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Winner Take Some: Loss Sharing and Commercial Impracticability

Leon E. Trakman*

The increasing invocation of the doctrine of commercial impracticability as an excuse for contract breach raises varied and complex problems of loss allocation. Trained in the formal application of legal doctrine, common law judges historically have refused to spread the burden of a contract discharged because its performance has been rendered commercially impracticable. Notwithstanding the theoretical availability of a broad array of loss-sharing remedies incorporated in the Restatement (Second) of Contracts1 and the Uniform Commercial Code,2 judicial adjustment of losses, until very recently, has been the exception, not the rule. Courts are increasingly recognizing, however, that in a commercial environment in which absolute liability for losses is both uneconomical and the source of individual hardship, loss allocation provides a plausible means of commercially wise and equitable accommodation.3 Yet, despite the historical application of loss splitting by admiralty courts, no consistent methodology has developed to allocate losses in cases of commercial impracticability.

This Article traces the evolution of the doctrine of commercial impracticability from its beginnings as a rare all-or-nothing remedy to its present status as an embryonic loss-sharing doctrine. It then proposes a methodology for the incorpora-

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2. See U.C.C. § 2-615 (1978). All references to the Uniform Commercial Code (U.C.C.) are to the 1978 Official Text and Comments, unless otherwise indicated.
3. This is particularly so in relation to long-term contracts in which both parties have reason to continue their relationship despite the intervening disruption. To insist on performance without relief or to excuse performance completely by law may undermine the continuity of the parties' relationship. Cf. Speidel, Court-Imposed Price Adjustments under Long-Term Supply Contracts, 76 Nw. U.L. Rev. 369, 372-75 (1981) (suggesting that long-term contracts should be more readily adjusted). But see Dawson, Judicial Revision of Frustrated Contacts: The United States, 64 B.U.L. Rev. 1 (1984) (courts should not adjust performance obligations under long-term contracts).
tion of loss-sharing concepts into the doctrine of commercial impracticability. The proposed methodology presents two distinct means of effectuating adjustment of losses in cases of commercial impracticability. The first alternative places primary responsibility for loss allocation on the parties themselves, recognizing the advantages to be gained by judicial facilitation of out-of-court settlement. In those cases in which private settlement cannot be reached, the second proposal considers several methods by which courts may uniformly allocate performance losses. Together, these two alternatives provide a uniform framework for the incorporation of loss-sharing principles within the doctrine of commercial impracticability.

I. COMMERCIAL IMPRACTICABILITY: AN EVOLUTION

For centuries the common law system concentrated on the narrow substantive law of impossibility without considering the availability of a remedial regime of adjustments.4 Courts

mechanically applied the general substantive rule that an obligation assumed without condition binds the promisor. Gradually, however, courts began to qualify the rigid principle that bound the parties unconditionally to the consequences of risks assumed by contract and developed a formidable body of non-performance doctrine, referred to variously, but not exhaustively, as impossibility, frustration, force majeure, or

5. This proposition can be traced back to the early English case of Paradine v. Jane, Aleyn 26, [1647] 82 E.R. 897, 898, and, in the United States, to Stees v. Leonard, 20 Minn. 448 (1874). In Stees, Judge Young stated:

The general principle of law which underlies this case is well established. If a man bind himself, by a positive, express contract, to do an act in itself possible, he must perform his engagement, unless prevented by the act of God, the law, or the other party to the contract. . . . This doctrine may sometimes seem to bear heavily upon contractors; but, in such cases, the hardship is attributable, not to the law, but to the contractor himself, who has improvidently assumed an absolute, when he might have undertaken only a qualified, liability. The law does no more than enforce the contract as the parties themselves have made it.

Id. at 451. The notion that risks are "assumed" by promisors is reflected in recent case law as well. In Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co., 508 F.2d 283, 294 (7th Cir. 1974), for example, the court stated, "We will not allow a party to a contract to escape a bad bargain merely because it is burdensome." See also Publicker Indus. v. Union Carbide Corp., 177 U.C.C. Rep. Serv. (Callaghan) 989, 992 (E.D. Pa. 1975) (parties intended risk of price increase would be borne by the seller); Trans-State Investments, Inc. v. Deive, 282 A.2d 119, 121 (D.C. 1970) (defendant assumed the risk of inability to perform); RESTATEMENT (SECOND) OF CONTRACTS § 268(2) (1981) (frustration excuse not applicable if party has assumed risk).

6. The term "impossibility" has traditionally been employed to determine circumstances in which an obligation should be excused. The problem lies in determining precisely what "impossibility" means—"physical" or "legal," "objective" or "subjective," "complete" or "partial." Each of these adjectives is used to qualify the ambit of an "impossibility" in law; but not all forms of "impossibility" lead to an excuse from performance. "Subjective," unlike "objective," impossibility does not relieve a promisor from assumed obligations. A promisor who cannot perform for such "subjective" reasons as financial hardship remains bound in contract. See, e.g., B's Co. v. B.P. Barber & Assocs., 391 F.2d 130, 137 (4th Cir. 1968) (subjective impossibility does not excuse performance); see also Henszey, UCC Section 2-615—Does Impracticability Mean Impossibility?, 10 U.C.C. L.J. 107, 108 (1977) (suggesting that courts selectively equate common-law impossibility with the UCC term "impracticability").

7. The term "frustration" developed in English law to include "frustration of the purpose" of the contract, "frustration of the adventure," or simply "frustration of the voyage." "Frustration" generally gives rise to nonperformance when the "purpose" of the contract is rendered "substantially," "fundamentally," or "radically" more difficult or costly to render, although not physically impossible. See Gow, supra note 4, at 291-93; McNair, Frustration of
commercial impracticability.9

The erosion of the rigid general rule began with a number

Contracts by War, 56 LAW Q. REV. 173, 176 (1940); Webber, supra note 4, at 285.

The doctrine of "frustration" has been incorporated into American law. See U.C.C. § 2-615 comment 3 (frustration doctrine incorporated in U.C.C. § 2-615(a)); RESTATEMENT (SECOND) OF CONTRACTS §§ 266, 267 (1981) (existing and supervening frustration); see also Corbin, supra note 4, at 4; Comment, Contracts—Frustration of Purpose, 59 MICH. L. REV. 98, 98-100 (1960). In Lloyd v. Murphy, 25 Cal. 2d 48, 153 P.2d 47 (1944), the court stated: "Although the doctrine of frustration is akin to the doctrine of impossibility of performance, . . . frustration is not a form of impossibility even under the modern definition of that term . . . . Performance remains possible but the expected value of performance . . . has been destroyed by a fortuitous event. . . ." Id. at 53, 153 P.2d at 50; see also Hass v. Pittsburgh Nat'l Bank, 495 F. Supp. 815, 819 (W.D. Pa. 1980) (party will be discharged from performance only when the purpose of the contract is substantially frustrated by a supervening event); Ma v. Community Bank, 494 F. Supp. 252, 257 (E.D. Wis. 1980) (frustration present only when a party's principal purpose is substantially frustrated by a supervening occurrence or event the nonoccurrence of which was a basic assumption on which the contract was made); Lord v. Wheeler, 67 Mass. (1 Gray) 282, 283 (1854) (building contract frustrated when the subject building was destroyed by fire).


of nineteenth century English cases excusing the performance of contracts interrupted by unforeseen occurrences. In *Taylor v. Caldwell*,¹⁰ for example, the court excused performance of a contract for the rental of a music hall on grounds of impossibility when the hall was destroyed by fire. In *Krell v. Henry*,¹¹ the court excused a promise to pay rent when the purpose of the contract, the viewing of a coronation procession, was frustrated by the cancellation of the parade. Over time, courts expanded the excuses from performance to include the death of the promisor, the sinking of a ship at sea, wars and war-related contingencies, strikes, lockouts, and other vagaries in the production and delivery of goods and services.¹²

The expansion of the nonperformance doctrines is attributable largely to the use of judicial fictions.¹³ Early courts reasoned that the "foundation," "object," or "basis" of a contract had "disappeared" or was "destroyed" when an unforeseen and intervening occurrence disrupted performance of the contract.¹⁴ Some courts, for example, held that the "basic assumption" of

¹¹. [1903] 2 K.B. 740.
¹². See authorities cited supra notes 4-9.
¹³. See Trakman, *supra* note 4, at 41. These judicial fictions can be traced back to such early cases as Taylor v. Caldwell, [1863] 3 Best & Smith 826, 122 E.R. 309, in which the court implied an excuse by law "because...it is apparent that the parties contracted on the basis of the continued existence" of the music hall that subsequently burned down. Id. at 830, 122 E.R. at 814 (emphasis added); see also Scott & Sons v. Del Sel, 1922 Sess. Cas. 592, 596-97, aff'd, 1923 Sess. Cas. 37 (H.L. Scotland) (implying terms on assumption that contract existed). Justice Holmes once said of the implied term fiction:

You can always imply a condition in a contract. But why do you imply it? It is because of some belief as to the practice of the community or of a class, or because of some opinion as to policy, or, in short because of some attitude of yours [the court's] upon a matter not capable of...founding exact logical conclusions. Such matters really are battle grounds where the means do not exist for determinations that shall be good for all time, and where the decision can do no more than embody the preference of a given body in a given time and place.

Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 466 (1897); see also Farnsworth, *supra* note 4, at 867 (suggesting that conditions may be implied).

¹⁴. For the origin of the "objects" or "purposes" approach in the common law, see Krell v. Henry, [1903] K.B. 740, 747. In *Krell*, the court held that the "purpose" of a rental contract, to view a coronation procession, had failed. In fact, however, only the tenant's "object" had failed when the procession was cancelled; the "object" of the promisee-landlord had not failed because a profitable lease still was possible. Only through judicial construction did the "object" of both parties fail. See also R. MCELROY & G. WILLIAMS, *IMPOSSIBILITY OF PERFORMANCE* 83-94 (1941); L. TRAKMAN, *THE LAW MERCHANT: THE EVOLUTION OF COMMERCIAL LAW* 92-93 (1983); Corbin, *supra* note 4, at 4; Wade, *supra* note 4, at 536-37.
the contract "failed"\textsuperscript{15} or that performance after the disruption constituted a "radically different" obligation from the performance contemplated by the parties at the time of contracting.\textsuperscript{16} Other courts indulged in the speculation that if the parties at

\textsuperscript{15} In Neal-Copper Grain Co. v. Texas Gulf Sulphur Co., 508 F.2d 283 (7th Cir. 1974), the court set out the following prerequisites to an excuse under U.C.C. § 2-615: "(1) a contingency must occur (2) performance must thereby be made 'impracticable' and (3) the non-occurrence of the contingency must have been a basic assumption on which the contract was made." \textit{Id.} at 293; see also Luria Bros. & Co. v. Pielet Bros. Scrap Iron & Metal, Inc., 600 F.2d 103, 111 (7th Cir. 1979); Heat Exchangers, Inc. v. Map Constr. Corp., 34 Md. App. 679, 684, 368 A.2d 1088, 1091 (1977). The element of a nonoccurrence of a "basic assumption" presupposes that contractors conclude agreements with a particular "assumption" in mind, without which they would not have contracted or would have contracted on different terms. As a result, this assumption need not be expressed in the agreement but may be "reconstructed" by judicial supposition. See Patterson, \textit{supra} note 4, at 913; Trakman, \textit{supra} note 4, at 45.


American Suez Canal cases have developed along similar lines. In Transatlantic Fin. Corp. v. United States, 363 F.2d 312 (D.C. Cir. 1966), for example, a merchant shipowner sought to be excused from performance on grounds that voyage costs increased as a result of the closure of the Suez Canal. Although it declined to excuse the performance, the court observed that the doctrine of impossibility is invoked when "[the] community's interest in having contracts enforced . . . is outweighed by the commercial senselessness of requiring performance." \textit{Id.} at 315 (emphasis added). The threshold of "commercial senselessness," like the threshold of "radical difference," is inevitably at that complex point at which a difference of degree becomes a difference of kind. \textit{See} Eastern Air Lines, Inc. v. McDonnell Douglas Corp., 532 F.2d 957, 991 (5th Cir. 1976) ("The rationale for the doctrine of commercial impracticability is that the circumstance causing the breach has made performance so vitally different from what was anticipated that the contract cannot reasonably be thought to govern."). But see American Trading \& Prod. Corp. v. Shell Int'l
the time of contracting had "anticipated" or "foreseen" the contingencies that disrupted the performance, they would have refrained from entering into the agreement.\(^\text{17}\) Although frequently discussed by judges, these imaginative rationales have usually not induced courts to grant excuses from performance.\(^\text{18}\)

Both the Restatement (Second) of Contracts and the Uniform Commercial Code maintain the earlier practice of creating doctrine by way of fiction. The Code, for example, provides for nonperformance in the event of the "failure of a basic assumption" because of "unforeseen supervening circumstances not within the contemplation of the parties."\(^\text{19}\) The Code thus perpetuates the fiction that underlying each contract is a "basic assumption" that the court is able to identify by ex post facto inquiry\(^\text{20}\) and that a judicial finding of "commercial impracticability".

Marine Ltd., 453 F.2d 939, 942 (2d Cir. 1972) (increase in cost not sufficient to excuse performance).

17. See, e.g., Chicago, M. & S.P. Ry. v. Hoyt, 149 U.S. 1, 15 (1892) (occurrence of event not in contemplation of parties at time of contracting will discharge obligation even though the language of the contract could be read to include the contingency); Williams Grain Co. v. Leval & Co., 277 F.2d 213, 215 (8th Cir. 1960) (occurrence of event not ordinarily anticipated and without the fault of the promisor excuses performance); Martin v. Star Pub. Co., 50 Del. (11 Ter.) 181, 191, 126 A.2d 238, 244 (1956) (court may supply terms that parties certainly would have agreed to had such terms been proposed); Nabaco, Inc. v. Riverview Realty Co., 87 Nev. 55, 57, 482 P.2d 305, 307 (1971) (defense of impossibility available to one whose performance is made impossible or impracticable by the occurrence of unforeseen contingencies); Crown Embroidery Works v. Gordon, 190 A.D. 472, 474, 180 N.Y.S. 158, 160 (1920) (subsequent unforeseeable illegality of contract performance discharges obligation). But see Madeirense Do Brazil S/A v. Stulman-Emrick Lumber Co., 147 F.2d 399, 404 (2d Cir. 1945) (seller assumed foreseeable risk of shortage of delivery ships during wartime); Berg v. Erickson, 234 F. 817, 821 (8th Cir. 1916) (parties impliedly allocated foreseeable risk of drought).


19. U.C.C. § 2-615; see also Restatement (Second) of Contracts § 152 comment b, illustrations 1-6 (1981).

20. These "basic assumptions" are undoubtedly difficult to determine.
bility" reflects what the parties would themselves have decided had they anticipated the intervening disruption.21 In most cases, however, courts cannot determine realistically what the "basic assumptions" of the parties were at the time of contracting, either because one or both of the parties had no such assumptions in mind or, even if they had, because they probably did not reveal those assumptions.22 Courts also cannot ascertain what the parties "contemplated" except by the process of ex post facto inquiry into and attribution of the parties' supposed "contemplations." As one commentator has noted, at work in the judicial re-creation of the parties' intent is often an "apologetic fiction which deprecates the part played by state policy and personal judgment in the administration of law."23

The fictions in the "construction" of contractual intention are well-recognized. Some bolder courts, however, have de-

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22. A contractor may fail to deal with an issue by agreement because no risk was contemplated or because it had contemplated the risk but considered it unimportant, unlikely to occur, or difficult to incorporate into the contract. See Chafee, The Disorderly Conduct of Words, 41 COLUM. L. REV. 381, 385-88, 398-402 (1941); Farnsworth, "Meaning" in the Law of Contract, 76 YALE L.J. 939, 945-47 (1967); Trakman, supra note 4, at 42; Williams, Language and the Law, 61 LAW Q. REV. 384, 401-06 (1945).

23. Patterson, Conditions, supra note 4, at 913. Often the court achieves this construction of the parties' intentions by maintaining that the contract has a casus omissus, or missing term, that the court needs to "fill in" for the parties. For a discussion of such judicial "gap-filling," see Corbin, Recent Developments in the Law of Contracts, 50 HARV. L. REV. 449, 465-66 (1937); Farnsworth, Some Considerations in the Drafting of Agreements: Problems in Interpretation and Gap-filling, 39 OKLA. B. ASS'N J. 917, 917-24 (1968); Trakman, supra note 16, at 280-94. Criticizing the judicial construction of the parties' "intention" out of their presumed expectations, Professor Farnsworth thoughtfully observes: "First, where there are no expectations, [the fiction] masks the real issues by encouraging courts to rationalize their treatment of casus omissi by means of a fictitious intention. And second, even where there are expectations, it distorts them by casting them in the form of contract terms." Farnsworth, supra note 4, at 867-68.
clined to indulge extensively in a fruitless chase after the intention of the parties, preferring instead to do what seems "just and reasonable" in the circumstances. 24

On the other hand, many courts tend to view excuse for nonperformance as a very narrow concept that should not be readily used to terminate contractual obligations. These courts reason that because there are few disruptions of performance that parties could not foresee in modern times of political and economic uncertainty, parties engaged in commercial transactions should be bound to fulfill their unqualified promises without excuse. 25 Moreover, a promisor who assumes an obligation without obtaining a contingent release clause should not be permitted to escape liability for breach at the expense of the promisee. Courts have refused to excuse energy suppliers from their petroleum and natural gas contracts, for example, notwithstanding the energy crises of the 1970's and the resulting inflated prices and rising costs of performance. 26 Refusing to excuse Gulf Oil Corporation from performance of a supply contract, the court in Eastern Airlines, Inc. v. Gulf Oil Corp. 27 observed that it was "justified in taking judicial notice of the fact that oil has been used as a political weapon with increasing success by the oil-producing nations for many years, and Gulf was

24. See Trakman, supra note 4, at 39-45. British judges Lord Wright and Lord Denning frequently argued that excuses from performance should be granted on grounds of "fairness and reasonableness," even when the contract itself was silent on the issue: "A modern court should realize what is its ideal, that of doing justice according to the actual facts, though on lines of established law." LORD WRIGHT, ESSAYS AND ADDRESSES 385 (1939); see also Denny, Mott & Dickson Ltd. v. James B. Fraser & Co., [1944] A.C. 265, 275; Cricklewood Prop. & Inv. Trust Ltd., and Others v. Leighton's Inv. Trust Ltd., [1945] A.C. 221, 61 T.L.R. 202, 206. For an American perspective on this approach, see Corbin, supra note 4, at 4; see also Aluminum Co. of Am. v. Essex Group, Inc., 499 F. Supp. 53, 89-91 (W.D. Pa. 1980); National Presto Indus., Inc. v. United States, 338 F.2d 99, 112 (Ct. Cl. 1964).

25. See supra notes 5 & 18.


well aware of and assumed the risk that the OPEC nations would do exactly what they [did].”

Some commentators have suggested that the availability of an excuse from performance should depend on which party is the “superior risk bearer.” The determination of risk-bearing superiority in turn depends on an economic analysis of the respective abilities of each party to sustain the risk associated with performance. In the interest of economic efficiency, the party who is better able to bear that risk must, under this analysis, ultimately sustain the loss. The analysis is thereby diverted from a doctrinal preoccupation with the limits to which promises should be sanctified to an evaluation of the circumstances in which such sanctity is justified as a matter of economic efficiency.

Courts need not focus exclusively on ascertaining which party, for doctrinal, economic, or other reasons, should be held responsible for the entire cost of nonperformance. Past experience in both common- and civil-law jurisdictions demonstrates that the allocation of losses arising from nonperformance is a logical and equitable alternative to the imposition of the full loss upon one contracting party. Legislation in Germany after the First World War, for example, empowered German courts to revalue contract prices in response to the rapid decline of the German mark. Similar enactments in Europe after the Sec-

28. Id. at 442.


30. Three factors assist in determining which party is the “superior risk bearer”: “Knowledge of the magnitude of the loss, knowledge of the probability that it will occur, and other costs of self- or market-insurance.” Posner & Rosenfield, supra note 29, at 117.

31. See id. The search for the “superior risk bearer” presupposes that one party is the superior risk bearer, that that party can be ascertained by after-the-fact judicial inquiry, and most pertinently, that the “superior risk bearer” should sustain the full loss arising out of that risk. This approach does not contemplate loss sharing between the superior and inferior risk bearers. For further economic analysis concerning commercial impracticability, see Ashley, The Economic Implications of the Doctrine of Impossibility, 26 HASTINGS L.J. 1251, 1262-70 (1975); Birmingham, A Second Look at the Suez Canal Cases: Excuse for Nonperformance of Contractual Obligations in the Light of Economic Theory, 20 HASTINGS L.J. 1393, 1406-12 (1969); Schlegel, supra note 4, at 441-42; Speidel, Excusable Nonperformance In Sales Contracts: Some Thoughts About Risk Management, 32 S.C.L. REV. 241, 242-44 (1980).

32. For discussions of the enormous upheavals in the German economy following the First World War and their effects on contracts of sale, see Cohn, Frustration of Contract in German Law, pts. III & IV, 28 J. COMP. LEGIS. &
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The Second World War enabled courts to adjust the prices and conditions of delivery in commercial contracts to limit the negative consequences of a devastated European economy. European tribunals in the postwar period have continued to adjust the conditions of commercial contracts, either by finding that code sections such as the “good faith” article of the German Civil Code warrant the modification of contract terms or by adopting an open textual method of interpretation to the same end.

Prominent common-law legislatures have also recognized the virtues of loss sharing. The Frustrated Contracts Act, enacted in the United Kingdom in 1943, illustrates the flexibility of a loss-sharing scheme. The Act, however, provides only limited guidance in the actual allocation of loss. The Uniform
Commercial Code is similarly open-ended. Under section 2-615, a judicial adjustment of losses is permissible in the interests of "good faith" and "justice," but the Code, like the Frustrated Contracts Act, provides little concrete guidance to courts faced with an allocation problem.38

The Code’s blanket, but unqualified, grant of authority has generally prompted United States courts to search for an absolute excuse on grounds of "impossibility" or "commercial impracticability."39 An excuse for nonperformance is either

or, as the case may be, recover the whole or any part of the sums so paid or payable, not being an amount in excess of the expenses so incurred.

§1(3). Where any party to the contract has, by reason of anything done by any party thereto in, or for the purpose of, the performance of the contract obtained a valuable benefit (other than a payment of money to which the last foregoing subsection [§§ 1(2) quoted above] applies) before the time of discharge, there shall be recoverable from him by the said other party such sum (if any), not exceeding the value of the said benefit to the party obtaining it, as the court considers just, having regard to all the circumstances of the case, and, in particular, (a) the amount of any expenses incurred before the time of discharge by the benefited party in, or for the purpose of, the performance of the contract, including any sums paid or payable by him to any other party in pursuance of the contract and retained or recoverable by that party under the last foregoing subsection, and (b) the effect, in relation to the said benefit, of the circumstances giving rise to the frustration of the contract.

6 & 7 GEO. IV, c. 40, §§1(2)-(3) (1943). For a discussion of this legislation and an appeal for similar enactments in the United States, see Comment, Apportioning Loss After Discharge of a Burdensome Contract: A Statutory Solution, 69 YALE L.J. 1054, 1074-89 (1960); see also infra text accompanying notes 96-101.

38. Comment 6 to U.C.C. § 2-615 provides:

In situations in which neither sense nor justice is served by either answer when the issue is posed in flat terms of "excuse" or "no excuse," adjustment under the various provisions of this Article is necessary, especially the sections on good faith, on insecurity and assurance and on the reading of all provisions in the light of their purposes, and the general policy of this Act to use equitable principles in furtherance of commercial standards and good faith.

The general language of § 2-615 and its comments provide no clear indication as to how the court is to "adjust" performance losses, what "good faith" should encompass, or how the "purposes" and "general policy" of the U.C.C. should be construed in relation to performance. See supra note 6. The Restatement (Second) is similarly unhelpful, except insofar as it provides that "justice" is deemed to include "protection" of the parties’ "reliance interest": "[I]n any case governed by the rules stated in [this] chapter [dealing with impracticability of performance and mistake], if those rules together with the rules stated in Chapter 16 [Remedies] will not avoid injustice, the court may grant relief on such terms as justice requires including protection of the parties’ reliance interests." RESTATEMENT (SECOND) OF CONTRACTS § 272(2) (1981).

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granted or emphatically denied. Judicial refusal to excuse performance is usually premised on either or both of two principal rationales: the promisor was reasonably able to foresee the disruptive contingency at the time of contracting, or the promisor should have avoided the consequences of the disruption by taking precautions in the language of the contract itself or by otherwise insuring against foreseeable loss.40

In Iowa Electric Light and Power Co. v. Atlas Corp.,41 for example, the court declined to excuse a uranium producer from performance of its supply contract despite an almost sevenfold increase in the market price of uranium following the alleged formation of a uranium cartel. The court stated that "[w]here the occurrences complained of are in some degree foreseeable and capable of being protected against contractually, . . . and where it is impossible to determine what share of the increase is attributable to unforeseen conditions, . . . it becomes unnecessary to [decide] how much increase constitutes impracticability."42 Although it was willing to engage in an ex post examination of the defendant's foresight, the court found that it was unable to determine with certainty the extent to which the defendant actually foresaw the rising cost of energy at the time of contracting. This result is not surprising. Any determination by way of hindsight is unlikely to be subject to accurate verification because the defendant will have every economic

40. See supra notes 4-5.
42. Id. at 135.
reason to persuade the court that the contingency was not contemplated at the relevant point in time. What is particularly surprising is the court's mechanical resolution of doubt as to the promisor's foresight by its absolute denial of any form of relief to the defendant. Partial foresight and partial control over disruptive contingencies may justify partial relief. By opting for no relief, the Iowa Electric court seriously undermined its capacity to modify the agreement in the face of undoubted economic hardship.

II. A NEW REGIME OF REMEDIES

A. The Benefits of Loss Sharing

Under a new regime of remedies, doubt over the permissible extent of relief afforded by the doctrine of commercial impracticability may be resolved by calculating the proportions in which each party should assume responsibility for the ultimate loss. Approaching questions of commercial impracticability as a remedial matter does not avoid the preliminary question of whether a state of commercial impracticability in fact exists. This preliminary question diminishes in importance, however, when primary focus is given to determining the proportions in which the parties should share performance losses. Questions concerning the permissible extent of relief should therefore be resolved by deciding the proportions in which each party should assume responsibility for the ultimate loss. Proportionate loss-allocation may be based on a number of factors, including the nature of the performance risk, the capacity of each party to exercise "control" over that risk, and the effects that competing allocations of performance risk likely would have on dependent producer and consumer interests. The ultimate goal of this remedial regime is to redirect the doctrine of commercial impracticability from its limited role as an excuse doctrine to its potentially more useful function as a remedial doctrine.

The remedial application of commercial impracticability doctrine would not require that the promisor be excused completely from the obligation to perform in every case.\textsuperscript{43} The suggested application proposes only that the promisor may be

\textsuperscript{43} Particular types of business ventures, however, may be singled out for the strict enforcement of obligations because the promisor foresaw and was able to "control" the risk of loss. See Berman, supra note 4, at 1428-36; Trakman, supra note 16, at 258-65. The language of the contract, however, should be examined in each case to determine the limits of each party's "assumption of risk." See infra notes 106-107.
relieved from some performance obligations, depending in each case on the degree to which the promisor could have foreseen and avoided the risk of loss by taking precautionary or other risk-averse measures. The regime of remedies permits an absolute excuse from performance in only three circumstances: where the promisor bargained for such an excuse in its agreement; when such an excuse can be fairly inferred from the course of dealings between the parties; or where the denial of an excuse might produce substantial public injury or community harm. To relieve the promisor from responsibility completely would be to ignore the promisor's superior position, in most cases, to avert, or at least mitigate, the consequences of performance disruptions.44

The need for a new regime of remedies is particularly evident from the realization that in the vast majority of cases the principal cause of nonperformance is attributable to an extraneous factor—an external casualty, an act of God, an energy crisis, or a period of rapid inflation—the effects of which neither party could completely prevent or delay. To hold one party wholly liable or, alternatively, completely free of responsibility for, the ensuing nonperformance is fundamentally unjust in cases in which neither party was originally responsible for causing the intervening disruption of the agreement and where at least one party must bear the economic burden flowing from the loss. Shared responsibility, albeit in differing proportions, requires both parties to assume a part of the loss.45

44. Contractors often revise their form contracts to take account of new events after each “novel” contingency has occurred. See generally Butte, A New Contract Through Old Eyes, 13 Tex. Int'l L.J. 1 (1977); Freehill, Mutually Exempted Perils, 49 Tul. L. Rev. 899 (1975); Holmes, Negotiating, Drafting and Enforcing Coal Supply Contracts, 9 Nat'l Resources Law. 353 (1976); Hurst, Drafting Contracts in an Inflationary Era, 28 U. Fla. L. Rev. 879 (1976); Rosein, supra note 9; Scott, Coal Supply Agreements, 23 Rocky Mt. Min. L. Inst. 107 (1977); Trakman, Nonperformance in Oil, 29 Oil & Gas Tax Q. 716 (1981); Williams, Coping with Acts of God, Strikes, and Other Delights—The Use of Force Majeure Provisions in Mining Contracts, 22 Rocky Mt. Min. L. Inst. 433 (1976).

45. Typical of a case in which both parties were viewed as equally capable of foreseeing the risk of inflation is Missouri Pub. Serv. Co. v. Peabody Coal Co., 583 S.W.2d 721 (Mo. Ct. App.), cert. denied, 444 U.S. 865 (1979), in which the court remarked:

The facts as shown by the record lead to the conclusion that at least some of the loss resulted from the fact that for some unexplained reason the Industrial Commodities Index lagged behind the Consumer Price Index, the measuring factor first proposed by Peabody, in reflecting inflationary cost increases. That such indexes were based upon different commercial and economic factors was pre-
The imposition of total loss on only one party may lead to distinct economic disutility in cases in which both parties could sustain the loss more efficiently. Moreover, the economic hardship sustained by a single risk bearer can have onerous ramifications within a wider community of interests. Holding energy suppliers fully responsible for losses caused by extraneous circumstances, for example, not only imposes financial hardship on those suppliers; it may also bring devastating consequences to a large, innocent group of interdependent producers and suppliers and to the ultimate consumers relying on the distribution network. Loss sharing may dilute the harshness of such negative economic consequences.

B. CONTRACT REFORMATION

Contract reformation is one alternative in a new regime of impracticability remedies. In an era in which costs and prices vary drastically over time, the need to develop a method for modifying contracts is especially pressing. Although past patterns of inflation suggest that parties to long-term contracts should anticipate the risk of inflation during the term of their agreement, the reality of inflation alone does not necessarily mean that the parties will be able to predict the timing or severity of inflation patterns or the effects inflation might have on performance. Courts have recognized that "foreseeability or even recognition of a risk does not necessarily prove its allocation." The fact that a supplier could continue to perform commercial obligations without upward adjustment of the price presumably known by both parties since each was skilled and experienced in those areas and the divergence between the indexes could not be said to be unforeseeable. Be that as it may, Peabody agreed to the use of the Industrial Commodities Index factor.

Id. at 728. The court nevertheless concluded, "It is apparent that Peabody did make a bad bargain and an unprofitable one under its contract with Public Service resulting in a loss, the cause and size of which is disputed." Id.

46. See Speidel, supra note 3, at 392-400; Note, supra note 9; Comment, Relief from Burdensome Long-Term Contracts: Commercial Impracticability, Frustration of Purpose, Mutual Mistake of Fact, and Equitable Adjustment, 47 Mo. L. Rev. 79 (1982); Comment, Equitable Reformation of Long-Term Contracts—The "New Spirit" of ALCOA, 4 Utah L. Rev. 985 (1982). But see Dawson, supra note 3, at 4-38 (judicial adjustment of performance obligations is unnecessary).

47. Aluminum Co. of Am. v. Essex Group, Inc., 499 F. Supp. 53, 76 (W.D. Pa. 1980) (quoting Transatlantic Fin. Corp. v. United States, 363 F.2d 312, 318 (D.C. Cir. 1966)). But see Lloyd v. Murphy, 25 Cal. 2d 48, 153 P.2d 47 (1944), in which Chief Justice Traynor reflected: "If it was foreseeable there should have been provision for it in the contract, and the absence of such a provision gives rise to the inference that the risk was assumed." Id. at 54, 153 P.2d at 50.
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term also does not require that strict performance be ordered. The purchaser may have been equally able to anticipate the risk of inflation and equally capable of taking precautions against its harmful effects through business planning, self-insurance, or market insurance.48

Contract modification is often inappropriate in cases involving low-volume, short-term contracts in which the parties can plan their affairs on the basis of known risks having ascertainable effects on performance.49 Modification is far more justifiable, however, when interdependent parties have bound themselves for a long period of time to perform in a market that is relatively closed to alternatives.50

49. In such cases, neither party stands to suffer significantly because the volume of the transaction is presumably low. Nor are the interests of the community at large likely to be harmed by either enforcement or termination of the transaction because the goods and services involved usually will be readily available elsewhere. Absent a continuing relationship between the parties, altering the short-term contract would usually be fruitless. See MacNeil, Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law, 72 Nw. U.L. REV. 854, 902 (1978) [hereinafter cited as MacNeil, Economic Relations]; see also MacNeil, Economic Analysis of Contractual Relations, 75 Nw. U. L. REV. 1018, 1027-28 (1981); MacNeil, Power, Contract and the Economic Model, 14 J. Econ. Issues 909, 912 (1980).

Professor Ian R. MacNeil suggests that a distinction be drawn between "transactional" and "relational" business ventures. Whereas "transactional" ventures involve "simple, monetizable economic exchanges," "relational" ventures introduce "complex personal-noneconomic satisfactions." MacNeil, Economic Relations, supra, at 902. "Transactional" ventures involve distinctly short-term agreements that are clearly and succinctly expressed. "Relational" ventures, on the other hand, involve continuous long-term relations that often are not fully articulated and need to be revised periodically. Id. at 903. The all-or-nothing approach of the classical law of impossibility clearly resembles "transactional" ventures. The parties are presumed to enter into clearly defined and short-term arrangements in which their performance obligations are succinctly allocated by contract. Most importantly, if such obligations are not performed timely and completely, the transaction lapses. Courts should not attempt to reform such "discrete" transactions.

50. Whereas "discrete transactions" are conducted largely between market "strangers," "relational arrangements" give rise to associations among parties over extended periods of time. Contracts are used in such relationships to regulate performance, but their terms are modified by explicit agreement or by conduct over the course of the agreement period. "Relations" adapt to market change. They vary in accordance with the reciprocal good faith of the parties, and they affect and are affected by a community of dependent interests. Such "relationships" are also marked by a reluctance to seek or "find" every solution to the division of performance risks and losses in the contract itself.

For purposes of this analysis, the principle characteristics of long-term supply contracts may be summarized as (1) an assumption that ex ante plan-
A number of distinctive features of long-term agreements dictate avoidance of a mechanical application of the nonperformance doctrine. Long-term agreements often tend to be incomplete in their coverage because they must attempt to define obligations arising well into the future. Although the agreement may contain a price escalation index, that index might itself be inadequate to take account of actual postcontract inflation.51 The longer the period of time between contracting and performance, the greater is the likelihood that time alone will produce its own array of pricing risks.52 Moreover, neither party will be able to predict all of the potential risks that might develop during the life of the contract. The parties will view most risks as unlikely, and even if they do anticipate an intervening occurrence, they probably will not have appreciated the full impact of that occurrence upon their ability to perform.53

Even when partial responsibility for an intervening occurrence can be attributed to one party to a long-term contract, that party may not have been been able to avert the full effect of that occurrence. An energy supply contract, for example, may be disrupted by external events; the nature of the performance obligation may constantly change in character; and the effect of the disruption may be more disastrous than the supplier had anticipated at the time of contracting.54 In addi-

51. This was precisely the opinion of the court in Aluminum Co. of Am. v. Essex Group, Inc., 499 F. Supp. 53 (W.D. Pa. 1980): "A remedy modifying the price term of the contract in light of the circumstances which upset the price formula will better preserve the purposes and expectations of the parties than any other remedy. Such a remedy is essential to avoid injustice in this case." Id. at 79.


54. See generally authorities cited supra notes 4, 9 & 46.
tation, the parties, at the time of contracting, may have expected to share the burden of intervening losses not regulated by the contract. This is especially likely when neither party could be faulted for causing the loss and when the losses involved might otherwise lead to destruction of their long-term relationship. Termination of a long-term relationship without modification of the agreement also gives rise to dislocation and relocation costs. "Exit" and "start up" costs elsewhere add to the transaction costs that both parties usually must bear in reestablishing their supply relationships with others.55

Losses that occur when an all-or-nothing doctrine is applied to long-term supply contracts also may have significant spillover effects. Indirect parties to such agreements—employees, subcontractors, and agents, for example—may all benefit economically from a contract modification that avoids the imposition of undue economic hardship on a principal contractor on whom they are dependent for their income.56

The rigid formalism of the all-or-nothing approach to impracticability must be avoided in long-term contract cases if such functional agreements are to be encouraged in the future. In reformulating a long-term contract for the supply of alumina, the court in Aluminum Co. of America v. Essex Group, Inc.57 aptly noted:

If the law refused an appropriate remedy when a prudently drafted long term contract goes badly awry, the risks attending such contracts would increase. Prudent business people would avoid using this sensible business tool. Or they would needlessly suffer the delay and expense of ever more detailed and sophisticated drafting in an attempt to approximate by agreement what the law could readily furnish by general rule.58

C. INTERPARTY SETTLEMENT

The independent or judicially motivated adjustment of contract terms in continuous commercial relationships is a fundamental reality of modern business planning.59 Businesses are

55. See authorities cited supra note 46.
58. Id. at 89.
59. See L. Friedman, Contract Law in America, A Social and Economic Case Study 193-94 (1965); Beale & Dugdale, Contracts Between Businessmen: Planning and the Use of Contractual Remedies, 2 BRIT. J.L. & SOC'Y 45, 52-59 (1975); Friedman, The Impact of Large Scale Business Enterprise on Contract, 7 INT'L ENCYL. OF COMP. LAW 3, 9 (1973); Macaulay, Non-contractual
constantly rearranging their affairs, both for their own convenience and to maximize their relative share of market profits. This "good faith" adjustment of losses is especially likely to occur in industries in which the members select their trade partners on the basis of reciprocal need and where the parties develop commercial "understandings" as to the manner of regulating risks. The ability of contractors, for example, to agree on interim changes in the price or quantity of goods to be delivered reflects a realization that each of them will need to make and receive concessions from time to time in order to continue their association. Moreover, the parties will appreciate that a breakdown of trust between them may give rise to more than a terminated relationship. Goodwill may be lost, morale may be lowered, and the costs of cultivating alternative business associations are likely to increase. Indeed, the parties have a very real incentive to determine their own division of losses and thereby avoid the costs and risks associated with a judicially-imposed allocation of liability.

Courts often must rely on the parties to establish the nature and extent of losses and to determine the manner in which those losses should be apportioned. Interparty settlement is one means by which courts may place primary reliance on the parties. As authors of their own agreement, the disputants may be "employed" to resolve their own disagreements. To facili-
tate interparty settlement, the court may stay proceedings for a specified period of time to allow the parties the opportunity to allocate performance losses between themselves. Judges can formalize this agreement process by instructing the parties as to the manner of settlement or by appointing masters to supervise that settlement.

The parties, of course, have strong incentives to settle performance disputes on their own terms. Apart from the desire to avoid the cost of litigating the dispute, parties may realize that an adverse outcome could give rise to costs that outweigh the utility of continuing with the litigation itself or that private settlement may well be safer than risking an adverse judicial imposition of full liability. The disputants may wish to avoid litigation altogether; in many cases they may seek merely to demonstrate to other trading partners that they are making a "serious" claim. In such cases, the parties may be content to allocate nonperformance losses between themselves by interim agreement.

The success of loss-sharing by informal settlement in individual cases depends on the complexity of the dispute and on the willingness of the parties to engage in a good faith allocation of losses. Factors such as radical differences in the parties' required by trial, so they have an incentive to settle that diminishes as their "investment" in the trial increases. Interparty settlement, however, may be used at any stage of the proceedings.

Judicial support for interparty settlement, whether pretrial or thereafter, is borne out by the energy and inflation cases that followed the 1973 oil crisis. In Iowa Elec. Light & Power Co. v. Atlas Corp., 467 F. Supp. 129 (N.D. Iowa 1978), rev'd on other grounds, 603 F.2d 130 (8th Cir. 1979), cert. denied, 445 U.S. 911 (1980), for example, the district court took notice "of the number of voluntary price adjustments entered into by other suppliers and buyers of [uranium] yellowcake." Id. at 136. The district court noted further that "[v]oluntary attempts at reaching equitable agreements and foregoing expensive litigation should be encouraged." Id. In In re Westinghouse Elec. Corp. Uranium Contracts Litigation, No. 235 (E.D. Va. Oct. 27, 1978), Judge Mehrige, in a bench opinion, repeatedly stressed that the case "ought to end in settlement," emphasizing the "court's availability, willingness and eagerness to participate . . . in the settlement negotiations."

64. Litigation may indeed be costly, time consuming, and wasteful. For discussions of the massive litigation efforts involved in the Westinghouse uranium litigation, see Eagan, The Westinghouse Uranium Contracts: Commercial Impracticability and Related Matters, 18 Am. Bus. L.J. 281, 282-83 (1980); Joskow, supra note 9, at 113.

65. This is perhaps the most telling explanation for pretrial settlement of litigation. See generally M. Rosenberg, The Pretrial Conference and Effective Justice (1964); Clark, To an Understanding Use of Pre-trial, 29 F.R.D. 454 (1961); Clark, Objectives of Pre-trial Procedure, 17 Ohio St. L.J. 163 (1956); Pollock, Pretrial Conferences, 50 F.R.D. 451 (1970).
views or a substantial difference in bargaining power may dissuade courts from encouraging informal settlement. In determining whether to promote informal settlement, courts therefore should evaluate the ability of the parties to divide performance losses by their own means in light of probable transaction costs. In addition, courts should assess the extent to which different forms of judicial supervision may inhibit or promote the parties' own settlement efforts.

Interparty settlement may provide the most equitable means of allocating losses from nonperformance. The parties themselves are usually in a better position than courts to determine the extent to which they have each assumed, contractually or otherwise, particular business risks. Because they have a more immediate understanding of the nature and extent of their respective performance losses, the parties are also better able to decide the manner in which to allocate their performance losses inter se. In addition, informed settlements may protect the business reputations of commercial parties and foster their continuing business relationship.66

1. Judicial Supervision of Interparty Settlements

The judicial supervision of interparty settlement operates at two distinct levels. Courts may provide the parties with information to guide their loss allocation, or the court may prescribe the manner in which their settlement is to operate. Judicial supervision may be advisory, as when the court explains to the parties what they should do to reach settlement, or it may be prescriptive, as when the tribunal sets a method that the parties are obliged to follow. Judicial supervision may be institutionalized, for example, by appointing a special master to direct the settlement, or it may be relatively noninstitutionalized by permitting the parties to direct their own settlement process.

Settlement instructions to the parties may include preliminary rulings relevant to the controversy. Courts, for example, might delineate the elements of a total or a direct and proximate performance loss, or they may outline the constituent elements of the loss itself.67 In addition, courts may themselves

66. Implicit in this inquiry is an examination of the bargaining relationship that exists between the parties, the duration of their past association, and their potential for future interaction notwithstanding their immediate dispute.

67. Courts generally are willing to make such assessments. Those courts that have "assessed" performance losses, however, have tended to impose full
allocate potentially disputed risks. A court may rule, for instance, that a party is deemed to have foreseen particular risks or to have assumed foreseeable risks to a stipulated degree. Courts may also determine that a party could have avoided certain aspects of a risk by adopting precautionary measures or by mitigating the effect of the ensuing loss. The court then may direct the parties to reflect on the promisor’s failure to avoid that risk in dividing the resulting performance losses between them.

Settlement “instructions” given to the parties in matters affecting the public interest will often be subtle and indirect—the parties may be “advised” that increases in the prices of particular goods might result in substantial public harm. Under this approach, courts need not direct that the parties must settle or settle in a particular manner. Rather, emphasis should be placed on pointing up key factors that the parties should consider in reaching their allocation of performance losses.

Courts may also advise that an unwillingness on the part of one or both parties to settle in good faith or an attempt to subvert the process of settlement in bad faith will result in specified penalties. The seriousness of these penalties may range from a finding that the defaulting party must bear full responsibility for the loss to a judicial readjustment of losses adverse to the interests of the defaulting party.\(^\text{68}\)


\(^{68}\) The concept of “bad faith” in settlement is itself difficult to define in the abstract. An unwillingness to settle does not by definition constitute bad faith. Parties may avoid settling because they believe that their reasonable demands are not being met, or because they consider their trade partner’s demands unreasonable. Whether holding such beliefs represents a “good faith” reluctance to settle will depend upon the reasons underlying the belief, the course of prior dealings between the parties, and the trade practices of persons engaged in analogous types of negotiations and settlements. Evidence of “bad faith” in settlement might consist of a persistent refusal to negotiate, an unwillingness to make any offer of contribution toward the loss, or an outright rejection of all offers presented by an opponent. For discussions of the limits of good faith in adjusting contractual obligations, see Hillman, Policing Contractual Modifications Under the U.C.C: Good Faith and the Doctrine of Economic Duress, 64 IOWA L. REV. 849, 880-90 (1979); Muris, Opportunistic Behavior and the Law of Contracts, 65 MINN. L. REV. 521, 552-72 (1981).
directions to the parties. Judicial "incentives" to settle do not assure private resolution. Contracting parties may still fail to reach accord for any number of reasons. Linguistic, cultural, or political barriers may impede prospects for settlement. Personal difficulties between the parties may reduce their effectiveness in negotiating. The parties may overstate their demands or underestimate their opponent's expectations, and neither party may be willing to make necessary concessions.69 Instructions to the parties as to the division of performance losses, however, can be fashioned to reduce the potential for conflict in settlement negotiations. For example, the court may identify particular disputed issues such as the total amount of loss or the extent to which each party foresaw the risk of disruption, and it may then direct the parties as to the manner of resolving their dispute.

The appointment of a special master may be the best device for resolution of such interparty settlement disagreements. Special masters may be able to facilitate loss-sharing negotiations70 when one or both of the parties are willing to negotiate a loss-sharing formula but reach a point of deadlock, or when one or both parties are unwilling to discuss settlement without the institutionalized supervision of a court. The special master can be required to report to the court on the progress of the negotiations, on the difficulties encountered during the course of those negotiations, and on the methods the master employed to overcome those difficulties.71 The special master may also examine evidence relevant to the risk, assess the nature of the

69. On the "strategy" of bargaining as it affects negotiations and settlements, see Schelling, An Essay on Bargaining, 46 AM. ECON. REV. 281 (1956); see also V. Aubert, Elements of Sociology 133 (1967); Eckhoff, The Mediator, the Judge and the Administrator in Conflict-Resolution, 10 ACTA SOCIOLOGICA 148 (1967).

70. Special masters have been appointed in several energy-related cases to oversee negotiations and settlements. See Wall St. J., June 2, 1978, at 3, col. 1 (reporting appointment of special masters in Westinghouse uranium contract litigation). The apparent success of the recent "Agent Orange" settlement was attributed in some measure to the quality and skill of the appointed masters. See Flaherty & Lauder, Inside Agent Orange, The 11th Hour Talks That Almost Failed, 6 Nat'l L.J. 1 (no. 37, 1984).


71. See FED. R. CIV. P. 53(c), (e).
loss, and propose a loss-sharing formula.\textsuperscript{72}

Although the appointment of a master does not ensure a successful division of losses by extrajudicial settlement in all cases,\textsuperscript{73} the use of special masters has proven especially effective in achieving settlements in certain identifiable categories of commercial impracticability. In cases involving difficulties in computing the division of losses, special masters with accounting expertise can help the parties arrive at a compromise figure. For example, an energy supplier seeking relief from its contract because of an increase in the cost of performance may produce accounting data to confirm the alleged economic loss. That data, however, may reflect the artificial book value of a loss or the improper depreciation of an asset. Such contrivances may escape the attention of the ordinary court, but they are more readily uncovered by expert special masters.

Interparty negotiations concerning the sharing of losses often require complex damage calculations in which the notions of fault, injury, and loss are inextricably interwoven.\textsuperscript{74} The


\textsuperscript{73} Not all courts perceive the appointment of a special master as a useful practice. One court has observed that “more respect for the judgment of the court arise[s] when the trial is by the judge.” Adventures In Good Eating, Inc. v. Best Places To Eat, Inc., 131 F.2d 809, 815 (7th Cir. 1942); see also La Buy v. Howes Leather Co., 352 U.S. 249, 256 (1957) (noting inefficient and excessive use of special masters); Cheramie v. Orgeron, 434 F.2d 721, 722 (5th Cir. 1970) (recalculation of damages necessary on remand because of master’s error).

\textsuperscript{74} See La Buy v. Howes Leather Co., 352 U.S. 249, 259 (1957) (circumstances may warrant reference of detailed accounting to master); Crateo, Inc. v. Intermark, Inc., 536 F.2d 862, 868 (9th Cir.), cert. denied, 429 U.S. 896 (1976) (use of special master to untangle complicated financial matters); Biechele v.
master's expertise may be especially useful in distinguishing direct from indirect damages and proximate from remote losses. For example, disputes over increased costs of energy sources in an inflationary era may reflect "exceptional conditions" warranting the appointment of a special master. A qualified master often may be better-equipped than courts to address such complex issues as producer and consumer dependence on energy or the availability of substitute sources of supply.

The appointment of a master, however, carries its own set of particular risks. The master's ability to divide losses competently between the parties depends on more than the master's expertise as an accountant, economist, or lawyer. The master must also appreciate the dynamics that surround the settlement process—the relationship between the parties, the nature of their dispute, and the likely effect that the appointment will have on their chances for settlement. The appointment of a special master may itself impede interparty settlement and cause delays, but this risk is not inherent in the appointment itself. The ability of the master to motivate the parties toward a consensual resolution of their dispute depends more on the terms of appointment and the abilities of the individual master than on any inherent strengths or weaknesses in the appointment process itself.

2. The Final Offer Rule

The final offer rule, a decision-making device seldom employed by courts, provides a potentially useful tool for loss allocation in both contract and tort cases.75 Final offers have been employed by professional sports negotiators to resolve salary conflicts and the procedure is in noticeable use in labor arbitra-


tion matters. Final offer arbitration in judicial proceedings may begin with the court's request to the parties to enter into negotiations, with or without a supervising master. At the end of these negotiations, each party decides the amount of its final offer as a contribution toward the total loss. The court may require that each final offer be supplemented by a statement explaining the reasons for the figures chosen. Once a party's final offer of contribution has been accepted by the court, the other party is held responsible to contribute the balance of the total loss. As a general rule, the decision maker is required to make an award on the basis of one of the two final offers submitted. The tribunal cannot reject both final offers, because to do so would presumably undermine the integrity of each party's contribution toward the loss. Conversely, by compelling the court to accept at least one of the "last offers," each party is given an incentive to avoid making a final offer that would be rejected by the court in favor of the more reasonable final offer tendered by the other party.

The last offer approach does present risks to the negotiating parties. First, there is the possibility that one or both of the parties may offer an unreasonably small amount. In such a case, the court would accept the more "reasonable" offer and thereby impose upon the lower offeror the balance of the loss. As noted above, however, the parties' awareness of this risk itself encourages the parties to make reasonable final offers. At the other extreme is the risk that each party, fearful of being held responsible for the bulk of the loss, will be tempted to second-guess the court and offer exactly what it believes the court


78. This risk in final offer arbitration is echoed repeatedly in the literature. See authorities cited supra notes 76-77.
will require that party to contribute. This risk is not harmful, however, so long as the parties anticipate that the court will make a rational and objective choice. Yet another risk may be that each party will make a mechanical offer to assume fifty percent of the loss. This risk, however, is counterbalanced by the realization that both parties will not invariably take this approach—one party may be risk averse whereas the other may be favorably disposed toward risk taking. Finally, one or both parties may decline to present a last offer of contribution to the loss at all. A party who fails to make any offer takes the chance that the court will accept the opposing party's last offer. If neither party presents a final offer, both parties assume the risk that the court will impose its own division of the loss upon them.79

Final offer resolution can be an effective means of implementing a loss sharing scheme, especially in long-term installment sales and supply agreements. Final offer arbitration would be most useful when both parties are sufficiently sophisticated to appreciate the economic risks and losses at issue and are able to identify the manner in which a tribunal would likely allocate responsibility for those risks and losses. The parties can then evaluate their positions realistically against the standards employed by courts.80 Final offer resolution may also tend to be more successful in situations that permit a number of possible solutions rather than a single all-or-nothing result. Parties faced with an all-or-nothing judicial allocation of loss have every incentive to embellish their claims in the hope of

79. Both parties likely will present final offers that they are able to substantiate in good faith when the risk of not making such offers leads to the court's adoption of an alternative offer of contribution. Parties who are required to present reasons for their final offers also would be discouraged from adopting a mechanical or arbitrary allocation of performance losses, because the court may expect them either to explain the nature and form of their proposed division of losses or risk the rejection of their final offer.

80. See Assembly Advisory Council on Public Employee Relations in California, Final Report 226 (March 15, 1973), quoted in Zack, supra note 75, at 577. It is interesting to note that in the baseball disputes resolved by final offer arbitration, baseball clubs have been far more successful than the players in having their final offers accepted by arbitrators. This phenomenon may be attributed in part to the superior sophistication and skill of clubs in predicting what arbitrators likely would accept as a last bid. There is no assurance, however, that such "gaps" in knowledge are necessarily lasting, especially given the increasing negotiating sophistication of players and their agents. See Fishman & Potter, Pinch-Hitting for Baseball's Present System—Impartial Arbitration as a Method of Dispute Resolution, 14 U.C.D. L. REV. 691, 707 n.100 (1981).
being the winner who takes all. Conversely, parties who expect to share in the loss are more likely to make final offers along a spectrum of possibilities because they have alternative offers of contribution from which to choose.

The final offer technique also is likely to be more efficient than judicial allocation of performance losses in multi-issue disputes. Courts often lack the information necessary to identify and balance complex performance losses. The parties themselves, on the other hand, frequently are able to base their last offers on a calculated assessment of and a conciliation among interrelated commercial concerns that lie outside the judicial purview. Undoubtedly, allocation of loss by final offer resolution may encourage undesirable gamesmanship. Judges may also consider themselves “confronted with two unpalatable last best offers.” These criticisms, however, are directed to the method of final offer dispute resolution, not to the concept of final offer arbitration itself. In adopting the final offer approach, the court does not delegate decision-making power to the parties; it merely permits the parties to act as advocates for their own preferred methods of loss allocation. The division of loss ultimately chosen is one that the court itself makes on the basis of the competing offers presented by the parties.

Although judges often are reluctant to adjust losses themselves, they are nevertheless capable of recognizing unrealistic and exaggerated last offers, and they may require the parties to give reasons for their final offers or to seek the assistance of expert assessors. Moreover, when the final offer method is invoked, the judge is not forced to “remake” the parties’ contract through a process of judicial conjecture or ex post speculation as to how the parties might have allocated the risk of loss had they contemplated that risk at the time of contracting. Instead, the final offer rule encourages the parties to present their own

82. See Weitzman & Stochaj, supra note 77, at 27.
83. Id. This critical position is sometimes forcefully advocated: “[Final offer arbitration] is the hydrogen bomb poised above the bargaining table whose very terror should assure its nonuse.” ASSEMBLY ADVISORY COUNCIL ON PUB. RELATIONS IN CALIFORNIA, FINAL REPORT 226 (March 15, 1973), quoted in Zack, supra note 75, at 577.
84. Final offer arbitration is usually construed as a pretrial procedure that may avoid the need for a trial. A jury trial, however, is still constitutionally guaranteed. See Note, supra note 81, at 537.
proposed allocation of loss for the court to apply.\textsuperscript{85}

D. JUDICIAL ADJUSTMENTS OF PERFORMANCE LOSSES

1. Methods of Judicial Adjustments

Not even the most conscientiously conducted or supervised negotiations always result in settlement. Judicial allocation of performance losses is therefore inevitable in some cases. When the parties are unlikely to reach a mutually agreeable settlement, or when the court considers itself better able than the parties to divide the loss, the court should take it upon itself to adjust performance losses.\textsuperscript{86} In addition, when the court is unable to facilitate a settlement through the use of a special master or by application of the final offer rule, it should order a loss-sharing arrangement between the parties. Judicial loss-sharing arrangements also should be imposed when the parties are unlikely to maintain a harmonious and ongoing relationship in their own settlement negotiations.\textsuperscript{87}

Once judicial adjustment becomes necessary, the court must determine how it should go about dividing performance losses between the parties. One approach is to adjust perform-

\textsuperscript{85} See supra text accompanying notes 13-24. A judge who invites competing offers of contribution does not delegate decision-making power. Ultimately the court, not the individual contractor, decides whether to adopt the final offer method, how to institute that method, and what weight to attach to each last offer. In this way, the court combines its roles as mediator and adjudicator.

\textsuperscript{86} The utility of a judicial allocation of performance losses depends in large part on the nature of the parties’ relationship, the complexity of the transaction in issue, and the extent of the loss sustained. For example, courts may need to adjust losses in situations in which one party is able to employ its superior position to secure an unconscionable adjustment in performance if the judicial supervision of the settlement process is unlikely to alter such a result. Superior bargaining power alone, however, is not sufficient to justify the displacement of interparty settlement. The Uniform Commercial Code properly emphasizes that “the principle [of unconscionability] is one of the prevention of oppression and unfair surprise . . . and not of disturbance of allocation of risks because of superior bargaining power.” U.C.C. § 2-302 comment 1.

\textsuperscript{87} The usefulness of judicial allocations of performance losses will also depend on such interpersonal factors as the degree of animosity or amicability existing between the parties and the extent to which both parties are willing to discuss their differences. A party may favor judicial adjustment because it hopes to do better by judgment than by settlement, because it mistrusts the other party’s willingness to negotiate a settlement, or because one or both of the parties mistrust the process of settlement. In these situations, a judicial adjustment of losses may be necessary even though settlement may be reasonably possible or even though the party refusing to settle may do so in bad faith. The court may impose a greater share of the loss upon a party whom it considers to be acting in “bad faith,” but it cannot decline to settle the matter.
ance losses only insofar as that adjustment is embodied in the contract itself or in the trade practices of the parties. Absent a price, quality, or quantity adjustment clause in the contract, the court, under this approach, would hold that the promisor assumed the risks of nonperformance. Any judicial adjustment of loss that extends beyond the confines of the agreement impairs the ex ante bargain and imposes an unjustifiable and inefficient ex post adjustment of losses upon the parties. 88 Had the parties wished their agreement to have been otherwise, they presumably would have written it to that effect. 89

This narrow view of adjustment assumes that the ex ante allocation of risk by the parties is the most efficient method of adjustment. It presupposes that those parties who do divide performance risks in their agreement do so with reasonable knowledge of the nature and extent of the contemplated risks. Ex ante efficiency, however, may tend to diminish when unanticipated risks materialize after the date of contracting, when transaction costs have expanded significantly, or when the costs of interparty settlement exceed the benefit of maintaining a continued relationship. The inability of the parties to agree later on an adjustment of losses may itself demonstrate that they did not reasonably contemplate that risk of loss in their ex ante allocation of performance risks. The risk of inflated costs of production, for example, may have been anticipated at the time of contracting—both parties may have bargained over whether to “cover” such a contingency—but neither party may have considered cost inflation to be a significant risk, and

88 See Speidel, supra note 3, at 393-94. Professor Richard E. Speidel contends that “the judicial readjustment of so-called ‘undeserved’ gains and losses [those not allocated by contract] has a ‘zero sum’ quality.” The effect will be to “redistribute without generating new wealth.” See id. at 393. “[S]ince the reallocation is not based upon a voluntary transaction,” Speidel states, “there is no presumption that a net increase in efficiency will result.” Id. at 394.

89 In Iowa Elec. Light & Power Co. v. Atlas Corp., 467 F. Supp. 129 (N.D. Iowa 1978), rev’d on other grounds, 603 F.2d 1301 (8th Cir. 1979), cert. denied, 445 U.S. 911 (1980), the district court, discussing U.C.C. § 2-209, observed: “That section contemplates modification emanating from ‘good faith’ bargaining between merchants. . . . It does not undertake to give the court a role in imposing an adjustment.” Id. at 139. In Aluminum Co. of Am. v. Essex Group, Inc., 499 F. Supp. 53 (W.D. Pa. 1980), the court commented that “[j]udges are seldom able businessmen; they seldom have the information, ability, or time to do a good job of contracting for the parties.” Id. at 91. The court, however, also stated that “[t]he parties may be better served by an informed judicial decision based on known circumstances than by a decision wrenched from words of the contract which were not chosen with a prevision of today’s circumstances.” Id.
neither may have appreciated fully its degree of devastation.\textsuperscript{90} Alternatively, both parties may have allocated performance risks efficiently at the time of contracting, but that allocation may become economically inefficient when market dynamics have altered the context that surrounded their bargain.\textsuperscript{91}

An alternative method of loss allocation would be to divide performance losses on the basis of the relative ability of each party to sustain the loss. Under this approach, a court faced with an impracticability case arising out of the 1956 Suez Canal blockage, for example, would have required the party who was better able to incur the added expense of shipping goods via the Cape of Good Hope to assume the greater proportion of the loss resulting from the blockade. This determination, however, is not always evident. One commentator on the Suez cases suggested that the buyer, not the seller, should have assumed the bulk of the losses because the blockage caused the goods affected to become more scarce, resulting in an increase in the price of the goods at the place of delivery. The buyers, therefore, could have resold the goods at inflated prices.\textsuperscript{92} The increase in market price at a particular place of delivery, however, does \textit{not} mean necessarily that \textit{all} buyers benefit from a delay in delivery. Buyers often face severe transaction costs precisely because there is a delay in delivery—sub-purchasers may cancel orders or sue buyers for nondelivery, and buyers may have no readily accessible alternative source of goods to sell at the inflated ex post prices.\textsuperscript{93} Moreover, in a competitive market the supplier’s nonperformance may not provide the promisee-buyer with a more highly valued commodity because the nonperformance of a single supplier will not alter seriously either market supply or market demand.\textsuperscript{94}

\textsuperscript{90} See supra notes 50-53 and accompanying text. Speidel, a strong proponent of interparty loss allocation, nevertheless admits that interparty settlement is suspect when “at the time of contracting [there is] inadequate information about the future.” See Speidel, supra note 3, at 398.


\textsuperscript{92} See Birmingham, supra note 31, at 1412-15.

\textsuperscript{93} Whether a particular buyer has faced these problems is inevitably a question of fact; however, to assume that buyers generally are able to offset short supplies with readily available substitutes and then resell the latter for a profit in the marketplace is too general an assumption to be imputed to a heterogeneous body of buyers and sellers engaged in conventional trade.

\textsuperscript{94} For discussions of the effects of perfect and imperfect market competi-
The premise that loss sharing should be based entirely on which party happens to be better able to bear the financial burden of a loss is itself questionable. The ability of a party to sustain a loss must be balanced in the first instance against that party's ability to prevent the loss from occurring at all. To maintain otherwise would be to discourage parties from taking precautions against the disruption of their performance.

In allocating performance losses, a court may seek to determine the ability of each party to foresee and plan for the risk of loss. One commentator has proposed that in situations involving "archetypical" contracts, the promisor should be assumed to have had significant control over most performance risks. The failure of such a promisor to manage those risks properly would result in its primary responsibility for ensuing losses. Conversely, in situations involving "nonarchetypical" contracts, the promisor is presumed to lack such risk awareness and bargaining skill and should therefore be less responsible for mismanaging the risk of performance loss. The problem with this proposal, however, is that parties to archetypical contracts, even if such contracts can be identified and neatly classified as "archetypical," are unlikely to be uniformly capable of managing their own performance risks. An energy supplier who is highly sophisticated in risk management, for example, may be only partially capable of managing the risk of any number of unforeseen contingencies, such as sudden oil embargoes or accelerations in the rate of inflation. The justification for any method of loss sharing ultimately must be founded on more than the mere stereotypical characterization of the parties' agreement.

One solution is to require that both parties share equally in performance losses when neither party could have avoided either the occurrence of those losses or their harmful consequences. This fifty-fifty loss sharing principle has been advocated as a possible statutory formula for loss allocation on the assumption that "only innocent parties will bear losses result-

95. Schlegel, supra note 4, at 447-48. Professor John H. Schlegel postulates that "contracts should be enforced only when the contract . . . is essentially similar to the archetypical contract . . . between brokers." Id. at 447. In nonarchetypical contracts, on the other hand, "essential reliance damages . . . as well as the costs of any partial performance should be split between the parties." Id.
ing from a contract discharged as burdensome, and . . . equitable considerations. . . . suggest that at least some . . . losses . . . should be evenly shared." This proposal, however, has several weaknesses. It provides an inflexible middle line, operating between the two extremes of all or nothing. Although perhaps more equitable than the approaches considered previously, this approach fails to provide a rational framework for loss allocation. The basic assumption that both parties are equally "innocent" in causing the loss is itself suspect. Contractors who are "risk managers" usually should assume a greater share of responsibility for the "managed" risk of harm, even though the source of that harm may have been beyond their "control." A purchaser and a supplier, for example, are not equally "innocent" when the supplier was primarily responsible for planning for the inflation risk by stockpiling inventories, diversifying sources of supply, or altering production techniques. Parties who are not equally innocent should not be required to bear an equal share of performance losses.

Allocating losses in a manner that the court deems "just and reasonable" avoids the mechanical features of an equal loss split. Such an approach, however, leaves unanswered two fundamental questions: what is a "just and reasonable" allocation of losses, and what methodology should guide the judge in making that determination? The United Kingdom's Law Reform (Frustrated Contracts) Act provides only limited guidance. Under that Act, the court is empowered to divide down payments made and expenses incurred by each of the parties prior to frustration if the court considers it "just to do so having regard to all the circumstances of the case." Particular circumstances that the court may consider are "the amount of any expenses incurred before the time of discharge by the benefited party" and "the effect, in relation to the said benefit, of the circumstances giving rise to the frustration of the contract." How these "circumstances" are to be evaluated and what effect they are to have in light of "all the circumstances of the case" is left for the judge to decide. Because of the absence of meaningful guidelines as to what constitutes a "just and reasonable" division of losses, courts in the United Kingdom have

96. Comment, supra note 37, at 1058-59; see also Comment, Loss Splitting in Contract Litigation, 18 U. Chi. L. Rev. 153 (1950).
97. See supra notes 36-37.
98. 6 & 7 Geo. IV, c. 40, §§ 1(2), (3) (1943).
99. Id. §§ 1(3)(a), (b).
100. Id. § 1(3).
made little use of the Act.101

American courts face similar problems in establishing a "just" distribution of performance losses. The parties could, for example, be required to share only in their reliance expenses or, alternatively, they could be ordered to split their expectation losses.102 American courts have tended to favor the reliance expenses approach;103 however, the reliance notion itself may be comparatively valueless when the subject matter of the contract has been destroyed, as when a ship carrying the goods has sunk, or when the goods or services have diminished in value in times of recession. Moreover, dividing only reliance expenses often is inadequate because it fails to recompense the parties for their capital expenditures. A purchaser of uranium, for example, may incur considerable capital improvement costs in expectation of continuous supplies of uranium from a particular supplier. These costs increase when the purchaser is unable to adapt the capital expenditures to alternative uses.104 Furthermore, merely restoring the parties to the positions they would have occupied had there been no contract may undermine the parties' ongoing association.105 Commercial contractors often are more concerned with maintaining than with


103. Courts frequently emphasize that the sharing of reliance losses is necessary to avoid unjust enrichment. See Transatlantic Fin. Corp. v. United States, 363 F.2d 312, 320 (D.C. Cir. 1966) ("If the performance rendered has value, recovery in quantum meruit for the entire performance is proper."). In Aluminum Co. of Am. v. Essex Group, Inc., 499 F. Supp. 53 (W.D. Pa. 1980), the court, commenting on McMahan v. Terkhorn, 67 Ind. App. 501, 116 N.E. 327 (1917), observed that "][i]n a fully executed contract, a price adjustment was necessary to protect the fair expectation of the parties and to prevent unjust enrichment." 499 F. Supp. at 79; see also RESTATEMENT (SECOND) OF CONTRACTS § 261 (1981); RESTATEMENT (SECOND) OF CONTRACTS introductory note, at 43-44 (Tent. Draft No. 9, 1974) ("In some cases a party who has already partly performed is entitled to recovery for what he has done under the rule on part performances as agreed equivalents. . . . Even where this is not so, relief may be available in the form of a claim for restitution or expenses incurred in reliance on the contract . . . ").


105. This is especially the case in so-called "relational" business ventures. See supra notes 49-50.
terminating their obligations notwithstanding performance disruptions.

2. A New Methodology

Each of the loss-sharing methods considered previously has at least some strengths. Mechanical methods of loss sharing, such as equal apportionment of performance losses, provide certainty of result. Loss sharing based on judicial discretion promotes flexibility both in method and result. Dividing losses on the basis of each party's relative fault in causing the loss or injury arising from the disruption takes account of the degree of fault or injury involved in the dispute. Yet no one method of loss sharing satisfies the needs of every case; each method focuses only upon one relevant consideration in the allocation of performance losses. This section proposes a general methodology for the allocation of performance risks and ensuing losses between contractors.106

As a general principle, each party should assume responsibility only for that proportion of performance risks and ensuing losses that are within its "control." This general principle requires that each party take precautions against those risks asso-

106. The following sets out the framework of principles on which the proposed methodology is founded:

1. A party assumes responsibility for that proportion of performance risks and ensuing losses that are within that party's "control."
   a. "Control" over performance arises when a contractor, through self-management or insurance, is better able than a co-contractor (1) to contemplate both the advent of the risk that intervened and its probable effect upon performance, and (2) to avert or mitigate the performance losses produced by that performance risk.
   b. The proportions in which each party shares in performance losses shall be adjusted further so that a greater proportion of the loss under principle 1 above is imposed upon (1) a party who in the opinion of the court and on a reasoned assessment of the evidence has failed to provide a cocontractor with adequate notice or other assistance necessary for the fulfillment of their respective performance obligations; (2) a party who in the opinion of the court and on an examination of the party's conduct has demonstrated bad faith in settling or in declining to settle, and (3) a party whose assumption of the risk of loss will, on a study of competing social interests, likely minimize public harm and maximize economic efficiency.

2. In calculating each party's proportionate responsibility for the loss, the court shall evaluate the type of parties, contract, and dispute in issue, emphasizing in particular the "transactional" or "relational" character of the agreement, the source of disagreement between the parties, and the likely effect of the court's allocation of performance losses upon future interparty relations.
ciated with its performance. The supplier usually assumes responsibility for supply-related risks, and the purchaser normally assumes responsibility for purchase-related risks. A seller in a supply contract would be expected to manage production problems because it is often in a position to streamline factory operations, to maintain efficiency in production, and to procure production insurance. The purchaser is similarly expected to manage such purchase-related risks as the inability to pay for the goods on delivery, because the purchaser should have secured credit or insurance to ensure payment.

Application of this general principle results in fair and economically sensible decisions in most cases. In the commercial context, the promisor-supplier typically will be the superior risk bearer because performance disruptions usually are caused by a dislocation of supplies. Assigning the risk of nonperformance to the promisor-supplier can be expected to yield satisfactory results. An energy purchaser, in contrast, cannot fairly or economically be expected to manage its supplier's workforce or production facility. Such activities are more suitably reserved to the supplier. Similarly, an energy supplier is usually better able than a purchaser to provide for inflation in the cost of supplies by stockpiling energy reserves, by negotiating substitute supply contracts, or by canvassing alternative energy producers. Conversely, an energy purchaser can be expected to manage such purchase-related risks as the inability to sell the goods ordered to third parties at the inflated price and the incapacity to diversify capital costs incurred as a result.


108. Risk insurance has been relied on heavily by suppliers faced with political and economic risks. See Uttal, Life is Getting Scary in the Oil Markets, FORTUNE, Jan. 28, 1980, at 54, 56.


110. Assigning the risk to the promisor-supplier also may be justified by the fact that promisees generally are unable to manage risks that are within the promisor's reasonable control. Professor Paul L. Joskow suggests that "[t]o provide otherwise might lead to an increase in opportunistic behavior or encourage inefficient risk-taking behavior on the part of the promisor." Joskow, supra note 9, at 135.
of cost inflation. In cases in which a promisor-supplier is not the superior risk bearer, the general principle may be rebutted.

The rebuttable presumption that promisors are usually better able than promisees to manage their own performance risks is widely canvassed in judicial opinions. For example, in *Transatlantic Financing Corp. v. United States*, the court required the shipper to assume the risk of transporting wheat from the United States to Iran, notwithstanding the blockage of the Suez Canal in 1956:

> [I]t is more reasonable to expect owner-operators of vessels [rather than their customers] to insure against the hazards of war. They are in the best position to calculate the cost of performance by alternative routes (and therefore to estimate the amount of insurance required).

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111. The risk that purchasers will incur extensive expectation costs is especially evident when purchasers under long-term contracts design their facilities around the products of their particular suppliers. Such situations are not unlikely in an age in which commercial interdependence stems from a need for technological compatibility. See generally cases cited supra note 67.

112. Many performance losses caused by intervening events arise without the fault of the promisor, yet the promisor still may be held responsible for the ensuing loss. For example, in *Jennie-O Foods, Inc. v. United States*, 580 F.2d 400, 410 (Ct. Cl. 1978), a supplier that failed to provide the United States with a promised flock of turkeys was denied an excuse from performance, notwithstanding the fact that its producer's supply of turkeys had been depleted by disease. The court reasoned that although the promisor did not cause the loss, it conceivably could have obtained turkeys from alternative sources of supply. The supplier was better able economically than the government to control the risk of shortages in supply. For cases reaching similar results, see *Luria Bros. & Co. v. Pielet Bros. Scrap Iron & Metal, Inc.*, 600 F.2d 103, 112 (7th Cir. 1979) (supplier failed to show unavailability of alternative sources of scrap iron supply); *Gulf Oil Corp. v. Federal Power Comm'n*, 563 F.2d 588, 601 (3d Cir. 1977), *cert. denied*, 434 U.S. 1062, *cert. dismissed*, 435 U.S. 911 (1978) (supplier's inability to acquire offshore oil leases does not excuse performance); *Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co.*, 508 F.2d 283, 294 (7th Cir. 1974) (no excuse when alternative supply available, albeit in excess of contract price); *Chemetron Corp. v. McLouth Steel Corp.*, 381 F. Supp. 245, 257 (N.D. Ill. 1974), *aff'd*, 522 F.2d 469 (7th Cir. 1975) (seller must employ any practicable alternative means to fulfill the contract); *Heat Exchangers, Inc. v. Map Constr. Corp.*, 34 Md. App. 679, 689-90, 368 A.2d 1088, 1094-95 (1977) (failure of seller to deliver not excused by inability to obtain component parts from suppliers); *Center Garment Co. v. United Refrigerator Co.*, 369 Mass. 633, 637-38, 341 N.E.2d 669, 672-73 (1976) (promisor not excused from contract to supply acetate after its supplier failed to perform); *Canadian Indus. Alcohol Co. v. Dunbar Molasses Co.*, 258 N.Y. 194, 199-200, 179 N.E. 383, 384-85 (1932) (molasses supplier not excused by refinery's inability to fill its order); *Deardorff-Jackson Co. v. National Produce Distrib., Inc.* 4 U.C.C. Rep. Serv. (Callaghan) 1164, 1166-67 (U.S. Dep't Agric. 1967) (seller of potatoes not excused when it failed to take adequate steps to ensure its source of supply would not fail).

113. 363 F.2d 312 (D.C. Cir. 1966).
and are undoubtedly sensitive to international troubles which
uniquely affect the demand for and cost of their services.  

Several practical reasons dictate that promisors ordinarily
should be deemed to be the managers of their own perform-
ances. As the Transatlantic court noted, the promisor typically
is better able to avert the intervening harm because it has
greater access than the promisee to information about the po-
tential disruption. The energy seller in a long-term supply con-
tract generally has greater "access" than the promisee to
information concerning such supply-related risks as labor un-
rest, shortages of raw materials, and the shutdown of oil refin-
eries. Unlike the supplier in Transatlantic, a promisor may
provide for an adjustment of performance losses in the contract
itself. In such cases, courts will likely hold that if other disrup-
tive circumstances do arise, the promisor is nonetheless obli-
gated to perform without adjustment. A contractor who
undertakes to perform subject to specified conditions is nor-

The general principle that parties should be responsible for
risks within their control seeks to encourage promisors to exer-
cise sound risk management. Courts, of course, should not
lightly excuse performance obligations. To substantially relieve
suppliers from their responsibility to perform is to discourage
those suppliers from addressing risk contingencies such as price
hikes and supply shortages. To excuse by law the party who

114. Id. at 319.  
Iowa 1978), rev'd on other grounds, 603 F.2d 1301 (8th Cir. 1979), cert denied,
445 U.S. 911 (1980), the court declined to excuse defendant Atlas from a ura-
nium supply contract, stating:
It would be unfair to expect Atlas to have prophesied the magnitude
of the increases complained of, but it is not clear that it was not in a
position to protect itself contractually from some of the risks which
would drive the price of yellowcake [uranium] up and consequently
affect the cost of production.  
Id. at 135; see also cases cited supra note 67.  
116. The promisor should not, however, be required to bear the risk of loss
when the parties' prior course of dealing or the commercial usage in the trade
require otherwise and when the "contemplation" or "mitigation" tests that de-


117. See cases cited infra note 112.  
118. Encouraging supplier foresight is a major policy concern underlying
is better able to manage performance risks also would likely increase potential transaction costs because parties faced with such judicial "modifications" of their contracts will seek to reformulate conditions of performance in future transactions to resurrect their status quo.\(^{119}\) Application of the proposed general principle should avoid this future reformulation.

In applying the general principle, courts should define control with reference to the ability of each party to contemplate the possibility and effects of an intervening risk. Contemplation of a risk of harm, however, does not serve as the sole determinant of a contractor's ability to "control" performance.\(^{120}\) A contractor may foresee a war, a storm, or spiralling inflation and yet still be unable to provide adequately for that contingency by contract. As the Transatlantic court noted, "Parties to a contract are not always able to provide for all the possibilities of which they are aware, sometimes because they cannot agree, often simply because they are too busy."\(^{121}\) Even the most experienced contracting parties will not foresee all of the possible contingencies that may develop, and those that are anticipated may be addressed in the contract only selectively or, even worse, in the unclear terms that often result from

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the development of the "assumption of risk" doctrine in relation to performance. See supra note 13 and cases cited supra notes 17-18.

119. See Joskow, supra note 9, at 156-57.

120. Regrettably, a substantial body of case law holds that the promisor's ability to foresee disruptions in performance constitutes prima facie evidence of an ability to "control" the risk. See, e.g., Iowa Elec. Light & Power Co. v. Atlas Corp., 467 F. Supp. 129, 134-35 (N.D. Iowa 1978), rev'd on other grounds, 603 F.2d 1301 (8th Cir. 1979); Eastern Air Lines, Inc. v. Gulf Oil Corp., 415 F. Supp. 429, 441-42 (S.D. Fla. 1975); Lloyd v. Murphy, 25 Cal. 2d 48, 54-56, 153 P.2d 47, 50-51 (1944); Missouri Pub. Serv. Co. v. Peabody Coal Co., 583 S.W.2d 721, 725-28 (Mo. Ct. App.), cert. denied, 444 U.S. 865 (1979). The extent to which a lack of foresight is required for relief under the UCC is unclear. Comment 4 to § 2-615 requires the presence of "some unforeseen contingency which alters the essential nature of the performance." Comment 8 to § 2-615 notes that before relief from performance will be denied, the contingency causing the increased burden should be sufficiently foreseeable "to be included among the business risks which are fairly to be regarded as part of the dickered terms" of the agreement. Comment 4 appears to elevate foresight to an essential component in determining whether the "essential nature of performance" has been altered, whereas comment 8 identifies foresight with the "dickered terms" of the contract. Both of these postulations arguably overstate the role of a contemplation test. See infra text accompanying notes 126-28; see also Glenn R. Sewell Sheet Metal, Inc. v. Loverde, 70 Cal. 2d 666, 676-77 n.13, 451 P.2d 721, 728 n.13, 75 Cal. Rptr. 889, 896 n.13 (1969) ("[T]he question whether a risk was foreseeable is quite distinct from the question whether it was contemplated by the parties.").

121. 363 F.2d at 318.
A contractor's anticipation of an intervening risk does not require that it necessarily take responsibility for its occurrence. As the Transatlantic court noted, "that some abnormal risk was contemplated is probative but does not necessarily establish an allocation of the risk of the contingency which actually occurs." A promisor may foresee a risk as a vague possibility, not as a probability, and it may not contemplate the extent of the injury actually caused by that contingency.

Even a party who foresees harm does not necessarily have a superior capacity to avoid that harm. The other party may be equally capable of foreseeing the risk of harm and be better able to avert its consequences. A domestic exporter of an indigenous product, for example, will usually have greater access to information concerning the contemplated suspension or denial of an export license, but a foreign importer may have equal or even greater access to such information. Foreign buyers often have had prior dealings with authorities at the place of exportation and sometimes have agents or brokers who operate within that locale. In such a case, courts may properly adjust the performance responsibility of the parties in accordance with their respective abilities to foresee and avert the risk of loss. In this way, the promisor will not be deemed to be exclusively responsible for managing the risk of nonperformance; rather, management responsibilities will be shared.

The prior occurrence of a particular risk also should not be
sufficient by itself to charge a party with knowledge of the recurrence of that risk or its severity. The fact that spiralling inflation has occurred in the past does not by itself suggest that either party should be able to anticipate future periods of inflation or the severity of inflation if it does recur. A prior disruption indicates only that one or both parties conceivably could have anticipated that a similar disruption might intervene and might hinder performance to an unspecified extent at some future date. Responsibility for the cost of such a devastation should not necessarily flow from hindsight. Moreover, a contractor may foresee a risk and yet be powerless to "control" either its occurrence or its harmful effects. Indeed, both parties may foresee the risk of loss and have an equal opportunity to insure against its occurrence. In each case, foresight is not determinative of the ability to control and must not be permitted to prescribe the relative performance responsibilities of the parties.

The use of a "contemplation test" for determining control is derived from the notion that anticipation of a performance risk may, but need not, indicate that a party is reasonably able to control that risk. It also involves a relative inquiry by courts into what the parties actually did contemplate. Contractors may anticipate that certain risks are more or less "likely" to occur. They may also view particular performance losses as more or less "probable." Thus, each party's performance responsibility is likely to increase in proportion to its contemplation of the risk of harm. The greater a contractor's foresight, the greater is the probability that it will assume a larger proportion of responsibility for the resulting loss.126 Where both parties are found to have contemplated the risk and ensuing harm, the contemplation test permits courts to charge both parties with a duty to exercise reasonable control over that performance risk. The court may then allocate the loss in proportion to the parties' relative ability to control the risk.127


127. For example, in Aluminum Co. of Am. v. Essex Group, Inc., 499 F. Supp. 53 (W.D. Pa. 1980), the court found that both parties "had every reason to predict that the likely range of variation [in the objective price index] would not exceed three cents per pound [of aluminum] . . . . Both consciously un-
The contemplation test does introduce difficulties in establishing the extent to which the parties were aware of the risk at the time of contracting.\textsuperscript{128} This is not a serious obstacle, however, so long as the test is confined by an objective standard of probable awareness. Courts may properly focus on what the parties did contemplate or \textit{reasonably should have} contemplated at the time of contracting in determining the proportion of the loss each party should be held to have actually assumed.

The contemplation test, as a means by which courts can define a party's "reasonable control" over performance risks and ensuing losses, is, however, incomplete. Courts should also include within the meaning of control the ability of each party to avert or mitigate the harmful effects of the risk on performance. A "mitigation test" would require that a party who was able to avert or mitigate the effects of a performance risk be held to have had control over that risk. It requires courts to identify the party who was better able to ascertain the nature of an intervening risk, to determine its probability of occurrence, and to appreciate its likely effect on performance. In addition, courts should determine which party was better able to avoid the consequences of the risk, through what means, and at what cost. Under the mitigation standard, a party thus is responsible for failing to take reasonable precautions to prevent a risk from materializing into a performance loss.\textsuperscript{129} A seller, for example, may be held responsible for failing to seek additional or alternative sources of supply in the event of a production shortfall or for failing to arrange for a modified means of delivery in the face of transportation impediments.\textsuperscript{130} On the other

\textsuperscript{128} Courts have attempted to determine what the parties reasonably could have foreseen. In Maple Farms, Inc. v. City School Dist., 76 Misc. 2d 1080, 352 N.Y.S.2d 784 (1974), for example, the court remarked: "We can reasonably assume that the plaintiff \textit{had to be aware} of escalating inflation. It is chargeable with knowledge of the substantial increase of the price of raw milk from the previous year's low." Id. at 1085, 352 N.Y.S.2d at 790 (emphasis added); see also \textit{supra} note 53 and accompanying text.

\textsuperscript{129} The duty to take precautions is a part of the continuing duty of cooperation that each party must fulfill in ongoing relationships. This is especially necessary when the parties are separated from one another by space and circumstance or when one party is better equipped than its trade partner to avoid disruptions in performance. See \textit{infra} text accompanying notes 133-36.

\textsuperscript{130} Courts often have held that sellers who do not secure alternative supplies in the face of supply shortages are responsible for failing to exercise control over the risk of loss. For example, in Canadian Indus. Alcohol Co. v. Dunbar Molasses Co., 238 N.Y. 194, 179 N.E. 383 (1932), the court refused to
hand, the buyer may be held responsible for failing to warn the seller of a performance obstacle known to the buyer that might undermine the buyer's performance. Thus, both parties may be responsible under this test. The promisor, although better able than the promisee to ascertain the nature and effect of an intervening performance risk, may not be better able than the promisee to avoid the harmful consequences of that risk. In such a case, the parties would share the loss in proportion to their relative capacities to avert both the risk and the harm.

The duty to exercise reasonable precautions in performance is especially evident in the energy cases. In Iowa Electric Light and Power Co. v. Atlas Corp.,131 for example, the district court refused to excuse Atlas from its obligations under its long-term, fixed-price contract to supply uranium. Finding that Atlas "was in the best position to protect itself from the vagaries of the marketplace and [was] obviously at least as able to bear the risk" as was the plaintiff, the court held Atlas fully liable for its nonperformance.132

The presumption that suppliers assume the full risk of nonperformance would be rebutted by a showing that the promisee-purchaser was able to exercise some degree of "control" over the particular risk. Purchasers have "control" over a risk when they have special knowledge concerning the likelihood of producer-induced cutbacks in supply, are aware that suppliers have no equivalent knowledge, and nevertheless fail to notify their suppliers of such cutbacks.

Under the general principle thus formulated, a party assumes responsibility for that proportion of risks and losses within its control. Each party's ability to control performance

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132. Id. at 140.
is an important component in risk management. Thus, a failure to cooperate in facilitating performance may increase the liability of the risk manager. To avoid this unnecessary increase in liability, contractors should provide their trade partners with reasonable notice or any other assistance necessary to fulfill their respective performance obligations.\textsuperscript{133} Those engaged in extended relationships are frequently able, and indeed expected, to provide notice of their inability to perform according to the terms of the agreement.\textsuperscript{134} Such parties are also expected to give notice of their need to alter the nature and content of their performance in order to fulfill preexisting obligations.\textsuperscript{135} For instance, under section 2-615(c) of the Uniform Commercial Code, "[t]he seller must notify the buyer seasonably that there will be delay or non-delivery . . . ."\textsuperscript{136} Similarly, a party who is in a position to provide a trade partner with information concerning intervening hazards that might disrupt the other's performance is under a "duty to cooperate" during the course of performance. In Canadian Industrial Alcohol Co. v. Dunbar Molasses Co.,\textsuperscript{137} a molasses supplier claimed that it was unable to make full delivery because the refinery that produced the molasses had reduced its production. The court stated that "[i]f the plaintiff had been so informed [of the reduction in supplies], it would very likely have preferred to deal with the refinery directly."\textsuperscript{138} The supplier, therefore, by not giving the purchaser notice of impediments to supply, con-

\textsuperscript{133} The obligation to "cooperate" during the course of contracting is well-established in both civil and common law systems. Culpa in contrahendo, or fault in negotiating, is a well-developed precept of German law. See Kessler & Fine, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study, 77 Harv. L. Rev. 401, 401-09 (1964). Commentators have urged that the significance and operation of "bad faith" in performance be carefully scrutinized by courts. See, e.g., Burton, Breach of Contract and the Common Law Duty to Perform in Good Faith, 94 Harv. L. Rev. 369, 394-402 (1980); Eisenberg, Good Faith Under The Uniform Commercial Code—A New Look at an Old Problem, 54 Marq. L. Rev. 1, 14-18 (1971); Farnsworth, Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code, 30 U. Chi. L. Rev. 666, 676-78 (1963); Hillman, supra note 68, at 876-901; Summers, "Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code, 54 Va. L. Rev. 195, 252-62 (1968).

\textsuperscript{134} See supra note 129 and accompanying text.

\textsuperscript{135} See supra note 133.

\textsuperscript{136} U.C.C. § 2-615(c); see also Bunge Corp. v. Miller, 381 F. Supp. 176, 180 (W.D. Tenn. 1974) (notification some three months after date of performance of inability to deliver not "seasonable").

\textsuperscript{137} 258 N.Y. 194, 179 N.E. 383 (1932).

\textsuperscript{138} Id. at 199, 179 N.E. at 384.
ceivably had prevented the purchaser from obtaining molasses by alternative means.

In order to promote interparty settlement of impracticability suits, courts should also require that each party demonstrate its good faith in attempting to settle. Those parties who fail to exercise good faith should assume additional responsibility for the loss. The concepts of "good faith" and "bad faith" are rendered more objective when premised on reliable evidence of a party's conduct in a given situation. Bad faith conduct may be evidenced, for example, by a party's unreasonable refusal to participate in the settlement process established by the court, by its attempts to impose unrealistic demands on a cocontractor, or by its refusal to comply with the terms of the settlement agreed to by the parties. On the other hand, when a party can establish to the satisfaction of the court that equitable settlement could not be attained despite its conscientious efforts, the court may find that the party acted in good faith even though it refused to settle. This may occur when a cocontractor is in an inherently superior bargaining position and is likely to employ that superior position to gain unfair advantage. Given the provision for judicial supervision of interparty settlement through the appointment of a special master or by recourse to a final offer procedure, however, there would be few cases in which a party reasonably could decline to settle consistent with the requirement of good faith. Where a party has evidenced bad faith in settling, the court may properly adjust the apportionment of loss in response to that bad faith.

The system of allocating performance losses should also reflect a policy in favor of minimizing public harm measured by the extent of diminished efficiency sustained by the economy as a whole.  

139. This is undoubtedly a difficult task. How is the court to measure the individual harm sustained by the promisor and the promisee? Even more problematic, how is the judge to delineate the ambit of a public loss? The answer will frequently require an interdisciplinary analysis: courts must identify in both quantitative and qualitative terms the nature and extent of social and economic interests that are most closely connected to the promisor's performance. The court may perhaps consult with market analysts to assist it in identifying interest groups that are directly or indirectly dependent upon the promisor. The court also may evaluate the availability of substitute employment for the promisor's employees, and it may consider the promisor's customers and their ability to acquire substitute goods at reasonable costs.
eral underemployment of capital resources, or decrease the availability of a scarce, staple product in the marketplace. This judicial adjustment of losses, however, should only be adopted in the presence of clear evidence of socioeconomic harm. It should not be employed to increase disproportionately the economic burden that must be borne by the buyer and the community of interests that depend on that buyer. The increase in cost of a good or service does not, in and of itself, evidence sufficient public injury to justify shifting the economic loss from the seller to the buyer in all cases. Such increments in cost are purely quantitative measures; they do not establish accurately the quality of socioeconomic harm suffered by either the parties themselves or by the community of interests that depend on the agreement between those parties. Similarly, public harm does not necessarily arise merely because a promisor would be rendered insolvent if compelled to perform.140 Rather, the judicial readjustment of losses should depend on whether compelling the seller to perform would lead to a large reservoir of unchannelled capital or labor or to the depletion of a valued product in the marketplace.

Judicial adjustment is especially useful in cases involving long-term supply and installment sales contracts when the continued association between the parties may have broad social and economic implications.141 Interdependent relationships involving enormous quasi-public organizations, like that between Westinghouse and its customers, arguably must be encouraged in order to maintain the supply of goods and services essential to industrial growth. The public interest in the continued performance of such contracts may warrant increasing the customers' share of the loss, even though their "control" over the risk of loss is limited by the "contemplation" and "mitigation" tests under the general principle outlined above.

In calculating each party's proportionate share of the loss, courts also should consider the "transactional" or "relational" nature of the agreement, the source of interparty conflict, and the possible effects that a judicial allocation of loss likely would have on future relations between the parties. Because contracts vary in their nature, content, and purpose, no one, all-encom-

140. Insolvency traditionally has been described as an example of "subjective impossibility." Unlike "objective impossibility," however, "subjective impossibility" has not been recognized as an excuse from performance. See supra note 6.

141. See supra notes 49-50 and accompanying text.
passing rule can regulate every agreement adequately.\textsuperscript{142} Contractors have differing degrees of "control" over risks; each may have a unique ability to contemplate risks and to avert the harmful consequences that stem from those risks. Moreover, the degree of socioeconomic harm caused by a performance loss will vary according to the duration and significance of the enterprise involved.\textsuperscript{143} Each case ultimately requires evaluation on its own merits in accordance with the principles formulated above. The judicial construction of the concepts of bad faith, individual hardship, and public harm of course will necessitate normative value choices. As long as their normative characteristics are identified and evaluated in the context of each dispute, however, such concepts can be employed usefully in the allocation of performance losses.

\section*{CONCLUSION}

A regime of legal remedies ideally should be integrated into the fundamental principles of substantive law. The need for a functional category of remedial adjustments, however, becomes more pressing when an all-or-nothing principle of law governs nonperformance and produces neither fairness nor economic efficiency. The proposed regime of remedies for loss adjustment is intended not only as a means to enhance socioeconomic utility, but also as a tool to implement the equitable notion that nonperforming parties should not always be

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\textsuperscript{142} Professor Corbin once stated: \\
We can not lay down one simple and all-controlling rule for these various kinds of frustration and impossibility. Many varying factors must be considered in each case that arises. . . . The problem is that of allocating, in the most generally satisfactory way, the risks of harm and disappointment that result from supervening events.

\textsuperscript{6} A. Corbin, Corbin on Contracts § 1322, at 327 (1962).

\textsuperscript{143} For example, in many long-term supply contracts, courts may properly increase the purchaser's proportionate share of performance losses, notwithstanding the supplier's apparent "control" over the risk of loss, if the purchaser anticipated the performance disruption, if it possibly could have taken precautions to avoid the risk of loss, or, most importantly, if imposing the entire performance loss upon the supplier would run contrary to the interests of a commodity-dependent public. In contrast, in many diverse transactions the purchaser may be unable to anticipate and avoid intervening risks because of its lack of prior dealings with the supplier or its inexperience in industry. Similarly, there is less likelihood of community hardship in discrete transactions because the public is generally less dependent on short-term, terminal transactions than it is on more extended and ongoing relationships. See supra notes 49-50 and accompanying text.
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COMMERCIAL IMPRACTICABILITY

held liable for all losses arising from commercially impracticable transactions.

When a party to a commercial agreement alleges that performance has become commercially impracticable, a court should consider first whether to divide performance losses between the parties as an alternative to the grant or denial of an absolute excuse from nonperformance. If the court determines that loss sharing is appropriate, and if the court believes that the contractors themselves are better able than the court to determine the scope of their settlement by their own means, it should encourage the parties to reach an interim settlement. If, however, the court determines that the parties are unlikely to reach an agreement in good faith, the court may require each party to present a "final offer" of contribution toward the loss and select the contribution figure of the preferred party. When a court concludes that neither interim settlement nor a final offer procedure is appropriate, it should allocate performance losses between the parties itself. The court-imposed allocation should vary in accordance with the capacity of each party to exercise control over the risk of loss.

This regime of judicial loss-sharing remedies depends on the courts' independent assessment of the facts of each case and on the ability of each court to divide fairly performance losses between the parties. Implicit in the judicial assessment is the need to reconcile the ex post principle embodied in the judicial allocation of loss with the ex ante principle whereby parties themselves assume the risks they are better able than their co-contractors to control. This ex post reconciliation requires the modification of the ex ante principle in the face of substantiated evidence of unfairness to one party or undue public harm. Judicial discretion, thus, is a necessary part of the loss-sharing regime. The value of such discretion, however, lies in its reasoned confinement.