Economic Crisis as a Supervening Event: Legal and Economic Perspectives on Impossibility Doctrine

Tri Harnowo*
* International Business Law Program, Universitas Prasetiya Mulya, Indonesia

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Corresponding Author:

Email: tri.harnowo@pmbs.ac.id

ABSTRACT

The article attempts to examine the application of the impossibility doctrine toward economic crisis from the legal and economic point of view using the Asian economic crisis case. From a legal perspective, the economic crisis occurs after the conclusion of the contract, unforeseeable at the time of the conclusion of the contract, beyond the control of the promisor, and the risk of the event was not assumed by the promisor may constitute impossibility. From the economic analysis, it is evident that the foreign lenders should bear the risk as they have relatively better ability in predicting the event's occurrence, are in a better position to diversify risks by pooling a self-insurance, engage in risky investment (mismatch maturity investment) while international environment makes borrowers less likely to hedge their loans. It also found that foreign banks do not expose to the Indonesia economic crisis, are better position to pooling a risk, have multiple cushions from being deprived out of the market. While another justification to apply the impossibility doctrine, in this case, is to avoid bankruptcy cost. It is suggested to use tools of analysis in applying impossibility doctrine: (i) the promisor (borrower) asking to discharged could not reasonably have prevented the event rendering his performance uneconomical, (ii) the promisee (lender) is in a better position to predict the probability of the occurrence of the event occurrence and the magnitude of the loss if it occurred, (iii) the promisee (lender) is in a better position to pooling risk, (iv) the promisor (borrower) does not have its wealth more positively correlated with the event (i.e. depreciation), and (v) he promisor (borrower) does not make a profit out of the market movement as a whole.

ABSTRAK

Artikel ini mengkaji penerapan doktrin kemustahilan terhadap krisis ekonomi dari segi hukum dan ekonomi dengan menggunakan kasus krisis ekonomi Asia. Dari segi hukum, krisis ekonomi terjadi setelah kontrak disepakati, tidak terduga pada saat kontrak disepakati, di luar kendali pihak yang berjanji, dan risiko kejadian yang tidak ditanggung oleh pihak yang berjanjidapat dianggap sebagai kemustahilan. Dari analisis ekonomi dapat dinyatakan bahwa pihak asing pemberi pinjaman seharusnya menanggung risiko karena mereka memiliki kemampuan yang relatif lebih baik dalam memprediksi kejadian, berada pada posisi yang lebih baik untuk mendiversifikasi risiko dengan menutup asuransi diri, terlibat dalam investasi yang berisiko (ketidaksesuaian jatuh tempo investasi) sementara lingkungan internasional membuat peminjam cenderung tidak dapat melakukan lindung nilai atas pinjaman mereka. Pihak asing pemberi pinjaman juga tidak terdampak krisis ekonomi Indonesia, memiliki posisi yang lebih baik untuk mengelola risiko,

memiliki banyak penyangga untuk tidak terlempar dari pasar. Sedangkan justifikasi lain untuk menerapkan doktrin kemustahilan dalam hal ini adalah untuk menghindari biaya kebangkrutan. Disarankan untuk menggunakan alat analisis dalam menerapkan doktrin ketidakmungkinan: (i) promisor (peminjam) yang meminta untuk dibebaskan secara wajar tidak dapat dapat mencegah kejadian yang membuat pemenuhan perjanjiannya menjadi tidak ekonomis, (ii) pihak yang menjanjikan (pemberi pinjaman) berada dalam posisi yang lebih baik untuk memprediksi kemungkinan terjadinya peristiwa dan besarnya kerugian jika itu terjadi, (iii) pihak yang menjanjikan (pemberi pinjaman) berada dalam posisi yang lebih baik dalam mengelola risiko, (iv) pihak promisor (peminjam) tidak memiliki kekayaan lebih yang berkorelasi positif dengan peristiwa (yaitu depresiasi), dan (v) promisor (peminjam) tidak memperoleh keuntungan dari pergerakan pasar secara keseluruhan.

INTRODUCTION

The Asian financial crisis started in July 1997 in Thailand and affected currencies, stock markets, and other asset prices in several Asian countries, including Indonesia.[1] As the country fell into crisis, many local businesses and governments that had taken out loans in US dollars, which suddenly became much more expensive relative to the local currency which formed their earned income, found themselves unable to pay their creditors. Their obligation had increased several folds due to the currency depreciation. Lots of cases were brought before the court and since the Indonesia bankruptcy law reform in 1998 many were forced into the bankruptcies initiated by their creditors.

This has raised a question as to whether the companies facing economic depression should be treated on the basis of equity with regard to their obligation to perform. Several bodies of doctrine in the law of contracts provide for the discharge of contractual obligation under certain unusual contingencies or supervening events. Therefore the main research question in this paper is as follows: "Can the currency depreciation in the Asian economic crisis be a supervening event resulting in the discharge of borrower's obligation on the ground of impossibility doctrine or *rebus sic stantibus*?"

The methodology used in the paper is normative both in legal and economics analysis approaching with comparative and argumentative in nature. The study focuses more on the crisis encountered in Indonesia especially faced by distressed companies in the sectors whose obligations were onerously resulting from currency depreciation, such as companies borrowing loans, (importer, construction), although the main objective is to show how should law efficiently treat obligor in general in situation aforementioned.

This paper consists of six chapters. Chapter One briefly provides the main issues and objectives, the research question, and the structure of the paper. Chapter Two briefly describes the history of the Asian economic crisis, the causes, and effects, particularly in Indonesia. Chapter Three elucidates the legal theory with regard to the definition and related various terms used (e.g. civil law *rebus sic stantibus*, imprecision, force majeure, and its common law impracticability, frustration, and impossibility). This part attempts to explain distinctive characters applying those terms in civil law and common law. It also investigates the existence of impossibility doctrine or alike in the Indonesian Civil Code.

[1] Alice D. Ba, *Asian financial crisishttps*, Britannica. http:://www.britannica.com/event/Asian-financial-crisis

Chapter Four explains the economics of the impossibility doctrine. It also provides some argument to the justification for the presence of the doctrine, especially for the country experiencing economic crisis and the judges' role in this regard. Chapter Five is the analysis of the event study (Indonesia economic crisis) using the legal and economics theoretical framework provided above. Chapter Six will sum up and provide some policy recommendations.

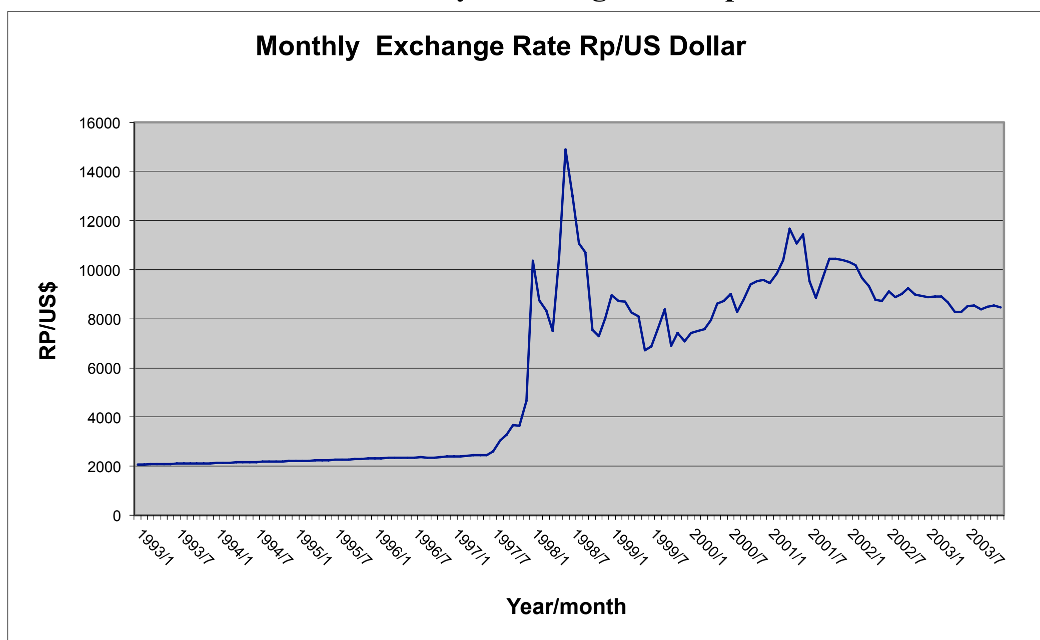
RESULTS AND DISCUSSION

1. Asian Economic Crisis

1.1. Historical Overview of the Crisis

As previously said, the Asian financial crisis started in July 1997 in Thailand and affected currencies, stock markets, and other asset prices in several Asian countries, many considered East Asian Tigers. Indonesia, South Korea, and Thailand were the countries most affected by the crisis. Hong Kong, Malaysia, Laos, and the Philippines were also hit by the slump. Mainland China, India, Taiwan, and Singapore were relatively unaffected. Japan was not affected much by this crisis but was going through its own long-term economic difficulties. Indonesia was the far worst affected economy in the crisis, with the severity of its crisis coming as a surprise to many observers.[2] For Indonesia, the movement of the declining rupiah value against the US Dollar can be seen in the Figure1. We can see in the figure that from 1993 to 1994 Rupiah was relatively stable in Rp. 2.000-2.200 per US$ 1, and around Rp. 2.200-2.300 between 1995 and 1996. When the Bath crisis began in July 1997 the Rupiah was still in a modest move in the level of Rp. 2.500/US$. From that point gradually the Rupiah began to fall down and eventually made a sudden move from Rp. 4650/US$ in December 1997 to Rp. 10.375 in January 1998. Rupiah again made the lowest point around Rp. 15.000/US$ in June 1998.

FIGURE 1. Monthly Exchange Rate Rp/US Dollar



[2] Reiny Iriana & Fredrik Sjoholm, *Indonesia's Economic Crisis: Contagion and Fundamentals,* The Developing Economies, XI-2, June, 2002, p. 135.

In June 1997, Indonesia seemed far from a crisis. Unlike Thailand, Indonesia had low inflation, a trade surplus of more than $900 million, huge foreign exchange reserves of more than $20 billion, and a good banking sector.[3] But a large number of Indonesian corporations had been borrowing in U.S. dollars. In July, when Thailand floated the Baht, Indonesia's monetary authorities widened the rupiah trading band from 8% to 12%. The rupiah came under severe attack in August. On 14 August 1997, the managed floating exchange regime was replaced by a free-floating exchange rate arrangement. The rupiah dropped further. The IMF came forward with a rescue package of US $23 billion, but the rupiah was sinking further amid fears over corporate debts, massive selling of the Rupiah, strong demand for the Dollar. The Rupiah and Jakarta Stock Exchange touched a new historic low in September 1998. Moody's eventually downgraded Indonesia's long-term debt to junk bonds. Companies that had borrowed in dollars had to face the higher costs imposed upon them by the rupiah's decline. Before the crisis, the exchange rate between the rupiah and the dollar was roughly 2000 rupiah to 1 US Dollar. The rate had plunged to over 18000 Rupiahs to 1 US Dollar at times during the crisis. Indonesia lost 13.5% of its Gross Domestic Product that year.

Source: DFI Data Service (IMF Washington)

1.2. Cause of the Crisis

The cause of the Asian economic crisis has always been debatable among scholars ever since. Opinions can be classified into three groups. The first blame to the government's domestic policy resistance to open economy. On the other hand, the other group argues that economic liberalization and worsened by the IMF's prescription had lead to Asian catastrophe. The other takes stand somewhat balanced.

According to Alan Greenspan[4] the government intervention in the market, especially the financial market was the cause of the crisis. The Asian economic crisis has remarked as the end of the state-directed system. Government directed investment system resulted in investment excesses and errors. Furthermore, government-directed production, financed with directed bank loans, could not adjust to the changing patterns of market demand for domestically consumed goods or export.

Stanley Fischer[5] pointed out the basic institutional deficiencies of the Asian market as the cause of the crisis contributed by: (i) failure to dampen overheating economic, (ii) maintenance of pegged exchange rates, (iii) lax financial regulation, (iv) insufficient political commitment. Bijan B. Aghevli adds factors such as partial capital market liberalization without opening the financial sector, weak corporate governance, competition pressure on exports caused by the depreciation Yen against the US dollar, devaluation of the Yuan, and NAFTA.[6] In the case of Indonesia, he also blamed the government's failure not to stick in following IMF prescription in the beginning.

While in looking at to cause of crisis Redelet & Sachs[7] said that one should emphasize less on domestic policy, but rather more on the inherent instability of the open economic model. The vulnerability of the open economic system to financial panic had resulted in

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[3] Wikipedia, "Asian Financial Crisis". https://en.wikipedia.org/wiki/1997_Asian_financial_crisis#Indonesia
[4] Robert Wade, *The Asian Debt and Development Crisis 1997-?: Causes and Consequences,* March 1998, pp.1-2.
[5] *ibid*, p. 2.
[6] Bijan B. Aghevli, *The Asian Crisis: Causes and Remedies,* Finance & Development, IMF quarterly magazine, June 1999, Vol. 36, No.2.
[7] Joseph Stern, *The Rise and Fall of the Indonesia Economy,* June 2003, p.4.

capital outflow by foreign investors. Robert Wade[8] concluded that Asian state capitalism is not a cause of the crisis but rather the weakness of the international credit regime. The main cause is due to full capital convertibility, excessive financial deregulation, and no capital control. The liberalization of the financial system too fast without a framework of regulation was to one to be blamed. The combination of massive devaluations, IMF pushed financial liberalization, and IMF facilitated recovery may even precipitate the biggest peacetime transfer of assets from domestic to foreign owners.[9] James Tobin said that Asians are victims of a flawed international exchange rate system that under the United States leadership gives the mobility of capital priority over all other considerations.[10] Jagdish Bhagwati imbued it as Wall Street Treasury complex, meaning that the US investment bankers are seeking market everywhere to unable to take capital in and out freely.[11] It also tries into the IMF's own desires which are to act as a lender of last resort. IMF requires countries to remove capital control and adopt full capital account convertibility and promote liberalizing financial services.

Robert Wade[12] explained IMF prescriptions to improve the balance of payments have made worse further. The prescriptions that were beyond traditional mandate included (i) high real interest rates, (ii) capital account opening, (iii) financial sector deregulation, (iv) labor market deregulation.[13] The effects of prescriptions are as follows: (a) higher real interest rates will tap many high debt/equity firms into bankruptcy and resulting financial instability and unrest may cause net capital outflows, (b) meeting western standards for the adequacy of bank's capital entails a rapid fall in banks' debt to equity ratios and a sharp cut in their lending, causing more company bankruptcies, (c) IMF approach is likely to generate big social cost long before there is any significant amount of debt reduction, all because of a short term and unforeseeable run by mobile capital, (d) hence the government should step in to reintroduce controls on capital movements, to create credit in order to cover the extra costs of foreign debt incurred by the devaluation (injecting equity into bank, directly buying loans from foreign creditors, etc), thereby setting off a controlled inflation which will spread the ultimate costs among the whole population of savers and the consumers of imports, (e) IMF further opening up Asian economies to international capital. This approach has been criticized as the reason to impose on capital account opening in countries that are awash with domestic savings.

Jeffrey Sachs blamed the IMF's insistence on shuttering many banks despite the fact that systems of deposit insurance hardly exist panicky depositors to withdraw their deposit even from soundbanks, and hold cash instead.[14] Its insistence on cutting demand and liquidity accelerated the bankruptcy or radical devaluation of the value of firms that were efficient and profitable.

According to Krugman[15] the causes of the Asian economic crisis were mainly due to the (i) financial excess characterized in emerging markets, (ii) overlook the institutional and policy problem, (iii) government guarantee, explicitly or implicitly, the rate of return on

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[8] Robert Wade, *op.cit* , p. 16.
[9] Robert Wade & Frank Veneroso, *The Asian Crisis: The High Debt Model v. The Wall Streat Treasury-IMF Complex,* New Left Review, March – April 1998, p.15.
[10] *ibid*, p.13.
[11] *ibid*, , p.14.
[12] *ibid*, , p.10..
[13] *ibid*, p.7.
[14] *ibid*, p.2.
[15] Joseph Stern, *loc.cit*, p.3.

risky projects, over-investment leading to overpricing the assets, (iv) government limited capacity to finance the cost of future bailouts.

Syahril Sabirin[16], Governor of Bank Central of Indonesia at that time, explained that fast steadily Indonesia economic integration into the global economy had contributed to the Indonesian economic crisis in 1998. The macroeconomic dynamic was not in line with the management of the business sector (microeconomic) explained by the low quality of decision taken by business and government due to the lack of transparency, consistency, and information. Those were worsened by sub-optimal of resources by the private and government sectors that lead to inefficiency of management of the business sector. Weak microeconomic fundamentals would cause the fragility of the banking sector. Implicit guarantee by the Central Bank to the survival of the banks had created moral hazards. The crisis weakened by the ineffectiveness of Bank Central supervision. The problems in the banking sector were mainly due to the related group lending creating mass of non-performing loans, (ii) lack of managerial bank, (iii) lack of transparency related to banking conditions leading to the difficulty to the analysis (market discipline).

Currency and maturity mismatch also one of the factors causing Indonesia financial crisis.[17] Short-term foreign loans were funding for long term investments (maturity mismatch) where most of the investments generated revenues in domestic currency (currency mismatch).

According to J. Soedrajat Djiwandono (former Governor of Bank Indonesia) historically the crisis started from the contagion effect when Rupiah depreciated after the Bath depreciation.[18] Furthermore the downward spiral effect brought to the banking crisis. This was then demonstrated by a lack of trust in the banking system by foreign partners who blocked the Letter of Credit (L/C) issued by Indonesian banks. This blocking had an impact on the real sector causing the loan/cost of funds to become more expensive. All of these were subsequently leading to the social crisis, where a lot of layoffs occurred. Lastly, it downturned to the political crisis (the fall of former President Suharto).

1.3. Effect of the Crisis

The crisis had caused stagflation and instability in 1998.[19] Rupiah depreciation and access to the foreign fund created lower product activities, difficulty to repay the loan by private sectors, massive layoffs resulting stop in production, high inflation (77,6%), reduce income per capita because of reducing in purchasing power, welfare level, and poverty, dysfunction of bank intermediation. Short-term interest rates rose to over 80%, and by its low point in 1998 the Rupiah had lost 80% of its value in nominal terms and about 70% in real terms.

Many of the crisis countries found themselves in a debt trap.[20] The costs of rolling over loans forced them into spiraling debt levels and public sector deficits. In such cases, the

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[16] Syahril Sabirin, *Upaya Pemulihan Ekonomi Melalui Strategi Kebijakan Moneter-Perbankan dan Independensi Bank Indonesia,* National seminar ón *Strategi Pemulihan Ekonomi Era Pemerintahan Baru,* Surabaya, February 5, 2000, p.2-3.

[17] See Burhanuddin Abdullah, *Peran Kebijakan Moneter dan Perbankan dalam Mengatasi Krisis Ekonomi di Indonesia*, p.8, Anwar Nasution, *The Meltdown of the Indonesian Economy: Causes, Responses and Lessons,* Magazine: ASEAN Economic Bulletin, August 2000, and Javad K. Shirazi, *The East Asian Crisis: Origins, Policy Challenges, and Prospects,* Presented at The National Bureau of Asian Research and The Strategic Studies Institute's Conference "East Asia in Crisis", Seattle, June 10, 1998. http://econ.worldbank.org/

[18] J. Soedradjad Djiwandono, *Krisis dan Pembaharuan Moneter,* Seminar Paper, 17 Juni, 1993, p.3..

[19] *Ibid,* p. 3-4.

[20] Richard Brealey, *The Asian Crisis: Lessons for Crisis Management and Prevention,* Goodhart and Gerhard Illing (ed), *Financial Crises, Contagion, and Lender of Last Resort,* Oxford University Press, 2002, p. 474

reduction in the wealth levels of the citizens, needed to escape from such a trap, was politically infeasible. Raising interest rates to protect the currency increased the burden of servicing domestic government debt and drove the government into yet larger deficits while allowing the currency to depreciate increased the cost of foreign currency debt and threatened the solvency of the banking system through which much of the foreign currency debt was channeled.

The crisis also created non-economic disastrous such as social unrest destroying distribution networks, panic buying, loss of confidence domestically and internationally, capital outflow by foreign capital. The economic crisis has caused political instability (the fall of former President Suharto). Political instability made the capital flight, reinforcing the crisis.

The economic crisis also created human rights crisis such as deterioration of: right to proper living, right to food, right to work, right not to lose work, right to health. For example, in Jakarta in 1997-1998 the price of basic nutrition food had increased by 75,57%, transportation by 63,29%, education by 20,1%, and health by 18,52%.[21]

2. Law of Impossibility Doctrine

2.1. Rebus sic Stantibus

Rebus sic stantibus was first applied by the ecclesiastical courts, especially when there was a suspicion of usury.[22] It was subsequently adopted by other courts and jurists and became widely accepted by the end of the eighteenth century. As early as the fifteenth century, the popularity of the theory of *rebus sic stantibus* had begun to disappear largely because of protests from burgeoning commercial interests. By the end of the eighteenth century, *pacta sunt servanda* or sanctity of contract reigned supreme. Liberalism, which was the predominant philosophical stream in the eighteenth century, brought new ideas incompatible with the restrictive application of *rebus sic stantibus*. *Pacta sunt servanda*, on the other hand, was perfectly coherent with the concept of *lasse faire*, *lassez passé*, and it also supported by the rise of scientific positivism, and the increasing emphasis on individual autonomy and liberty of contract at that time. Therefore, the codes that were enacted in this period, the Napoleon Code did not adopt *rebus sic stantibus*. After the outbreak of World War I, European jurists had to search for a theoretical justification for excusing promisors from contracts whose performance had become extremely burdensome. Consequently, *Rebus sic stantibus* was again recycled, under different names and legislative enactments of various countries, such as hardship rule, *essesivamente onorosa*, *wegfall des geschäftsgrundlage imprévision* impracticability, and frustration of purpose which will be discussed in the following sections. The leading cases related to the application of this principle among other things are the Coronation of King Edward VII case, Canal de Craponne case, Taylor v. Caldwel, and Mineral Park Land Co v. Howard. [see Appendix 2 for detail]

Rebus sic stantibus should not be confused with *force majeure*. *Force majeure* excuses the obligor to perform only if there is an irresistible and unforeseeable obstacle. In *force majeure*, the performance must be physically or legally impossible and must not be merely

[21] ELSAM, *Indonesia Dalam Krisis: Tiada Reformasi Tanpa HAM,* 1998, p.6.
[22] Aziz T. Saliba, *Rebus sic Stantibus: A Comparative Survey,* E-Law Murdoch University Electronic Journal of Law, Vol. 8, No. 3, Septermber 2001, p.3.

more onerous to perform.[23] Unlike *rebus sic stantibus*, *force majeure* does not include economic hardship nor even economic impossibility. Force majeure resembles the common law doctrine of impossible and frustration.

Rebus sic stantibus or hardship or other terms equivalent to it is a controversial one. The opponents argue that this doctrine operates in circumstances falling short of impossibility (*force majeure*), the circumstances are hard to define, each leads to uncertainty and threatens the sanctity of contract.[24] On the other hand, the proponents defend that this doctrine is important nowadays due to an increase in long-term contracts, which are more sensitive to unforeseen events.[25] It corrects any injustice from an imbalance in the contract causes by supervening events. If the sanctity of contract were applied strictly, parties would be given a stronger incentive to introduce appropriate clauses into their contracts where experiences suggest that frequently parties are not sufficiently sophisticated and they do not cover every eventuality.[26] Unforeseen event is difficult to measure causing the parties only draft a moderate change to anticipate the change in circumstances. In the European Union, the balance is in favor of *rebus sic stantibus* or hardship where UNIDROIT (International Institute for the Unification of Private Law) and PECL (Principles of European Contract Law) have adopted the instrument.[27]

Indonesia has not adopted the concept of hardship in the contract law system, but rather uses the concept of force majeure or overmacht.[28] In contrast to force majeure (overmacht), hardship has not been regulated wherein if a related case occurs, the judge will decide based on overmacht even though there are differences in concepts between overmacht and hardship.[29] Hardship places more emphasis on fundamentally unbalanced situations between parties, while force majeure has a more general meaning which refers to unexpected events beyond the control of the parties.[30] The legal consequences of absolute force majeure make it impossible to fulfill the achievement again and immediately the contract is terminated, while the legal consequences of hardship on the contract mainly concern the opportunity for the aggrieved party to propose renegotiation.[31]

2.2. Hardship

The majority of countries in the European Community have introduced some mechanism intended to correct change of circumstances caused by supervening events which the parties could not reasonably have foreseen when they made the contract.[32] In practice, contracting parties adopt supplementing the general rules of law with a variety of clauses, such as a hardship clause. Some legal systems have relieved the debtor performance, though not impossible, has become excessively onerous, e.g. Italian *essesivamente onorosa*[33], or so different that the economic basis on which the contract was made has

[23] Aziz T. Saliba, *op.cit*, p.2.
[24] Sir Guenter Treitel, *Frustration and Force Majeure,* Thomson, Sweet & Maxwell, Second edition, 2004, p. 347..
[25] Denis Tallon, *Hardship,* in Arthur Hartkamp et.al. (ed), *Towards a European Civil Code,* Kluwer Law International, 2004, p. 499.
[26] Ole Lando and Hugh Neale (ed), *Principles of European Contract Law*, Kluwer Law International, 2000, p. 323
[27] See Article 6.2.3 UNIDROIT Principles. https://www.unidroit.org/instruments/commercial-contracts/unidroit-principles-2010/, Article 8:108, "Excuse Due to an Impediment. https://www.trans-lex.org/400200/_/pecl/. See Also Joseph Perillo, *Force Majeure and Hardship Under the UNIDROIT Principles of International Commercial Contract,* Tulane Journal of International & Comparative Law, Vol.5, 1997, p.21. & Larry A. DiMatteo, *Contractual Excuse Under CISG:Impediment, Hardship and the Excuse Doctrines,* Pace International Law Review, Vol. 27, Spring, 2015, p.272,
[28] Agus Yudha Hernoko, *Force Majeure atau Hardship Clause, Problematika Dalam Perancangan Kontrak Bisnis,* Perspektif, Vol. XI, No. 3, July, 2006, p. 214.
[29] *ibid.*
[30] *ibid.*, pp. 222-223.
[31] *Ibid.*
[32] Ole Lando and Hugh Neale (ed), *loc.cit*
[33] Italian Civil Code Art. 1467

elapsed, e.g. Germany *Wegfall des Geschäftsgrundlage*[34]. A hardship rule is found in Dutch law a similar rule on *imprévision* in French administrative law, American's commercial impracticability, and Common law frustration of purpose. Relief in case of hardship is also provided in PECL[35] and UNIDROIT Principles[36].

Hardship is where the occurrence of events fundamentally alters the equilibrium of the contract either because of the cost of the party's performance has increase or the value of performance a party receives has diminished, provided that (i) the events occur after the conclusion of the contract (ii) the event is unforeseeable at the time of the conclusion of the contract (c) the event is beyond the control of the promisor (d) the risk of the event was not assumed by the promisor. Generally, hardship applies only to performance not yet rendered and normally occurred in long-term contracts.[37] PECL also stipulates hardship under the name 'change of circumstances' in article 6.111 similar to those in UNIDROIT (The International Institute for the Unification of Private Law) Principles. Additionally according to PECL risk is not applicable if risk shifting is expressed in the contract or if the contract is a speculative one (e.g. future market).[38]

2.3. Impracticability

The principle of discharge by impracticability in the American system can be found in the Restatement 2d and the Comments to s.2-615 of the Uniform Commercial Code (UCC). This principle also refers to commercial impracticability. Impracticability includes extreme and unreasonable difficulty, expense, injury, or loss to one of the parties, for example, a severe shortage of raw materials or of supplies due to war, embargo, local crop failure, the unforeseen shutdown of major sources of supply, or the like, which causes a marked increase in cost.[39] It provides for an excuse by the failure of presupposed conditions where the agreed performance has been made impracticable by the occurrence of a condition, the non-occurrence of which was a basic assumption on which the contract was made. Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency, which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover. A mere change in the degree of difficulty or expense due to such causes as increased wages, prices, or raw materials or cost of construction, unless well beyond the normal range, does not amount to impracticability. A contracting party may be discharged if, as a result of unexpected supervening events, the performance of the contract, though remaining physically possible, has become severely more burdensome for that party. Put it on another way the contract may be discharged even though no physical (or legal) obstacle has arisen which would prevent its performance or make such performance unlawful.

However, there is a restrictive attitude of American courts towards impracticability due to market movement as a ground of discharge. Numerous cases[40] explain why the argument

[34] BGB § 313
[35] Art.6.111
[36] Art. 6.2.1 – 6.2.3
[37] Article 6.2.2 UNIDROIT Principles.
[38] Ole Lando and Hugh Neale (ed), *op.cit*, p. 324-326
[39] Sir Guenter Treitel, *op.cit*, p. 262.
[40] Eastern Airlines Inc v. Gulf Oil Corp, Publicker Industries Inc v. Union Carbide Corp, Virginia Electric & Power Co v. Westinghouse Electric Corp, IowaElectric Power Co v. Atlas Corp, Maple Farms Inc v. City Schoool District of Elmira, Nora Springs Co-operative Co v. Brandau, Nothern Illinois Gas Co v. Energy Co-operative Inc, Northern Indiana Public Service Co v. Carbon County Coal Co, Transatlantic Finance Corp v. US, American Trading & Production Corp v. Shell International Marine, Florida Power & Light Co v. Westinghouse Electric Corp, Aluminium Corp of America v. Essex Group Inc.

rarely succeeds:[41] (1) the claim of unforeseen market fluctuation is doubtful and insufficient to bring about a fundamental change of circumstances, (2) no direct correlation between an increase in the price (of a particular raw material) into a loss resulting from the performance of the contract, (3) the request of discharge has litter merit because the promisor still makes a profit out of the market movement as a whole, (4) where the contract contain a price escalation clause, the court has been inclined to rely on it to exclude discharge[42], (5) the essentially speculative nature of a long term contract is regarded in the US as an argument against discharge by reason of changing market condition.

3.4. Frustration of Purpose

One should notice that the term "frustration" is used in a variety of senses which refer to four usages: (i) frustration of contract, (ii) frustration of adventure, (iii) frustration of purpose, (iv) frustrating contract.[43] The frustration of contract refers to the whole doctrine of discharge by supervening events, irrespective of the type of event which brings about discharge. A contract is to be frustrated whether discharge occurs by supervening destruction of the subject matter, or by its temporary unavailability, or by the frustration of purpose (which will be discussed here) or by supervening illegality. The frustration of the adventure refers to cases in which performance has not become permanently impossible, but has been merely affected by temporary obstacles which are later removed. Frustrating breach refers to the type of breach which is sufficiently serious to justify the victim's rescission of the contract, in the sense that it gives the victim the option of refusing, on account of the breach, to perform his own part in breach.

The frustration of purpose resembles impracticability.[44] The typical contract is an arrangement under which one party agrees to supply a thing (or a service or some other facility) to the other, and the latter agrees to pay a sum of money for it. In cases of impossibility, the contract is discharged because the supervening event has made it impossible for the former party to supply. In cases of alleged impracticability, there is no such impossibility, but the normal position is that the supplier argues that the cost of providing the thing has risen, or that other difficulties of so dong have increased, to such an extent that he should be discharged. In cases of alleged frustration of purpose, it is normally the recipient of the thing (or service or facility) who argues that the contract should be discharged. His own obligation to pay money cannot have become impossible nor has any impossibility affected the obligation of the supplier, which can still be performed.[45]

The frustration of purpose thus resembles impracticability in that it can lead to the discharge of contracts in cases falling short of impossibility, and for the reason the doctrines are sometimes confused with each other. But they differ in that generally in cases of impracticability discharge is claimed by the supplier which is to be supplied under the

[41] Sir Guenter Treitel, *op.cit.*, pp. 279-280..
[42] The argument is that such a clause is evidence of the parties' intentions to allocate risks, so that any fluctuations in costs or values which the clause does not take into account is at the risk of the party on whom it may fall. The courts have also relied on the absence of flexible pricing clause as evidence of intention to allocate the risk of supervening events.
[43] *ibid*, p. 68.
[44] *ibid*, p. 309.
[45] But the recipient's case is that the contract should be discharged because the supplier's performance is no longer of any use to the recipient for the purpose for which both parties had intended it to be used. This was the ground of discharge recognized in the Coronation cases (see appendix).

contract, while in cases of the frustration of purpose it is the recipient who claims that the contract has been discharged.

2.5. Force Majeure and Frustration

The concept of *force majeure* is an established doctrine in French Law that relieves a promisor from responsibility for non-performance in certain circumstances.[46] To invoke successfully a defense of *force majeure* the debtor must show that performance has been made impossible and not merely onerous.[47] In this respect *force majeure* corresponds to the English law of “frustration”. In German law, the equivalent concept of frustration is construed very broadly and encompasses solely economic factors.

The difference between *force majeure* and frustration is the rule that technical performance excludes the defense.[48] If the contract is capable of technical performance a defense of *force majeure* will not be available, even though the foundation of the contract may have disappeared. English law of frustration relieves a promisor in such circumstances, where French law takes into account physical or legal impossibility only. Both in English and French Law, to qualify as force mejeure the event preventing performance must have been unforeseeable and irresistible.[49] It was foreseeable if provision for it should have been made in the contract or the obligation out not to have been assumed. It is irresistible in the sense that it was both unavoidable and insurmountable, where there is an alternative method of performance or where the obstacle to performance might have been removed, the promisor will not be able to invoke the doctrine.

Another difference between French and English law is with regard to the effect of *force majeure*.[50] In English law, the doctrine operates to bring the contract automatically to an end at the time of the frustrating event. The English courts have no power to adopt a long term contract to an uncontemplated fundamental change.[51] While French law, the court can grant rescission (or in cases where the contract has been performed in part before the *force majeure* event or where the *force majeure* does not wholly or permanently prevent performance) can alternatively reduce or vary the promisee’s obligation. Hardship and *force majeure* may overlap. The fundamental difference is a party may seek excuse under *force majeure* regime while renegotiating under a hardship regime.[52]

2.6. The Role of Court in *Rebus sic Stantibus*

According to Article *6.2.3* UNIDROIT in case of hardship, the promisor has opted to renegotiate or bring it before the court. If the parties disagree on how to allocate risks in the renegotiation due to the supervening event, they may bring it to before the court. In deciding hardship the court may then: (i) terminate the contract, (ii) adjust/adapt the contract, or (iii) resume/confirm to the initial contract.

[46] William Swadiling, *The Judicial Construction on Force Majeure Clauses*, in Ewan McKendrick (ed.), Force Majeure and Frustration of Contract, Llyod’s of London Press, 1991, p.6.
[47] *ibid*.
[48] *ibid*.
[49] *ibid*, p.7.
[50] *ibid*, pp.7-8.
[51] J.A. McInnis, *Frustration and Force Majeure in Building Contracts,* in Ewan McKendrick (ed.), Force Majeure and Frustration of Contract, Llyod’s of London Press, 1991, p. 156
[52] Unidroit Principles of ICC 2004, International Institute for the Unification of Private Law, Rome, 2004, p. 187

Similarly, under PECL the modification by the court can take more specific forms:[53] (a) reject the application[54], (b) extend the performance, (c) increase/reduce the price, (d) increase/reduce the contract quantity (e) compensatory payment, (f) granting delay de grace (g) reduce counter-performance (h) terminate it[55].

The court decision to terminate or to modify the contract should be a very much a last resort.[56] The show procedure is devised to encourage the parties to reach on amicable settlement hence the obligation to enter negotiations. The court may also remit the matter to the parties for a last effort of negotiation. In the absence of agreement, it is up to the court to decide. Similarly under PECL court should be last resort and rather encourage parties to negotiate, if necessary appoint a mediator.[57] If successful, then the court may modify it but the risk must be shared.

2.7. Indonesian Legal System Pertinent to Force Majeure

Indonesia's legal system only recognizes *force majeure* doctrine, not *rebus sic stantibus* or impracticability doctrine (at least not explicitly stipulated in Indonesia civil code). A failed debtor may defend itself by several defenses inter alia: [58] *force majeure* ("overmacht"), *exceptio non adimpleti contactus*, and waiver of rights ("rechsverwerking").

Force mejeure is stipulated in Article 1244 and 1245 Indonesia Civil Code. Force majeure is an event that is unpredictable, unintentional, and the debtor cannot be liable, and the debtor really cannot be forced to fulfill the obligation.[59] The event must not only beyond the debtor's control but it is also not known when the contract was made, at least the risk was not vested in the Debtor.[60] Principally the delay or the non-performance of a contract is not caused by the debtor's fault, therefore an innocent person cannot be imposed with a sanction. [61]

According to doctrine, there are two conditions of *force majeure*:[62] (i) absolute *force majeure*, and (ii) relative *force majeure*. Absolute *force majeure* is when the obligation really cannot be performed at all (e.g. the object (good) is destroyed because of a natural disaster). In this case, automatically the contract will be terminated.[63] Relative *force majeure* is when a contract may be possible to be performed, but by the excessive debtor's sacrifice/cost (e.g. the price of imported goods to be supplied becomes excessively expensive, or local government suddenly prohibits to bring out the good from a certain port). When the good promised is still exists or the contract may still be performed, the fulfillment of obligation still can be enforced by the creditor when the event of *force majeure* has lapsed, but the creditor cannot ask for damages for the delay because it is not a debtor's fault.[64] However, Prof. Mariam Darus[65] said that Indonesian jurisprudence only

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[53] Ole Lando and Hugh Neale (ed), *op.cit.*, p. 327.
[54] if the remedy would be worse that the harm
[55] because the parties cannot reach and judge cannot rewrite the contract (e.g. judge cannot order the power plant to burn oil instead of coal as promises in the contract.
[56] *ibid*
[57] *ibid*, p. 326-327
[58] Prof. Subekti, *Hukum Perjanjian,* PT. Intermasa, 4th edition, 1976, p.52.
[59] *ibid*, p.53.
[60] Prof. Subekti, *Pokok-pokok Hukum Perdata,* PT. Intermasa, 30th ed, 2002, p. 150.
[61] Prof. Subekti, *Hukum Perjanjian, op. cit.*, p.52.
[62] Prof. Subekti, *Pokok-pokok Hukum Perdata, loc. cit.*
[63] *ibid*, p. 151.
[64] *Ibid.*
[65] *Emmy Yuhassarie (ed),* Kredit Sindikasi dan Restrukturisasi*, Pusat Pengkajian Hukum, 2005, p. 199.*

recognizes absolute *force majeure* doctrine, meaning that the event is beyond human control so the debtor is discharged from paying its obligation. [66]

In determining a *force mejeure* (especially when the good promised still exist or the contract may still be performed), the judge should not only look that the performance totally becomes impossible but merely that the situation is not proper to force the debtor to perform as promised.[67]

2.8. Rebus sic Stantibus Cases
2.8.1. The Coronation Case[68]

These cases arose when the coronation of King Edward VII was postponed because of the illness of the King. Many contracts had been made in anticipation of the coronation, e.g. for the hire the rooms, or of seats on stands which the hirers or ticket holders expected to be able to watch the procession which had been planned. It remained possible for the owners to provide the rooms or seats, and for the hirers or ticket holders to occupy them and to look out on an ordinary day's London traffic, but this would have been a pointless exercise. Therefore, they claimed that the contracts were discharged on the ground of frustration of purpose, because the facilities to be provided by the owners were no longer of any use for the coronation cases, first, whether the contracts were discharged by the cancellation of the originally planned festivities, and secondly, what were the exact legal effects of discharge, especially in relation to payments made or to be made under the contracts.

In December 1901, it was announced that the coronation of King Edward VII was to take place on June 26, 1902. On that day, there was to be a procession from Buckingham Palace to Westminster Abbey and back, this was referred to as the Coronation Procession. On the following day, there was to be a second procession called the Royal Progress, the highlight of which was to be a visit to the City of London. On the day after the Royal Progress, there was to be a Naval Review at Spithead. The King fell ill on June 24, and at 10 am on that day the decision was taken to operate on him for a form of appendicitis. After recovering from the operation, the King was crowned on August 9, and the procession on that day followed the same route as that which had originally been planned for June 26.

Krell v. Henry is usually regarded as the leading case on the frustration of purpose, though its facts present some highly unusual features. Mr. Krell, who had rooms at 56A Pall Mall, overlooking the routes of both processions, had gone abroad in March 1902 and instructed his solicitor to let the rooms. In June, Mr. Henry saw an announcement in the windows of the rooms, stating that they were to be let for viewing the coronation processions. By an exchange of letters between him and Mr. Krell's solicitor on June 20, Mr. Henry agreed to take the rooms for the days but not the nights of June 26 and 27, for a price of £ 75, of this sum, £25 was paid on June 20, and the balance was to be paid on June 24. These letters made no reference to the coronation, and in this respect, Krell v. Henry is unique among the coronation cases. It is also unique in its payment provisions in the part of the money promised to Mr. Krell was paid before the procession was canceled, while the balance did not become due until after the event; it was due on June 24 and this meant that Mr. Henry was not bound to pay it till midnight, while the cancellation occurred at 10 am, on that day.

[66] ibid.
[67] Prof. Subekti, *Pokok-pokok Hukum Perdata, loc.cit.*.
[68] Wikipedia, "Krell v. Henry". https://en.wikipedia.org/wiki/Krell_v_Henry

It was held that the contract had been discharged by the cancellation of the processions, so that Mr. Krell was not entitled to the £50 which was to have been paid on June 24. On the other hand, Mr. Henry abandoned his counterclaim for repayment of the £25 already paid, no doubt because the Court of Appeal had in the meantime decided that money paid before the precessions had been canceled could not be recovered back pa the payor. The end result can therefore be described as a form of rough loss splitting: Mr. Henry did not have to pay the £50, while Mr. Krell kept the £25 and this sum would cover any expenses which he might have incurred in connection with the transaction. Krell v. Henry represents an advance on the "all or nothing" solutions which the common law had generally reached where a contract was held to have been discharged by the supervening event.

2.8.2. Canal de Craponne case[69]
A contract for the supply of water had been made in 1576 and over 300 years later the court rejected the supplier's claim that he should be relieved on the ground that the cost of supplying the water had risen considerably above the price fixed by the contract for the supply. It is worth noting that the supplier claimed, not to be discharged from the contract but to be entitled to a judicially imposed increase in his charges. Such a remedy is available in French administrative law, where the supply is to be made to a public authority; in this context, the need to ensure performance by the supplier and hence the maintenance of services to the public is thought to prevail over the principle of sanctity of contract, so that the remedy was available even in respect of a contract which specified the time for which the supply was to be made.

2.8.3. Taylor v. Caldwell[70]
The owner of a concert hall had no liability to the promoters of a concert for lost profits when the hall burned down and the owner was unable to provide the promised concert facility. The contract, made on the use of the Surrey Gardens and Music Hall for the purpose of giving a series of four grand concerts on June 17, July 15, August 19, 1861. The plaintiffs were to pay £ 100 in respect of each concert in the evening of the said respective days; they also agreed to provide the artists who were to perform at the concerts. The contract went on to give the plaintiffs the right to certain box-office receipts, and it gave them the right to advertise the concerts at the entrance to the Gardens one week before each of the specified days. The defendants, for their part, undertook not only to make the premises available but also to maintain specified sideshows in the Gardens. On June 11, the Music Hall was destroyed by fire, and the destruction was so complete that the concerts could not be given as intended; the cause of the fire appears to have been the carelessness of a plumber in leaving an unattended flambé in the roof of the Hall. The plaintiffs claimed damages in respect of the expenses, which they had incurred in advertising and preparing for the concerts. Their claim was dismissed on the ground that in contracts in which the performance depends on the continuous 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.

2.8.4. Mineral Park Land Co. v. Howard[71]

[69] Janwillem, *Unexpected Circumstances Arising from World War I and Its Aftermath: Open versus Closed Legal Systems,* Erasmus Law Review, No. 2, October, 2014, p. 69. http://www.erasmuslawreview.nl/tijdschrift/ELR/2014/2/ELR_2210-2671_2014_007_002_003.pdf
[70] Wikipedia, "Taylor v Caldwell". https://en.wikipedia.org/wiki/Taylor_v_Caldwell
[71] Court Listener, "Mineral Park Land Co. *v.* Howard, 156 P. 458 See https://www.courtlistener.com/opinion/3309849/mineral-park-land-co-v-howard/.

This case is the application of the United States impracticability doctrine. A promise by a construction company to take its requirements of gravel from the plaintiff's land was discharged when much of the gravel was unexpectedly below the water table, raising the cost of excavating it by ten to twelve-fold – a difference in cost so great as to make performance impossible. A contract had been made by which the defendants agreed to take all the gravel required for a particular construction project from the plaintiff's land for payment of 5¢ per cubic yard. Only about half, the agreed quantity was taken and the plaintiff claimed damages for failure to take the remainder. The claim was rejected on the grounds that all the gravel which the defendants had not taken was below the water level and could only have been extracted at the prohibitive cost of 10 or 12 times the usual cost of such an operation, and the use of this gravel in the construction project would have caused delays because it would have been necessary to dry the gravel before such use. The court said that a thing is impossible in legal contemplation when it is not practicable and the defendants were not binding themselves to take what is not there.

2.8.5. German Inflation[72]

A case law similar to the situation to the Asian economic crisis (e.g. depreciation and inflation) is the German Inflation. Prior to World War I, the dollar value of the mark was approximately four marks to the dollar. In November 1923, the dollar value of the mark was quoted at 4.2 trillion. The rate of depreciation was not constant during those years. The Mark had fallen by the end of 1918 from its pre-war dollar value of 4.198 to 7.43.

Although the government managed to restore some balance of payment, by the end of 1921, the Mark started to depreciate and quoted at 191, then at 7589 in December 1922, at 17972 in January 1923, 353412 in July 1923 until finally reached 4.2. trillion in November 1023. In October 1923, a new currency called the Rentenmark was issued to curb the great inflation.

The German Civil Code provision concerning the impossibility of performance was intended by the drafters to be narrowly construed and restricted to cases in which performance could be said to be literally impossible. The code did not include rebus six stantibus doctrine and no one considered the good faith provision to be relevant for dealing with unforeseen circumstances.

However, gradually the courts started to be more flexible with respect to impossibility performance, and rescission was granted in many contracts by war conditions. When prices during the years 1918-1919 went up much more rapidly in two decisions of December 1918 and July 1920 the court was willing to recognize that although a rise in prices is by itself insufficient, if dislocation of industry and trade would make performance essentially different than that contracted for, or would lead to the economic ruin of a party to a contract, rescission should be granted.

By the end of 1921, the Mark started to depreciate rapidly and the courts, recognizing that changes in prices are mainly attributed to changes in the value of money, were forced once again to gave up the requirement of economic ruin as a basis for relief, and developed new theories of fair 'equivalence of performance' and 'changed conditions' under the provision

[72] Janwillem, *Unexpected Circumstances Arising from World War I and Its Aftermath: Open versus Closed Legal Systems,* Erasmus Law Review, No. 2, October, 2014, pp. 69-74. http://www.erasmuslawreview.nl/tijdschrift/ELR/2014/2/ELR_2210-2671_2014_007_002_003.pdf https://www.ejcl.org/81/art81-2.html#parBIV

of good faith. The remedy granted to the creditor under such theories is rescission, unless the debtor is willing to pay a reasonable increase in the contract price.

In November 1923, when the dollar parity of the Mark quoted at 4.2 trillion, the Court gave the most famous decision which stated that under the new circumstances of inflation, the legal tender legislation contradicted the provision of good faith of the Civil Code. For the first time, the court ordered revalorization of simple money debt, the rate to be fixed by the court failing the parties' agreement on a fair price.

3. Law and Legal Analysis

3.1. Legal Analysis

As mentioned above the financial crisis in 1997 had made several Asian companies borrowing loans overseas dominated in foreign currency (i.e. UD dollar) could not fulfill their obligation resulted from the sharp depreciation of its own currencies against mostly US dollars. Imagine that when most Indonesian companies that commonly borrowed loans from foreign banks dominated in the US Dollar in the currency exchange of Rp. 2000 in a year 1990s and when the debts become due the exchange rate became in the amount more than Rp. 10.000, the obligation of the companies would have increased more than fivefold.

As legal theory previously explained before, *rebus sic stantibus* is where the occurrence of events fundamentally alters the equilibrium of the contract either because of the cost of the party's performance has an increase or the value of performance a party receives has diminished, provided that (i) the events occur after the conclusion of the contract (ii) the event is unforeseeable at the time of the conclusion of the contract (c) the event is beyond the control of the promisor (d) the risk of the event was not assumed by the promisor. In this case, the event must be onerous, unreasonable difficult, and beyond the normal range. At this point, from a legal analysis of impossibility doctrine, the economic crisis due to the sharp currency depreciation has satisfied the criteria to constitute *rebus sic stantibus*, because the obligation of a party becomes extremely onerous in which the depreciation is beyond the normal range.

In addition, at the time it was almost non-existent to include the economic crisis due to sharp depreciation in order to allocate such risk in the parties' contract. Unforeseen event is difficult to measure causing the parties only draft a moderate change to anticipate the change in circumstances. Thus, even if it occurs in the practices, the parties only allocated the risk of depreciation or inflation at the rate of a slightly modest manner.

Furthermore, from the theory previously mentioned, we must also investigate that the event must be unforeseen. In this case, no one could have predicted the Asian economic crisis due to the fact that the affected countries basically had sound fundamental macroeconomic illuminated by fast growth, low inflation, macroeconomic stability, strong fiscal position, high saving rates, open economics, and thriving export sectors.[73] For Indonesia's case, although long before a few economists scholars had aware of the probable crisis due to bubble economics but they missed put Indonesia on the lists.[74] Compare to Thailand Indonesia seemed far from the crisis as Indonesia had low inflation, a trade surplus of more than $900 million, huge foreign exchange reserves of more than $20 billion, and a good

[73] Bijan B. Aghevli, *loc.cit.*
[74] Joseph Stern, *The Rise and Fall of the Indonesia Economy,* June 2003, p.1.

banking sector. Moreover, even after Bath depreciation, the IMF Report (June 1997) stated that Indonesia would not be affected by Bath depreciation.[75] All of these make a justification that the Asian (especially Indonesia) economic crisis is an event that can hardly be predicted ex-ante.

Thus, from legal analysis of impossibility doctrine, Asian economic crisis, especially for Indonesia, one should conclude that the event satisfies the requirement as a supervening event that creates *rebus sic stantibus*, hardship, impracticability, or other similar terms. Furthermore, the challenging question is whether the Asian Economic crisis can constitute a *force majeure*. As explained that to constitute force majeure the event must be physically and legally impossible, not only onerous. It is already discussed above that the crisis due the currency depreciation makes the obligatory payment of debtor become increase several folds.

Force majeure due to the illiquidity caused by the economic crisis is a common excuse brought by the defendant or debtor in Indonesia bankruptcy cases during that time.[76] However, some Indonesian scholars disagree to use the economic crisis as an excuse for force majeure. Prof. Mariam Darus[77] states that Indonesian jurisprudence recognizes absolute *force majeure* doctrine, meaning that the event is beyond human control so the debtor is discharged from paying its obligation. An economic crisis is not a *force majeure* but rather a change in circumstances so as the debtor is not discharged for its debt but may to restructure it. On the other hand, Arief Surowidjojo[78] argued that force majeure in a contract means an event beyond reasonable control. Banks and corporations are the parties knowledgeable and accustomed to the financial transaction. Currency depreciation occurred in gradually is still under the control. In this stage, the parties to the contract may have decided as to whether to continue the contract or not. Besides that, the debtor may hedge its debt to ensure the transaction in case of currency change.

However one also can argue that the crisis hit Indonesia was not solely affecting the currency value, but the crisis had caused stagflation (sharp depreciation, high inflation, and negative growth) and instability. The crisis had made the banking system collapsed. The collapse of the banking system affected all economic and business sectors. Upstream and downstream businesses were affected making disastrous to the whole economy. Even the business that should make a profit caused by depreciation such as exporters, could not take advantage as international banks had blocked Indonesia L/C. The economic crisis has caused political instability that created uncertainty for business. All of these features can be depicted as "a national economic catastrophe" that might be interpreted as similar to natural disasters. However, the analysis of it is beyond this paper and need separate research.

3.2. Economic Analysis

3.2.1. Risk Allocation Rule

The purpose of the parties to make a contract is because of:[79] (1) the mutual desirability to the future provision of goods and services; (2) mutually beneficial reallocation or sharing

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[75] *ibid, p.*3.

[76] *Robertus Bilitea, Persoalan-Persoalan Hukum dalam Perkara Kredit Sindikasi, in Emmy Yuhassarie (ed), Kredit Sindikasi dan Restrukturisasi, Pusat Pengkajian Hukum, 2005, p. 257.*

[77] *Emmy Yuhassarie (ed),* Kredit Sindikasi dan Restrukturisasi*, Pusat Pengkajian Hukum, 2005, p. 199.*

[78] Ibid.

[79] Steven Shavell, *Economic Analysis of Contract Law,* Harvard John M. Olin Center for Law, Economics, and Business, 2003, p. 4.

of risks; (3) differences of opinion about subsequent events; (4) altering the timing of consumption.

Given that the parties to make contracts want the court to enforce their contracts because without enforcement:[80] (a) a party would be able to appropriate funds that had been paid before contract performance, generally rendering the contract unworkable, (b) a party might not deliver the promised good or perform the promised service, (c) the price cannot be fixed in advance, which is to say, price holdup might occur - a party might bargain opportunistically about the price of a transaction - reducing the value of the contract or discouraging the making of it altogether.

However, according to economists by its nature, a contract is always incomplete. A contract is incomplete when it is insufficiently to state contingent[81] and impractical to try to spell them out in detail under all states of the world.[82] The incompleteness is due to the high transaction cost and asymmetric information. The costs associated with it are high because: (a) of the cost of specifying an action in a particular state of the world; (b) futures states cannot fully be foreseen; (c) people are boundedly rational. Therefore, it is hard for parties to establish an ex-ante contract stating all obligations and risks allocation. Generally, due to the incompleteness, scholars suggest the court supply the public good of efficient default rule[83]. By supplying efficient default rules transaction costs will be minimized.[84]

When the unforeseen event materializes and the performance by the promisor becomes so burdensome, the promisor may seek an excuse to invoke impossibility doctrine. Impossibility or some related doctrine is invoked where by reason of an unforeseen event, a performance by one of the parties of his obligations under the contract has become so much more costly than he foresaw at the time the contract was made as to be uneconomical, that is, the costs of performance would be greater than the benefits.[85]

Posner and Rosenfield suggest impossibility doctrine can efficiently allocate the risks of certain unfortunate contingencies to the promisee under circumstances where the promisee is best able to bear them.[86] The superior risk bearer is the party who is in the best position to (i) to minimize the probability of the adverse contingency, (ii) to minimize the extent of the loss to the promisee resulting from nonperformance either before it occurs (precaution) or after (mitigation), or (iii) to ensure (by self or with third parties) against the residual risk of the loss that cannot be feasibly avoided.[87]

If the promisor is the superior risk bearer, nonperformance should be treated as a breach of contract. As said, a superior risk bearer means that the party that is the more efficient bearer of the particular risk in question, in particular circumstances of the transaction.

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[80] *ibid*, p. 5.
[81] Alan Schwartz, *Incomplete Contracts,,* in The New Palgrave Dictionary of Economics and the Law, Palgrave Macmillan, vol.2, 2002, p.277.
[82] Kenneth E. Scott, *Agency Cost and Corporate Governance,* Dictionary of Economics and the Law, Palgrave Macmillan, vol.1, 2002, p. 26.
[83] Default rule is a legal rule defining the obligations (or lack of obligations) that result when a contract does not itself specify what rules should govern, or rules that mimic the ex ante agreements the parties would reach if they could bargain for and enforce their agreements costlessly.
[84] Robert Cooter & Thomas Ulen, *Law and Economics",* Pearson Addison Wesley, Fourth edition, 2003, p. 214.
[85] HG Beale, WD Bishop, MP Furmstan, *Contract Cases and Materials*, Butterworth, 2001, p.399
[86] Alan O. Sykes, *Impossibility Doctrine in Contract Law,* Palgrave Dictionary of Economicis and Law, Macmillan, 1998, p. 265.
[87] George G. Triantis, *Unforeseen Contingencies, Risk Allocation in Contract,* p.108

However if the parties have expressly assigned the risk to one of them, there is no occasion to inquire which is the superior risk bearer. The inquiry is merely an aid to interpretation.

The factors are relevant to determining which party to the contract is the cheaper insurer are:[88] (1) risk appraisal costs, and (2) transaction costs. Appraisal costs comprise the costs of determining the probability that the risk will materialize and the magnitude of the loss if it does materialize. The amount of risk is the product or the probability loss and the magnitude of the loss if it materializes. Both elements must be known in order for the insurer to know how much to ask from the other party to the contract as compensation for bearing the risk in question. The transaction costs are the costs involved in eliminating or minimizing the risk through pooling it with other uncertain events, that is, diversifying away from the risk. This can be done either through self -insurance or through the purchase of an insurance policy (market insurance).

However, the superior risk bearer rule has been criticized and developed more by Sykes, Triantis, and Renner. Sykes argues that promisee is not always a less risk bearer where promisor may be the one who can bear it more efficiently, therefore it should focus on (a) unforeseen contingencies, and (b) the excessive of multiplied increased in cost borne by the promisor.[89] The fact that many promisors such as a large public company whose shareholders might in a better position to diversify the risk to the insurance company. Thus, impossibility may be constituted only if costs rise due to unusual contingencies and if they rise above some critical threshold. The promisor at least remains liable for the damage up to a several-fold increase in cost, but the risk of losing the benefits of the bargain abruptly shifts to the promisee when the cost becomes sufficiently large and unusual.[90]

If the cost is too high to constitute impossibility doctrine, the promissory will choose to breach a contract instead, i.e. paying expected damages. The value of the contract is reduced to promisee and the promisee pays a lower price for that goods or services. In turn, the expectation damages payable where the breach occurs are somewhat higher; expectation damages are equal to the difference between the value of the performance to the promisee, and the price that the promisee must pay – this difference has risen because of the impossibility doctrine due to the price paid by the promisee has fallen.[91]

The impossibility doctrine reduces downside risk for the promisor and increases it in others, and without more assumptions about the precise utility of the promisor, it is not sure the parties will benefit from the introduction of impossibility doctrine.[92] However, if a discharge is not allowed in case of performance is jointly efficient, it will lead to inefficient breach or renegotiation cost. Impossibility doctrine may create a moral hazard problem when the promisor takes less precaution level, or the promisor has better information about the likelihood of the contingencies events. But the problem will arise if there is no requirement for the promisor to disclose it.

While Triantis[93] explains that comparative advantages in the taking of precautions are related almost by definition to the cause of the threatened loss from an increase in cost or

[88] HG Beale, et al, *op cit* , p.400
[89] Alan O. Sykes, *loc cit*
[90] *ibid*.
[91] *ibid*
[92] *ibid*.
[93] George G. Triantis, *loc cit*

decrease in the value of the contract. A cost increase may be due to a natural disaster (general cause), which may be a tornado, earthquake, flood, or drought (specific cause). To the extent that the risk is endogenous, there may be benefits to specific allocation because it sharpens the assignment of responsibility for precautions.[94]

Contracting parties might condition damages liability on the failure of the seller to take reasonable precautions against cost increases and the reasonable precautions of the buyer (including the efficient level of reliance).[95] However, contracts are rarely written in these terms because reasonable behavior is typically based on unverifiable information – particularly because the *ex-ante* probability of breach is difficult to prove *ex-post* at trial. The cost of verifying information concerning actions before breach or repudiation explains why contracts condition on contingencies rather than the actions of the parties. The mitigation requirement in contract law does limit the recovery of the promisee to the loss that could not be avoided by reasonable measures taken only after the promisee learns of the promisor's repudiation or breach.

Renner develops the theory of impossibility doctrine using inflation as a supervening event. She argues that the risk should be allocated to a party who is better able to estimate the rate of inflation and who have their wealth more positively correlated with inflation than others.[96] Related to risk appraisal cost she argues that the magnitude of the risk does not depend so much on the amount of payment but rather on the extent to which the bearer of the risk has a hedge against inflation. If the risk is allocated to the seller, the magnitude of the risk depends on the extent to which he is exposed to the risk of currency depreciation through other transactions in which he is engaged as a payer. There might be no real loss if the risk materializes. The seller may engage in other transactions as a payer where there is no allocation of inflationary risk. It will apply as well if the buyer is made to bear the risk. If one of the parties can fully hedge against the risk through other transactions, the future rate of inflation and its anticipation becomes irrelevant.[97]

However, if neither party has a full hedge against the inflationary risk the ability to anticipate the future rate of inflation becomes relevant.[98] The party who has its wealth more positively correlated with inflation than others can be an indication that he has a better ability to anticipate inflation. Furthermore, the party who has engaged more in commercial activity is also in a better position to anticipate inflationary risk. Familiarity with a market is probably greater for those who already own something in that market, than for those who might be new entrants to the market. Thus, the party who gains more from inflation should compensate those who lose or gain less from inflation.[99] Sykes offers other alternatives to justify the application of the impossibility doctrine. Impossibility doctrine may have some valuable justification such as:[100] (1) reduction of the promisee's over-reliance to contract, (2) improvement of promisee's to reduce damages, (3) avoidance of bankruptcy cost.

Where bankruptcy would result not from a poor management decision or a change in the competitive position of the enterprise, but instead from a freakish event that could not have

[94] Irrigation systems are effective precautions against droughts, but not tornadoes.
[95] George G. Triantis, *loc cit*
[96] Shirley Renner, *Inflation and the Enforcement of Contract,* Edward Elgar, 1999, p. 57.
[97] *ibid*, p. 48
[98] *ibid*, p. 49
[99] *ibid*, p. 64
[100] Alan O. Sykes, *op cit* , p. 266.

been anticipated or avoided and that does not signal the need for the redeployment of resources, society might gain at times from avoiding the associated bankruptcy cost. Such reasoning might suggest a justification for discharging certain obligations of firms that would otherwise force them into bankruptcy.

If we follow the Posner-Rosenfield theory of risk allocation rule, the payee, or lender, in this case, will be more likely to be the party who is a less risk bearer. It might be also true when we analyze the foreign lenders- domestic (Indonesia) borrowers relationship in allocating the risk during the Asian economic crisis. In answering the first test, although already explained that no one could predict the Asian economic crisis due to the magnitude of currency depreciation, it may be argued that in this case, the foreign lenders might have relatively better ability in predicting the event's occurrence. When the financial institution lenders commit to providing loans abroad, it can be assumed that they have sufficient knowledge of the world economy in the general and the domestic economy (the country to which the loan is disbursed) in particular. In addition, the one who has engaged more in commercial activity is a better position to anticipate inflationary or depreciation risk. In assessing the Indonesian economic crisis, the domestic borrowers have relatively disadvantage comparing to foreign lenders in estimating the depreciation risk because of (a) the borrowers do not possess sufficient knowledge and experiences of the financial and economic market, (b) the scope of their commercial activities is less wide (rather domestically one), both of which in comparison to the foreign lenders. Thus even if the domestic borrowers are financial institutions they still possess relatively disadvantage in assessing depreciation risk comparing to the foreign counterparts.

The furtherance test here is to determine the cheaper insurer. Generally, the (foreign) lenders are in a better position to diversify risks by pooling a self-insurance. They are able to diversify the risk through other their transactions or source of incomes, i.e. through a loan/investment portfolio. The lenders' sources of income are not derived from one borrower/debtor. Their loan portfolios are not only invested in the country experiencing an economic crisis, like Indonesia but also in the other countries not affected by the crisis. Moreover, the size of loans provided to Indonesia may represent a small fraction number of their total portfolios.

Here, one should also investigate whether the borrowers are a better insurer as well. One of the challenging questions is the Indonesian borrowers would have not experienced financial difficulty had they protect their loans by financial hedging. Financial hedging at that time was not common instruments and consider cost addition to the companies. In addition, the environment at the time makes less incentive to Indonesian borrowers to hedge their loan. Many loan financing at that time were not hedged due to the following conditions:[101] (a) international environments provide an abundant supply of funds at perceived low costs; (b) broad financial deregulation and the opening of the capital account made it easier to tap into foreign markets form financing; (c) exchange rate policies that in effect pegged currencies to the US Dollar reduces perceived risks for investors. Thus, the Indonesian borrowers are not in a better position to diversify risk through buying market insurance (i.e. financial hedging).

Using the Renner theory, in addition to the parties who are better able to estimate the rate of depreciation the risk should also be allocated to the parties who have their wealth more

[101] Javid K. Shirazi, *The East Asian Crisis: Origins, Policy Challenges, and Prospects,* Seattle, June 10, 1998.

positively correlated with depreciation than others. Then those who gain more from currency depreciation should compensate those who lose or gain less from it.

Indonesian companies may reinvest the loans obtained from foreign lenders to the assets yielding more net profits. Before the crisis, for certain, most of the company's portfolio assets were not invested in relatively risk-free assets such as certificate deposits or government bonds that might yield positive wealth, but rather in the risky assets or projects. The economic crisis had affected the business activities of the company and its subsidiaries that had lowered the ability of the company to make a profit caused by excessive expenses such as high-interest rate and non-performance debt by its debtors. For instance, the company had provided an operating lease for 7 (seven) aircraft (Foker) to a national flight company, but because the national flight company was also exposed to the crisis (where its incomes were derived from local currencies while it must repay the loan to Bakrie in US Dollar), they rescheduled the debt financing with the loss in Bakrie because it had to write off some assets (i.e. loan receivables). As previously explained the crisis had brought to the banking crisis where lack of trust in the banking system had made foreign blocked Letter of Credit (L/C) issued by Indonesian banks. This blocking had an impact on the real sector causing the loan/cost of funds to become more expensive. International banks have slashed credit lines to all borrowers, including export-oriented firms that should be benefiting from currency depreciation. Therefore due to the systemic crisis that affected all sectors of business and industries at every level, both at the upstream and downstream levels, most Indonesian companies at that time could not gain advantage having positive wealth correlated with currency depreciation. The argument that impossibility doctrine may create a moral hazard problem, can not be seen in the Indonesian economic crisis.

On the other hand, as previously explained that the crisis was also caused by currency and maturity mismatch, the creditor (foreign lender) has better knowledge than the debtor (borrower) how to structure the loan policy and manage/cope with the mismatch risk. In another word, the creditor from the beginning has already assumed to take a risky behavior.

3.2.2. Other justification of impossibility doctrine

Sykes had argued that impossibility doctrine may have some valuable justification such as avoidance of bankruptcy cost. This justification fits into the situation where most Indonesian companies during the economic crisis must face the bankruptcy petition filed by their creditors. Costs of bankruptcy comprises of (i) direct cost and (ii) indirect cost.[102] Direct cost includes fees of the lawyer, trustee, appraiser, and other professionals, as well as administrative fees associated with the bankruptcy filing and recording. Indirect costs are immeasurable opportunity costs include: (a) lost sales and profits as well as decline in

[102] Lawrence A. Weiss, *Bankruptcy Resolution: Direct Cost and Violation of Priority Claims,* in Jagdeep S. Bhandari (ed), *Corporate Bankruptcy,* Cambridge University Press, 1996, pp. 263-264, and Michelle J. White, *The Corporate Bankruptcy Decision,* in Jagdeep S. Bhandari (ed), *Corporate Bankruptcy,* Cambridge University Press, 1996, p.220.

the value of inventory[103], (b) increased operating cost[104], (c) reduction in the firm's competitiveness[105].

In addition, one should take into account the bankruptcy multiplier or contagion effect where the bankruptcy of each over-indebted firm may drift the firm's equally over-indebted suppliers turning into more bankruptcies worsening the economy as a whole.[106] Although most scholars argue that depression leads to bankruptcies, not the other away around, but an economic crisis like those of Asia in 1997 featured with systemic risks the multiplier effect is more likely to occur.

Where bankruptcy would result not from poor management or a change in the competitive position of the enterprise, such as the economic crisis that could have not been anticipated, it would create social cost. Therefore the companies facing an economic crisis like in Indonesia should have been given some relief and more precisely not being bankrupt as the costs exceed the benefits. Additionally, the bankruptcy policy in the financial crisis should be designed differently as in the normal situation in treating the debtor as recommended by the Worldbank[107]:

> *"Insolvency laws are designed to deal with business failures in a normal economic environment. The rules of the game may change in systemic financial crises, where asset and enterprise values become artificially deflated or harder to predict. Commencement criteria should not be altered to achieve desired results for market aberrations. Rather, where crises require special treatment, interim solutions should be cautiously tailored to the market in question, to maintain commercial predictability and encourage market activity".*

4. The Role of the Court in Deciding Economic Crises as a Supervening Event

Cooter and Ullen[108] provide general steps for the court to supply efficient rules which is, first, the court must establish the risk to the more efficient least bearer. Second, the court must consider adjusting the price of the contract to reflect the efficient allocation risk. In case of impossibility doctrine, Posner and Rosenfield suggest that the courts can complete the contract with respect to those remote risks the parties could not foresee at the time of contracting, according to the principles of efficient risk allocation.

The suggestion for the court in applying efficient rules for the discharge of contract would be:[109] (1) the promisor asking to discharged could not reasonably have prevented the event rendering his performance uneconomical, and (2) the promisee could have insured against the occurrence of the event at a lower cost than the promisor because the promisee was in a better position to estimate both the probability of the event's occurrence and the magnitude

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[103] Customers may become concerned about assured supply and warranties. In certain industries, e.g. financial services, these costs can completely destroy the value of the firm.
[104] Firms may lose key employees or have to pay more to keep them from abandoning a troubled firm. Supplier may refuse to ship on favorable credit terms, and the firm's cost of capital may increase.
[105] Management attention is focuses on the bankruptcy, increasing firm's vulnerability to competitors. Firms have forgone investment opportunities during the bankruptcy procedure, and loss value of funds that are tied up during bankruptcy.
[106] Merton H. Miller, *Leverage,* in Jagdeep S. Bhandari (ed), *Corporate Bankruptcy,* Cambridge University Press, 1996, p.7.
[107] The World Bank Principles and Guidelines For Effective Insolvency and Creditor Rights Systems (April 2001), Principle 6, point 93, p.30.
[108] Robert Cooter & Thomas Ulen, *op cit*, pp. 214-217.
[109] HG Beale, et al, *op cit* , p.400

of the loss if it did occur, and (b) could have self-insured, whereas the promisor would have had to buy more costly market insurance.

But this solution is under suspicion by Triantis saying that the role of the judge, in this case, is more complex. The benefit of specific allocation may be reproduced if a court later allocates *ex-post* the once-remote risk, but only if the ruling is predictable.[110] The judicial allocation of losses cannot yield the intended efficiency benefits of efficient precaution and insurance unless it can be predicted *ex-ante*. The superior risk bearer analysis must play with sets of criteria that often cut in opposite directions and call for information that is often unverifiable. As a result, parties may well contract *ex-ante* to avoid the additional risk of judicial intervention or may over-invest in precautions. Schwartz argues that common law excuse rules conditioned on unobservable or unverifiable information will be unusable by courts and rejected by future contracting parties.[111] As a normative matter, the courts should intervene to allocate remote risks when the incompleteness of the contract is due only to contracting costs, and not to obstacles of verification.

As previously explained, general law provides three possibilities dealing with the application of *rebus sic stantibus* request, in which the court may (i) terminate the contract, (ii) adjust/adapt the contract, or (iii) resume/confirm to the initial contract. However, the role of the court must be the last resort and rather encourage parties to negotiate, if necessary appoint a mediator. Since Ronald Coase published “The Problem of Social Cost”, it has been understood that when transaction costs are zero, and efficient use of resources results from private bargaining, regardless of the legal right, and that legal rules can promote the benefits of contractual endeavors in a world of scarce information and high transactions cost by prescribing the outcomes the parties themselves would have reached had the information been plentiful and negotiations costless. Private ordering arguably is superior to a court order in terms of: ascertaining whether a state of the world realization qualifies as an exception, the efficacy of the resulting adjustment, and the cost of reaching an agreement on the adjustment.[112]

However when the parties cannot cooperate due to high transaction costs such as asymmetric of threat value and cooperative solution, involves more parties, anticipate many contingencies, opportunistic and unreasonably behavior, the court can assign an efficient solution by lowering transaction cost. The establishment of the Jakarta Initiative Task Force (JITF) in 1998 by the Indonesian Government as an out-of-court negotiation forum for resolving corporate debts between foreign lenders and domestic borrowers is a plausible policy.[113]

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[110] Triantis, George G., *op cit,* p.111
[111] *ibid*
[112] Oliver W. Williamson, *Assessing Contract*, Journal of Law, Economics and Organization, I:1, 1985, p. 201
[113] Jakarta Initiative Task Force (JITF) was inaugurated in November 1998 as an out-of-court negotiating framework resolving the corporate debt. Both debtors and creditors, with some concerns, were generally supportive of the JITF’s establishment. It was modeled on workout techniques followed in the United States and Europe. The JITF was actively involved in facilitating deal-making, including through professional staff experienced in restructuring and mediation who were lacking in Indonesia. It was also designed to be a “one-stop” forum for facilitation of regulatory applications required for restructuring plans. In this role, it would also recommend incentives for restructuring and removal of disincentives regarding, for example, taxation, legal lending limits, disclosure of financial information, and divestiture by banks of equity acquired in restructuring transactions. The JITF framework can be considered a success. JITF mediated over 150 cases, involving close to $30 billion of debt. JITF’s importance lay in the fact that, in the absence of a credible legal system and within a difficult political environment, it provided a predictable, neutral, transparent forum for restructuring. See Ashok Bhundia et.al., *IMF Country Report No. 04/189 - Indonesia: Selected Issues*, International Monetary Fund, July, 2004.

Also even when it is brought to the bankruptcy court the court (common cases in Indonesia happened during the crisis where the creditors file a petition of bankruptcy to their debtors in financial distress) as far as possible should encourage the parties to negotiate outside the court. It is a belief that private restructuring (i.e. renegotiate outside the court) is cheaper than restructuring using the bankruptcy court. Gilson[114] points out some research explaining that private restructuring (workout) results in a shorter time than in bankruptcy proceeding (reorganization under Chapter 11 US Bankruptcy Code) mainly due to the fact that in workout firms only need to deal with creditors whose claims are in default. [115] Furthermore, the length of time spent also associates with the hourly billed to the lawyer (and other professionals). In a bankruptcy case, generally, lawyers and other professionals have incentive to prolong the bankruptcy process (e.g. filing an excessive motion with the court) because their fees have priority over all the firm's other claims.[116] Besides less expensive, an informal workout is also less damaging and less stressful comparing to the bankruptcy procedure.[117]

From the theory mentioned above, I propose in applying efficient rules for impossibility doctrine the court should decide in the following consideration: (1) the promisor (borrower) asking to discharged could not reasonably have prevented the event rendering his performance uneconomical, and (2) the promisee (lender) is in a better position to predict the probability of the occurrence of the event occurrence and the magnitude of the loss if it occurred, and (3) the promisee (lender) is in a better position to pooling risks., (4) the promisor (borrower) does not have its wealth more positively correlated with the event (i.e. depreciation), and (5) the promisor (borrower) does not make a profit out of the market movement as a whole.

From the previous analysis of the case, the Asian (Indonesia) economic crisis can be regarded as an unforeseen event, and in which the obligation of the Indonesia borrower/debtor become so onerous due to the currency depreciation. The borrower is not a less risk bearer, precisely he is not in a better position to estimate depreciation risk and also not a cheaper insurer. The borrower also cannot take advantage as having wealth positively correlated to the depreciation in other transactions his investment or debtors in other transactions are also affected by the crisis. And for certain, the borrower does not make other profits out of the market movement as a whole. While on the other hand, the foreign lenders are more likely can be a superior estimator to the depreciation risk and relatively able to be better self-insured.

When a company is declared bankrupt not because of mismanagement or inefficiency it will create loss to society. And vice versa, when a bank (lender) is let to be liquidated it is more likely also to create welfare loss. However, a bank is in a better position as less likely to be declared bankrupt then a non-bank company. It can be argued that a non-bank company must protect itself for not being declared bankruptcy by its creditors.

[114] Stuart G. Gilson, *Managing Default: Some Evidence on How Firms Choose between Workouts and Chapter 11,* in Jagdeep S. Bhandari (ed), *Corporate Bankruptcy,* Cambridge University Press, 1996, p. 310.
[115] This comparison between workout and reorganization under Chapter 11 US Bankruptcy Code might be used in attempting at stressing out the need of adaptation of contract among the parties which basically a private negotiation instead of using bankruptcy procedure in resolving the non performance of contract.
[116] Stuart G. Gilson, *loc cit.*
[117] John Mc Connell, *The Economics of Prepackaged Bankruptcy,* in Jagdeep S. Bhandari (ed), *Corporate Bankruptcy,* Cambridge University Press, 1996, p. 322.

The banking sector has always been heavily regulated because of the vulnerability of banks to a loss of public confidence where confidence in the financial system is a social benefit that will not be adequately valued by individuals in the market.[118] On the other hand banking regulation also provides a safety net for banks not to be forced for liquidation. "It is too big to fail". Bank regulators are naturally reluctant to allow a bank (especially a big bank) to fail and cause losses to its depositors because it is more likely the financial disruption will occur.[119] It is always a providence that it may be less costly to restructure an insolvent bank than allow it to fail.[120]

The central bank acts as a lender of last resort[121] for banks by providing liquidity support to overcome informational asymmetry[122] and financial instability risk[123]. Liquidity support is deemed necessary because of the important function of the bank[124]. Liquidity problems and insolvent banks can have an impact on financial stability.

A banking regulation, therefore, has always made a belief that: [125] (a) the government will ensure the safety of deposits with all financial institutions leads savers to deposit their money without giving thought to the behavior of the company with whom they bank, and (b) the banks will always be rescued from collapse causes financial institutions to take greater risks in their lending policies in search of higher returns.

In most jurisdictions, even an ill bank will likely be treated with favor. Instead, to let the bank bankrupt, the government will treat the ill-bank under special auspices by a central bank or special institution to cure or recover the bank and let it operate in a normal market when it assumes healthy. Worldbank principles on insolvency itself provide a special rule that a bank cannot be bankrupt through normal procedures.

The Author believes that banks are important for society, thence giving them protection from collapse is justifiable. In normal conditions, the role of banks might be more important than non-bank companies. However under certain condition, like a severe economic crisis which cause a country in a debt trap, political instability, and human right deprivation, we have to find an efficient solution for all parties. Especially for a foreign

[118] Peter Howells & Keith Bain, *The Economics of Money Banking and Finance,* Addison Wesley Longman, 1998, p.426.
[119] Frederic S. Mishkin, *the Economics of Money, Banking, and Financial Markets,* Pearson Addison Wesley, 7th edition, 2004, p. 263.
[120] Xavier Freixa et.al., *Lender of Las Resort: A Review of the Literature,* in Charles Goodhart and Gerhard Illing (ed), *Financial Crises, Contagion, and Lender of Last Resort,* Oxford University Press, 2002, p. 37
[121] The concept of lender of last resort originated at the beginning of the nineteenth century when Henry Thornton spelt out the basic elements of sound central bank practice with respect to distress lending. The roles of lender of last resort are: (i) to protect the money stock, (ii) to support the whole financial system rather than individual financial institution, (iii) to behave consistently with the longer run objective of stable money growth, and (iv) to preannounce its policy in advance of crisis so as to remove uncertainty. See Xavier Freixa et.al., *Lender of Las Resort: A Review of the Literature,* in Charles Goodhart and Gerhard Illing (ed), *Financial Crises, Contagion, and Lender of Last Resort,* Oxford University Press, 2002, p. 27

[122] Informational asymmetry which makes otherwise solvent banks vulnerable to deposit withdrawals and/or the drying up of inter-bank lending in times of crisis; this can result in insolvency for otherwise sound banks, and thus a welfare loss to the bank's stakeholders. See Xavier Freixa et.al., *Lender of Las Resort: A Review of the Literature,* in Charles Goodhart and Gerhard Illing (ed), *Financial Crises, Contagion, and Lender of Last Resort,* Oxford University Press, 2002, p. 44.
[123] The potential risk to the stability of the financial system as a whole following the failure of a solvent bank. Widespread financial instability may prevent the financial system from performing its primary function including smooth operation of the payments system, and intermediating between savers and borrowers with an efficient pricing of risk. Such problems may be induced by the failure of a large financial institution, or a group of smaller ones, which have ripple effects on other financial institution through direct credit or payments or via contagion. See Xavier Freixa et.al., *Lender of Las Resort: A Review of the Literature,* in Charles Goodhart and Gerhard Illing (ed), *Financial Crises, Contagion, and Lender of Last Resort,* Oxford University Press, 2002, p. 45.
[124] The important function of the bank are inter alia: (i) intermediary institution between savers, investors and consumers, (ii) shifting financial resources over industries by being active participation in the flow of funds, (iii) clearing and settling payment, (iv) facilitating Letter of Credit. See Frederic S. Mishkin, *The Economics of Money, banking and Financial Markets,* Addison Wesley Higher Education Group.
[125] Peter Howells & Keith Bain, *The Economics of Money Banking and Finance,* Addison Wesley Longman, 1998, p.428.

bank, that (i) do not fully expose to the Indonesia economic crisis, (ii) is a better position to pooling a risk, (iii) have multiple cushions from being deprived out of the market, finding a balanced solution for the creditor (foreign lender), a debtor (borrower) and society as a whole is a must.

In the legal analysis above the Asian economic crisis can be a justification for the borrower to seek relief under *rebus sic stantibus* doctrine, hardship rule, or impracticability. Even there is a possibility to interpret the Asian economic crisis as a *force majeure* that leads to discharge where in some jurisdiction it will result in automatic termination of the contract. In case the promisor is the seller/supplier or property developer, the court grant termination of the contract as due to systemic crisis the promisor could not render its promise. However in the case of a borrowing-lending relationship, the lender has already invested some disbursement of the fund in return for principal and interest, therefore it is not fair for the lender if the court terminates the contract. And certain it is impossible for the court to enforce the initial contract as *de facto* the borrower could not pay the amount as stated in the contract. Furthermore, we have to avoid the bankruptcy of the borrower as taking the bankruptcy procedure itself is costly and it is economically inefficient if the companies must be filed into bankruptcy not because of the mismanagement but rather of the uncontrollable occurrence where event a prudential operator could not avoid it.

Therefore, I propose that the court in deciding the case discussed above should give relief to the debtor in form of suspension (of payment). Suspension of payment closely operates like a debt moratorium.[126] The remedy is similar to the one in case of *force majeure* where a debtor is excused temporarily non-performance but he must resume his obligation when the event constituting *force majeure* ends. Performance that is excused has to be rendered at all or at partial depending on the negotiation of the parties. By giving a suspension remedy, the creditor is assumed the risk of the supervening event but only temporarily. The remedy similarly in form of a suspension is also recognized in PECL under the name of granting *delay de grace*.

Suspension of payment serves two purposes: (i) to give breathing space to the debtor, and (ii) to induce the creditor to renegotiate. By giving a grace period, the debtor is allowed to reconsolidate its business and utilize remaining assets sufficiently needed to stay operating its business in order to repay its creditors. The creditor should closely monitor the operation of the debtor but not take over the management of the debtor's company because the debtor is the party who knows better to operate a specific business than its creditor. In addition, we must take into account that the non-performance of the company (the debtor) during a crisis is not due to mismanagement. As said before the renegotiate is a better solution for dealing with this situation. Lending will continue because there is no alternative solution. The lender can only recoup its losses by renegotiation and the extension of new credit, and not by filing bankruptcy procedure.

[126] A debt moratorium is a delay in the payment of debts or obligations. The term is generally used to refer to acts by national governments. A moratory law is usually passed in some special period of political or commercial stress; for instance, on several occasions during the Franco-German War the French government passed moratory laws. Debt moratoriums are generally opposed by creditors. Proponents of debt moratoriums argue that it is a sovereign decision by the government of a nation to suspend payment of debt to its creditors, in the event that to do otherwise would do irreparable harm to the welfare of its citizenry.

5. CONCLUSION

Rebus sic stantibus is a doctrine that gives a mechanism intended to correct change of circumstances caused by supervening events which the parties could not reasonably have foreseen when they made the contract. *Rebus sic stantibus* was introduced under different names and legislative enactments of various countries. There is a slight difference between *rebus sic stantibus* and *force majeure,* but in the practice, the use of each may overlap. Asian economic crisis can be regarded as a supervening event that might constitute impossibility doctrine.

The most efficient way for the parties when facing a supervening event is to make private negotiations. The role of government is to facilitate the party to make an efficient bargain. The court is only a last resort to solve it. However, if it is brought under the court, the judge should modify the contract, in the form of granting a suspension of payment. The creditor (foreign lender) bears the risk of the supervening event because (i) the lender is in a better position to predict the probability of the occurrence of the event occurrence and the magnitude of the loss if it occurred, (ii) the lender is in a better position to pooling risks, (iii) the borrower does not have its wealth more positively correlated with the event (iv) the borrower does not make a profit out of the market movement as a whole, (v) the lender has a comparatively better position to avoid itself being bankrupt.

A suspension means giving temporary relief for the borrower to reconcile and restructure itself in order to repay its creditor (lender) in the future, therefore it still serves the creditor's interest. The problem observed in suspension is to determine as to how long the suspension of the contract. This problem might become further study.

Indonesia civil code does not recognize impracticability doctrine or hardship, but rather *force majeure* doctrine, therefore it is suggested for Indonesia to amend its civil code. However in the absence of impracticability or hardship rule, in an urgent situation where economically and socially desirable, the judicial construction to interpret the crisis as *force majeure* solely on the ground of equity may be served as a solution. The judicial construction with this regard may also be conducted in separate research.

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