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- **The role of a balanced contract
in preventing disputes**

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What is balance of a contract? I

- The contracting parties have presumably the best knowledge of their interests and equity: so they are best placed to organise the balance of their contract.
- Balance must exist in the moment of conclusion of the contract and during all of the period of performance.



What is balance of a contract? II

- Balance is distinctive only for a mutually binding and commutative contract.
- If there is an obvious imbalance between the performances of the parties, it is clear that one party is going to suffer a prejudice.
- If the disproportion is valuable in money and exists at the moment of concluding the contract, this may be a cause of injury of the contract.



What is balance of a contract? III

If there was a balance in the contract at its conclusion,

but

during its performance there are changes due to some economic or unpredictable circumstances,

this leads to:

unpredictability theory.



What is balance of a contract? IV

- Injury will encourage rebalancing of the contract, as it may lead to the re-negotiation of the contract.
- Each contracting party is motivated to conclude the contract because he expects a result which achieves his interest.

But what is a party's interest?



Defining a party's interest

I

Defining the interest – the object of the contract – for each contracting party is not an easy task.

- In a mutually binding contract, the interest consists of rights and obligations for the parties.
- In these contracts, the parties are dependent on each other to achieve their individual interest.



Defining a party's interest

II

Opposition between the interests of contracting parties was considered as the best guarantee that their respective obligations are assumed on the basis of respect of a balance which responds to each party's interests.



Time...

Time is a movable notion and can affect the quality of the contractual relationship during its execution (i.e. increasing of the production/execution costs as a consequence of increasing of fuel, materials or manpower costs).

Time = an issue for long duration contracts and contracts for the performance of continuing obligations.



Risk assessment in a contract

- Contractual freedom allows the parties to assess the risks which might interfere in the performance of a contract).
- If this assessment is not contained in the contract – the parties are liable for the consequences of their silence.



Theory of efficient breach of contract I

- Popular in Anglo-Saxon and American contracts.
- Evidences the interest of one of the parties to terminate unilaterally or breach the contract, either because it cannot obtain the expected profit or because it received a more profitable offer from elsewhere, so that profit from a new contract is superior to the losses of terminating or breaching the existing contract.



Theory of efficient breach of contract II

- Applicability of this theory in Romanian law: art. 1075 of the Civil Code:

“Any obligation to do or not to do something is changed in damages in case of non-execution of the obligation”

which is based on art. 1142 of the French Civil code.



Theory of efficient breach of contract III

- In Romania each obligation shall be exactly executed if the obliged party to perform the obligation cannot prove that this performance is impossible due to the guaranteed and defended individual freedom.
- In practice, there is no direct method to enforce "to do" obligations and the result is still damage, so the efficient breach of the contract theory may be applicable.



Theory of the non-zero-sum solution I

- In game theory and economic theory, **zero-sum** describes a situation in which a participant's gain or loss is exactly balanced by the losses or gains of the other participant(s).
- If the total gains of the participants are added up, and the total losses are subtracted, the result will be a total of zero.



Theory of the non-zero-sum solution II

- Zero-sum can be thought of more generally as **constant sum** where the benefits and losses to all players sum to the same value of money (or utility).
- Cutting a cake is zero- or constant-sum, because taking a larger piece reduces the amount of cake available for others.



Theory of the non-zero-sum solution III

- In contrast, **non-zero-sum** describes a situation in which the interacting parties' aggregate gains and losses is either less than or more than zero.
- Zero-sum games are also called *strictly competitive*.



Unpredictability theory

I

- Applicable for commutative contracts and contracts for the performance of continuous obligations.
- Unpredictability = a legal situation deriving from a contract, which is determined by dramatically adverse changes of the circumstances during performance of the contract compared to the date of its conclusion.



Unpredictability theory

II

- Cumulative conditions to be met:
 - a) There is no fault of the debtor = absence of bad faith of the debtor;
 - b) There is no adjustment clause in the contract; and
 - c) The non-execution of the contract is lawful.



Unpredictability theory

III

Involves a new arrangement of the contract which:

- ❖ will include a re-negotiation of the contract;
- ❖ may involve either modification of the contract or its termination;
- ❖ will involve a high risk of a dispute as parties might not reach a complete common understanding; and
- ❖ can be contractual, legal or judicial.



Unpredictability theory

IV

Revision of the contract:

- ❖ termination of the contract for the cause of unpredictability;
- ❖ suspension of the contract;
- ❖ prorogation of the contract;
- ❖ anticipated enforcement of the debtor's obligation;



Unpredictability theory

V

Revision of the contract (continued):

- ❖ amicable conciliation of the parties;
 - ❖ direct intervention of the court for:
 - (1) fixing the limitation of the revision of the performances; and
 - (2) the exact determining of the value of the performances;
- and



Revision of the contract (concluded):

- ❖ insertion of a re-negotiation obligation in the contract, or the indirect intervention of the court (the judgment obliges the parties to insert a re-negotiation obligation in the contract).

The legislator's intervention will regulate certain matters of limitations of the performances revision.



Unpredictability in Romania I

- Attempted interference of the law in contractual freedom - Law 469/2002 regulated the obligation for contractual parties to insert in their contracts clauses related to price adjustments in case of inflation or depreciation.

This Law is no longer valid since June 2009.



Unpredictability in Romania II

- Romanian law practice tends to follow the principle *pacta sunt servanda* (the obligatory power of the contract between parties) and not to accept the regulated unpredictability theory.



Hardship

I

Hardship is created in an international commercial agreement by events which:

- ❖ are produced without fault of the contracting parties, who could not anticipate them at the making of the agreement, no matter how reasonable and careful they have been, and
- ❖ essentially modifies data and elements taken into account by the parties, thus creating consequences so onerous that it would not be fair for one party to bear alone.



- A Hardship clause (revision clause) is stipulated in a long-lasting contract; the parties must promptly and without prejudice adapt the contract, either after re-negotiation or using reconciliation or mediation / arbitration. Such clause is performed where, during the performance of the contract, extraordinary circumstances appear which affect the balance of the contract.



Indexing clauses

- A contractual clause which aims to maintain the value of the agreement for a long term by avoiding difficulties which might occur due to prices fluctuations.
- Provides the binding of the amounts recorded in an agreement either to a monetary standard, or by one or more of the basic products.
- The old price is automatically replaced by a new price, depending on the fluctuation of the agreed standard.



Hardship & indexing clauses contrasted

- Revision clauses (hardship) require parties to renegotiate the agreement or, in absence of such mutual agreement on renegotiation, to submit to reconciliation or arbitration procedure in order to rebalance the provision of services.
- Indexing clauses do not require further intervention of parties, but operate automatically depending on the fluctuations of the mutually agreed standard.



Value of hardship & indexing clauses

- Being established by mutual agreement of the contracting parties, the observance of such clauses and, implicitly, the acceptance of their effects maintains the balance of their respective contractual obligations and is meant only to emphasise, enhance the application of the

"pacta sunt servanda"

principle.



Crucially....

- The use of hardship and indexing clauses can help to maintain the balance of contracts and prevent disputes.

Thank you for your attention.



For further information...

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