Excuse Doctrine: The Eisenberg Uncertainty Principle

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EXCUSE DOCTRINE:
THE EISENBERG UNCERTAINTY PRINCIPLE

Victor P. Goldberg

The world is in a bit of a mess. Oil prices soared to more than $140 per barrel and within months plummeted to below $40. The pound fell from $2 to less than $1.40. Housing and stock prices crashed. Foreclosures, bankruptcies, and bailouts became newspaper staples. When things go awry like this, inevitably many people and firms regret having entered into contracts under more favorable circumstances. Many of them will be looking for ways to limit, or better yet, avoid the consequences. A preeminent contracts scholar, Melvin Eisenberg (2009), has provided them with considerable ammunition in a recent paper, arguing for expanding the domain of the excuse doctrines. His arguments for giving the disappointed contracting party a “get out of jail (almost) free” card, however, are seriously flawed.

The core of his argument is the inability of private actors to anticipate remote risks. Contracting parties, he argues, have bounded rationality; they can’t think of everything. If the parties shared an incorrect tacit assumption about some low-probability event, performance would be excused (the shared-assumption test). He breaks out a subcategory for special treatment: when a change in prices would be sufficiently large to leave the promisor with a loss significantly greater than would have reasonably been expected (the bounded-risk test). He argues that courts should have a broader set of responses than excuse or don’t excuse. Rather than an on-off switch, he suggests that the more appropriate analogy is to a dimmer. Relief need not mean that the contract is terminated with no remedy for the promisee. He proposes remedies that fall short of full expectation damages.

At first glance, his emphasis on the parties’ awareness of the risk of low-probability events seems plausible. Nonetheless, it is an unsatisfactory default rule, relying as it does on facts that are difficult to verify. To answer the
question of whether the parties contemplated the occurrence of a particular event when entering into their agreement, a number of issues would have to be determined. Was the event part of a larger class of events that the parties did contemplate or should have contemplated? What if other similarly situated parties explicitly dealt with the problem; what inference should be drawn from silence? What if the risk was impounded in the market price? How could one tell? To illustrate the problematic nature of the test, in Section 1, I will reexamine the case Eisenberg uses as his primary illustration, Krell v. Henry. I will follow that up with a brief discussion of the granddaddy of the impossibility cases, Taylor v. Caldwell. Application of the shared-assumption test, especially after the qualifications proposed by Eisenberg, would be difficult at best. But that does a lot better than the bounded-risk test, which is simply and fundamentally wrong. By focusing on market-wide changes, rather than promisor-specific events, he recognizes the wrong set of instances in which parties would likely choose to limit their exposure to large cost changes. The bounded-risk test will be analyzed in Section 2.

Parties can, of course, design their contracts to take changed circumstances into account. Eisenberg implicitly assumes that courts will do this better ex post than the parties could do it either in their original agreement or in a voluntary post-agreement modification. Although we cannot rule out the possibility that a wise court could do better, we can conclude with confidence that a court following Eisenberg’s advice would do worse. It is important to bear in mind that what is at stake is “only” a set of default rules. If the law were too liberal in granting excuses, sophisticated parties would draft around the rule, and vice versa. Courts do, however, impose barriers to contracting around defaults, and the unwary might well be trapped. So it would be helpful if the rule would conform with what reasonable parties would have chosen had they thought of it.

1. WHO COULDA THUNK IT?

The first Eisenberg principle is: “Judicial relief normally should be granted if the parties shared a tacit incorrect assumption that the non-occurrence of some circumstance during the life of the contract was certain rather
than problematic, and the incorrectness of that assumption would have provided a basis for judicial relief if the assumption had been explicit rather than tacit” (Eisenberg 2009, 209). This standard raises three immediate issues: how certain must we be; how can we tell if we meet that threshold; and how would we deal with the problem if the assumption were made explicit? His answer to the first two questions is a reasonable person standard, perhaps combined with observation of what other parties actually do. “[T]he tacit assumptions of contracting parties . . . are normally best determined by considering what similarly situated parties would likely have assumed” (209). “As a practical matter that question will usually be resolved on the basis of the fact-finder’s common sense intuition” (216).

Eisenberg recognizes some exceptions to the shared-assumption test. If the assumption were merely problematic or the circumstance foreseeable, there would be no excuse. So, if we were to observe a number of similarly situated contracts that dealt with precisely this circumstance, presumably we should conclude that the circumstance would not be an excusable ground. Likewise, if the circumstance were so well foreshadowed that the probability of its occurrence was impounded in the market price, he would not excuse.4

Eisenberg argues that unexpected circumstances are really unexpected, and therefore it would have been unreasonable for parties to have planned for their occurrence.

Most unexpected-circumstances cases arise because the parties tacitly assume that a given kind of circumstance will not occur during the contract time. In such cases the parties do not consider or even foresee, let alone appraise, the risk that the unexpected circumstance will occur. Indeed, if the parties do foresee the relevant risk, judicial relief normally should not be granted. Accordingly, it is more or less irrelevant for present purposes which party can better appraise the probability or magnitude of an unexpected circumstance, because most unexpected-circumstances cases arise precisely because neither party has thought about engaging in such an appraisal (2009, 251).

4 There are other exceptions as well (Eisenberg 2009, 218–222). They make application of the Eisenberg test even harder.
His primary illustration of the application of the shared-assumption test is one of the “coronation cases,” *Krell v. Henry*. A closer look highlights the weakness of the test and calls into question Eisenberg’s presumptions about the ability of actors to anticipate remote events. *Taylor v. Caldwell* provided the basis for the coronation cases; the notion that parties would fail to foresee the possible risks in this type of situation is even less plausible.

### 1.1. Krell v. Henry and the Coronation of Edward VII

I will begin with a bare bones version of the story and with Eisenberg’s analysis. Queen Victoria reigned from 1837 to 1901. The coronation of her son, Edward VII, was to take place on June 26, 1902 and two great processions were planned in London—the coronation procession on June 26 and the royal progress on the following day. On June 20, Henry entered into a written agreement with Krell in which Henry would have access to Krell’s rooms overlooking the procession routes for two days (but not the nights). The purpose, obviously, was to view the processions, but that was not stated explicitly. Henry agreed to pay £75 for the two days and immediately paid £25. On June 24, the king came down with appendicitis and the processions were postponed. Krell sued for the remaining £50 and Henry counterclaimed for the return of the £25. The counterclaim was subsequently dropped and the House of Lords found that the basic purpose of the contract had been frustrated. “I think it cannot reasonably be supposed to have been in the contemplation of the contracting parties when the contract was made, that the coronation would not be held on the proclaimed days... or along the proclaimed route.”

For Eisenberg, the postponement was clearly an unanticipated shock:

*So in Krell v. Henry we can be pretty confident that: (i) actors in the positions of the contracting parties would have shared the tacit assumption that the coronation would take place in six days scheduled; (ii) the contract was made on the basis of that assumption; (iii) Henry was not assuming the risk*

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5 For more details on the coronation cases, see G. H. Treitel (2004, 314–325) and R. McElroy & Glanville Williams (1941a, 1941b).

that the assumption was incorrect—was not gambling, and was not being paid to gamble, on whether the coronation would take place (2009, 214). Eisenberg goes on to assert that “many or most unexpected-circumstances cases involve either events that are too special to be covered by normal market insurance, such as the illness of a king on a given day” (2009, 250). Notice the subtle switch. The “tacit assumption” was that the coronation would take place as scheduled. But here he appears to narrow the focus to a single cause—the illness of the king. Even with that more restrictive definition of the intervening event, his argument fails.

The risk of postponement looks less remote if we tell the story differently. Although this particular contract was entered into only six days before the event, the planning horizon for the event was roughly six months, the date and route being announced in December 1901 (Treitel 2004, 315). The likelihood that a sixty-year-old, grossly overweight, heavy smoker, who had been the target of at least one assassination attempt might be unavailable was not trivial. Moreover, the procession was to be in a city renowned for its miserable weather. That someone might have thought about a possible postponement or cancellation no longer seems so far-fetched.

And, in fact, they did. Less than a week before the coronation Lloyds was quoting odds of 300 to 1 against cancellation. “Many thousands of pounds sterling were underwritten on this basis. This shows to what extent public nervousness has grown in certain circles” (New York Times, June 22, 1902). In an article the day after the postponement was announced, the New York Times provided an indication of the extensive insurance coverage.

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7 Judge Posner makes a similar statement in Northern Indiana Public Service Company v. Carbon County Coal Company, 799 F.2d 265, 277: “The question was, to which party did the contract (implicitly) allocate the risk? Surely Henry had not intended to insure Krell against the possibility of the coronation’s being postponed, since Krell could always relet the room, at the premium rental, for the coronation’s new date. So Henry was excused.” Eisenberg uses Krell’s ability to relet the room as a ground for denying him any compensation. Although it is true that the rescheduled procession passed by Krell’s flat, that was not true for all the coronation cases. Many of the dignitaries chose not to return to London for the subsequent processions and the value of viewing sites apparently fell. See Treitel (2004, 316) and Graphic (1902).

8 President Reagan’s 1985 inaugural parade was cancelled due to inclement weather (Clines 1985).
The loss of the British insurance companies, particularly those of London, which accepted risks on the coronation, will, it is estimated, run into the millions. . . . Thousands of insurance policies have been issued during the past year to tradesmen and others who depended for their livelihood for some time to come upon the ability of the King to pass through the coronation ceremonies. The business took a great boom when active preparations were begun for the coronation, and nearly all classes of tradesmen who were directly or indirectly dependent upon the successful termination of the great event bought policies.

* * *

The companies at first promised large sums if the coronation should not take place. The rate was 10 guineas for each £100. This rate was due to the fact that Lloyds, with whom much of the insurance was taken, unlike regular insurance companies, had no means of arriving at the state of health of the person insured. It was therefore age merely—the general allowance that would be placed on the average man at the age of the King—which was considered. Thus the premium for insurance of the late Queen Victoria at the time of the diamond jubilee was £14 per £100 for a year.

* * *

Hotel proprietors, restaurant men, costumers, owners of grand stands, managers of places of amusement have all insured themselves against loss in the event of the failure of the coronation to take place. Many thousands of pounds sterling against the coronation were underwritten at Lloyds at long odds and the large amount of business done was taken as an indication of the extent of the public nervousness (New York Times, June 25, 1902).

The next day, the New York Times noted that “Few of the caterers of hotels availed themselves of insurance, the recently offered Lloyd’s rate of 10 percent, being considered too high. Many proprietors of reviewing stands were protected by insurance.”

The opinion in Krell tells us nothing about Henry’s identity. Was he just a very rich guy who wanted to watch the procession? Since per capita annual income in England at the time was only around £45, this would have been a very expensive impulse purchase. Perhaps he was an entrepreneur.

There were twelve pence in a shilling, twenty shillings in a pound, and twenty-one shillings in a guinea.
who intended to charge admission to spectators and for reasons unknown waited till the last minute. This seems plausible given some of the prices mentioned in other coronation cases. For example, in both Blakeley v. Muller & Co. and Hobson v. Pattienden & Co., the plaintiff was a customer who had already paid for seats; in the former case, he paid £15 for three seats, in the latter £14 for two. In Lumsden v. Barton and Co. the plaintiff had paid £42 for eight seats for the first day. In Chandler v. Webster, the plaintiff had paid £141 for the first day with the intention of building a stand and letting seats. We aren't even certain as to whether Krell or Henry had insured against the postponement. We do know that their contract did not explicitly deal with a possible postponement or cancellation. In some of the other litigated coronation cases, the possibility of postponement was explicitly taken into account. For example, Victoria Seats Agency v. Paget dealt with two contracts for spectators to watch the royal progress (the June 27 event). One provided for the room on the date “or such other day as the said processions should pass the premises. Should the procession not pass the premises, I agree to refund the money.” The second said that in the event that the procession did not take place, the renter would get back his money, less 10 percent. According to the New York Times (June 26, 1902), an “important question remains as to whether the money paid for seats will necessarily be refunded. Only a few seats out of nearly half a million were sold with any specific proviso on this point.”

So, if Eisenberg wants to place his reliance upon an event which no one could have foreseen, Krell turns out to be a poor vehicle. The postponement

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10 However, Justice Darling, who decided the initial decision in Krell, stated in a subsequent decision that “there was no evidence in [Krell] that the letter of the room had gone to any expense in providing a stand or seats” (Lumsden v. Barton and Co., [1902], 19 T.L.R. 53, 54). The lack of evidence does not, of course, mean that it didn’t happen.


12 In Blakeley, the rental was only for the second day. A third possibility is that he was renting the room for a slew of family and friends.

13 Chandler v. Webster, [1904] 1 KB 493.


15 Elliott v. Crutchley, 1903 2 K.B. 476 involved a claim by a refreshment supplier against the Navy League, which had chartered a steamer to view the naval review to be held in conjunction with the coronation. The letter memorializing the deal included this postscript: “It is of course understood that in the event of a cancellation of the review before any expense is incurred by the contractor there shall be no liability on our side.”
of the coronation was clearly foreseen by others—lots of others. If an event that seemed to him (and others) so obviously beyond the imagination of the contracting parties was, in fact, anticipated by many, that suggests that courts and commentators should be more cautious about their ability to recognize tacit assumptions. In this, Eisenberg is not alone. Numerous commentators and the Restatement Second emphasize the role of the unexpected or remote risks. Indeed, despite the wealth of information about the public’s awareness of the coronation risks available to the Law Lords, they too invoked the unexpected to justify excuse—“it cannot reasonably be supposed to have been in the contemplation of the contracting parties.”

1.2. Taylor v. Caldwell

Krell and other coronation decisions relied on Taylor v. Caldwell, generally considered to be the first case to recognize the impossibility defence. On May 27, 1861 the parties entered into a contract for the use of the Surrey Gardens and Music Hall in which Taylor, the promoter, was to put on four grand concerts in the summer, paying the owners £100 for each concert. On June 11, before any of the concerts had been held, the Music Hall was destroyed by a fire caused by a careless plumber. The concerts were cancelled and Taylor sued for £58, the costs incurred in preparation for the concerts. Holding that “in contracts in which the performance depends on the continued existence of a given person or thing, a condition is implied that the impossibility of performance arising from the perishing of the person or thing shall excuse performance.” Impossibility would relieve both parties of their contractual obligations. The expenses incurred by Taylor in preparation could not be recovered.

Eisenberg gives the case much less attention, simply asserting that it was an “unexpected circumstance” case (2009, 225) and focusing instead on whether Taylor should have been compensated for his reliance expenditures (231). He argues that even though the defendant was not at fault and should be excused, Taylor should still have been compensated for his reliance (the £58). His argument is based on the notion that the owners were

16 The fact that Lloyds had offered insurance on Queen Victoria’s diamond jubilee (1897) suggests that the English were quite prepared to deal with such unfortunate matters well before Edward’s appendicitis.

17 Any facts not in the opinion are from Treitel (2004, 44–45).

"in control" of the premises, even if they were not at fault.\textsuperscript{19} I think that is wrong, but that is beside the point.\textsuperscript{20} The more significant point is that this was hardly an unexpected event. That a structure might be destroyed by fire should not come as a shock to contracting parties. Fire insurance had been available in England since shortly after the Great London fire of 1666;\textsuperscript{21} the owners of the Surrey Gardens had fire insurance.\textsuperscript{22} The notion of a shared tacit assumption works even worse in this context. The possibility that a venue or artist would be unavailable without fault is a predictable risk and parties can contract to determine how the risks should be allocated. \textit{Taylor v. Caldwell} merely establishes a default rule if the parties neglected to provide for the possibility in their agreement.\textsuperscript{23}

Although we do not know how parties dealt with these contingencies in the nineteenth century, nowadays parties routinely allocate the risks through insurance and specific contract language. News accounts following Michael Jackson's death discussed the efforts of the tour packager, AEG, to obtain insurance. Because of questions regarding Jackson's health and his

\textsuperscript{19} "Liability in such cases can be based on the ground that responsibility follows from control, because control implies some ability to take steps to prevent the loss from occurring" (Eisenberg 2009, 230). He continues:

The facts (although not the decision) in \textit{Taylor v. Caldwell} illustrate how the control principle should be applied.... The court said, "we must take it on the evidence [that the destruction of the hall] was without the fault of either party," and held that the owners were excused. That result was correct as far as expectation damages but seems doubtful as far as reliance damages. The owners were in control of the hall and, therefore, had at least some ability to prevent a fire; the lessee did not. Although the owners were not proven to be at fault, given their control over the premises they bore some responsibility to ensure its safety, and it would have been appropriate to make the owners responsible for the lessee's costs on that basis (231, emphasis in original).

\textsuperscript{20} When Michael Jackson died suddenly less than a month before the start of his 50-show English tour, the company running the tour had spent more than $20 million in reliance (Waddell 2009). Jackson was "in control," but I don't believe anyone (even Eisenberg) would have the Jackson estate compensate the reliance costs.

\textsuperscript{21} See Museum of London 2009.

\textsuperscript{22} Treitel (2004, 50). They probably did not have insurance to cover business losses.

\textsuperscript{23} The simple default rule that I prefer would be to leave the parties where they were at the time of the event. The rule that has evolved in England and the United States requires restitution for prepayment and, possibly, some compensation for reliance expenditures. \textit{Fibrosa Spolka Akcyjna v. Fairhavens Lawson Combe Barbour, Ltd.} [1942] A.C. 32 established the restitution rule in England, and shortly thereafter Parliament passed the \textit{Frustrated Contracts Act}, which allowed for compensation for reliance in certain circumstances. The Restatement Second §272 gives the court the power to "grant relief on such terms as justice requires, including protection of the parties' reliance interests [if necessary to] avoid injustice." However, although they typically grant restitution, they usually deny reliance claims; see Allan Farnsworth (2008, §9.9).
history of concert cancellations, those efforts were only partially successful. If the artists are popular (and therefore have a high opportunity cost) and have substantial pre-concert expenses, they are likely to require that the venue give them substantial compensation if the venue were to become unavailable. Indeed, they might even require that the venue pay some of their fee, even if the artist is unable to perform. For example, a Paula Abdul contract included this: “In the event that ARTIST is unable to perform during the period of time specified in the Contract due to no fault of her own, ARTIST shall be paid the full compensation agreed upon without the necessity of ARTIST’S performing.”

A Rod Stewart contract distinguished between the artist's health problems and other excusing events.

If any party's obligations contained in this Agreement are rendered impossible by any act, requirement or regulation of any public authority or bureau, strike or labor dispute (except for claims by the musicians' or other performer's unions, which are expressly excluded from this paragraph), flood, fire, riot, Acts of God, absence of power or other essential services, failure of technical facilities, or failure or delay of transportation facilities, or any other cause beyond such party's reasonable control (excepting causes of which [Rod Stewart] or Rio had knowledge, or in the exercise of due diligence should have had knowledge), then there shall be no claim for damages by either party to this Agreement, and the performance shall be rescheduled to a mutually agreeable time.

In the event Stewart is ill or incapacitated for any reason, and as a result incapable of performing as determined by Stewart in his absolute discretion, the show(s) will be canceled, and Rio shall have no obligation to pay any further sums in connection with the canceled show and Stewart shall refund the payment made by the Rio to [him] (Rio Properties, Inc v. Stewart Annoyances, Ltd 2005 WL 3767233 [D.Nev.] Rio’s Trial Brief, pp. 2–3).

24 “Given the rumored decline of Jackson's health, British bookmakers—who apparently take bets on everything—are already giving odds that Jackson doesn't perform at all, or at least doesn't complete the run of 10 shows” (Rock and Roll Daily 2009). “It is thought the company was unable to get insurance for at least 30 of the concerts—which were due to start next month—after obtaining limited cover for between 10 and 20 of up to £130 million. Insurers declined to take on the financial risk of the shows not going ahead, apparently concerned that the singer, who appeared frail at the unveiling of the concerts in March, would not be able to complete the run” (Swaine & Dunkley 2009).

Notwithstanding that language, his failure to perform and refusal to repay the $2 million fee precipitated a nasty, costly litigation that has been going on for about a decade.\(^\text{26}\)

I do not mean to argue that the default rule should be never to excuse performance, nor do I undertake to specify the content of that default rule. My aim is more modest—to undercut the notion that "unexpected circumstances" should be the basis for excusing performance. Eisenberg's standard—"if the parties do foresee the relevant risk, judicial relief normally should not be granted" (2009, 251)—should lead him to refuse to excuse in both Krell and Taylor (and, certainly, in post-Taylor entertainment contracts). If he is to rescue these, some other doctrinal hook will be necessary.

2. MAGNITUDE DOES MATTER, BUT...

Whatever the problems with the shared-assumption test, they pale in comparison with Eisenberg's bounded-risk test. While the shared-assumption test was concerned with the unforeseeability of an event, the bounded-risk test concerns the magnitude:

Under this test, which I will call the bounded-risk test, a promisor should be entitled to judicial relief if as a result of a dramatic and unexpected rise in costs, performance would result in a financial loss significantly greater than the risk of loss that the parties would reasonably have expected the promisor to have undertaken. . . . [F]or purposes of unexpected-circumstances cases a circumstance can be defined not only by its characteristics but also by its magnitude, that is, its dollar cost (2009, 234).

If the event causing the rise in the seller's costs was specific to that seller, this test would be plausible. It is consistent with excuses routinely incorporated into force majeure clauses. But that is not what Eisenberg has in mind. He is concerned primarily with market-wide cost (and demand) changes. "Cases in which the seller's cost of performance unexpectedly rises above the contract price often, perhaps usually, involve a cost increase that is market-wide. In such cases, the increase normally will raise not only the seller's costs but also the buyer's value for, and the market value of, the contracted-for

commodity” (2009, 238). “[T]he bounded-risk test should apply only when a cost increase is market-wide” (246, emphasis added). However, all four of his illustrations, Vernon v. Los Angeles, Mishara v. Transit-Mixed Concrete Corp., Mineral Park v. Howard, and Moyer v. Little Falls, were completely unrelated to overall market conditions. How he reconciles the principle and these cases remains a mystery.

Assuming for the moment that he really means that his concern is with market-wide cost increases, then it raises an obvious question of symmetry. Why should the test only apply when costs and prices rise; why doesn’t it apply when costs and prices decline in tandem? I will return to that question later.

To understand why Eisenberg’s bounded-risk test is flawed, consider his illustration:

For example, suppose that Packer agrees to sell 10,000 pounds of N nuts, a delicacy, to Distributor at a price of $1.00/pound. Packer expects to purchase the nuts from farmers at 50¢/pound. Distributor operates at a 100 percent gross margin and expects to resell the nuts to retailers at $2.00/pound, for a total profit of $10,000. Because of a blight, the quantity of N nuts available on the market falls dramatically, and the price of N nuts to packers rockets to $6.00/pound. The demand for N nuts is relatively inelastic. The price charged by packers to distributors rises to $7.00/pound, and the price charged by distributors to retailers rises to $14.00/pound. If Packer does not perform and is not entitled to judicial relief, she will incur damages of $60,000 (based on the difference between the $1.00/pound contract price and the $7.00/pound market price to distributors). Distributor, in turn, will reap a windfall profit of $130,000 (based on damages of $60,000 plus the $70,000 difference between the $7.00/pound market price to distributors and the $14.00/pound charged by distributors), compared with its ex ante expected profit of $10,000 (2009, 239).

31 The illustration, and much of the analysis, is based on Pietro Trimarchi (1991). However, Trimarchi does allow for the case in which costs and price decline.
What's wrong with this picture? Lots. To begin, there is no good economic reason for the notion that the percentage markup is fixed. The margin is payment for the distributor’s services and there is no reason to believe that these have become relatively scarcer. But that is merely a quibble when compared to the other problems. The example depends on the timing of the contracting of both parties. If the distributor entered into her distribution contract at the same time as her contract with the packer, upon breach she suffers a serious loss—she has sold at $2, but now has to cover at $7. Not only does she not get a windfall, but she might even be able to cry “Excuse me” under the Eisenberg principles. In all his chain-of-transactions examples, Eisenberg assumes a specific time structure. The distributor’s hypothesized windfall comes because he bought early/low and, in a separate contract, apparently sold late/high. The nut packer, on the other hand, is hypothesized to have sold early/low and bought late/high. Timing itself is an economic decision. If the packer deliberately took a short position, that reflected his judgment, which happened in this instance to be wrong. The distributor, on the other hand, happened to be right. The packer’s liability should not be conditional on whether the distributor entered into a forward contract and when it did so.

The most significant problem with his analysis, however, is that he directs attention to precisely the wrong set of circumstances—where the change was market-wide. I will come back to this point, but first I want to underscore some further problems, even if we were to assume that the market-wide cost increase is the relevant concern.

His argument hinges on the correlation between the supply and demand sides. How tight does that correlation need to be? Does the change have to

32 His linking of the two contracts is a common error that shows up in another area of contract law—the measurement of damages in the “middleman” cases in which the middleman contracts for a fixed fee (or percentage fee) (for example, Tongish v. Thomas, 840 P.2d 471 [Kan. App. 1992] and Allied Canners v. Victor, 209 Cal. Rptr. 60, 61–62 [Cal. Ct. App. 1984]). Following a substantial increase in the market price, the seller breaches, the contract-market price difference being substantially greater than the middleman’s fee. The seller argues that awarding anything more than the middleman’s expected profit (its fee) would amount to a windfall. If the middleman were acting as a broker, the ultimate buyer would be able to sue for the entire market-contract price difference and the middleman would indeed be entitled to only its fee. However, when the middleman contracts separately with both buyer and seller, then it assumes the counterparty risk in both contracts. It would potentially be liable to the buyer for the market-contract price difference. In cases like Tongish and Allied, the middleman succeeded in limiting its liability in its contract with the buyer—hence the appearance of a windfall gain. That parallels Eisenberg’s distributor who bought early in one contract and sold late in another. For more detail on the middleman cases, see Victor Goldberg (2006, ch. 11).
affect all suppliers equally? Does the increase have to pass through completely to the final price? There is no reason to think that the correlation would be very high, unless the root cause of the price increase was a very high rate of inflation. A good example of an instance in which the correlation was negative comes from a casebook standard—*Columbia Nitrogen v. Royster*. The price of the primary input—sulphur—soared while demand for (and the price of) the final product—fertilizer—fell. One anecdote by itself does not prove anything, but the broader point is that if the bounded-risk test would be triggered only if the correlation was high enough, we would have to figure out how much is enough and whether that is to vary between contexts. Whether the high correlation scenario is a common one is an empirical question. I doubt that it is. But, and this is the important point, it doesn’t matter.

It is hard to determine the domain of the bounded-risk test. There is a hint of a Goldilocks test—the time frame should be neither too long nor too short:

In some cases, it can be inferred from the circumstances that the seller was taking the risk of a very large loss due to market-wide cost increases. The most obvious case is that in which one or both parties are speculators. Within limits, the acceptance of such a risk may also be inferred from the fact that a contract is for a period of many years, because the longer the term of a contract, the more it becomes reasonably foreseeable that a very large increase in costs may occur during that term. Price-escalation provisions in a long-term contract may also suggest that the seller made an evaluative choice among various types of such provisions and was taking the risk that her choice would turn out badly (Eisenburg 2009, 241–242).

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33 Mere pass-through is not enough. His illustration is pass-through on steroids—a 500 percent increase in the seller’s costs leading to a 600 percent increase in distributor’s price.

34 For more details, see Goldberg (2006, ch. 7). In *Alcoa v. Essex*, 499 F. Supp. 53 (W.D. Pa 1980), Alcoa counted on a correlation between its costs at its Warrick smelter and its other smelters; Warrick’s divergence from the costs of the others was one of the causes of the failure of its price index to track costs, although not one considered by the court. See Goldberg (2006, ch. 20).

35 A Columbia executive testified: “During this particular period sulphur prices went unexpectedly high. In fact, historically high, while phosphate prices themselves went down, historically down” (Goldberg 2006, 166).
Eisenberg adds another wrinkle. Courts should not confine their attention to the contract in dispute; rather, they should look at how the event affected the rest of the promisor's business as well. He illustrates this with *Missouri Public Service Company v. Peabody Coal Company*.6

Peabody had entered into a ten-year contract to deliver coal in 1967. The parties negotiated over a proper escalator, finally agreeing on the Industrial Commodities Index of the Wholesale Price Index (the WPI-IC). Following the 1973 oil shock, the price of coal increased much more than the WPI-IC and Peabody tried to renegotiate the price. It failed, and informed the power company that it would not deliver more coal. Missouri sued for specific performance and in its defense Peabody invoked commercial impracticability. The defense was rejected and the court granted specific performance. The court noted that "Public Service, over objection, was permitted to show that since performance of the contract began, Peabody had experienced an approximate three-fold increase in the value of its coal reserves, presumably brought about by the same inflationary trend and other causes to which it ascribes its loss under the contract." For that reason, Eisenberg would have denied Peabody's defense.6

Implicit in his analysis is the notion that but for the profitability in the remainder of the business, he would have acceded to Peabody's demand to renegotiate the price. That presents a problem for him because the claim is problematic on three of his criteria. First, the buyer did not get a windfall—it was a regulated public utility. Second, the contract was for ten years, a time horizon plausibly long enough so that "it becomes reasonably foreseeable that a very large increase in costs may occur during that term" (241). Third, the parties negotiated extensively over the index, with Peabody initially proposing indexing with the CPI, finally agreeing to the WPI-IC.

Many of the major excuse cases were like *Peabody*, in that they involved long-term energy-related contracts, large changes in the energy markets, and negotiated price indexes that didn’t work properly. In neither *In
Re Westinghouse\textsuperscript{38} nor Eastern Airlines v. Gulf\textsuperscript{39} was there any correlation between the price of the input (fuel) and the output (electric power and airplane tickets). Alcoa v. Essex even shared the same flawed price index; it differs from the others only because the price of the final product—aluminum—had risen. That price increase was not linked to the rise in Alcoa’s fuel costs, however, as in Eisenberg’s example; it resulted from general inflation and an increase in demand for aluminum.\textsuperscript{40} Are all these casebook favorites to be excluded from the bounded-risk test?\textsuperscript{41}

Eisenberg suggests one other limit on the test. “In the normal case, however, a seller would not be willing to accept an extremely large risk, or perhaps more accurately, would charge the buyer a steep premium to accept such a risk, because if the loss materialized it would significantly decrease the seller’s wealth” (2009, 242). Most contracts, even with the huge cost increases that concern Eisenberg, are not bet-the-company affairs. Westinghouse’s many uranium contracts taken together would fall in this category. But, by and large, companies have a large portfolio of contracts and will rarely suffer a significant decrease in wealth because of extreme losses in one. When we put all these criteria together, it is possible that no cases would pass the bounded-risk test. I don’t believe that is what Eisenberg had in mind.

The “cotton cases” might possibly have fit his criteria. Bad weather in 1973 resulted in a huge, indeed unprecedented, increase in the price of cotton.\textsuperscript{42} Cotton producers tried every trick in the book to avoid their contracts. Not only did they fail to get excused, the courts in many of the litigated cases ordered specific performance, despite the fact that the cotton was fungible.\textsuperscript{43} Courts came to a similar conclusion in cases involving

\begin{itemize}
\item \textsuperscript{38} In Re Westinghouse, 405 F. Supp. 316.
\item \textsuperscript{39} Eastern Airlines v. Gulf, 415 F. Supp. 429 (1975).
\item \textsuperscript{40} For more details on Alcoa, see Goldberg (2006, ch. 20). The poor performance of the WPI-IC index was not, it turned out, the worst flaw in the contract.
\item \textsuperscript{41} I should make clear that I would not have excused in any of these. The question is whether Eisenberg would have ruled them out.
\item \textsuperscript{42} “The present actions are the result of an unprecedented rise in the price of domestic cotton from approximately $30 per pound to $80 or $90 per pound between the spring and the fall of 1973. This has been the fastest rise and to the highest price known in more than a century. Suits for specific performance of cotton contracts have been brought throughout the southeastern part of the United States” (Carolinas Cotton Growers Association, Inc. v. Arnette, 371 F. Supp. 65, 66 [D.S.C. 1974]).
\item \textsuperscript{43} For a discussion of the cotton cases, see Goldberg (2006, 213–214).
\end{itemize}
Campbell Soup’s contracts with growers when market prices were large multiples of the contract price.\textsuperscript{44} The one factor distinguishing these cases from Eisenberg’s hypothetical is that there is no reason to believe that the costs of the parties asking to be excused had changed—they just wanted the windfall for themselves.

If parties excuse performance, they typically do so for events that are specific to a particular contract. Indeed, the expected low correlation with market conditions is at the core of force majeure clauses.\textsuperscript{45} The asymmetry implied by Eisenberg—only excuse for a cost increase—makes some sense if the event were specific to the promisor. Performance can be excused if some act of God causes the costs of this particular seller to increase; the expected effect on the market price would be zero. That sort of shock is common—a local fire, a burst water pipe, and so forth. In expectation, the buyer does not lose a good deal because there is no reason to believe that the local problem would be associated with a market-wide price increase. The buyer would expect that on average it could cover at the original contract price. The converse, an act of God that lowers the seller’s costs without also lowering the costs of other suppliers, is less likely. Not surprisingly, parties are unlikely to excuse performance when circumstances result in a reduction of the seller’s costs unrelated to market conditions. Thus, if crops are destroyed, a farmer would be excused if the contract referred to crops grown on the seller’s land (or if that could be inferred).\textsuperscript{46} A generic contract to deliver crops, however, would not be excused, regardless of the magnitude of the price change—the promisor could buy the goods on the market. The Campbell contracts illustrate one way parties deal with extreme conditions that might cause a crop failure. Campbell would agree to take all the output (subject to a maximum) from a particular grower. If the crop failed completely, the seller would have no liability—no excuse necessary. If the crop failure were less than complete, the grower would be responsible only for delivery of the surviving crop.

As a general rule, parties do not excuse performance because of changes in the market price. That does not mean that they simply set a price that

\textsuperscript{44} In \textit{Campbell Soup v. Wentz}, 172 F.2d 80 (3d Cir. 1948), the court denied specific performance because it found the force majeure clause unconscionable. With that clause removed, specific performance was upheld in subsequent Campbell Soup–grower cases; see Goldberg (2006, ch. 9).

\textsuperscript{45} See Goldberg (2006, ch. 21).

\textsuperscript{46} UCC 2-615 comment 9.
is unvarying with conditions. Magnitude does matter. But that should not
give courts a license to revise.\textsuperscript{47} The parties are perfectly capable of do-
ing it themselves. They can, and often do, impose boundaries on the price.
They have available a rich variety of price adjustment mechanisms. These
include indexing, but they also include floors and ceilings, meeting compet-
tition clauses, renegotiation mechanisms, and third-party determination
(for example, gross inequity clauses).\textsuperscript{48} Some of these mechanisms will in-
clude the possibility of termination. A contract might, for example, say that
if the indexed price exceeds a maximum, the parties should renegotiate in
good faith and, if that fails, the contract will terminate after a certain period.\textsuperscript{49}
Instead of relying on the parties’ determination of the boundaries on their
price risk, Eisenberg proposes that the courts impose the boundaries, ex
post. Actually, because of the asymmetry in his argument, there would be
only one boundary—a floor.

Eisenberg proposes a modified expectation damage measure: If the price
increase is too extreme, the court should substitute a new price.

The remedy under that test should follow from the underlying theory of
relief. This theory is that if the parties had addressed the issue, the seller
would have accepted the risk of cost increases up to a certain point but not
beyond. Accordingly, the buyer should be entitled to expectation damages
measured by the difference between the contract price and a hypothetical
price based on the increased costs the seller could reasonably have been
expected to bear (2009, 244).

And how is that hypothetical price to be determined?

[T]he buyer should be entitled to the expectation damages that would have
been awarded if there had been a reasonably foreseeable increase in the sell-
er’s cost of performance and a corresponding increase in the market value
of the commodity. What constitutes a reasonably foreseeable increase in the
seller’s cost of performance should be historically based; more specifically,
it should be the maximum percentage increase in the cost of the relevant
inputs over a comparable stretch of time during a reasonable past period.

\textsuperscript{47} Eisenberg would have them excuse and revise. German courts eliminate the first step; they
keep the contract in force, but revise; see John Dawson (1984).

\textsuperscript{48} These are sometimes called “hardship clauses.” For a discussion of the ways and means of price
adjustment, see Goldberg (2006, ch. 20).

\textsuperscript{49} For examples of such clauses, see Goldberg & John Erickson (1987, 387–396).
In most cases, consideration of price movements during the prior ten to twenty years probably would suffice (Eisenburg 2009, 245).

This remedy seems inextricably linked to his assumption that the triggering event is a market-wide increase in costs. He continues:

[T]he remedy should be the difference between the contract price, and a hypothetical price based on maximum historical percentage price increases for the relevant inputs. It might be objected that this remedy would saddle the buyer with an opportunity cost, on the theory that if the buyer had made a contract with another supplier, he would have been able to acquire the contracted-for commodity at the contract price. However, the bounded-risk test should apply only when a cost increase is market-wide. As a result, the costs of all sellers of the relevant commodity would have increased in the same way, and all sellers would have the same defense, so that the buyer would have done no better if he had contracted with another seller (Eisenburg 2009, 246, emphasis added). So historical data over the previous ten to twenty years would determine the seller’s maximum exposure. The constraint would not be input cost per se, but the maximum rate of change of cost in that period. I guess that means if this were a two-year contract we would search for the greatest two-year price increase in the preceding decades. That is, we would match the length of the comparison period with the length of the contract. Again, in the context of his market-wide paradigm, Eisenberg provides a simple version: “The easiest kind of situation in which to apply the bounded-risk test consists of cases, like the nut... [hypothetical], in which the buyer is purchasing for resale. In such cases the buyer’s only expectation is to make a profit, and if the buyer is awarded the maximum profit that he would have reasonably expected ex ante, this expectation will be fulfilled” (2009, 245).

This last version of the remedy bears a familial resemblance to the one imposed by the court, and later rejected by the parties, in Alcoa v. Essex. He caps the buyer’s profits; the Alcoa judge put a floor under the seller’s profits. Alcoa is, in a sense, the dog that didn’t bark. It is one of the rare American cases that arguably took a bounded-risk argument seriously, yet it is nowhere mentioned in Eisenberg’s paper. Perhaps he avoided it because

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50 Note that this presumes that all the buyers would wait to resell until after the market price had changed.
he feared that his analysis would be tainted if it were associated with such a bad decision.

It is possible, as I have suggested, that hardly any cases would be affected by the bounded-risk test. The correlation would be too low, the length of the contract too long or too short, and so forth. However, almost certainly that is not Eisenberg's intent. His use of non-market-wide cases as illustrations suggests that he does not feel at all bound by his assumptions. He, in effect, is proposing that all (many? some?) contracts would include an implied gross inequity clause. The relative rarity of explicit gross inequity clauses suggests that parties would not welcome such a clause. Parties do contract over the possibility of large cost changes all the time, and they will sometimes include caps, floors, and instructions as to what should happen if either were hit. If parties choose not to include caps or floors, that is pretty good evidence that they didn't want them. If Eisenberg's rule were to become the default rule, we should expect anti-court-modification clauses in response. Any judicial presumption in favor of his default rule would give the disappointed party one more handful of sand to throw into the machinery of justice.

3. CONCLUDING REMARKS

Oliver Wendell Holmes observed that "The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, and nothing else. . . . If you commit a contract, you are liable to pay a compensatory sum unless the promised event comes to pass" (1897, 462). That aphorism has to be qualified by recognizing that in the face of changed circumstances, the performance might be modified or excused and that parties often do include such qualifications in their agreements. Contract law adds some default rules to these qualifications for impossibility, impracticability, and frustration. Eisenberg presumes that parties would not be very good at designing responses to changed conditions and proposes a beefed-up excuse doctrine. He proffers two tests and associated remedies. His first test—the shared-assumption test—is based on the notion that some events are so unlikely that no one would actually have thought of them. When

51 A casebook standard, Norcon v. Niagara Mohawk, 682 N.Y.S.2d 664 (1998), revolves around a rather complicated cap-floor plus adjustment formula. The Alcoa contract had a cap, but no floor. Caps and floors were common in Great Lakes Carbon's petroleum coke contracts; see Goldberg & Erickson (1987, 389, 394).
such an event comes to pass, the promisor should be excused. Case law often invokes the unforeseeability of such events, but a quick review of the core cases—the coronation cases and *Taylor v. Caldwell*—suggests that parties are better at this than Eisenberg gives them credit. His emphasis on the remoteness of the event is not, unfortunately, out of line with the Restatement 2d. The boldness of Eisenberg’s argument illuminates the more subtle flaws of the Restatement, which uses softer, vaguer language.

His bigger errors concern his bounded-risk test. He asserts that large changes in costs are typically associated with large changes in final market demand, and this dubious proposition drives his analysis (even as he abandons it for his application to actual cases). If the magnitude of a cost (or price) change is large enough, he argues, the courts should insert a ceiling that would provide some protection for the seller. His analysis has some serious logical errors, as noted previously. But the biggest problem is that it identifies the wrong set of instances in which parties would be most likely to excuse, ex ante, for an unanticipated change in costs.
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