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Alan Schwartz

Indiana University School of Law

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SALES LAW AND INFLATIONS*

ALAN SCHWARTZ**

The defendants, naturally, don't want to sell cotton because the price has gone up and if I were one of those defendants I would feel the same way. I would be sick as an old hound dog who ate a rotten skunk, but unfortunately—well, not unfortunately—fortunately we all abide by contracts and that (is) the foundation on which all of the business that you [the jury] have heard about here today is done.†

Inflation is defined as “a sustained rise in the general price level.”¹ It is the product of federal fiscal or monetary policy.² Radical changes in relative prices also occur, without changes in the general price level, because of unexpected shortages or gluts. Although both phenomena are discussed, the term “inflation” will be used to denote large price rises caused by government action.

This Article initially set out to consider how unanticipated causes of price rises, of which inflation is a paradigm example, affected the enforceability of sales contracts. In fact, these causes traditionally have had no effect on the enforceability of sales contracts; courts required defaulting promisors to pay damages. Recent commentators, however, have argued that to impose on sellers all costs attributable to unanticipated events is unacceptably harsh.³ They are supported in this view by a comment to

* A preliminary version of this Article was presented before the Commercial, Contract and Related Consumer Law Section of the Association of American Law Schools, on December 28, 1975. Professors Michael E. Levine and Edward A. Dauer made quite helpful comments on prior drafts, as did my colleagues Joseph Brodley, Jon T. Hirschhoff, and Morris S. Arnold. The responsibility for any errors which remain is mine. Were it customary to dedicate articles, this Article would be dedicated to Professor John P. Dawson, whose great work on earlier inflations created the framework within which all further analysis must be done.

** Professor of Law, Indiana University; Visiting Professor of Law, University of Southern California Law Center, 1976-77. B.S. 1961, Bates College; LL.B. 1964, Yale University.

† Jury charge of the Hon. Wilber D. Owens, Jr., in *Mitchell-Huntley Cotton Co. v. Fulton Benson*, Civ. Action 2902 (M.D. Ga. 1974), quoted in *Bolin Farms v. American Cotton Shippers Ass'n*, 370 F. Supp. 1353, 1359 (W.D. La. 1974), *aff'd*, 515 F.2d 508 (5th Cir. 1975).

1. W. PETERSON, *PRINCIPLES OF ECONOMICS MACRO* 41 (1974).

2. Gordon, *The Demand for and Supply of Inflation*, 18 J. LAW & ECON. 807 (1975).

3. See Hawkland, *The Energy Crisis and Section 2-615 of the Uniform Commercial Code*, 79 COMM. L.J. 75 (1974); Rosett, *Contract Performance: Promises, Conditions and the*

section 2-615 of the *Uniform Commercial Code*⁴ (Code), which suggests that extraordinary, unforeseeable cost increases should excuse sellers. Moreover, a few cases decided under the Code have excused sellers when unanticipated events unexpectedly made performance more costly.⁵ The question of the effect unanticipated events should have on the enforceability of sales contracts is therefore open. It is also an important question because the most important such cause is inflation, and this country apparently has failed to achieve domestic price stability.

Section I of this Article briefly describes the cases. Section II analyzes the themes that apparently underlie the commentators' distaste for enforcement, and develops the only appealing case for excuse. Section III, however, shows that application of this case would require courts to make extraordinarily difficult factual inquiries and to engage in complex economic analysis. The confusions that inevitably arise when courts are required to do more than they can would here render judicial outcomes so uncertain as to impair contract stability. A concern to ensure contract stability, Section III concludes, thus explains and justifies the courts' decision to enforce. Section IV then argues that that decision is also anti-inflationary. Finally, Section V shows that the *Uniform Commercial Code* permits enforcement.

I. JUDICIAL TREATMENT OF PRICE RISES RESULTING FROM UNANTICIPATED CAUSES

The cases apparently are in two classes: (1) seller breaches because a price rise enables him to resell for much more than the contract price; (2) seller is

Obligation To Communicate, 22 U.C.L.A.L. REV. 1083 (1975); Schmitt & Wollschlager, *Section 2-615 "Commercial Impracticability": Making the Impracticable Practicable*, 81 COMM. L.J. 9 (1976). *But see* White, *Impossibility, Impracticability and Supervening Illegality*, in BREACH OF CONTRACT IN A SHORTAGE ECONOMY 9 (PLI 1974); Hurst, *Freedom of Contract in an Unstable Economy: Judicial Allocation of Contractual Risks Under UCC Section 2-615*, 54 N.C.L. REV. 545 (1975) (courts should not excuse except when "it would be truly unconscionable to enforce").

Other commentators argue that the price term should be revised to reflect subsequent unanticipated events. *See* Sommer, *Commercial Impracticability—An Overview*, 13 DUQUESNE L. REV. 521 (1975); Note, *UCC § 2-615: Sharp Inflationary Increases in Cost as Excuse from Performance*, 50 NOTRE DAME LAW. 297 (1974); Comment, *The Energy Crisis and Economic Impossibility in Louisiana*, 49 TUL. L. REV. 605 (1975). *See also* Baudouin, *Theory of Impevision and Judicial Intervention to Change a Contract*, in ESSAYS ON THE CIVIL LAW OF OBLIGATIONS 151 (J. Dainow ed. 1969); Smit, *Frustration of Contract: A Comparative Attempt at Consolidation*, 58 COLUM. L. REV. 287 (1958). This essentially is an argument for excuse, as its proponents urge the undesirability of enforcing the contract and apparently seek the same objectives by price fixing that others seek by nonenforcement. The textual discussion, which treats only the alternatives of enforcement or excuse, is thus relevant to this suggestion. *See* note 52 *infra*.

4. UNIFORM COMMERCIAL CODE § 2-615, Comment 4 (all citations are to the 1972 Official Text). *See* text accompanying notes 57-66 *infra*.

5. *See* notes 7-12 and accompanying text *infra*.

a dealer or manufacturer, who breaches because the price of his inputs has risen such that his resale contract would be performed at a loss. As an example of this, a dealer contracted to sell popcorn at \$6.75 a hundred weight, but breached when the price to him went to \$8.50.⁶

Sellers always lose Class I cases⁷ and traditionally have lost Class 2 cases.⁸ Recent authority faintly suggests that the latter result may change. In

6. See *ABC Vending Corp. v. Zussman*, 105 F. Supp. 950 (D. Mass. 1952) (the dealer lost).

7. This category is illustrated by the recent cotton cases in which the price that dealers paid to farmers usually approximated \$.30 a pound, and the market went as high as \$.80. *E.g.*, *R.N. Kelley Cotton Merchant, Inc. v. York*, 494 F.2d 41 (5th Cir. 1974); *Cone Mills Corp. v. A.G. Estes, Inc.*, 377 F. Supp. 222 (N.D. Ga. 1974); *Mitchell-Huntley Cotton Co. v. Waldrep*, 377 F. Supp. 1215 (N.D. Ala. 1974); *Bolin Farms v. American Cotton Shippers Ass'n*, 370 F. Supp. 1353 (W.D. La. 1974), *aff'd*, 515 F.2d 508 (5th Cir. 1975); *Cone Mills Corp. v. Hurdle*, 369 F. Supp. 426 (N.D. Miss. 1974); *R.N. Kelley Cotton Merchant, Inc. v. Cox*, 18 UCC REP. SERV. 950 (Ala. 1976); *Harris v. Hine*, 232 Ga. 183, 205 S.E.2d 847 (1974). *But see* *Loeb & Co. v. Schreiner*, 294 Ala. 722, 321 So. 2d 199 (1975) (contract unenforceable because in violation of statute of frauds); *Cox v. Cox*, 292 Ala. 106, 289 So. 2d 609 (1974) (contract unenforceable because in violation of statute of frauds).

For illustrations of Class I cases in other markets, see *Pacific Trading Co. v. Mouton Rice Milling Co.*, 184 F.2d 141 (8th Cir. 1950); *Brevard Tannin Co. v. J.F. Mosser Co.*, 288 F. 725 (4th Cir. 1923); *Distillers Factors Corp. v. United Distillers Prods. Corp.*, 76 F. Supp. 48 (D. Conn. 1947); *Eskew v. California Fruit Exch.*, 203 Cal. 257, 263 P. 804 (1927); *Meyer v. Sullivan*, 40 Cal. App. 723, 181 P. 847 (1919); *Southern Scrap Material Co. v. Commercial Scrap Material Co.*, 239 La. 958, 120 So. 2d 491 (1960); *Davison Chem. Co. v. Baugh Chem. Co.*, 134 Md. 24, 106 A. 269 (1919); *Ohio Grain Co. v. Swisshelm*, 40 Ohio App. 2d 203, 318 N.E.2d 428 (1973); *Universal Coal Co. v. Old Ben Coal Corp.*, 32 Ohio App. 254, 167 N.E. 904 (1929); *Blaffer & Farish v. Gulf Pipe Line Co.*, 218 S.W. 89 (Ct. Civ. App. Tex. 1919); *Hess Bros. v. Great N. Pail Co.*, 175 Wis. 465, 185 N.W. 542 (1921).

A possible exception is *Campbell Soup Co. v. Wentz*, 172 F.2d 80 (3d Cir. 1948), in which the court refused specific enforcement of a contract to sell carrots when the price was \$30 a ton, and the market went to \$90. The basis of the decision, however, was the unconscionable nature of the nonprice terms; the court did not say that specific performance would have been denied had such terms been more balanced. In *West Point-Pepperell, Inc. v. Bradshaw*, 377 F. Supp. 154 (M.D. Ala. 1974), a cotton case, the court rejected an unconscionability defense based primarily on the discrepancy between contract and market prices.

8. For cases involving dealers, see, *e.g.*, *Williams Grain Co. v. Leval & Co.*, 277 F.2d 213 (8th Cir. 1960); *Wickham & Burton Coal Co. v. Minnesota Coal Co.*, 7 F.2d 873 (7th Cir. 1925); *P.N. Gray & Co. v. Cavalliotis*, 276 F. 565 (E.D.N.Y. 1921), *aff'd*, 293 F. 1018 (2d Cir. 1923); *Pilsen Coal Co. v. West Chicago Park Comm'rs*, 221 Ill. App. 162 (1921); *Ellis Gray Milling Co. v. Sheppard*, 359 Mo. 505, 222 S.W.2d 742 (1949); *Wilson & Co. v. Freemont Cake & Meal Co.*, 153 Neb. 160, 43 N.W.2d 657 (1950), *cert. denied*, 342 U.S. 812 (1951); *Maple Farms, Inc. v. City School Dist.*, 76 Misc. 2d 1080, 352 N.Y.S.2d 784 (Sup. Ct. 1974); *Terry Contracting v. Commercial Ins. Co.*, 16 Misc. 2d 475, 156 N.Y.S.2d 285 (Sup. Ct. 1956); *Vanetta Velvet Corp. v. Kakunaka & Co.*, 256 App. Div. 341, 10 N.Y.S.2d 270 (1939); *International Minerals & Metals Corp. v. Weinstein*, 236 N.C. 558, 73 S.E.2d 472 (1952). Courts, of course, do enforce exculpatory clauses. See, *e.g.*, *Roessler & Hasslacher Chem. Co. v. Standard Silk Dyeing Co.*, 254 F. 777 (2d Cir. 1918) (very broad *force majeure* clause, explicitly including "war," the excusing event); *Thomson v. Thomson*, 315 Ill. 521, 146 N.E. 451 (1925) (contract made subject to rules of Chicago Board of Trade; the Board required the seller to breach).

For cases involving manufacturers and contractors, see, *e.g.*, *Farmers Fertilizer Co. v. Lillie*, 18 F.2d 197 (6th Cir. 1927); *Lang & Gros Mfg. Co. v. Fort Wayne Paper Co.*, 278 F. 483

one case,⁹ a dealer was allowed to breach a contract to sell propane gas because the energy crisis had made propane unexpectedly scarce. However, the buyer failed to argue that the energy crisis was an impermissible ground for excuse: the court merely assumed it was, the case turning on the fairness of the seller's allocation of scarce gas among his customers.¹⁰ In another case,¹¹ a New York trial court denied the buyer's motion for a summary judgment for specific performance of a contract to build a boat, holding that if the seller's greatly increased costs were attributable to the energy crisis, he would be excused. A federal district court also recently suggested that the energy crisis might excuse an oil company from supplying gasoline to retail stations, although the point apparently had not been argued.¹² While these cases scarcely constitute a trend, they do suggest that the question whether price rises resulting from unanticipated causes should excuse sellers is no longer closed.

Before proceeding to the possible grounds for excusing sellers affected by such causes, it should be noted that the above classification is merely formal: the two case categories are actually one. Consider a Class 1 seller where the contract price is \$1.00 and the market goes to \$1.50. His "cost of" or "loss from" compliance is \$.50, the sum he foregoes by performing. Now take a Class 2 seller who contracts to resell goods he does not own, where the cost of the goods to him would have been \$.80 a unit had he bought when his

(7th Cir. 1921); *Eastern Air Lines, Inc. v. Gulf Oil Corp.*, 19 UCC REP. SERV. 721 (S.D. Fla. 1975); *Publicker Indus. Inc. v. Union Carbide Corp.*, 17 UCC REP. SERV. 989, 993 (E.D. Pa. 1975); *Shedd-Bartuch Foods v. Commodity Credit Corp.*, 135 F. Supp. 78 (N.D. Ill. 1955), *aff'd*, 231 F.2d 555 (7th Cir. 1956); *Dwight v. Callaghan*, 53 Cal. App. 132, 199 P. 838 (1921); *Freeto v. State Highway Comm'n*, 161 Kan. 7, 166 P.2d 728 (1946); *Kohlman v. Witherell & Dobbins Co.*, 155 La. 57, 98 So. 756 (1924); *Hein v. Fox*, 126 Mont. 514, 254 P.2d 1076 (1953); *London & Lancashire Indem. Co. v. Board of Comm'rs*, 107 Ohio St. 51, 140 N.E. 672 (1923); *Schafer v. Sunset Packing Co.*, 256 Ore. 539, 474 P.2d 529 (1970); *Gross v. Exeter Mach. Works, Inc.*, 277 Pa. 363, 121 A. 195 (1923); *Goldstein v. Old Dominion Peanut Corp.*, 177 Va. 716, 15 S.E.2d 103 (1941).

9. *Mansfield Propane Gas Co. v. Folger Gas Co.*, 231 Ga. 868, 204 S.E.2d 625 (1974).

10. When the excusing event affects only part of the seller's ability to perform, he "must allocate production and deliveries among his customers . . . in any manner which is fair and reasonable." UNIFORM COMMERCIAL CODE § 2-615(b).

11. *Gay v. Seafarer Fiberglass Yachts, Inc.*, 14 UCC REP. SERV. 1335 (N.Y. Sup. Ct. 1974).

12. *Intermar, Inc. v. Atlantic Richfield Co.*, 364 F. Supp. 82 (E.D. Pa. 1973) (dictum). Sellers still try. The Anaconda Company recently sued Reynolds Metals Company for breach of a contract to sell 360,000 tons of refined aluminum ore. Although the contract contained a price escalation clause, Reynolds claimed that recent cost increases raised production well above the contract rate. See *Louisville Courier Journal*, July 8, 1975, § B, at 10, col. 5. Westinghouse Electric Corporation also recently announced that it would renege on its contracts to sell refined uranium because the price of raw uranium unexpectedly tripled, making production at the contract rate "commercially impracticable." *Wall Street Journal*, Sept. 30, 1976, at 1, col. 6; *id.* Sept. 9, 1975, at 5, col. 2. This action was severely criticized, in an editorial in *Barron's*, on the ground that Westinghouse should have hedged against price rises as its competitors allegedly did. See *Sanctity of Contract? You Can't Be Sure If Its Westinghouse*, in *Barron's*, Sept. 15, 1975, at 7, col. 1. See also *N.Y. Times*, Feb. 1, 1976, § 3, at 4, col. 5.

resale contract was made and the resale price is \$1.00. Inflation raises the goods' cost to \$1.05 and prices in the seller's market to \$1.31. Again the loss from compliance is the difference between the new market and contract prices—here \$.31. This is the sum the seller foregoes by performing, and out of which he would be made whole for the increase in input cost. Courts now occasionally treat Class 2 sellers more leniently,¹³ apparently because an increment of their performance cost is often a large out-of-pocket loss—the \$.05 in the above example. Consequently, Class 2 sellers make sympathetic defendants. Because of the interest these sellers have aroused, and to simplify a regrettably complex analysis, this Article will focus only on the Class 2 case, but the reader should take it that most of what is said, and the conclusion, apply to Class 1 situations as well.¹⁴

II. THE CASES FOR EXCUSE

Two principal themes apparently underlie the commentators' imprecisely stated argument that sellers seriously affected by unanticipated events should be excused. The first focuses on the harshness of imposing large costs on sellers. This theme, referred to as the "harshness case" for excuse, presupposes that courts should redistribute the gains and losses that unanticipated market-affecting events create. Section II-A, however, shows that courts are institutionally incompetent to do this.¹⁵ The second theme focuses on the seemingly "undeserved" character of the losses to sellers and gains to buyers that unanticipated market-affecting events create. This theme, referred to as the "desert case" for excuse, is compelling in its theoretical form; but as Section III shows, the difficulties inherent in its use

13. See text accompanying notes 7-12 *supra*.

14. The distinction drawn in the text between Class 1 and Class 2 sellers, that only the latter may suffer out-of-pocket losses, is not always correct. A Class 1 seller who buys at preinflationary prices and is compelled to sell at the preinflationary contract price receives dollars which inflation has devalued, and thus also incurs an out-of-pocket loss. Currency depreciations in this century have been sufficiently mild as to yield no cases in which sellers have shown significant harm from dollar devaluations. The current prevalence of long-term contracts, coupled with the present inflation rate, may yet produce such cases. Performance even then probably would not be excused unless the depreciation were quite extraordinary. See *Brubrad Co. v. United States Postal Serv.*, 404 F. Supp. 691 (E.D.N.Y. 1975); Dawson & Cooper, *The Effect of Inflation on Private Contracts: United States, 1861-1879*, 33 MICH. L. REV. 852 (1935); cf. Nussbaum, *Debts Under Inflation*, 86 U. PA. L. REV. 571 (1938). Judicial reluctance to apply the frustration doctrine in other contexts has already been noted. Anderson, *Frustration of Contract—A Rejected Doctrine*, 3 DE PAUL L. REV. 1 (1953). It should also be emphasized that the Class 2 seller's harm from contract enforcement is defined as the difference between the new market and contract prices, not the out-of-pocket loss he suffers from the rise in input cost, because it would be out of the market/contract differential that he would meet this rise and obtain his profit; the seller's loss, that is, is his inability to capture the gains inflation makes possible.

15. See notes 17-20 and accompanying text *infra*.

would create an unacceptable threat to contract stability.¹⁶

A. THE HARSHNESS CASE FOR EXCUSE

The harshness case assumes that it is undesirable to impose large costs on seller's. However, if their buyers can resell at the inflationary price, the seller's costs are gains to buyers. Thus, to make the harshness case, it must be shown that the satisfaction or utility (hereinafter both are referred to as "satisfaction") that sellers lose by enforcement is greater than the satisfaction buyers gain by it. This plainly is not always so. For example, assume that the seller at bar is rich and without family while the buyer is middle-class and will use the profits to pay the medical bills of his seriously ill children. Many situations could be imagined in which most of us would conclude that *enforcement* increases total satisfaction. Thus, the harshness case cannot excuse every breach. Inquiries into the particular parties' circumstances seem necessary.

However, the judicial process is unsuited to draw the comparisons respecting relative satisfaction which these inquiries would entail. Two reasons make this so. Initially, courts often would be unable to get the facts necessary to decide whether a seller's satisfaction loss would exceed his buyer's satisfaction gain. The rules of evidence would exclude much of the essential data because it would reflect issues, such as the parties' family circumstances, traditionally considered irrelevant to contract litigation. Even if the rules were relaxed, a serious "revealed preference problem" would be created. Each party would attempt to reveal only those facts that would improve his claim. Although this problem always obtains, it is exacerbated when the relevant facts are so personal to the litigants that they are difficult for outsiders to ascertain and assess. Also, when the litigants are corporations, the effect of a decision bears on shareholders and employees. Bringing them before the court, and ascertaining the possible impact of alternative results on their lives, is apparently impossible. In addition, the process of testimony and cross-examination seems unlikely to expose those deeper attitudes and desires which may be most important to deciding what result would actually maximize the parties' satisfaction.¹⁷

16. See notes 28-47 and accompanying text *infra*.

17. Respecting the question of comparisons of real income, Professor Little observed: [s]ince people have different tastes, a comparison of the objective factors, money incomes and prices and available goods, [is] insufficient. Even if two people of different tastes had the same money incomes, and were always faced with the same available goods at the same prices, it could not very well be said that they were economic equals both before and after a change which greatly raised the prices of everything which the one bought and the other did not buy. It appears that comparisons of real income must be comparisons, in part at least, of mental states or changes in mental states.

I. LITTLE, A CRITIQUE OF WELFARE ECONOMICS 56-57 (2d ed. 1963).

The judicial system is additionally unsuited to make comparisons respecting relative satisfaction because these comparisons are only partly factual: they also raise value conflicts of a kind courts should not attempt to resolve. Most people think that the middle class buyer with the sick children had a "better" use for the money than the rich seller without family. However, in other cases the relevant values would be in dispute or inconclusive, and few people could agree on the right result. Assume that the buyer tithed and the seller gambled; or the buyer had two children and the seller six. Questions like these, involving relative wealth, need, and desert, are perhaps the most hotly disputed ones our society faces. They are not questions which the judicial process is designed to resolve.

Moreover, pursuit of the harshness case would impair contract stability. When the seller would have to decide, after an inflation had occurred, whether to perform or breach, neither he nor the buyer could predict the outcome of a lawsuit. It would initially be difficult to know what values a court or jury would pursue. If this were known, it would be very hard to determine the result those values would direct. The judicial decision would entail a comparison of the parties' circumstances. Neither party could therefore predict it unless he knew enough about his adversary's circumstances to foresee how they might influence decision. People are seldom this informed respecting the relative strangers with whom they deal. Were the judicial outcome to be this uncertain, sellers seriously affected by inflation, or other unexpected causes of price advances, would be strongly tempted to breach.¹⁸

Adopting a general rule that inflation always does or does not excuse, based on satisfaction criteria, would avoid few of these difficulties. Any general rule would be more arbitrary than the individual decisions just discussed. A judge cannot imagine the actual impact on all affected parties of a decision always to enforce or excuse. Asserting that either result would produce more or less aggregate satisfaction, as a matter of fact, is simply fantasy. Moreover, no set of generally accepted values directs judges to favor sellers or buyers, considered as classes. Finally, any general rule would probably be rife with exceptions because in individual cases the conclusion that satisfaction would be maximized by a result opposite to the one the rule requires would often seem obvious. The exceptions would make it more difficult to predict the judicial decision; and unpredictability is in these circumstances a temptation to breach.

The apparent impropriety¹⁹ and obvious difficulty of applying 'the

18. For a rigorous statement of the intuitive perception that uncertainty in these circumstances would often lead to breach, see text following note 27 *infra*.

19. The argument against the harshness case is a particular application of a broad theme,

harshness case for excuse explain why courts reject it. Courts have always been reluctant to make judgments of the kind that the harshness case makes relevant. Whether that is so, these considerations support the decisions. Making the decision to excuse or enforce turn on relative satisfaction would lead to arbitrary results and would impair contract stability.²⁰

B. THE DESERT CASE FOR EXCUSE

A judicially tenable case for excuse must rest not on the fact or magnitude of a seller's loss but on the circumstances which engendered it. The commentators often recognize this, the chief focus of their concern being the unforeseeability of the causal event. This leads to the potentially useful notion of "desert"—the belief that sellers do not deserve the losses nor buyers the gains which enforcement yields. The desert notion yields a precise and appealing statement of a case for excuse because, unlike the harshness case, it rests on widely acceptable values—that people should not be made to bear losses they did not consent to risk, nor be deprived of gains they bought the right to enjoy. Thus, an "undeserved" loss will here mean a loss resulting from the materializing of a risk a party was not paid to bear, or a gain a party bought the right to enjoy but which a court prevented him from realizing by excusing the other party. An "undeserved" gain will mean a gain a party did not buy the right to enjoy or a loss resulting from a risk a party was paid to bear but which a court shifted to his contract partner. When the market price of the goods at issue rises by more than twice the foreseeable high, excuse would minimize "undeserved" gains and losses. Thus an appealing case for excuse

that common law courts seldom can redistribute wealth in institutionally appropriate ways. For a fuller statement of this general idea, see Schwartz, *Products Liability and Judicial Wealth Redistributions*, 51 IND. L.J. 558 (1976).

20. Several commentators have urged courts in impossibility situations to split the losses resulting from supervening events. E.g., Mueller, *Contract Remedies: Business Fact and Legal Fantasy*, 1967 WIS. L. REV. 833, 837; Comment, *The Energy Crisis and Economic Impossibility in Louisiana*, 49 TUL. L. REV. 605, 616-23 (1975); Comment, *Apportioning Loss After Discharge of a Burdensome Contract: A Statutory Solution*, 69 YALE L.J. 1054 (1960); Comment, *Loss Splitting in Contract Litigation*, 18 U. CHI. L. REV. 153 (1950). A recent author correctly observed that the proponents of loss-splitting never explain the desirability of that cost distribution. Comment, *The Economic Implications of the Doctrine of Impossibility*, 26 HASTINGS L.J. 1251, 1261 (1975). Although loss-splitting imposes equal monetary losses on the parties, it will rarely impose equal burdens since the utility of a dollar to a party is a function of his tastes and circumstances. Contract partners are quite unlikely to have the same tastes or be in the same circumstances, and will thus value equal dollar losses unequally. If the object of the loss-splitting proposal is merely to increase satisfaction by forcing each party to bear part of a loss, it is subject to the objection made above: courts cannot judge the actual effect on satisfaction of any particular loss-sharing configuration. The reluctance of courts to split losses may reflect their recognition of this institutional limitation. Professor Birmingham also argues that courts should use the frustration and impossibility doctrines to make distributional judgments, but he does not consider the objections raised above. See 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 (1969).

exists for some sellers adversely affected by unanticipated market-affecting events. This conclusion is demonstrated by use of several hypotheticals, all involving an unanticipated inflation.

The initial illustration assumes the following: (1) Two merchants contract to sell corn. The seller does not then own the corn but will purchase it shortly before delivery.²¹ (2) Corn fluctuates in price. Knowing this, the parties assume a particular range through which fluctuations will move. (3) Buyers ordinarily expect sellers to deliver on a price rise. That is implicit in contracts for future delivery at fixed prices. This buyer expectation necessarily implies the expectation that sellers bear standard price-affecting risks, such as a short crop. These buyer expectations are known to sellers. The contract price thus compensates the seller for bearing the risk of price rises; a portion of the price is a premium for risk-taking. However, neither party foresees a serious inflation. (4) An unexpected inflation does occur, attributable to expansionary monetary policy, and raises prices above the expected fluctuation range. More precisely, the inflation raises all relevant prices—the price of goods to the seller, the price at which people in the seller's market resell, and the price at which buyers resell—by the same factor.

The initial problem utilizes these assumptions. The seller, *S*, is a dealer; the buyer, *B*, a wholesaler. The contract price is \$1.20 per bushel. When the contract is made, the price to dealers like *S*—the price at elevators—is \$1.00 a bushel; the price to retailers—the price at which *B* expects to resell—is \$1.50. The parties assume that corn selling at \$1.00 may fluctuate through a range bounded by \$.82 on the low side and \$1.18 on the high side (*i.e.*, \pm \$.18). They know the risk of these fluctuations is fully reflected in the current prices dealers charge. This knowledge necessarily implies an expectation by *B* that *S* will deliver for \$1.20 if the price at elevators goes to \$1.18, although if *S* breached he could resell at \$1.38.²² An unanticipated 50 percent inflation occurs, raising the price at elevators to \$1.50; from dealers like *S* to buyers like *B* to \$1.80; and from wholesalers like *B* to retailers to \$2.25. *S* breaches, buys the corn at \$1.50, and resells to another at \$1.80; *B* covers at \$1.80 and resells at \$2.25.

Were *S* to be excused, his nominal profit would rise to \$.30 (the difference between \$1.80 and the \$1.50 he must pay), but in real terms he would still make only \$.20.²³ However, he would save the loss of \$.18 which

21. The hypothetical assumes a dealer who has not hedged. Such dealers seek profits both from speculation and from the middleman service. The principles this hypothetical illustrates also apply to certain manufacturers who make contracts for future delivery. These manufacturers do not hedge against cost increases in their inputs either because they are speculating or because no futures market exists for certain inputs, such as energy.

22. *I.e.*, \$1.20 (contract price) + \$.18 (dealer cost increase).

23. A 50% inflation reduces each dollar's value by one-third. Thus, the seller's "real" profit, his profit in constant dollars, remains \$.20 per bushel.

he would have incurred had the market stopped at \$1.38. This saving is an undeserved gain because *S* implicitly contracted to bear the risk of a price rise to \$1.38 and was compensated for doing so. Put another way, *S* was paid to forego the gain an \$.18 rise would create. *B*'s new nominal profit would be \$.45 (the difference between his resale price of \$2.25 and the cover cost of \$1.80), but in real terms would remain \$.30. However, *B* would have lost the \$.18 he could have realized had the market stopped at \$1.38; that is, *B* would have been able to purchase at \$1.20 and resell at a price which reflected the \$.18 rise (*i.e.*, \$1.68). As *B* bought the right to enjoy this \$.18 gain, preventing him from recovering it would create an undeserved loss. Enforcement, on the other hand, requires *S* to pay \$.60 in damages, the difference between the contract (\$1.20) and cover (\$1.80) prices. Since *S* was only paid to bear the risk of an \$.18 rise, \$.42 of the \$.60 damages represents an undeserved loss. This \$.42 is correspondingly an undeserved gain to *B*, as he did not pay *S* to forego profiting from a price rise of that magnitude.

The above example illustrates that an appealing case for excuse sometimes exists. Enforcement would create an undeserved gain for *B* of \$.42, the increment of the price rise he did not buy the right to enjoy, and an undeserved loss for *S* of \$.42, the increment of the rise he was not paid to forego. By contrast, excuse would result in corresponding undeserved gains and losses of only \$.18. Excuse thus minimizes undeserved gains and losses.²⁴

The desert case plainly does not always hold. Assume that an unanticipated inflation raised the price in the seller/buyer market from \$1.20 to \$1.54. Were *S* to be excused, *B* would incur an undeserved loss of \$.18, the expected rise. Enforcement, on the other hand, yields an undeserved loss to *S* of \$.16, the increment of the rise which *S* was not paid to forego (damages are \$.34, the difference between \$1.54 and \$1.20). Thus, enforcement here minimizes the parties' undeserved gains and losses. The desert case therefore holds only when an unanticipated market-affecting event causes the market price of the goods at issue to rise by more than twice the anticipated amount.²⁵

24. Had *B*, immediately after his contract with *S*, made a resale contract at, for example, \$1.50 a bushel, the desert case would still justify excuse. The price compensated *S* only for bearing the risk of an \$.18 rise; enforcement requires him to pay \$.60 in damages, of which \$.42 is an undeserved loss to him and an undeserved gain to *B*. Excuse, however, would then apparently require *B* to cover at \$1.80 to fulfill a contract paying him only \$1.50, but the remedy is to excuse *B*, as seller, on his resale contract.

25. This relationship may be stated generally in algebraic form:

(1) Let PK = Contract price between *S* and *B* (*i.e.*, \$1.20).

R = Maximum expected price fluctuation range (*i.e.*, \$.18).

P_b = Buyer's expected resale price when original contract is made (*i.e.*, \$1.50).

Assume a price rise in the amount of R .

On excuse, *S* sells at $(PK + R)$.

B sells at $(P_b + R)$, and buys at $(PK + R)$.

S's gain from excuse is R , *B*'s loss from excuse is R .

Both gain and loss are undeserved.

(2) Let I = Inflationary rise factor (*i.e.*, 50%).

It is this "desert case" which seemingly underlies much of the claim that sellers should be excused during severe inflations, and which may have motivated the few recent excuse decisions.²⁶ Its validity will now be examined.²⁷

III. THE DESERT CASE AND CONTRACT STABILITY

The desert case is unsatisfactory because it would require courts to make factual findings and economic judgments of such complexity that the parties would often be unable to predict judicial outcomes. This uncertainty would seriously threaten contract stability by making performance much more costly to sellers than breach. For example, a seller confronted with a serious inflation will compare performance and breach costs. The performance cost is the difference between the market and contract prices, the sum he foregoes by performing. The breach cost is the damages the seller would have to pay, here the same market/contract differential, discounted by the probability of his losing the suit. When that probability is much less than 100 percent, as when the litigation outcome is quite uncertain, the performance cost substantially

On excuse, S sells at $(PK + IPK)$.

B sells at $(P_b + IP_b)$, and buys at $(PK + IPK)$.

S 's gain from excuse is IPK , B 's loss from excuse is IPK .

(3) On enforcement, in the case (1) situation, S 's gain from excuse, R , becomes a loss, also R , as S must sell at PK . This is a deserved loss. Let DL be the deserved loss (so that $DL_s =$ seller's deserved loss). $DL_s = R$. Similarly, in the inflation case, S 's gain from excuse, IPK , is converted into a loss from enforcement; also IPK , as S must sell at PK .

(4) When $IPK - DL_s > 0$, enforcement produces for S an undeserved loss; IPK is the total loss from enforcement and DL_s the deserved loss from enforcement. Conversely enforcement produces for B an undeserved gain, as he realized more than R , that is, IPK .

(5) When $IPK - DL_s > DL_s$, the undeserved loss to S exceeds the deserved loss (and conversely for B).

(6) $IPK - DL_s > DL_s$ when $IPK > 2DL_s$. As $DL_s = R$, the expected high, $IPK - R > R$ when $IPK > 2R$. Thus when the inflationary rise (IPK) more than doubles the expected rise (R) enforcement maximizes undeserved gains and losses. The case for excuse is made.

26. Unfortunately, courts seldom state the actual grounds of decisions to excuse or enforce. Nevertheless, the Massachusetts Supreme Judicial Court recently explained its affirmance of a decision excusing a seller from compliance because of an unforeseeable labor dispute by observing that when a risk materializes which has "such severe consequences" that it "must have been beyond the scope of the assignment of risks inherent in the contract" requiring performance "would be to grant the promisee an advantage for which he could not be said to have bargained in making the contract." *Mishara Constr. Co. v. Transit-Mixed Concrete Corp.*, 365 Mass. 122, 310 N.E.2d 363, 367 (1974). This is the desert case, although in a different context.

27. A third theme also contributes to the distaste for enforcement. While excuse deprives buyers of speculative gains, enforcement often imposes out-of-pocket losses on sellers. Although the economic cost of these misfortunes is identical, some probably feel that a party cares less about being forced to forego a speculative gain than to incur a net loss, or that society should be more concerned to prevent reductions in a party's estate than to protect gains to it. Sellers should thus be excused. This third theme plays a less significant role than those set out in the text; applying it would also entail many of the same difficulties inherent in the desert case. It does, however, raise an important issue, perhaps best pursued in other contexts, respecting when the law should treat identical economic costs differently.

exceeds the breach cost, thereby creating a significant incentive to breach. For example, assume the contract price was \$1.20, the market rose to \$1.80, and the seller thought he had only a 70 percent chance of losing a suit. The performance cost would be \$.60 while the breach cost—the risk of breach—is \$.42 ($.70 \times \$.60$). The seller thus is likely to breach.²⁸

Courts would face three difficulties in applying the desert case: (1) ascertaining the expected fluctuation range; (2) deciding whether the cause of the market advance was foreseeable; and (3) ascertaining whether that cause was principally responsible for the advance. Again, discussion will focus primarily on inflation as a paradigm case.

A. THE EXPECTED FLUCTUATION RANGE

The desert case requires excuse only when the actual price rise more than doubles the expected high.²⁹ Applying it thus requires a finding as to what the expected high was. This finding will be difficult to make because the expected high is a fictional concept adopted for expositional purposes. Although the parties know that prices may rise, they foresee the possibility in terms of several future prices, each having a different probability of occurrence. Thus, their expectations are not represented by a point but by a curve of possible future prices discounted by their respective probabilities. Excuse would then minimize undeserved gains and losses when the actual price rise more than doubles the outside point on the curve, or points to which the parties attached a sufficiently low probability as to ignore.

Therefore, courts must ascertain the shape and scale of the future price curve. When the contract is silent and the parties otherwise say nothing respecting fluctuations, a common situation, this entails reconstructing a curve from tacit expectations alone, an obviously difficult job. The contract price is irreducibly ambiguous. It is the product of many factors, including predictions of market participants respecting future price levels, but it discloses nothing about how those factors were assessed. Past history is germane but would often be inconclusive. Even if the instant price rise is the largest on record, it may have been anticipated if current market factors differed from past ones; whether they did, and how the differences cut, will

28. Performance cost often equals damages in contract cases, so that uncertainty as to judicial outcomes would frequently create an incentive to breach. This partly explains the courts' emphasis on predictability in contract law. The textual discussion is nevertheless too simple, as it presupposes that the seller is not risk-averse. More seriously, goodwill losses must be added to damages when computing breach cost. When the seller's out-of-pocket increment of performance cost is large, however, performance may create "secondary" losses, such as the inability to fulfill business plans because of the cash shortage resulting from buying high and selling low. These secondary costs may often outweigh the good-will loss from breach. When that is so, litigation uncertainty would acutely threaten contract stability.

29. See text accompanying notes 21-27 *supra*.

usually be hard factual issues. Other evidence, such as negotiations by different parties or market letters, might help, but that evidence too would often fail to shed much light on what the parties at bar assumed, or should have assumed.³⁰

It may be objected that since actual price rises are likely to exceed expected ones by a wide margin in disastrous inflations, limiting excuse to such inflations would relieve courts from finding the future price curve with precision. Put simply, sellers can make out a prima facie case for excuse on this issue by proving a disastrous inflation because the economic effects of such inflations are likely to outstrip the parties' expectations by the requisite margin. Moreover, the parties would be able to predict judicial outcomes as they too would know when the heavens had fallen. This objection may be tenable for catastrophic inflations such as the German one of 1920-23. However, many inflations fall far short but are nonetheless serious. In them, changing the factual referent from "future price curve" to "disastrous inflation" would seldom make judicial outcomes more predictable. For example, is a 40 percent inflation disastrous? Did the United States experience "disastrous" inflations in 1946 and in 1973 and 1974?³¹

Ascertaining the expected fluctuation range is the initial obstacle to judicial application of the desert case for excuse. Unfortunately, the last two elements of this case would also be difficult to apply.

B. FORESEEABILITY

The appeal of the desert case derives primarily from the view that a party should not be made to bear costs resulting from risks he did not consent to take. The desert case thus presupposes that the event relied on to excuse was unforeseeable, since neither party consents to bear costs resulting from unforeseeable risks. Sellers do implicitly consent to bear foreseeable

30. Professor Michael Levine of the University of Southern California Law Center has pointed out that the parties' expectations may in fact be asymmetric. The price reflects the aggregate expectations of market participants, but the litigating parties may have different subjective views as to the expected fluctuation range. This may not be unusual in markets where speculation is frequent, as people apparently speculate because they hold unrepresentative beliefs as to future prices. See Hirshleifer, *Speculation and Equilibrium: Information, Risk and Markets*, 89 Q.J. ECON. 519 (1975). Thus, a court may sometimes have to find two expected price fluctuation curves, not one. Actual rises which more than doubled the outside of *both* parties' curves would satisfy the case for excuse, while rises clearly within both curves would not. The parties might assign such differing values to the expected high, however, that the desert case would be nondirective for inflations of certain extents. A court would then have to decide which party's expected price fluctuation prediction was the more reasonable, making litigation even less predictable.

31. German courts, probably in response to difficulties such as these, only began excusing when the inflation became truly extraordinary. See Dawson, *Effects of Inflation on Private Contracts: Germany, 1914-1924*, 33 MICH. L. REV. 171, 180-200 (1934).

price-affecting risks when they agree to fixed-price contracts. Some who breach during inflations, however, will not have foreseen—will not have subjectively consented to bear—the risk of the price-affecting event which materialized; and many sellers can plausibly claim they did not. The issue for courts is whether the particular risk should have been foreseen. The evidence respecting the foreseeability of inflations is, however, usually inconclusive, which again implies that judicial outcomes based upon the desert case would be difficult to predict.

The argument that modern inflations are foreseeable begins with the fact that price is a function of consumer income.³² Thus, parties concerned to predict future prices must, and often do, make predictions respecting income.³³ Consumer income itself varies directly with aggregate demand, the total demand yielded by consumption, private investment, and government spending. Market participants must therefore estimate aggregate demand for relevant future periods. One doing this may be expected to realize that “[E]very inflation in U.S. history has been associated with a too rapid expansion of nominal aggregate demand.”³⁴ These expansions are caused by expansionary fiscal and monetary policies, the pursuit of which is frequently public knowledge. Moreover, such policies are often initiated during wars, a fact which by now seems well known.³⁵ The widespread use of escalator clauses in private contracts³⁶ thus evidences the apparent foreseeability of government-caused inflationary price rises.

32. G. STIGLER, *THE THEORY OF PRICE* 34 (3d ed. 1966).

33. For an explanation of how predictions respecting aggregate income are included in price forecasts, see S. KROLL & I. SHISHKO, *THE COMMODITY FUTURES MARKET GUIDE* 186-93 (1973).

34. C. BAIRD, *MACROECONOMICS: AN INTEGRATION OF MONETARY, SEARCH, AND INCOME THEORIES* 258 (1973) (emphasis original).

35. Apparently, all inflations in American history save one, the slow rise in prices between 1896 and 1914, have been associated with increases in the money supply effected by government attempts to finance wars. See *AMERICAN ECONOMIC GROWTH: AN ECONOMIST'S HISTORY OF THE UNITED STATES* 363-65 (L. Davis, R. Easterlin & W. Parker eds. 1972). See also A. ALCHIAN & W. ALLEN, *UNIVERSITY ECONOMICS* 672-73 (3d ed. 1972); W. PETERSON, *PRINCIPLES OF ECONOMICS* MACRO 46-47 (1974).

36. [A] price escalation clause permits the seller to adjust a currently determined price . . . to reflect subsequent changes in the cost to the seller of specific items directly or indirectly involved in the manufacturing of the product or provision of the service. Stothoff, *Escalation Clauses . . . Are Escalating*, CONFERENCE BOARD RECORD, Dec. 1973, at 23. Such clauses usually contain a description of the cost elements to be escalated, a stipulation of the indices by which cost changes are measured—for example, the Metal and Metal Products Index—and the limit within which fluctuations may occur (*e.g.*, price may go up or down no more than 15%). For observations as to how common these clauses are becoming, see *id.*; *On the Escalator*, in *Wall Street Journal*, Mar. 10, 1974, at 4, col. 15; *Machine Tools; Forced to the Escalator*, *IRON AGE*, Apr. 15, 1974, at 36; *Suppliers' Unfirm Prices Push Contractors Toward Escalator Clauses in Bids*, in *AIR CONDITIONING, HEATING & REFRIGERATION NEWS*, Aug. 1973, at 28.

Other significant causes of price rises may also have been foreseeable. For example, the most recent serious shortage was in oil. The belief that the Arab states could not use oil as a political weapon was widespread because those states had seldom acted effectively in concert. They did act effectively in concert. But that political factors could affect oil prices seemed knowable. Moreover, the long-standing use of broad *force majeure* clauses evidences the apparent foreseeability of significant market-affecting events.³⁷

The argument that such events are often unforeseeable is based on the failure of many parties to foresee recent economic expansions. For example, the "real" rate of interest (the nominal rate less the percent by which inflation increased) on prime commercial paper in 1969 and 1972, two inflationary years, was 2.4 percent and 1.4 percent, respectively,³⁸ suggesting that professional lenders badly underestimated the existence and extent of inflationary pressures. There were similar miscalculations by many nonfinancial corporations.³⁹ The energy crisis also plainly found many sellers unprepared. Since so many professionals made mistakes, it seems plausible to infer that the data which would permit accurate predictions was lacking.

Evidentiary conflicts of this kind would make judicial outcomes difficult to predict for two reasons. First, the evidence in particular cases would often be inconclusive. Second, because of this, judicial decision would probably turn on matters extraneous to the foreseeability issue. The most likely of these would be the effect on the parties of enforcement or excuse; courts would compare satisfactions under the guise of foreseeability. The outcome of these comparisons, as noted previously, is often impossible to predict.

It may again be objected that disastrous inflations or radical supply interruptions are most frequently unforeseeable; thus these prediction difficulties would be obviated if courts only excused in such cases. The objection has force in an inflation like the German one, but the factual referent "disastrous" would too often be insufficiently directive.

37. Commentators thus claim that in, 1956, concerned parties were aware of the possibility that the Suez canal might be closed. See Berman, *Excuse for Nonperformance in the Light of Contract Practices in International Trade*, 63 COLUM. L. REV. 1413, 1422-23 (1963); Schlegal, *Of Nuts, and Ships and Sealing Wax, Suez, and Frustrating Things—The Doctrine of Impossibility of Performance*, 23 RUTGERS L. REV. 419, 430 (1969).

38. W. PETERSON, *PRINCIPLES OF ECONOMICS* MACRO 54 (1974).

39. See Bach & Stephenson, *Inflation and the Redistribution of Wealth*, 56 REV. ECON. & STAT. 1 (1974).

C. CAUSATION⁴⁰

The desert case for excuse assumes that the seller has not agreed to bear the risk of a serious inflation. A causation problem exists because actual price rises are often the result of several causes, the risks of some of which sellers *do* usually agree to bear. Thus, a court cannot excuse without isolating and evaluating inflation's contribution to the price rise at issue. In this section it is shown that: (1) price rises do have multiple causes; (2) a case for excuse ordinarily exists only when inflation produced more than 50 percent of the price rise at issue; (3) it will be extraordinarily difficult for courts to isolate inflation's contribution; so that (4) were courts to use the desert case, the parties would often be unable to predict the judicial outcome on the causation issue.

Inflation occurs when nominal aggregate demand exceeds the economy's productive capacity. Output cannot expand quickly enough to satisfy the increased demand, with the result that resources become scarce and therefore more expensive. Individual prices, however, do not necessarily rise at the same rate as the general price level⁴¹ because inflation does not affect the causes of changes in relative prices. For example, assume that product A originally costs less than product B. *Without inflation*, consumer tastes changed so that more people want A and less want B. The price of A will rise; the price of B will drop. An inflation would then increase the prices of both products. With respect to a manufacturer of A who has made a contract for future delivery at the original price, the market increase—and hence the seller's loss from compliance with the contract—may be substantial, but only a small fraction of this loss may result from inflation.

However, the case for excuse can only be made when (1) the price rise more than doubled the expected high;⁴² and (2) inflation caused more than 50 percent of the rise. This is so because, were inflation's contribution to be less than one-half, *excuse* would maximize *undeserved* gains and losses. To illustrate this, assume that the parties foresaw no inflation, that the contract price was \$5, and that the expected price range up was \$2, but the actual advance more than doubled this, being \$4.20. Let inflation cause \$2.05 of this rise; normal foreseeable supply factors, \$2.15. Excuse saves \$4.20, the difference between the contract price (\$5) and the market price (\$9.20). Of this sum, \$2.15 is an undeserved gain to *S* and an undeserved loss to *B*, as *S* was paid to forego losses caused by normal, foreseeable events.

40. The textual discussion which follows exclusively concerns inflations. For an explanation of its application to price rises resulting from unanticipated supply shortages, see note 46 *infra*.

41. C. BAIRD, *MACROECONOMICS: AN INTEGRATION OF MONETARY, SEARCH, AND INCOME THEORIES* 254 (1973).

42. See notes 21-26 and accompanying text *supra*.

Enforcement would cause *S* a loss of \$4.20 (*B*'s damages) of which only \$2.05 is undeserved (and an undeserved gain to *B*), being the result of an unforeseeable inflation. Thus, *enforcement* minimizes undeserved gains and losses, and always will when inflation causes less than one-half of the price rise at issue.⁴³ Courts must therefore find which portion of the rise was attributable to inflation.

If the other operative cause was a change in consumer tastes, as in the illustration above, ascertaining inflation's contribution seems terribly difficult. Sellers very roughly know their own demand curves and ultimately recognize shifts in them.⁴⁴ Yet how much of a particular shift is attributable to a change in tastes and how much to a general increase in aggregate demand seems very hard to know without market surveys. Yet these surveys are costly—too costly to be done for many lawsuits. Moreover, surveys may be inconclusive. A buyer himself might not know whether he bought the hat because hats had become fashionable, or because his income went up, or for both reasons.

In addition, a product may increase in price because of (1) a rise in the price of demand-related goods: if the price of butter goes up, more buyers

43. This illustration's assumptions seem inconsistent with those used to develop the desert case initially, because it is assumed here that *S* was paid to risk some price rises above the expected fluctuation range. The new assumptions, made explicit in this note, add realism to the argument. The text now assumes that sellers are expected to deliver on all price rises within the expected range, however caused, because the parties seem to share this assumption. Their motive apparently is that as price rises can have many causes, it is not worth analyzing causation when the market result remains normal. The text also assumes, again because the parties seem to, that sellers bear the risk of price rises above the range—although perhaps not those substantially above it—if those rises result from standard, foreseeable price-affecting events. This assumption follows largely from the lack of evidence of a custom to share the risks arising from such events. Rather, the scanty evidence which exists is the other way. Risk-sharing seems to be accomplished through the use of escalator clauses. However, these are used mainly in times of economic upheaval. They are meant to allocate the risk of events such as inflation, depression, and so forth, not to split the risks of standard, foreseeable price-affecting events. Also, as courts have always fully allocated these risks to the parties—sellers bear the risk of rises, buyers of declines—the parties to a fixed-price contract which is silent respecting risk-sharing may be presumed to share the courts' construction of their intentions. Sellers, in sum, are assumed to bear the consequences of standard, foreseeable risks unless they say otherwise. Thus, the desert case applies only when the full or major cause of a price rise is a nonstandard, unforeseeable event, such as inflation, embargo, war, tidal wave, etc.

44. Baird describes the difficulty sellers have in recognizing shifts in their demand curves:

The position of the demand curve faced by any seller is not known with certainty. Each seller's sales rate fluctuates up and down from day to day. For a given set of demand conditions these sales rates are distributed around some mean (average). If this sales distribution is shifted to the left by a restrictive monetary policy, at first the lower sales rate will be interpreted as coming from the lower end of an unchanged distribution. Only after time will the seller become convinced that his demand curve has shifted down.

C. BAIRD, *MACROECONOMICS: AN INTEGRATION OF MONETARY, SEARCH, AND INCOME THEORIES* 273 (1973). See also *id.* at 53, 274. This information problem also exists when, because of expansionary policies, the sales distribution shifts to the right.

will switch to margarine, its principal substitute, the price of which will then rise; or (2) a drop in the price of supply related goods: if the price of wool drops, less will be produced, thereby reducing the supply and increasing the price of mutton.⁴⁵ Let product A rise in price. If the increase was caused by the price rise of a substitute which itself was not a function of inflation, or a drop in price of a supply-related product, the A seller's contract should be enforced; conversely, if the A price rise was the result of the inflationary price increase of an important substitute, the A seller should be excused. This makes germane, in an action against a breaching seller, the price movements of supply and demand related goods, the causes of *these* movements, and their contribution to the price rise at issue. The lawsuit would be quite complex.

Price rises also are a function of supply elasticity. When faced with an inflationary demand increase, an industry with slack capacity—where supply is relatively elastic—will expand output; prices will not rise by much. An industry already at full capacity, however, will in the short run ration output by price. In the latter case, inflation *and* supply inelasticity *both* contributed to the price rise. Such short-run supply inelasticity in an industry seems sufficiently important and knowable that the risk of its adverse impact on prices can be classed as ordinary. Therefore, since sellers bear ordinary price-affecting supply risks, a court must distinguish the effects of inflation from those of supply elasticity, which again seems quite difficult.

Finally, when multiple factors cause a price rise, relative causation is extraordinarily difficult to establish. A particular rise may be a function of taste changes, substitute price changes, supply inelasticity, government regulation and increases in aggregate demand. Economic analysis can tell us with relative convenience which potential causes contributed to the price rise at issue; but it cannot isolate (even approximately) the contribution of each factor without a large, complex econometric model of the industry, specifying accurately the supply and demand sides of the market. The model would then require a great deal of data for its operation. The costs of doing this would seem almost always to outweigh the gains either party could derive from a lawsuit. Yet without such a model, the desert case would be nondirective in multiple cause cases. It would require a finding which absent the model could not be made, that an unanticipated inflation caused more than 50 percent of the price rise at bar. Any decision to excuse would therefore be arbitrary.⁴⁶

45. J. HIRSHLEIFER, PRICE THEORY AND APPLICATIONS 27 (1976); G. STIGLER, THE THEORY OF PRICE 23, 31-33 (3d ed. 1966).

46. Causation may seem easily established when an isolated event, such as an embargo,

To summarize, the causation issue—which increment of an unanticipated price rise was caused by inflation—raises factual questions that are tortuously difficult to resolve, and which often may not be litigated fully because the costs to the litigants of developing the facts will often exceed the gains to them of doing so. Decisions to excuse would therefore often be arbitrary. The opinions would specify a variety of factual circumstances without coherent explanations of their relevance. With the meaning of the causation requirement so obscure, the parties would have little guidance as to the consequences of breach, with the inimical effect on contract stability already explored. Moreover, sellers affected by cost increases resulting only from risks they had agreed to bear might nevertheless breach, attributing the increases to government economic policy, the risk of which they did not assume. Because the government so frequently pursues expansionary policies, which have widespread effects, many of these claims might appear superficially plausible. The difficulty of isolating the contribution of inflation to a price rise would make the appearance hard to dispel.⁴⁷

SUMMARY

The cases offer four reasons for requiring sellers to pay: (1) since sales contracts allocate market fluctuation risks, the promisor is bound to

produce the price rise. This is sometimes true with respect to sales of the affected item itself, but simplicity disappears when the product becomes a factor in the production of other things. For example, the rise in agricultural prices is sometimes said to result from the energy crisis, which raised the price of many agricultural inputs. Yet agricultural economists show that several events, including shifts in consumer tastes, inflation, and government agricultural policy contributed in complex ways to the food price increases. See Hathaway, *Food Prices and Inflation*, in BROOKINGS PAPERS ON ECONOMIC ACTION 63, 83-102 (A. Okun & G. Perry eds. 1974). See also Carter, *The 1975 Report of the President's Council of Economic Advisers: Food and Agriculture*, 65 AM. ECON. REV. 533, 536 (1975).

47. Courts in sales cases apparently do not mention the causation problem explicitly, although they seem influenced by it. A federal district court, however, partly explained its refusal to revise upward the rental term of a 10-year lease which inflation allegedly made obsolete by noting:

Sorting out how much of inflation is attributable to deficit budgets to finance essential federal programs, how much results from oil price increases by OPEC countries, how much from uncontrolled collective bargaining agreements, and how much from other domestic and international causes, would be a fearsome task. A court should not, without Congressional guidance, single out a particular landlord or other victim of inflation to be compensated at the expense of all the other taxpayers in the United States.

Brubrad Co. v. United States Postal Serv., 404 F. Supp. 691, 695-96 (E.D.N.Y. 1975) (respecting a lease with the Postal Service, the court held that the Service need only pay the 1964 rental until termination).

Professor Dawson has also suggested that one source of judicial reluctance to intervene in private bargains affected by inflation may lie in the difficulty of distinguishing monetary from supply-demand causes of rising prices. Dawson & Cooper, *The Effect of Inflation on Private Contracts: United States, 1861-1879*, 33 MICH. L. REV. 852, 871, 892-93, 913-14 (1935).

perform;⁴⁸ (2) that performance has become more burdensome is no excuse;⁴⁹ (3) the promisor should have foreseen the event causing the loss;⁵⁰ and (4) the promisor should have protected himself against the price rise at issue.⁵¹ The first two of these are tautologies. The last two do not explicitly respond to the desert case for excuse, but they do suggest an awareness of its administrative difficulties. That case, as previously noted, rests on widely acceptable values—that people should neither bear unpleasant consequences they have not agreed to risk nor be deprived of gains they bought the right to enjoy. The appeal of these values may largely explain the commentators' distaste for the courts' results. Yet the desert case seems too complex for courts to apply. The risk of pursuing it is that the utility of forward sales contracts may be seriously impaired. The complexity and the risk largely explain the courts' longstanding decision to enforce. More importantly, they justify it, as do the macroeconomic considerations to which consideration must now be given.⁵²

48. *E.g.*, *Pacific Trading Co. v. Mouton Rice Milling Co.*, 184 F.2d 141, 149 (8th Cir. 1950) ("The fluctuation in market prices is within the contemplation of the parties to every contract to sell for future delivery, and the risk of loss attendant upon it is assumed by the buyer and seller alike in the absence of an explicit provision against it in the contract.").

49. *E.g.*, *Gross v. Exeter Mach. Works, Inc.*, 277 Pa. 363, 368, 121 A. 195, 197 (1923) ("The affidavit [of seller] also avers that, owing to the abnormal demand for rolling mill products, defendant was unable to obtain the required material 'within any reasonable bounds of effort or expense'; but that is unavailing; mere hardship or difficulty is no excuse for failure to perform a contract. . . . [citations omitted]").

50. *E.g.*, *Maple Farms, Inc. v. City School Dist.*, 76 Misc. 2d 1080, 1085, 352 N.Y.S.2d 784, 789 (Sup. Ct. 1974) ("[A]ny businessman should have been aware of the general inflation in this country during the previous years and of the chance of crop failures.").

51. *E.g.*, *Terry Contracting v. Commercial Ins. Co.*, 16 Misc. 2d 475, 476, 156 N.Y.S.2d 285, 287 (Sup. Ct. 1956) ("He [the seller] made no attempt to protect himself . . . against a rise in the price of steel during the period necessarily intervening before plaintiff might require delivery.").

52. Some commentators suggest that courts should revise the price term to reflect the unanticipated event rather than excuse. *See* note 3 *supra*. The suggestion is untenable if made in pursuit of the harshness case, since courts can neither find the facts nor make the value choices required to fix a "fair" price. The unpredictability the effort would foster would also seriously impair contract stability. Price fixing in pursuit of the desert case, however, seems justifiable. A price could be set to ensure the buyer his speculative gain, thereby imposing a deserved loss on the seller, but also to prevent windfall profits. For example, in the textual illustration accompanying notes 21-24 *supra*, the contract price was \$1.20, the expected rise was \$.18 and the price at which parties like *S* sold and *B* bought rose to \$1.80. Were a court to fix *S*'s price at \$1.62, *B* would have his deserved gain of \$.18, as he would resell in a market reflecting a wholesale cost of \$1.80; *S* would incur a deserved loss of \$.18, as he would be compelled to sell below the \$1.80 market price. Nevertheless, *B* would have to pay \$.42 above the contract price, thereby ensuring that he realized no undeserved gain, nor *S* an undeserved loss. Unfortunately, this happy outcome seems precluded by the administrative difficulties just discussed. To fix prices in this way courts would have to ascertain the future price curves, find that the event causing the rise was unforeseeable, and resolve the causation issue. Courts are incompetent to perform these tasks, and the effort would again unacceptably impair contract stability.

IV. MACROECONOMIC CONSIDERATIONS

Enforcement maximizes the use of escalator clauses, which are anti-inflationary. Every sale for future delivery is attended with the risk that a subsequent inflation may adversely affect a party's costs. If sellers are excused, buyers bear this "inflation risk"; if contracts are enforced, sellers bear it. Escalator clauses, which permit a seller to adjust the contract price to reflect subsequent cost changes, minimize the seller's inflation risk.⁵³ The magnitude of this risk is partly a function of supply elasticity; prices rise more in industries operating close to capacity before the demand increase. A seller who deals directly with manufacturers or suppliers has a better opportunity to know supply conditions than his buyers and is therefore more likely to predict accurately the effect an inflation would have on his industry. Thus, assigning the inflation risk to sellers, *i.e.*, enforcing, yields more escalator clauses than would the contrary risk allocation.

It may be responded that, were buyers to bear the risk (*i.e.*, were sellers to be excused), knowledgeable sellers would offer escalator clauses so as to reduce buyer risks, and thus buyer costs. This objection ignores the parties' unequal access to information and their incentives. The buyers' inflation risk is the risk that his seller will breach and be excused, so that the buyer would incur the expense of making two purchases and lose his expected speculative profit. The value of this risk is partly a function of the likelihood of the seller breaching—of, that is, there occurring an inflation of the requisite extent. If a buyer, because he lacks supply information, incorrectly believes that a serious inflationary price rise is unlikely, he also subjectively believes that the value of the inflation risk is less than it actually is. Thus he perceives an artificially low purchase cost. A seller would have no incentive to dispel this erroneous belief. Initially, as sellers in this legal regime are excused in the event of a serious inflation, they have little need for escalator clauses. Also, these clauses may reduce the chance of sellers escaping the deal.⁵⁴ Finally, the fact of a seller offering an escalator clause may inform the buyer that he was undervaluing the inflation risk, and thus had an artificially low cost perception. Since more goods are purchased at lower prices, the awareness that costs are higher than they seem is one sellers do not want buyers to have. Therefore, were the inflation risk assigned to buyers, fewer escalator clauses would be used than now are.

The "macro" benefit of maximizing the use of these clauses is that

53. See note 36 *supra*. The argument in Section IV applies only to the inflation problem of course.

54. One recent case, for example, read an escalator clause as shifting the risk of foreseeable cost increases to buyers but imposing the risk of unforeseeable increases on sellers. See *Publicker Indus. Inc. v. Union Carbide Corp.*, 17 UCC REP. SERV. 989 (E.D. Pa. 1975).

they produce price reductions when demand drops, and thus assist government measures to fight inflation.⁵⁵ This occurs because escalator clauses reduce the unpleasant side effects of anti-inflationary actions, making it more likely that they will be undertaken. For example, a restrictive monetary policy reduces aggregate demand. Manufacturers initially faced with decreased demand reduce output rather than price, because they do not know whether the decrease will continue. Reducing output produces unemployment. Since unemployment is politically unpopular, there is pressure against the government reducing the money supply. A reduction, however, would cause relatively prompt price declines in some markets sensitive to economic trends, such as commodities and raw materials. These declines, which are reflected in standard indices, trigger escalation clauses, causing sellers to reduce prices rather than output. This maintains employment. Thus, escalator clauses reduce the pressure on government not to reduce the money supply, thereby aiding it to fight inflation. Other things being equal, courts should then adopt rules encouraging the use of these clauses. To be sure, as inflations are sometimes hard to anticipate and as the supply effect may be limited, imposing the risk of inflation on sellers may not yield many more escalator clauses than would the opposite risk allocation. Also, as theories of what actually motivates government decisionmakers are quite primitive, the anti-inflationary impact of these clauses is speculative. However, some macro gains may flow from maximizing their use and none seem to flow from their absence.⁵⁶

V. SECTION 2-615 OF THE UNIFORM COMMERCIAL CODE

Section 2-615 excuses a seller "if performance . . . has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made"⁵⁷ This rubbery language only reproduces the common law rules of frustration and impossibility, and therefore permits courts to do what they have always done. However, comment 4 to section 2-615 expresses the draftsmen's hope that the section excuse sellers in certain of the situations discussed here:

55. For commentary on the anti-inflationary effects of escalator clauses, see Giersch, *Index Clauses and the Fight Against Inflation*, in *ESSAYS ON INFLATION AND INDEXATION I* (American Enterprise Institute for Public Policy Research 1974); Friedman, *Monetary Correction*, in *id.* at 25.

56. Some economists claim that under some circumstances escalator clauses may accelerate the rate of inflation by producing rapid price rises. See Bernstein, *Indexing Money Payments in a Large and Prolonged Inflation*, in *id.* at 71; Ritter, Book Review, 13 J. ECON. LIT. 925, 926 (1975). This claim seems unpersuasive, since the inflation rate is exogenously determined—that is, it is a function of aggregate demand, not individual firm costs, and aggregate demand is itself a function of national income. Escalator clauses do transmit the effects of inflation quickly and evenly, but this has no effect on the rate and is otherwise desirable on equity grounds.

57. UNIFORM COMMERCIAL CODE § 2-615.

[A] severe shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shut-down of major sources of supply or the like, which . . . causes a marked increase in cost . . . is within the contemplation of this section.⁵⁸

Two justifications of this use of section 2-615 may be attempted: (1) it codifies the authorities; or (2) it is a justifiable application of the section.

The first justification cannot be made. The only authority the draftsmen cited in direct support of comment 4 is a lower court English case⁵⁹ which excused a seller who imported wheat to make flour from complying with a contract to sell flour because of the market disturbances World War I caused. However, the contract, made on July 27, 1914, authorized the seller to cancel "in case of prohibition of export . . . preventing shipment or delivery of wheat to this country . . .,"⁶⁰ and 21 countries, including some substantial English suppliers, prohibited the export of wheat.⁶¹ The court, relying exclusively on the contract, held that the quoted clause was meant to apply to serious interferences with the English supply, and not only to the total prohibition of imports, since it was inconceivable that England would ever be completely cut off from external sources of wheat.⁶²

The Code comments go on to cite two American cases in support of the position that sellers should be excused when the parties "contemplated or assumed" that the goods were to be obtained from "a particular source of supply," and it failed through casualty.⁶³ These authorities not only fail to support the position, but contradict the claim that unexpected and dramatic cost increases excuse sellers. One case⁶⁴ involved a contract to deliver timber from a particular place. The court held that the seller was not liable for failing to deliver timber that had been destroyed by fire but refused to excuse him from delivering the remainder, although the fire caused the delivery cost to rise to about \$20.00 per cord and the contract price was \$5.50. In the other,⁶⁵ the court refused to excuse a seller where delivery was prevented by an embargo the European powers imposed in World War I, and where, as a result, the price of the domestic substitute rose from \$.075 to \$1.00 per pound. The comments cite no other cases which even purport to

58. *Id.*, Comment 4.

59. *Ford & Sons (Oldham) v. Henry Leatham & Sons*, 31 T.L.R. 522 (K.B. Div. 1915).

60. *Id.*

61. *Id.*

62. *Id.* at 523.

63. UNIFORM COMMERCIAL CODE § 2-615, Comment 5.

64. *International Paper Co. v. Rockefeller*, 161 App. Div. 180, 146 N.Y.S. 371 (1914).

65. *Thaddeus Davids Co. v. Hoffmann-La Roche Chem. Works*, 178 App. Div. 855, 166 N.Y.S. 179 (1917).

excuse sellers in the circumstances described in this Article, and, as Section I shows, pre-Code law plainly required performance.⁶⁶

The conclusion comment 4 draws—that sellers should be excused—also fails to follow from its premise, that performance was affected by an unforeseen contingency. Such a contingency imposes costs on both parties. Whether sellers should be excused turns on whether the desert case for excuse can be made out. The draftsmen, however, made no effort to establish the case in the circumstances they describe. Indeed, they failed to perceive the necessity of doing so. Moreover, nothing in section 2-615's language, comments, or history indicate which case for excuse the statute adopted; nor do these materials reveal any perception of the threat to contract stability that all cases for excuse raise, or any awareness of the possible anti-inflationary effect of the decision to enforce. Courts should therefore refuse to accept comment 4's invitation to apply section 2-615 to the inflation problem.⁶⁷

CONCLUSION

Courts generally enforce sales contracts although the seller's performance was made more costly by unanticipated events. Two arguments may be made against this result: (1) imposing large costs on sellers is unacceptably

66. See notes 7-8 and accompanying text *supra*.

67. This Article does not consider legislative solutions explicitly directed to these problems; its scope is limited to the remedies that sales law affords. Legislative solutions may have advantages over judicial ones. In particular, legislatures may appropriately resolve many of the value conflicts the harshness case would raise. Legislatures are also permitted grosser classifications than those courts may make. For example, a statute could excuse all sellers of a certain kind who contracted between specified times—presuming that the desert case would require excuse for enough of them to make the classification justifiable. However, the "distributional" judgments of the harshness case do seem more difficult than those legislatures ordinarily make: the affected parties are business professionals who often are in the same social and economic classes, thereby precluding the standard distributional classifications of "rich," "middleclass," and "poor." Moreover, as parties in the same trade have apparently had disparate success in resolving these problems (see note 12 *supra*), any classification based on the desert case might be excessively inaccurate. Thus far no significant legislative relief has issued. Congress recently passed the Small Business Emergency Relief Act, 89 Stat. 1095 (1975), affecting government contractors who (1) are "small businesses" within the meaning of the federal act (72 Stat. 384 (1958)), and (2) made fixed-price government contracts, the performance of which was affected by "significant" unanticipated cost increases, between August 15, 1971 and October 31, 1974. An object of this Act is to prevent the contractors from suffering "financial ruin," but the relief provided is only to authorize government agencies, in their discretion, to excuse contractors from performance, a power business buyers now possess. See H.R. Rep. 94-154, 94th Cong., 1st Sess. 1 (1975); S. Rep. 94-378, 94th Cong., 1st Sess. 2 (1975). Under prior law, the government had to enforce all procurement contracts. The House bill also authorized government agencies to increase prices on certain contracts if that would most efficiently aid procurement, but this the Senate rejected. See H.R. 5541, 94th Cong., 1st Sess. (1975); 121 CONG. REC. S. 18993 (daily ed. Oct. 30, 1975).

harsh; (2) often, a substantial portion of those costs are "undeserved," in that they reflect the materializing of risks which sellers did not agree to bear. The first argument is judicially inadmissible. The costs sellers incur are gains to buyers; courts should thus excuse only when the satisfaction sellers lose by enforcement outweighs the satisfaction buyers gain by it. However, judgments based on relative satisfaction require courts to make moral comparisons which they are institutionally incompetent to make and require facts relevant to those comparisons which courts cannot get. Moreover, neither party, at the time of performance, could predict the outcome of these interpersonal comparisons were courts to make them. This uncertainty would cause many sellers affected by unexpected cost increases to breach, as the cost of breaching would often be lower than the cost of performance. The second argument, which focuses on "desert," is appealing, for it is implied by widely acceptable values. However, it seems administratively unworkable. The uncertainties inherent in its use would make judicial outcomes unpredictable, thereby again threatening contract stability. The courts, therefore, have chosen the efficiency case for enforcement over the equity case for excuse. When the anti-inflationary effect of the decision to enforce is also put on the scale, that choice seems plainly right. Finally, a comment to section 2-615 of the *Uniform Commercial Code*, that suggests that courts should excuse in certain of the circumstances described here, should not be followed. The section's loose language enables courts to exclude the unanticipated cause case without being faithless to the text.

