

Frustration of contracts  
as a consequence  
of the actual market crash  
under Spanish law.



Obviously, the global financial crisis is also affecting the shipping industry and the credit crunch in the world trade is causing severe difficulties for many in said industry.

### Lehman losses

Lehman Brothers shares closed below \$4 and is down 94.3 percent from its January peak.

**Lehman Brothers (LEH)**



SOURCE: Thomson Financial AP



Rates for dry goods are drastically  
falling down  
and  
freights rates for shipping are crashing.



Claims across all sectors of the shipping industry are increasing and just as one example of this shipowners are facing the risk of repudiation of charterparties, non-payments of freight and hire as well a potential liability for charterers bad debt.



Another practical example of this is that the number of vessels being recorded in the 2009 Registry of Panama for Lay-up vessels, who have stopped the commercial activity due to the financial crisis, is almost daily increasing.





On the other, the present position on the banking market makes very difficult to raise finance for new projects and due to the lack of finance in the shipbuilding sectors many buyers are trying to pull out of contracts. Many of the new buildings presently under construction will likely not be completed.



In this situation, many have been considering whether their contracts of sale, charterparties, or other are profitable, and if they are not, looking for a way out of said contracts.



Nowadays the exercise of the contractual options to cancel by way of an express right to terminate has significantly increased.





On the other hand, whilst express rights to cancel hardly ever provide on economic grounds, many around the world are considering whether or not they can argue that their contracts are frustrated in view of the financial crisis.



Let's see then if under Spanish law the actual market crash could frustrate commercial contracts.



The issue of the importance that any change resulting from the circumstances that the parties have taken into account in order to be developed or to reach their aims may have, was not included in the Spanish Civil Code, enacted by the end of 19th century, which includes rulings on obligations and contracts.

The same happened with other continental civil codes then enacted, where there were certain economic and social stability.



In the Spanish Civil Code, the general principle is the compulsory performance of the contract (pact sunt servanda), that general rule being provided for in sect. 1091 of the said Civil Code:

*“Obligations arising from contracts have the force of law between the contracting parties and must be performed pursuant to the provisions of the contracts involved”.*





However, in practice, an unconditional faithfulness to the contract may lead to consequences which may seem clearly unfair and then, the dilemma is between the unconditional faithfulness to the contract and the admission of certain relevance of changes resulting in the contractual relationship.



In Spain, may any change in the circumstances, especially the economic ones, which were the basis to entering into a contract, involve any change in the legal system of the contractual relationship? Or, on the contrary, does the contract have to be unchanged and be performed in its original and own terms?



In principle, it seems that in Spain, it is the second option which prevails, the one of unconditional allegiance of the contract, based on the general principle (*pacta sunt servanda*).



Nevertheless, both doctrine and case-law have decided, in certain circumstances, to choose the second option of the problem, being inclined to admit a change in the legal system of the contractual relationship and of the interest's organization system between the parties.





I have heard that it has happened this way in other countries of the continent, such as in France, Germany and Italy, although with different solutions.



That case law of the Spanish Supreme Court has accepted the clause called “*rebus sic stantibus*”, admitting the change of the contract from a theoretical point of view, although markedly restrictive in practice.



## Provided that:

- 1 – There is any extraordinary change in the circumstances at the moment of performing the contract in connection with those whom it was entered into.
- 2 – There is an exorbitant disproportion and out of any calculus among the obligations of the contracting parties, which collapse the contract.
- 3 – That all the above occur due to the appearance of radically unforeseeable circumstances.
- 4 – That there is no other mean to remedy and save the damage.

In 1983, the Spanish Supreme Court already expressed the following:

*“Even with all reservations and cautions that our times and circumstances advise to praise in respect with the clause “rebus sic stantibus”, the case law admits the same as a fair solution to the expressed problems, although demanding certain requirements, including the occurrence of extraordinary events, unforeseeable and unforeseen by the parties, of such an importance that it may cause the imbalance of the basis of the contract, basis of its fair reciprocity. It does not happen that way when those circumstances do not appear, either because the imbalance arising does not go beyond tolerable limits in the contractual economy, or because the parties early foresaw or assumed the risks...”*





The leading judgement is that of the 20th day of February, 2001, admitting the change in the contract and providing:

*“This judgement follows the line of pacific and consolidated case law on this matter, relative to the fact that due to the application of the implied “rebus sic stantibus” clause, there is a possibility that, although in special cases and with caution since this may cause a big change in the “pacta sunt servanda” principle and in the certainty of the legal system, the Court may, once the particular circumstances of each particular case have been attended, carry out a change (not a rescission or a discharge) of the contract, by defect or change in the basis of the negotiation and because the balance of obligations and rights was broken.*



When the requirements mentioned before come together, the contract may be legally modified, readjusted or revised in Spain in order to balance the imbalance of the contract, as a consequence of the changes resulting from the circumstances.



I have heard that in other continental legal systems, the effect of discharging a contract due to the excessive onerous burden of the contract is the general rule and not the readjustment or the legal revision of the contract, which is the exception, contrary to what happens in Spain.



The discharge of the contract, as general rule, due to disappearance of the basis of the negotiation, in lieu of the effect of revising the contract, is defended by some distinguished authors in Spain, who understand that, whenever those circumstances happen, there is an authority attributed to the damaged party by the resulting event, which is the one who may opt between performing the contract in its own terms and repudiating it.





Nevertheless, the general line of the Spanish case law is favourable to the effect of revising instead of discharging the contract.



To sum up, case law points out that, in Spain, it does not seem, in principle, that a contract may be revised by the mere fact that, as a consequence of the crisis, it has become more onerous on one side, or that it entails a lack of benefit for the same.



However, this could happen if, when analyzing the particular case, the Court reaches the conclusion that the established requirements by case law are met:

A) Completely extraordinary change of the circumstances taken into account when the contract was entered into.

B) Exorbitant disproportion among the rights and obligations of the parties.

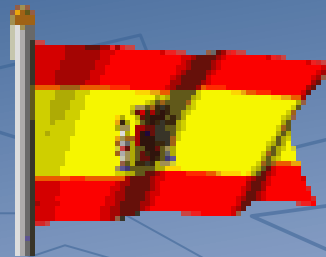
C) That this is caused due to unforeseeable circumstances.




If in the opinion of the Court, the economic crisis can be considered as an extraordinary change resulting from the starting circumstances of the particular contract which it analyzes and which may imply a big imbalance, then it could change the studied contract, after an application of revision by one of the parties.



Definitely, the Spanish legal system chooses certainty as general rule, but it is inclined in favour of the admission to change in the contract or fairness, always with caution, and exceptionally, when special circumstances come together.







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LONDON, October 2009