement was soon relaxed to the extent that performance should merely produce intolerable results for the party in question.

In 1921, Paul Oertmann¹ published his book *Die Geschäftsgrundlage. Ein neuer Rechtsbegriff*. He introduced the notion of the "basis of the transaction", which he expressly wished to be understood in an objective way, thereby distancing himself from Windscheid's approach. The "basis of the transaction" was not part of the legal act (and thus not a condition) and was also not to be identified with its purpose.² Oertmann defines:

"Geschäftsgrundlage ist die beim Geschäftsabschluß zutage tretende und vom etwaigen Gegner in ihrer Bedeutsamkeit erkannte und nicht beanstandete Vorstellung eines Beteiligten oder die gemeinsame Vorstellung der mehreren Beteiligten vom Sein oder vom Eintritt gewisser Umstände, auf deren Grundlage der Geschäftswille sich aufbaut."³

Although Oertmann sought to move towards a more objective approach by distinguishing the basis of the transaction from the transactional will, his approach remains in essence a subjective one. The minds of the parties still form the focus of enquiry, and the basis of the transaction is still sought in the parties' conceptions. Like Windscheid, Oertmann considered it a basic requirement that the partners shared or at least recognized the conception as being fundamental to the contract. He tried to distinguish the assumption-basis of the transaction from an irrelevant motive by saying that the opposing party must have actually recognized the assumption and "tacitly" consented to it. The mere possibility of recognizing the assumption - as Windscheid had said - would not be sufficient. Thus, Oertmann said that the assumption constituted not only the basis for the individual declaration of one party - as it did for Windscheid - but for the whole transaction. It was, however, still not sufficiently clear how the assumption-basis of the transaction differed from an irrelevant, although perhaps emphasized, motive. If one party expresses a motive for the transaction but does not indicate that he wants to make it a condition, one cannot expect the other party to object to something he will regard as irrelevant to the binding force of the transaction. In fact, seen purely from a psychological perspective, there seems to be nothing "in between" a condition and an irrelevant motive. The only distinction from a psychological perspective might be if the assumption motivated both parties equally to enter into the transaction. But Oertmann did not want to confine the doctrine to such cases, because to do so would exclude most cases of unforeseeable objective change of circumstances. The

¹who incidentally was Windscheid's son-in-law.

²*Die Geschäftsgrundlage* 26sqq.

³*Die Geschäftsgrundlage* 37.

attempt to include these cases in his understanding of the assumption, revealed the limits of the purely psychological account of the will-theory: Even when it was clear that the parties did not consciously think about the change of circumstances because it was unforeseeable, Oertmann argued that the parties would at least rely on the continuation of the *status quo*. But this obviously is not the same thing as if someone has a clear understanding which he wants to make the basis of the transaction. Oertmann thus inevitably slides into a logical deduction and normative interpretation from and of the parties' will, hiding it behind a pseudo-psychological argumentation.¹ In this respect, he did not differ from Windscheid, whose "actual will" ("*eigentlicher Wille*") was also not really a psychological, but rather a normative will. The result of this lack of methodological clarity was that Oertmann's formula could theoretically account for all kinds of change of circumstances in an almost unrestricted manner. Considering the question of when exactly the transactional basis falls away, Oertmann was also unable to offer more precise criteria other than the reasonableness for the parties in the individual case. The consequences of the lapse of the transactional basis would vary from case to case: rescission or partial rescission if the collapse concerned only a part of the transaction. This shows that although Oertmann did not expressly say so, he had in mind the possibility of an adjustment of the contract.²

Oertmann's views inevitably attracted the same criticism levelled at Windscheid and Kaufmann, namely that he put too much emphasis on subjective requirements. One could not construct contracts on the basis of imputed, hypothetical and rather fictional conceptions extracted from what the parties did not actually expect. Furthermore, his views were reproached for lacking in precision and it was claimed that the resort to provisions of the BGB regarding the *clausula* - idea was unjustified.³

Despite this criticism, Oertmann's doctrine came at a time when the courts were in need for a justification for their attempts to move away from the strict rule of *pacta sunt servanda* in special cases. Thus, in its decision of the 3rd of February 1922, only one year after the publication of Oertmann's views, the *Reichsgericht* anointed the doctrine of *Wegfall der Geschäftsgrundlage* with the highest legal acknowledgement.⁴

In this case - dealing with the devaluation of currency due to massive inflation - the court established that the doctrine was to be employed when the equivalence of performance and counter-performance was substantially disturbed because of a change of circumstances. The dogmatic basis of the doctrine

¹Larenz, *Geschäftsgrundlage und Vertragserfüllung*, 3rd ed. (1963), 10.

²Abas, *Rebus sic stantibus* 19, 20.

³Köbler, *supra* 96.

⁴RGZ 103, 329,332.

was (and is) sought in the principle of good faith and equity, § 242 BGB. The adjustment of the contract was to be undertaken by encouraging the parties to re-negotiate the terms of the contract. The doctrine of *Wegfall der Geschäftsgrundlage* goes beyond the limits of the old *clausula* doctrine since the latter only comprised objective changes and not subjective conceptions or expectations.

By 1923, the new doctrine had found application in no less than twelve of the *Reichsgericht's* decisions, and from that time on, it has had a remarkable career in German jurisprudence. This was mainly due to the flexibility of its broad terms and its legal effects, which gives the judge a considerable discretion to bring about equitable results. The courts were, and are so fond of using the doctrine, that today there are again widespread calls for a restriction of the *Wegfall der Geschäftsgrundlage*.¹

Apart from Oertmann, other jurists also attempted to account for changing circumstances. The most significant of these is the approach of Locher² in 1923. He also uses the term of basis of the transaction but defines it differently as

"... die Gesamtheit derjenigen Umstände, ohne deren Vorhandensein, Fortbestand oder Eintritt der mit dem Geschäft nach seinem Inhalt bezweckte Erfolg (der Geschäftszweck) durch das Geschäft trotz ordnungsmäßigem Abschlusses und trotz Aufwendung der nach dem Inhalt des Geschäfts den Beteiligten zuzumutenden Opfer nicht erreicht werden kann."

In short:

"Geschäftsgrundlage sind die zur Erreichung des Geschäftszwecks mit den Geschäftsmitteln notwendigen Umstände."³

By emphasizing the objective circumstances and speaking of the purpose of the contract, Locher, in contradiction to Oertmann, who in essence did not desert the will-theory, built his theory on the *clausula*-concept of the old *ius commune* (and thus on Aristotelian-Thomistic legal thinking). Locher accepts as transactional purpose only what has been accepted by both parties and is reflected by the content of the contract, thereby deliberately retaining a subjective element. All unilateral conceptions are irrelevant. This aspect has been criticised. Locher enlarged the range of application of the

¹Roth in *Münchener Kommentar zum Bürgerlichen Gesetzbuch*, 3rd ed. (1994) § 242 Rn 512 sqq.; Köbler, *supra*, 144 sqq.

²"Geschäftsgrundlage und Geschäftszweck", *AcP* 121, 71sq. 1923.

³Locher, *supra*, 71.

clausula by giving up the requirement of subsequent change. It should make no difference whether the transactional basis fell away later or had been missing right from the beginning. To him the crucial point was the assessment, with reference to the content of the contract and to good faith and equity, of the limit of efforts which could be reasonably demanded from the party in order to carry out the contract. He also spoke of an *Unzumutbarkeit* (intolerability). A major criterion, according to Locher, is that there should ordinarily be an equivalence of performance and counter-performance, in order for a contract to be enforceable.

A number of other authors¹ saw the *clausula*, as was done at the beginning of the century, mainly as a problem of interpretation, seeking the hypothetical will of the parties, in the event that they had contemplated the changes that were to come.

Under national-socialist rule, the development of the doctrine of *Wegfall der Geschäftsgrundlage* continued unaltered. The Judiciary applied the doctrine largely without employing national-socialist vocabulary to give content to the broad terms of Oertmann's definition. Only in one decision, of the 15th December 1941, was the transactional basis related to the *völkische Gesamtordnung* (general order of the people).²

In this time, Larenz, too, dealt with *Wegfall der Geschäftsgrundlage*, which he, drawing expressly on Locher, understood in an objective sense, rooting it firmly in the principle of good faith.³

The Second World War did not - as might have been expected - bring about a further development of the doctrines of *Wegfall der Geschäftsgrundlage* or *clausula*. This was due to the fact that the national-socialist government, foreseeing the impact of the war on the economy, provided for changes of circumstances by means of the *Vertragshilfe* statutes. Several ordinances empowered judges to balance the interests of the parties in an equitable manner in the case of economic predicament. The rule stated in § 4 I of the *Kriegsvertragshilfeverordnung*,⁴ for instance, was that losses should be apportioned by half, but the judge was given a large discretion on what measures to apply in individual cases in order to ensure a new allocation of risk. There was accordingly no need, and no

¹eg Wacup, *Der augenblickliche Stand der Lehren von der Voraussetzung, der clausula rebus sic stantibus und Geschäftsgrundlage*, Diss. 1928, p. 24; Schmitz, in *Schlegelbergers Rechtsvergleichendes Handwörterbuch*, 1929, vol. II, p. 635; Rhode "Die beiderseitige Voraussetzung als Vertragsinhalt", *AcP* 124 1925, 257, 322; Heck, *Lehrbuch des Schuldrechts*, 1929, 180sqq.

²RGZ 168, 121, 124.

³*Vertrag und Unrecht* I, 1936, 162sqq., 165.

⁴Cited by Köbler, *supra* 122.

authority for the courts to apply *Wegfall der Geschäftsgrundlage* except in those cases not covered by the ordinances.

After the war, this approach was carried further with the *Vertragshilfegesetz* (contract aid law) of the 26th March 1952, which applied to contracts affected by the long-term consequences of the war, and the *Umstellungsgesetz*, which dealt with the consequences of the change of currency from *Reichsmark* to *Deutsche Mark* on the 21.06.1948.

Three interesting re-statements of the idea of the *clausula* have been formulated during the nineties which are likely to influence further discussion both nationally and internationally.

In 1991, the German commission tasked with the revision of the law of obligations by the minister of justice (*Kommission zur Überarbeitung des Schuldrechts*) in its concluding report, suggested the incorporation of the doctrine of *Wegfall der Geschäftsgrundlage* into the BGB. According to this submission, the new § 306 BGB would read:

- ”(1) Haben sich die Umstände, die zur Grundlage des Vertrags geworden sind, nach Vertragsschluß schwerwiegend verändert und hätten die Parteien den Vertrag nicht oder mit anderem Inhalt geschlossen, wenn sie diese Veränderungen vorausgesehen hätten, so kann Anpassung des Vertrags verlangt werden, soweit einem Teil unter Berücksichtigung aller Umstände des Einzelfalls, insbesondere der vertraglichen oder gesetzlichen Risikoverteilung, das Festhalten am unveränderten Vertrag nicht zugemutet werden kann.
- (2) Einer Veränderung der Umstände steht es gleich, wenn Vorstellungen, die zur Grundlage des Vertrages geworden sind, sich als falsch herausstellen.
- (3) Ist eine Anpassung des Vertrags nicht möglich oder einem Teil nicht zumutbar, so kann der benachteiligte Teil vom Vertrag zurücktreten. An die Stelle des Rücktrittsrechts tritt für Dauerschuldverhältnisse das Recht zur Kündigung aus wichtigem Grund.”¹

The "Principles of International Commercial Contracts", published in 1994 by the International Institute for the Unification of Private Law (Unidroit), contains in sections 6.2.1 to 6.2.3. a general rule regarding change of circumstances. The principles merely speak of a "hardship" which exists when certain events fundamentally change the contractual equivalence. For relief to be granted, it is required that (1) the change of circumstances occurred after the conclusion of the contract or was unknown to the parties at its conclusion and could not reasonably have been known, (2) the possibility of such change of circumstances could not reasonably be considered at the time of the conclusion of

¹Roth in *Münchener Kommentar*, *supra*, § 242, Rz 516.

the contract (unforeseeability), (3) the risk of these changes was not attributed to the affected party by the contract, and (4) the events were outside the control of the parties.

The "Principles of European Contract Law, Part I" published in 1995 by the Commission on European Contract Law (Lando-Commission) deals with change of circumstances in sections 2.117 (1) and (2). This section reaffirms that the principle of *pacta sunt servanda* will prevail if performance has only become "more onerous", but not when it becomes "excessively onerous" because of a change of circumstances. Except for the last element, the requirements for relief are the same as in the Unidroit-Principles. Both sets of "principles" state as the consequence, that the parties are obliged to renegotiate their contract in order to adjust or terminate it.¹

2. The approach of the Courts

2.1. The principle

Soon after the end of the Second World War, the *Bundesgerichtshof*, in a decision of the 23rd May 1951,² confirmed the case law of the *Reichsgericht*³ that the doctrine of *Wegfall der Geschäftsgrundlage* is part of German Law:

"Bereits das Reichsgericht hat eine Berücksichtigung des Fortfalls der Geschäftsgrundlage ... anerkannt, wenn mit Rücksicht auf den Geschäftszweck das Festhalten an dem Vertrag nach Treu und Glauben dem Verpflichteten nicht mehr zugemutet werden kann, und der Oberste Gerichtshof für die Britische Zone ist in dieser Richtung noch weitergegangen, indem er die Durchbrechung des obersten Grundsatzes der Vertragstreue unter diesem Gesichtspunkt nur zur Vermeidung untragbarer, mit Recht und Gerechtigkeit schlechthin unvereinbarer Ergebnisse zugelassen hat ...".

Following the *Reichsgericht*, the BGH thus adopted Oertmann's formula of the *Geschäftsgrundlage* and identified the requirement of *Unzumutbarkeit* (intolerability) according to the standard of good faith and equity in § 242 BGB as the key issue and central point of the investigation. All other requirements, like unforeseeability, were just circumstantial evidence suggesting a possible *Unzumutbarkeit* (intolerability).

¹both sets of "principles" cited after Zimmermann, "Konturen eines Europäischen Vertragsrechts", *Juristenzeitung (JZ)* 1995, Nr.10, p. 486, 487.

²BGHZ 2, 188.

³RGZ 141, 216sq.; RGZ 148, 172sq.; RGZ 160, 265sq.

This has remained the Court's basic approach towards the *Wegfall der Geschäftsgrundlage* up to today. In a decision from the 8th of January 1978¹ for instance, concerning the effects of the Oil-crisis in 1973, the BGH reaffirms its position:

"Nach der gefestigten Rechtsprechung des BGH wird die Geschäftsgrundlage eines Vertrages gebildet durch die nicht zum eigentlichen Vertragsinhalt erhobenen, aber bei Vertragsschluß zutage getretenen gemeinschaftlichen Vorstellungen beider Vertragsparteien oder die dem Geschäftsgegner erkennbaren und von ihm nicht beanstandeten Vorstellungen der einen Vertragspartei von dem Vorhandensein oder dem künftigen Eintritt oder dem Fortbestand gewisser Umstände, auf denen der Vertragswille sich aufbaut Bei gegenseitigen Verträgen ist in der Regel die Vorstellung von der Gleichwertigkeit von Leistung und Gegenleistung Geschäftsgrundlage. Dieser Grundsatz gilt allerdings dann nicht, wenn der Vertrag ergibt, wie die Parteien die Veränderung bestimmter Umstände geregelt wissen wollten. Wie der BGH in ständiger Rechtsprechung entschieden hat, geben Umstände, die nach dem Vertrag ersichtlich in den Risikobereich einer Partei fallen, dieser kein Recht, sich auf eine Störung der Geschäftsgrundlage zu berufen. Nicht jede Störung der Geschäftsgrundlage ist nämlich rechtlich bedeutsam. Angesichts der überragenden Bedeutung, die dem Grundsatz der Vertragstreue zukommt, ist die Berufung auf eine Änderung oder einen Wegfall der Geschäftsgrundlage nur zulässig, wenn das zur Vermeidung eines untragbaren, mit Recht und Gerechtigkeit nicht zu vereinbarenden und damit der betroffenen Partei nicht zumutbaren Ergebnisses unabweislich erscheint."

The basic rule remains *pacta sunt servanda* - this rule may only be put aside by means of the doctrine of *Wegfall der Geschäftsgrundlage* under exceptional circumstances amounting to *Unzumutbarkeit* (intolerability) for the affected party.

The doctrine of *Wegfall der Geschäftsgrundlage* serves as an exceptional *ultima ratio*, a last resort, which is employed when the rules of interpretation or the rules of the Code which enjoy priority of application do not offer a binding, satisfactory and equitable result. It is therefore essentially of a subsidiary nature. This demonstrates that the doctrine of *Wegfall der Geschäftsgrundlage* is simply a concrete application of § 242 BGB, the principle of *bona fides*. It exemplifies the role of *bona fides* in the legal system as a whole. Oertmann's formula of the basis of the transaction is thus a technical tool used to operationalise the principle of good faith, one of the several possible dogmatic garments in which this principle may appear. The final decision depends on whether the duty of unaltered

¹JZ 1978, 236.

performance is in conflict with *bona fides* - which is the case when there is an *Unzumutbarkeit* (intolerability) - or not.

The question of how to assess the significance of changes of circumstances in relation to contracts is today generally considered to be a question of the allocation of risk. The consequence of a *Wegfall der Geschäftsgrundlage* is a redistribution of the risk of changed circumstances or error and disappointed expectations among the parties to the contract. This is only justified when the risk which was manifested by the change had not been clearly allocated by the contract to one of the parties alone. The doctrine of *Wegfall der Geschäftsgrundlage* as tool of *ultima ratio* cannot supersede an allocation of risk made by the contract itself or by the Code. When the parties have recognized a risk and made provision for it, this provision generally prevails. Exceptions may be made when the provision turns out to be inefficient and futile. That the parties have recognized a risk and nevertheless not made any special provision for it indicates that they wanted the affected party to bear the risk alone. Only when the parties have mutually not foreseen the risk at all, or have misjudged it as trivial, does the affected party merit protection.

In practice it is often difficult to decide whether the contract or the Code does not offer a reasonable solution to the problem, and in fact, the courts are considered to be quite liberal in assuming that in the particular case neither contract nor Code indicates a reasonable solution in order to avail themselves of the great flexibility of the doctrine of *Wegfall der Geschäftsgrundlage* in order to bring about an equitable solution. This rather liberal approach towards the finding of gaps in the provisions of the contract or the Code has prompted much criticism in the jurisprudence: these will be described in the next chapter.

2.2. First prerequisite: the risk of a change of circumstances is not allocated by the provisions of the contract or the rules of the Code

Risk may be allocated contractually or by the rules of the code. Each party, as a rule, must bear the risk attributed to her either by the terms of the contract or imposed by the law governing the contract and may not question it: *pacta sunt servanda* prevails. Only if the change of circumstances entails a risk which has not been allocated expressly or implicitly by the contract or by law, or, on the other hand, if the contractual or the allocation of risk by law produces an intolerable result, incompatible with the principle of *bona fides* in a particular situation, may the doctrine of *Wegfall der Geschäftsgrundlage* be resorted to. The analysis has therefore to proceed on three levels, namely, in order of priority: the contract itself, the provisions of the Code and finally the basis of the transaction (*Geschäftsgrundlage*). If any of the levels enjoying priority offers a conclusive solution, the remaining levels are thereby excluded from the search for a solution.

2.2.1. Contractual allocation of risk

As a rule, according to the principle of freedom of contract, any contractual allocation of risk has absolute priority and thus excludes a recourse to the doctrine of *Wegfall der Geschäftsgrundlage*. Since it is the very purpose of a contract to create a bond which compels a party to honour an agreement until its execution, it is a natural characteristic of the contract to place certain risks typical of the performance of a contract on the parties, according to their role in the contract. Each contract must therefore be examined to determine the allocation of risk under it. This may already become clear from express provisions, such as, for example, index clauses.¹ In any case, the content of the contract has to be interpreted according to §§ 133, 157 BGB, that is, the actual intention of the parties has to be determined according to the principle of *bona fides* and accepted customary standards (*Verkehrssitte*). If the express provisions of the agreement do not solve the problem, interpretation according to § 157 BGB goes beyond the content by enquiring into the hypothetical will of the parties. This method of interpretation is called supplementary interpretation (*ergänzende Vertragsauslegung*): it asks what the parties would have willed, had they recognized their agreement to be incomplete. Supplementary interpretation presupposes a gap in the agreement. There is no room for supplementary interpretation if it appears that the parties wanted the agreement to be final.² There is also no room for supplementary interpretation if that would extend the original content and produce legal consequences which go further than the original agreement.³ It is furthermore excluded if various possibilities of filling in the gap present themselves and there are no reliable clues to determine which of the alternatives the parties would have chosen.⁴

On the level of interpretation, a distinction must be made between the construction of an implied condition and *Wegfall der Geschäftsgrundlage*. The existence of an implied condition is established by interpretation. It thus forms part of the content of the contract itself, and not of its basis.¹ The consequence of an implied condition, furthermore, is inevitably the invalidity of a contract, not its adjustment as in the case of *Wegfall der Geschäftsgrundlage*. The modern German version of the *clausula rebus sic stantibus* has therefore outgrown the device of the implied condition.

In practice, the difference between supplementary interpretation and the basis of the transaction often becomes blurred as soon as the case requires an evaluative judgement (*Wertung*). In borderline

¹BGH in *WM* 1969, 869.

²BGHZ 2, 383.

³BGHZ 16, 77; BGHZ 77, 304.

⁴BGHZ 90, 80.

situations it is often arbitrary to distinguish between the content established by interpretation and the basis of the contract. In such cases, the courts sometimes base their decision generally on "§§ 157, 242 BGB".²

2.2.2. Allocation of risk by the rules of the Code

If no express or implicit allocation of risk can be determined from the contract itself, it has to be found in the law in general. Allocation of risks effected by the rules of law governing contracts have, as a rule, to be accepted. Priority is given to the rules governing the individual types of contracts and especially the rules governing impairment of the performance in general (*Leistungsstörungenrecht*), concerning impossibility, delay, positive breach of contract (*positive Vertragsverletzung* or *pVV*) and *culpa in contrahendo*.

Rules concerning situations of change of circumstances or common mistake related to special types of contracts generally have priority. The doctrine of *Wegfall der Geschäftsgrundlage* can therefore only be employed if these special rules appear to be inconclusive in an individual case. The purpose of the special law may, for instance, clearly be inapplicable in a given situation so that the employment of the doctrine of *Wegfall der Geschäftsgrundlage* does not collide with that purpose. Of crucial importance is that the question whether a special rule is conclusive or not, already entails an evaluative judgement (*Wertung*).

An example is § 779 BGB concerning settlement contracts. It states that the contract is invalid if the parties had been mistaken about the facts of the case which according to the content of the contract had been made the basis of their agreement. The doctrine of *Wegfall der Geschäftsgrundlage* is excluded to the extent that this special rule is applicable. A requirement of § 779 BGB is, however, that the facts forming the basis of the agreement should somehow have been reflected in the content of the contract itself. The doctrine of *Wegfall der Geschäftsgrundlage*, on the other hand, may be employed in situations not covered by § 779 BGB. Such situations were held to be present, for example, when unforeseeable later consequences of a damage causing event led to a gross inequivalence between the loss and the settlement sum;³ or when the value of a performance changed

¹BGHZ 16, 8.

²e.g. BGH in *NJW* 1977, 385.

³BGH in *VersR* 1967, 804; *NJW-RR* 1992, 714.

unexpectedly and considerably.¹ Changes in the law may also affect the settlement and would not fall under § 779 BGB.²

The application of the doctrine of *Wegfall der Geschäftsgrundlage* is also restricted by the need to preserve certain legal consequences entrenched in the Code. Paragraphs 626, 723 BGB, for example, prescribe cancellation for an important reason (*Kündigung aus wichtigem Grund*) as the only way to terminate a long-term contract *de futuro*, in order to avoid retroactive rescissions. This rule may also not be circumvented by the application of the doctrine of *Wegfall der Geschäftsgrundlage*. For example, cancellation may not be granted because of *Wegfall der Geschäftsgrundlage* on the basis of requirements less strict than those stated in the provisions of the Code. It is only justified to move away from the rules of the Code in the cases of *Wegfall der Geschäftsgrundlage* if the party entitled to cancel the contract desires a less strict legal consequence, namely only adjusting the contract instead of terminating it.

In the cases of *Wegfall der Geschäftsgrundlage*, performance has not become literally impossible for the party affected by changed circumstances, it has only become a considerable hardship or useless for that party.

The *Reichsgericht* initially attempted to subsume the cases of *Wegfall der Geschäftsgrundlage* under impossibility by saying that performance would mean such a hardship for the affected party that it would amount to an "economic impossibility".³ But this solution was soon abandoned because it was incompatible with the literal meaning of the notion of impossibility, and it also did not bring about better results than the doctrine of *Wegfall der Geschäftsgrundlage*. The notion of impossibility would have had to be interpreted very widely to comprise all the cases of hardships due to fundamental change of circumstances and this entailed necessary evaluative judgements (*Wertungen*) to no lesser extent than the doctrine of *Wegfall der Geschäftsgrundlage* itself. Furthermore, the flexible legal consequence of adjustment of the contract suited the interests of the parties (and the basic principle of *pacta sunt servanda*) much better than the strict consequence of dismissing the contract as in the case of impossibility.

But frustration of purpose (*Zweckvereitelung*) must be distinguished from the cases of termination of purpose (*Zweckfortfall* or *Zweckerreichung*). In these cases, the purpose of the contract has been attained, but by other means than the performance of the parties. This represents a kind of

¹BGH in *BB* 1970, 1191.

²BGH in *NJW* 1958, 1540.

³*RGZ* 100, 129.

impossibility. The regular example for this is the ship trapped on a sandbank which comes free on its own before another hired ship arrives to tow it away. The owner of the hired ship cannot claim payment because his performance - to save the ship trapped on the sandbank - has become impossible due to the fact that the trapped ship has come free on its own. In the cases of *Zweckvereitelung*, performance is still possible but it has lost its reason, it has become useless for the affected party because the purpose of the performance has been frustrated due to the change of circumstances.

If a party is in delay with her performance, that party bears the risk of accidental impossibility of performance.¹ Consequently, *Wegfall der Geschäftsgrundlage* cannot be employed in such a case. The risk is allocated to the party in delay without regard to the nature of the change of circumstances. Compensation claims like those based on the German notions of positive breach of contract (*pVV*) and pre-contractual fault (*culpa in contrahendo* or *cic*) require fault on the side of one of the parties. The doctrine of *Wegfall der Geschäftsgrundlage* is thus excluded since it only applies to cases where the change of circumstances is not attributable to either of the parties.²

Paragraph 812 I sentence 2, 2nd alternative BGB (*condictio causa data causa non secuta*) states that the performing party may reclaim her performance if the purpose evident from the content of the contract has not been attained. This condition of purpose (*Zweckkondiktion*) is particularly difficult to distinguish from the notion of *Geschäftsgrundlage*. The *condictio* requires that there was an agreement on a common purpose which goes beyond the mere execution of the contract and which does not exhaust itself with the execution of the latter. It is required that the common purpose must have been reflected somehow in the content of the contract although not made an express part of it.³ This kind of agreement regarding a purpose is considered to occupy a position midway between an express condition and the basis of the transaction (*Geschäftsgrundlage*). It should therefore not be confused with the *Geschäftsgrundlage*, although it is often difficult to distinguish the two.⁴ Therefore, in cases where there is a common purpose which is not at all reflected in the content of the contract itself, the doctrine of *Wegfall der Geschäftsgrundlage* might be employed if that purpose is frustrated due to a change of circumstances.

If a common mistake relates to circumstances which are vital for the formation of the contractual will itself, the rules of the Code governing mistake and avoidance (*Anfechtung*) have priority. Paragraph 119 I BGB concerns error about the content of the transaction itself (*Inhaltsirrtum*). Paragraph 119 II

¹§ 287 BGB.

²Roth in *Münchener Kommentar*, § 242 Rn 542.

³BGH in *NJW* 1992, 2690.

⁴BGH in *NJW* 1966, 448.

BGB makes error about characteristics of things and people (*Eigenschaftsirrtum*) a basis for avoidance as well. This provision of the Code is considered to be problematic because it fails to make a clear distinction between errors in the contractual will relevant for avoidance and errors in motive, which are generally considered irrelevant. Different opinions have developed on the matter.¹ These rules usually apply to mistake irrespective of whether they are unilateral or common. But this is where the problem starts because § 122 BGB imposes on the avoiding party the duty to compensate the other for her losses due to the avoidance. This result is inequitable in the case of common mistake. When both parties were labouring under the error, it is arbitrary which party will choose avoidance first and have to pay compensation. For that reason, the courts tend to assume *Wegfall der Geschäftsgrundlage* whenever possible so as to avoid the result of § 122 BGB.

In some cases of error about the subject matter of a sale, the rules governing liability for defects, §§ 459 sqq. BGB, might also apply and thus exclude *Wegfall der Geschäftsgrundlage*. This is due to the prevailing subjective theory of defect (*subjektive Fehlertheorie*) which says that an item is defective when it differs from what the parties had mutually assumed it to be. For example, liability for defect was assumed when the parties erroneously believed the land sold was building land.²

2.3. Second prerequisite: common subjective basis of the transaction (*Geschäftsgrundlage*)

The second important requirement, from which the doctrine derives its name, results from the subjective relationship of both parties to the change of circumstances. This is especially evident in the cases of common error and disappointed common expectations, but applies as well to the cases of supervening change of circumstances. The doctrine of *Wegfall der Geschäftsgrundlage* therefore makes an error in motive or a frustration in motive legally relevant under certain requirements. The parties must share certain motives, that is conceptions or expectations concerning the present or the future. They must at least have jointly relied on the continuation of the existing state of affairs at the time of the formation of the contract or a "normal", foreseeable development. In order to justify the sharing of a risk of changing circumstances, normally attributed to the affected party alone, to the opposing party, it is necessary that the latter somehow shared, or at least recognized, the conceptions or expectations of the affected party as being fundamental to the contract. If these common conceptions or expectations (be they based on the foreseeable course of events or on an error) are frustrated by reality (be it by the unforeseeable change or emergence of circumstances or the

¹see Zimmermann, *Law of Obligations*, p. 617; Larenz *Allgemeiner Teil des BGB* § 20 II b; Medicus *Allgemeiner Teil des BGB* Rz 770; Kramer in *Münchener Kommentar*, § 119, Rz 89sqq.

²BGH JZ 1977, 177.

discovery of the error), it is considered equitable to let the opposing party participate in bearing the consequences which fortuitously fell on the affected party alone.

The question of the extent to which the opposing party should have shared the affected party's conceptions, depends on the weighing up of the interests of the parties in the individual case. There are cases where it was considered sufficient that the opposing party merely recognized the affected party's conceptions as fundamental for her performance. In other cases, it was required that the opposing party should not only have recognized, but actively adopted, these conceptions as vital to her own interest. But the general rule remains that there must be evidence in the individual case to the effect, that - based on the shared conceptions of the parties - the affected party was not destined to carry the risk of change alone.

The importance of the subjective basis of the parties' conceptions has diminished since the days of Oertmann. In the original version of his doctrine the common subjective basis, the *Geschäftsgrundlage*, was the crucial element, and the determination whether a certain circumstance formed part of it or not was decisive to its operation. Now the emphasis has shifted almost completely to the notion of *Unzumutbarkeit* as the indicator of when it is justified to intervene on the basis of *bona fides*. Oertmann followed Windscheid in adopting a subjective approach because of the prevalent "will-theory" of the late 19th century. The courts nowadays, although retaining Oertmann's formula as a starting point, prefer a more objective approach. The common subjective basis is by no means superfluous, however. It is one of a number of criteria which have to be evaluated when determining *Unzumutbarkeit* by weighing up the parties' interests.

2.4. Third prerequisite: intolerability (*Unzumutbarkeit*)

This is the vague, but crucial normative criterion for every intervention into legal transactions on the basis of § 242 BGB, the principle of *bona fides*. Here, eventually, the decisive evaluative judgement (*Wertung*) comes into play: the objective hardship of the individual case has to amount to an *Unzumutbarkeit*. The principle of private autonomy in contract law grants self-determination to, and demands self-responsibility of the parties and in consequence imposes a high degree of judicial self-restraint in respect of interventions into contractual relationships. It is in any event questionable whether a judge is a more satisfactory arbiter of contractual fairness than the parties themselves. For that reason, the objective hardship must always cross a certain "threshold of intolerability" (*Unzumutbarkeitsschwelle*) before a *Wegfall der Geschäftsgrundlage* can be assumed. This evaluative judgement is the result of an all-encompassing process of weighing the parties' interests (*Interessenabwägung*) according to the circumstances of the individual case. There is no fixed

standard of *Unzumutbarkeit*, the degree of hardship required to amount to *Unzumutbarkeit* can vary from case to case according to the individual circumstances.¹ Certain aspects always play an important role in the determination whether there is *Unzumutbarkeit* and thus a *Wegfall der Geschäftsgrundlage* and which are inextricably interwoven in the weighing up of the parties' interests. Thus, *Unzumutbarkeit* is always excluded in the following situations:²

2.4.1. Speculative transactions

If a transaction entails an unusually high risk which is, however, balanced on the other hand by the chance of an unusually high profit, and the parties have consciously accepted these risks, neither party may claim a *Wegfall der Geschäftsgrundlage*. The risks in such cases are obviously allocated to the affected party only.³

2.4.2. Self-induced frustration

If the crucial change of circumstances is attributable to the conduct of the affected party or occurs while she is in delay, she may not claim *Wegfall der Geschäftsgrundlage*.⁴ The opposing party's fault may on the other hand be considered in favour of the affected party.⁵

2.4.3. Foreseeability

The affected party may not claim a *Wegfall der Geschäftsgrundlage* if she had foreseen or was able to foresee the change of circumstances because in that case she could have made adequate provisions. If she did not do so, she is considered to have assumed the risk on her own. The same rule applies in the case of mistake: the affected party should not have been able to recognize the error.⁶

2.5. Legal consequences

¹Roth in *Münchener Kommentar*, *supra*, § 242 Rn 540.

²Roth in *Münchener Kommentar*, *supra*, § 242 Rn 541 sqq.

³BGH LM (Bb) Nr. 47, Nr. 61: BGHZ 74, 370.

⁴BGH LM (Bb) Nr. 61; BGH in ZIP 1993, 234.

⁵BGH NJW 1992, 2690.

⁶Roth in *Münchener Kommentar*, *supra*, § 242 Rn 543.

The consequences of a *Wegfall der Geschäftsgrundlage* are neither invariable nor automatic. The adequate distribution of risk and balancing of the parties' interests which lie at the heart of the doctrine require a considerable judicial discretion, guided by parameters established by the expressed intention of the parties and the provisions of the Code.¹

Any intervention into the contract should be as restricted as possible. Contracts are therefore only to be adjusted cautiously, with *ex nunc* termination and especially the possibility of an *ex tunc* invalidity, being considered as *ultima ratio* only. Concerning long-term contracts, termination *ex nunc* is a less harsh consequence than invalidity *ex tunc*, but even termination will in most cases not be in the interests of the parties. Adjustment of the future relationship will prevail in most cases, with the criterion of *Unzumutbarkeit* playing an important role in the determination of the legal consequence. The *Wegfall der Geschäftsgrundlage* is meant to be an exception to the principle of *pacta sunt servanda*, so that the need for a *favor contractus* is best met by the possibility of adjustment of the consequences of the contract.

2.6. The legal nature of the doctrine of *Wegfall der Geschäftsgrundlage*

Whether the application of the doctrine of *Wegfall der Geschäftsgrundlage* is of a declaratory or a constitutive nature (involving *Rechtsfindung* as against *Rechtsgestaltung*), remains obscure. Because the prospect of an arbitrary judicial interventionism is frowned upon, the prevailing opinion is that, despite appearances, the court gives effect to a *Wegfall der Geschäftsgrundlage* by means of a declaratory judgement, rather than shaping these consequences by means of a constitutive judgement (*Gestaltungsurteil*).² This cannot, however, distract from the fact that albeit that the judge's flexibility is guided by weighing the parties' interests on the basis of allocation of risk and *Unzumutbarkeit*, the legal consequences of a *Wegfall der Geschäftsgrundlage* are not self-evident.

It has been argued that the best way to safeguard the principle of party autonomy would be to simply oblige the parties to re-negotiate the terms of their contract.³ It is questionable, however, how far this concession to party autonomy extends. Judges are obliged to give a detailed judgement on cases brought before them and thus have to pre-determine the results of the parties' negotiation anyway. Furthermore, if the parties do not reach consensus, the final decision here, as always, remains with the

¹Roth in *MünchKommZ*, *supra*, § 242 Rn 544.

²Roth in *MünchKommZ*, *supra*, § 242 Rn 551.

³e.g. Horn: "Neuverhandlungspflicht" *AcP* 181 (1981), 255sq., 276; Haarmann: *Wegfall der Geschäftsgrundlage bei Dauerschuldverhältnissen*, 1979, 103sq.

court.¹ The assumption also that the court may only impose a duty of consent to an adjusted contract, or may only grant a rescission right which still has to be executed,² is rather formalistic since in such a case also the real decision is taken by the court itself.³

3. The doctrine of *Wegfall der Geschäftsgrundlage* in German legal science

The thought of two of post-war Germany's most influential scholars in Private law: Werner Flume and Karl Larenz, exemplifies criticism and support for the doctrine of *Wegfall der Geschäftsgrundlage*.

3.1. Werner Flume

Flume became the most influential opponent of a general doctrine of *Wegfall der Geschäftsgrundlage*.⁴ In his work *Das Rechtsgeschäft*,⁵ he elaborates his fundamental criticism. The doctrine, in his view, reflects the constant temptation not to take contractual obligations seriously anymore. It tends to reduce the importance of the contract and look for solutions outside the contract, instead of concentrating on the contract itself.⁶

”Die Lehre von der Geschäftsgrundlage wird immer wieder begünstigt durch Entscheidungen, welche im Ergebnis richtig sind und dadurch, daß sie auf die Lehre von der Geschäftsgrundlage gestützt sind, glauben machen, daß diese Lehre notwendig sei und zu richtigen Ergebnissen führe, während in Wirklichkeit der Vertrag selbst die Lösung ergibt”.⁷

¹Roth in *Münchener Kommentar, supra*, § 242 Rz 552.

²BGH *NJW* 1975, 390; *BGHZ* 101, 143; BGH *NJW* 1993, 1641.

³Roth in *Münchener Kommentar, supra*, Rz 552, 552a.

⁴Other authors have followed his position, with the majority stressing that *Wegfall der Geschäftsgrundlage* should be treated as a question interpretation. Among them are: Dieter Medicus, "Vertragsauslegung und Geschäftsgrundlage", in: *I. Festschrift für Werner Flume*, 1978, pp. 629sqq.; Beuthien, *Zweckerreichung und Zweckstörung im Schuldverhältnis*, 1969; Koller, *Die Risikozurechnung bei Vertragsstörungen in Austauschverträgen*, 1979; Nicklisch, "Ergänzende Vertragsauslegung und Geschäftsgrundlagenlehre - ein einheitliches Rechtsinstitut zur Lückenausfüllung?" , in: *Betriebsberater* 1980, pp. 949 sqq.; Littbarski, "Neuere Tendenzen zum Anwendungsbereich der Lehre von der Geschäftsgrundlage", in: *Juristenzeitung* 1981, pp. 8 sqq.; Wieling, "Entwicklung und Dogmatik der Lehre von der Geschäftsgrundlage", in: *Jura* 1985, pp. 505 sqq.; Emmerich, *Das Recht der Leistungsstörungen*, 3rd ed. 1963, p. 2.

⁵1965, 494 sqq.

⁶Flume, *Das Rechtsgeschäft*, 526.

⁷Flume, *supra*, 515.

Flume identifies as the main problem the relationship of contract and reality. The question is who has to bear the "risk of reality" ("*Wer trägt das Risiko der Wirklichkeit?*"¹). Flume emphasizes that this question is the main theme of the rules of the Code concerning the law of obligations. Their allocation of risks must be respected. The solution should therefore always be sought by interpreting the rules of the Code with reference to the individual contract. Flume claims that the rules of impossibility, rescission and other rights for termination, liability for defects and all the other rules concerning the specific types of contracts entrenched in the Code suffice to solve most of the cases in which the doctrine is invoked:

"Die Lehre von der Geschäftsgrundlage ist nichts anderes als eine Ergänzung der gesetzlichen Normierungen im Recht der Schuldverhältnisse für alle Fälle, von denen man meint, daß sie gesetzlich nicht geregelt seien".²

These cases are so diverse, he says, that they cannot be dealt with in a unifying manner.³ To deal with the cases simply on the basis of §242 BGB does not improve the situation since the invocation of "good faith and equity" is nothing but another way of saying that one has to look for a just solution.⁴

"...eine rechtliche Wertung hinsichtlich der *naturalia negotii* [ist] nur möglich..., wenn der konkrete, zur rechtlichen Entscheidung stehende *Schuldvertrag nicht als Singularität sondern als Vertragstypus begriffen wird*. An Stelle von Einheitslösungen, um welche man sich in der Lehre von der Geschäftsgrundlage bemüht hat und die im Ergebnis zu einer bloßen Billigkeitslösung geführt haben, geht es darum, jeweils für den konkreten Vertragstypus als *naturalia negotii* die sich für ihn gehörige Regelung der Frage zu finden, wer von den Vertragspartnern das Risiko der Wirklichkeit trägt".⁵ "Man könnte...vielleicht meinen, daß es nicht darauf ankomme oder es nur ein Formulierungsproblem sei, ob man auf die Geschäftsgrundlage oder die vertragliche Vereinbarung abstellt. Dem ist aber nicht so. Die Orientierung an der vertraglichen Vereinbarung schafft eine präzisere Abgrenzung der für die rechtliche Wertung zu beachtenden und nicht zu beachtenden Wirklichkeit und bietet allein die Gewähr, daß,...*die vertragstypische Risikoverteilung.....verwirklicht wird*".⁶

¹Flume, *supra*, 500.

²Flume, *supra*, 498.

³Flume, *supra*, 499.

⁴Flume, *supra*, 500.

⁵Flume, *supra*, 501.

⁶Flume, *supra*, 526.

Concerning common mistake, Flume emphasizes that the mistake must have become part of the contract's content. If the error is unilateral, it is irrelevant; if both parties have erred, there are two different versions of the contract and the question is which one has priority. If both versions are of the same rank, neither party can be held to the more unfavourable version (for the respective party) of the contract.¹

The cases in which performance becomes more onerous, to Flume, are a problem of the rules concerning impossibility. The relevant rules of the Code show that a party should be relieved only when the performance becomes "extraordinarily" onerous. But to determine this, Flume also has to resort to the measure of "intolerability" (*Unzumutbarkeit*).²

Concerning contracts of lease, Flume assigns the purpose of the envisaged use (*Verwendungszweck*) to the content of the contract in most cases. If so, it is part of the "*vertragsmäßiger Gebrauch*" (stipulated use) of the rented item, and thus the landlord is liable for this particular use under § 536-538 BGB. Again, if that purpose has not become part of the content of the contract, it remains irrelevant.³

Flume wants to solve almost all cases dealt with in terms of the doctrine of *Wegfall der Geschäftsgrundlage*, by means of a resort to the interpretation of the contract and the relevant rules of the Code. This approach, however, entails the danger of an overly generous interpretation of the contract and Code in cases which are not obvious, in order to reach fair results. This does not necessarily make the results more reliable, let alone obvious.⁴ Flume does not indicate the limits of interpretation in this regard, but maintains that if the circumstances in question cannot be said to form part of the contractual content, they should remain irrelevant. As a matter of principle, he rejects the consideration of any conception, motive or the objective aspect of the parties' interests falling outside the ambit of the content of the contract. He is confident that a reasonable solution can almost always be found on the basis of the contract and the Code itself.

"Almost" implies that even Flume acknowledges that his approach does not suffice for all cases covered by the doctrine of *Wegfall der Geschäftsgrundlage*. He exempts cases of "general changes of social existence" (*Änderungen der Sozialexistenz*), comprising change of currency, large-scale inflation, changes in the law, natural catastrophes and wars. These risks are never part of any

¹Flume, *supra*, 507.

²Flume, *supra*, 509.

³Flume, *supra*, 513.

⁴Roth in *Münchener Kommentar, supra*, § 242 Rz 573.

contractual or statutory allocation of risk. But these, says Flume, comprise highly exceptional cases, which should be dealt with by the legislator. Only if the legislator does not react, is judicial intervention on the basis of purely equitable arguments justified, and then only until the legislator reacts:

”Da der Vertrag keinen Anhalt für die Risikoverteilung betreffs des Geschehens der Sozialexistenz gibt und durch allgemeine Rechtsnormen die Risikoverteilung nicht geregelt werden kann, bleibt keine andere Lösung als die Billigkeitsentscheidung”.¹

Flume’s position reflects his basic attitude towards the law which is in essence determined by his strong orientation towards Savigny. Flume consciously and deliberately goes back to Savigny in his adoption of a primarily historical-systematic approach² in *Das Rechtsgeschäft* which does not deal extensively with the methodological developments until then.³ Like Savigny, Flume accepts only the four classic elements of interpretation: grammatical, logical, historical and systematic, the most important being the systematic interpretation.⁴ Flume furthermore also rejects the consideration of outward purposes (ends), because the *ratio legis*, the underlying value-judgement of the legislator, is not really part of the law itself so that it would be illegitimate to impose inferred purposes from the outside by interpretation.⁵ Teleological interpretation, the crucial element of the *Wertungsjurisprudenz*, is therefore dismissed by Flume just as it was by Savigny. The basic reason for this is, again, that Savigny believed that the jurist should not occupy himself with philosophy, with the *why* of the law, but only with the historical material of the law as it has come down to him. Flume adopts the same attitude when he speaks about the principle of private autonomy as being based on (Kant’s) ethical personalism: he does not consider in detail why it is justified to make private autonomy the centrepiece of civil law, but simply by way of justification to its positive entrenchment in the constitution and regards this as settling the matter.⁶

With Savigny, Flume does not deny the necessity of the further development of the law, but is equally cautious: such further development, like the interpretation, has to take place by means of the contemplation (*Anschauung*) of the - systematic - whole of the legal system, its organic structure.⁷

¹Flume, *supra*, 525.

²Part I § 4.

³Brox, "Fragen der rechtsgeschäftlichen Privatautonomie" in *Juristenzeitung* 1966, 762, a review on Flume’s book *Das Rechtsgeschäft* and a critique from the perspective of the *Wertungsjurisprudenz*.

⁴Flume, *supra*, 293.

⁵Brox, *supra*, 763.

⁶Flume, *supra*, 1; Brox, *supra*, 762.

⁷Flume, *supra*, 297.

This purely systematic approach to the further development of the law, which accepts the law as a given and does not enquire into the *why* of the law, restricts further development to the cautious drawing of analogies to already existing legal rules, legal institutions or the "types" of contracts entrenched in the Code, just like Savigny had done.¹ Applied to contracts this approach means that the contract and its content, as the law of the parties, is the sole basis of interpretation - motives, underlying interests or value-judgements of the parties are irrelevant. The contract has to be interpreted and evaluated in the light of the relevant rules of the Code. The value-judgements and basic principles underlying these rules are, again, irrelevant, since they are to be evaluated in a purely systematic and formal way. Systematically, the Code identifies certain types of contracts and these are thus the sole legitimate points of reference for the contracts in question. Only if these rules offer no solution at all, is there space for supplementary interpretation, which should consist preferably only of drawing analogies from existing rules dealing with similar problems.

At the basis of Flume's position concerning the doctrine of *Wegfall der Geschäftsgrundlage*, therefore, is his purely systematic understanding of the legal act (*Rechtsgeschäft*), and especially the contract, which differs fundamentally from the view that is held by the *Wertungsjurisprudenz*.² Flume observes that the decision to entrench principles of private autonomy and *pacta sunt servanda* in the Code must be respected. Exceptions are only permissible in situations mentioned in the Code.

The adherents of the *Wertungsjurisprudenz* reject this approach. They want to enquire further because the Code is not perceived as the ultimate authority. They observe that the authority of the Code is justified by its aim of compliance with the idea of the law and the realisation of justice. They enquire about the *why* of the legal rules, they want to interpret and understand the rules on the basis of their underlying reasons with reference to the ideal of justice. They investigate the *why* of private autonomy and *pacta sunt servanda*, and the role of these notions in the pursuit of justice are interpreted and analysed. The contract is accordingly perceived as a means to a certain end, which is to achieve a just balance of the parties' interests. In this respect, individuals can only exercise their will with the sanction of the law if they reach an agreement in which each takes account of the interest of the other. The parties have to be *ad idem* as regards their interests at the time of the formation of the contract and only then will the contract become binding. Parties therefore have to adjust their respective interests to those of the other. Because a contract derives its binding character from this aspect, the *Wertungsjurisprudenz* has regard to common motives and value-standards of the parties when interpreting the contract. The contract is thus entrenched in the Code as a means to order human relationships because it offers a high probability of achieving equal balances of the interests of

¹Flume, *supra*, 324.

²Brox, *supra*, 762.

individuals.¹ From the correct understanding of the rationale of principles such as private autonomy and *pacta sunt servanda*, the *Wertungsjurisprudenz* also proceeds to develop solutions on the basis of the interpretation of the contract, understood correctly as the means to an end. A complete frustration of the contractual end in an individual case, must have consequences for the contract. And the less the rules of the Code offer solutions to the problems, the more inevitably the *Wertungsjurisprudenz* has to search for solutions by referring back to the basic principles and value-judgements of the legal system.

3.2. Karl Larenz

Larenz claimed that the problem of the *clausula rebus sic stantibus* is not only restricted to exceptional, extraordinary cases but represents one of the basic problems of every legal system: how to accomplish the inevitable limitation of the principle of *pacta sunt servanda* in a justified and dogmatically sound manner in order to avoid the result of the old maxim *summum ius - summa iniuria*.² The legal order should not capitulate before the problems which the cases of *clausula* and *Wegfall der Geschäftsgrundlage* pose.³

In 1951, in the first post-war monograph on that this subject, *Geschäftsgrundlage und Vertragserfüllung*, Larenz took positions which he consistently upheld since then. In his foreword, Larenz warned of the dangers of judicial decision making based on purely equitable arguments ("*reine Billigkeitsrechtsprechung*"), and stated his aim of contributing clarification of the doctrine of *Wegfall der Geschäftsgrundlage*, and particularly the criterion of *Unzumutbarkeit* in the interests of legal certainty.⁴ He also emphasized the essentially philosophical nature of the question underlying the doctrine. This related to the implications of the dialectical relationship between private autonomy and commutative justice (*ausgleichende Gerechtigkeit*), which are lying on the same level as the relationship between legal certainty and substantive justice. The solution of the problems resulting from these questions should not be left entirely to legal intuition (*Rechtsgefühl*).⁵ In the same vein, he sought to contribute to the correct understanding of § 242 BGB, which he regarded as sometimes misunderstood by the courts as entailing a free ticket for judges to devise a solution on the basis of

¹Brox, *supra*, 762.

²*Verhandlungen zum 40. Deutschen Juristentag*, 1953, vol. II, B 32sqq.

³Larenz, *Lehrbuch des Schuldrechts*, vol. I, 14th ed.; 1987, 331.

⁴Larenz, *Geschäftsgrundlage und Vertragserfüllung*, 3rd ed. 1963, 2.

⁵Larenz, *supra*, 160.

purely equitable arguments. Judges were (and are) not quite free because § 242 BGB binds them to objective value standards which need concretisation in a methodologically sound way.¹

On this basis, Larenz distinguishes three kinds of *gesetzesübersteigende Rechtsfortbildung* (further development transcending the written law): *unabweisbares Bedürfnis des Rechtsverkehrs* (compelling need of legal intercourse), *Natur der Sache* (the nature of things) and *Rechtsfortbildung mit Rücksicht auf ein rechtsethisches Prinzip* (with regard to an ethical principle). The doctrine of *Wegfall der Geschäftsgrundlage* is a prominent example of the last form of further development of the law because it has been perceived to be an emanation of the principle of *bona fides*:²

According to Larenz, ethical principles of the law are value-standards which serve as guidelines for all kinds of legal development. They can justify legal decisions by mere power of persuasion. They must be distinguished from the merely technical principles of the law which are only based on reasons of practicability. Principles are specifications of the idea of law itself, linked to the legal conscience (*Rechtsbewußtsein*) of the general public in a given period of the historical development. These principles are not specific rules applicable to individual cases but guidelines which normally do not of themselves have a normative character, and which therefore need concretisation (*Konkretisierung*) into positive rules by legislation or jurisdiction. Some are entrenched in the constitution, some - like the principle of *bona fides* - are expressly entrenched in the Civil Code and thereby given immediate normative character, some have to be gathered from the *ratio legis*. As "objective-teleological criteria", these principles play a guiding role on all levels of legal development: interpretation, filling in gaps as well as in the further development of the law.

A *gesetzesübersteigende Rechtsfortbildung* with regard to an ethical principle occurs upon the recognition and persuasive formulation of a principle or a novel application of an already known principle. The impulse for this is usually provided by cases in which interpretation or *gesetzesimmanente Rechtsfortbildung* fail to satisfy the demands of the legal conscience. After their articulation, such principles are quickly acknowledged by the legal conscience of the time because of their inherent persuasiveness. At that stage it also becomes clear that the courts have already been led by that principle albeit without consciously recognising it as a principle in its own right. After the realization and formulation of the principle, a process of concretisation and demarcation on the basis of exemplary cases takes place until a coherent doctrine is established. The principle of *bona fides* has been especially fertile in this respect.

¹Larenz, *supra*, 167sqq.

²Larenz, *Methodenlehre*, 405, 406.

The context of the *gesetzesüberschreitende Rechtsfortbildung* is the framework of the legal system as a whole. The new principle or novel application of a principle has to conform to the immanent reasonableness and structure of the legal system as a whole, and fit into the framework of all the other basic principles and their implications. Another limit is constituted by the separation of powers between the legislature and the jurisdiction as entrenched in the constitution: all considerations which are not of a specifically legal nature and do not evolve necessarily from the law itself, especially considerations of pure practicability, must be left to the legislator. In that respect, the legislator enjoys the "primacy of concretisation" (*Konkretisierungsprimat*). Beyond this limit, the courts are only entitled to further development of the law in the case of a "real legal state of emergency" (*echter Rechtsnotstand*). This may happen when there are drastic problems in society which need to be addressed urgently in order to avoid great damage and harm to a considerable part of the population and the legislator does not react timeously.¹ The most famous example for such a situation was the revalorization jurisdiction of the Reichsgericht on the height of inflation in 1923.²

Larenz was the first to distinguish an objective basis of the transaction (*objektive Geschäftsgrundlage*) - supervening change of circumstances - and a subjective basis of the transaction (*subjektive Geschäftsgrundlage*) - common mistake and disappointed common expectation.³ He sees the objective basis as part of the rules governing impairment of the performance (*Leistungsstörungenrecht*) and the subjective basis as part of the rules governing error (*Rechtsgeschäftslehre, Irrtumslehre*). He further identified frustration of equality of exchange (commutative justice) and frustration of purpose as the typical situations in which a *Wegfall der Geschäftsgrundlage* might come into effect. With regard to the principle of equality in exchange (*Äquivalenzprinzip*) Larenz adopts a subjective approach: in general, it is up to the parties to decide what they regard as a fair exchange. But since everybody enters into a contract of exchange in the expectation of obtaining a return that he subjectively regards as an equivalent in value of what he gives, a limit has to be drawn when the counter-performance cannot in any way be seen as an equivalent judged from the perspective of the two parties ("*...nicht mehr annähernd als Gegenleistung zu sehen*").⁴

Larenz identifies as the purpose of the contract the common, and to that extent objective, purpose of both parties ("*...gemeinsam, und in diesem Sinne objektiv*"). Although Larenz acknowledges that the

¹Larenz, *Methodenlehre*, 410, 411.

²RGZ 107, 78, 87sq.

³Larenz also deals with the objective basis of the transaction in his *Lehrbuch des Schuldrechts*, vol. I, 14th ed., (1987), §21 II, 320sq.; and with the subjective basis of the transaction in his *Allgemeiner Teil des deutschen bürgerlichen Rechts*, 7th ed., (1989), § 20 III, 391sq.

⁴Larenz, *Geschäftsgrundlage*, 78sq.

parties originally have diverse or even conflicting purposes, he maintains that at the time of the formation of the contract, the purposes of the parties merge, for otherwise there would have been no consensus and no contract. This entitles one to speak of the objective purpose of the contract.¹

Larenz' distinction between an objective and subjective basis has been criticised as artificial because the borderline between the case-groups often becomes blurred. In various places, Larenz has, however, pointed out that he does not understand the two notions as mutually exclusive, and that his aim was merely to identify typical situations, which are nevertheless closely related and complementary, for the sake of clarification.²

Larenz rejects Oertmann's psychological approach based on the 19th century will-theory and picks up the thread from Locher and Krückmann, as well as Erich Kaufmann. To Larenz, the key-element is not the individual will of the parties as a psychological reality, but the result of what the parties have willed and to which they are bound: the contract itself as an independent "objective, comprehensible structure of meaning" ("*...Vertrag als ein objektives, verstehbares Sinngebilde*")³. The enforcement of the will of the parties through the law - the consequence of the principle of private autonomy - depends on the form in which that will is voiced, in most cases the contract. The will can therefore only be enforced in the form and expression which it has found in the contract and the parties are bound to that form and expression - *pacta sunt servanda*. That means that the contract is not entirely subjectively determined by the psychological will of the parties, but has to be considered detached from the parties as an objective fact which has to be interpreted objectively, not merely from the perspective of the parties, but also from that of the legal system. The legal system has its specific reasons for bestowing a binding character on contracts (as being a means to an end) and if the parties want their transactions to be binding, they have to submit to the aims of the legal system as expressed in its basic rules and principles.⁴ The contract must therefore also be interpreted in the light of the basic rules and principles of the legal system as a whole - Larenz speaks of the imperative of immanent contractual justice (*Gebot der immanenten Vertragsgerechtigkeit*), which in the case of reciprocal contracts is nothing else than commutative justice.⁵ Larenz sees the idea of commutative justice as part of the spirit of the legal order which is not stated expressly in the Code, but

¹Larenz, *Geschäftsgrundlage*, 104sq.

²Larenz, *Geschäftsgrundlage*, foreword, V,VI; *Lehrbuch des Schuldrechts*, 327.

³Larenz, *Geschäftsgrundlage*, 157.

⁴see above the section on Flume's understanding of contract and how it differs from the understanding of the *Wertungsjurisprudenz*.

⁵On commutative justice see also Larenz, *Allgemeiner Teil des deutschen Bürgerlichen Rechts*, §2 V, 45.

undoubtedly underpins many of its rules.¹ If the contract does not comply with these principles, the law has no reason to honour it:

”Indem aber die Vertragsschließenden sich wechselseitig an das von ihnen Erklärte binden und sich damit selbst eine Norm für ihr beiderseitiges Verhalten setzen, unterstellen sie diese von ihnen selbst gesetzte Norm zugleich dem höheren sittlichen Gebot der ‘immanenten Vertragsgerechtigkeit’. Das darf nicht mißverstanden werden. Unsere Meinung ist nicht, daß die Parteien rechtsgültig von vornherein nur etwas vereinbaren könnten, was nach irgendwelchen objektiven Kriterien auch ‘gerecht’ wäre. Von der Privatautonomie - in den bereits angedeuteten Schranken, die keiner bestreiten wird - soll nichts wieder abgezogen werden. Wie die Parteien ihre Angelegenheiten ordnen, das ist, in den angegebenen Grenzen, ihre eigene Sache. Aber: indem sie für diese ihre Regelung rechtliche Verbindlichkeit beanspruchen, zu ihrer Durchführung notfalls die Hilfe der Rechtsordnung in Anspruch nehmen, unterstellen sie sie damit dem Grundgedanken des Rechts, der Idee des Sozialen. Deshalb kann ein gesetzes- oder sittenwidriger Vertrag keine Rechtsgültigkeit beanspruchen. Und deshalb sind Verträge so auszulegen (und nach ihrem eigenen Sinn zu ergänzen, § 157 BGB), wie ‘Treu und Glauben’ mit Rücksicht auf die Verkehrssitte (immerhin eine objektive Norm!) es erfordern. Jedem Vertrag wohnt einfach deshalb, weil er eine rechtsverbindliche Regelung sein will, die Richtung auf ausgleichende Gerechtigkeit inne. Der Maßstab der ausgleichenden Gerechtigkeit ist dem Vertrag nicht wesensfremd - wird nicht erst durch ein nachträgliches Gebot der Rechtsordnung an ihn herangetragen -, sondern sinngemäß immanent”.²

When the contract is thus understood objectively, then its ”nature”, its purpose, its basic ideas must be considered.³ Then the contract and its content can be to a certain degree independent of the actual will of the parties in the sense that some consequences can be derived from the nature and purpose of the individual contract and not merely the ”type” of contract which the parties have not consciously thought of. This is the task of supplementary interpretation (*ergänzende Vertragsauslegung*) under § 157 BGB which supplements the content of the contract on the basis of what the nature and purpose of the contract implies in respect of the given problem. The limit of the supplementary interpretation is reached where the content of the contract itself offers no more indications for the solution of the problem or where such interpretation would run against the expressed will of the parties:

¹Larenz, *Allgemeiner Teil des deutschen Bürgerlichen Rechts*, § 2 V, 47.

²Larenz, *Geschäftsgrundlage*, 161, 162.

³Larenz, *Geschäftsgrundlage*, 159.

”Die ergänzende Vertragsauslegung reicht...so weit, als die zu ergänzende Bestimmung aus dem Zusammenhange des Rechtsgeschäfts in einer für die Parteien verständlichen Weise gemäß Treu und Glauben gefolgert werden kann und muß; sie findet ihre Grenze also nicht schon dort, wo es an dem entsprechenden Parteiwillen, sondern erst dort, wo es an einem hinreichenden Anhalt im Gesamtinhalt der Vertragserklärungen und damit an der Möglichkeit fehlt, das zu Ergänzende als (in einer jedem Vertragsteil verstehbaren Weise) *sinngemäß miterklärt* anzusehen”.¹

Supplementary interpretation is confined to the framework of the contract itself. It can only solve the problem with recourse to the content of the contract. Only if that fails, and the content does not offer a solution, is it possible - under strict conditions - to revert to the understanding of the role of contract itself in the legal system with reference to the basic rules and principles.

The essential difference between supplementary interpretation and *Wegfall der Geschäftsgrundlage* (with regard to its distinct origin in the further development of the law), has been emphasized by Larenz at various stages *vis-à-vis* the claims of its opponents that it is in reality only a question of interpretation.² Larenz points out that both legal devices have different origins and different purposes and thus yield different results. Larenz therefore cannot accept a general rejection of the doctrine:

”Ein derartig rigoroser Standpunkt wird jedoch dem Problem, um das es in der Lehre vom Wegfall der Geschäftsgrundlage geht, nicht gerecht. Dieses Problem ist nicht das der Ausfüllung von Vertragslücken, sondern das der Vermeidung der Gerechtigkeit Hohn sprechender Ergebnisse bei Aufrechterhaltung des Vertrags mit unverändertem Inhalt. Die Anwendungsbereiche mögen sich überschneiden; ersetzen kann der eine Rechtsbehelf den anderen nicht”.³

Larenz differentiates by clarifying the notion of *Lückenfüllung* (filling in of gaps). Supplementary interpretation seeks to fill in the gaps of contracts. Such gaps are also described in German legal science as a *”planwidrige Lücke”*, because the term "gap" pre-supposes an incoherent whole, which is the underlying plan of the legal transaction envisaged by the parties. A gap exists when the conclusion is that something is missing, and that the plan is incomplete in the absence of an element necessary to

¹Larenz, *Geschäftsgrundlage*, 159, 160.

²Larenz, "Ergänzende Vertragsauslegung und Rückgriff auf die Geschäftsgrundlage", *25 Jahre Karlsruher Forum*, 1983, 156sq.; similarly in his *Allgemeiner Teil des deutschen Bürgerlichen Rechts*, 7th ed., 1989, 544sqq.

³Larenz, "Ergänzende Vertragsauslegung und Rückgriff auf die Geschäftsgrundlage", *supra* 159,

make the whole plan meaningful and reasonable. Supplementary interpretation thus adds an absent element in order to make the contractual plan effective. This is a necessary requirement because supplementary interpretation is restricted to the framework of the contractual content and thus its plan. It cannot change the plan as such, but may only fill in elements which are objectively necessary to prevent a failure of the plan.

Cases of *Wegfall der Geschäftsgrundlage* are different because of the nature of the doctrine and its origin in the *gesetzesüberschreitende Rechtsfortbildung* with regard to an ethical principle. Its aim is therefore to ensure a minimum level of contractual justice and to avoid drastic injustice, but only under strict conditions (“...*Wahrung eines Mindestmaßes an Vertrags-gerechtigkeit*”).¹

Wegfall der Geschäftsgrundlage therefore deals with cases where there are no gaps in the strict sense, but where the plan as a whole is frustrated. What is required is a changed plan, and not merely the supplying of a missing aspect. This is the case when, as described above, the content of the contract - and thus the plan - offers no indication, no hint for a solution which could still be based on the content of the contract itself. Up to this point, supplementary interpretation has priority. In those cases dogmatic clarity and intellectual honesty requires recognition of the fact that no solution can be inferred from the contract itself. If the consequences of the contract violate basic principles of the law, a solution must be sought by means of another legal device which itself has to comply with the demands of a rational and critical legal science. In this respect, Larenz is more positive about the doctrine of *Wegfall der Geschäftsgrundlage* than many of his fellows. He perceives the doctrine as an indispensable *ultima ratio* to ensure the minimum of contractual justice in the individual case required if the law is to comply with its ultimate aim: the realisation of justice, which gives the legal system its authority and justification.

Larenz is therefore critical of Flume and his followers for understanding the notion of interpretation too widely and not respecting its limits. In order to avoid unjust results, this inevitably means that all elements of interpretation must in some way or other be portrayed as being part of the contractual content. This will at some point necessitate a resort to fictions at the expense of the clarity, preciseness and persuasiveness of legal dogmatics.² Larenz also criticises Flume’s understanding of contracts as always reflecting one or other “type” of contract which have to be dealt with by means of the rules of the Code pertaining to the relevant kind of contract. He stresses that the rules of the Code also contains gaps if they provide no appropriate rules for the specific problem of an individual transaction. The rules of the Code should also not be interpreted too generously merely to reach a fair

¹Larenz, *supra*, 161.

²Larenz, *Allgemeiner Teil, supra*, 396.

result: the task should rather be left to supplementary interpretation. If that fails, only the doctrine of *Wegfall der Geschäftsgrundlage* remains as *ultima ratio*.¹ Larenz summarises:

”Ergänzende Vertragsauslegung und Rückgriff auf die Geschäftsgrundlage sind verschiedene Rechtsinstrumente, die unterschiedlichen Zwecken dienen. Die ergänzende Vertragsauslegung dient der Ausfüllung einer Vertragslücke zum Zweck der Durchführung des Regelungsplans der Vertragspartner. Eine solche Lücke liegt vor, wo der Regelungsplan - wie im Fall des Praxistausches - eine zusätzliche Regel erfordert oder das von den Parteien gewählte Mittel - wie im Fall der Roggenklausel - sich als ungeeignet erweist, nicht ‘greift’. Die Lücke ist auszufüllen gemäß dem ‘hypothetischen Parteiwillen’, wie er sich aus dem Regelungsplan und dem Gesetzeszusammenhang der getroffenen Regelung ergibt. Der Rückgriff auf die Geschäftsgrundlage dient der Vermeidung krasser Ungerechtigkeiten, wie sie sich für den Fall des Festhaltens an dem unveränderten Inhalt des Vertrages dann ergeben können, wenn die Parteien beim Vertragsschluß die Wirklichkeit beide falsch beurteilt haben oder sich die für den Vertrag bedeutsamen Umstände entgegen ihrer Voraussicht grundlegend geändert haben. Er kann dann zu einer Anpassung des Vertragsinhalts an die (veränderten) Verhältnisse, zur Auflösung des Vertrags oder zu seiner Umwandlung in ein Abwicklungsverhältnis führen. Maßgebend ist, soweit ein solcher hier noch zu ermitteln ist, der hypothetische Parteiwille, sonst der Gedanke eines gerechten Interessenausgleichs. Bei der Anpassung sind die ursprünglichen Wertungen der Parteien - bei einem gegenseitigen Vertrag also die von ihnen angestrebte ‘subjektive Äquivalenz’ - beizubehalten. Die ergänzende Vertragsauslegung hat da, wo sie durchführbar ist, den Vorrang vor dem Rückgriff auf die Geschäftsgrundlage. Diese ist aber als ‘ultima ratio’ - nicht nur in den Fällen der sogenannten ‘großen Geschäftsgrundlage’ - unverzichtbar. Die ergänzende Vertragsauslegung vermag die Lehre vom Wegfall der Geschäftsgrundlage nicht zu ersetzen”.²

As Larenz points out, his view is largely confirmed by the approach of the courts. The *Bundesgerichtshof* obviously wants to restrict the understanding of a gap when it says:

¹Larenz, *supra*, 540.

²Larenz, "Ergänzende Vertragsauslegung und Rückgriff auf die Geschäftsgrundlage", *supra* 162.

”[Von einer Vertragslücke kann] nach feststehender Rechtsprechung nur gesprochen werden, wenn ein Vertrag innerhalb des tatsächlich gegebenen Rahmens oder innerhalb der wirklich gewollten Vereinbarungen der Parteien eine ersichtliche Lücke aufweist”.¹

Larenz further points to two cases which illustrate the difference between the application of supplementary interpretation and the doctrine of *Wegfall der Geschäftsgrundlage*: the *Roggenklauselfall* (rye-clause-case),² in which the court applied supplementary interpretation and excluded *Wegfall der Geschäftsgrundlage*, and another, dealing with the adjustment of interest on a heritable building right on account of inflation and the increase of costs of living,³ in which the court had applied the doctrine of *Wegfall der Geschäftsgrundlage*. The only difference between the two cases was the fact that in the rye-clause case the contract contained a stable value clause which was frustrated, whereas there was no such clause in the other case. The stable value clause showed that the parties had contemplated the problem of inflation, the problem was therefore part of their plan. In that case, supplementary interpretation must be employed because a solution can be developed the problem can be solved on the basis of the original plan.. The intention of the parties was clear, the only problem being that the envisaged measure to deal with inflation was unsuccessful. In the other case the parties did not contemplate the problem of inflation, or at least not in any discernible way, so that their plan offered no indication as to what to do in such a situation.. In this case, Larenz argues, there is no gap in the correct sense of the word and the court correctly resorted to the doctrine of *Wegfall der Geschäftsgrundlage*.⁴

Larenz is sceptical of the usefulness of the notion of *Unzumutbarkeit* which figures so decisively in the approach of the courts, because it does not shed much light on the process of weighing the parties' interests and the evaluative judgement required from the court. He instead emphasizes the necessity of defining legal requirements, such as equality of exchange and frustration of purpose, and to identify case-groups, and secondly distinguish two steps of the evaluative judgement.

The first step is to establish the purpose (*causa finalis*) of the individual contract, as well as the interests and underlying evaluative standards (*Wertungsgrundlagen*) of the parties (as far as they are conceivable from the contract). A second step is to measure the current state of the contract (after the supervening circumstances have occurred or the common mistake came to light) against the principle of commutative justice, and to evaluate whether the contract still achieves its end of establishing a

¹BGHZ 9, 278.

²BGHZ 81, 135.

³BGHZ 77, 194.

⁴Larenz, "Ergänzende Vertragsauslegung und Rückgriff auf die Geschäftsgrundlage", *supra* 157, 158.

balance of interests, seen from the point of view of the parties as reflected in their consensus at the time of the formation of the contract. This can, as a matter of course, only be denied in sufficiently grave cases.¹ The legal consequences, in turn, have - for the sake of private autonomy - to be considered in view of the same interests and evaluative standards of the parties from which the whole evaluation started.

Larenz points out that the idea of commutative justice, as a fair balance of interests in a contract requires that every party should at least be able to safeguard her most basic interests. In a manner reminiscent of Kant, it is contended that no party should be left at the mercy of the other party, no party should be subjected only to the other party's purpose without having the possibility of promoting her own purposes as well (a hint from Kant).² Larenz concedes that this is ontological, and not psychological, thinking, but maintains that even though every party pursues primarily her own purposes, they both desire to be treated fairly and should therefore both be held to that standard. The law, furthermore, only sanctions contracts because it requires and assumes that the parties think honestly and interpret the contracts accordingly.³ Larenz summarises:

"Wir kommen damit zwar auch zu dem Ergebnis, daß die Berücksichtigung des Fehlens oder Fortfalls der Geschäftsgrundlage - in den von uns beschriebenen Fallgruppen - eine Forderung ist, die sich aus dem Grundsatz von 'Treu und Glauben' ergibt. Insofern befinden wir uns in Übereinstimmung mit der heute [1963!] in Deutschland in Schrifttum und Rechtsprechung durchaus herrschenden Auffassung. Aber im Gegensatz zu der Auffassung der Rechtsprechung, jedoch in Übereinstimmung mit Schmidt-Rimpler⁴ und mit fast allen früheren Bearbeitern dieser Lehre, verstehen wir unter 'Treu und Glauben' nicht die Anweisung zu einer alles umfassenden, über das konkrete Vertragsverhältnis weit hinaus-greifenden und letzten Endes nur noch in das Ermessen des frei 'gestaltenden' Richters gestellten 'Billigkeit', sondern die Forderung der ausgleichenden Gerechtigkeit, unter der jeder Vertrag als eine von den Parteien sich selbst gesetzte Rechtsnorm steht, und die dieser Forderung entsprechende Denkweise 'redlicher' Vertragsparteien. Nur solche Umstände können daher als Geschäftsgrundlage in Betracht kommen, die gerade dieses konkrete Vertragsverhältnis betreffen, seinen Inhalt und Charakter zu ändern vermögen. Und nur solche Folgen dürfen aus dem Fehlen oder Wegfall der Geschäftsgrundlage gezogen werden, die sich aus dem Sinne dieses

¹Larenz, *Lehrbuch des Schuldrechts*, 331.

²Larenz, *Geschäftsgrundlage*, 162.

³Larenz, *Geschäftsgrundlage*, 163

⁴Schmidt-Rimpler, "Grundfragen einer Erneuerung des Vertragsrechts" in *AcP* 147 (1947),130sqq.

Vertrages ergeben oder zur Wahrung der ausgleichenden Gerechtigkeit in bezug auf diesen Vertrag unerlässlich sind. Damit verlangen wir, daß die Privatautonomie, selbst im Falle einer Abänderung des Vertrages, insoweit gewahrt wird, als den Parteien nichts aufgenötigt werden darf, was nicht dem ursprünglichen Sinne ihrer Abmachungen, insbesondere ihrer eigenen Wertungsgrundlage, entspricht und durch die 'ausgleichende Gerechtigkeit' gerade im Hinblick auf diesen Vertrag gefordert wird".¹

Larenz calls the whole process "corrective contractual interpretation" - *korrigierende Vertragsauslegung* - because it is in its nature related to interpretation. Paragraph 157 and 242 BGB have the same aim: to ensure a minimum of substantive justice in contracts. But he also stresses the crucial difference: interpretation can only supplement, the doctrine of *Wegfall der Geschäftsgrundlage* goes further than that and corrects.²

The weight of opinion in Germany, apart from the Courts, appears to have followed Larenz' position in principle.³

4. *Wegfall der Geschäftsgrundlage* and *causa finalis*

The first part of the thesis has highlighted the crucial role of purpose (*causa finalis*) for the essence and understanding of law in general and contract in particular on a philosophical basis. It is submitted that the development of the doctrines of *clausula rebus sic stantibus* and *Wegfall der Geschäftsgrundlage* reveals that they are based directly on this decisive element of contract. They are emanations and concretisations of a general principle of frustration of the contractual purpose. This connection has been emphasized by Larenz, as described in the preceding paragraph.

¹Larenz, *Geschäftsgrundlage*, 165, 166

²Larenz, *Geschäftsgrundlage*, 166.

³Among these authors are: Wieacker, "Gemeinschaftlicher Irrtum der Vertragspartner und Clausula rebus sic stantibus", in: *Festschrift für Wilburg*, 1965, pp. 229, 242 sqq.; Lehmann in: Lehmann/Hübner, *BGB Allgemeiner Teil*, § 35 A VII, 15th ed. 1966; Köhler, *Unmöglichkeit und Geschäftsgrundlage bei Zweckstörungen im Schuldverhältnis*, 1971; Fikentscher, *Die Lehre von der Geschäftsgrundlage als Frage des Vertragsrisikos*, 1971; Haarmann, *Wegfall der Geschäftsgrundlage bei Dauerrechtsverhältnissen*, 1979; Häsemeyer, "Geschäftsgrundlage und Vertragsgerechtigkeit", in: *Festschrift für Hermann Weitnauer*, 1980, pp. 67 sqq.; Chiotellis, *Rechtsfolgenbestimmung bei Geschäftsgrundlagenstörungen in Schuldverträgen*, 1981; Horn in: *Gutachten und Vorschläge zur Überarbeitung des Schuldrechts*, vol. I, 1981, p. 636; Teichmann in Soergel-Teichmann, *Bürgerliches Gesetzbuch*, 11th ed., 1986, vol. 2/1, *Schuldrecht*, I/1, § 242, Rz 432; Müller in: *Juristenzeitung* 1981, pp. 337, 338; Köbler, *Die clausula rebus sic stantibus als allgemeiner Rechtsgrundsatz*, 1991; Abas, *Rebus sic stantibus*, 1993.

Baldus had based the *clausula* on the concept of *causa finalis*, on the Aristotelian-Thomistic understanding that the essence of a thing is *inter alia* determined by its purpose, its being a means to a particular end. The *clausula* declined in the same measure as its philosophical basis lost its acceptance. But its connection with the notion of purpose was never completely lost, it even influenced the codification of the Prussian General Land Law (§§ 378, 380, I, 5, ALR). Mainstream legal science of the 19th and early 20th century neglected the role of purpose because it did not fit into their positivistic concept of legal science and because of their fixation on a psychological understanding of the will of the contracting parties. Consequently, they were compelled to resort to imputations and fictions as soon as inevitable normative value-judgements had to be taken. Yet some authors continued to emphasize the relevance of the contractual purpose (Stahl, Erich Kaufmann, Locher). This position has been expressly confirmed and reinforced by several judicial statements in the past.¹

From the basis of a sound understanding and evaluation of the philosophical and methodological implications of the problem of fundamental change of circumstances, Larenz consciously drew on Aristotelian-Thomistic legal thinking and identified the contractual purpose with commutative justice. Consequently, *Wegfall der Geschäftsgrundlage* comes into effect in cases of frustration of equality in exchange regarding either value or the fitness of the subject matter of the performance for a special purpose. Larenz also distinguished the categories of supervening change of circumstances and common mistake.²

So placed, it is submitted that the German courts, when inquiring into the existence of a common subjective basis of a transaction, are actually dealing with the question of the *causa finalis* of that transaction. The application of the *Unzumutbarkeit*-criterion, furthermore, is, it is submitted, best understood as involving the question when exactly the *causa finalis* is frustrated. Cases of *Wegfall der Geschäftsgrundlage* can therefore, it is submitted, be categorised and analyzed on the basis of the principle of frustration of the contractual purpose (*causa finalis*).³

Because of the vast number of cases decided on the basis of *Wegfall der Geschäftsgrundlage*, it is not possible to evaluate all of them within the confines of this thesis. But insofar as distinct case-groups have emerged, they are presented below with illustrative cases.

¹Mentioned in §§ 1 and 2 are the "mill-cases" of the Reichsgericht from 1889 and 1898, *Seufferts Archiv* vol. 45, 114; RGZ 42, 114; as well as BGHZ 2, 188; BGH JZ 1978, 236.

²§ 3.2.

³Part IV.

4.1. Objective (supervening) change of circumstances

4.1.1. Frustration of equality of exchange (commutative justice) regarding value

4.1.1.1. Inflation

Some degree of inflation is to be expected in respect of monetary debts and is therefore a foreseeable part of the normal economic risk which are to be borne by the party affected thereby. Exceptions were traditionally only made when the inflation reached an extent which was totally unforeseeable, and if the purpose of the transaction and the interests of the parties evidently demanded an adjustment. Initially, the *Reichsgericht* rejected any revalorization of debts pertaining to paper money. It was only after the total collapse of the *Reichsmark* at the end of 1923, when the value of the Mark was a mere one trillionth of its value in 1914, that the courts felt compelled to step in. Arguing on the basis of *Wegfall der Geschäftsgrundlage*, *clausula rebus sic stantibus* and § 242 BGB, the *Reichsgericht* obliged the owner of mortgaged property to pay the mortgagee a supplementary sum above the nominal value of the mortgage in order to alleviate the devaluation of the paper money.¹ The court stressed that because equality of exchange is of the essence of the contract and it may give rise to the defence of changed circumstances:

"In RGZ Bd. 106, S.7 ist für langfristige Grundstückskaufverträge anerkannt, daß eine infolge der Geldentwertung eingetretene erhebliche Verschiebung des Wertverhältnisses zwischen Leistung und Gegenleistung den Einwand der veränderten Umstände rechtfertigen kann, weil infolge des Sturzes der Mark die Geldleistungen wirtschaftlich nur noch einen geringen Bruchteil des Wertes darstellen ... Auch beim Darlehen besteht seinem Wesen nach die Voraussetzung einer Gleichwertigkeit zwischen Leistung und Gegenleistung."²

In 1925, the legislator adopted this solution in the *Aufwertungsgesetz* (Revalorization statute).

In a case from 1933,³ the contracting parties had fixed the purchase price in pounds sterling. When England unexpectedly abandoned the gold-standard in 1931, the disadvantaged vendor was allowed to claim an increment towards the loss attributable to the devaluation. On the evidence of the case, it was clear that the common purpose of choosing the pound as currency had been to have a fixed value standard to protect the vendor from value depreciations.⁴ This purpose was frustrated when the pound

¹RGZ 107, 86.

²At 90, 91.

³RGZ 141, 212.

⁴214.

became a free-floating currency and was devalued by 30 %. The court held that in terms of the contract, the "new" pound represented a "totally different" currency.¹ The court also confirmed once again, that equality of exchange was of the essence of the contract:

"Bei gegenseitigen Verträgen bildet mangels besonderer, dagegen sprechender Umstände das Gleichgewicht zwischen Leistung und Gegenleistung die von den Beteiligten stillschweigend angenommene Vertragsgrundlage."²

After the Second World War, a similar development was under way prior to the currency reform in 1948, but any revalorization was soon prohibited by the so-called "a mark is a mark" statutes of the allied authorities which aimed to secure the goals of the planned currency reform. Since then, the so-called nominalist principle, holding that a money-debt entails only a claim for the fixed nominal sum promised which allocates the risk of inflation to the creditor, has held sway in respect of monetary debts. In consequence, § 3 *Währungsgesetz* (currency statute) contains a far-reaching prohibition of money-guarantee-clauses.³ Because on this approach, the creditor has to bear the impacts of inflation alone, this principle has, however, increasingly come under assault. Most authors nevertheless still consider nominalism a better means of fighting inflation than the contrary principle of valorism, but advocate a greater readiness to depart from the nominalist principle in individual cases by permitting a re-evaluation of the extent of the debt have, however, in general remained committed to the nominalist principle.⁴ In the potash-mining-cases,⁵ for example, the fact that the purchasing power of the currency had decreased by one-third was considered insufficient, and *Wegfall der Geschäftsgrundlage* was accordingly founded on other circumstances. Exceptions may, however, be made if the devaluation has been so considerable that to leave the contract unaltered would amount to intolerable hardship for the affected party and if the extent of the devaluation had been unforeseeable at the time of the formation of the (usually long-term) contract.

4.1.1.2. Escalation-clauses

If contractual escalation clauses (not prohibited by § 3 *WährG*) turn out to be ineffective, the BGH treats them in a somewhat contradictory manner.⁶ In one case the BGH established the rule that an

¹215.

²216.

³Roth in *Münchener Kommentar*, *supra*, § 242 Rn 606.

⁴for references see Roth in *Münchener Kommentar*, *supra*, § 242 Rn 603.

⁵1959, 1960, 1965, see below.

⁶Roth in *Münchener Kommentar*, *supra*, § 242 Rn 604.

escalation clause indicates that the parties have foreseen the change and that the doctrine of *Wegfall der Geschäftsgrundlage* is accordingly excluded:

"Der Senat hat ... ausgeführt, eine - von den Parteien nicht vorausgesehene - Beeinträchtigung des Gleichgewichtsverhältnisses von Leistung und Gegenleistung könne eine Abweichung vom Grundsatz der Vertragstreue nur bei derart grundlegenden und einschneidenden Änderungen der maßgeblichen Umstände rechtfertigen, daß ein weiteres Festhalten am ursprünglichen Vertrag zu einem mit Recht und Gerechtigkeit schlechthin nicht mehr vereinbaren Ergebnis führen würde. Um eine von den Vertragsparteien nicht vorausgesehene Beeinträchtigung handelt es sich aber hier ... nicht"¹

In another case, the court refrained from using the doctrine of *Wegfall der Geschäftsgrundlage* but resorted to supplementary interpretation to declare that the existence of the escalation clause indicated that the parties required an adjustment of the contract should the clause turn out to be ineffective.² Both of these views have plausibility. The basis for the differentiation between them is, however, not so obvious.³ Escalation clauses might, for instance, be excessive in effect, as when the agreed index increases far more quickly than expected, and totally out of proportion to the contractual performances. In such cases, the courts have granted relief because the purpose of the clause was to protect the creditor from losses and not to give him the opportunity of additional gains.⁴ On the other hand, relief was denied when the excessive increase due to the escalation clause was justified by a purpose on which the parties had agreed and if interests which merit protection are involved.⁵ The limit of intolerability is set higher in such cases.

¹BGH in *WM* 1973, 839.

²BGHZ 81, p. 135, the "rye-clause case". In this case it was contractually agreed that a heritable building right interest was to be calculated on the basis of the price for a certain amount of rye. The purpose of protecting the interest from value fluctuations was held frustrated by the court, when the price for rye was not anymore determined by the market after the introduction of fixed prices in the European community.

³see Larenz' explanation in § 3.2.

⁴BGH *LM* (Bb) Nr. 69. The approach of the Court has been criticised as being inconsistent by Roth in *Münchener Kommentar*, *supra*, § 242, Rn 604. Larenz' explanation of the rye-clause case and the related index-clause cases does not explain why the *Bundesgerichtshof* has in the case BGH in *WM* 1973, p. 839 held that the very existence of an index-clause excludes the doctrine because of foreseeability. This approach appears to be too inflexible and apodictic. The authority of that case can probably be regarded as overruled by the rye-clause case BGHZ 81, p. 135, which adopts a more differentiated approach.

⁵BGH in *WM* 1965, 953; 1973, 384. In this case a real estate was sold against a life-long rent. Therefore, the specific purpose of maintenance came into play. Consequently, even if the index led to an increase of the rent that was out of

4.1.1.3. The potash cases

When the quota-system of the German potash combine fell away after the war due to the combine's dissolution upon the prohibition of restraints of trade, the court reduced the so-called "interim payments" of the potash mining contracts on the basis of the doctrine of *Wegfall der Geschäftsgrundlage*.¹ The amount of these payments was based on the bargaining power of the former potash combine and when the combine was dissolved, the payments appeared to be unreasonably high. The circumstances which had been the basis for the amount of the payments had fallen away and the affected party would have never entered the contract under the new circumstances.

In another of the potash cases, an increase of the haulage fee was sought because the prices for potash had risen. The court held that equality of exchange is of the essence of the contract:

"Worauf es dem Berufungsrichter bei seiner Entscheidung ankam, lassen die Ausführungen über den Sinn des Vertrages als eines Austausches von - in den Augen der Parteien - annähernd gleichwertigen Leistungen erkennen; dieser Sinn gehe verloren, wenn sich das Äquivalenzverhältnis derartig verschiebe, daß 'der eine Teil die Leistung des anderen auch nicht annähernd mehr als ein Äquivalent für seine Leistung betrachten' könne. Das ist rechtlich bedenkenfrei."²

But in accordance with its jurisdiction concerning inflation, the court stressed that an increase of the haulage fee could only be granted if the rise of prices for potash was due to an increase in its actual value and not only to inflation.³

4.1.1.4. Maintenance contracts

This constitutes the one fundamental exception to the nominalist principle and the general judicial reluctance to address the inflation phenomenon. In 1923 already, the *Reichsgericht* had made an exception for maintenance agreements in family law by ruling that the *clausula rebus sic stantibus* to

proportion to the value of the real estate, this development was considered to be still covered by the maintenance purpose, as long as the increase of the rent was in proportion with the necessities of life of the recipient.

¹BGH LM (Ba) § 242 Nr. 2.

²BGH LM (Bb) § 242 Nr. 39, 3.

³BGH LM (Bb) § 242 Nr. 39, 3.

be implicit in these contracts.¹ A long period of rejection of this approach after the war was followed in 1973 by a ruling of the Federal Labour Court (*Bundesarbeitsgericht*) that company pensions had to be adjusted when the costs of living had increased more than 40% after the formation of the contract.² The BGH adopted this approach and extended it to all contracts characterised by the purpose of maintenance,³ because of the special character and purpose of maintenance agreements, ie to secure a person's reasonable subsistence. This purpose is frustrated if the amount of the pension is devaluated to an extent that a reasonable subsistence is no longer possible, at least not in the way the parties had originally envisaged:

"Auch hier läßt sich das Ruhegehalt als ein Teil des Entgelts für die Dienste auffassen, die der Berechtigte bei Eintritt in den Ruhestand bereits geleistet ... hat. Das darin begründete, bei der Übernahme der Pensionsverpflichtung vorausgesetzte Gleichgewicht der Leistungen wird empfindlich gestört, wenn das Ruhegeld infolge der Kaufkraftminderung ... seine vorgesehene Aufgabe, die Erhaltung des bisherigen Lebensstandards ..., nicht mehr erfüllen kann ..."⁴

The legislator has, once again, reacted to this jurisdiction and has introduced the new § 16 *BetrAVG* (*Betriebs-Altersversorgungs-Gesetz*; company pension scheme statute) which requires the re-evaluation of companies' pensions on a three yearly basis.

On the other hand, maintenance payments, especially those done by way of company pensions, can be reduced on the basis of the doctrine of *Wegfall der Geschäftsgrundlage* if the economic conditions of the company have declined in a way as to threaten its very existence.⁵ The same applies to pension funds in general.⁶

4.1.1.5. Rent

Wegfall der Geschäftsgrundlage is generally denied when the costs of renting a shop retrospectively appear excessive as too high because an expected economic success was not achieved, even when this was expected by both parties:

¹RGZ 106, 235.

²BAG in *WM* 1973, 566.

³BGHZ 61, 31.

⁴36.

⁵BGH *LM* (Bb) Nr. 6; BAG in *ZIP* 1988, p. 1348.

⁶BGH *WM* 1973, 1311.

"Daß insoweit ein gemeinsamer Irrtum der Vertragschließenden vorlag, reicht angesichts der dem Vertrag innewohnenden typischen Risikoverteilung nicht zur Anwendung der Grundsätze über das Fehlen der Geschäftsgrundlage aus." ¹

The success of an undertaking is regarded as a typical example of a normal economic risk. Exceptions to the general rule are only made where the reason for the frustration of purpose falls within the sphere of the landlord as well or when he shared that purpose because of a personal interest in it.

Wegfall der Geschäftsgrundlage was accordingly held to have occurred when rented shops in a shopping mall were totally unprofitable because the landlord could not find tenants for the other shops or because he had permitted a change of the surroundings which deterred people from coming.² The landlord was held to share the risk of frustration because the attainment of the purpose was his risk as well:

"Der von jeder Partei erstrebte wirtschaftliche Erfolg ... hing von der gemeinsamen Erwartung ab, daß sich das I-Zentrum als funktionsfähig im Sinne der ursprünglichen Planung erweisen werde. Das außerhalb der unmittelbaren Einflußsphäre beider Parteien liegende Risiko der Funktionsunfähigkeit oder eines Funktionswandels dieses Zentrums ist hiernach ... von beiden Parteien zu tragen. ... Die derart zur Geschäftsgrundlage der Betreibenspflicht gemachten Erwartungen der Parteien haben sich nicht erfüllt."

When a contract for the lease of a machine imposed the duty to make repairs on one of the parties only, *Wegfall der Geschäftsgrundlage* was assumed when the machine was totally destroyed during an air raid at the end of the Second World War, so that both parties were obliged to share the costs.³ The court held that the increased danger of air raids had frustrated the equality of exchange in respect of the repair duty:

"Durch die steigende Verschärfung des Luftkrieges ist jedenfalls die Gleichwertigkeit der beiderseitigen Vertragsleistungen der Parteien, die beim Vertragsschluß vorausgesetzt wurde, grundlegend erheblich gestört worden."

¹BGH *NJW* 1970, 1313.

²OLG Celle *NJW* 1978, 2510; *OLGZ* 1990, 88 sqq.

³BGH *NJW* 1957, 826; OLG Hamburg *MDR* 1948, 116.

4.1.2. Frustration of equality of exchange regarding the fitness of the performance for a special purpose

4.1.2.1. Sale

The purchaser normally bears the risk that what he bought can be utilized to serve his purpose. There is no *Wegfall der Geschäftsgrundlage* if the purchaser cannot do so because his business has to close down,¹ because his landlord gave notice of cancellation,² if he could only resell the item at a loss because of a decrease of the market price³ or if an acquired enterprise turns out to be unprofitable.⁴

A typical case is that the purchaser of land acquired for building purposes always bears the risk that building might later on be prohibited by the authorities. This kind of sale is regarded as speculative, and speculative contracts imply that the parties assume a higher risk than usual.⁵ But a building prohibition can constitute a *Wegfall der Geschäftsgrundlage* under special circumstances, e.g. if the purchaser of a piece of prospective building land has promised to build upon the remaining real estates of the vendor as counter-performance.⁶ When building was prohibited on both the sold and the remaining land of the vendor, the purpose of the sale was frustrated.

In the case of a sale of land at a very low price because the seller expected many customers for his adjacent restaurant from the minigolf course which the purchaser wanted to build on the site, *Wegfall der Geschäftsgrundlage* was assumed when the authorities refused permission for the building project.⁷ The land had been sold for the purpose of the erection of the minigolf-course.

The outcome was similar where the purchasers of prefabricated wooden houses were, contrary to the expectations of the parties, not permitted to erect them in a protected landscape area.⁸ The houses had been sold precisely for the purpose of being erected in that particular area.

¹OLG Stuttgart *NJW* 1954, p. 233.

²BGH *NJW* 1985, 2693.

³BGH *BB* 1955, 205.

⁴BGH *MDR* 1978, 132.

⁵BGHZ 74, 370.

⁶BGHZ 47, 51.

⁷BGH *NJW* 1975, 776.

⁸BGH *WM* 1966, 475.

4.1.2.2. Rent

The tenant usually bears the risk that the rented item can be used as intended by him. *Wegfall der Geschäftsgrundlage* has therefore been denied where a party could not run a profitable enterprise on the rented piece of land¹ or if she lacked the means to build on the rented ground as planned.² Similarly, the doctrine was not applied where rooms in a hotel had been rented because of an exhibition which was later called off.³ In all these cases the detrimental circumstances fell within the sphere of the tenant and did not concern the landlord.

As has been already pointed out, exceptions to this general rule are only possible where the reason for the frustration of purpose falls within the sphere of the landlord as well and when he shared that purpose because of a personal interest in it. *Wegfall der Geschäftsgrundlage* accordingly occurred when a landing-stage at a lake was rented for the common purpose of re-renting it to boat-owners but no further boats were admitted on the lake by the authorities, thereby frustrating the possibility of re-renting the landing-places on the stage.⁴ The landlord was held to share that risk because the rent was calculated on the basis that a profitable re-renting of the individual landing-places would be possible.

4.1.2.3. Interdependent contracts

Wegfall der Geschäftsgrundlage has also been assumed in respect of two transactions closely connected through their common purpose where one of the contracts fell away for some or other reason. A special example is that of the leasing contract, where a contract of sale is *Geschäftsgrundlage* for the leasing contract itself.⁵ The hire-purchase transaction which used to constitute a further example, is now provided for by § 9 VerbrKrG (*Verbrauchercreditgesetz* - consumer credit statute).

4.2. Subjective change of circumstances (common mistake)

Common errors about present circumstances or disappointed common expectations concerning future circumstances, did not form part of the *clausula rebus sic stantibus* of the *ius commune*, but were

¹BGH NJW 1970, 1313.

²BGH NJW 1974, 1081.

³OLG Braunschweig NJW 1976, 571.

⁴BGH WM 1971, 1300.

⁵BGHZ 68, 118; BGHZ 81, 298.

included under the doctrine of *Wegfall der Geschäftsgrundlage* because of the subjective definition of the basis of the transaction.

4.2.1. Frustration of equality of exchange regarding value (commutative justice)

4.2.1.1. Valuation error

In a number of cases the parties mutually erred about the value of the subject matter of their performances. The most famous case is the "Rouble-case":¹ The recipient of a loan of 30 000 Russian Roubles obliged himself to pay back what was believed to be the equivalent value of 7500 German *Reichsmark*, but the real value was only 300 *Reichsmark*. The *Reichsgericht* employed § 119 I BGB - error about content - which was problematic since the parties did not err in speaking of Roubles and *Reichsmark*. Paragraph 119 II BGB is excluded in the cases concerning value because the value of an item is not considered to be one of its characteristics, but the result of all of its characteristics. The court also had difficulties dealing with the consequence of § 119 I BGB, the duty of compensation imposed on the avoiding party by § 122 BGB, which was clearly inappropriate in these cases. The *Bundesgerichtshof* eventually preferred to employ *Wegfall der Geschäftsgrundlage* in these cases, for example when the parties agreed to pay the "usual" fee which they mutually believed to be much higher than it actually was.² One decisive reason for this was that *Wegfall der Geschäftsgrundlage* gave the court the freedom to adjust the contract to the real value.

4.2.1.2. Calculation error

In these cases the parties make a mistake when calculating their prices or costs. The error can result from a mistake in the calculation process or because the calculation proceeded on the wrong basis. These errors must as always be distinguished from an irrelevant error in motive. The first step is to distinguish the latent calculation error (*verdeckter Kalkulationsirrtum*) - of which the other party knows nothing and which is therefore an irrelevant error in motive - and the patent calculation error (*offener Kalkulationsirrtum*) when, for instance, one party tells the other in detail how she reached her result. But even the patent calculation error will be usually irrelevant because the other party must be able to rely on the agreed price. Only if it is clear that the other party would also have consented to the other price or her refusal would amount to *venire contra factum proprium*, can the calculation error be relevant. In other words, it depends on the extent to which the other party merits protection.

¹RGZ 105, 406, the decision is from 1922.

²BGHZ 46, 273.

A calculation error is usually part of every party's own risk. Only if the other party has taken part in the calculation or is in some other way closely connected with it, may there be a *Wegfall der Geschäftsgrundlage*. The doctrine has for example been applied in the following cases:

When parties based the calculation of the rent of a pub on the amount of beer sales, the landlord is obliged to reduce the rent paid by the tenant if the basis turns out to be unrealistic.¹ The same applies if rent is calculated on the basis of a misapprehension regarding the area of the premises.² If both parties agree on the basis of the calculation, they are both obliged to bear the consequences if it turns out to be wrong.

4.2.2. Frustration of equality of exchange regarding the fitness of the performance for a special purpose

4.2.2.1. Interdependent contracts

A building owner had concluded both the contract of sale of land and the construction contract with the vendor. When the construction contract was rescinded due to the misconduct of the vendor, the court held that this constituted a *Wegfall der Geschäftsgrundlage* for the contract of sale since the two contracts had not been meant to exist independently from each other, but had been concluded in view of one another.³ The idea had been to obtain the plot and the construction of the building from the same party.

Where both contracting parties are aware of the fact that each of them undertakes their obligations for the sake of an act or forbearance of the other, *Wegfall der Geschäftsgrundlage* may be assumed when the other party does not conform to this expectation, even though that act or forbearance has not been made a part of the contract.⁴

4.2.2.2. Suretyship

Since it is the typical purpose of suretyship to protect the creditor against the financial difficulties of the debtor, this risk is allocated to the surety. Similarly, a joint and several debtor bears the risk

¹BGH *WM* 1990, 522.

²BayObLG *NJW* - *RR* 1991, 721.

³BGH *WM* 1970, 906.

⁴BGH *WM* 1971, 276.

regarding the success of his claim of recourse, and a mortgagor for the debt of another bears the risk of his recourse against the personal debtor.

But where a common expectation regarding the future course of events formed the basis of the conclusion of the suretyship, and the risk that these events did not occur was not allocated to the surety, the doctrine of *Wegfall der Geschäftsgrundlage* may apply:

"Da der Bürge schlechthin und uneingeschränkt das Risiko der Leistungsfähigkeit des Schuldners übernimmt, kann er sich in aller Regel nicht darauf berufen, er habe - dem Gläubiger erkennbar - das Risiko unrichtig beurteilt und insoweit einen anderen Geschehensverlauf erwartet. Damit wird aber nicht ausgeschlossen, daß die Parteien Umstände außerhalb des Bürgschaftsrisikos zur Geschäftsgrundlage gemacht haben."¹

Wegfall der Geschäftsgrundlage was accordingly assumed when the parties had envisaged that the debtor would be permitted to pay in instalments but the creditor subsequently did not agree to this.² In another case, both parties had relied on an attempted reorganization of the indebted company.³ In both cases, the suretyship was unanimously concluded for the purpose of securing the abovementioned measures. A suretyship cannot, on the other hand, be set aside if the expectations concern circumstances within the surety's sphere of interest only which do not concern the creditor, even if he knows about them. Such motives do not relate to the basis of the transaction with the creditor. For that reason, for example, *Wegfall der Geschäftsgrundlage* cannot be assumed on the basis of the surety's divorce or his exit from a partnership, even if the wife or the partnership benefits from the suretyship.⁴

¹BGH *LM* (Bb) § 242, Nr. 49a, 2.

²*supra*.

³BGH *WM* 1977, 752.

⁴BGH *NJW* 1986, 252; 1987, 1629.

Part III: England

1. The development of the doctrine of frustration of contract and the treatment of common mistake

1.1. The doctrine of frustration of contract

1.1.1. The evolution of the doctrine

The treatment of fundamental change of circumstances in the common law has developed on pathways somewhat different from those on the continent due to the different sources and attitudes of its contract doctrine. Nevertheless, as several studies have already pointed out,¹ there was a constant influx of legal arguments from the continent, which accounted for the fact that - all in all - there is a striking similarity as far as the argumentation in the cases and the results are concerned.

The common law of contracts developed from the law of torts (trespasses). The breach of a promise was regarded as a private wrong which was remedied through the action of *assumpsit* by granting compensatory damages.² This basic attitude that the non-fulfilment of a promise constitutes a misconduct, which can only be remedied by the payment of damages has led to the perception that a contract represents a kind of warranty: a man is absolutely bound to perform any obligation which he has undertaken, and no supervening event can excuse him from doing so. If he had not intended to perform under certain circumstances, he could have provided for such eventualities in the contract. This harsh rule as to "absolute" contracts was laid down in the classic decision of *Paradine v. Jane* in 1647.³

Paradine sued *Jane* for rent due upon a lease. *Jane* pleaded that he had been expelled and held away from his possession by an alien army which had invaded the country, whereby he could not take the profits. The Court held that this was no excuse:

"When the party by his own contract creates a duty or charge upon himself, he is bound to make it good, if he may, notwithstanding any accident by inevitable necessity, because

¹e.g. Zimmermann, "Der europäische Charakter des englischen Rechts", *ZEuP* 1993, 4sqq.; " 'Heard melodies are sweet, but those unheard are sweeter...'- *Conditio tacita*, implied condition und die Fortbildung des europäischen Vertragsrechts" in *AcP* 193 (1993), 121 sqq.

²Simpson, *A History of the Common Law of Contract* (1975) 199 sqq.

³*Aleyn* 26; 82 E.R. 897.

he might have provided against it by his contract. And therefore if the lessee covenant to repair a house, though it be burned by lightning, or thrown down by enemies, yet he ought to repair it."¹

The first exception to this rule came as early as 1691 with the decision *Brewster v. Kitchell*² for cases of supervening illegality. The second exception made was that in contracts of personal services, the death of the contractor served as an excuse because it renders performance impossible. Thus, in *Hyde v. The Dean of Windsor*³ the Court held:

"If an author undertakes to compose a work, and dies before completing it, his executors are discharged from this contract: for the undertaking is merely personal in its nature, and, by the intervention of the contractor's death, has become impossible to be performed."

But it was only in 1863, that Blackburn J cut a decisive inroad into the rule as to absolute contracts in his decision *Taylor v. Caldwell*,⁴ which established impossibility as a general excuse from performance and marked the beginning of a long line of cases which were to restrict the rule as to absolute contracts in an ever-increasing manner.

The defendant agreed with the plaintiff to let him a music-hall for the purpose of entertainment. Before the day of performance arrived, the music-hall was destroyed by fire. The plaintiff sued the defendant for damages for breach of the contract which the defendant, through no fault of his own, was unable to perform. Blackburn J first acknowledges the rule as to absolute contracts in principle, but then provides a qualification:

"But this rule is only applicable when the contract is positive and absolute, and not subject to any condition either express or implied: and there are authorities which, as we think, establish the principle that where, from the nature of the contract, it appears that the parties must from the beginning have known that it could not be fulfilled unless when the time for the fulfilment of the contract arrived some particular specified thing continued to exist, so that, when entering into the contract, they must have contemplated such continuing existence as the foundation of what was to be done; there, in the absence

¹At p. 27.

²1 Salk. 198; *Atkinson v. Ritchie* (1809) 10 East 530, 534-535.

³Cro.Eliz. 552, 553.

⁴3 Best & Smith's Reports 826.

of any express or implied warranty that the thing shall exist, the contract is not to be construed as a positive contract, but as subject to an implied condition that the parties shall be excused in case, before breach, performance becomes impossible from the perishing of the thing without default of the contractor."¹

Blackburn J then refers to the cases *Hyde v. The Dean of Windsor* and *Hall v. Wright* and says:

"The principle seems to us to be that, in contracts in which the performance depends on the continued existence of a given person or thing, a condition is implied that the impossibility of performance arising from the perishing of the person or thing shall excuse the performance."²

The argument of an implied condition, used by Blackburn J to wrestle down the rule as to absolute contracts, was of particular importance for the development of contract law both on the continent and in England.³ Pothier was the source of the civilian influence on the common law, especially through his treatises *Traité des Obligations* (1761) and *Traité de Contrat de Vente*. Both works were cited by Blackburn J in his judgement to support his position. Blackburn himself was one of several famous judges from Scotland, educated in the civil law as well, which have used civilian legal arguments to give the common law new directions.⁴

The *clausula rebus sic stantibus* of the *ius commune* was, as demonstrated above, also seen as founded on an implied condition.⁵

But even in cases of impossibility, as Blackburn J himself has pointed out, the rule as to absolute contracts continued and continues to apply, where - with regard to the nature and circumstances of the contract - the contract must be construed in a way that the contractor has assumed the risk of, and thereby warranted, the existence of a particular thing.⁶ Only impossibility resulting from a failure of a common assumption of both parties leads to discharge.⁷

¹Law Journal Reports QB vol. 32 II N.S. (1863) 166.

²Law Journal Reports, *supra*, 168.

³see Zimmerman, "Heard melodies are sweet but those unheard are sweeter....", in *AcP* 193 (1993), 139.

⁴see Zimmermann, "Der europäische Charakter des englischen Rechts" in *ZEuP* 1993 5 sqq., 37.

⁵Part II § 1.1.

⁶The classic case of an implied warranty is *The Moorcock* [1889] 14 P.D. 64.

⁷Treitel, *The Law of Contract*, 10th ed. 1999, 809.

Although the rule of *Taylor v. Caldwell* was first introduced to cover situations where the physical subject matter of the contract had perished, it was soon extended outside the sphere of literal impossibility by combining it with the rules of maritime law concerning "frustration of the common adventure". As early as 1831, 32 years before *Taylor v. Caldwell* was decided, in the case *Freeman v. Taylor*¹, the purpose of a charterparty had been held to be frustrated by a delay.² In the decision *Jackson v. Union Marine Insurance Co.Ltd.* (1874),³ the same situation and the same result was explained by means of an implied condition. The plaintiff's ship had been chartered to proceed in January to Newport and there load a cargo of iron rails to San Francisco. On the way to Newport she ran aground and was not got off until over a month had elapsed. She was taken into Liverpool and underwent lengthy repairs lasting until August. In the meantime the charterers had chartered another ship. The plaintiff claimed from the defendant insurance company for a total loss, by perils of the sea, of the freight to be earned under the charterparty. The question whether or not there had been such a loss depended on whether or not the charterers had been justified in throwing up the contract instead of waiting until the ship was repaired and then loading her. The jury found that the time necessary to get the ship off and to repair her had been so long as to put an end in a commercial sense to the speculation. Bramwell B. held that

"the voyage the parties contemplated had become impossible; that a voyage undertaken after the ship was sufficiently repaired would have been a different voyage, not, indeed, different as to the ports of loading and discharge, but different as a different adventure - a voyage for which at the time of the charter the plaintiff had not in intention engaged the ship, nor the charterers the cargo."⁴

If the charterparty were read as a charter for a definite adventure, there was necessarily an implied condition that the vessel should arrive at Newport on time. Not arriving on time put an end to the contract and both parties were discharged.⁵

The rule in *Taylor v. Caldwell* and the notion of "frustration of the adventure" were thus seen to be of the same nature.⁶ Later decisions confirmed this view:

¹10 L.J.C.P. 26, 28.

²Peter Hay, "Geschäftsgrundlage im anglo-amerikanischen Recht", in *AcP* 164 (1964), 236.

³Law Reports, 10 Court of Common Pleas 125.

⁴Law Journal Reports, vol. 44 N.S. Court of Common Pleas, 28..

⁵Beatson, *Anson's Law of Contract*, 27th ed. 1998, p. 505.

⁶Beatson, *Anson's Law of Contract*, p. 506.

"When this question arises in regard to commercial contracts, the principle is the same, and the language as to 'frustration of the adventure' merely adapts it to the class of cases in hand."¹

"The doctrine of frustration is only a special case of the discharge of contract by an impossibility of performance arising after the contract was made."²

The modern practice is to use the term "frustration" to cover cases of both classes.

After the combination of the rules of impossibility and frustration of the adventure in *Jackson v. Union Marine Insurance Co. Ltd.*, the next step was to extend the use of the notion of frustration of purpose outside the commercial context (where the rule had originally developed). This happened in the famous "coronation cases", prompted by the postponement of the coronation of King Edward VII. at the 26th and 27th of June 1902, due to his sudden illness.

The most important of these cases was *Krell v. Henry*.³ On June 17, 1902, the defendant noticed an announcement in the windows of the plaintiff's flat at 56A Pall Mall to the effect that windows to view the coronation procession were to be let. The defendant interviewed the housekeeper on the subject, when it was pointed out to him what a good view of the procession could be obtained from the premises and he agreed to take the suite for June 26 and 27, the days on which the coronation processions were to take place. The writing did not mention the procession. The procession did not take place and the defendant refused to pay. The plaintiff sued for the sum. Vaughan Williams LJ delivered judgement:

" I do not think that the principle of the civil law as introduced into the English law is limited to cases in which the event causing the impossibility of performance is the destruction or non-existence of some thing which is the subject matter of the contract or of some condition or state of things expressly specified as a condition of it. I think that you first have to ascertain, not necessarily from the terms of the contract, but, if required, from necessary inferences, drawn from surrounding circumstances recognised by both contracting parties, what is the substance of the contract, and then to ask the question whether that substantial contract needs for its foundation the assumption of the existence

¹*F.A.Tamplin Steamship Co. Ltd. v. Anglo-Mexican Petroleum Products Ltd.*(1916), 2 A.C. 397, at p. 404, per Lord Loreburn.

²*Joseph Constantine Steamship Line, Ltd. v. Imperial Smelting Corporation, Ltd.*(1942), A.C. 154, per Viscount Maugham at p. 168.

³[1903] 2 KB 740.

of a particular state of things. If it does, this will limit the operation of the general words, and in such case, if the contract becomes impossible of performance by reason of the non-existence of the state of things assumed by both contracting parties as the foundation of the contract, there will be no breach of the contract thus limited....

In my judgement the use of the rooms was let and taken for the purpose of seeing the Royal procession. It was not a demise of the rooms, or even an agreement to let and take the rooms. It is a licence to use rooms for a particular purpose and none other. And in my judgement the taking place of those processions on the days proclaimed along the proclaimed route, which passed 56A Pall Mall, was regarded by both contracting parties as the foundation of the contract;

Each case must be judged by its own circumstances. In each case one must ask oneself, first, what, having regard to all the circumstances, was the foundation of the contract? Secondly, was the performance of the contract prevented? Thirdly, was the event which prevented the performance of the contract of such a character that it cannot reasonably be said to have been in the contemplation of the parties at the date of the contract? If all these questions are answered in the affirmative (as I think they should be in this case), I think both parties are discharged from further performance of the contract."¹

Realizing the crucial importance of the requirement that the particular state of things had to be the foundation of the contract for both parties, their "common object", the Lord Justice emphasized:

"It was suggested in the course of the argument that....it would follow that if a cabman was engaged to take someone to Epsom on Derby Day at a suitable enhanced price for such a journey, say £10, both parties to the contract would be discharged in the contingency of the race of Epsom for some reason becoming impossible; but I do not think this follows, for I do not think that in the cab case the happening of the race would be the foundation of the contract. No doubt the purpose of the engager would be to go to see the Derby, and the price would be proportionately high; but the cab had no special qualifications for the purpose which led to the selection of the cab for this particular occasion. Any other cab would have done as well....Whereas in the case of the coronation, there is not merely the purpose of the hirer to see the coronation procession and the relative position of the rooms which is the basis of the contract as much for the lessor as the hirer;..."²

¹Law Journal Reports (1903) KB vol. 72 N.S., 797.

²Law Journal Reports, *supra*, 798.

This crucial point is also illustrated by another of the coronation cases, *Herne Bay Steamboat Co. v. Hutton*,¹ also decided by Vaughan Williams LJ, which is a kind of twin-brother to *Krell v. Henry*, and the two always have to be regarded in conjunction in order to be assessed properly.

It had been publicly announced that the royal naval review at Spithead would be held on June 28, 1902. The defendant wished to charter a steamboat to take paying passengers to see the review, and he entered into a contract with the plaintiffs, the owners of steamboat *Cynthia*, in these terms: "The *Cynthia* to be at Mr. Hutton's disposal...on the morning of June 28...to take out a party....for the purpose of viewing the naval review and for a day's cruise round the fleet; also on Sunday, June 29 for similar purposes...." On June 25, 1902, an official announcement cancelling the review was published. The plaintiff thereupon wired to the defendant, "What about *Cynthia*? She ready to start six tomorrow", but received no answer. The plaintiff then employed the ship on her ordinary sailings. On the two days in question, although the review was cancelled, the fleet remained anchored at Spithead. The plaintiffs sued. The defendant alleged that it was a condition of the agreement that the naval review should take place on June 28, and that the consideration for the agreement wholly failed.

Vaughan Williams LJ held, briefly:

"I see nothing that makes this contract differ from a case where, for instance, a person has engaged a brake to take himself and a party to Epsom to see the races there, but for some reason or other, such as the spread of infectious disease, the races are postponed. In such a case it could not be said that he could be relieved of his bargain. So in the present case it is sufficient to say that the happening of the naval review was not the foundation of the contract."

Romer LJ added:

"The ship (as a ship) had nothing particular to do with the review or the fleet except as a convenient carrier of passengers to see it; and other ships suitable for carrying passengers would have done equally as well."²

Vaughan Williams LJ thus saw his counter-example from *Krell v. Henry* come true in this particular case. He held that the naval review was not the common object of both parties but merely relevant to

¹[1903] 2 KB 683.

²Law Journal Reports, *supra*, 882.

the one-sided motive of the defendant.¹ For the plaintiff, as for the cabman, it was business as usual to rent his steamboat or cab and neither steamboat nor cab had, to the knowledge of the lessor, any special qualifications, which would tie them to the purpose of the lessee. The cruise around the fleet might have very well carried out, and Vaughan Williams LJ saw the danger of determining the object of an ordinary contract of letting and hiring only with reference to the subjective purposes of the lessee. Only where the particular subject matter of the contract was, to the knowledge of both parties decisively connected to its intended use by the lessee, could it be said, as was held in *Krell v. Henry*, that such use constituted the common object of both parties to the contract.

1.1.2. The juridical basis of the doctrine

By 1903, the doctrine of frustration of contract was firmly established. Its further development was marked by criticism of the fictional character of the theory of implied terms, reflecting the general crisis of the 19th century will-theory, and uncertainty as to its juridical basis. Various explanations of the nature of frustration of contract inextricably entangled two related but basically distinct questions: On the one hand, the question was as to the source of the Court's power to declare a contract frustrated (*why*), and on the other, the question as to the precise test to be employed in cases of frustration of contract (*when*).²

1.1.2.1. The implied term approach

The implied term theory exerted its influence until the Second World War. The speech of Lord Loreburn in *F.A. Tamplin Steamship Co., Ltd. v. Anglo-Mexican Petroleum Products Co., Ltd.*³ is considered to be its classic exposition:

"A Court can and ought to examine the contract and the circumstances in which it was made, not of course to vary, but only to explain it, in order to see whether or not from the nature of it the parties must have made their bargain on the footing that a particular thing or state of things would continue to exist. And if they must have done so, then a term to that effect will be implied, though it be not expressed in the contract.... Sometimes it is put that performance has become impossible and that the party concerned did not promise to perform an impossibility. Sometimes it is put that the parties contemplated a

¹Beatson, *Anson's Law of Contract*, 507; Larenz, *Geschäftsgrundlage und Vertragserfüllung*, 75.

²Atiyah, *An introduction to the Law of Contract*, 5th ed. 1995, 239. Treitel, *The Law of Contract*, 832.

³[1916] 2 A.C. 397, 403.

certain state of things which fell out otherwise. In most of the cases it is said that there was an implied condition in the contract which operated to release the parties from performing it, and in all of them I think that was at bottom the principle upon which the Court proceeded."

The implied term theory was probably never understood in a purely subjective way, that is in the sense that the Court merely gives effect to the actual intention of the parties at the time of contracting. Lord Loreburn himself said:

"From the nature of the contract it cannot be supposed that the parties as reasonable men intended it to be binding on them under such altered conditions...."¹

The criterion is therefore a more objective one: the hypothetical will of reasonable men in the situation of the parties.²

Similarly, Lord Watson had said in *Dahl v. Nelson, Donkin & Co.*:³

"The meaning of the contract must be taken to be, not what the parties did intend (for they had neither thought nor intention regarding it), but that which the parties as fair and sensible men, would presumably have agreed upon if, having such possibility in view, they had made express provision as to their several rights and liabilities in the event of its occurrence."

1.1.2.2. Disappearance of the foundation of the contract

Lord Atkin said in the decision *Russkoe Obschestvo D'lia Izgstvlenia Shariadov I'voennick Pripassov v. John Stirk & Sons, Ltd.*:¹

"There are many positive rules of law imposed upon contracting parties which govern the whole creation, performance, and dissolution of a contract which are quite independent of the intention of the parties. For my part I see no reason why, in a certain set of circumstances which the Court finds must have been contemplated by both parties as

¹[1916] 2 A.C. 397, 404.

²Treitel, *supra* 859; Beatson, *Anson's, supra*, 515.

³[1881] 6 App.Cas.38, 59.

being of the essence of the contract and the continuance of which must have been deemed to have been essential to the performance of the contract, the Court should not say that when that set of circumstances ceases to exist, the contract ceases to operate."

In *Tatem Ltd. v. Gamboa*,² Goddard J. based his decision on this argument:

"If the foundation of the contract goes, either by the destruction of the subject matter or by reason of such long interruption or delay that the performance is really in effect that of a different contract, and the parties have not provided what in that event is to happen, the performance of the contract is to be regarded as frustrated."

This shifting of emphasis in the argumentation was the first move towards a more openly objective approach, away from the fictional character of the implied terms under the influence of the will-theory. The metaphor of "foundation" was, however, too vague to be very helpful in determining when exactly the foundation fell away.³ It remained more or less only an illustrative, objective epithet for the implied term theory without any difference in substance, and was regularly employed alongside the implied term - as Lord Loreburn had done in the *Tamplin*-case.⁴ The notion of foundation was also employed in the cases of common mistake.⁵

1.1.2.3. The just and reasonable solution

The counter-reaction against the will-theory and its subjectivism occasionally assumed much more fundamental tones in attempts to describe the role of the Courts in respect of frustrated contracts objectively.

Lord Sumner, in *Hirji Mulji v. Cheong Yue Steamship Co.Ltd.*,⁶ for instance, described the doctrine of frustration as

¹[1922] 10 Ll. L.R. 214, 217.

²[1939] 1 K.B. 132, 139.

³Treitel, *supra*, 860.

⁴[1916] 2 A.C. 132, 404.

⁵*Bank Line, Ltd. v. Capel & Co.* [1919] A.C. 435, *per* Lord Haldane at p. 445; *Bell v. Lever Bros.* [1932] A.C. 161, *per* Lord Atkin at p. 226. Contrast *Joseph Constantine Steamship Line, Ltd. v. Imperial Smelting Corporation, Ltd.* [1942] A.C. 154, *per* Lord Wright 186; *Bell v. Lever Bros.* (*supra*), *per* Lord Thankerton 237.

⁶[1926] A.C. 497 510.

"a device by which the rule as to absolute contracts are reconciled with a special exception which justice demands."

Lord Wright took up this argument when he said:

"The truth is that the Court or jury as a judge of fact decides the question in accordance with what seems to be just and reasonable in its eyes."¹

In *British Movietonews, Ltd. v. London and District Cinemas, Ltd.*,² Lord Denning, referring to Lord Wright's statements, re-asserted that the doctrine of frustration was based on a judicial power to qualify the literal words of the contract when justice so required. The Court should not always slavishly follow the literal meaning of the words in a contract, but must construe them in the commercial context of the contract:

"Even if the contract is absolute in its terms, nevertheless if it is not absolute in intent, it will not be held absolute in effect. The day is done when we can excuse an unforeseen injustice by saying to the sufferer 'It is your own folly. You ought not to have passed that form of words. You ought to have put in a clause to protect yourself.' We no longer credit a party with the foresight of a prophet or his lawyer with the draftsmanship of a Chalmers. We realize that they have their limitations and make allowances accordingly."

This decision was, however, reversed in the House of Lords, with the Court insisting on the literal construction of the contract by reiterating the statement of Lord Loreburn that no Court has an absolving power.³

Today, it is hard to conceive why so much objection was taken to it and the suspicion remains that personal animosities explain the extreme tone of disapproval adopted by the House of Lords. The assertions of the law lords about the nature of the judicial role in construction and frustration cases appear today "outdated, and frankly absurd".⁴ It was probably the mere boldness of Lord Denning's formulation which sparked an instinctive resistance. That his assertions were not meant to be understood that the courts can do what they think just whenever a change of circumstances causes hardship to one party, and that the strict rules determining the scope of the doctrine were not to be

¹*Legal Essays and Adresses*, 259; see also *Denny, Mott & Dickson Ltd. v. Fraser & Co.Ltd.*, [1944] A.C. 265, 274-6; *Joseph Constantine Steamship Line Ltd. v. Imperial Smelting Corporation Ltd.*, [1942] A.C. 154.

²[1951] 1. K.B. 190, 202.

³[1952] A.C. 166, 148.

⁴Atiyah, "Contract and Tort", in *Lord Denning: The Judge and the Law*, 1984, p. 50.

superseded,¹ was demonstrated by Lord Denning's decision in *Davis Contractors Ltd. v. Fareham Urban District Council*,² which was upheld by the House of Lords and in which he denied frustration.³

1.1.2.5. Failure of consideration

Failure of consideration is sometimes used to explain why both parties are excused from performance although only the performance of one party has become impossible. This normally has no effect on the obligation of the other party unless one asserts that he is discharged for failure of consideration because he cannot receive the performance he had bargained for. This explanation is commonly given in the United States.⁴ It is not surprising that this argument would at least sometimes be raised, since the doctrine of consideration has developed from the *causa*-doctrine of the *ius commune*, which had also influenced the doctrine of the *clausula rebus sic stantibus*.⁵ But in England such cases are commonly explained in terms of frustration of the "common object" of the parties.⁶ Moreover, since the current rules of consideration require the failure to be total, it cannot work for all cases of frustration, since the doctrine also comprises cases of partial destruction and partial performance.⁷ This argument has for that reason been rejected in the House of Lords.⁸

1.1.2.4. Radical change in the obligation

In *Davis Contractors Ltd. v. Fareham Urban District Council*⁹ Lord Radcliffe re-asserted the juridical basis of the doctrine and formulated the test of frustration which has been acknowledged as authoritative ever since.

Lord Radcliffe dismissed the implied-term theory and followed Lord Wright and Lord Denning's view that frustration depends on the operation of a rule of law, rather than the intention of the parties:

¹Treitel, *supra*, 859.

²[1955] 1 Q.B. 302 (C.A.).

³[1956] A.C. 696 (H.L.).

⁴e.g. *Earn Line Steamship Co. v. Sutherland Steamship Co.Ltd.*, 254 F. 126, 131 (1918); Corbin, *Contracts*, §§ 1320, 1322; Restatement 2d, *Contracts*, Introductory Note to Chap. 11, p. 310.

⁵see Zimmermann, *The Law of Obligations*, 554 sqq.

⁶*Hirji Mulji v. Cheong Yue SS.Co.Ltd.* [1926] A.C. 497, 510.

⁷Treitel, p. 861.

⁸*National Carriers Ltd. v. Panalpina (Northern) Ltd.* [1981] A.C. 675, 687, 702.

⁹[1956] A.C. 696.

"Lord Loreburn ascribes the dissolution to an implied term of the contract that was actually made. This approach is in line with the tendency of English courts to refer all the consequences of a contract to the will of those who made it. But there is something of a logical difficulty in seeing how the parties could even impliedly have provided for something which *ex hypothesi* they neither expected nor foresaw; and the ascription of frustration to an implied term of the contract has been criticised as obscuring the true action of the court which consists in applying an objective rule of the law of contract to the contractual obligations that the parties have imposed upon themselves."¹

But Lord Radcliffe went on to define a little more precisely when and how this rule of law would operate:

"By this time it might seem that the parties themselves have become so far disembodied spirits that their actual persons should be allowed to rest in peace. In their place there rises the figure of the fair and reasonable man. And the spokesman of the fair and reasonable man, who represents after all no more than the anthropomorphic conception of justice, is and must be the court itself. So perhaps it would be simpler to say at the outset that frustration occurs whenever the law recognises that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract. *Non haec in foedera veni*. It was not this that I promised to do.....It is for that reason that special importance is necessarily attached to the occurrence of any unexpected event that, as it were, changes the face of things. But, even so, it is not hardship or inconvenience or material loss itself which calls the principle of frustration into play. There must be as well such a change in the significance of the obligation that the thing undertaken would, if performed, be a different thing from that contracted for."

Lord Radcliffe thus placed the main requirement of the old "frustration of the adventure" doctrine of maritime commercial law into the centre of the new doctrine of frustration, as it had already been done in *Jackson v. Union Marine Insurance Co.Ltd.*

¹*supra*, 728.

This approach was continually approved and re-affirmed in cases such as *Tsakiroglu & Co.Ltd. v. Noble Thorl GmbH*,¹ *Ocean Tramp Tanker Corporation v. V.O. Sovfracht (The Eugenia)*,² *Palmco Shipping Inc. v. Continental Ore Cpn.*³ and *National Carriers Ltd. v. Panalpina (Northern) Ltd.*⁴ In the *Eugenia*-case, Lord Denning said:

"To see if the doctrine applies, you have first to construe the contract and see whether the parties have themselves provided for the situation that has arisen. If they have provided for it, the contract must govern. There is no frustration. If they have not provided for it, then you have to compare the new situation with the situation for which they did provide. Then you must see how different it is. The fact that it has become more onerous or more expensive for one party than he thought is not sufficient to bring about a frustration. It must be positively unjust to hold the parties bound. It is often difficult to draw the line. But it must be done."⁵

1.1.2.6. Construction

Since all approaches emphasize the crucial importance of the true construction of the contract, Treitel appears to reduce the whole doctrine of frustration to a simple matter of interpretation: "It seems that this is the most satisfactory explanation of the doctrine of frustration."⁶

1.2. The treatment of common mistake

1.2.1. Common mistake and doctrine of frustration

The close analogy between cases of common mistake and cases of frustration of contract has certainly not gone unnoticed. It was already apparent at the time of the birth of the full-grown doctrine of frustration in the coronation cases. In the case *Griffith v. Brymer*⁷ the facts were the same as in *Krell v. Henry*, the only difference being that the announcement of the postponement had already been made at the time of contracting without the parties being aware thereof. The contract was held void

¹[1961] 2 W.L.R. 633.

²[1964] 2 Q.B. 226.

³[1970] 2 Lloyd's Rep. 21.

⁴[1981] A.C. 675.

⁵[1964] 1 All E. R. 166.

⁶Treitel, *supra* 860.

⁷[1903] 19 T.L.R. 434; see also *Clark v. Lindsay* [1903] 19 T.L.R. 202.

for mistake. In some cases it is difficult to determine whether the event is more properly classified as a pre-existing fact or as a subsequent event. In many borderline instances the result will be the same irrespective whether the case is treated as one of common mistake or of frustration. Even where the distinction is clear, cases of common mistake are often decided with the same or similar arguments and criteria as in those of frustration. The same test of the radical difference of the subject matter of the contract has been employed in both kinds of categories.¹ Furthermore, both legal categories were originally dealt with by way of implied conditions: the condition precedent in the instance of common mistake - which rendered the contract void *ab initio* - and the condition subsequent in the instance of frustration - which discharged the contract *ex nunc*.² This has led Atiyah to treat both these situations side by side in one category in his *Introduction of the Law of Contract*. He distinguishes two main classes: cases of impossibility and those where performance is not exactly impossible but where the enforcement would nevertheless be excessively hard on one of the parties. In both situations the reasons for the impossibility or the excessive hardship can be either the ignorance of pre-existing facts or subsequent events. The former is dealt with by common mistake and the latter by frustration.³

However, important differences have to be acknowledged. The crucial difference concerns the legal consequences: in the case of a mistake, the contract is void *ab initio*; in the case of frustration, the contract is discharged *ex nunc*. The effects of the two differ considerably at Common Law. Because of its drastic proceeding consequences, courts are even more reluctant to hold contracts void on the basis of a common mistake than on the basis of frustration. Apart from the fact that the Law Reform (Frustrated Contracts) Act 1943 applies only to discharge by supervening events, there are also differences concerning the risk-allocation in these two areas of the law: Because parties can usually be expected to be aware of existing risks when they contract, and future events are less easily anticipated, risks arising from pre-existing facts are more easily allocated to the parties than are the risks of frustrating events.⁴

1.2.2. The evolution of common mistake

The English doctrine of mistake constituted a late importation into the common law. It was closely related to the consensus doctrine of contract, received via Domat, Pothier, Chitty, Colebrooke and the

¹*Bell v. Lever Brothers Ltd.* [1932] A.C. 161, per Lord Atkin; *Associated Japanese Bank Ltd. v. Credit du Nord SA* [1988] 3 All E.R. 902, per Steyn J.

²Zimmermann, "Heard melodies are sweet but those unheard are sweeter...", *supra* 149-152.

³Atiyah, *supra* 219.

⁴Treitel, *supra* 862; H.G. Beale in *Chitty on Contracts*, General Principles, 27th ed. 1994, 5-019.

other treatise-writers from the civil law.¹ It has never fitted in very happily in the common law, and has been overlaid by estoppel ideas and the "objective test" approach. It is often complex and confusing, and the different types of mistake are perceived to have little or nothing in common.² The matter is further complicated by the fact that mistake can be treated differently at law and in equity, where its scope is wider, but the effect less drastic. Traditionally, the common law dealt with mistake by way of an implied condition, just as in the case of the doctrine of frustration: the agreement was taken to have included a condition to the effect that a certain state of affairs existed (ie a supposed condition precedent in lieu of the condition subsequent resorted to in the case of frustration). If the assumption proved to be unfounded, the contract was abortive, not because the parties had failed to reach consensus, but because of their tacit agreement to that effect.³ These two approaches led to uncertainty about the juridical nature of mistake at a later stage.⁴

1.2.3. The juridical nature of common mistake

The classic case of *Couturier v. Hastie*⁵, dealing with initial impossibility, and more particularly mistake as to the existence of the subject matter of the contract, adopted the implied term approach, although the decision does not mention either the term "implied condition" or "mistake", but portrayed the problem simply as one of construction. The wording was immediately understood in the sense of an implied condition.⁶

In the leading case concerning common mistake, *Bell v. Lever Brothers Ltd.*,⁷ Lord Atkin dealt with the matter on both grounds - mistake as vitiating consent and an implied condition - and came to the conclusion, that, because the case entailed a mistake as to quality or substance, the test was similar to that in cases of frustration:

"This brings the discussion to the alternative mode of expressing the result of a mutual mistake. It is said that in such a case as the present there is to be implied a stipulation in

¹Zimmermann, *The Law of Obligations*, p. 620; "Heard melodies are sweet but those unheard are sweeter..", 131sq.

²Atiyah, *supra* 219.

³Simpson, "Innovation in Nineteenth Century Contract Law", (1975) 91 *Law Quarterly Review*, 268sq.

⁴*Bell v. Lever Bros.* [1932] A.C. 161; *Associated Japanese Bank Ltd. v. Credit du Nord Sa* [1988] 3 All E.R. 902, where both approaches were employed side by side.

⁵[1856] 5 H.L.C. 673.

⁶Zimmermann, "Heard melodies are sweet but those unheard are sweeter...", 149, with references, e.g. Pollock, *Principles of Contract*, 9th ed. 1921, 327sq.

⁷[1932] A.C. 161.

the contract that a condition of its efficacy is that the facts should be as understood by both parties... Nothing is more dangerous than to allow oneself liberty to construct for the parties contracts which they have not in terms made, by importing implications which would appear to make the contract more businesslike or more just. The implications to be made are to be no more than are 'necessary' for giving business efficacy to the transaction, and it appears to me that, both as to existing facts and future facts, a condition would not be implied unless the new state of facts makes the contract something different in kind from the contract in the original state of facts. Thus, in *Krell v. Henry*, Vaughan Williams LJ finds that the subject of the contract was 'rooms to view the procession': the postponement, therefore, made the rooms not rooms to view the procession... We therefore get a common standard for mutual mistake, and implied conditions whether as to existing or as to future facts. Does the state of the new facts destroy the identity of the subject matter as it was in the original state of facts? To apply the principle to the infinite combinations of facts that arise in actual experience will continue to be difficult, but if this case results in establishing order into what has been a somewhat confused and difficult branch of the law it will have served a useful purpose."¹

Contrary to what might have been expected, Lord Atkin's statements didn't bring greater clarity into the English doctrine of mistake, although, perhaps justifiably, it seems to have contributed to the disintegration of the doctrine. The decision has been interpreted in various ways:

Firstly, it has been said that Bell's case established that there is no general doctrine of English law that a fundamental common mistake makes a contract void.² Yet it was assumed by each of their Lordships that mistakes of some kind will avoid a transaction.

A second view is that a contract will only be void for common mistake if a term can be implied that, unless the facts are or are not of a particular nature, or unless an event has or has not happened, the contract is not to take effect.³

Finally, the opinion has been put forward that the case lays down the rule that "a contract will be void only if there is nothing to contract about,...and the ground of such a nullity is not the mistake but the absence of a *res*."⁴ But this appears to be too narrow a view.

¹[1931] All E. R. 31, 32.

²Slade (1954), 70 *Law Quarterly Review* 385; Shatwell (1955) 33 *Canadian Bar Review* 164.

³Slade (1954), 70 *Law Quarterly Review* 385; Atiyah (1957), 73 *Law Quarterly Review* 340.

⁴Cheshire&Fifoot, *Law of Contract* (11th ed. 1986), 225.

Lord Denning, in *Solle v. Butcher*,¹ sought to ensure substantive justice in the cases of mistake with a resort to equity:

"A contract is also liable in equity to be set aside if the parties were under a common misapprehension either as to facts or as to their relative and respective rights, provided that the misapprehension was fundamental and that the party seeking to set it aside was not himself at fault."²

Lord Denning presumably saw the applicable test as to whether a mistake was sufficiently fundamental as too narrow, and found the common-law allocation of risks excessively hard in certain cases.³ His view gained the support of the High Court of Australia,⁴ but otherwise the profession as a whole seems to remain unconvinced of the existence of this equitable power to set contract aside for mistake. It was a bold suggestion nevertheless, since the House of Lords does not usually overlook the difference between common law and equity. Yet there is not a great deal of difference between dealing with these mistake cases by means of implied conditions or as questions of construction, and dealing with them on equitable grounds.⁵

In *Associated Japanese Bank Ltd. v. Credit du Nord SA*,⁶ Steyn J reaffirmed Lord Atkin's position that a mistake might render a contract void provided it rendered the subject matter essentially and radically different from what the parties believed it to be. Just like Lord Atkin had done, he first established that there was an implied condition precedent in the contract, and then went on discussing whether the contract was void for mistake, treating this as a different ground, by simply citing Lord Atkin.

As in cases of frustration, it has been repeatedly emphasized that the main problem is the allocation of risks.⁷ The necessary test for the allocation of risk, as laid down by their Lordships Atkin and Radcliffe, appears to be the essential change - or difference - of the original obligation, from that which is sought to be enforced.

¹[1950] 1 K.B. 671; [1949] 2 All E.R. 1107; further in *Leaf v. International Galleries* [1950] 2 K.B. 86 and *Magee v. Pennine Insurance* [1969] 2 Q.B. 507, [1969] 2 All E.R. 891.

²[1949] 2 All E.R. 1120.

³Atiyah, *supra* 244.

⁴*Taylor v. Johnson* [1983] 45 A.L.R. 265.

⁵Atiyah, "Contract and Tort", in: *Lord Denning: The Judge and the Law*, 49.

⁶[1989] 1 W.L.R. 255, 266-267, 268; [1988] 3 All E.R. 902.

⁷H.G. Beale, *Chitty on Contracts*, 5-008; Atiyah, *supra* 229, 241, 242; Beatson, *Anson's Law of Contracts*, 298.

The adoption of the frustration test makes the scope of operative common mistake rather narrow as compared to the position on the continent, and especially in Germany. The test is narrowed even more by certain policy considerations: because they could have been discovered beforehand, risks regarding pre-existing facts are more readily allocated to parties than those pertaining to subsequent events. Courts furthermore dislike holding apparent contracts to be inoperative *ab initio*, which is the only possible consequence of an operative mistake. This must be regarded as one of the main reasons for the very narrow scope of operative mistake in English law.

2. The approach of the Courts

2.1. First prerequisite: the change is not covered by the provisions of the contract

Lord Simon stated the general rule in *Joseph Constantine SS. Line Ltd. v. Imperial Smelting Corp. Ltd.*:¹

"There can be no discharge by supervening impossibility if the express terms of the contract bind the parties to performance, notwithstanding that the supervening event may occur."

A provision that excludes frustration may also be implied: for example, where the nature of the contract makes it clear that the parties intended the risk of supervening events to lie where it falls. In *Larrinaga & Co. v. Société Franco-Américaine des Phosphates de Médulla*² a contract was made in 1913 for the carriage of six cargoes of phosphates between March 1918 and November 1920. After the end of the First World War, the carriers argued that the contract was frustrated because of the altered shipping conditions then prevailing. The argument was rejected by the House of Lords. A contract of this kind, not to be performed for many years, was essentially speculative, since each party had consciously taken the risk that conditions might alter. The speculative character of an agreement also excludes *Wegfall der Geschäftsgrundlage* in Germany. An implied agreement to exclude frustration may also be based on other characteristics of a transaction. In *The Maira (No.2)* agents had undertaken to manage a ship which was subsequently lost. It was held that this did not frustrate the management contract since the purpose of the contract was also to attend to such matters as the repatriation of the crew and the settlement of claims arising out of the loss.

¹[1942] A.C. 154, 163.

²(1923) 92 L.J.K.B. 455.

The general rule that frustration can be excluded by provision for the supervening event is not seriously disputed, but the rule is subject to a number of qualifications.

A clause may be literally wide enough to cover the event, but be held on its true construction not to have this effect. In *Metropolitan Water Board v. Dick, Kerr & Co.*¹ contractors agreed in July 1914 to construct a reservoir in six years. In the event of delays "however occasioned," they were to be given an extension of time. In February 1916, the contractors were required by a Government Order to stop work, and to sell their plant. It was held that the contract was frustrated although the events which had happened were literally within the delay clause. The purpose of that clause was meant to apply to temporary difficulties, such as labour shortages, bad weather, or failure of supplies. Not covered by the purpose of the clause is the case in which the interruption is of such a character and duration that it vitally and fundamentally changes the conditions of the contract.² *A fortiori*, an express provision in a contract for some events which might otherwise frustrate it does not exclude the possibility of frustration by other events.³

A clause may make some provision for the event which happens, but fail to make complete provision for it. In *Bank Line Ltd. v. Arthur Capel & Co.*⁴ the charterer argued that frustration was excluded by two clauses giving him, but not the owner, the option to cancel when the ship was requisitioned by the Government or if she was not delivered by a certain date. But the House of Lords held that the charterparty was frustrated. The cancellation clauses entitled the charterer to cancel even if the contract was not frustrated. He could escape liability in that event, but this did not justify the conclusion that the ship owner should remain liable if requisition or delay did amount to frustration.

A contract may provide for discharge on the occurrence of specified events. The question when and how such a "contractual frustration clause"⁵ operates, depends only on its construction and not on the rules of frustration developed by the general law.

This is reminiscent of the *Bundesgerichtshof's* treatment of an escalation-clause in the rye-clause case (*Roggenklauselfall*), where the court held that the existence of the clause indicated that the parties envisaged an adjustment of the contract even if the clause turned out to be ineffective or insufficient due to a change of circumstances.⁶ The BGH saw this as a matter of supplementary interpretation,

¹[1918] A.C. 119.

² 126.

³*Intertradex S.A. v. Lesier-Tortaux S.A.R.L.* [1978] 2 Lloyd's Rep. 509, 515.

⁴[1919] A.C. 435.

⁵*Bremer Handelsgesellschaft mbH v. Vanden Avenne-Izegem P.V.B.A.* [1978] 2 Lloyd's Rep. 109, 112.

⁶BGHZ 81, p. 135.

thus excluding the doctrine of *Wegfall der Geschäftsgrundlage*. In another case the existence of an escalation-clause was held to exclude *Wegfall der Geschäftsgrundlage* because it indicated that the change had been foreseeable.¹ The doctrine was employed both in cases where there was no index-clause at all, or where the index-clause turned out to be excessive: the courts granted relief because they saw this as an instance of frustration of purpose - the purpose of the clause was to protect a party from losses and not to give him the opportunity of additional gains. The approach of the courts has been criticised as being inconsistent,² but it seems clear that also individual clauses of a contract, not only the whole contract as such, can be frustrated on their own (independently from the contract as a whole).

In the case of common mistake, the contract will not be held void if it is interpreted to contain an implied warranty. In the *Associated Japanese Bank* case³ the actual decision was based on the ground that the guarantee contained an implied condition (condition precedent) in favour of the guarantor that the machinery was in existence, and as the machinery did not in fact exist, the guarantor was not liable.⁴ In *Mc Rae v. Commonwealth Disposals Commission*⁵ the defendants sold to the plaintiffs the wreck of an oil tanker, said to be lying on the Jourmand Reef, and to contain oil. The plaintiffs sent out an expedition to salvage the tanker but found that there was not, and never had been any such tanker. The High Court of Australia held that the defendants had impliedly guaranteed that there was a tanker there; and that, being in breach of this guarantee, they were liable in damages.

¹BGH *WM* 1973, p. 839.

²Roth in *Münchener Kommentar, supra*, § 242, Rn 604; but see the explanation given by Larenz in Part II § 3.2. Yet this explanation does not explain why the BGH has in the case BGH *WM* 1973 839 held that the very existence of an escalation-clause excludes the doctrine because of foreseeability. This approach appears to be too inflexible and apodictic. The authority of that case can probably be regarded as overruled by the rye-clause case *BGHZ* 81, p. 135, which adopts a more differentiated approach.

³[1989] 1 W.L.R. 255.

⁴Steyn J. rejected the claim against the guarantor on both grounds: on construction (condition precedent) and alternatively on mistake. This case shows that mistake and construction are not mutually exclusive processes. Construction only displaces mistake (as a ground of invalidity) where it is clear from the words of the contract or from the surrounding circumstances that one party or the other promised to undertake responsibility in any event.

⁵(1951) 84 C.L.R. 377.

2.2. Second prerequisite: common object

As under German law, frustration will only come into effect if it concerns the "common object"¹ of both parties. The change of circumstances remains irrelevant if it concerns only the sphere of one of the parties. It must concern an object which is crucial for both parties or must at least from the nature and the circumstances of the transaction be held to be crucial to both parties.

Supervening impossibility normally affects only one party's performance and this fact was at one time thought to support the view that, *e.g.* a time charter, could not be frustrated by the unavailability of the ship. But the argument was rejected on the ground that even the owner's object "is not only to get hire but to afford services".² The "common object" in such cases is the exchange of services or facilities to be provided by one party for the payment to be made by the other. The court thus refers to the contractual purpose of equality in exchange. The same reasoning applies to cases of frustration of purpose (quasi-impossibility). In *Krell v. Henry* the common object of the parties was the provision of facilities for seeing the coronation procession. Thus both parties are discharged even though the supervening event only affects the performance of one.

2.3. Third prerequisite: radical change of the obligation

This criterion had first been formulated by Lord Radcliffe in *Davis Contractors Ltd. v. Fareham Urban District Council*³ and re-stated by Lord Simon of Glaisdale in *National Carriers Ltd. v. Panalpina (Northern) Ltd.*:

"Frustration of a contract takes place when there supervenes an event (without default of either party and for which the contract makes no sufficient provision) which so significantly changes the nature (not merely the expense or onerosity) of the outstanding contractual rights and/or obligations from what the parties could reasonably have contemplated at the time of its execution that it would be unjust to hold them to the literal sense of its stipulations in the new circumstances; in such case the law declares both parties to be discharged from further performance."⁴

Lord Denning emphasized the relationship to interpretation in the *Eugenia*-case:

¹*Hirji Mulji v. Cheong Yue SS.Co.Ltd.* [1926] A.C. 497, 507.

²*Bank Line Ltd. v. Arthur Capel & Co.* [1991] A.C. 435, 453.

³[1956] A.C. 696.

⁴[1981] A.C. 675.

"To see if the doctrine applies, you have first to construe the contract and see whether the parties have themselves provided for the situation that has arisen. If they have provided for it, the contract must govern. There is no frustration. If they have not provided for it, then you have to compare the new situation with the situation for which they did provide. Then you must see how different it is. The fact that it has become more onerous or more expensive for one party than he thought is not sufficient to bring about a frustration. It must be positively unjust to hold the parties bound. It is often difficult to draw the line. But it must be done."¹

2.4. Limitations

The doctrine of frustration of contract knows the same general limitations as the doctrine of *Wegfall der Geschäftsgrundlage*:

2.4.1. Speculative transactions

The essentially speculative character of a transaction is usually established by interpretation and has therefore already been mentioned above when dealing with the case *Larrinaga & Co. v. Société Franco-Américaine des Phosphates de Médulla*.²

2.4.2. Self-induced frustration

A party cannot rely on frustration due to his own conduct or to the conduct of those for whom he is responsible. This conduct may consist of a breach of contract³ (by either party or by both⁴) or any

¹[1964] 1 All E.R. 166.

²(1923) 92 L.J.K.B. 455.

³For example a charterer consciously orders a ship into a war-zone where she is detained; see *The Eugenia* [1964] 2 Q.B. 226; *The Lucille* [1984] 1 Lloyd's Rep. 244; *Mertens v. Home Freeholds Co.* [1921] 2 K.B. 526.

⁴e.g. where both breaches contribute to an allegedly frustrating delay: *The Hannah Blumenthal* [1983] 1 A.C. 854.

deliberate act or forbearance¹ that leads to frustration, even though the act is not itself a breach of contract.² But the other party may be able to rely on it for the purpose of discharging the contract.³ It is not authoritatively decided whether negligence generally excludes frustration. It probably will since it would be unjust to let the other party bear the loss caused by negligent conduct.⁴ "Negligence" in this context is not restricted to "breach of an actionable legal duty", it includes

"an event which the party relying on it had means and opportunity to prevent but nevertheless caused or permitted to come about."⁵

2.4.3. Foreseeability

When the risk of a supervening event interfering with performance was foreseeable for the parties, they are usually taken to have contracted with reference to that risk. Having thus allocated the risk, the contract should not be held frustrated if the event indeed occurs.⁶ As Vaughan Williams L.J. had said in *Krell v. Henry*⁷:

"The test seems to be whether the event which causes the impossibility was or might have been anticipated...".

Nevertheless, this proposition is also subject to a number of qualifications.⁸ The inference that the parties contracted with reference to the supervening event can only be drawn if the event was either actually foreseen or if the degree of foreseeability was a very high one. It is not sufficient that a delay or some interference with performance can be foreseen if the delay or interference which occurs is wholly different in extent. A party can therefore only be held to have accepted the risk of events to the

¹e.g. failure to take any steps to obtain planning permission: *Amalgamated Investment & Property Co.Ltd. v. John Walker & Sons Ltd.* [1977] 1 W.L.R. 164.

²*Denmark Productions Ltd. v. Boscobel Productions Ltd.* [1969] 1 Q.B. 699; *Black Clouston International Ltd. v. Papierwerke Waldhof-Aschaffenburg A.G.* [1981] 2 Lloyd's Rep. 446, 457.

³Thus where an employee has been prevented from performing the agreed work because he has been imprisoned for a criminal offence, the employer can rely on this circumstance as a ground of frustration, and he can do this even though the offence had no connection with the employment: *Harrington v. Kent CC* [1980] I.R.L.R. 353; *F.C. Shepherd & Co. Ltd. v. Jerrom* [1987] Q.B. 301; *Hare v. Murphy Bros.* [1974] I.C.R. 603, 607.

⁴Treitel, p. 844.

⁵*The Super Servant Two* [1990] 1 Lloyd's Rep. p. 10.

⁶See *Comptoir Commercial Anversois v. Power, Son & Co.* [1920] 1 K.B. 868, 895, 901.

⁷[1903] 2 K.B. 740, 752.

⁸Treitel, *supra*, 840.

extent as they were actually foreseeable in a somehow concrete manner.¹ The inference that the parties have assumed the risk of foreseen or foreseeable events can be excluded by evidence of the contrary intention, especially when the interpretation of the contract suggests another allocation of risk (in this respect the instances of foreseeability and contractual provisions excluding frustration coincide).² The parties may foresee an event and intend, if it occurs, to consciously leave the consequences to the Court,³ or they may actually provide that if the event occurs they will then determine how it is to affect the contract.⁴ If the parties cannot reach agreement, the contract may then be frustrated even though the event was foreseen.

2.5. Legal consequences

Frustration terminates a contract automatically at the time of the frustrating event.⁵ The common law starts with the principle that frustration discharges the parties only from duties of "future performance".⁶ Rights accrued before frustration therefore remain enforceable while those which would, but for the frustrating event, have accrued after the time of discharge do not become due.

Hardship resulting from these rules has been mitigated by the Law Reform (Frustrated Contracts) Act of 1943.

Section 1(2) of the Act lays down three rules:

All sums payable under the contract before the time of discharge cease to be payable on frustration. All sums actually paid in pursuance of the contract before the time of discharge are recoverable from the payee "as money received by him for the use of the" payor. As the subsection does not refer to a total failure of consideration, this statutory right to recover money arises even where the failure is only partial. If the contract contains a stipulation for prepayment and the party to whom sums were paid or payable in pursuance of the contract has, before the time of discharge, incurred expenses in or for the purpose of the performance of the contract, the court has a discretion to allow him to retain or recover the whole or any part of the sums so paid or payable. The upper limit of recovery is the

¹See Treitel, *supra* 840, 841 for illustrations.

²Treitel, *supra*, 842.

³*The Eugenia* [1964] 2 Q.B. at p. 234.

⁴*Autry v. Republic Productions* 180 P. 2d. 888 (1947).

⁵*Hirji Mulji v. Cheong Yue SS. Co.Ltd.* [1926] A.C. 497, 505; *B.P. Exploration (Libya) Ltd. v. Hunt* [1979] 1 W.L.R. 783, 809; *The Super Servant Two* [1990] 1 Lloyd's Rep. 1,8,9,14. Frustration therefore can be invoked by either party. This often enables a party to actually profit from frustration. Treitel, *supra*, 848 criticises that possible effect and would prefer to give an option to terminate the contract only to the prejudiced party. He draws support from the cases relating to self-induced frustration.

⁶*Joseph Constantine case* [1942] A.C. 154, 187; *The Super Servant Two* [1990] 1 Lloyd's Rep. 1, 18.

amount of expenses actually incurred or the amount of the stipulated prepayment. In the exercise of its discretion the court can split the loss in such proportions as it thinks just.

Section 1(3) of the Act states:

"Where any party to the contract has, by reason of anything done by any other party thereto in, or for the purpose of, the performance of the contract, obtained a valuable benefit (other than a payment of money to which [section 1(2)] applies) before the time of discharge, there shall be recoverable from him by the said other party such sum (if any), not exceeding the value of the said benefit to the party obtaining it, as the court considers just, having regard to all the circumstances of the case"

and in particular to (a) the amount of any expenses incurred by the benefited party before the time of discharge, and (b)

"the effect, in relation to the said benefit, of the circumstances giving rise to the frustration of the contract."

Section 2(4) of the Act provides that if parts of a contract which have been wholly performed can properly be severed from the remainder, they are to be treated as separate contracts, and that the provisions of section 1 shall apply to the remainder of the contract.¹

According to section 2(3) of the Act the provisions of the Act can be excluded by contrary agreement. Whether a term has that effect depends on its interpretation.

Section 2(5) of the Act exempts certain kinds of contracts from application: voyage charterparties and other contracts for the carriage of goods by sea, insurance contracts, and exceptions regarding the Sale of Goods Act 1979.

3. Frustration of contract and *causa finalis*

The English cases of frustration of contract, it is submitted, can be categorised and analyzed on the basis of the principle of frustration of the contractual purpose (*causa finalis*) the same way as it has been done with the German cases of *Wegfall der Geschäftsgrundlage*.²

¹See Treitel, *supra*, 854 for illustrations.

²Part II § 4.

Cases of absolute impossibility, covered by the doctrine of frustration but not by the doctrine of *Wegfall der Geschäftsgrundlage*, are not considered here since they are of less interest for a comparison with German and South African contract law. However, cases of what has been termed below in paragraph 4. absolute and relative impossibility can hardly be clearly separated since English law never adhered to a narrow literal understanding of impossibility. This observation is also important to understand the South African contract law regarding impossibility.

3.1. Objective (supervening) change of circumstances

3.1.1. Frustration of equality of exchange regarding value (commutative justice)

3.1.1.1. Increase in prices and cost

Because "impossibility" is in itself a relative term and may depend partly on the current state of technology and partly on the amount of trouble and expense to which one is prepared to go to achieve it, a trend has developed in the United States to abandon the very word "impossibility" and to use instead the term "impracticability",¹ which includes extreme and unreasonable difficulty, expense, injury or loss to one of the parties.² The caveat is that "Increased cost alone does not excuse performance..."³ - but it is suggested that a price increase "well beyond the normal range"⁴ could lead to discharge.

English law, however, is stricter and adheres as closely as possible to the idea of impossibility. Although dicta saying that a contract may be discharged if its performance becomes "impracticable" are occasionally found in the cases,⁵ the weight of English authority rejects this view. Thus it has been said in the House of Lords that "a wholly abnormal rise or fall in prices"⁶ would not affect the bargain, and that

¹U.C.C.s.2-615, Restatement 2d, *Contracts*, § 261.

²Restatement, *Contracts*, § 454; Restatement 2d, *Contracts*, § 261 Comment d.

³*supra*.

⁴Restatement 2d, *Contracts*, § 261 Comment d.

⁵*e.g. Horlock v. Beal* [1916] A.C. 486, 492; *The Furness Bridge* [1977] 2 Lloyd's Rep. 367, 377; *Nile Co. for the Export of Agricultural Crops v. H.&J.M.Bennett (Commodities) Ltd.* [1986] 1 Lloyd's Rep. 555, 581; *Moss v. Smith* (1859) 9 C.B. 94, 103; *Robert H. Dahl v. Nelson Donkin* (1881) 6 App.Cas. 38, 52; *The Badagry* [1985] 1 Lloyd's Rep. 395, 399.

⁶*British Movietonews Ltd. v. London and District Cinemas* [1952] A.C. 166, 185.

"The argument that a man can be excused from performance of his contract when it becomes 'commercially' impossible seems to me a dangerous contention which ought not to be admitted unless the parties have plainly contracted to that effect."¹

In *Davis Contractors Ltd. v. Fareham U.D.C.*² contractors agreed to build 78 houses for a local authority in eight months for £94,000. Because of labour shortages, the work took 22 months and cost the contractors £115,000. They claimed that the contract had been frustrated and that they were entitled to extra remuneration. The House of Lords rejected the claim however, as the events which caused the delays were within the ordinary range of commercial probability and had not brought about a fundamental change of circumstances. Lord Radcliffe said:

"It is not hardship or inconvenience or material loss itself which calls the principle of frustration into play. There must be as well such a change in the significance of the obligation that the thing undertaken would, if performed, be a different thing from that contracted for."³

The Suez cases similarly reject the argument that the greater expense caused to the party prejudiced by the closure of the Suez Canal in 1956 and again in 1967 was a ground of frustration. In *Tsakiroglou & Co.Ltd. v. Noble Thorl GmbH*⁴ a contract was made for the sale of Sudanese groundnuts at an inclusive price to cover the cost of the goods, insurance and carriage to Hamburg. When the contract was made both parties expected that shipment would be via Suez, but the contract did not so provide. It was held that the contract was not frustrated by the closure of the Suez Canal, so that the seller ought to have shipped the goods via the Cape of Good Hope. Although this would have taken two and a half times as long as shipment via Suez and would have doubled the cost of carriage, the difference between the two methods of performance was held not to be sufficiently fundamental to frustrate the contract. It was also suggested that the contract would not have been frustrated even if it had provided for shipment via Suez.⁵ The same view is supported by a number of other cases.⁶ Accordingly, in cases dealing with the consequences of inflation, the English authorities generally reject the view that inflation constitutes a ground of frustration.

¹*Tennants (Lancashire) Ltd. v. C.S. Wilson & Co.Ltd.* [1917] A.C. 495, 510.

²[1956] A.C. 696.

³[1956] A.C. at p. 729.

⁴[1962] A.C. 93.

⁵*supra*, 112.

⁶e.g. *The Captain George K* [1970] 2 Lloyd's Rep. 21; *The Washington Trader* [1972] 1 Lloyd's Rep. 463.

In *Staffordshire Area Health Authority v. South Staffordshire Waterworks Co.*¹ a hospital had ceded its right to take water from a well to a Waterworks Company in 1919, and the Company had in return promised "at all times hereafter" to supply water to the hospital at a fixed price. In 1975 the cost for the company of supplying the hospital had risen to over 18 times the contract price and the Company gave seven months' notice to terminate the agreement. It was held that this notice was effective. Lord Denning M.R. regarded the contract as frustrated by the change of circumstances which had occurred between 1919 and 1975:

"So placed we have to ask ourselves: what were the circumstances in which the contract was made? Does it apply in the least to the new situation which has developed? If events occur for which they have made no provision - and which were outside the realm of their speculations altogether - or of any reasonable persons sitting in their shoes - then the court itself must take a hand and hold that the contract ceases to bind."²

But the majority of the court, on the other hand, held that it was only a question of interpretation: the contract was intended to be of indefinite, but not perpetual, duration. Thus the case fell within the general principle under which, in commercial agreements of indefinite duration, a term is implied entitling either party to terminate by reasonable notice. Treitel says that "at all times hereafter" was "obviously" not to be taken literally, but meant "at all times hereafter during the subsistence of the agreement".³ This appears to be a rather arbitrary construction since the literal meaning of the words points into the opposite direction.⁴ It seems clear that the decisive reason for holding the notice effective was the vast increase in costs due to inflation, and the fact that the contract had become totally unreasonable for the Company. The strained construction of the crucial words "at all times hereafter" serves only to obscure the matter. Lord Denning's view is therefore preferable because it states the reasons for the decision in a clear and honest manner. His approach has been criticised because the reasoning was based on his statements in the *British Movietonews* case which had been rejected by the House of Lords.

In the *British Movietonews* case "a sudden depreciation of currency" is listed as one of the un contemplated turns of events which do not frustrate a contract.⁵ Again, in *Wates Ltd. v. G.L.C.*⁶ a

¹[1978] 1 W.L.R. 1387.

² 1395.

³ 795, footnote 71.

⁴That was also the opinion of the lower court which was overruled by the Court of Appeal.

⁵[1952] A.C. 166, 185.

⁶(1983) 25 Build.L.R. 1.

building contract to some extent protected the builder against inflation, by means of a price-escalation clause; and it was said that the fact that

"inflation increased not [at] a trot or at a canter but at a gallop... was not so radical a difference from the inflation contemplated and provided for as to frustrate the contract."¹

But, in English law also, it is admitted that

"the possibility that extreme (as opposed to merely severe) inflation may be capable of frustrating a contract cannot be wholly ruled out."²

This statement, as well as the *Staffordshire Waterworks* case affirms the perception that whether circumstances such as inflation might serve as a ground for frustration, depends on the extent of the distortion of equality in exchange resulting therefrom.

Concerning the instance of inflation especially, the difference between the German and the English doctrine is obvious. Although the German doctrine equally stresses the fact that inflation in principle is not a ground for *Wegfall der Geschäftsgrundlage*, and courts are reluctant to accept it as frustrating the contract in special cases, there are by far more cases in which inflation was in fact held to amount to a frustration - *Wegfall der Geschäftsgrundlage*. The reason is probably the fact that on the one hand Germany has had more drastic experiences with inflation and that on the other hand, the German doctrine focuses more on the individual situation of the affected party, measuring it against the standard of good faith and equity (*bona fides*) by means of the notion of *Unzumutbarkeit*. Thus, above all, maintenance agreements have become a general exception of the nominalist principle, and exceptions have also been made in other extreme cases. In fact, in the *Staffordshire Waterworks* case, Lord Denning had urged that it was time "to revise our views about the principle of nominalism."³

3.1.1.2. Delay and interruption

A contract may be frustrated if its subject matter, or a thing or person essential for the purpose of its performance, though not ceasing to exist or suffering permanent incapacity, becomes temporarily

¹*supra*, 34.

²Treitel, *supra*, 823, referring to a statement of Lord Roskill in *National Carriers Ltd. v. Panalpina (Northern) Ltd.*, where he mentioned "inflation" as one of the "circumstances in which the doctrine has been invoked, sometimes with success, sometimes without."

³at p. 1398.

unavailable for that purpose, even though no fixed time has expressly been specified for performance and time is not otherwise of the essence of the contract. Thus charterparties have been frustrated where the ship was seized, detained¹ or requisitioned,² where the goods themselves were requisitioned³ and where a cargo was unavailable because of a strike at the ports of loading.⁴ Contracts for personal services have been frustrated where one of the parties fell ill⁵ or was interned or conscripted.⁶

In *Jackson v. Union Marine Insurance Co.*,⁷ a charterparty was made in November 1871 for the carriage of rails from Newport to San Francisco. On her way to Newport, the ship went aground in January 1872 and was not repaired until the following August. The contract was held to have been frustrated by the length of the delay, in consequence of which the voyage which the ship was still capable of making was substantially different from that envisaged in the contract. Contracts in cases of this kind are frustrated because performance at the end of the delay is no longer of any use to the party to whom it was to be rendered. The purpose of the contract has been defeated.

The contract may also be frustrated for the reason that, after the delay, performance would be significantly more onerous for the party who was to render it. In *Acetylene Co. of Great Britain v. Canada Carbide Co.*⁸ the shipment of goods under a contract of sale was delayed for three years by war-time requisitioning of all the available shipping space. When performance again became physically possible, it was held that the seller was no longer bound to deliver because market conditions had radically changed.

If performance for some balance of the contract period remains, or is likely to remain, possible after the delay or interruption, the outcome of claims relating to that period depends on the ratio which the interruption bears, or is likely to bear, to the contract period: the higher the ratio is, the more likely it is that the contract will be frustrated. In *The Nema*,⁹ a charterparty for six or seven voyages to be made from April to December was frustrated when, after the first voyage, a long strike at the loading port made it impossible to accomplish more than a further two voyages within the contract period. On

¹e.g. in the Gulf War cases, and in *The Adelfa* [1988] 2 Lloyd's Rep. 466.

²e.g. *Bank Line Ltd. v. Arthur Capel & Co.* [1919] A.C. 435.

³e.g. *Re Shipton, Anderson & Co.* [1915] 3 K.B. 676.

⁴*The Nema* [1982] A.C. 724.

⁵e.g. *Hart v. A.R. Marshall & Sons (Bulwell) Ltd.* [1977] 1 W.L.R. 1067.

⁶e.g. *Morgan v. Manser* [1948] 1 K.B. 184.

⁷(1874) L.R. 10 C.P. 125.

⁸(1922) 8 Lloyd's Law Rep. 456.

⁹[1982] A.C. 724.

the other hand, in *Tamplin SS.Co.Ltd. v. Anglo-Mexican Petroleum Co.*¹ the war-time requisition of a ship in February 1915 did not frustrate a five year charter which was not due to end until December 1917. The majority of the House of Lords speculated that the war would not last until the end of the contract period.²

3.1.2. Frustration of equality in exchange (commutative justice) regarding the fitness of the performance for a special purpose

This category of cases was inaugurated by *Krell v. Henry*, as interpreted in the light of *Herne Bay Steamboat Co. v. Hutton*. *Krell v Henry* has attracted much criticism.³ The obvious danger of such a rule is that it can all too easily be invoked by a party for whom a contract has simply become a bad bargain.

Normally, a contract is not frustrated merely because supervening events have prevented one party from using the subject matter according to his intention, even though that use was also contemplated by the other. A contract by which a gas company agreed with a local authority to "provide, maintain and light" street lamps was not frustrated when war-time black-out regulations prohibited the lighting of such lamps, since the purpose of the contract extended also to the maintenance of the lamps, which remained possible.⁴ A contract for the sale of goods is not frustrated merely because the buyer's purpose to export the goods from, or to import them into, a particular country is defeated by export or import restrictions.⁵ In *Amalgamated Investment & Property Co.Ltd. v. John Walker & Son Ltd.*,⁶ it was held that a contract for the purchase of property for redevelopment was not frustrated when the

¹[1916] 2 A.C. 397.

²[1916] 2 A.C. at p. 405.

³*Blackburn Bobbin Co.Ltd. v. T.W.Allen & Sons Ltd.*[1918] 1 K.B. 540, 542; *Larrinaga v. Société Franco-Américaine des Phosphates de Medulla* (1923) 92 L.J.K.B. 455, 459; *Maritime National Fish Ltd. v. Ocean Trawlers Ltd.* [1935] A.C. 524, 528; *Scanlan's New Neon Ltd. v. Toohey's Ltd.* (1943) 67 C.L.R. 169, 191-194; *Corbin on Contracts*, § 1355 at pp. 464-465; Landon, 52 L.Q.R. 168.

⁴*Leiston Gas Co. v. Leiston-cum-Sizewell U.D.C.* [1916] 2 K.B. 428; for contrasting decisions on the effect of black-out regulations on contracts for the hire of electric advertising signs, see *Scanlan's New Neon Ltd. v. Toohey's Ltd.*, *supra* (contract not discharged), and *20th Century Lites v. Goodman*, 149 P.2d. 88 (1944) (contract discharged).

⁵e.g. *D.McMaster & Co. v. Cox McEwen & Co.*[1921] S.C. (H.L.) 1; *Congimex S.A.R.L. (Lisbon) v. Continental Grain Export Corp. (New York)* [1979] 2 Lloyd's Rep. 346; *Congimex Companhia Geral, etc. S.A.R.L. v. Tradax Export S.A.* [1983] 1 Lloyd's Rep. 250.

⁶[1977] 1 W.L.R. 164.

buildings on the land were listed as being of special architectural or historic interest, so that redevelopment became more difficult or impossible and the property lost most of its value.

While these cases make it difficult to establish the defence of frustration of purpose, they do not make it impossible. In *Denny, Mott & Dickson v. James B. Fraser & Co.Ltd.*¹ a contract for the lease of a timber yard was made for the purpose of enabling the parties to carry out a contract between them for the sale of timber. When performance of the contract of sale was prohibited by war-time regulations, the House of Lords held that the agreement for the lease of the yard was also frustrated.

The situation in Germany is quite similar. As a rule, it is not sufficient if one party is simply aware of the other party's purpose. In order for that purpose to form a common object, each party has to have adopted the purpose and has to have a personal interest in the attainment of that purpose. That rule is based, as in England, on the idea of reliance, or *venire contra factum proprium*. Because of the speculative character of such contracts, such as that in the *Amalgamated Investment* case the purchaser of prospective building land in Germany also bears the risk that building might be prohibited by the authorities later on. All in all, however, German courts appear to be more willing to assume *Wegfall der Geschäftsgrundlage* if the reason for the frustration does not only fall into the sphere of one party, but also into that of the other and when both shared the purpose and had a personal interest in its attainment.

In the case of a lease of land it was held in earlier English decisions that the subject matter of the contract was limited to giving the tenant the right to exclusive possession for the specified time. This subject matter survived even if where subsequent events prevented the tenant from making any use of the premises. The commercial reality, however, is that the tenant generally bargains for use and occupation and not merely for a legal right of possession. In *National Carriers Ltd. v. Panalpina (Northern) Ltd.*,² the House of Lords held that the doctrine of frustration could therefore also apply to leases of land, but emphasized that the frustration of a lease will be a very rare event.³ A tenant had claimed that a ten-year lease of a warehouse had been frustrated when, four and a half years before the end of the term, the only access road to the premises had been closed by the local authority and had remained closed for 20 months. The claim was rejected on the ground that the interruption was not sufficiently serious to bring about frustration. In the given case of a lease for a long period of years the contract is in its nature a long-term speculation since the parties must contemplate that circumstances may change radically during its currency, and so to a large extent take the risk of

¹[1944] A.C. 265.

²[1981] A.C. 675.

³ 692, 697.

supervening events. In the case of an interruption of the possession, the reason for that interruption will in most cases of long-term-leases not be sufficient to frustrate the contract. The doctrine of frustration is therefore most likely to apply where the lease is a short-term one for a particular purpose: e.g. where a holiday cottage which has been rented for a month is burnt down without the fault of either party. In Scotland the lease of a salmon fishery was held to be frustrated when construction of a nearby bombing range prevented the tenant from using the fishery.¹

The doctrine of frustration also applies to contracts for the sale of land,² but its operation is restricted by the rule that risk of loss passes - unless otherwise agreed - as soon as the contract is made. Consequently, there is no frustration if the house or buildings on the land (for the sake of which the land was bought) are destroyed or seriously damaged between contract and completion.³ The rule that risk passes on contract is therefore commonly varied by contract: for example, by provisions leaving the risk with the seller until completion, and giving a right to rescind the contract either to the purchaser if the property has become unusable for its purpose at the date of the contract, or to the vendor if the property has been destroyed and he cannot get planning permission to rebuilt it.⁴

3.2. Subjective change of circumstances (common mistake)

Cases of relative impossibility and quasi-impossibility concerning frustration of equality in exchange regarding value or the fitness of the subject matter of the performance for a special purpose, are intertwined in the English doctrine of mistake under the heading of mistake as to quality. A mistake as to quality can relate either to the value or to the utility of the subject matter for the parties' purpose.⁵

In *Griffith v. Brymer*⁶ a contract was made for the hire of a room on June 26, 1902, the day fixed for the coronation of King Edward VII, for the purpose of viewing the coronation procession. The contract was held void because, when it was made, the decision to postpone the coronation had - unknown to the parties - already been taken.

¹*Tay Salmon Fisheries Co. v. Speedie*, 1929 S.C. 593.

²*Amalgamated Investment and Property Co.Ltd. v. John Walker & Co.Ltd.* [1977] 1 W.L.R. 164.

³*Paine v. Meller* (1801) 6 Ves. 349.

⁴Law Society's Standard Conditions of Sale (1992) Conditions 5.1.1 to 5.1.4.

⁵Treitel, *supra*, 264.

⁶(1903) 19 T.L.R. 434.

In *Kennedy v. Panama, etc., Royal Mail Co.*¹ the plaintiff had bought shares in a company on the faith of an untrue statement (made by innocent misrepresentation) that the company had secured a contract to carry mail for the New Zealand Government. The decision was that the resulting contract was valid. In reaching this conclusion Blackburn J. referred to the Roman doctrine of *error in substantia*, by which mistakes as to quality may make a contract void if they relate to the "substance" of the subject matter. He held that the plaintiff had obtained the very shares he bargained for, and that his mistake did not affect the substance of the transaction. The equality in exchange was not frustrated because the acquisition of shares was of a speculative character because of the natural tendency of shares in a company to fluctuate in value.

In *Bell v. Lever Bros.*,² Bell and Snelling had agreed with Lever Bros. to serve for five years as chairman and vice-chairman of a company controlled by Lever Bros. Before the end of this period, Lever Bros. wished to terminate these service contracts and the parties entered into compensation agreements under which Bell and Snelling received between them £50,000 for loss of office. Lever Bros. then discovered that Bell and Snelling had broken their service contracts in a way that would have justified their summary dismissal without compensation. It was found that Bell and Snelling had forgotten about these breaches of the service contracts when the compensation agreements were made, so that they were not guilty of fraudulent concealment, nor were they under any duty to disclose their breaches of duty. The remaining issue was whether the compensation agreements were void for mistake, so that Lever Bros. could recover back the £50,000 which they had paid to get rid of Bell and Snelling while they might have got rid of them for nothing. The Court of Appeal held that the compensation agreements were void as Lever Bros. had made them under a fundamental mistake. The House of Lords however, by a narrow majority, reversed this decision. The mistake related only to a quality of the service contracts and was not fundamental. Lord Atkin said:

"The contract released is the identical contract in both cases [whether the service contracts were valid or voidable] and the party paying for release gets exactly what he bargained for."³

Lord Atkin said that mistake as to quality

¹(1867) L.R. 2 Q.B. 580.

²[1932] A.C. 161.

³ 223.

"will not affect assent unless it is the mistake of both parties and is as to the existence of some quality which makes the thing without the quality essentially different from the thing as it was believed to be."¹

There was nothing to show that Bell and Snelling had regarded the validity of the service contracts as vital, only Lever Bros. had done so. The common purpose of the compensation agreement had been attained. Lever Bros. got rid of Bell and Snelling in return for compensation. The fact that they could have gotten rid of them without compensation was part of their unilateral risk. In the absence of any responsibility on the side of Bell and Snelling for Lever Bros.' mistake, they could not be held to share that risk.

4. Assessment and comparison with Germany

The comparison of the doctrines of English law described here with the doctrine of *Wegfall der Geschäftsgrundlage* in Germany reveals a striking similarity in the details of development and argumentation, but also a significant difference in the general approach.

In Germany as in England, the crisis of the will-theory resulted in a shift from a subjective to a more objective approach to the problem of fundamental change of circumstances. Because of the perils for the principle of *pacta sunt servanda*, furthermore, the respective doctrines serve as an *ultima ratio*, a last resort, "not lightly to be invoked"² in both countries.

The obvious difference between the English and the German doctrine is that *Wegfall der Geschäftsgrundlage* does not include cases of impossibility. This, of course, is due to the fact that impossibility was already provided for in the Code when the doctrine of *Wegfall der Geschäftsgrundlage* was developed as case-law to complement the Code in cases where there was not a literal impossibility but a situation somewhat related to the situation of impossibility. In England, the notion of impossibility was the natural point of departure for the doctrine of frustration. The English doctrine therefore illustrates perfectly the close relationship between *Wegfall der Geschäftsgrundlage* / frustration of contract and impossibility.

Lacking acknowledged objective legal norms, the only way for the further development of the law (*Rechtsfortbildung*) in England involved reasoning from case to case by way of supplementary interpretation of the contract at hand, guided by the nature and the circumstances of the individual

¹ 218.

² *J. Lauritzen A. S. v. Wijsmuller B. V. (The Super Servant Two)* [1990] 1 Lloyd's Report 1, p.8, per Bingham LJ.

contract, its reasonable meaning and the presumed intentions of the parties. The very fact that impossibility was not from the very beginning a ground for relief contributed to a flexible approach in cases falling short of impossibility in the literal sense.¹ Through the influence of maritime commercial law (the rule as to "frustration of the adventure") and the steady influence of commercial standards (merchants were always more willing to treat something as impossible which might theoretically still have been possible), England gained a more flexible concept of impossibility than on the continent. Notions like "performance in a business sense" and "merchantable character" in the cases give evidence of that fact.

Initially, the development in Germany followed the same path. First, there were the two "mill-decisions" of the *Reichsgericht* in 1889 and 1898 where the court argued that although there was no real impossibility, the circumstances had changed in such an unforeseeable manner as to impair and thwart the original purpose of the transaction, and thus to change the content given to it by the parties - in other words making it a different obligation, an *aliud*.² In a case from 1920, after the First World War, the *Reichsgericht* drew an analogy to § 325 BGB (impossibility) and spoke of an "economic impossibility", connecting it with a revival of the idea of the *clausula rebus sic stantibus*.³

Since the *Davis Contractors*-case and Lord Radcliffe's formulation of the test of a radical change of the obligation, it has become generally accepted in English law that in order for the doctrine of frustration to operate, there must always be a situation somewhat analogous to impossibility: impossibility in the common law sense of relating not just to the object of performance itself but to the content of the contract as a whole, the obligation as such. The concept of impossibility remains the reference point of the doctrine of frustration (and common mistake).

The criteria to determine whether the obligation is radically different after the change of circumstances are basically similar to those employed by the doctrine of *Wegfall der Geschäftsgrundlage*. Frustration of purpose (*causa finalis*) in the sense of equality in exchange especially, appears to be the basic constellation in which the doctrine, under certain limitations, can be invoked - just as in the case of *Wegfall der Geschäftsgrundlage*. Frustration of purpose is the basic idea. It generally renders a contract objectionable. But whether it will actually invalidate it depends of the nature of the contract and the circumstances.

¹Larenz, *Geschäftsgrundlage und Vertragserfüllung*, 67, 68.

²*Seuffert's Archiv* 45, p. 114; RGZ 42, p. 42.

³RGZ 100, p. 129.

Impossibility is nothing else but the most obvious case of frustration of purpose. The cases which deal with an impossibility in the literal, narrow sense of the word, can be comprised in the category of *absolute impossibility*. A disruption of equality of exchange is at least an indicator for frustration of purpose. It can result out of an unforeseen material or personal hardship of one party for which that party is not accountable. Whether it amounts to a total frustration of purpose or not depends largely on the extent of the disruption. Both in England and in Germany it is considered insufficient that the contract merely turns out to be a bad bargain. The cases dealing with a disruption of equality in exchange amounting to frustration of purpose regarding value can be comprised in the category of *relative impossibility*.

Then there can be other cases of frustration of purpose which do not necessarily concern the value of the subject matter of performance, but where a certain fact or state of things is attributed such a crucial importance by both parties that its disappearance or change renders the contract unreasonable and virtually pointless. This kind of case can be comprised in a category which might be called *quasi-impossibility*.¹ These are naturally borderline cases which must be and are kept within very narrow confines.

The German doctrine of *Wegfall der Geschäftsgrundlage*, seen from an English perspective, deals with the categories of relative impossibility and quasi-impossibility.

In both England and Germany it is recognized that such categories can only serve as a general guideline, the question in the end always depends of the nature of the contract and the circumstances in the individual case. This lies in the nature of things since the possible combinations of facts that can bring about a frustration of purpose are infinite.

In both countries the problem is recognized to be primarily one of risk-allocation and the importance and priority of the construction of the contract is acknowledged and emphasized.

Both countries know an objective and a subjective basis of the contract. Objective in the sense of supervening change of circumstances (frustration) and subjective in the sense of common mistake. Also in Germany there were voices which wanted to deal with the subjective basis in the context of

¹Atiyah uses a similar structure in his *Introduction to the Law of Contract*. He treats cases of absolute and relative impossibility ("...not necessarily impossible, but yet in which it would seem excessively hard on one of the parties...", 219) under the heading of "Frustration through impossibility of performance" (231 sq.), and cases of quasi-impossibility under the heading of "Frustration of the common venture" (232 sqq.).

the doctrine of mistake,¹ but the perception has gained ground that these cases concern the exact same problems and are treated with the exact same means and criteria as in the cases of the objective basis and therefore should be dealt with as two sides of the same coin.² In England the statements of Lord Atkin in *Bell v. Lever Bros.* and Steyn J. in *Associated Japanese Bank Ltd. v. Credit du Nord SA* point in the same direction.

Finally, both countries employ identical limitations to the doctrine in order to narrow its scope. The most important of these limitations is the requirement of a common subjective basis, or common object (purpose) shared by both parties. This is evident in the cases of common mistake but also applies to the cases of the objective basis. In these cases too, the purpose of the contract can only be frustrated if it was shared by both parties and regarded as essential by both. The other common limitations are foreseeability, fault (or self-induced frustration) and speculative transactions.

Yet there is a significant difference in the approach in German law.

The development in Germany took a different direction after the "mill-cases" and the "commercial impossibility"-jurisdiction of the *Reichsgericht*. The court did not think it fit to extend freely the meaning of impossibility because it interpreted §§ 275, 325 BGB as referring only to impossibility in its literal sense (absolute impossibility). In the famous decision of the 3rd February 1922³, in which the *Reichsgericht* accepted Oertmann's formula of *Wegfall der Geschäftsgrundlage*, it founded its absolving power directly on § 242 BGB, the principle of good faith and equity (*bona fides*) and developed in this context the criterion of *Unzumutbarkeit* as the authoritative test. It is quite obvious that this move was motivated by the fact that § 242 BGB did not entail a strict legal consequence. It

¹Wieacker in *Festschrift für Wilburg*, 1965, pp. 242-247; Stötter, "Versuch zur Präzisierung des Begriffs der mangelhaften Geschäftsgrundlage", in *AcP* 166 (1966), 149, 173-178.

²The doctrine of *Wegfall der Geschäftsgrundlage* has in German law served as a convenient escape route from the disadvantages and shortcomings of the doctrine of mistake. Especially because the result of common mistake namely that the contract void *ab initio* with a duty to pay compensation is highly inconvenient and unequitable, there is a tendency to rather assume *Wegfall der Geschäftsgrundlage* when ever possible because of the more flexible and equitable results. Furthermore, where an error in motive is regarded as fundamental to the contract, but cannot be portrayed as relating to a characteristic of the subject-matter, the courts often apply the doctrine of *Wegfall der Geschäftsgrundlage* (*subjektive Geschäftsgrundlage*) to make it legally relevant. One reason for that is that where both parties share the error, neither party merits special protection and they can be expected to share the risk. This development is an indication that, in Germany as well, the doctrine of mistake has not solved the problem of the disappointed expectations of the parties' in a convincing way. It appears that the aspect of mistake should be de-emphasized, for it is never of decisive importance. The decisive criteria are found in elements such as frustration of purpose, reliance and allocation of risk, which should be accorded pride of place in dogmatic analysis.

³*RGZ* 103, pp. 329, 332.

was since long accepted that the principle of *bona fides* gave the power to intervene into existing contractual relationships which did not comply with its standards, but it did not state precisely how this is to be done and therefore gave the court a considerable discretion in adjusting the contract according to what it regarded as fit for the individual case. The court clearly wanted to evade the drastic legal consequences of assuming an impossibility which it did not see as appropriate in the cases concerned.

The criterion of *Unzumutbarkeit* obviously focuses on the affected party and its subjective condition. The underlying idea is to ensure substantive justice in the individual case and justice, in the end, is directed towards individuals.

The English criterion of the radical difference of the obligation focuses only on the contract itself. It measures everything against the idea of impossibility, while the criterion of *Unzumutbarkeit* measures everything against the idea of good faith and equity.

The obvious reason for this difference is that the English law does not know such a powerful legal tool that in itself combines *ius strictum* and *ius aequum*. Therefore there is also not much choice as to the legal consequences: the contract is always put aside, which often creates unjust results. Even after the Law Reform (Frustrated Contracts) Act of 1943, the result is frequently an all-or-nothing situation.¹ In this particular aspect the common law, often envied for its flexibility, is more rigid and inflexible than its continental counterpart. This is a major reason why the English doctrine appears to be, on the whole, much narrower than the German doctrine and much more reluctant to actually acknowledge a frustration or an operative common mistake. The German doctrine is more liberal for the simple reason that the consequences are far less drastic and *Wegfall der Geschäftsgrundlage* actually sometimes acts as a convenient means of adapting a contract to a new situation.

A comparable approach in English law has been promoted by Lord Denning, who tried to oust common mistake as far as possible from the field of the common law and deal with it in terms of equity, where the focus is also on the individual, and there is greater flexibility concerning the legal consequences because the primary aim is to ensure substantive justice in the individual case.

Comparing the two approaches, the English test at first sight appears to be more precise and clear-cut and therefore better fit to ensure legal certainty (*Rechtssicherheit*). Yet that might still to some extent be open to question, since the notion of "radical difference of the obligation" is not a completely unambiguous concept and subject to the complex nature of the problem with its infinite possible

¹see the statements of Lord Simon of Glaisdale in *National Carriers Ltd. v. Panalpina*, *supra* a.bb.(d).

constellations.¹ Evaluative judgements (*Wertungen*) are inevitably involved here, too, albeit maybe to a lesser extent than in the case of *Unzumutbarkeit*.

¹In order to specify (*konkretisieren*) the notion of "radical difference in the obligation" it might also be helpful to look for orientation in the Aristotelian philosophy of essences linked to ends (*causa finalis*) as it is promoted by James Gordley (see Part A ch.I). A theory of *causa finalis* appears to be useful both in the German and the English doctrine. Both the German and the English doctrine and the high prominence of frustration of purpose in both inevitably brings us back to the question as to what constitutes the essence of an obligation and thus to Aristotle and Thomas Aquinas.

Part IV: The principle of *causa finalis*

The description of the historical development, the application in the case law and the dogmatic treatment of the doctrines of *Wegfall der Geschäftsgrundlage* in Germany and frustration of contract in England has illustrated the importance of purpose for the inescapable need for evaluative judgments in both civil and common law. The treatment of purpose in both legal systems corresponds strikingly to that in Aristotelian-Thomistic philosophy and in the legal works of their adherents, especially in so far as the notion of *causa finalis* is concerned.

The need to approach dogmatic problems in this area from a broad perspective seems beyond dispute. What the law requires is a coherent general theory. Legal dogmatics should not be conducted in an aimless and fragmentary manner, its results should not resemble a legal patchwork.

The confusion which surrounds the doctrines of *Wegfall der Geschäftsgrundlage* and frustration of contract, is an immediate consequence of a doctrinal crisis in private law concerning its theory of contract. This crisis is accordingly not of purely theoretical interest, it affects all aspects of legal dogmatics, right down to the level of everyday problems of practical relevance. The doctrinal crisis is - in the long run - of crucial practical relevance. The binding character of the law, which depends on its acceptance among its subjects, turns in the final analysis on its inherent persuasiveness. If there is no coherent concept behind the individual legal rules they will seem arbitrary, and their persuasive character will be lost. A coherent legal theory presupposes a sound philosophical and methodological basis. Methodology links philosophy to legal doctrine and practice, it puts philosophy into action, enabling the jurist to ask what justice is, and how it can be realised. Viewed in this light, the claim that the doctrines of *Wegfall der Geschäftsgrundlage* and frustration of purpose can be reduced to mere problems of interpretation, is too simplistic to be maintained without more. Interpretation is not a simple legal tool, it entails a general legal technique involving the concretisation of precepts, the filling in of gaps in the law and its further development. The acknowledged or unacknowledged aim of interpretation is the pursuit of justice. Interpretation is such a broad phenomenon that it may well be equated with legal methodology itself. Interpretation is nothing else than the means whereby, in the sense of Arthur Kaufmann, the Is may be assimilated to the Ought.¹

Any reference to interpretation therefore, requires elucidation. Larenz did so when he differentiated purely subjective interpretation (based on the will of the parties alone), supplementary interpretation (entailing a mixed subjective-normative approach) and corrective interpretation (predominantly

¹see Part I § 12.

normative, based on the idea of good faith, and only based on the subjective will of the parties as far as the parties can be held to expect good-faith-conduct complying with the basic principles of contract law). Larenz emphasized that "corrective" interpretation transcends interpretation in the original sense since it consciously intervenes into the contract under specific, restricted circumstances. It is nevertheless related to interpretation in so far as it is the logical next step when the "normal" interpretation does not lead to a solution. Larenz sees the doctrine of *Wegfall der Geschäftsgrundlage* as an instance of "corrective" interpretation.¹

The basic problem of the doctrines of *Wegfall der Geschäftsgrundlage* and frustration of contract - the classic dichotomy between the aim of legal certainty (*Rechtssicherheit*) and the aim of substantive justice in the individual case (equity - *Einzelfallgerechtigkeit*) - was described by Aristotle when speaking about the relationship between justice and equity in his *Nicomachean Ethics* (book V, chapter 10):

"What creates the problem is that the equitable is just, but not the legally just but a correction of legal justice. The reason is that all law is universal but about some things it is not possible to make a universal statement which shall be correct. In those cases, then, in which it is necessary to speak universally, but not possible to do so correctly, the law takes the usual case, though it is not ignorant of the possibility of error. And it is none the less correct; for the error is not in the law nor in the legislator but in the nature of the thing, since the matter of practical affairs is of this kind from the start. When the law speaks universally, then, and a case arises on it which is not covered by the universal statement, then it is right, where the legislator fails us and has erred by over-simplicity, to correct the omission - to say what the legislator himself would have said had he been present, and would have put into his law if he had known. Hence the equitable is just - not better than absolute justice, but better than the error that arises from the absoluteness of the statement. And this is the nature of the equitable, a correction of law where it is defective owing to its universality. In fact this is the reason why all things are not determined by law, viz. that about some things it is impossible to lay down a law, so that a decree is needed. For when the thing is indefinite the rule also is indefinite, like the leaden rule used in making the Lesbian moulding; the rule adapts itself to the shape of the stone and is not rigid, and so too the decree is adapted to the facts."²

¹Larenz, *Geschäftsgrundlage und Vertragserfüllung*, 3rd.ed. 1963; "Ergänzende Vertragsauslegung und Rückgriff auf die Geschäftsgrundlage", in: *25 Jahre Karlsruher Forum*, 1983, 156sq.; *Allgemeiner Teil des deutschen Bürgerlichen Rechts*, 7th ed., 1989, 544sq.

²Oxford's World's Classics edition, 133.

The interest in the role of purpose in the law has never waned since Ihering, and has led to a renewed interest in the *causa finalis* of the old *ius commune* which is likely to increase in the future. Its affinity to Aristotelian-Thomistic philosophy is not a handicap anymore, since it can once again be related to the conclusions of modern legal philosophy, especially phenomenology and hermeneutics.¹ From a German point of view, the writings of Karl Larenz and Arthur Kaufmann appear to be the most fertile in this respect.² I am confident that similar developments have taken place in the other countries of the western hemisphere because philosophy, and legal philosophy in particular, is no longer conducted in national isolation anymore. It is no longer illegitimate to look to Aristotle and Thomas Aquinas for orientation and to seek to establish their influence on legal thought.

The principle of *causa finalis* contributes to answering the neglected question *why* the law has the content that it does.³ As such it is the antithesis to legal formalism which, although its handicap in the past, may be its advantage in the future. The explanation for this put forward by James Gordley is:

"One is committed to some ideal of human welfare that makes some changes better than others, even if one does not conceive of the good in the same way as Aristotle and Thomas Aquinas."⁴

"One has to explain why the law does not place the same value on all commitments. This was the task once performed by the Aristotelian virtues of fidelity, liberality and commutative justice. Moreover one has to explain what it is to which the parties are committed and what that commitment entails. One cannot do so by simply looking to the thoughts and expectations of the parties themselves, which are ambiguous and usually different. This was the task once performed by the idea that the essence of an action can be defined in terms of its end. ... The definitions will be arbitrary unless there is some pre-existing relationship independent of the will of the definer, that links together the elements of the definition and the consequences extracted from it."¹

"Modern theorists tend to set in opposition on the one hand the will of the parties, and on the other any attempt by a court or legislature to judge the fairness of the contract. For the late scholastics and the natural lawyers there was no such radical opposition. ... The

¹Part I §§ 9, 10.

²Part I §§ 11, 12.

³Part I §§ 11, 12.

⁴Gordley, "Enforcing promises", *California Law Review* 1995, 576.

parties could set aside the terms natural to their contract by express provision. Nevertheless, they could not do so in a way opposed to the nature of the contract itself."²

"[The 19th century jurists] had to explain rules that were in force in order to serve human purposes by a definition that abstracted from those purposes. It was like trying to explain a machine without regard to its function. ... The will-theorists could not have explained the differences in treatment without speaking, not merely of the will of the parties, but of the reasons why the will should be respected."³

The principle of *causa finalis* is concerned with the content and effect, the aim, the end of the contract. It therefore aims directly at the crucial problem of evaluative judgment in the law and contractual fairness for which Aristotle's concept of virtue had originally provided the standard. It is thus directly relevant for the justification and persuasiveness of the binding character of the law. The principle of *causa finalis* poses the question of the binding character of a contract (the *why*) in an objective-normative way.

Causa finalis describes a means-to-ends relationship. In its relational character, the principle reflects and corresponds to the basic nature of the law as analyzed by Arthur Kaufmann.⁴ The law is relational, contract is relational-reciprocal and *causa finalis* is the basis of this characteristic trait. The principle of *causa finalis* is thus a crucial part of the essence of a contract.

The problem was that the 19th century jurists did not find a good way of distinguishing the *causa finalis* of a contract from the other ends or motives of the contracting parties'. They had purged the law of the Aristotelian-Thomistic concept of virtue - but the courts bent the rules to enforce contracts made with virtuous intentions.

Three authors deal specifically with the relevance of the principle of *causa finalis* for the modern private law. One is James Gordley, who figures already rather prominently in this thesis, the other two are Harm-Peter Westermann⁵ and Jan Smits.¹ Westermann, Gordley and Smits each try to shed light

¹Gordley, *Philosophical Origins*, 244,245.

²Gordley, *supra*, 109,110,111.

³Gordley, *supra*, p. 164.

⁴Part I § 12.

⁵*Die Causa im Deutschen und Französischen Zivilrecht*, diss. Köln 1964. Westermann analyzes and emphasizes the role and continuing relevance of *causa* in both the Code Civil and the BGB, where this is less obvious, since the concept of *causa* has not specifically been made part of the codification.

on the nature of the principle. All three emphasize that the principle does not describe a tautology: *causa* and will are not identical as it was supposed in the 19th century, the *causa finalis* is not arbitrary but specific and makes sense in that it is a useful tool to explain the law and its consequences.

Every investigation of the principle of *causa finalis* has to follow four crucial questions as guidelines:

1. Can there be something like "the" purpose, or "essential" purpose of an act or a contract ?
2. How does one determine, what is that essential purpose ?
In other words: how does one separate the legally relevant from irrelevant purposes ?
3. When exactly is the frustration of that essential purpose operative?
4. What are, or can be the legal consequences of such an operative frustration of purpose ?

1. As to the first question:

The first question can be answered in the affirmative with reference to modern legal philosophers like Arthur Kaufmann and Karl Larenz.²

2. As to the second question:

The second question is the main topic of the discussion by Westermann, Gordley and Smits. The results of the three authors in defining the content of the principle of *causa finalis* do not lie far from each other. Above all, they all emphasize the relational character of the principle, their respective key-elements of *causa finalis* all illustrate a specific relationship. They all, furthermore, point out that the *causa finalis* has an essentially normative character. The difference between them lies mainly in how far they want to go, in their aim in dealing with the principle.

Gordley identifies the Aristotelian virtues of commutative justice or liberality as the *causa finalis* of every contract.³ Westermann relates the *causa finalis* to the contractual synallagma (genetical and functional), that is, reciprocity.⁴ Smits takes up this thread and identifies *causa* with reciprocity.⁵ The notion of synallagma (reciprocity) describes why, and to what end parties enter into contracts.

¹*Het vertrouwensbeginsel en de contractuele gebondenheid*, proefschrift Leiden, 1995. Smits dismisses the reliance principle as dogmatically useless and boldly postulates the *causa finalis* as the cornerstone of the theory of contract.

²Part I §§ 11, 12.

³Gordley, *Philosophical Origins*, *supra*, 232, 240 sq., 244.

⁴Westermann, *Die Causa*, *supra*, 95 sqq.

⁵Smits, *Van wil, causa en verrijking*, *supra*, Stell LR (1997) 287, 295.

Consequently, Smits understands "reciprocity" and "contractual performance" in the broadest sense. The "performances" which the parties exchange do not only refer to the specific items of performance but to the whole content of the contract as such. The concept of reciprocity, in turn, is connected with the topic of equality in exchange ie commutative justice. Smits distinguishes "normal" and "abnormal" cases: the first category comprises contracts with "normal" counter-performances - these are standard situations of contractual exchange in which the justification of the exchange can be assumed if there are no indicators to the contrary, the second category comprises cases with abnormal counter-performances which need an additional justification from the circumstances of the individual contract. In both categories, the criterion to find out whether a contract has been formed, is whether, if no contract would be recognised, any unjust enrichment would arise. The idea of unjustified enrichment is closely linked to the concept of reciprocity:

"De overeenkomst dient ertoe een uitwisseling van goederen te bewerkstelligen en men is over het algemeen slechts bereid tot een dergelijke uitwisseling omdat men meent dat, om welke reden dan ook, die uitwisseling gunstig is. Dit betekent dat de *causa* voor de gebondenheid doorgaans zal kunnen worden aangenomen omdat de verrichte of beloofde prestatie in het voordeel van de handelende persoon wordt geacht te zijn. Dat is 'normaal'.

...

Praktisch komt dit daar op neer dat slechts dan een tot gebondenheid aanleiding gevende samenhang bestaat waar het voordeel dat de ene persoon verkrijgt, niet in een wanverhouding staat met het nadeel dat de andere partij lijdt. ...

De theoretische grondslag van de *causa* werd vervolgens ingevuld aan de hand van het ethisch gedachtengoed dat ook tot uitdrukking komt in bijvoorbeeld de *iustum pretium*-leer."¹

Here we are back with Gordley's Aristotelian virtues.

Westermann classified the German cases into categories in a way similar to those of Smits. He distinguished contracts with a "typical" *causa* (where the just *causa* is assumed) and others, where the *causa* needs a special agreement of the parties:

"Causa ist ein vom Recht auf Grund einer Parteivereinbarung oder wegen seines typischen Vorkommens beachteter, auf diese Weise aus der Reihe der Motive herausgehobener Zweck einer Vermögenszuwendung. Die beiden Formen der *causa*

¹Smits, "Van wil, *causa* en verrijking: over een alternatieve route naar de contractuele gebondenheid", *Stellenbosch Law Review* 1997, 292,295.

unterscheiden sich dadurch, daß die typische *causa* einer Zuwendung regelmäßig zusammen mit der Einigung über diese zustandekommt; eine darüberhinausgehende *causa* bedarf einer von der Einigung über die Zuwendung geschiedenen Vereinbarung. Der typische Zweck wirkt also als Vermutung für den im Rahmen der Vertragsfreiheit grundsätzlich maßgebenden vereinbarten Zweck."¹

Although Westermann wants to keep closer to the parties' actual agreement, it seems clear that in "untypical" cases, the necessary "extra *causa*" must be extracted from the contract as a whole, not necessarily from the expressed words of the parties only, but also from the accompanying circumstances. It will not be difficult to see a thus identified *causa* as part of the contract and part of the parties' agreement. The difference between Westermann and Smits in this respect seems to be more a matter of formulation.

Westermann, however, seems to differ from Smits and Gordley in that he regards material equivalence, that is, equality in exchange, as of no significance:

"Subjektiv genügt es also, wenn die Parteien ihre Leistungen für austauschwürdig, nicht etwa für gleichwertig halten. Es kommt ferner nicht auf das objektive Wertverhältnis von Leistung und Gegenleistung an."²

Yet Westermann does not seem to differentiate the subject matter of performance and the contractual performance as a whole. Equality of exchange in the sense of Gordley and Smits refers rather to the whole of the contract as such: advantages and disadvantages of the parties should be in a relative equilibrium and not totally disproportionate. Several circumstances of the contract can play a role in determining whether that is the case or not.³

¹Westermann, *supra*, pp. 63,64.

²Westermann, *supra*, p. 96.

³This very brief and selective sketch of the three authors' position may suffice for the purposes of this thesis.

Because all three have different aims, they do differ in important points when dealing with *causa finalis*. The main difference between Westermann and the other two is that Westermann merely wants to analyse the situation of the relevance of *causa* for the Code Civil and the BGB as it is (or was 1964). The projects of Gordley and Smits go further. They do not simply want to describe the law as it is, want to develop it further. Smits is the boldest in attempting to base the whole theory of contract on the *causa finalis* and his far-reaching consequences from this is not persuasive in all respects. According to Smits, the very question whether a contract has come into existence depends on whether the requirement of *causa finalis* is satisfied or not (Smits, *Het vertrouwensbeginsel*, *supra*, p. 236). Westermann emphasizes that the requirement of *causa finalis* has consequences for the question whether a contract retains its binding character, and not whether the contract comes into existence at all. Its significance is therefore more that of a defence (Westermann, *supra*, pp. 60,61). In my view, Smits turns the relation between form and substance in the law into the opposite of the traditionally held view: in the past the formal

In view of the foregoing, the principle of *causa finalis* could also be formulated as follows:

The causa finalis (end or purpose) of a contract (seen as a first step just abstractly, without regard to its individual content) is a balanced, and therefore just, equivalence of interests of the parties. In contracts of exchange, therefore, the causa finalis of the contract entails equality in exchange (commutative justice) in view of all the obligations of a contract as a whole. Equality in exchange may regard the value or the fitness of the subject matter of the performance(s) for a special purpose. In the case of unilateral contracts (like donation) the causa finalis of the contract is - in accord with the Aristotelian-Thomistic tradition - liberality.¹

Advantages and disadvantages of the parties must in the terminology of Arthur Kaufmann be "comparable", or "assimilated". Equivalence - assimilation (analogy) is the essence of justice.² This is only another formulation for commutative justice, and it is a guideline and measure for the allocation of risk, which plays such a prominent role in modern jurisprudence. The law only bestows binding force on a contract when the parties reach agreement and when each of the parties shows consideration for the interests of the other party. And this reciprocal consideration must last for the duration of the contractual transaction. That is the essence of the principle of good faith. This already leads us to the conclusion, that *causa finalis* and good faith are concepts that complement each other because they both aim at content and are both value-orientated. Larenz actually identifies the principle of good faith with commutative justice (and not simply equity).³

3. As to the third question:

The third question - when exactly is a frustration of purpose operative - is, of course, the decisive one and the most difficult to answer. The difficulties lie in the nature of the problem. It does not seem possible that there could be something like a general pattern of how and when the purpose of a contract can be frustrated.

aspect of the law was overemphasized, Smits runs the risk of doing the opposite when he wants to decide all relevant questions about the content of a contract under the rubric whether the contract has actually come into existence. It appears to be more realistic to acknowledge in certain circumstances that a contract has been formed, but that it may be dissolved if its content does not meet the necessary requirements. Smits is eventually forced to split up the contract into a formal and a substantial agreement in an artificial way (Smits, *Het vertrouwensbeginsel*, *supra*, p. 284).

¹Part I § 1, Gordley, *Philiosophical Origins*, 17 sqq. and 49 sqq.

²Part I § 12.

³Part II, § 3.2.

To apply the principle of *causa finalis*, one has - as it is advocated by Larenz -, in the first instance to assess the balance of exchange (interests) of the individual contract, as agreed by the parties, which determines the allocation of risk, and secondly to evaluate whether the change of circumstances has led to a total defeat of that balance of exchange and thus to a frustration of equality in exchange.¹

This is the task performed by the doctrines of *Wegfall der Geschäftsgrundlage* and frustration of contract as emanations and concretisations of the underlying informing principle of *causa finalis*.

Since the *causa finalis* of a contract of exchange is equality in exchange, the individual contract must be scrutinized to assess the elements vital to both parties which form the individual balance of exchange on which the parties are *ad idem*, and the realization of which is the common purpose of their contract. The absence or unattainability of one or more of these elements is required to result in a situation so different from originally envisaged that the obligation changes its whole character and the realization of the balance of exchange becomes impossible, that is frustrated.

The essence - which is, with respect to the relational nature of the contract, determined mainly by the purpose - of an individual contract must be determined with reference to the balance of interests typical of that class of contract. The same applies for atypical contracts, although it is more difficult to establish the contractual purpose in the absence of a well-known contractual standard situation for purposes of orientation.²

One has in each case to scrutinise closely the circumstances of the contract to identify the relevant elements of the exchange and how the balance was designed by the parties. If the fundamental change of circumstances does not affect an element which was vital for that balance, the risk remains in the sphere of the affected party. The *causa finalis* or purpose of the contract must be common to all parties in order to be binding for them. It is determined in a mixed objective-subjective approach.

Its determination depends on the one hand, and primarily, on the common intention of the parties regarding the contract - meaning the point where their different intentions and motives met (Larenz) and were thus brought into coherence (or assimilation).³ According to Larenz, it is justified to speak of a common purpose of the parties since they would not have concluded the contract, if their individual purposes had not met at a certain point and insofar been objectivised.⁴ This depends of

¹Part II § 3.2. at the end, Larenz, *Lehrbuch des Schuldrechts*, 331.

²The terminology of "typical" and "atypical" contracts has been introduced by Westermann and Smits, see above.

³Part I § 12.

⁴Part II § 3.2.; Larenz, *Geschäftsgrundlage*, 104 sqq.

course on the evidence that can be gathered from the surrounding circumstances at the time of the conclusion of the contract.

On the other hand the *causa finalis* decisively depends on the normative character of the obligation. Whether it is still justified to speak of a just balance of interests after the change of circumstances is, as pointed out, a normative question requiring a normative answer with reference to the principles of good faith and commutative justice. The law is not and cannot be blind towards the purposes of the parties. The law does not simply sanctify the will of the parties without due regard to its content - as the will-theory sometimes seems to suppose. The law makes distinct value-judgements regarding purposes. It favours the "good cause" - the cause that is good in the eyes of the law. Law is always guided by - and aiming at - values. These values change but that does not make the law arbitrary. It should be conscious about its underlying values and the continuing change in these values. That would make the whole process more transparent and controllable. The subjective purposes of the parties and the objective purposes of the law thus have to be brought into coherence (assimilation).¹ Only then will the law sanction the agreement of the parties.

If the essential purpose of the contract is or becomes unattainable, that is, frustrated, that has consequences for the binding character of the contract. The purpose of the contract is frustrated when there is in actual fact no equivalence anymore between the interests of the parties; when the contract no longer complies with the requirements of commutative justice and the disruption of equality in exchange amounts to a frustration of purpose. The borderline is certainly difficult to draw, but it is equally certain that a borderline has to exist beyond which the binding character of the contract must come into question. The value-orientation of the law, its focus on justice, demands such a borderline. As Lord Denning said in the *Eugenia*-case:

"It must be positively unjust to hold the parties bound. It is often difficult to draw the line. But it must be done."²

To regard the inability of the principle of *causa finalis* to provide a clear-cut solution for every individual case as a failure, would mean to miss its real significance and its nature as an informing principle, which is in providing the contract law with a cornerstone for a coherent theory as regards its dogmatic clarification and orientation. It explains the need to intervene into some contracts and not in others and why, in order to attain his objectives, the promisor must be bound under some

¹Kaufmann, see Part I § 12.

²Smith & Thomas, 533

circumstances and why other circumstances lie outside his commitment. For practical reasons, all central principles often cannot be *directly* applied, but that alone does not question its merits. *Causa finalis* as an informing principle cannot possibly provide a single clear-cut solution for all cases of frustration of purpose, but it makes clear what the really decisive point is.

The possibilities of *how* a frustration may occur are endless. Similarly, the issue as to the threshold beyond which the purpose of the contract is to be regarded as frustrated also depends on the individual contract and the surrounding circumstances.

It has been said above that it might be possible to identify certain typical situations or typical kinds of contracts in which there are similar patterns of how and when the contract becomes frustrated.¹ Nevertheless it will never be possible to describe a general pattern for all kinds of frustration of purpose, but it might be possible to describe sub-patterns for specific kinds of frustration of purpose, and to lay down abstract rules for such cases. The most obvious examples are to be found in established rules of law or provisions of the Code which, although the concept of frustration of purpose is not employed, nevertheless amount to manifestations of this basic phenomenon. The rules of the Code governing impossibility afford but one example since impossibility is one of the most obvious instances of frustration of purpose. It comprises a class of recurring cases, and can therefore be encapsulated in abstract rules. Such instances can be called "typical" situations of frustration of purpose. They are dealt with by the abstract rules of law or provisions of the Code.

But there will always be situations and instances of frustration of purpose that fall through the net of "normal" or "typical" situations provided for in the Code, due to the endless possibilities of frustration of purpose. These "atypical" cases cannot be dealt with by abstract rules of law or provisions, and must therefore be left to judicial decision. This is confirmed by Aristotle's words about equity cited at the beginning of this part of the thesis:

"...for the error is not in the law nor in the legislator but in the nature of the thing,.... When the law speaks universally then, and a case arises on it which is not covered by the universal statement, then it is right, where the legislator fails us and has erred by oversimplicity, to correct the omission... In fact this is the reason that all things are not determined by law, viz. that about some things it is impossible to lay down a law, so that a decree is needed. ... the [Lesbian] rule adapts itself to the shape of the stone and is not rigid, and so too the decree is adapted to the facts."²

¹Westermann, Smits, *supra*.

²Aristotle, *Nicomachean Ethics*, Oxford's World's Classics Edition, 133.

For these cases, only the general principle can be formulated or codified in the abstract, with the treatment of particular cases depending on the circumstances of the individual contract. These are the situations for which the doctrines of *Wegfall der Geschäftsgrundlage* and frustration of contract (at least concerning the instances of relative and quasi-impossibility) have been developed by the judiciary. The *ultima-ratio*-character of these doctrines has often been emphasized.

In both cases, the crucial criterion for the courts, be it the "Unzumutbarkeit" or the "radical difference of the subject matter of the obligation", only states a general guideline which echoes the principle of *causa finalis*. Both criteria are efforts to circumscribe when exactly there is an operative frustration of the contractual purpose of commutative justice, the common law criterion from an objective, the civil law criterion from a subjective point of view. In the statements of the *Bundesgerichtshof* and of Larenz, this connection comes to the fore clearly:

"Bei gegenseitigen Verträgen ist in der Regel die Vorstellung von der *Gleichwertigkeit von Leistung und Gegenleistung* Geschäftsgrundlage. ... die Berufung auf eine *Änderung* oder einen *Wegfall* der Geschäftsgrundlage [ist] nur zulässig, wenn das zur Vermeidung eines untragbaren, mit Recht und *Gerechtigkeit* nicht zu vereinbarenden und damit der betroffenen Partei nicht zumutbaren Ergebnisses unabweislich erscheint."¹

"Nur solche Umstände können daher als Geschäftsgrundlage in Betracht kommen, die gerade dieses konkrete Vertragsverhältnis betreffen, seinen Inhalt und Charakter zu *ändern* vermögen. Und nur solche Folgen dürfen aus dem Fehlen oder Wegfall der Geschäftsgrundlage gezogen werden, die sich aus dem Sinn dieses Vertrages ergeben oder zur Wahrung der *ausgleichenden Gerechtigkeit* in bezug auf diesen Vertrag unerlässlich sind."²

Even though the English courts are reluctant to speak openly of equality of exchange, and emphasize that increase of expense or hardship is not in itself a ground for frustration, it is clear from authoritative statements that the term "radical difference of the obligation" relates to the *extent* of the disruption of equality in exchange that is required and does not relate to a different category altogether:

¹BGH JZ 1978, 236.

²Larenz, *Geschäftsgrundlage*, 166.

"But, even so, it is not hardship or inconvenience or material loss *itself* which calls the principle of frustration into play. There must be *as well* such a change in the significance of the obligation that the thing undertaken would, if performed, be a different thing from that contracted for."¹

"Frustration of contract takes place when there supervenes an event ... which so significantly changes the nature (not *merely* the expense or onerosity) of the outstanding contractual rights and/or obligations ... that it would be *unjust* to hold them to the literal sense of its stipulation in the new circumstances."²

It would in any case be difficult to imagine cases in which a radical change of the nature of the obligation would leave the equality of exchange - understood in the broad sense advocated here - untouched.

The Radcliffe-test makes it clear that a frustration of equality of exchange can only be assumed beyond a certain threshold, that is, when the obligation has totally changed in character through the change of circumstances and now represents a totally different contract altogether compared to what was originally agreed. This objective formulation can probably be regarded as more accurate and useful for practical purposes than the notion of *Unzumutbarkeit*.

Both doctrines are emanations of the basic principle of *causa finalis*, which also influences other areas of the law.³ Both legal systems employ similar requirements (frustration of common purpose or *causa finalis*) and restrictions (foreseeability, fault, express provision).

Consequently, Piet Abas, on the basis of his comparative study *Rebus sic stantibus*, encompassing the law of almost all European countries on this topic, follows Larenz' teleological position, and

¹*Davis Contractors Ltd. v. Fareham Urban District Council* [1956] A.C. 696, *per* Lord Radcliffe.

²*National Carriers Ltd. v. Panalpina (Northern) Ltd.* [1981] A.C. 675, *per* Lord Simon.

³Westermann denies an identity between *causa finalis* and *Wegfall der Geschäftsgrundlage* (Westermann, *supra*, pp. 123sq.). Westermann acknowledges many parallels between the two doctrines but denies any real relationship, which seems inconsistent to me. Of course, *causa finalis* and *Wegfall der Geschäftsgrundlage* cannot be simply identified, but a relationship between the two is evident and suggests itself. They are of the same essence. They are simply situated on two different dogmatic levels and their relationship is that of principle to concretisation. Westermann's anxiety to keep the two doctrines apart appears artificial, and is motivated by the fact that his aim is not to break new ground in the law. He only wants to describe the situation as it is, and to integrate the *causa finalis* into the BGB: hence the assertion that all possible cases of frustration of purpose have been dealt with by the provisions of the Code and that outside these provisions, an operative frustration of purpose cannot be accepted (Westermann, *supra*, pp. 134,135).

advocates a combination of the German and the English approaches. He states the following as requirements for a successful defence based on fundamental change of circumstances:

- "1. der Umstand ist *nach Vertragsschluß* eingetreten;
2. das Eintreten des Umstandes ist *redlicherweise nicht vorhersehbar* gewesen;
3. dieser Umstand macht die Erfüllung *nachträglich unzumutbar*: davon ist auszugehen, wenn die Leistung jetzt *wesentlich anders* ist, als die ursprünglich vereinbarte war, und zwar in dem Sinne, daß die Erfüllung einer *neuen* Leistung zu einem dermaßen großen *Nachteil* führte, daß die *Gegenleistung* in keiner Weise als *gleichwertig* bezeichnet werden kann;
4. der Umstand ist nicht demjenigen *vorzuwerfen*, der sich zu seiner Befreiung auf sie beruft;
5. der Umstand fällt nicht in die *Risikosphäre* desjenigen, der sich zu seiner Befreiung darauf beruft; daß ist der Fall, wenn der Umstand die Partei persönlich angeht;
6. derjenige, der sich zu seiner Befreiung auf den Umstand beruft, darf sich selbst *nicht im Verzug* befinden."¹

4. As to the fourth question:

No single or uniform consequence can be imposed in respect of the fourth question, namely that as rigid legal consequence would not serve the interests of the parties, it would be too harsh. This is part of the problem in the common law doctrine of frustration of contract.

Uniform legal consequences can only be laid down for the "typical", "normal" situations of frustration of purpose mentioned above, as has been done by means of the provisions of the Code.² This is possible because these typical cases of frustration of purpose have a common pattern. The atypical cases of frustration of purpose, our cases of *Wegfall der Geschäftsgrundlage* and frustration of contract, do not reveal such common patterns, and a uniform legal consequence is accordingly inappropriate. This is the difficulty posed by the doctrine of frustration of contract, and the main reason for its very restricted application. German private law is in a better situation because of the possibility to fall back on § 242 BGB to devise legal consequences which suit best the interests of the parties and which gives judges a rather unrestricted hand to adjust the contract to the new circumstances. This is actually most appropriate for these cases and shows again, how *causa finalis* and good faith complement each other, for the adjustment of the contract follows from the nature of

¹Piet Abas, *Rebus sic stantibus*, 1993, 309, 310.

²Westermann, *supra*, 108.

the principles of *causa finalis* and good faith. In the cases of *Wegfall der Geschäftsgrundlage*, *causa finalis* had been there from the outset, but has been frustrated due to change of circumstances. *Causa finalis* of a contract is a just equivalence of the parties' interests, an equivalence of both parties' advantages and disadvantages. If this equivalence is destroyed, the natural consequence is that commutative justice demands the restoration of the equivalence, if that is possible. This is the consequence that is of most interest to the disadvantaged party. The duty for the advantaged party to restore, or participate in the restoration of the equivalence and thus adjust the contract to the new circumstances, in turn follows from the principle of good faith. The duty to act according to good faith is a natural incidence of all contracts and it demands that both parties have to do what can be expected of them to attain the *causa finalis* of the contract. This shows that the notion of contractual adjustment, although not very precise, is actually very appropriate. Its flexibility corresponds to the character of the principle of *causa finalis*.

Both *causa finalis* and good faith operate on the same level - that of contractual principles. Both can be employed by way of defence. Neither questions the validity of the contract, they relate instead to its enforceability. The presence of a *causa finalis* at the formation of the contract can be presumed, but its frustration, be it due to the fact that it has become unattainable afterwards or has been unattainable from the very beginning, can be established as a defence. Both principles are concerned with values, with the content of the law, as opposed to the form. They both are material principles of the law, designed to ensure that the law stays true to the idea of the law, which is the pursuit of justice.

On this basis, the principle of *causa finalis* is also perfectly reconcilable with the traditional approach to contracts which takes the will-theory as its point of departure. The principle merely reminds us that will cannot be treated divorced from its aim or purpose. The will of the parties will always be the basis of a contract but the law is not and never was blind to the aim of that will. What seems to have been sometimes forgotten in theory - though not in practice, as the cases show - is that how the contract is treated by the law depends in fact more of the aim of the will rather than the pure empirical fact that something has been willed with the intention of being bound.

This outline may suffice to sketch the major traits of the principle of *causa finalis* and its relationship to the doctrines of *Wegfall der Geschäftsgrundlage* and frustration of contract for the purposes of this thesis. The result corresponds to the position of Karl Larenz *vis-à-vis* the doctrine of *Wegfall der Geschäftsgrundlage* as laid down in his classic monograph *Geschäftsgrundlage und Vertragserfüllung*.¹ This position is, of course, only tenable if one adopts a *teleological* understanding

¹Part II § 3.2.

of the concept of contract, as it is the case with Karl Larenz, Arthur Kaufmann and the adherents of the *Wertungsjurisprudenz*, and not a purely *systematic* understanding of contract like that of Flume, and before him Savigny.¹

Many studies probably remain to be done to work out the implications of the principle of *causa finalis* in all fields of private law - be it civil law or common law. The principle could thereby also serve as a bridge between civil law and common law. James Gordley has already made a great contribution in that respect and continues to do so. It will be interesting to see whether or not the future will bring a higher prominence of the principle of *causa finalis* in legal dogmatics.

To quote Gordley once more:

"Aristotle was constantly defending his principles by pointing out that they could explain the actions of people who acted in accordance with these principles but could not formulate them abstractly. One can imagine him pointing to the American case law as a vindication of his ideas of liberality and commutative justice."²

This applies to the laws of the whole western hemisphere, that is, all countries which have been influenced by Aristotle's philosophy.

¹Part II § 3.1.

²Gordley, *Philosophical Origins*, 614.

Part V: South Africa

1. Introduction

No legal system can ignore the basic problem of change of circumstances and the fundamental questions about the law which it entails.

At a first glance, South African law does not accommodate a doctrine similar to frustration in the common law, *Wegfall der Geschäftsgrundlage* in German law or *clausula rebus sic stantibus* of the *ius commune*. There are judicial statements which expressly assume that the English doctrine of frustration is not part of South African law. In *Algoa Milling Co v Arkell & Douglas*,¹ Maasdorp JA said:

"If we put aside for the moment the condition contained in the marginal note, then in fact, if it is a fact, that the plaintiffs could not find available space during the month of July, and that it was impossible for them to ship during July, will be no excuse for their failure to ship during July. Nowhere in our law is it laid down that an impossibility arising from changed circumstances after a contract has been entered into would excuse a party from performing the conditions of the contract. ... As a matter of fact none of our legal textbooks deal specifically with the effect upon a contract of an impossibility arising from changed circumstances after a contract has been concluded."²

In *Beretta v Rhodesia Railways Ltd*³, Tredgold JA said:

"Two possible views have been advanced: (a) That, when one party is disabled from performing his obligation for an unreasonably extended period, this gives the other party the right to cancel the contract; (b) that such disability when prolonged beyond a reasonable period has the effect of automatically terminating the contract as from the time when the disability originated. The latter view has been accepted in England. ... But the English law on this point is complicated by the development of a somewhat artificial doctrine described as 'frustration', a development which has no parallel in our law. A consideration of this view reveals the artificiality to which I have referred and further the difficulties which it involves. It is postulated that the contract is not at once discharged.

¹1918 AD 145, 170.

²Supervening impossibility was recognized as an excuse in *Peters, Flamman & Co v Kokstad Municipality* 1919 AD 427.

³1947 2 SA 1075 (SR) 1078, 1081.

But after the passage of an unspecified time, which must vary greatly with the circumstances of each contract, a situation arises which has retroactive effect and discharges the contract as from a prior date. It is not, as Mr. Greenfield ingeniously suggested, a case of time revealing the evidence of a prior occurrence. For the contract continues for a period as a matter of substantive law and later, as the situation develops, is discharged in respect of the same period. The correct method of dealing with any rights which may have vested during this period remains an enigma. The former view presents no such difficulties."¹

The most recent and elaborate statement on this subject is to be found in *Techni-Pak Sales (Pty) Ltd v Hall*,¹ by Colman J:

"What the plaintiff is seeking to invoke here is the English doctrine of frustration of contracts. That is a doctrine under which further performance of a contract is excused when something which is found to have been the basis of the transaction has fallen away or failed to come into existence. The limitations of the doctrine and its jurisprudential basis are somewhat obscure. That it extends to cases falling outside the ambit of the rules relating to impossibility of performance, is clear. But what is not clear is whether it is anything different from an application of the rules relating to implied terms. Some eminent English Judges would answer the last question in the negative (see, e.g. the remarks of Viscount Simon in *Joseph Constantine Steamship Line Limited v. Imperial Smelting Corporation Limited*, (1941) 2 All E.R. at p. 171, and the cases referred to). But other no less eminent authorities like Lord Sumner in the *Hirji Mulji v. Cheong Yue Steamship Company* case (1926) A.C. 507, stoutly resist that theory and hold that the doctrine is an equitable device whereby the rules as to contracts are reconciled with a special exception which justice demands. On the latter approach it would seem the Court may give relief even when the requirements for the implication of a term are not satisfied. If the Courts are to interfere on the grounds of equity alone in commercial bargains, where does the process end? Some of the *dicta* seem to suggest that we have here the thin end of a wedge whose exact shape and full dimensions remain undefined. A few more taps, maybe, and the granite concept of sanctity of contract will be shattered. But I do not think that I am called upon to pursue that interesting possibility. In our own

¹With reference to the case *Schlengemann v Meyer, Bridgens & Co, Ltd* 1920 CPD 494, a parallel case which could suggest the application of the doctrine of frustration in South African law, he argued: "Only English cases were quoted in the judgement and the differences between our own law and the English law in regard to impossibility of performance ... were given no account."

Courts the doctrine of frustration has upon occasion been referred to by that name, but it is not clear to me that it has ever been applied to a situation which was not covered also by one or other of our more familiar rules relating to implied terms or impossibility of performance. Counsel have not been able to refer me to any case in which one of our Courts has assumed the type of broad equitable jurisdiction which the Courts of England are said to have in respect of frustration."

It should be noted that in all these cases, the rejection of the doctrine of frustration was not the decisive reasoning on which the judgement rested.²

The *dicta* in the cases cited above reflect the difficulties with which the English doctrine of frustration had to grapple, especially the discussion around its juridical basis. They also voice the fundamental concern that is always connected with the doctrine: sanctity of contracts and legal certainty.

Yet it is submitted that these *dicta* only serve to obscure the matter. A closer look at the relevant cases reveals that once again the distinctive hybrid of common and civil law that is the South African law³ proves to be more complex and multi-faceted than it appears to be at the surface. I would like to argue that the doctrine of frustration has - in a typically South African way - become part and parcel of the South African law regarding supervening impossibility.

In § 2 below, selected cases relating to the areas of supervening impossibility, supposition, implied terms and common error are analysed from the perspective which has been developed in the earlier parts of this thesis, in order to demonstrate that the formal position on frustration apparent from the *dicta* cited above present an inaccurate picture, and furthermore investigate whether there might even be support in South African case law for the submission that the principle of *causa finalis* is the decisive criterion in cases of fundamental change of circumstances.

2. Fundamental change of circumstances and frustration of purpose in South African law

2.1. Supervening impossibility and supposition

¹1968 3 238 (W).

²*Beretta v Rhodesia Railways Ltd, supra*, 1081; *Techni-Pak Sales (Pty) Ltd v Hall, supra*, 239.

³Zimmermann and Visser "Introduction - South African law as a mixed legal system" in: Zimmerman and Visser (eds) *Southern Cross* (1996) 1 seqq.

A particularly illustrative case concerning the relation of both supervening impossibility and supposition to the topic of frustration of purpose is *Kok v Osborne*.¹

The facts were the following: The plaintiff sought a declaratory order that she was entitled to the receipt of the purchase price (R 47000) of a plot allegedly sold to her by the first defendant. The seller, at the time the registered owner of the plot, had in May 1991 entered into a written agreement with one Hobson-Jones in terms of which he had sold it to the latter for R 47000. The agreement had stipulated that the purchase price had been paid in full on the date of the sale. In fact, Hobson-Jones had given the seller three post-dated cheques in payment. In the meantime the plaintiff, who had lent Hobson-Jones certain moneys for which he had given her a post-dated cheque that had bounced, found out about the purchase and insisted that, failing immediate repayment of the loan, she be substituted as purchaser of the land. Hobson-Jones proceeded to tell the seller that he, Hobson-Jones, had purchased the plot together with the plaintiff in a joint venture and that they intended developing it together and sharing the proceeds. The agreement was to be concluded in the plaintiff's name but the payment (by the three post-dated cheques) was to stand. The seller did not object: as far as he was concerned he was now contracting with Hobson-Jones and plaintiff as participants in a joint venture using plaintiff's name. The original deed of sale was cancelled and a fresh one prepared and signed by all three parties. The new agreement provided that the purchase price had already been paid 'in cash'. In reality the 'joint venture' was a fabrication of Hobson-Jones, but the seller believed what he had told him. The plaintiff believed Hobson-Jones when he told her the purchase price had been paid in cash in full. A few days after the signature of the new agreement, Hobson-Jones told the seller that the joint venture between himself and the plaintiff had fallen through, and that there were therefore no funds to meet the cheques, and the seller agreed not to present the cheques and to cancel the sale. The plaintiff knew nothing about this. The seller subsequently resold the plot to the second defendant. When the plaintiff heard about this she obtained an interim interdict to prevent transfer pending the outcome of the instant action. The plaintiff relied on the prior sale to her and argued that she was not bound by Hobson-Jones' purported cancellation of the sale to her, because he had not been authorised to cancel it on her behalf. The main defence raised by the seller was that the agreement was invalid for lack of consensus because of fundamental mistake relating to the identity of the party or parties with whom he was contracting.

The court held that the defendant was entitled to retain the proceeds of the sale and based the decision on two grounds: first, that the contract was void for mistake and, secondly, that the contract between the litigants hinged on the assumption that Hobson-Jones had indeed paid the defendant, which in fact never came to pass, and that the contract thus failed due to supervening impossibility of performance.

¹1993 4 SA 788 (SECLD).

The reasoning of the court, given *per* Jones J, regarding the second ground of the decision, serves as a thorough statement on the subject to what extent the doctrine of frustration is in line with - and in fact part of - South African law.¹ The judge first established from the facts of the case that the payment to Osborne by Hobson-Jones was the fundamental reason for entering into the contract for both Mrs. Kok and Osborne. To Mrs. Kok, the money paid to Osborne should originally have been used to repay her and although she did not want the property, her substitution as purchaser was the only safe way of getting some of her money back. Osborne, on the other hand, only agreed to the substitution in order to make sure that Hobson-Jones' cheques would be met:

"In the light of the above, the issue can simply and conveniently be resolved by applying the rule in *Peters, Flamman and Co v. Kokstad Municipality* 1919 AD 427 and *African Realty Trust v. Holmes* 1922 AD 389. The rule is variously stated. Indeed, it is the subject of different approaches by writers on the law of contracts, most of whom warn against the danger of undue reliance on the principles of the English doctrine of frustration. I prefer the formulation of the rule by Kerr *The Principles of the Law of Contract* 4th ed at 403. It is precisely and appropriately worded. The author puts it as follows:

'The basic rule is that if during the currency of a contract the conditions necessary for its operation cease to exist, the change not being due to the fault of either party or to a factor for which either party bears the risk, the contract ceases to exist.'

Usually, *vis major* or some other supervening physical or legal act occurs which makes the contract impossible of performance and brings it to an end, such as destruction of the subject matter of a sale, or the outbreak of war, or an Act of Parliament prohibiting conduct which was formerly permissible. But this is not always the case. Literal impossibility is not a prerequisite. The law recognises that the realities of the world of business demand that provision be made for a situation where unforeseen contingencies prevent the attainment of the commercial purpose which the parties had in mind when they contracted. That, too, can amount to legal impossibility."²

Jones J then proceeds to review the authorities for support of his judgement. He relies on South African cases which, in dealing with impossibility of performance, cite with approval typical English frustration cases.³ In *African Realty Trust v Holmes*,¹ De Villiers AJA had referred to the Coronation

¹At 801D-805A.

²*Kok v Osborne, supra*, 801J-802E.

³*Kok v Osborne, supra*, 802E-804G.

Cases as being in accord with South African law. In *Bischofberger v Van Eyk*,² Boshoff JP cites the decisive passage from the English case of *Morgan v Manser*³ with approval, saying that although worded differently, it does not seem to be at variance with South African law. The same applies to *Rossouw v Haumann*,⁴ where Herbstein J cites Lord Sumner in the *Hirji Mulji* case⁵ with approval. Jones J also refers to *Williams v Evans*,⁶ where the term basis of the contract was employed in relation to common supposition, and to *Sishen Hotel (Edms) Bpk v Suid-Afrikaanse Yster en Staal Industriële Korporasie Bpk*.⁷ He concludes:

"I am of the view that these authorities support the conclusion that the rule of *Peters, Flamman and Co v. Kokstad Municipality* and *African Realty Trust v. Holmes* is applicable to the situation which arises in this case. The common object of the parties is frustrated because Hobson-Jones fraudulently induced Osborne not to present the cheques. Further, on the evidence of Mrs. Opperman, the cheques would not have been met even if they had been presented. The basis of the agreement, namely payment by Hobson-Jones, has accordingly failed and therefore the contract fails. Whether the parties had in mind the substitution of only one buyer or two joint buyers for the original buyers in a valid and binding contract of sale, their object fails completely because the common supposition or assumption of payment fails. The result is an entirely different contract from that intended by the parties."⁸

The decision in *Kok v Osborne* was criticised by Pretorius and Floyd⁹ for following Kerr's exposition of the law while the majority of South African writers maintain that commercial impossibility or frustration of the common purpose is not part of South African law.¹⁰ They also reproach Jones J for equating the instances of a contractual assumption or supposition with supervening impossibility of performance. While they concede that the courts have indeed dealt with assumptions under the mantle of supervening impossibility in cases such as *Bischofberger v Van Eyk* and *Rossouw v Haumann*, they

¹1922 AD 389, 400.

²1981 2 SA 607 (W) 610H-611H.

³[1947] 2 All ER 666, 670.

⁴1949 4 SA 796 (C) 799, 800.

⁵*Hirji Mulji and others v Cheong Yue Steamship Co Ltd* 1926 AC 497, 507.

⁶1978 1 SA 1170 (C).

⁷1987 2 SA 932 (A).

⁸*Kok v Osborne, supra*, 804H-J.

⁹Pretorius and Floyd, "Mistake and Supervening Impossibility of Performance" 1994 *THRHR* 325 328-329.

¹⁰The authors refer to Lubbe and Murray *Farlam and Hathaway: Contract: Cases materials and commentary* 1988, 773-774; Christie, *The law of Contract in South Africa* (1991) 563-565; Ramsden *Supervening impossibility of performance in the South African law of contract* (1985) 68-75.

insist that this was incorrect because of the different legal consequences (voidness *ab initio* as opposed to extinction *ex nunc*). The court should for that reason have restricted itself to the concept of supposition. The authors concede that the concept of supposition, especially when relating to the future as in the two cases mentioned, is unclear in South African law.

The argument that supervening impossibility and supposition should not be confounded because their legal consequences differ, does not go very far. Common supposition is largely congruent with common error.¹ Jones's J equation of supervening impossibility (as he understands it) with supposition only reiterates the perception of the close analogy between cases of common error and cases of frustration of contract that has gained ground in England, which has lead Atiyah to deal with both kinds of cases side by side in one category in his *Introduction of the Law of Contract*.² The close relation between common error, assumption and the identical test to be employed in cases of common error and frustration - which is evidence of the same underlying principle - is best illustrated by the famous case *Bell v. Lever Brothers Ltd.* 1932 AC 161, where Lord Atkin said:

"Sir John Simon formulated for the assistance of your Lordships a proposition which should be recorded: 'Whenever it is to be inferred from the terms of the contract or its surrounding circumstances that the consensus has been reached upon the basis of a particular contractual assumption, and that assumption is not true, the contract is avoided: that is, it is void *ab initio* if the assumption is of present fact and it ceases to bind [*ex nunc*] if the assumption is of future fact.' I think few would demur to this statement, but its value depends upon the meaning of 'a contractual assumption,' and also upon the true meaning to be attached to 'basis,' a metaphor which may mislead. ... We therefore get a common standard for mutual mistake and implied conditions whether as to existing or as to future facts. Does the state of the new facts destroy the identity of the subject matter as it was in the original state of facts? To apply the principle to the infinite combinations of facts that arise in actual experience will continue to be difficult, but if this case results in establishing order into what has been a somewhat confused and difficult branch of the law it will have served a useful purpose."³

¹Van der Merwe, Van Huyssteen, Reinecke, Lubbe, Lotz; *Contract - General Principles* (1993) 203, note 209; De Wet & Van Wyk *Kontraktereg*, 5th ed (1992), 27-28, 155; Hoffmann 1935 *SALJ* 432-434; Bamford 1955 *SALJ* 289-294; Palley 1961 *RNLJ* 196, 201-203; Hunt 1964 *SALJ* 153, 156; see also De Groot *De jure belli ac pacis* 2 11 6.

²Atiyah, *Introduction of the Law of Contract*, 5th ed (1995) Chapter 12 §§ 2 and 3.

³Smith & Thomas, *A Casebook on Contract*, 9th ed. (1992) 490-494.

The two legal consequences can be reconciled under the same principle: Frustration of purpose is there from the beginning in cases of common error or supposition and thus the contract is discharged *ab initio*, or the contract is discharged from the moment of supervening frustration of purpose.

The use of the term "commercial impossibility" is misleading and not helpful because it tries to retain the concept of impossibility while trying to relativise it. In reality, impossibility - and especially commercial impossibility - is only the most obvious case of the underlying principle of frustration of purpose, the need for a kind of "commercial impossibility" only demonstrates this fact.

As to the question whether there can be no supposition *in futuro*, I cannot see any logical or other compelling reason for why a supposition should be possible regarding past or present but not the future.¹ The case of *Bell v. Lever Brothers*, above, also suggests that there is no decisive difference. The decisive reason for the efforts to avoid a supposition *in futuro* are made clear by Christie:²

"Attempts were made to resurrect [*Williams v. Evans*], but it is better left dead. If litigants are obliged to plead, as *Sonarep* and *Hare's Brickfields* oblige them, that their contract contained a tacit term or was subject to a tacit suspensive or resolute condition we know where we are because those concepts are well known to the law. But if they are allowed to plead, as *Williams v. Evans* would allow them, that their contract was entered into on the basis of a common assumption as to a future state of affairs we do not know where we are. The limits of the concept would have to be defined. If they turned out to be the same as the limits of a tacit condition the whole exercise would have been an expensive waste of time. If they turned out to be different, the difference would have to be justified, and no such justification is apparent."

¹De Wet & VanWyk, *Kontraktereg*, 156 deny the viability of a supposition *in futuro*, and so does Christie, *Contract*, 400-401. De Vos *Verrykingsaanspreeklikheid in die Suid-Afrikaanse reg* (1987) 11-12, and 1976 *TSAR* 82, Kerr 1987 *SALJ* 550 and Van der Merwe & Van Huyssteen 1985 *THRHR* 469, on the other hand, are of the view that it is possible. In *Williams v. Evans* 1978 1 SA 1170 (C) 1174-1175 it was accepted that a supposition *in futuro* is of the same nature as a supposition about the past or present, while in *Osman v. Standard Bank National Credit Corporation Ltd* 1985 2 SA 378 (C) 386 the court, citing *Williams v. Evans*, remarked that 'if a contract is entered into on the basis of a common assumption as to a past, present or future state of affairs, and that assumption turns out to be unfounded, the contract will be void'. The court, however, did not specifically consider the viability of a supposition *in futuro*. In *Sonarep SA (Pty) Ltd v. Motorcraft (Pty) Ltd* 1981 1 SA 889 (N) 901-902 the court apparently took the view that a supposition *in futuro* could not occur, and in *Hare's Brickfields Ltd v. Cape Town City Council* 1985 1 SA 769 (C) the court expressly held that *Williams v. Evans* was wrong in apparently accepting that a supposition *in futuro* could result in 'failure' of the contract 'if the supposition fails'. For a criticism of that decision see Van der Merwe & Van Huyssteen 1985 *THRHR* 469, with whom I respectfully agree.

²Christie, *The Law of Contract in South Africa*, 3 ed (1996) 369.

This kind of legal conservatism is not the most forceful of arguments. It correctly points to the difficulties and irritations in the broad field of the interrelated concepts of tacit and implied terms, conditions, suppositions and irrelevant motives, reminiscent of the criticism against Windscheid's *Voraussetzungslehre*.¹ A complex field indeed. But that makes it all the more necessary to closely investigate this area of the law. On the basis of what has been worked out in the earlier parts of this thesis, the solution appears to lie not in the identification of more and more kinds of contractual terms and mental reservations which have to be imputed into the parties' minds and from there into the contract, but in a more objective approach under consideration of the teleological nature of the contract as advocated by Larenz or Kerr in South Africa. Such an approach can be based on more general norms such as public policy and good faith.² Van der Merwe and Van Huyssteen incline in this direction when they observe that in the case of assumption or supposition - as opposed to the case of a condition - the reason for the failure of the contract is not so much an awareness of an uncertainty surrounding particular facts but rather the high degree of certainty in the minds of the parties about the factual basis of their contract.³ Consequently, the general criticism *vis-a-vis* implied terms applies: if the parties never doubted the correctness of their assumption, it cannot be inferred that the parties intended to provide for the case that the assumption was wrong, lest such a tacit term is actually based on objective considerations which go beyond actual consensus.⁴ This is the direction which has to be pursued and which is advocated in this thesis.

Lubbe and Murray argue against *Kok v Osborne* that the instance of frustration of purpose goes beyond the limits of the South African doctrine of impossibility of performance which requires some performance under the contract becoming impossible.⁵ This view is shared by Christie, opting for sanctity of contracts to prevail over an unforeseen change of circumstances.⁶ These authors contend that the *dictum* of De Villiers JA in *African Realty Trust v. Holmes* provides little support for Kerr's position as approved by Jones J in *Kok v. Osborne*, since the judge himself had stressed that

¹See above Part II § 1.1.

²Van der Merwe *et al*, *Contract* p. 387, note 183; Van der Merwe & Van Huyssteen, 1990 *Stell LR* 244; Lubbe and Murray, *Contract*, 773-774.

³Schalk van der Merwe, LF van Huyssteen, "Hare's Brickfields Ltd v Cape Town City Council 1985 1 SA 769 (C)" 1985 *THRHR* 469 471.

⁴Van der Merwe *et al*, *Contract*, 203 note 210.

⁵Lubbe and Murray, *Contract*, 773, relying on *MacDuff & Co Ltd v Johannesburg Consolidated Investment Co Ltd* 1924 AD 573. Yet in this case Solomon JA approved of the doctrine of frustration of contract as expounded by Lord Loreburn in *Tamplin SS Co v Anglo-American Petroleum Co* and frustration of purpose was denied on the ground that the transaction was of a speculative character, which is one of the classic limitations of the doctrine, *MacDuff & Co Ltd v Johannesburg Consolidated Investment Co Ltd*, *supra*, 603 607. The case is cited below in §2.4 in "Cases illustrative of the general limitations".

⁶Christie, *Contract*, 465.

"we are after all not concerned with the motives which actuated the parties in entering into the contract, except in so far as they were expressly made part and parcel of the contract or are part of the contract by clear implication."¹

It is correct that De Villiers JA's statements in *African Realty Trust* were *obiter* since the decision finally rested on an express term of the contract in question. Yet, it is submitted that the Judge would not have gone at such length on the matter if he had not regarded this approach as a possible solution had the contract contained no provision for the problem in question. If these *dicta* are of no authority because they were made *obiter*, they are at least evidence that such an approach would not be untenable in South African law. The statement cited above merely concerns the crucial distinction between the common contractual purpose as understood by the doctrine of *causa finalis* and a legally irrelevant motive, and does not constitute an argument against the idea of frustration of purpose.

It is interesting in this respect to note the dissenting judgement of Solomon JA, whose approach tends into the same direction as De Villiers' JA *obiter dicta*:

"In my opinion the real question to be determined is whether the substitution of a concrete for a rock-fill dam is an alteration of the works within the meaning of the agreement, as was found by the learned Judge-President. And the conclusion to which I have come is that it is not, and that for two reasons. The first is, that the construction of Lewis' concrete dam is *something entirely different* ... And the second is, that even if the substitution of the one for the other can be regarded as an alteration, it is not such an alteration as was intended in the agreement between the parties."²

"I am not concerned to enquire whether the irrigation board was justified in abandoning Kanthack's dam and substituting Lewis'. Granted that they were right in doing so on the ground that the former would not have been safe, the fact remains that the contract between the parties makes no provision for such a substitution. *The whole basis, therefore, of the agreement falls away, and the result is that the agreement itself lapses and is of no effect.*"³

¹At 402, 403.

²At 409, my italics.

³At 410, my italics.

"But I cannot conceive that they ever contemplated an alteration *of so radical a nature* as to double the original estimate of the cost."¹

Here again, the crucial elements of frustration of purpose return. What was later to become Lord Radcliffe's frustration-test is employed and is linked to the idea of equality in exchange.

The *African Realty Trust* case is in any event not the only case from which support for Kerr's and Jones' J position can be drawn, and in which the decision of *Krell v. Henry*² and other typical English frustration cases are cited with approval.

First of all, it should be noted that *Peters, Flamman and Co v Kokstad Municipality* only stated the general principle of *impossibilium nulla obligatio* without elaborating on the details thereof. Solomon ACJ observed that the English law and the Civil law are different on this subject, but did not declare the English law as being generally misleading in this respect. In fact, he found

"that although the English law looks at the subject from a different point of view from ours, in the result the difference between the two systems is not very great."³

Thus it was only stated that the law of the two systems was not the same on the subject, but the way was still open to look to English cases for guidance when the implications of the doctrine of impossibility were not evident. The case of *Krell v Henry* had already been cited with approval and decided upon by Bristowe J in *Witwatersrand Township Estate and Finance Corporation Ltd v Rand Water Board*.⁴ One year after *Peters, Flamman and Co.*, the influence of English decisions on frustration of purpose on the doctrine of impossibility is again apparent in *Schlegemann v Meyer, Bridgens & Co Ltd*.¹ Meyer, Bridgens and Schlegemann had formed a company and each acted as Managing Director. When war broke out with the German Empire, Schlegemann was interned as an enemy subject in 1915. After his release in 1919 he sued for reinstatement as Managing Director. Gardiner J observed:

"The difficulty which arises is in finding what is impossibility of performance and what is suspension of performance. No authorities have been cited on our law to show how this distinction is to be drawn. The English cases and principles, it seems to me, must

¹At 411.

²[1903] 2 KB 740.

³At 437.

⁴1907 TS 241.

apply to this matter, for they are principles not specially applicable to English law, but principles which must be at the root of any contract. I would refer to the remarks of Earl Loreburn in the case of *F A Tamplin Steamship Co Ltd v Anglo-Mexican Petroleum Products Co Ltd* (115 L.T., 31). He says:

'A Court can and ought to examine the contract and circumstances in which it was made, not, of course, to vary, but only to explain it, in order to see whether or not from the *nature* of it the parties must have made their bargain on the *footing that a particular thing or state of things would continue to exist*. And if they must have done so, then a term to that effect will be implied, though it need not be expressed in the contract. In applying this rule it is manifest that such a term can rarely be implied except where the discontinuance is such as to upset altogether the *purpose* of the contract. Some delay and some change is very common in all human affairs, and it cannot be supposed that any bargain has been made in the tacit condition that such a thing will not happen in any degree.'²

In applying the reasoning of the cited frustration case to the facts of the case at hand, Gardiner J concluded:

"That shows that the absence of Mr. Schlengemann necessitated or caused *a radical change* in the carrying on of the business of the company. It seems to me that the contract was made on the footing that he should give his continuous personal service to the company. When he was interned the possibility of continuous service had gone. The possibility of any service within a reasonable time had also gone."³

Again, it is apparent that the notion of impossibility was stretched beyond its strict sense, on account of the court's conscious investigation whether the contractual purpose had been frustrated along the lines of what was later to become the test for frustration.

In *Benjamin v Myers*⁴ Herbstein AJ employed Lord Sumner's statement about frustration in *Hirji Mulji v Cheong Yue Steamship Co*,⁵ but held that the case at hand was one of self-induced frustration.

¹1920 CPD 500 at 503.

²*Schlengemann v Meyers, Bridgens & Co Ltd*, *supra* 501, my italics.

³*Schlengemann v Meyers, Bridgens & Co Ltd*, *supra* 503, my italics.

⁴1946 CPD 662 663.

⁵1926 AC 497 507.

He confirmed his approval of Lord Sumner's exposition of the law in *Rossouw v Haumann*,¹ cited by Jones J in *Kok v Osborne*:

"If then this agreement has become impossible of performance, what are the consequences? These have been stated by Lord Sumner in the case of *Hirji Mulji and Others v. Cheong Yue Steamship Co. Ltd* 1926 AC 497 at 507 in these words:

'An event occurs, not contemplated by the parties and therefore not expressly dealt with in their contract, which, when it happens, frustrates their object. Evidently it is their common object that has to be frustrated, not merely the individual advantage which one party or the other might have gained from the contract. If so, what the law provides must be a common relief from this common disappointment and an immediate termination of the obligations as regards future performance. This is necessary, because otherwise the parties would be bound to a contract, which is one that they did not really make. If it were not so, a doctrine designed to avert unintended burdens would operate to enable one party to profit by the event and to hold the other, if he so chose, to a new obligation.'

This was followed in *Benjamin v. Meyers* 1946 CPD 655."

Jones J had also cited *Bischofberger v Van Eyk*, where Boshoff J had approved the frustration principle, citing another typical English frustration case:²

"On this latter point the position is stated differently in English law but it does not seem to be at variance with the position in our law. It is stated as follows:

'If there is an event or change of circumstances which is so fundamental as to be regarded by the law as striking at the root of the contract as a whole and beyond what was contemplated by the parties and such that to hold the parties to the contract would be to bind them to something to which they would not have agreed had they contemplated that event or those circumstances, the contract is frustrated by that event immediately and irrespective of the volition or the intention or the knowledge of the parties as to the particular event, and even though they have continued for a time to treat the contract as still subsisting:' *Morgan v. Mauser* [1947] 2 All ER 666 at 670.

On the facts of the instant case the parties contracted on the basis that the money in respect of the sale of the Hyperfin Ltd properties was available to the respondent and would be ceded to the applicant within a reasonable time. When that sale fell through and the guarantee was withdrawn there was a change of circumstances which was within the

¹1949 4 SA 796 (C) 799.

²1981 2 SA 607 (W) 611.

contemplation of neither the applicant nor the respondent which made performance in terms of the agreement impossible.

In the circumstances the obligations under the agreement fell away and the agreement ceased to exist."

All these cases bear witness to the fact that the English doctrine of frustration of contract is in the process of infiltrating South African law on account of its being approved and applied by some South African courts under the mantle of the doctrine of impossibility. Because, however, impossibility of performance is only the most obvious manifestation of the broader notion of frustration, and in view of the fact that the distinction between absolute, relative and quasi-impossibility is always difficult, if not impossible to draw precisely, this process can be expected to continue.

Jones J in *Kok v. Osborne* also pointed to another line of cases classified as supervening impossibility, where frustration of purpose has been dealt with without reference to English frustration cases. These cases deal with the frustration of the purpose for which an item was let, which, as is apparent from the discussion of the German and English cases, represents a typical instance for the application of the frustration doctrine.¹ It has been stressed that the principle laid down in these cases is not a special rule only applicable to leases, but that these cases are only illustrations of the general principle applicable in instances of supervening impossibility of performance.²

The first case is *Kopelowitz v. Hansen, Schrader & Co.*³ The defendants were, on the outbreak of the Boer War, the assignees of a lease which expired on the 30th of June, 1901. The lease was in respect of certain premises in Johannesburg, which were let for the purpose of being sub-let as bars, shops, bedrooms, and offices. It was proved that the defendants remained in possession for the whole period; that when the war threatened the defendant's sub-tenants, who were practically all British subjects, left the country, and that the Government of the South African Republic closed all bars.

The court held that the defendants were, as to the bar, entitled to a total remission of rent for the period during which it was closed by order of the Government; and that as to the bedrooms, shops, and offices, they were entitled to a total remission of rent in respect of the period during which they were, owing to the departure of tenants, unable to sub-let their apartments. Although the effect of the war as *vis maior* or an act of state was only indirect this was considered sufficient to constitute

¹See above Part II § 4.1.2.2., Part III § 3.1.2.

²*Kopelowitz v. Hansen, Schrader & Co.* 1903 TH 143, 144; *Bayley v. Harwood* 1954 3 SA 498 (A) at 505; Ramsden, *Supervening impossibility of performance in the South African law of contract*, 1985, 71.

³1903 TH 143, 144.

impossibility of performance if the purpose to sub-let the premises was nearly totally frustrated (the possibility of letting to Afrikaners seems, apparently, not to have been taken into account).

In his judgement, Mason J relied on the authority of French civilian writers, namely Pothier and Troplong:

"In a later section (234) Troplong [*Droits civils, Louage*] refers to another aspect of the same matter, namely, where the act of *vis major*, while leaving untouched the property hired, destroys or very materially affects the objects or *purpose* for which the premises are used. If these objects or purposes, he says, were selected by the lessee, then no remission of rent is claimable; but if the purposes for which the premises were destined are contemplated between the parties, and formed the determining element in the contract of lease, then the tenant is entitled to relief. ... The law which is referred to by these authorities appears in the writings of many commentators, and has been accepted in many cases decided under our system of jurisprudence."¹

These *dicta* emphasize that the contractual purpose must be common to the parties in order to qualify for remedy.

In the case of *Bayley v. Harwood*,² cited by Kerr in support for his treatment of the topic,³ there was again no real impossibility, because the leased premise could have been used for the contemplated purpose under a certain condition, imposed by legislation, which the court considered as unreasonable (unconscionable or *unzumutbar*) for the affected party under the circumstances.

In April 1950, the appellant had leased from the respondent, from 1 May 1950 to 31 December 1951, certain premises which the lessor had been using as a health and pleasure resort and which the lessees contemplated using for the same purpose. The lessor undertook to transfer all trading licenses held by him in respect of the premises and the lessee undertook to retransfer them at the expiration of the lease. In February 1951, the licensing board had refused the lessee's application for licenses for that year unless certain substantial structural alterations and additions, as required by the Peri-Urban Areas Health Board in terms of its bye-laws promulgated in February 1951, were made. As the lessor had refused to carry these out, the lessee vacated the premises tendering rent up to the date of vacation.

Schreiner JA held:

¹*Kopelowitz v Hansen, Schrader & Co, supra*, 143, my italics.

²1954 3 SA 498 (A).

³Kerr, *supra*, 225, 491.

"In the present case the change in the law created a barrier to beneficial enjoyment which was direct and immediate, though it was not irremediable. The use of the premises for the *purpose* for which it was let was wholly prohibited unless something was done to correct the position. In such a case it seems clear that one must look at the thing that has to be done to avoid the effect of the prohibition, and at the provisions of the lease. If the lessee is under obligation to do what is required *cadit quaestio*. If it is something that he is not obliged to do but which he could reasonably be expected to do I assume that the same result would follow, namely, that no remission could be claimed. For then it could, perhaps, be said that the loss of enjoyment was occasioned by the lessee's own fault The lessee could, on this view, reasonably be expected, I think, to incur *some* increased expenditure in respect of the use of the premises occasioned by new legislation. Increases in licence fees and the cost of newly required medical inspections, at least *if not disproportionate to the ordinary benefits from the lease*, would presumably not entitle the lessee to remission. But, if what has to be done to ward off the prohibitory effect of the change in the law is something that the lessee *could not reasonably be expected to do*, there seems to me to be no principle upon which it can be held that he has no right of remission."¹

This statement illustrates particularly well the fact that there is always a threshold beyond which commutative justice, the contractual equivalence, is totally destroyed so that, in consequence, the *causa finalis* of the contract is frustrated. Schreiner JA speaks of "unreasonableness" where the German doctrine would speak of *Unzumutbarkeit*.

In *Kok v Osborne*,² Jones J had also referred to *Sishen Hotel (Edms) Bpk v Suid-Afrikaanse Yster en Staal Industriële Korporasie Bpk*.³ Although the case was decided on the basis of a material breach of contract which justified cancellation, Botha JA, with whom the other judges concurred, based his approach on an analogy to the situation in which the *commodus usus* is frustrated by *vis major* or *casus fortuitus*.

In terms of a contract of lease between the respondent as landlord and the appellant as tenant, the respondent leased certain land to the appellant for a period of 20 years. A hotel had been erected on the leased land by a previous tenant. In the lease the leased premises were described as a 'hotel site'

¹At 507, my italics.

²*Kok v Osborne, supra*, 804B.

³1987 2 SA 932 (A).

and a portion of the rental consisted of a small percentage of the gross proceeds of the liquor sales of the hotel. The respondent conducted certain mining operations in the surrounding district and, in order to ensure that hotel accommodation of a high standard was available for visiting officials, the respondent included in the lease certain provisions obliging the appellant to conduct its business according to certain high standards. The hotel was situated next to the national road between Kuruman and Upington and, because of its situation, attracted considerable custom. About six to seven years after the conclusion of the lease, the respondent decided to extend its mining operations in the district which necessitated the diversion of the route of the national road. The Provincial Administration granted the respondent's application for the diversion of the national road and eight years after the conclusion of the lease the diversion of the road was completed. As a result of the diversion of the national road the appellant's hotel attracted much less custom than previously with the result that the appellant's profits declined and the hotel business was eventually conducted at a loss. The hotel was closed down about eleven years after the conclusion of the lease. The appellant instituted an action against the respondent for payment of damages for breach of contract. The court held that the respondent had leased the premises to the appellant with the *specific object* of enabling the appellant to conduct a hotel business thereon and make a profit from it. It held further that although the diversion of the national road, procured by the respondent, had no direct physical effect on the leased premises, nevertheless indirectly hampered the appellant's *commodus usus* by restricting the flow of custom to the hotel, and that the hotel premises after the closure of the road were *no longer the same* as they were at the commencement of the lease:¹

"Inderdaad kan die inhoud en omvang van 'n huurder se *commodus usus* in enige gegewe geval nie bepaal word anders as met verwysing na die doel waarvoor die saak verhuur is ingevolge die huurkontrak nie. In ons regspraak word die begrip *commodus usus* ook vasgekoppel aan die doel waarvoor die huursaak verhuur is (... vgl ook *Bayley v. Harwood* (*supra* op 502-3)). Dit is eintlik 'n vanselfsprekende gedagte, maar een wat van belang is in die huidige saak."²

Botha JA cites Pothier's treatise *Letting and Hiring*, paragraph 152, where he - most appropriately - gives the example of a hotel along a road which was closed. This text had already been cited in *Kopelowitz v. Hansen, Schrader & Co.* at p. 142. The learned judge continues:

"Pothier tref hier 'n onderskeid tussen die gebruik van die gebou as sodanig, en die voordelige benutting daarvan vir die doel waarvoor dit gehuur is, nl om te gebruik as 'n

¹*Sishen Hotel v Suid-Afrikaanse Yster en Staal, supra*, 953A 954CF.

²At 952H.

herberg. Die teenstelling is treffend, met die oog op die betoog namens die respondent in die huidige saak, soos vroeër aangedui, dat die appellant na die sluiting van die pad nog steeds die vrye en ongesteurde gebruik van die hotelperseel self gehad het, dat die ingange tot die hotelperseel dieselfde gebly het en dat die hotelbesigheid nog voortgesit kon word. Dit lyk amper asof Pothier se teks spesifiek ontwerp was om 'n pertinente antwoord op hierdie betoog te verskaf."¹

But the judge equally emphasizes that the crossing of a certain threshold is required:

"Uit die gevalle wat ek vroeër by wyse van voorbeeld uit *Voet* aangehaal het, blyk dit dat die huurder slegs in vry drastiese omstandighede die reg gegun word om die huurperseel te ontruim en aanspraak te maak op 'n kwytstelling van die huurgeld."²

This decision again may be taken as evidence that impossibility is not understood in the strict sense since this case was only concerned with the diminution of profits.³ It is clear that commutative justice, or contractual equivalence is the crucial issue. In the final analysis, Botha JA's statements bear out that the common contractual purpose is of the essence of the parties' contractual duties (in this case the lessor's duty to give beneficial use and occupation) and that this purpose can be frustrated when the subject matter of the obligation cannot be regarded as being the same any more - which means that the same test as in the English frustration cases is employed. Kerr comments on this case:⁴

"It follows that the *Sishen Hotel* case needs to be considered whenever impossibility of performance is in issue. It provides a good illustration of the point that '*impossibility of performance*' is a misnomer - what the principle is concerned with is a change in *circumstances* of such an extent that performance is either impossible or is possible but the circumstances are so different from those in which the contract was intended to operate that the performance which is possible is *vitaly different* from what should reasonably have been within the contemplation of both parties."

¹*Sishen Hotel v Suid-Afrikaanse Yster en Staal, supra*, 955B.

² At 958B.

³This is pointed out by Kerr, "Impairment of profitability of premises let; implied contractual provisions; standing of Pothier" 1987 *SALJ* 550.

⁴Kerr 1987 *SALJ* 552, my italics.

Before closing the section on supervening impossibility, Ramsden's position should be mentioned.¹ Ramsden proposes a flexible concept of impossibility that would permit a solution of the problem of frustration by recourse to the ordinary rules of interpretation:

"One must scrutinize the contract entered into between the parties to ascertain exactly what was promised, and if it has become impossible then the rules of supervening impossibility apply. Hence in the so-called 'Coronation' cases in England what was promised was not a room, but in fact a vantage point from which the coronation procession could be viewed. When that became impossible of fulfilment, the contract was at an end. ...

It might not be necessary to imply a term in any contract in order to find that it has been terminated by supervening impossibility of performance if one were only to look at precisely what was promised by each party to the other. By this I do not mean that a term may not be implied in an appropriate case, provided that the implication of such a term follows the ordinary rules of interpretation of contract and does not become instead a legal fiction, as it would if the approach of the 'Coronation' cases or the approach of Windscheid is adopted in our law."²

Ramsden's position *vis-à-vis* the English doctrine of frustration and the whole problem of change of circumstances is entirely determined by his rejection of the implied-term approach. This view appears to be somewhat narrow since the implied-term approach is in the process of being abandoned in England in view of the persuasive restatement of the basis of the doctrine of frustration in *Davis Contractors Ltd v Fareham Urban District Council*.³ The argument that the problem of change of circumstances is merely a matter of interpretation, has been dealt with in the discussion of Larenz' position and the section on *causa finalis*.⁴ While interpretation is intimately involved in this issue, it represents only the starting point, and not the complete answer to the search for solutions in this area. Ramsden's statements also reveal the dilemma which arises from the failure to recognise that impossibility is only the most obvious manifestation of frustration of purpose or *causa finalis*: the notion of impossibility becomes increasingly indefinite because its limits are difficult, if not impossible to draw, so that it in the end becomes a purely normative aspect of a more or less fictitious character:

¹Ramsden, *Supervening impossibility of performance in the South African law of contract*, 1985.

²Ramsden, *supra*, 72-73.

³Part III § 1.1.2.5.

⁴Part II § 3.2., Part IV.

"I have already considered (a) above and put forward the view that our law does not allow undue hardship to be used as excuse for non-performance of a contractual obligation which it is not absolutely impossible to perform; *though, in considering whether performance is absolutely impossible, regard may be had to the contract read in the light of the surrounding circumstances to determine whether what is required could properly be said to fall within the ambit of the contract.*"¹

It is, however, inconsistent to speak of *absolute* impossibility with such a proviso. With the approach of Ramsden, the notion of impossibility becomes as fictitious as the implied-term approach which he criticises precisely on this score.

2.2. Implied terms

In *M. Levisieur & Co v Friedman*² Levisieur had endeavoured to obtain a loading authority from the Railway Department for the transport of maize which he had purchased from Friedman. Owing to unforeseen delay on the part of the Railway Department, which has a discretion in issuing loading authority, no authority was available to enable Friedman to load the maize within the period allowed under the contract, time being admittedly of the essence of the contract. The court held that the contract was discharged and that Levisieur was not liable for the purchase price of the maize because of an implied condition, that the loading authority would be furnished in time. McGregor J based the decision on the doctrine of frustration of contract:

"I am disposed to hold that the present case falls under the principles laid down by the courts in cases like *Nickoll v. Ashton* (1901, 2 K.B. 126, 84 L.T.R. 804), and very possibly in what has been termed the 'Coronation Cases', of which the case of *Krell v. Henry* (1903, 2 K.B. 740, 89 L.T.R. 328) is an example."³

After evaluating the abovementioned cases, the judge concluded:

"Now seeing that the English doctrine was initially derived from the Roman Law and thereafter developed to meet fresh conditions, there seems no reason why a similar development should not obtain with us also - bearing in mind the Roman maxim

¹Ramsden, *supra*, 74, my italics.

²1922 OPD 182.

³*Levisieur v Friedman*, *supra*, 192.

'*impossibilium nulla obligatio est*' (D. 50.17.185). ... Thus in the recent case of *Tamplin S.S. Co.* (1916, 2 A.C. 397, 115 L.T.R. 315), it was observed by Lord Haldane that 'when people enter into a contract which is dependent for the possibility of its performance on the continued availability of a specific thing, and that availability comes to an end by reason of circumstances beyond the control of the parties, the contract is *prima facie* regarded as dissolved. The contingency which has arisen is treated, in the absence of a contrary intention made plain, as being one about which no bargain at all was made.' ... All this may, not unreasonably, be regarded as a liberal and equitable extension of the principle stated by Pothier (*Oblig.*, s. 149): 'Where a person who was obliged to do any act, is prevented by accident or force ... from doing it ... there is no ground for subjecting him to damages.'¹

Here again there was no case of literal impossibility. Unreasonable delay is one of the typical instances for the application of the doctrine of frustration of contract, and it is accordingly not surprising that the court looked for orientation to the typical frustration cases of *Krell v Henry* and *Tamplin SS Co.*² The contract mentioned no specific delivery date, and the parties had not anticipated that the delay occasioned by the Railway Department would render performance useless: upon the eventual arrival of the mealies at Algoa Bay, the ships on which Levisieur had intended exporting the maize had already left and there was no adequate storage available. The court therefore had to imply a term and stretch the notion of impossibility in order to reach the only appropriate result. Mc Gregor J approved of the principle laid down in *Krell v. Henry*³ and found it to be reconcilable with *Peters, Flamman v. Kokstad Municipality*.⁴ This case indicates again the fact that impossibility is only the most obvious case of frustration of purpose and that it can hardly be distinguished from other instances of frustration of purpose.

McGregor J had emphasized that the fact that the contract became more onerous due to a fall in prices during the delay, was not material for the decision of the case.⁵ That this statement is only partly correct, and that much depends of the degree of onerosity, is illustrated by the similar case of *Lanificio Varam SA v Masurel Fils (Pty) Ltd.*⁶ A contract for the sale of wool to a Brazilian company provided that the latter should apply to the Brazilian authorities for an import licence and transmit it to the seller to enable it to ship the wool. The contract made no mention of the time for obtaining the

¹ *Levisieur v Friedman, supra*, 194.

² [1903] 2 KB 740; [1916] 2 AC 397.

³ [1903] 2 KB 740.

⁴ 1919 AD 427.

⁵ *Levisieur v Friedman, supra*, 195.

⁶ 1952 4 SA 655 (A).

licence. The sale was concluded on the 19 October 1949. On the 15 December 1949, the defendant repudiated the contract on the ground that the import licence had not been tendered within a reasonable time. On the 11 February 1950, the plaintiff tendered the licence to the defendant and, upon refusal of performance by the defendant, instituted an action to recover the difference between the contract price and the market price of the wool.

The court held that a term could be implied that, should such licence not be granted within reasonable time, the contract would be discharged and further, that in determining the length of the period of reasonable time, the Court would have to take into account the nature and extent of the fluctuations in the value of wool. Also relevant was the contemplation of the parties as to the time within which the Brazilian authorities would be likely to grant an import licence. The judgement was given *per* Hoexter JA:

"Finally, the trial Court might reasonably hold that the parties must have intended that the contract should be discharged if, owing to the delay of the Brazilian authorities, it would not be performed within a reasonable time, because neither party could be held responsible for such a delay. ... In determining the length of the period of reasonable time that Court will certainly have to take into account the nature and extent of the fluctuations in the value of wool and the time, contemplated by the parties, within which the Brazilian Authorities would be likely to grant an import licence."¹

This reasoning may well be understood in the sense that beyond a certain threshold of onerosity, the contractual equivalence is disturbed to such a degree (practically nonexistent) that the purpose or *causa finalis* of the contract (commutative justice) is frustrated.

Another interesting case is *Sonarep (SA) (Pty) Ltd. v. Motorcraft (Pty) Ltd.*² The respondent had leased certain immovable property to appellant for seven and a half years as from 1 February 1971. In addition to a provision for an increase of monthly rental twice during the currency of the lease, clause 27 thereof read:

"Should the Rand, the official currency of the Republic of South Africa, be devalued in terms of sterling or US dollars at any time from the act of signature hereof, then the monthly rental payable from the first day of the month following such devaluation shall

¹ *Lanificio Varam SA v Masurel Fils (Pty) Ltd supra*, 661A H.

² 1981 1 SA 889 (N).

be increased to the extent that it becomes equal to what the monthly rental was prior to the devaluation of the currency in terms of which the Rand was devalued."

A dispute arose as to the validity of, and construction to be placed upon this clause (and hence the rental payable) after the Bretton Woods Agreement, in terms of which currencies of participating countries were fixed in terms of a specified mass of gold, had come to an end. The court held that the contract stood, and that there was no implied term or supposition to the effect that if the Bretton Woods Agreement came to an end, the clause would not apply. The decisive reason for this conclusion was formulated by Kumleben J in the following manner:¹

"I doubt whether the parties, in reply to the appropriate question from the mythical bystander, would have said 'Of course, it was obvious that clause 27 would be a dead letter should the Bretton Woods Agreement come to an end'. The lessor may well have replied 'I have no idea under what monetary system South Africa will then operate or to what extent official acts will then be a realistic adjustment of 'real rent', but *any such increases will still serve my interests* and the provision is therefore to stand'. The lessee, on the other hand, might have answered: '*Since I have no particular interest in how realistic the criterion is, and am in any event committed to an unpredictable basis of adjustment*, I assume that the provision will continue to apply until the end of the lease'. In seeking to imply such a term Mr. Knight laid great stress on those words in clause 27 following 'increased' and submitted that the *purpose of the adjustments was to 'equalise' the rental*. Accepting that broadly speaking this was the reason for its inclusion ..., in the context of the clause as a whole it is to my mind not the dominant object and it ought not to be given preference over the express term to which it gave rise. Just as error in motive does not affect the validity of a contract ..., so a change in the circumstances which gave rise to the inclusion of an express and unambiguous term ought not necessarily to prevent such a term remaining operative throughout the subsistence of an agreement."

It is submitted that the basic reason for this decision was the fact that the common purpose of clause 27 of the contract was not really entirely frustrated by the lapse of the Bretton Woods Agreement. Even after this change in the circumstances, the clause still provided a means to adjust the rental to value-fluctuations of the currency, which was its main purpose. In any case, the existing clause served the common purpose better than the contract without the relevant provision. The provision was not working contrary to the common purpose after the change of circumstances, although its application had become less obvious. But as the common purpose was clear, it could still be interpreted with

¹ *Sonarep (SA) (Pty) Ltd v Motorcraft (Pty) Ltd, supra*, 901D-H, my italics.

reference to that purpose in order to serve that purpose and thus make it comply with that purpose. It is clear that simply regarding clause 27 as invalid would have been contrary to the common purpose. It has been stressed in Part I of this thesis that there can be no frustration if the contract can be made to comply with the common purpose by means of the rules of interpretation.

2.3. Common mistake

In *Dickinson Motors (Pty) Ltd v Oberholzer*¹ the defendant (appellant) sold a Plymouth car to the plaintiff's (respondent on appeal's) son under a hire-purchase agreement and received an acknowledgment of debt from the son for the amount owing. The defendant later took judgement against the son for the amount owing; a warrant of execution was issued and served on the son. A *nulla bona* return was made, and it was recorded that the son had stated that this car was on his father's, the plaintiff's, farm. This statement was false as far as the identity of the car was concerned in that the son had in the meantime purchased another Plymouth from a third party (A Motors) and exchanged it for a Hudson car belonging to his father. The son then sold this car and the first Plymouth to certain garages. The messenger, still acting under the judgement obtained by the defendant, attached the second Plymouth which was in plaintiff's possession on his farm. The plaintiff had allowed the messenger to take the car away and was told that he could have the car back if he paid an amount of £257. Efforts by the plaintiff to obtain the return of his Hudson car from his son having failed, some time later he wrote to the defendant asking whether the Plymouth which had been attached had been sold, and if not, whether the offer to let him have it was still open for acceptance by him. The reply was that if he paid in cash the amount outstanding on the car - approximately £291 - he could call and collect it, which he did, the hire-purchase agreement relating to the first Plymouth being cancelled on the signature of the plaintiff and a representative of the defendant. As a result of a judgement obtained by A Motors, a representative of this firm went with the messenger and removed the second Plymouth from the possession of the plaintiff. The plaintiff thereupon instituted an action to recover the £291 paid to the defendant. He pleaded that he paid this amount, which was not owing by him to the defendant, in error. The defendant averred that this amount had been paid in payment of the amount owed by plaintiff's son. It was admitted that the sum was not owing by the plaintiff and that when the amount was paid, the plaintiff knew this. The trial Court had given judgement for the plaintiff. On appeal, Schreiner JA held:

"For once it is clear, as it undoubtedly is, that the plaintiff, to the defendant's knowledge, was only interested in obtaining the car and not in paying his son's debts except as a means of obtaining the car, the identity of the car at Vereeniging as the one

¹ 1952 1 SA 443 (A).

that A.G. Oberholzer had bought from the defendant was of vital importance. ... The £291 was paid under *a common mistake in regard to a matter which was vital to the transaction* and if either of them had been aware of the true position the transaction would not have gone through. In *Huddersfield Banking Company Ltd. v. Henry Lister & Son Ltd.* 1895 (2) Ch. 273, Lindley L.J. states the proposition,

'that an agreement founded upon a common mistake, which mistake is impliedly treated as a condition which must exist in order to bring the agreement into operation, can be set aside, formally if necessary, or treated as set aside and as invalid without any process or proceedings to do so.'

This seems to me to express in clear language a principle which is inherent in all developed systems of law."¹

The formulation used would be exactly the same whether the case would be treated under the head of implied term, supposition or common mistake, and it is submitted that the decisive consideration was that the common purpose of both parties, was not the payment of the son's debt, but rather the purchase of a car, and that this had been frustrated because of the common error about the identity of the car.

The fact that it is often arbitrary which legal tool is employed to give effect to the underlying principle, is also apparent from *Volkskas Bpk v Geyser*,² which lies on the border between common mistake, innocent misrepresentation and rectification. The defendant had bound himself to the plaintiff as surety and co-debtor for one J in an amount of £300. When J had failed to pay the amount, it was claimed from the defendant. In his plea, the defendant denied that the copy of the deed of suretyship, which was annexed to the declaration, was a true record of the terms arrived at between the parties. He pleaded that at the time the deed of suretyship was signed, he had orally agreed with the manager of a branch of the plaintiff that he would, for a period of six months, or until J's existing harvest was reaped and sold, guarantee as surety and co-debtor J's deficiency in respect of his existing overdraft and obligations which he would incur before his existing harvest was reaped. At the request of the manager he had signed a guarantee without reading it, and without having any knowledge of its contents and before it was all completed. He had throughout acted under the *bona fide* impression that the printed portion of the deed contained nothing which was in conflict with the oral agreement. The court held, that the plea was based on a defence that as the result of a common error and/or misrepresentation of the manager, the deed of suretyship did not reflect the true agreement of the

¹ *Dickinson Motors (Pty) Ltd v Oberholzer*, *supra*, 450A-E, my italics.

² 1960 4 SA 412 (T).

parties, and that it was unnecessary for the defendant to claim rectification specifically. The judgement was given *per* Steyn J:

"Na my mening, egter, berus die pleit nie op 'n bewering van eensydige dwaling aan die kant van verweerder nie maar, indien dit wel die geval mag wees, is daardie dwaling, volgens die pleit, veroorsaak deur die wanvoorstelling (hetsy skuldige of onskuldige) van die bestuurder Swart dat die borgakte voltooï sou word ooreenkomstig die voorafgaande mondelinge ooreenkoms en nie in stryd daarmee nie. Andersinds, en na my mening, berus die pleit op die verweer, alhoewel nie in soveel woorde uitgedruk nie, dat as gevolg van gemeenskaplike dwaling en/of wanvoorstelling deur die bestuurder, die borgakte nie die ware ooreenkoms tussen die partye weergee nie. In beide bovermelde gevalle sou die feit dat die verweer op bewerings berus wat strydig is met die terme van die borgakte nie ter sake wees nie daar getuienis in hierdie verband en onder hierdie omstandighede toelaatbaar sou wees om daardie verweer te staaf."¹

Another particularly interesting case is *Diedericks v Minister of Lands*,² the South African counterpart to *Bell v Lever Bros*.³ It illustrates again, that it may from a practical perspective be arbitrary under which legal category the case is resolved - be it common error, assumption or implied term - albeit the decisive principle may be obscured by the legal point of departure. *Diedericks'* case reiterates that it is not common error itself which discharges the contract, but the question whether or not the error makes the subject matter of the contract essentially different compared to what had originally been contemplated by the parties (frustration-test).

In 1953 the plaintiff had under a written agreement been allotted farm properties under Act 12 of 1912, as amended. The agreement provided for the lease of the properties subject to a right to purchase them at a fixed price payable in a series of annual instalments. The agreement contained a clause entitling the defendant to resume possession should such properties be required for irrigation purposes, and for the payment of compensation in a determined manner. In 1961 the defendant required a portion of one of the farms to be released from the operation of the lease and informed the plaintiff accordingly. In a letter dated 14 March 1962, signed by a regional representative in the Department of Lands, the plaintiff was offered an amount of R 2477 subject to him notifying the defendant within 30 days of the acceptance of this offer. On 23 March 1962 the plaintiff accepted the offer. In April 1962 the regional representative of the defendant informed the plaintiff that the State

¹ *Volkskas Bpk v Geyser*, *supra*, 417E-H.

² 1964 1 SA 49 (N).

³ [1926] AC 161.

had, under the agreement of 1953, the right to resume occupation against compensation calculated pro rata on the price as fixed in 1953. Accordingly he stated that the offer made in March had been made in error, clearly due to an oversight by a clerk. Plaintiff was informed that the defendant intended to repossess the portion against the payment of R 148,73 and a further sum of R 480 for improvements. Plaintiff refused to accept the repudiation and maintained that the defendant was bound by its written offer of the 14th and plaintiff's acceptance of the 23 March respectively. Miller J held:

"The issue, therefore, is not whether there was a mistake concerning ownership of the land but whether there was a mistake in the sense that the provisions of the resumption clause were overlooked, and if there was such a mistake, whether it was of such a nature that it justified the defendant's refusal to be bound by the contract. Although the plea suggests that this mistake was common to the parties, Mr Allaway, rightly in my opinion, conceded that in fact the mistake was unilateral."¹

"[W]hereas defendant was motivated in what he did by his mistaken belief that the resumption clause was not available to him, plaintiff's ignorance of its existence played no part in his decision to accept the defendant's offer. ... The only party who really laboured under a mistaken belief in concluding the contract was the defendant who says that but for his mistake he would not have made the offer to plaintiff at all. In this sense, the mistake upon which defendant relies was unilateral."²

"The situation which arises in this case is in many respects similar to that which arose in *Bell v. Lever Bros. Ltd.* 1932 A.C. 161."³

"The words of Lord Atkin, which I have quoted above, seem to me to epitomise the complaint of the defendant in this case: as a result of his own error, the defendant concluded a bad bargain instead of the good one he could have concluded had he not made the error. His position, in principle, is no different from that of a party who agrees to certain terms of a contract because he miscalculated his potential profit or forgot to take into account a factor which he should have included in his reckoning. The error which the defendant made did not relate to the identity or nature, or even to the quality of

¹ *Diedericks v Minister of Lands*, *supra*, 53E-F.

² At 54C-F.

³ At 55F.

the subject matter of the contract, for on that score the parties were *ad idem*, each receiving and giving exactly what he bargained for."¹

PMA Hunt criticises the decision for giving too narrow a meaning to "common mistake".² While it may often be the case - like here - that one party consciously assumes a fact that turns out to be different while the other does not even think about it, it would be nevertheless true to say that both were mistaken. Hunt argues that the case should have been decided as concerning an operative common mistake *in substantia* or alternatively common assumption.³ In his opinion, the fact that Diedericks' rights to the property was defeasible because of the resumption clause, was an element of the identity of those rights which were the subject matter of the contract.⁴

While Hunt is correct in that the term "common mistake" need not be given too narrow a meaning, it is clear from the judgement that Miller J employed the term in a normative way by linking it to the really decisive criterion whether the error was for both of the parties vital to the transaction, touching on the identity of the subject matter of the obligation, or whether it was vital only for one of them and in that sense unilateral. The crucial issue is, as always, whether one regards the error in the particular case as fundamental, that is, concerning a vital aspect of the contract. Of course, this is not always apparent. *Diedericks'* case and *Bell v. Lever Bros.* appear to be particularly illustrative borderline cases. In such cases the solution will always be far from obvious - as the narrow majority of judges in *Bell v. Lever Bros.* demonstrates.

In Bell's case Lord Atkin and Lord Thankerton had employed the frustration test to determine whether the mistake was fundamental or not. Lord Atkin said that the mistake

"will not affect assent unless it is the mistake of both parties *and* is as to the existence of some quality which makes the thing without the quality essentially different from the thing as it was believed to be."¹

Lord Thankerton further emphasized that a mistake as to the subject matter must relate to

"something which both must necessarily have accepted in their minds [consciously or unconsciously] as an essential and integral element of the subject matter."²

¹ At 56D-F.

² Hunt, "Mistake in the Formation of Contract: The Case of the Careless Clerk" 1964 *SALJ* 153 157.

³ Hunt, 1964 *SALJ* 156. Hunt rejects the implied-term approach because of its fictitious character, 160.

⁴ Hunt, 1964 *SALJ* 159.

In the view of the majority of the judges there was nothing to show that Bell and Snelling regarded the validity of the service contracts as vital, only Lever Bros. did so.

I am of opinion that the decisions in *Bell v Lever Bros* as well as *Diedericks'* case, were correct. It has been argued here that generally, the *causa finalis* of a contract is to be found in equality in exchange, and that the individual contract must be scrutinized to assess the elements vital to both parties which form the individual balance of exchange on which the parties are *ad idem*, and the realization of which is the common purpose of their contract. The absence or unattainability of one or more of these elements must result in a situation so different from originally envisaged that the obligation changes its whole character and the realization of the balance of exchange becomes impossible, that is to say, frustrated.

The purpose of the contract was the release of sub-division 1 from the terms of the 1953 agreement.³ This purpose was achieved, though for the defendant it was a bad bargain due to his own imprudence and oversight of the resumption clause. Hunt's opinion that the defeasibility of Diedericks' rights due to the resumption clause formed part of the essence of those rights is questionable. Rather, Diedericks' rights to the property and the resumption clause are two different things. The resumption clause does not describe the identity of Diedericks' rights but on the contrary, gives a certain right to the State. A failure of the State to make use of this right - albeit erroneously - concerns its own sphere of risk, and does not concern Diedericks. The resumption right therefore played no role in the balance of exchange, since it related neither to the essence nor the value of the subject matter of the contract. The decisive reasoning of Miller J, guided by the decision in *Bell v. Lever Bros.*, appears to be correct: The common mistake related to a fact which played no part in the plaintiff's decision to accept defendant's offer. It was only vital for defendant's motivation.

As Lord Atkin and Miller J pointed out in their respective judgements, both parties got exactly what they bargained for, there being no essential difference in the contract before and after the discovery of the error. The plaintiff, for whose motivation the misapprehended fact played no part, cannot be compelled to share in the risk of such an error. The error in this case could easily have been avoided by the defendant, and it falls within his sphere of responsibility.

¹ At 218.

² At 235.

³ Miller J at 53D.

2.4. Cases illustrative of the general limitations

As set out in the earlier parts of this thesis,¹ there are certain accepted limitations of a doctrine of frustration of purpose. These limitations are also reflected in South African case law. The invocation of frustration of purpose can be excluded because of an express provision of the contract, because the frustrated purpose was not common to the parties but merely unilateral, or there could have been a self-induced frustration, foreseeability of a risk or an assumption of risk of some other nature.

2.4.1. Self-induced frustration

Here again, the close relationship of impossibility and frustration comes into play. As in the case of impossibility through a prevention of performance, cases of frustration brought about by any act or forbearance of one of the parties to the contract, cannot result in a release of the party concerned. *Dicta* to that effect can be found e.g. in *M Levisieur & Co v Friedman per McGregor J.*:²

"Reference has already been made to the matter of negligence or fraud. In *Taylor v. Caldwell* the rule was expressed as being applicable under circumstances arising 'without default of the contractor.' It may be that where the one party can establish that it was owing to the negligence or default of the other party that the requisite or material thing or event was not present, the principle would no longer apply. And a like result would even more probably follow if fraud were proved."

Then there is the statement by Colman J in *Techni-Pak Sales (Pty) Ltd v Hall*:³

"It is unnecessary, however, for me to decide whether our law goes as far in that regard as the English law is said to do, or whether, even if it does, the doctrine can ever be applied to the frustration of a term like the one in issue here. I say that because what is abundantly clear, even in the law of England (it was stressed by the House of Lords in the *Joseph Constantine* case which I have mentioned), is that the doctrine does not operate in favour of the party who has himself brought about the frustration; and that is what the present plaintiff did when it contracted for its release from the obligations to pay royalties. It makes no difference, to my mind, that the defendant was an assenting party to that release."

¹ Part II §2.4.1-3; Part III §2.4.

² *M Levisieur v Friedman*, 1922 OPD 182 195.

³ *Techni-Pak Sales (Pty) Ltd v Hall*, 1968 3 238 (W) 239AB.

It has been argued that the doctrine of frustration of purpose may include cases of relative impossibility.¹ That this is not the case when the relative or subjective impossibility has been caused by an act or forbearance of one of the parties, is also laid down in *Benjamin v. Myers* and *Grobbelaar v. Bosch*.²

2.4.2. Assumption of risk

Self-induced frustration must be distinguished from the case where the risk of a change of circumstances brought about by external factors is assumed by one or both of the parties. Apart from speculative transactions, cases where a change of circumstances is foreseeable require consideration in this regard.

2.4.2.1. Foreseeability

In *Mountstephens & Collins v Ohlssohn's Cape Breweries*,³ Solomon J held:

"But the point is this, that the act of the licensing court is one which might have been contemplated at the time of the lease. The parties must have known that the court might refuse to renew it at any time, but there is no clause in the lease providing against this contingency."

In *Hoffend v. Elgeti*,⁴ Centlivres JA held:

"The test is what was the cause of the loss and not what was the amount of the loss. If I agree to bear a loss the cause of which was within my contemplation when I entered into a contract, I am bound by such an agreement, and it would be no defence on my part to say that the extent of the loss exceeded my expectations or was greater than what would normally have been expected."

¹ Part III, §§ 3.2 and 4.

² 1946 CPD 655 and 1964 3 SA 687 (E).

³ 1907 TH 56 59.

⁴ 1949 3 SA 91 (A) 103.

2.4.2.2. Speculative transactions

Agreements which by their very nature have a speculative character, like the bulk of business transactions, cannot be treated as frustrated if the commercial endeavour results in failure, the transaction turns out to be a bad bargain, and the purpose of making a profit is not attained or even transformed into the opposite. In these cases, the parties have consciously assumed and accepted the risk that their speculations as to profit may fail. Such cases are related to those relating to foreseeability in that the parties usually act on the basis of a prognosis which by its nature is uncertain and includes the risk of failure. Because these transactions are by nature speculative, the common purpose cannot be frustrated by an economic failure.

Thus, in *MacDuff & Co Ltd (in liquidation) v Johannesburg Consolidated Investment Co Ltd* Solomon JA in principle approved of the doctrine of frustration as exposed by Lord Loreburn in *Tamplin SS Co v Anglo-American Petroleum Co*:¹

"It was contended, however, in argument, that in law a contract becomes impossible of performance where the parties make a bargain on the footing that a particular state of things will continue to exist, and where there has been a discontinuance of that state of things such as to upset altogether the purpose of the contract. And it is said that in the present case the footing on which the parties contracted was that there should still exist an undertaking capable of expansion on the lines indicated in MacDuff's letter of the 28th July, 1920, and that there was no such undertaking at the time when the new company should have been formed. The principle of law here invoked is taken from the judgement of the Lord Chancellor in the case of *Tamplin S.S. Co. v. Anglo-American [Mexican] Petroleum Co.* (1916, 2 A.C. 403) ...

It will be observed that Lord Loreburn extends the rule of the civil law that a person is discharged from his obligation under the contract, if the thing the subject matter of the contract has ceased to exist, to the case where a particular state of things has ceased to exist, if the parties have bargained on the footing that that state of things would continue to exist. I am not aware that there is any express authority in our law to that effect, but the principle was accepted in the case of *Schlegemann v. Meyer Bridgens & Co.* (1920, C.P.D. 420), and for the purposes of my judgement I shall assume it to be good law."

But on the facts of the case the judge denied frustration because of the speculative character of the transaction:¹

¹ 1924 AD 573 603.

"The defendant company deliberately undertook, with full knowledge of the fact that the position was not so rosy as it had been painted by MacDuff and Lawn, to float a company to take over the MacDuff company. It was well aware that the undertaking might fluctuate from time to time, and it might in the contract have made provision to meet such a case as this. Not having done so, I do not think that it is entitled now to repudiate its obligation because the MacDuff company had fallen upon bad times."

In *Hersman v Shapiro & Co* it was held per Stratford J:²

"Looking at the nature of this contract - that it was of a speculative character and both parties ran whatever commercial risk resulted from a rise or fall of the market against them - I cannot think the condition of things that has happened is not a condition of things that might well have been in the contemplation of the parties. Therefore, on the particular facts of this case, I am prepared to go the length of saying that, looking at all the circumstances surrounding the making and performing of this contract, the implication of the contract is that the defendant should not be relieved because of a failure of crops in the Union."

In *Dithaba Platinum (Pty) Ltd v Erconovaal Ltd and another* it was held per Preiss J:³

"On the one hand, to decree specific performance would be to allow the applicant to purchase a valuable mineral right for a ridiculously low price. On the other hand, there are a number of features which cannot be ignored. They are the following:

1. The respondents, through the engineer, Mr. Albertyn, valued the mineral rights as best they could, and with the information then at his disposal, the latter fixed the value at no more than 10 cents per hectare. Though nominal, it was not shown to be an artificially low value;
2. The respondents concluded the cession and sale agreements with full knowledge of the fact that the applicant was the holder of the grant, and they were aware of its terms.
3. The applicant is in no way responsible for the dilemma in which the respondents now find themselves.

¹ *MacDuff & Co Ltd v Johannesburg Consolidated Investment Co Ltd*, *supra*, 607.

² 1926 TPD 367 374.

³ 1985 4 SA 615 (T) 628.

5. The respondents, as authors of their present distress, should be held to the terms of the agreements."

In *Snyman v. Fowlds*¹ it was held that a purchaser is not entitled to resile from a contract where after the sale a burden is imposed upon the land purchased by operation of law or by the exercise of statutory powers. This was taken to be a risk which every purchaser of a farm has to accept.

2.5. Conclusion

Frustration cases turn up under several different legal categories in the South African case law. Claire Palley has observed this situation when she said:

"It seems that there are so few cases of common mistake giving rise to *restitutio* because in most cases the identical claim will lie on grounds of innocent misrepresentation, or alternatively the common assumption will have been incorporated into the contract as either as an express or implied term."²

What most of these different legal rubrics have in common and what links them together is that they all aim at ensuring contractual justice. That applies also to supervening impossibility, if - as in the case of the South African law of contract - it is understood in an extended way under the influence of the English doctrine of frustration.

The reason why in South Africa frustration cases are often dealt with by means of the notion of impossibility is simple: The English law of frustration does not differentiate between cases of impossibility and frustration. It comprises indiscriminately cases of absolute, relative and quasi-impossibility. South African Courts are aware of the difference between the civilian doctrine of impossibility and the English doctrine of frustration, but, as usual, in applying the doctrine of impossibility, they looked for orientation to English cases. In doing so, they did not always succeed in differentiating cases of absolute, relative and quasi-impossibility. Thus they have also applied typical English frustration cases when speaking of supervening impossibility.³ That was a logical development since, as pointed out earlier, frustration and impossibility rest on the same underlying

¹ 1950 3 SA 74 (T).

² Claire Palley, "Comparative study of mistake", *Rhodesia and Nyasaland LJ*, 1961, 206.

³ English frustration cases were referred to in *Bischofberger v. Van Eyk*, 1981 2 SA 607 (W); *Rossouw v. Haumann* 1949 4 SA 796 (C); *Benjamin v. Myers*, 1946 CPD 655; *Schlegemann v. Meyer, Bridgens Co.Ltd.*, 1920 CPD 494; *Peters, Flamman Co. v. Kokstad Municipality*, 1919 AD 427; *Witwatersrand Township Estate and Finance Corp.Ltd. v. Rand Water Board*, 1907 TS 231.

principle and the borderline is always difficult to draw. This development was probably reinforced by statements like that of Viscount Maugham in *Joseph Constantine Steamship Line Ltd v Imperial Smelting Corporation Ltd*:¹

"The doctrine of frustration is only a special case of the discharge of contract by an impossibility of performance arising after the contract was made."

Closely related to instances of supervening impossibility are cases decided on the basis of the supposition and implied terms. The concept of the common supposition is most obviously related to the concept of frustration. The South African understanding of this closely resembles Windscheid's doctrine of contractual assumption (*Vorraussetzungslehre*) in the late 19th century in Germany.² The implied term is already by its nature related to the common supposition.³ Both concepts have increasingly come under assault, a development which parallels that in Germany and England. The arguments are the same everywhere: suppositions can only with difficulty be distinguished from conditions and legally irrelevant motives, and implied terms are often purely fictitious and only serve as a last-resort-tool to remedy a certain injustice.⁴

Also closely related to the supposition, are cases of common error.⁵ These two concepts will to a large extent be interchangeable.⁶ The relation between cases of common error and frustration has already been described earlier in the part dealing with the English law.⁷

South African law does not accommodate a specific doctrine of change of circumstances or frustration of purpose. The relevant cases are remedied by several different legal concepts. Yet it is obvious that the relevant cases relating to fundamental change of circumstances are somehow connected, they have something in common. The jurisprudence should take note of that. These cases bear witness of an important principle which cannot be ignored. It is submitted on the basis of what has been worked out in this thesis that the principle of *causa finalis* provides a good explanation of these cases and the legal tools employed to resolve them, and leads towards more clarity and dogmatic coherence in these

¹ 1942 AC 168.

² See above Part II § 1.1. at the end.

³ Van der Merwe et al *Contract - General Principles* 202.

⁴ Eg. Ramsden, *Supervening impossibility of performance in the South African law of contract* 1985, 69sq; Scholtz, "Pacta sunt servanda en verandering van omstandighede na kontraktsluiting", 1976 *Responsa Meridiana* 153sq; Hunt, "Mistake in the formation of contract: the case of the careless clerk" 1964 *SALJ* 160.

⁵ Lubbe & Murray 446, note 2.

⁶ Hunt, "Mistake in the formation of contract: the case of the careless clerk", 1964 *SALJ* 156, note 1.

⁷ See above Part III § 1.2.1.

areas of the law. The distinct charm of the principle is that it has its place in both common and civil law which could make it especially suitable for the South African law with its continuing blend of the two major legal traditions.

The example of Professor Kerr shows that the role of the principle of *causa finalis* in contract law and its relevance for the problem of fundamental change of circumstances has not remained unnoticed in the South African jurisprudence. Kerr observes:

"Every contract is made with one or more purposes in view and is intended to operate in certain circumstances."¹

And therefore:

"Every contract has a sphere of operation beyond which it is of no effect."²

He refers to initial impossibility as entailing the

"absence at the time agreement is reached of the circumstances necessary for the operation of the contract"³

and to supervening impossibility as the

"absence during the currency of the contract of the circumstances necessary for its operation."⁴

Kerr observes that the rules as to impossibility are not only concerned with absolute impossibility but also encompass cases of what has been termed relative and quasi-impossibility.⁵ The contractual purpose has to be common to both parties, and may not only concern the unilateral motive of one of them.⁶ Although most of the relevant cases deal with changes brought about by *vis maior* or *casus fortuitus*, these are not the only possible causes.⁷ Kerr emphasizes that an intervention into the

¹ Kerr, *The Principles of the Law of Contract*, 223.

² Kerr, *supra*, 157.

³ Kerr, *supra*, 223.

⁴ Kerr, *supra*, 486.

⁵ Kerr, *supra*, 224.

⁶ Kerr, *supra*, 224, 225.

⁷ Kerr, *supra*, 226.

contract depends only on the extent of the departure from the contractual norm, and he adopts the Radcliffe-test to draw the line.¹

Kerr summarizes his opinion on the matter as follows:²

"The basic rule is that if during the currency of a contract the conditions necessary for its operation cease to exist, the change not being due to the fault of either party or to a factor for which either party bears the risk, the contract ceases to exist. As is mentioned above, there is no objection to the traditional phrase 'supervening impossibility of performance' if performance becomes impossible in fact. However, as in the case of initial impossibility of performance, there is difficulty with the word 'impossible'. Performance precisely as contemplated at the time the contract was entered into may no longer be possible but the result intended may be able to be achieved in some other way. The party bound to perform remains bound if the departure from the norm for the particular contract in question is minor, he is not bound if it is major, i.e. if the kind of performance which is possible in fact is 'vitaly different from what should reasonably have been within the contemplation of both parties when they entered into the contract'. ... The fact that the impossibility, as in *Bayley's* case, above, may relate to the purpose of a lease and not to the occupation of the premises as such shows that the class of case generally referred to under the title 'failure of the basis of the contract' is not foreign to our law."

Kerr mentions the same limitations as are employed both in Germany and in England: the change may not be covered by contractual provisions or other rules of law, self-induced frustration and assumption of risk.³

He relies especially on the cases *Bayley v. Harwood* and *African Realty Trust Ltd v Holmes* for his position and criticises the courts for obscuring the matter through a superficial distinction between English and South African law without a detailed investigation into the differences and similarities of the law regarding this subject.¹

Kerr's treatment of *causa* (*redelijke oorzaak*) in the South African law of contract also goes into the same direction as expounded in this thesis. He observes that the authoritative decisions on the topic

¹ Kerr, *supra*, 225. Kerr does not refer expressly to the case *Davis Contractors*, but to the American author Williston, § 1931, vol. 18, p. 8.

² Kerr, *supra*, 487, 491.

³ Kerr, *supra*, 493 sqq.

only describe what *causa* is not, while remaining obscure about what the term actually denotes. It is only settled that *causa* is not to be equated with valuable consideration as understood by the English law.² Apart from that, the judges employ vague and ambiguous terms to describe *causa*, e.g. as "the origin of the agreement",³ "the ground or reason for the undertaking",⁴ or "a reason for a contract, a rational motive for it, whether the motive is benevolence, friendship, or other proper feeling, or, on the other hand, is of a commercial or business nature."⁵ Kerr identifies the distinction of the ground or reason of the contract from an irrelevant motive as the crucial question.⁶ He examines the old authorities Grotius, Domat, Pothier, Van der Keessel, Van der Linden, Van Leeuwen and Huber and states:⁷

"It is clear, however, that in our law use of the word *causa* is not confined to counter-performance, the word being found in other contexts as well, in particular, when purpose is envisaged."

From the differing choice of words in the sources concerning *causa* he concludes:⁸

"This indicates that a *causa* in the sense of the ground or reason or purpose is considered to be present in contracts within the normal classes. It is there because, as Voet says,⁹ such contracts are 'underlain by their very nature by a ground of obligation'. ... Modern law no longer places the emphasis Roman law did on membership of a particular class of contracts so it seems that nowadays a plaintiff who sues on what he claims to be a contract need show no more to begin with than that the parties entered into the transaction, or appear to have entered into the transaction 'seriously and deliberately and with the intention that a lawful obligation should be established'. It is then open to the defendant to show that there was no *causa*,¹⁰ or that there was a *causa* but that it was *iniusta* (or another of the equivalent expressions, eg *illicita*, *inhonesta*, *turpis*, *oneerlijke*

¹ Kerr, *supra*, 490 - 493.

² *Conradie v Rossouw* 1919 AD 279.

³ *Rood v Wallach* 1904 TSC 187 199 *per* Innes CJ.

⁴ *Ibid* and 211, *per* Solomon J.

⁵ *Conradie v Rossouw supra* 286 *per* Solomon ACJ.

⁶ Kerr, *supra*, 164.

⁷ Kerr, *supra*, 167.

⁸ Kerr, *supra*, 166, 167.

⁹ Voet 12.1.1

¹⁰ Kerr refers to *Froman v Robertson* 1971 1 SA 115 (A) 122A and *Saambou-Nasionale Bouvereniging v Friedman* 1979 3 SA 978 (A) 990F-992F for support of his view.

etc). In this connection it should be noted that in *De Jager v Grunder*,¹ Botha JA adopted this approach and put the onus of proving a similar exemption on the defendant."

Kerr's exposition of the law regarding this topic clearly is in line with the treatment of *causa* advocated in Part IV above. The crucial element of *causa* is its finalistic nature denoting the purpose of the contract. In cases of change of circumstances, be it objective or subjective, lack or frustration of *causa* can be established as a defence by the affected party. Kerr also links the concept of *causa* with the concept of public policy when he points out that the *causa* of a contract may naturally not be in conflict with law, morality or public policy.²

3. *Causa finalis* in South African law

To resurrect the issue of *causa* once more will probably touch a sensitive nerve in the soul of some South African lawyers. *Causa* is probably the most nebulous and obscure concept inherited from the Roman-Dutch law. It was in the centre of the most famous judicial debate among the highest South African judges at the beginning of the century when Chief Justice Lord De Villiers equated it with the English concept of valuable consideration. This was not surprising since the concept of *causa*, in the sense of commutative justice, relates to the notion of reciprocity.³

The decision in *Conradie v. Rossouw* authoritatively laid down that *causa* was not the same as valuable consideration in the English sense, and more specifically, that it had a much wider meaning than the latter.⁴ But the judgement only finally settled what *causa* was not - its positive significance continued to be a matter of confusion. The dominant opinion, formulated by Kotzé, Innes and Solomon JAA, held that *causa* simply denoted the reason or ground for a promise and that *iusta causa* meant that the reason or ground should be "a good and legitimate one and not one contrary to law or morality or public policy".⁵ This definition, however, does not offer much insight as to the practical relevance of the concept of *causa*. From this definition the conclusion seemed inescapable that *iusta causa* had finally been swallowed up by other requirements for contractual validity, in particular the requirements of serious and deliberate intention to contract and legality. This situation has led to

¹ 1964 1 SA 446 (A) 463B-C.

² Kerr, *supra*, 167, 171 sqq.

³ For a modern view that *causa* denotes reciprocity in the broadest sense see: Jan Smits, *Het vertrouwensbeginsel en de contractuele gebondenheid*, Leiden 1995.

⁴ 1919 AD 279.

⁵ At pp. 279,288.

widespread calls for the total abolishment of the concept of *causa* from the realms of South African law. The weight of opinion formulates its criticism thus:

"However even there [in the case of accessory agreements] it seems that the concept has no independent role to play, because if it is required that the parties should expressly or implicitly have agreed to make the validity of the accessory agreement dependent on the existence of a valid principal agreement or obligation, then the so-called *iusta causa* is no more than a term of the accessory agreement: more particularly a condition or common supposition. Indeed, any reason for contracting which the parties elevate to the status of a fundamental supposition should then qualify as a *iusta causa*. This is borne out by the subsequent case of *Tauber v. Von Abo ...*"¹

On the basis of the theme developed in this thesis, it is submitted that the conclusion to be drawn from *Tauber v. Von Abo*² is the exact opposite: it reveals the basic principle behind the concept of supposition and related concepts, which is in itself open to criticism.³

The plaintiff had granted a written option for the sale of his farm to S. S subsequently ceded its rights in and to the option to the defendant. When the defendant wished to exercise his right, the plaintiff informed him that he no longer wished to sell his farm. After discussion between the parties, both of them considering the option to be valid and binding, an agreement was entered into between them whereby the defendant agreed to release the plaintiff from his obligations under the option on condition that the plaintiff pay the defendant a certain sum of money. As a result of the agreement, the plaintiff signed an acknowledgment of debt which became the source of the dispute in this case. The plaintiff claiming an order declaring the acknowledgment of debt to be of no legal force and effect and not binding on him because it had subsequently been discovered that the option was a nullity all along.

The court held that the fact that the option was void and unenforceable meant that the basis for the conclusion of the subsequent agreement had fallen away, and that consequently the subsequent agreement was invalid and unenforceable.⁴ Van Rensburg J formulated the principle as follows:⁵

¹ Hutchison "Contract Formation" in: Zimmermann & Visser (eds) *Southern Cross*, 172; to the same effect: Stassen, "Causa in die Kontraktereg", 1979 *THRHR* 357 374; Reinecke and Van der Merwe, 1979 *THRHR* 435; Van der Merwe *et al*, *Contract* 142.

²1984 4 SA 483 (E).

³§ 2.1.

⁴*Tauber v Von Abo*, *supra*, 489B.

⁵*Tauber v Von Abo*, *supra*, 490A-D, my italics.

"This brings me to Mr. Van Riet's argument that the acknowledgment of debt is invalid on grounds of a lack of *justa causa*. This argument can be dealt with briefly. In the present matter the plaintiff agreed to pay the defendant R 150 000 and signed an acknowledgment of debt for this amount on the common assumption that the option was valid and enforceable. In other words the existence of a valid option was the underlying *causa* for the subsequent agreement. The option having been declared void, it follows that the acknowledgment of debt must also fail for lack of *justa causa*. *Froman v. Robertson* 1971 (1) SA 115 (A) at 120-122; *Saambou-Nasionale Bouvereniging v. Friedman* 1979 (3) SA 978 (A) at 991F. *It is correct, as was submitted by Mr. Viljoen, that the requirement of justa causa may be sufficiently satisfied if the promise is made seriously and deliberately, and with the intention that a lawful obligation should be established, but where, as I have found in the present case, there was a specific underlying causa for the parties contracting, namely the existence of a valid option, and the option fails, the conclusion is inescapable, that the subsequent agreement must also fail.*"

The common purpose of the parties regarding the acknowledgment of debt was to pay for the release of the plaintiff from the option. This purpose was frustrated when the option turned out to be invalid. To nevertheless hold the plaintiff to the acknowledgment of debt would be against the common purpose of the parties and would militate against commutative justice.¹

To require an agreement between the parties on the *iusta causa* means nothing more than that the *causa* must be common to both parties.² *Causa finalis* is not a new distinct kind of contractual term (that would require that the parties had foreseen the possible change of circumstances at the time of the formation of the contract) - it is as much a term of a contract as good faith is: it is an objective, necessary principle of contract law, and it certainly does not only relate to accessory agreements although its importance is particularly obvious in these cases. It would be naïve and futile to ignore or disregard the role of purpose (*telos*) in the law, because its role is crucial to the essence of the law.

¹ The case is also distinguishable from cases like *Diederick's v. Minister of Lands* (*supra*) and *Bell v. Lever Bros.* (*supra*) in that in this case the release from the option was the sole object of the acknowledgment of debt and thus the voidness of the option related directly - and not only indirectly or by implication - to the common purpose.

² This is borne out in *Froman v. Robertson* 1971 1 SA 115 (A) at 127F, and *Saambou-Nasionale Bouvereniging v. Friedman* 1979 3 SA 978 (A) at 992H, see below.

South African writers are correct in so far as they stress that *causa* cannot be an additional requirement for the validity of contract formation. Whenever there is a deliberate, serious and legal intention to be bound, a *causa* is present. The doctrine of *causa finalis* does not regulate the formation of contract, but its execution - not its validity, but its enforceability. It may afford a defence if the contract is not executed according to the *causa finalis* - the common purpose of the parties. The doctrine is perfectly reconcilable with the traditional approach to contracts which takes the will-theory as its point of departure, it merely reminds us that will cannot be treated divorced from its aim or purpose. The law is not, and never was, blind to the aim of the parties' will. How the contract is treated by the law will in fact often depend more on the aim of the parties than the pure empirical fact that something has been willed with an intention to be bound.¹

The 'missing link' in the South African context is the crucial relation of *causa* to purpose in the sense of *causa finalis*. The discussion of *causa* in South Africa is obscured by the fact that *causa* has always only been equated with 'ground' and 'reason' and its crucial relation to purpose, its relational, finalistic nature, has never been adequately emphasized, let alone worked out in a coherent and precise manner.

It has been described how in Europe the concept of *causa* faded into the background for exactly the same reason: the significance of *causa* as relating to purpose and its implications were misunderstood, because its roots in Aristotelian-Thomistic philosophy were not appreciated anymore. Will and purpose had become divorced - with serious and disturbing consequences for the law of contract.² The merit of restating the significance of *causa finalis* belongs to James Gordley.³ Because there is no will without an aim towards which it is directed, the purpose or *causa finalis* of the contract must be understood as part of the agreement which has come into being through the will of the parties and it ought therefore not be disregarded. The very reason why the parties decide to be bound is that they want to achieve a common purpose with the contract. If that purpose is frustrated, their will is invalidated, and the ground for the intention to be bound has lapsed.

The relevance of purpose or common intention and its invocation as a defence, can also be extracted from judicial statements in other cases dealing with the concept of *causa*.

In *Rood v. Wallach*⁴ the relation of *causa* to purpose becomes clear from the authorities cited with approval by Innes CJ and Mason J:

¹ See Part IV.

² Part I § 2.

³ *The Philosophical Origins of Modern Contract Doctrine*, 1991.

⁴ 1904 TS 187.

"With the edition of Grotius published in 1667 is printed a list of the Dutch meanings of Latin words used throughout the book. The definition of *causa* in that list is *een waerom* - the ground or reason, *the why and wherefor* of any matter. Strangely enough, Toullier, a French writer on the Code, gives almost the same definition (*Le Droit Civil Français*, 3,4,sec. 166). 'By the cause of an obligation or of a contract,' he says, 'the Code means the motive for making the promise which it contains, the reason why (*le pourquoi*) it was made.'"¹

"The *intention* is the essential element in contract as in delivery; it is a state of mind due to a *desire to attain some object*, and if the object be lawful, then the desire or motive forms a lawful *causa*."²

"Many of the writers divide contracts into those in which a mutual advantage is sought, or in which one party only is to get the advantage; the latter are called 'benevolent contracts', and any intention of *liberality* is considered a sufficient *causa* to support them. It is difficult to see what agreements intended to have a binding character are not included in one of these two classes."³

The basic traits of the doctrine of *causa finalis* are stated here: that *causa* relates to purpose and that purpose relates to either commutative justice or liberality.

That the concept of *causa* must be linked to the purpose of the contract is also borne out by the judgement in *Kennedy v. Steenkamp*,⁴ where it was held by Watermeyer AJP:

"Unless *causa* includes the purpose of a contract it would seem however that even the maxim '*ex turpi causa non oritur actio*' is not wide enough to afford a comprehensive test of the *enforceability* of contracts. Grotius (3.1.42 & 43) seems to me to deal clearly with the matter and bring out the distinction between illegality in the *causa*, in the contract itself, and the aim or purpose."⁵

¹ *Rood v Wallach*, *supra*, 200, *per* Innes CJ, *my italics*.

² *Rood v Wallach*, *supra*, 224, *per* Mason J, *my italics*.

³ *Rood v Wallach*, *supra*, 225, *per* Mason J, *my italics*.

⁴ 1936 CPD 113.

⁵ *Kennedy v Steenkamp*, *supra*, 117, *my italics*.

In *Froman v. Robertson*¹ it was held *per* Corbett AJA:

"As between the payee and the drawer these promises are *enforceable* only if supported by *justa causa* in the above-described sense; or, to put it in another way, as between himself and the payee, the drawer, when sued on the cheque, is always entitled to raise the *defence* that he drew and issued the same without there having been the necessary *justa causa* (see Cowen, *The Law of Negotiable Instruments in South Africa*, 4th ed., p. 97)."²

The decision makes clear that to apply the requirement of *iusta causa* to the contract of cheque means to have regard to the purpose of a cheque. The cheque is a medium - a means to an end - for the payment of a monetary obligation. The purpose of the cheque is therefore to discharge that obligation. If that obligation is, e.g., void, the purpose of the cheque fails or may be said to be absent. It would not be permissible to contend that the cheque is supported by *iusta causa* simply because it was drawn and issued seriously and deliberately and with the intention to establish a lawful obligation (which is the case). It is clear from the judgement that this rule is a general principle and not confined to cheques or negotiable instruments or accessory agreements. That *iusta causa* does not necessarily consist of a separate obligation is further emphasised when Corbett AJA says:

"Where, as is often the case, the cheque has been drawn and issued *in order to* discharge a pre-existing obligation, this obligation must naturally be looked to when determining whether there is *justa causa*; but I do not accept that such an obligation is an essential requirement of sec. 25 (1) [of the Bills of Exchange Act of 1964]. I reach this conclusion upon an interpretation of, primarily, para. (a) of sec. 25 (1) ['any cause sufficient to support an action founded on contract *or agreement*'], read against the background of the common law."³

In *Saambou-Nasionale Bouvereniging v. Friedman*⁴ it was held by Jansen JA that *animus contrahendi* and *iusta causa* were different concepts which had to be distinguished for the sake of clarity. Furthermore, the decisive role of common intention (purpose) was emphasised:

¹ 1971 1 SA 115 (A).

² *Froman v Robertson*, *supra*, 121G, my italics.

³ At 127F, my italics.

⁴ 1979 3 SA 978 (A).

"In hierdie Hof het die vereiste van redelike oorsaak in ons reg in *Froman v. Robertson* tap weer na vore gekom - altans wat die kontrak tussen nemer en trekker van 'n tjek betref (wat as voorbeeld van 'n suiwer eensydige kontrak beskou kan word). Alhoewel die Hof redelike oorsaak nog in terme van *animus contrahendi* omskryf (te 121D en 127D-F), is dit heel duidelik dat 'oorzaak' ook aan die onderliggende verhouding gekoppel word (te 121E en 127E-F). Dit sal tot meer helderheid lei as in die toekoms die twee begrippe uitmekaar gehou sou word sodat *animus contrahendi* nie meer die 'redelike oorsaak', wat in die onderliggende verhouding gesoek word, oorvleuel nie."¹

"Nemer en trekker sal dit *eens moet wees* oor dit *waaraan* die opbrengs van die tjek bestee moet word alvorens daar sprake van redelike oorsaak kan wees. Deur hierdie ooreenkoms word die band tussen wisselkontrak en die onderliggende verhouding gelê."²

This passage makes it clear that 'agreement' in the above sense denotes nothing else than common purpose and that without that common purpose there is no *causa*.

In his essay on contract formation in *Southern Cross*, Dale Hutchison, dealing with *iusta causa*, concludes:

"The only conclusion that may safely be drawn from these cases is that the last word has yet to be spoken on the meaning and role of *iusta causa* in the modern South African law of contract. This is an unfortunate state of affairs, and it is ardently hoped that, when next it has an opportunity to pronounce on the matter, the Appellate Division will unequivocally declare that the *iusta causa* requirement, having served its historically important purpose, has now become redundant. Such a pronouncement would not only reflect the preponderant weight of academic opinion in the country today, it would also finally conclude a chapter of our legal history that has already dragged on for far too long."³

It is submitted that there are good reasons not to follow Hutchison's appeal. The matter is far more complex than a purely South African perspective would suggest. No legal concept with a long and fruitful tradition should be abolished only because its significance and relevance has not been properly understood and therefore is difficult to assess. It will be a vain attempt. One must only look

¹ At 991E-G.

² At 992H, my italics.

³ At 173.

at the development in Germany regarding *clausula rebus sic stantibus* and remind oneself of Windscheid's prophecy: thrown out of the door, it will always re-enter through the window.¹

4. Legal development

The problem of fundamental change of circumstances, though it has not received attention of a very fundamental nature, has certainly not gone unnoticed, and several writers have urged that it be dealt with on the basis of the principle of good faith (the implications of which have also not yet found exhaustive treatment in the South African case law).² Although this would not be an inappropriate line of enquiry, it is submitted that the notion of *causa* affords a more pertinent perspective. Understood in the sense of *causa finalis*, it contributes to dogmatic and methodological clarity and persuasiveness in dealing with cases of fundamental change of circumstances.

The South African Law Commission has recommended to integrate Article 2.117 of the *Principles of European Contract Law*,³ dealing with change of circumstances, into the proposed Bill on the Control of Unreasonableness, Unconscionableness or Oppressiveness in Contracts or Terms.⁴ While it is a good thing that the problem of fundamental change of circumstances is addressed directly with statutory means and with regard to legal developments on an international level, it is submitted that the Lando-Principles' distinction between "more onerous" and "excessively onerous" does not adequately capture the decisive point for practical purposes. It is submitted that although the principle of frustration of the contractual purpose is also unable to ultimately preconceive the decision in every case in question in a cogent manner, it at least provides a clear dogmatic basis for the justification of the decision and binds the court to a certain intelligible standard which has to be established from every individual contract by way of concretisation. In this process of concretisation, due regard is to be paid to the actual intention of the parties as well as to the normative understanding of the concept of contract. The change of circumstances has to be measured against the thus established contractual purpose. The final decision always inevitably depends on the facts of the individual case and the court's understanding of the contract, but - it is submitted - at least the court is forced to establish an intelligible standard from the case and on that basis decide whether the threshold of frustration has been crossed or not. This will at least methodologically discipline the judicial reasoning and make it

¹ Windscheid "Die Voraussetzung" in *AcP* 78 197.

² Coenraad Visser, 1984 *SALJ* 641 655; Lubbe & Murray, *supra*, 773; Christie, *supra*, 19; Van der Merwe *et al*, *supra*, 233; Scholtz "Pacta sunt servanda en verandering van omstandighede na kontraksluiting" 1976 *Responsa Meridiana* 153 168.

³ Lando and Beale, *Principles of European Contract Law* (1995); see Part II §1.2. at the end.

⁴ South African Law Commission Report, Project 47, *Unreasonable Stipulations in Contracts and Rectification of Contracts* (1998), clause 4.(1) - (3), 194, 220.

more comprehensible and convincing. The possibility of recurring to purely equitable arguments will be reduced considerably. The decision will seem less arbitrary as opposed to when the court only determines whether the situation has become "more onerous" or "excessively onerous". It cannot be conceived without qualification why this distinction, why the threshold between the two notions is so decisive - unless the reasoning is linked to the role (which means: the purpose) of the concept of contract in the legal system in general and the role of the contractual purpose in particular.

The most detailed contribution to this particular subject is that of LF van Huysteen's and Schalk van der Merwe,¹ in which all the issues of importance raised by the subject - e.g. whether change of circumstances is in itself a ground for intervention, the implied-terms approach, legal certainty vs. equity (substantive justice), adjudication of interests (value-judgements), the value-orientation of the law, concretisation - are identified. This thesis seeks to respond to this article by attempting to evaluate these issues in greater depth. The developments described in this thesis should be seen within the broader context of a return to the ethical foundations of the earlier *ius commune* and the renaissance of Aristotelian-thomistic ideas in legal thought.² The crucial role of legal philosophy and legal methodology in determining the content of detailed rules of the law, and especially the philosophical and methodological premises of the function and purpose of contract, have been emphasized. This perception has also been gaining ground in South Africa.³

¹ "Good faith in contract: proper behaviour amidst changing circumstances" in 1990 *Stellenbosch Law Review* 244-251.

² This process is described by Zimmermann in his *Law of Obligations, supra*, pp. 259sq., 268sq., *Southern Cross, supra*, p. 256, and James Gordley in his *Philosophical Origins, supra*.

³ Eg Harker, "The role of contract and the object of remedies for breach of contract in contemporary western society", 1984 *SALJ* 121; Alfred Cockrell, "Substance and form in the South African law of contract", 1992 *SALJ* 40; Van der Merwe *et al, supra*, 10; Van Reenen, "Philosophical underpinnings of modern comparative legal methodology", 1996 *Stell LR* 37.

Summary

On the basis of a comparative analysis of the case law in Germany, England and South Africa dealing with fundamental change of circumstances, it is submitted that the underlying principle of this problem area is the idea of frustration of the contractual purpose (*causa finalis*).

The problem of fundamental change of circumstances is directly connected with basic issues of legal theory such as the dichotomy between legal certainty and substantive justice, the role and limits of interpretation, the concretisation of principles, the adjudication of interests and the problem of value-judgements in the law which are of immediate influence on the understanding of the problem by judges and legal commentators. A broad perspective on the topic is necessarily indicated hereby.

The thesis therefore starts off with an account of the role of purpose (*causa finalis*) in the history of legal philosophy, with a focus on developments in Germany. The continuing relevance of Aristotelian-Thomistic legal thinking is emphasized. The German and English case law dealing with fundamental change of circumstances is analyzed in an analogous manner. An account of the history and development of the doctrines dealing specifically with fundamental change of circumstances is given: the *clausula rebus sic stantibus* of the *ius commune*, the doctrine of *Wegfall der Geschäftsgrundlage* in Germany and the doctrine of frustration of contract and common mistake in England. The crucial elements of the approach of the courts are restated. The positions of the two most influential German legal authors involved on opposite sides of the debate concerning the doctrine of *Wegfall der Geschäftsgrundlage* are discussed. At the end of the discussion of English case law, the approach of the English courts is compared with that of their German counterparts.

On the basis of the analysis of the cases, the historical and philosophical developments as well as the position of legal commentators the principle of *causa finalis* is restated in the following terms:

The *causa finalis* (end or purpose) of a contract is a balanced, and therefore just, equivalence of interests of the parties. In contracts of exchange the *causa finalis* of a contract entails equality in exchange (commutative justice) in view of the obligation as a whole. Equality in exchange may relate to either the value or the fitness of the subject matter of the performance for a special purpose. In the case of unilateral contracts, the *causa finalis* of the contract may alternatively be - like in the case of donation - liberality.

To apply the principle, one has, in the first instance, to assess the balance of exchange (interests) of the individual contract, as agreed by the parties - which determines the allocation of risk - and secondly, to evaluate whether a change of circumstances has totally defeated that balance of exchange. This is the task performed by the doctrines of *clausula rebus sic stantibus*, *Wegfall der Geschäftsgrundlage* and frustration of contract. They constitute emanations and concretisations of the underlying informing principle of *causa finalis*.

The principle of *causa finalis* does not regulate the formation of a contract, but rather its execution - not its validity, but its enforceability. It may afford a defence if the contract is not executed according to the *causa finalis* of the contract - the common purpose of the parties. The doctrine is perfectly reconcilable with the traditional approach to contracts which takes the will-theory as its point of departure, it merely confirms that the will of the parties cannot be dealt with divorced from its aim or purpose. The law is not and never was blind towards the aim of the will of the parties. How the contract is dealt with by the law, often depends more on the aim of the will of the parties rather than the pure empirical fact that something has been willed with the intention to be bound.

Notwithstanding the fact that South African law does not recognize a doctrine dealing specifically with fundamental change of circumstances, and in spite of *dicta* to the effect that the English doctrine of frustration of contract is not part of South African law, it is submitted that the doctrine of frustration of contract has nevertheless strongly influenced the South African law of supervening impossibility and supposition, and has arguably become part and parcel of it. Likewise, cases of frustration of the contractual purpose due to a fundamental change of circumstances have been dealt with by means of other doctrinal devices such as common mistake.

It is submitted, finally, that the famous and controversial issue of the role of *causa* in South African law should be reconsidered, since it may contribute to the understanding of the notion of contract, and assist in overcoming the current doctrinal crisis of the theory of contract.

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