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Judicial Intervention in Contractual Relationships Under the Uniform Commercial Code and Common Law

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JUDICIAL INTERVENTION IN CONTRACTUAL RELATIONSHIPS UNDER THE UNIFORM COMMERCIAL CODE AND COMMON LAW

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I. INTRODUCTION

The recent instability in the Middle East and its effect on both the domestic and world economies illustrates the importance of long-term contracts.[1] Long-term contracts can allow parties to avoid sudden

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1. Oil, a strategic commodity for almost all of the world's economies, jumped in price from just over $15 a barrel prior to Iraq's invasion of Kuwait to over $40 by October 15, 1990 (Brent North Sea Crude). *Crude Oil Falls Below $30 as Sentiment Shifts*

and temporary increases in prices caused by shocks to the economy.[2] This instability has emphasized the importance of contract law and the doctrines of commercial impracticability, frustration of purpose, and mistake. Earlier oil crises demonstrated the importance and relevance of these doctrines.[3] A commercial entity can attempt to limit the long-term negative effects of such shocks to the economy through the use of strategic planning and long-term contracts.

A. *Strategic Planning for Businesses*

Strategic planning is an important aspect of any successful business. A business must carefully manage its growth. For example, a manufacturing concern must forecast its potential sales growth so that management can determine production requirements. A forecast also provides a realistic outlook for the company's shareholders and lenders. Based on this forecast, management may hire more employees, seek more or less manufacturing space, obtain a steady source of raw materials, or seek additional sources of capital.

The strategic planning process for a manufacturer usually starts with the sales department forecasting sales volume and timing for the period in question. Once management is comfortable with this number, which is essentially a good faith estimate, the forecast is sent to the purchasing department. The purchasing department then estimates the raw materials needed to meet the sales forecast. Next, it locates sources for the needed raw materials and seeks commitments from its suppliers to provide the raw materials. The company probably will contact several suppliers to obtain the best price and an assurance that the supplier can provide the materials on time. Often the needed materials come from overseas and are seasonal in nature, or they are in

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After Statements in Middle East, Wall St. J., Oct. 23, 1990, at A3, col. 2 (see the accompanying graph in the newspaper article, which shows July-October rise in prices).

2. Many shocks to the economy, such as recent increases in oil prices, are only of brief duration. If the term of a contract is several years, the buyer and seller in a fixed-price contract would be able to avoid the effects of any short-term price fluctuation. A long-term contract provides an element of stability during which the contract price will not be subject to change. Any risk of a short-term price fluctuation is thus tempered by the long-term commitment to price. If the contract term is long enough, the price of the particular commodity may rise or fall and return to its original price during the contract term. Thus, many purchasers of oil products avoided price increases during the recent Middle East War through their long-term contracts. The risk exists, however, that any change in a commodity's price will be a long-term change. If the change extended beyond the contract's term, it would potentially limit the benefit from a long-term contract.

3. *See infra* notes 20-28 and accompanying text; Gulf Oil Corp v. Federal Power Comm'n, 563 F.2d 588 (3d Cir. 1977), *cert. denied*, 434 U.S. 1062 (1978); Day v Tenneco, Inc., 696 F. Supp. 233 (S.D. Miss. 1988).

short supply and cannot be guaranteed.

Of the many variables, the most important to management is to obtain reliable sources for raw materials at a reasonable price. In the United States, corporate management views labor as a variable cost, one that can be increased or decreased as demand dictates. Employers are usually able to hire on short notice all but the most skilled employees.

A manufacturer must obtain reliable sources for its raw materials to efficiently meet customer demand. Unless a manufacturer has a unique or very high-quality product, most customers will not accept a long delay in delivery. Customers also want a stable price so that they can incorporate the manufacturer's prices into the cost of their own finished products.

In order to achieve price stability and assured sources of raw materials, a company will attempt to enter into long-term, fixed-price contracts with its suppliers. Such contracts significantly reduce the element of risk for the buyer because the buyer is contractually guaranteed a supply of goods at a set price for a set number of years.[4]

Although the strategic planning process is generally the same throughout the business world, different industries address the need to obtain a steady source of raw materials in different ways. Sellers generally seek to enter into volume purchase or minimum purchase agreements. Purchasers prefer contracts that do not bind them to minimum purchase quantities.

In the oil and gas industry, energy suppliers often enter "take or pay" contracts that bind a purchaser to take the gas it contracted for or pay for it even if not used.[5] These contracts seem to be unique to the energy industry. The energy industry, along with the agricultural industry, often enters into "commitment contracts" in which the purchaser agrees to purchase the entire output of an oil well or the entire crop prior to the planting season. The price agreed upon represents an allocation of risk between the parties.[6]

Given the size of some companies, the risk and the accompanying dollar value involved may be quite large. For this reason, many companies protect themselves from risk by purchasing futures. This is especially true in the food industry and in those industries that utilize pre-

4. These contracts are known as volume purchase agreements. They provide for discounts commensurate with a certain level of purchases. These contracts may or may not have a minimum purchase amount or "billbacks" if the purchaser fails to buy a minimum dollar amount. In either case, the price is usually the variable element in the contract. The more definite the purchase requirement by the buyer, the lower the price.

5. *See generally A New Opportunity for Lawyers*, FORBES, Feb. 19, 1990, at 152.

6. *See, e.g.*, Lawrance v. Elmore Bean Warehouse, Inc., 108 Idaho 892, 702 P.2d 930 (Ct. App. 1985).

cious metals such as gold, silver, copper, and platinum. By using puts or calls, an entity can limit its exposure on the price of a particular commodity at a predetermined time in the future.[7] In this manner, an entity can also protect itself from significant price swings in a commodity on which its business depends.

Companies that buy and sell commodities internationally also seek to limit their liability from currency fluctuations. They will purchase currency futures in the particular currency in which products are purchased or sold. The cost of these options is incorporated into the price of each product or profit margin. By providing for both an increase in raw material cost and a decrease in currency value, an entity's risk is minimized considerably.

B. Impact of Economic Fluctuation on Business Planning

The recent fluctuations in the United States economy have emphasized the importance of long-term strategic planning and long-term contracts. The immediate and sharp increase in energy prices has affected almost every industry. For some, the impact is immediate. Long-term contracts will not eliminate the problems associated with an increase in energy prices, but will reduce the number and magnitude of these problems.

Sharp price swings in raw materials force companies to stress long-term planning. Necessity will dictate that companies place greater reliance on contracts and planning to ensure a reasonable supply of raw materials at a reasonable price. This is very important because the company itself might have executed a supply contract with a third party to supply the third party with goods at a set price.

If a manufacturer could not rely on its contractually mandated commitments, it might be paralyzed. If the supplier of the manufacturer's raw materials failed to make delivery, the manufacturer would still have to meet its commitment to the ultimate purchaser.

To compensate for such problems, a manufacturer might seek a security deposit from the other contracting party to ensure that party's compliance. Requiring companies to provide a security deposit, a letter of credit, or a bond could cause severe financial hardship. Letters of credit or bonds can be costly and a security deposit restricts much-needed capital. Before requiring a purchaser to provide any of these, the manufacturer first must determine whether these options, given the nature of the industry, allow the manufacturer to compete. If the manufacturer is the only manufacturer in its product market requiring a security deposit, its vendors and customers probably will use other

7. *See infra* text accompanying notes 169-70.

manufacturers. If a manufacturer must incorporate these costs, a form of security will have to be built into the pricing structure, which raises the ultimate cost of the goods to consumers.

If the sanctity of long-term contracts is disturbed, the accompanying uncertainty could create instability in the economic markets. Without the stability provided by long-term contracts, the economy itself might mirror any strong fluctuations in the costs of raw materials. As a result, any sharp swing in the price of raw materials, such as energy costs, could be much more pronounced than under the present system, which creates even greater concern.

Because allocating risks through long-term contracts is essential to accurate planning and, thus, to the viability of a business in a free market economy, courts rarely excuse sophisticated commercial parties from their contractual obligations. Therefore, contracting parties rely on the judiciary's reluctance to intervene in commercial agreements. If the courts adopted a more liberal policy toward judicial intervention in contractual relations, the assumption that agreements will be enforced would be at risk and the stability created by contractual relations would be threatened. To protect the significant economic benefits created by long-term contractual agreements, courts should continue to limit intervention in contractual relations.

Part II of this Article reviews the traditional legal foundations for judicial intervention in contractual agreements. It also discusses the requirements for judicial intervention based on commercial impracticability, frustration of purpose, mistake, and *force majeure*, as well as the willingness of the judiciary to excuse performance based on these theories. Part III examines the relationships between these doctrines, and Part IV examines the potential impact on our economic system of taking a more liberal approach toward judicial intervention. Finally, this Article argues that little justification exists for expanding judicial intervention in contractual agreements.

II. Judicial Intervention in Contractual Relations

Several legal concepts allow judicial intervention in a contractual relationship. In order of relative importance, they are: (1) commercial impracticability, (2) frustration of purpose, (3) mistake, and (4) *force majeure*.

A. *Commercial Impracticability*

The doctrine of commercial impracticability is incorporated into

the Uniform Commercial Code (U.C.C.).[8] Section 2-615 of the U.C.C. provides:

> Delay in delivery or non-delivery in whole or part by a seller . . . is not a breach of his duty under a contract for sale if a performance as agreed has been made impractical by *the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made* . . . .[9]

Thus, three elements are necessary to establish a commercial impracticability defense: (1) the seller must not have assumed the risk of some unknown contingency; (2) the nonoccurrence of the contingency must have been a basic assumption underlying the contract; and (3) the occurrence of that contingency must have made performance commercially impracticable.[10] Courts rarely allow a party relief from its contractual obligations, however, on the basis of commercial impracticability.[11] Thus, courts that construe section 2-615 carefully distinguish

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8. U.C.C. § 2-615 (1988). The commercial impracticability doctrine arose from the common-law doctrine of frustration or impossibility, which is most often illustrated by the body of case law generated from the various closings of the Suez Canal. Louisiana Power & Light Co. v. Allegheny Ludlum Indus., Inc., 517 F. Supp. 1319, 1325 (E.D. La. 1981) (citing Transatlantic Fin. Corp. v. United States, 363 F.2d 312 (D.C. Cir. 1966)); *see also* Glidden Co. v. Hellenic Lines, 275 F.2d 253 (2d Cir. 1960), *aff'd*, 315 F.2d 162 (2d Cir. 1963). *See generally* American Trading and Prod. Co. v. Shell Int'l Marine, 453 F.2d 939 (2d Cir. 1972) (doctrine of commercial impracticability did not apply to shipment of goods from Texas to India, despite the closing of the Suez Canal, when the contract did not specify a route and the Cape route was an acceptable alternative).

9. U.C.C. § 2-615 (1988) (emphasis added). Section 2-615 governs only the sale of "goods," which has been broadly defined under the Code as: "all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (Article 8) and things in action." *Id.* § 2-105.

10. Friedco, Ltd. v. Farmers Bank, 529 F. Supp. 822 (D. Del. 1981); Iowa Elec. Light & Power Co. v. Atlas Corp., 467 F. Supp. 129, 134 (N.D. Iowa 1978), *rev'd on other grounds*, 603 F.2d 1301 (8th Cir. 1979), *cert. denied*, 445 U.S. 911 (1980). Traditionally, the commercial impracticability doctrine has been applied to sellers. *See, e.g.*, International Minerals & Chem. Corp. v. Llano, Inc., 770 F.2d 879 (10th Cir. 1985), *cert. denied*, 475 U.S. 1015 (1986); Louisiana Power & Light Co. v. Allegheny Ludlum Indus., Inc., 517 F. Supp. 1319 (E.D. La. 1981). It has also been applied to purchasers in a few isolated cases. *See* U.C.C. § 2-615 comment 9 (1988); Hancock Paper Co. v. Champion Int'l Corp., 424 F. Supp. 285 (E.D. Pa. 1976), *aff'd*, 565 F.2d 151 (3d Cir. 1977); Nora Springs Coop. Co. v. Brandau, 247 N.W.2d 744 (Iowa 1976). *Cf.* Lawrance v. Elmore Bean Warehouse, Inc., 108 Idaho 892, 702 P.2d 930 (Ct. App. 1985) (buyer is entitled to exemption if statutory requirements are met); Northern Ill. Gas Co. v. Energy Coop., Inc. 122 Ill. App. 3d 940, 954, 461 N.E.2d 1049, 1060 (1984) (citing comment 9, the court held § 2-615 applies to buyers that meet statutory requirements).

11. McGinnis v. Cayton, 312 S.E.2d 765, 775 (W. Va. 1984) (Harshburger J. concurring); *see also* Jennie-O Foods v. United States, 580 F.2d 400, 409 (Ct. Cl. 1978) ("[T]his Court has not applied [the doctrine of commercial impracticability] with frequency or

between whether a contract is physically impossible or is instead commercially impracticable to perform.[12]

Defining commercial impracticability is difficult because the U.C.C. does not define "basic assumption" and "impracticability." The *Restatement (Second) of Contracts* states that "impracticability" denotes a meaning between "impossibility" and "impracticality."[13] However, the courts have not reached a consensus on a definition. Some courts have stated that to show commercial impracticability, the party seeking to excuse performance must demonstrate that "the cost of performance has in fact become so excessive and unreasonable that the failure to excuse performance would result in grave injustice."[14]

Under this standard, showing mere loss or unanticipated expense is not sufficient. The loss or expense must be severe, extreme, excessive, or unreasonable.[15] An increase in the price of raw materials does not amount to impracticability unless it is well beyond a normal price increase because price changes can be addressed by fixed price contracts. To excuse performance, therefore, the subsequent price increase must be significant or unreasonable.[16]

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enthusiasm."); Iowa Elec. Light & Power Co. v. Atlas Corp., 467 F. Supp. 129, 134 n.7 (1978) ("The doctrine of impracticability has been narrowly construed."). The *Atlas* court stated further: "Although proponents of liberal interpretation point to Mineral Park Land Co. v. Howard, 172 Cal. 289, 156 P. 458, 460 (1916), for the proposition that excessive and unreasonable cost can excuse performance, few courts have excused performance on that theory alone." *Atlas*, 467 F. Supp at 134 n.7 (italics omitted).

12. *E.g.*, International Minerals & Chem. Corp. v. Llano, Inc., 770 F.2d 879, 886 (10th Cir. 1985) (quoting Wood v. Bartolino, 48 N.M. 175, 146 P.2d 883 (1944)); Freidco, Ltd. v. Farmers Bank, 529 F. Supp. 822, 825 (D. Del. 1981) ("Although the standard of impracticability is not impossibility, neither is it mere impracticality."); 18 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1978, at 886 (3d ed. 1978 & Supp. 1990) ("Physical impossibility is no longer required to show impracticability; performance can become impracticable due to some unreasonable difficulty, expense, injury, or loss . . . ."). Although § 2-613 allows relief only if performance is physically impossible, courts do not construe § 2-615 as strictly.

13. RESTATEMENT (SECOND) OF CONTRACTS § 261 comment d (1981).

14. Gulf Oil Corp. v. Federal Power Comm'n, 563 F.2d 588, 599 (3d Cir. 1977), *cert. denied*, 434 U.S. 1062 (1978); Sabine Corp. v. ONG W., Inc., 725 F. Supp. 1157, 1176 (W.D. Okla. 1989) (the court explained that "[w]hether 'grave injustice' would result from failure to excuse performance is merely an inquiry used to assess whether the cost *to the contracting party of performing the contract* is so excessive and unreasonable as to warrant the conclusion that performance has become impracticable.") (emphasis in original); *Freidco*, 529 F. Supp. at 825 (quoting *Gulf Oil*, 563 F.2d at 599).

15. The *International Minerals* court required "extreme or unreasonable difficulty, expense, injury or loss." 770 F.2d at 886 (quoting Wood v. Bartolino, 48 N.M. 175, 146 P.2d 883 (1944) and 6 WILLISTON ON CONTRACTS § 1981 (1938)); *see Gulf Oil*, 563 F.2d at 600; *Sabine*, 725 F. Supp. at 1175; *Freidco*, 529 F. Supp. at 825; Northern Ill. Gas Co. v. Energy Coop., Inc., 122 Ill. App. 3d 940, 461 N.E.2d 1049 (1984).

16. Transatlantic Fin. Corp. v. United States, 363 F.2d 312, 319 (D.C. Cir. 1966)

A number of factors may influence a court to conclude that a twenty percent price increase is not unreasonable in one case while a twelve percent increase in another case may be unreasonable. One potential factor is the importance of the particular good in the purchaser's overall manufacturing process and the percentage of the good's cost in relation to the cost of the final product.[17] Price increases must be viewed in light of the underlying contract, including the quantity to be purchased and the length of the contract.[18] Comparing the cost of a good that was originally $100,000 and increases twenty percent to $120,000, to the cost of a good that doubles in price from one dollar to two dollars illustrates that the aggregate financial impact on a purchaser would be much greater if it purchased a large quantity of $100,000 items versus a small quantity of one dollar items. The greater the aggregate dollar value, the greater the impact and, thus, the greater the importance to the court, especially if meeting these contractual obligations threatened the business with bankruptcy.[19]

Another factor a court may consider is the foreseeability of any potential increase in price. The court in *Maple Farms, Inc. v. City School District*[20] stated that "where the circumstances reveal a willingness on the part of the seller to accept abnormal rises in costs, the question of impracticability of performance should be judged by stricter terms than where the contingency is totally unforeseen."[21] Thus, in *Maple* the seller was not entitled to relief because he knew that the price of milk had fluctuated significantly in the past and could do so in the future.

A third factor is the ability of one party to mitigate its damages and fulfill its contractual obligations. In *Transatlantic Financing*

("While it may be an overstatement to say that increased cost and difficulty of performance never constitute impracticability, to justify relief there must be more of a variation between expected cost and the cost of performing by an available alternative than is present in this case . . . ."); Iowa Elec. Light & Power Co. v. Atlas Corp., 467 F. Supp. 129 (N.D. Iowa 1978) (an increase in price of 50% to 58% did not justify relief); American Trading & Prod. Corp. v. Shell Int'l Marine, Ltd., 343 F. Supp. 91 (S.D.N.Y. 1971) (less than 33% increase in cost of shipping material did not justify relief); Mineral Park Land Co. v. Howard, 172 Cal. 289, 156 P. 458 (1916) (over 1000% cost increase justified relief); Lawrance v. Elmore Bean Warehouse, Inc., 108 Idaho 892, 702 P.2d 930 (Ct. App. 1985) (a 40% increase in price did not justify relief); Maple Farms, Inc. v. City School District, 76 Misc. 2d 1080, 352 N.Y.S.2d 784 (Sup. Ct. 1974) (a 23% cost increase did not justify relief).

17. *See, e.g.*, Lawrence v. Elmore Bean Warehouse, Inc., 108 Idaho 892, 702 P.2d 930 (Ct. App. 1985).

18. *See* Mineral Park Land Co. v. Howard, 172 Colo. 289, 159 P. 458 (1916).

19. *See, e.g., id.; Elmore Bean Warehouse, Inc.*, 108 Idaho at 892, 702 P.2d at 930.

20. 76 Misc. 2d 1080, 352 N.Y.S.2d 784 (Sup. Ct. 1974).

21. *Id.* at 1085, 352 N.Y.S.2d at 790.

Corp. v. United States[22] the court held "there must be more of a variation between expected cost and the cost of performing by an available alternative than is present in this case."[23] Thus, the court implies that it will consider the alternative means available that would allow a party to fulfill its contractual obligations and will also consider the accompanying cost.

Two decisions, both in the United States Court of Claims, have also indicated judicial leniency in crop failure disputes. In *Dillon v. United States*[24] and *Mitchell Canneries, Inc. v. United States*[25] the court allowed the plaintiffs to recover for the excess costs incurred to provide food to the army because of unforeseen circumstances. The validity and applicability of these cases to other areas is questionable, however, because they are firmly rooted in the doctrine of strict impossibility.[26]

Finally, a particular court may be more sympathetic than another depending on the nature of the case. An Oklahoma court may be much more willing than a Florida court to rule in favor of energy producer that has been hurt by a sudden fluctuation in energy prices on an impracticability claim. Consequently, different courts will interpret the law differently, resulting in a degree of disparity.

The commercial impracticability doctrine is illustrated in *Eastern Air Lines, Inc. v. Gulf Oil Corp.*[27] In that case Gulf agreed to supply all of Eastern's reasonable demands for aviation fuel at several locations. The contract contained a price index clause that allowed Gulf to pass on to Eastern any increase in the price of crude oil. The price index was tied to the cost of a widely traded grade of oil known as "West Texas Sour."[28]

Shortly after the execution of the contract, the United States government levied price controls on West Texas Sour and, consequently, on the price of jet fuel under the contract. In 1973 the government implemented a two-tiered price structure for domestically produced oil.[29] The amount of oil produced by each well in May 1972 was the benchmark for these price controls. Oil produced by those new wells in excess of the benchmark amount, and oil produced by new wells, was

22. 363 F.2d 312 (D.C. Cir. 1966).
23. *Id.* at 319.
24. 156 F. Supp. 719 (Ct. Cl. 1957).
25. 77 F. Supp. 498 (Ct. Cl. 1948).
26. Note, *UCC § 2-615 Defining Impracticability Due to Increased Expense*, 32 U. FLA. L. REV. 516, 535 n.155 (1980).
27. 415 F. Supp. 429 (S.D. Fla. 1975).
28. *Id.* at 432-33.
29. *Id.* at 433.

not restricted in price.[30]

Prior to 1973 foreign oil was marginally less expensive than domestic oil. When OPEC initiated its oil embargo in 1973, however, the cost of foreign oil increased dramatically, causing the price of the domestic oil that was not restricted in price to rise as well.[31] Gulf sought to terminate the contract on the basis of commercial impracticability. Gulf argued that the contract was no longer profitable because of the increased market price of foreign and certain domestic crude oil and, thus, it should be excused from performance.[32]

The *Eastern* court held Gulf was not entitled to relief under the doctrine of commercial impracticability.[33] The court recognized that unprofitability alone will not render a contract commercially impracticable.[34] It cited comment 4[35] and comment 8[36] to section 2-615 of the U.C.C. to justify its decision.[37] The court discounted Gulf's two arguments: that the price index did not work as originally intended, and that oil prices had risen without any corresponding rise in the fuel prices under the contract. The pricing index used in the contract was based upon West Texas Sour for which the price was fixed. It did not reflect the higher price of foreign oil which accounted for a significant portion of Gulf's cost of raw materials in refining jet fuel.[38] Finally, the court emphasized that the oil crisis was reasonably foreseeable and

30. *Id.* at 433-34.
31. *Id.* at 434.
32. *Id.* at 440.
33. *Id.* at 441.
34. *Id.* at 438-39.
35. U.C.C. § 2-615 comment 4 (1988) provides:

Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover. But a severe shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance, is within the contemplation of this section.

36. U.C.C. § 2-615 comment 8 (1988) provides:

The provisions of this section are made subject to assumption of greater liability by agreement and such agreement is to be found not only in the expressed terms of the contract but in the circumstances surrounding the contracting, in trade usage and the like. Thus the exemptions of this section do not apply when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the dickered terms, either consciously or as a matter of reasonable, commercial interpretation from the circumstances.

37. *Eastern*, 415 F. Supp. at 438.
38. *Id.* at 439-40.

that Gulf should have taken actions to protect itself.[39]

The *Eastern* court correctly applied existing contract law to the factual situation. It recognized the importance of long-term contracts for the smooth operation of the nation's economy. The facts of the case revealed that both parties were pleased with the agreement when they signed it. Gulf obtained a steady market for the fuel produced by its new plant, and Eastern received immediate savings through reduced base prices.[40] Only when Gulf began to suffer a loss because of a change in oil prices did it seek relief from the pricing mechanism established in the contract.[41]

B. Frustration of Purpose

The legal theory of "frustration of purpose" or "discharge by supervening frustration" is defined by section 265 of the *Restatement (Second) of Contracts*:[42]

> Where, after a contract is made, a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary.[43]

Under the *Restatement*, to successfully bring an action to rescind a contract for frustration of purpose, a party must prove that the principal purpose of the contract is frustrated, that the frustration is substantial, and that the nonoccurrence of the frustrating event is a significant assumption underlying the agreement.[44]

The requirements for proving frustration of purpose are substantially similar to those for proving commercial impracticability.[45] In the case of a price change the party seeking rescission must demonstrate disparity in the existing market price and the contract price, and that the nonoccurrence of such a price change was a basic assumption underlying the agreement.[46] Discharge of a party's obligations under this doctrine, however, has been limited to situations in which a "virtually cataclysmic, wholly unforeseeable event renders the contract valueless

39. *Id.* at 441-42.
40. *Id.* at 432.
41. *Id.* at 439-41.
42. RESTATEMENT (SECOND) OF CONTRACTS § 265 (1981).
43. *Id.*
44. *Id.* comment a.
45. *Id.*
46. *Id.*

to one party."[47]

The clear intent when parties enter into a long-term, fixed-price contract is to ensure supply and a market for the underlying commodity at a defined price with the goal to make a profit.[48] In reaching such an agreement, the parties agree upon a price that fairly and adequately compensates them for the risk each bears. To correctly determine whether substantial frustration exists, a court must look to the parties' objective intent when they executed the agreement.[49]

It is extremely difficult to demonstrate that the purpose of the contract has been frustrated because it is difficult to determine the intent of the parties when they entered into the agreement. The parties most likely entered into a long-term, fixed-price contract to limit the effect of any unforeseen price changes.[50] The Restatement requires that the object of the contract must so permeate the basis for the contract's existence that, as both parties understand, without it the contract makes little sense.[51] The intent of one party to receive or to pay a competitive market price for the commodity for the term of the agreement is not enough to justify rescinding the contract.[52]

A court must interpret a contract by its plain meaning.[53] It should not attempt to determine the subjective intent of the parties because their subjective intent is irrelevant.[54] The parties are bound by their objective intent as manifested in their contract.[55] Otherwise the underlying principles of contract law would collapse.

In *Hotchkiss v. National City Bank*[56] Judge Learned Hand articu-

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47. United States v. General Douglas MacArthur Senior Village, Inc., 508 F.2d 377, 381 (2d Cir. 1974). *Contra* RESTATEMENT (SECOND) OF CONTRACTS § 265 comment a (1981) ("foreseeability of the event is here, as it is [with impracticability], a factor in that determination, but the mere fact that the event was foreseeable does not compel the conclusion that its non-occurrence was not such a basic assumption.").

48. *See* Lawrence v. Elmore Bean Warehouse, Inc., 108 Idaho 892, 895, 702 P.2d 930, 932 (Ct. App. 1985) (The reason the defendant contracted to grow pinto beans was because "there was a chance to make a profit . . . .").

49. *Id.*; Hancock Paper Co. v. Champion Int'l Corp., 424 F. Supp. 285 (E.D. Pa. 1976), *aff'd*, 565 F.2d 151 (3d Cir. 1977).

50. *See, e.g.*, Northern Ind. Pub. Serv. v. Carbon County Coal, 799 F.2d 265, 278 (7th Cir. 1986).

51. RESTATEMENT (SECOND) OF CONTRACTS § 265 comment a (1981); *see MacArthur Senior Village*, 508 F.2d at 381.

52. RESTATEMENT (SECOND) OF CONTRACTS § 265 comment a (1981).

53. *See* Lelsz v. Kavanagh, 824 F.2d 372, 374 (5th Cir. 1987); *Hancock Paper Co.*, 424 F. Supp. at 289.

54. *Hancock Paper Co.*, 424 F. Supp. at 289.

55. *Id.*; *see also* RESTATEMENT (SECOND) OF CONTRACTS § 265 comment b (1981) (the language of the contract controls the application of the rule).

56. 200 F. 287 (S.D.N.Y. 1911), *aff'd sub nom.* Ernst v. Mechanics' & Metals Nat'l Bank, 201 F. 664 (2d Cir. 1912), *aff'd*, 231 U.S. 60 (1913).

lated the reason for accepting the objective intent of the parties to bind them to the pricing provisions of the contract. Judge Hand wrote:

> A contract has, strictly speaking, nothing to do with the personal, or individual, intent of the parties. A contract is an obligation attached by the mere force of law to certain acts of the parties, usually words, which ordinarily accompany and represent a known intent. If, however, it were proved by twenty bishops that either party, when he used the words, intended something else than the usual meaning which the law imposes upon them, he would still be held, unless there were some mutual mistake, or something else of the sort.[57]

The *Restatement* clearly provides that failure of the transaction to become profitable for a party will not frustrate the purpose of a contract.[58] For the party seeking rescission, this statement goes to the core of its argument. Because the contract is no longer profitable due to changes in market pricing, the disadvantaged party believes it should no longer be bound by the contract. Under such reasoning, the sole "purpose" of the contract would be to make a profit and if the party can no longer do so, its purpose has been frustrated. If this reasoning is accepted, every contract could be terminated under its *force majeure* clause. The correct interpretation requires the court to recognize that the initial reason the party entered into the contract was to buy or sell the underlying commodity. The court should ignore the motivation of each party to make a financial profit.

The comments to the Restatement indicate that in certain limited situations the frustration could be so severe that the frustrating event cannot be fairly regarded as within the risks assumed by the parties to the contract.[59] By agreeing to a fixed price, both parties agree to bear the risk of any decrease or increase in the market price.[60]

C. *Mistake*

In an effort to avoid severe economic injury for strong swings in the market price of a commodity, many parties attempt to reform or rescind the agreement on the basis of a mutual mistake.[61] One justification for such a claim is that in reaching the agreement, they never realized that the price of the underlying commodity could change so

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57. *Id.* at 293.

58. RESTATEMENT (SECOND) OF CONTRACTS § 265 comment a (1981).

59. *Id.*

60. Universal Resources Corp. v. Panhandle E. Pipe Line, Co., 813 F.2d 77, 80 (5th Cir. 1987).

61. *See, e.g.*, Sabine Corp. v. ONG W., Inc., 725 F. Supp. 1157, 1187-89 (W.D. Okla. 1989).

drastically.[62] Thus, no meeting of the minds or requisite intent to form a contract existed. The doctrine of "mutual mistake" provides:

> [w]here a mistake of both parties at the time a contract was made as to a basic assumption on which the contract was made has a material effect on the agreed exchange of performances, the contract is voidable by the adversely affected party unless he bears the risk of the mistake . . . .[63]

"Mistake" is defined as "a belief that is not in accord with the facts."[64] If the mistake is unilateral, however, relief will not be granted.[65]

1. *Reformation*

Reformation is an equitable remedy that may be imposed in the presence of a mutual mistake.[66] It requires clear and convincing evidence of an antecedent agreement in which the terms of a writing should be reformed and a mutual mistake that resulted in a writing which does not reflect either party's intention.[67] Additionally, the party seeking reformation must be free of neglect. Parole evidence may be used to prove that the parties' actual intent is not reflected in the written agreement.[68]

A party seeking reformation must prove that the assumptions underlying its decision to enter into the agreement were mistaken.[69] Demonstrating that a mistake was mutual is difficult because the complaining party must show evidence of the other party's beliefs, understanding, or assumptions when the parties entered into the agreement, to prove the mistake was mutual. Thus, the complaining party has the difficult task of proving that the agreement was conditioned on the unusual assumption that the price of the underlying

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62. *See* Resources Inv. Corp. v. Enron Corp., 669 F. Supp. 1038, 1042 (D. Colo. 1987); Aluminum Co. of Am. v. Essex Group, Inc., 499 F. Supp. 53, 60-67 (W.D. Pa. 1980).

63. RESTATEMENT (SECOND) OF CONTRACTS § 152(1) (1981).

64. *Id.* § 151.

65. *See, e.g.*, Leasco Corp. v. Taussig, 473 F.2d 777, 781 (2d Cir. 1972).

66. McGinnis v. Cayton, 312 S.E.2d 765, 769 (W.Va. 1984); *see also* Bond v. Chalfant, 201 Okla. 600, 603, 208 P.2d 535, 537 (1949) (allowing rescission of a deed); Lovell v. City of Altus, 118 Okla. 106, 109, 246 P. 468, 470 (1925) (allowing rescission of contractor's bid).

67. Cleary Petroleum Corp. v. Harrison, 621 P.2d 528, 533 (Okla. 1980); Boettler v. Rothmire, 442 P.2d 511, 514-15 (Okla. 1968); Dennis v. American-First Title & Trust Co., 405 P.2d 993, 997-98 (Okla. 1965).

68. Nelson v. Daugherty, 357 P.2d 425, 432 (Okla. 1960); Webster v. Woods, 586 P.2d 337, 338 (Okla. Ct. App. 1978).

69. *Nelson*, 357 P.2d at 425; *Webster*, 586 P.2d at 337.

commodity would remain near the contract price.

2. *Rescission*

Rescission of a contract because of mutual mistake is an appropriate remedy when there has been no "meeting of the minds" between the contracting parties regarding a fact that goes to the essence of the agreement.[70] The contract is unenforceable because the parties did not truly agree.[71] The complaining party must demonstrate that the mutual mistake concerns a past or present fact material to the agreement and not a mistake of prophecy or opinion relative to an uncertain event.[72] A contracting party is not entitled to rescission merely because of subsequent developments turn a contractual provision to his disadvantage.[73] Thus, mistaken predictions regarding future economic conditions do not justify relief from a contract.[74]

Alternatively, a party must show that the mistake concerned a material portion of the agreement and, therefore, prevented a meeting of the minds.[75] As when seeking reformation, the complaining party must demonstrate that it was not negligent when it entered into the agreement.[76] The moving party is faced with the difficult task of proving that any mistake was mutual.[77] It is difficult to show the other party's motives or beliefs when entering into an agreement. Furthermore, the complaining party can expect strong opposition to its motion because the other party typically stands to benefit significantly.

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70. *See supra* note 69.

71. Madill Bank & Trust Co. v. Herrman, 738 P.2d 567, 572 (Okla. Ct. App. 1987) (citing OKLA. STAT. tit. 15 §§ 62-64 and Watkins v. Grady County Soil and Water Conservation Dist., 438 P.2d 491 (Okla. 1968)).

72. *See* Holmes v. Missouri-Kan.-Tex. R.R., 574 P.2d 297, 298-99 (Okla. 1978) (quoting Davis v. Higgins, 95 Okla. 32, 217 P. 193, 195 (1923) and Birch v. Kee, 449 P.2d 700, 702 (Okla. 1969)).

73. *Id.*

74. Resources Inv. Corp. v. Enron Corp., 669 F. Supp. 1038, 1042-43 (D. Colo. 1987).

75. Watkins v. Grady County Soil & Water Conservation Dist., 438 P.2d 491, 494 (Okla. 1968); Madill Bank & Trust Co. v. Herrmann, 738 P.2d 567, 572 (Okla. Ct. App. 1987).

76. Ware v. City of Tulsa, 312 P.2d 946, 950 (Okla. 1957) (citing Eason Oil Co. v. Whiteside, 175 Okla. 254, 256, 52 P.2d 35, 37 (1935)).

77. The moving party may introduce parole evidence, however, to show that the contract does not reflect the intent of the parties. Nelson v. Daugherty, 357 P.2d 425, 432 (Okla. 1960). The parole evidence rule does not apply because the evidence being introduced is not being used to contradict or vary the contract. Webster v. Woods, 586 P.2d 337, 338 (Okla. Ct. App. 1978).

D. *Force Majeure*

The term *force majeure* is derived from the french language and is translated as a superior or irresistible force.[78] In everyday usage it has come to be equated with "an act of God."[79] Although the concept of *force majeure* is easily understood, it is very difficult to identify a precise legal definition. A *force majeure* clause "protect[s] the parties in the event that a part of the contract cannot be performed due to causes which are outside the control of the parties and could not be avoided by exercise of due care."[80] Courts have defined *force majeure* as an unforeseen event that may excuse nonperformance within the contract period,[81] or an event beyond a party's control and occurring without its fault or negligence.[82]

Because *force majeure* clauses by their nature are designed to protect against an unanticipated contingency, they cannot be limited to a precise definition or a finite list of examples. Consequently, most agreements that contain a list of examples are careful to provide that the *force majeure* clause includes, but is not limited to, the events contained in the list.[83]

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78. BLACK'S LAW DICTIONARY 645 (6th ed. 1990). *Force majeure* is synonymous with the latin expression *vis major*. *See* Pacific Vegetable Oil Corp. v. C.S.T., Ltd., 29 Cal. 2d 228, 238, 174 P.2d 441, 447 (1946). It has also been referred to as *force majesture*. *See* Fogg v. Van Saun Coal Co., 12 N.J. Misc. 680, 681, 174 A. 419, 420 (1934).

79. *See, e.g.*, General Index A-F, "Force Majeure," AM. JUR. 2D 795 (1988).

80. BLACK'S LAW DICTIONARY 645 (6th ed. 1990).

81. *See, e.g.*, United States v. Brooks-Callaway Co., 318 U.S. 120, 122-24 (1943) (referring to a nonwarranty contract); Gulf Oil Corp. v. Federal Energy Regulatory Comm'n, 706 F.2d 444, 452 (3d Cir. 1983), *cert. denied*, 464 U.S. 1038 (1984).

Most contractual agreements provide a laundry list of excusable events instead of attempting to articulate a definition of *force majeure*. The most prevalent events set forth in such agreements include: acts of God, fire, flood, acts of civil disobedience, war, riot, nuclear disaster, labor disputes, acts of governments, unusual climatic conditions, acts of a public enemy, explosion, or power failure. *See, e.g.*, Nissho-Iwai Co. v. Occidental Crude Sales, Inc., 729 F.2d 1530, 1539 (5th Cir. 1984); Eastern Air Lines, Inc., v. McDonnell Douglas Corp., 532 F.2d 957, 998 (5th Cir. 1976).

The test of whether an event of *force majeure* exists is whether "under the particular circumstances there was such an insuperable interference occurring without the party's intervention as could not have been prevented by the exercise of prudence, diligence, and care." *Pacific Vegetable*, 29 Cal. 2d at 238, 174 P.2d at 447. *See also* National Carbon Co. v. Bankers' Mortgage Co., 77 F.2d 614, 617 (10th Cir. 1935) (loss by natural cause which could not have been prevented by due care).

82. *See, e.g.*, Challenger Minerals, Inc. v. Southern Natural Gas Co., No. 84-C-357-E (N.D. Okla. Sept. 9, 1986). Some poorly drawn clauses have simply stated "[u]sual force majeure conditions apply." *See, e.g.*, Kaiser Trading Co. v. Associated Metals & Minerals Corp., 321 F. Supp. 923, 926 (N.D. Cal. 1970).

83. *See, e.g.*, Gulf Oil Corp. v. Federal Energy Regulators Comm'n, 706 F.2d 444, 448 n.8 (3d Cir. 1983), *cert. denied*, 464 U.S. 1038 (1984).

The lack of a precise definition of *force majeure* has led to attempts to include "economic considerations" within its meaning. An agreement's *force majeure* clause is rarely definitive enough to reject outright the argument that it excludes economic considerations.[84] As a result, courts are often burdened with determining what is an unforeseen contingency without clear guidelines upon which to base their decisions.

The first recorded use of economic *force majeure* occurred in *Marionneaux v. Smith.*[85] Although the court did not use this term, it addressed essentially the same issue. In *Marionneaux* an individual contracted for the right to cut and remove timber from a tract of land within five years. Because of the world-wide economic depression, which occurred after the contract had been signed but before the timber had been harvested, the timber's value had been greatly reduced. If the purchaser had removed the timber within the five-year period, he would have suffered a significant loss.[86] Upon the expiration of the five-year period, the purchaser invoked a clause in the contract that granted him two additional years in which to remove the timber for "circumstances beyond his control."[87]

The Louisiana Court of Appeals rejected this use of the *force majeure* clause.[88] It concluded that a financial depression was not encompassed by the clause and that a *force majeure* clause does not excuse the promisor from performance on the grounds of intervening impossibility merely because the performance of a contract is rendered difficult, burdensome, or unprofitable.[89]

Madeirense Do Brasil S/A v. Stulman-Emrick Lumber Co.[90] further illustrated the underlying reasoning of *Marionneaux.* In

84. In Golsen v. ONG W., Inc., 756 P.2d 1209, 1211 (Okla. 1988), the parties included the ambiguous phrase "failure of gas supply or markets" as an event of *force majeure.* The phrase suggests that an economic event could trigger the *force majeure* clause.

The trial court concluded that a 26.4% reduction in demand over a two-year period and a decrease in revenues of $45 million constituted a failure of the markets. *Id.* at 1212. The appellate court rejected this interpretation on the basis that the inability to sell a commodity at a profit is not considered to be an event of *force majeure,* and that the ability to sell the gas at or above the contract price was irrelevant to whether there was a "failure of the markets." *Id.* at 1212-13. The court of appeals correctly recognized that "lack of *market demand* as distinguished from absolute demand is a function of price . . . ." *Id.* at 1213 n.2 (emphasis in original).

85. 163 So. 206 (La. 1935).

86. *Id.* at 206-07.

87. *Id.* at 207.

88. *Id.* at 209.

89. *Id.* at 208.

90. 147 F.2d 399 (2d Cir.), *cert. denied,* 325 U.S. 861 (1945).

Madeirense a Brazilian company negotiated a contract to sell and deliver wood to the United States. Prior to delivery, the company invoked the contract's *force majeure* clause and claimed that war (World War II) made it impossible to obtain a vessel to deliver the lumber.[91] The Second Circuit Court of Appeals rejected this argument and noted that neither the United States nor any South American countries had entered the war in Europe that had begun a year earlier.[92] The court held that "the lack of ships . . . was a foreseeable risk which plaintiff willingly took upon itself; and it cannot under such circumstances plead the defense of 'force majeure.' "[93]

More recently, in *Gulf Oil Corp. v. Federal Energy Regulatory Commission*[94] the Third Circuit Court of Appeals addressed the use of a *force majeure* clause under a warranty contract. Gulf had failed to deliver defined daily quantities of gas to a pipeline. Gulf denied its liability and attempted to invoke the contract's *force majeure* clause. It claimed that routine mechanical repairs of its wells and pipes were designated in the contract as events of *force majeure*.[95] Gulf claimed that the quantities called for in the contract would require Gulf to utilize all of its fields, which would be impossible because some of its fields were always undergoing preventative maintenance or experiencing mechanical failure.[96]

First, the court considered the meaning of *force majeure* as used in a warranty contract. The court held that *force majeure* events "can excuse the supplier's nonperformance for events beyond its control only to the extent that the supplier has shown that it had available resources to meet its warranty obligation."[97] Next, the party invoking the *force majeure* clause must show "what action it took to perform the contract regardless of the occurrence of the excuse."[98] Finally, the court emphasized that the *force majeure* events must be unforeseeable.[99] The court noted that although an event might initially be unforeseeable, subsequent and frequent recurrences might make the event foreseeable.[100] Thus, a frequent and almost predictable occur-

91. *Id.* at 401-03.
92. *Id.* at 403.
93. *Id.*
94. 706 F.2d 444 (3d Cir. 1983), *cert. denied*, 464 U.S. 1038 (1984).
95. *Id.* at 448-50. The contract provided that "[t]he term 'force majeure' . . . shall mean . . . the necessity for making repairs to or alterations of machinery or lines of pipe . . . ." *Id.* at 448 n.8.
96. *Id.* at 449-50.
97. *Id.* at 452.
98. *Id.*
99. *Id.* at 453-54.
100. *Id.*

rence removes an event from the realm of *force majeure*. The court illustrated this proposition by citing Gulf's inability to keep its fields producing at one hundred percent capacity and concluded that the frequent mechanical failures that plagued Gulf could not be characterized as *force majeure* because of their continued and expected recurrence.[101]

III. Comparison of Commercial Impracticability, Frustration of Purpose, Mistake, and *Force Majeure*

The doctrines of impracticability, frustration of purpose, mistake, and *force majeure* discharge an obligor from his obligation to perform a contractual duty when the failure of a basic assumption underlying the agreement significantly impacts the value of the exchange to one party. Commercial impracticability emerged from the common-law doctrines of impossibility and frustration of purpose[102] and the principal elements remain essentially the same.[103] The doctrine of mutual mistake is also derived from the doctrine of impracticability.[104] These doctrines arose to prevent unjust enrichment from supervening events and were united through the judicial principle that the failure to accurately predict future market conditions is not a sufficient basis on which to grant relief.[105]

These doctrines are distinguished most clearly by the circumstances they attempt to address. Impracticability "focuses on occurrences which greatly increase the costs, difficulty, or risk of the party's performance"[106] while frustration addresses "a party's severe disappointment . . . caused by circumstances which frustrate his principal purpose for entering the contract."[107] Commercial impracticability,

101. *Id.* at 454.

102. McGinnis v. Cayton, 312 S.E.2d 765, 774 (W. Va. 1984).

103. *Compare* commercial impracticability, *supra* notes 14-49 and accompanying text *with* frustration of purpose, *supra* notes 50-68 and accompanying text.

104. The doctrine of mistake contains two of the same elements as commercial impracticability: it requires the mistaken fact to be a basic assumption and it is qualified by the notion of risk allocation. *In re* Westinghouse Elec. Corp. Uranium Contracts Litig., 517 F. Supp. 440, 457 (E.D. Va. 1981).

105. *See* Northern Ind. Pub. Serv. Co. v. Carbon County Coal Co., 799 F.2d 265, 276-78 (7th Cir. 1986) (comparing the doctrines); Resources Inv. Corp. v. Enron Corp., 669 F. Supp. 1038, 1042-43 (D. Colo. 1987); Sunflower Elec. Coop., Inc. v. Tomlinson Oil Co., 7 Kan. App. 2d 131, 138-39, 638 P.2d 963, 969-70 (1981).

106. Aluminum Co. of Am. v. Essex Group, Inc., 499 F. Supp. 53, 73 (W.D. Pa. 1980) (incorrectly citing § 281 of the *Restatement (Second) of Contracts* in place of § 261, which addresses impracticability).

107. *Id.* (incorrectly citing § 285 of the *Restatement (Second) of Contracts* (1981) in place of § 265, which addresses frustration).

frustration of purpose, and mistake all discharge an obligor from his duty of performance.[108]

Each of these doctrines is limited by the notions of allocation and assumption of risk. The doctrine of impracticability requires that the nonoccurrence of a certain event or fact causing the impracticability be a basic assumption on which the contract was made.[109] The doctrine of frustration of purpose, like the doctrine of impracticability, requires the nonoccurrence or nonexistence of a basic assumption upon which the parties relied in making the agreement.[110] Similarly, the doctrine of mistake of fact requires that the mistake relate to a basic assumption on which the contract was founded.[111]

The doctrines of impracticability and frustration, however, differ from the doctrine of mistake in several important ways. The doctrines of impracticability and frustration are directed toward hardship. The *Restatement (Second) of Contracts* provides that a party is excused from performance when a supervening event renders his performance impracticable.[112] The Forward to Tentative Draft No. 10 of the *Restatement (Second)* states: "Cases involving impracticability or frustration also involve mistake but to the extent that the focus is on hardship to the adversely affected party [they receive different treatment]."[113]

The doctrines of impracticability and frustration each address different types of hardship. Impracticability focuses on acts that significantly increase the costs, risks, or difficulties associated with a contract, while frustration grants relief for contracts that could be performed but for which no purpose exists to complete the contract.[114] The principles regarding foreseeability and assumption of risk, applicable under the doctrine of commercial impracticability, are also applicable under the doctrine of frustration of purpose.[115]

Both the doctrine of commercial frustration and the doctrine of impossibility of performance attempt to address the effects of supervening events upon the parties' contractual obligations. Under commercial frustration, performance remains possible when the reason the parties entered into the agreement has been negated by the super-

108. *Id.* at 70.

109. *See supra* note 15 and accompanying text.

110. *See supra* note 52 and accompanying text.

111. *See supra* note 78 and accompanying text.

112. RESTATEMENT (SECOND) OF CONTRACTS § 261 comment a (1981).

113. *See* RESTATEMENT (SECOND) OF CONTRACTS (1981) (forward to Tentative Draft 10, 1975).

114. *Compare* Mineral Park Land Co. v. Howard, 172 Cal. 289, 156 P. 458 (1916) *with* Lloyd v. Murphy, 25 Cal. 2d 48, 153 P.2d 47 (1944).

115. *Lloyd*, 25 Cal. 2d at 52, 153 P.2d at 50.

vening event. The purpose or object of the agreement must be totally or almost totally destroyed. Under the doctrine of impossibility of performance, however, performance must be undertaken unless it is rendered impossible by law, by the other party, or by an act of God (*force majeure*). Similarly, *force majeure* only excuses performance if performance is not practicable.

Each of these doctrines may exist within the same time period. The doctrines of frustration, impracticability, and mistake are applicable to occurrences that occur after the execution of the agreement.[116] Thus the "mistake" could occur at, or subsequent to, execution of the contract. Similarly, the Restatement recognizes that the doctrines of impracticability and frustration may exist at the time of execution and need not arise from the occurrence or nonoccurrence of an event after the execution of the agreement.[117]

If one or more of these doctrines is applied improperly, the parties' risk allocations will be altered. Improper allocation of the element of risk is a serious concern because risk allocation is the primary reason for entering a contract.[118] Altering the allocation of risk in a manner different from the intentions of the parties defeats the purpose of the contract.

Force majeure is most similar to the doctrine of impracticability because both doctrines allow relief when a supervening event has seriously disrupted performance to such a degree that performance would place an undue burden on one of the parties or to such an extent that the underlying object of the contract is no longer practicable.[119] Finally, in each of these doctrines the burden of proof is placed upon the party seeking to avoid performance.[120]

The importance of these doctrines and their interrelationship with each other is revealed by the following illustrations. Although the contracting parties may have included a *force majeure* clause in their contract and attempted to address potential U.C.C. problems, a problem may arise that is not directly addressed by the contract's *force majeure*

116. *See* Aluminum Co. of Am. v. Essex Group, Inc., 499 F. Supp. 53, 71 (W.D. Pa. 1980). *But see* Louisiana Power & Light Co. v. Allegheny Ludlum Indus., 517 F. Supp. 1319, 1327 (E.D. La. 1981) *and* Shear v. National Rifle Ass'n of Am., 606 F.2d 1251, 1260 (D.C. Cir. 1979) (both citing RESTATEMENT (SECOND) OF CONTRACTS § 293 comment a (1981) for the proposition that the doctrine of mistake applies only to the parties' beliefs at the time of the making of the contract).

117. *See Aluminum Co. of Am.*, 499 F. Supp. at 72 (citing both the first and second *Restatement of Contracts*).

118. *Id.* at 61.

119. As to *force majeure*, see International Minerals & Chems. Corp. v. Llano, 770 F.2d 879, 885 (10th Cir. 1989).

120. *In re* Westinghouse Elec. Corp. Uranium Contracts Litig., 517 F. Supp. 440, 450 (E.D. Va. 1981).

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clause or by the U.C.C.

To illustrate this problem, consider the following:

> Illustration 1. On January 1 National Airlines and ABC Oil enter into a contract for National to purchase and ABC to sell two million gallons of aviation fuel for $1.00 a gallon, the market price on January 1, during the upcoming calendar year. On August 1 one Middle East country attacks another, creating a sudden rise in the price of aviation fuel to $1.50 a gallon. ABC's oil does not originate from either of these two countries and is not refined in the Middle East.
>
> The sudden rise in oil prices causes ABC to lose money it could have otherwise made by selling the fuel at the new higher price. ABC attempts to void its contractual obligations based on the contract's *force majeure* clause, mistake, commercial impracticability, and frustration of purpose under the U.C.C.

Like the *Gulf* case, commercial impracticability is inappropriate in this illustration because performance has not become so unreasonable that it would result in a great injustice. Furthermore, it is not impracticable to complete the contract. ABC's wells, production, and refining facilities were unaffected. Finally, there was not an occurrence of a contingency, the nonoccurrence of which was a basic assumption on which the contract was made as required under the U.C.C. Given the volatile nature of the Middle East and because ABC was not dependent on the Middle East for its fuel production, it would be extremely difficult for ABC to argue successfully that the noninvasion of one middle east country by another was a basic assumption underlying the contract.

Frustration of purpose is equally inapplicable because the purpose of the contract has not been frustrated. ABC can still deliver the fuel and National still needs a source of fuel.

ABC is also unlikely to prevail on a claim of mistake. To reform or rescind a contract on the basis of mistake, both parties at the time of execution must have made a mistake as to a basic assumption that has a material effect on the contract. Relief will not be granted if the mistake was unilateral. Although ABC might make this point, National will correctly argue that it realized fuel prices might increase sharply and that was its reason for entering into a long-term contract. Consequently, it would be very difficult for ABC to demonstrate a mutual mistake.

ABC might be entitled to relief under the contract's *force majeure* clause, but it is unlikely. Any determination will depend on the exact wording of the clause. Most clauses provide relief for acts of war, civil disturbance, acts of God, etc. Although at first glance these may seem applicable, ABC itself was not directly affected. ABC's wells and refineries were not located in the Middle East. ABC can argue that it was affected by a war or civil disturbance, but to prevail, it would have to

prove it was directly and seriously impacted by the war.

To illustrate the effects of fluctuations in the world's economy that might seriously impact the contracting parties without affecting the actual price of the underlying commodity, consider the following:

> Illustration 2. On June 1 ABC Refining Co. enters into a contract to purchase oil from Telmex, the national oil company of Mexico. The contract requires ABC to purchase one million barrels of oil from Telmex at 15,000 pesos a barrel, the equivalent of twenty dollars a barrel, (at a conversion rate of 750 pesos to the dollar) which is the existing world market rate. By December 1 due to political and economic instability in Mexico, the conversion rate rises to 3000 pesos to the dollar, giving ABC a real purchase price of $5 a barrel. Telmex is now effectively losing $15 a barrel in comparison to the world market price, which has remained constant at $20 a barrel. Telmex now seeks to avoid its contractual obligations.

In Illustration 2, Telmex would have a tenuous claim under the doctrine of impracticability. Telmex's actual cost of production did not increase from June 1 to December 1. Similarly, the world price for a barrel of oil has remained constant at twenty dollars a barrel. The only change has been in the exchange ratio, which has risen from 750 pesos to the dollar to 3000 pesos to the dollar. The driving force in this change was not related to the product or production costs, but rather to currency fluctuations caused by political and economic instability.

The doctrine of impracticability may incorrectly appear to be relevant on first impression. Under section 2-615(a) of the U.C.C., Telmex must prove the contracting parties assumed the non-occurrence of currency fluctuations. Its argument is founded on the belief that because the parties had not made provisions for currency fluctuations, the contract should be rescinded. This is a difficult argument to prove because the world's currencies fluctuate constantly. If anything, it is likely that the peso-to-dollar ratio would fluctuate and that the parties wanted to agree on a fixed price to avoid any risk.

Section 2-615(a) of the U.C.C. states that an increase in price alone is not enough to invoke the doctrine of impracticability. For a court to rescind a contract due to impracticability, a price increase must be significant. In Illustration 2, Telmex's costs have remained constant and the contractual price should be enough to pay Telmex's costs, which presumably, are not affected by the exchange rate. Thus, because the actual cost of performance has not increased, Telmex's argument is very weak.

Currency fluctuations are similar to the effects of inflation. If Telmex had executed an agreement for a fixed price which was made unprofitable due to a high level of inflation in Mexico, Telmex would not be allowed to avoid its contractual obligations. In both cases,

Telmex should have had the contract priced in dollars to avoid potential problems.

Telmex could argue further that the parties assumed there would not be political and economic instability in Mexico during the term of the contract. Telmex could argue that if ABC believed there would be instability, ABC would not have contracted with a Mexican corporation. Furthermore, most parties that contract with another party assume the stability of the country in which the other party is located. This argument will probably fail because these are clearly the types of risk reasonable parties consider.

Contracting parties usually do not assume the risk of political and economic instability. Such risk is typically addressed in an agreement's *force majeure* clause which covers acts of civil disturbance, civil unrest, etc. Depending on the level of the instability, Telmex may be able to avoid meeting its contractual obligations under the agreement's *force majeure* clause. Telmex's ability to do so would rest upon the actual wording of the agreement's *force majeure* clause. This possibility illustrates the need for a contract's *force majeure* clause to specifically exclude both currency fluctuations and the underlying economic considerations to protect both parties interests.

A more difficult problem arises when the facts of a particular situation do not permit a clear distinction among the different doctrines. For example:

> Illustration 3. Buyer, a gourmet grocery store, contracts prior to the growing season with Seller, a farmer in Fulton County, Georgia, to buy ten tons of Vidalia onions from Seller. Because of an unforeseen drought, Seller produces only five tons. Furthermore, Buyer and Seller then discover that Vidalia onions can only be grown in Vidalia County, Georgia. Thus, the onions grown by Seller are not Vidalia onions, which causes their value to Buyer to decrease significantly.

Under the facts of Illustration 3, first impression indicates that the doctrines of impracticability, frustration of purpose, mistake, and *force majeure* may all apply.

As to commercial impracticability, Seller's nondelivery was a direct result of the occurrence of a contingency, the drought, the nonoccurrence of which was a basic assumption on which the contract was made. Given that the parties did not perceive the possibility of drought and the contract called for a particular variety of onions, which might not be easily acquired by Seller if the drought was wide spread, commercial impracticability appears to apply.

A closer examination is required to determine the applicability of this doctrine. What effect has the drought had on the price of Vidalia onions? Can they be obtained at any price? If they can be obtained at a higher price, will this cause a great injustice to Seller? To what ex-

tent can performance occur? The cost to Seller to cover his contractual obligations will dictate whether the court will impose the doctrine of commercial impractibility. Obviously, the greater the burden to Seller the greater the likelihood the doctrine will be imposed. Given previous case law, it appears that the Seller has a strong argument.

The relevance of this doctrine is further questioned, however, by the fact that Seller was physically unable to grow Vidalia onions on its property. Thus, in examining Seller's burden to meet its contractual obligations, the court most likely will look to how much of an additional burden the drought imposed on Seller, given that Seller would have had to purchase the Vidalia onions on the open market whether or not the drought had occurred.

The doctrine of frustration of purpose may also apply. To determine its relevance, one must look to the effects of the drought and the inability of Seller to grow Vidalia onions on its property. Because Seller's performance has not become worthless to Buyer, Seller would be unable to invoke the doctrine of frustration of purpose. The drought was not responsible for frustrating Buyer's purpose. After the contract had been made, Seller's principal purpose had been substantially frustrated through no fault of its own by the drought, the nonoccurrence of which was a basic assumption when the agreement was made.

However, Buyer could make a more compelling argument. Although Seller could deliver the five tons of onions grown, they were not Vidalia onions and, thus, had little or no value to Buyer. The doctrine of frustration of purpose would thus apply to Buyer because Seller's performance, even to the extent it is able to perform, is worthless to Buyer because he contracted for Vidalia onions.

A stronger argument may be made, however, that the doctrine of mistake under section 294 of the *Restatement* directly applies. Reformation or rescission on the grounds of mutual mistake requires proof by clear and convincing evidence that at the time the agreement was made, both parties had mistaken beliefs that had a material effect on the agreed exchange of performances. In such a case, the adversely affected party may void the agreement unless it assumed the risk of mistake.

Both Seller and Buyer had a mistaken belief about what constituted a Vidalia onion. At the time they entered the agreement, they believed that Seller could grow Valdalia onions, which have a premium market value. Unfortunately, this was impossible because Seller's property was located outside of Vidalia County, Georgia. As a result, both parties were mistaken at the time the agreement was made as to a basic assumption on which their agreement was founded, and this had a material effect on the agreement.

This mistaken assumption about the ability of Seller to produce Vidalia onions and what constitutes a Vidalia onion resulted in the

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failure of the contracting parties to have a meeting of the minds regarding the essence of the agreement, the ability of Seller to produce Vidalia onions. This material mistake was not one of prophecy or opinion related to a certain event and went to a material portion of the agreement. The doctrine's applicability, however, is founded upon the assumption that the party seeking to void the contract did not assume the risk of mistake.

Finally, the doctrine of *force majeure* may be relevant. Seller could make a strong argument that the drought was an act of God, which was unforeseeable, and that performance is excused under the agreement's *force majeure* clause. The drought prevented the Seller from producing a full crop of onions. The potential applicability of the agreement's *force majeure* clause depends on its wording. Most *force majeure* clauses include language that addresses nonperformance, however, because of the weather, acts of God, or other acts of nature that are outside the control of the contracting parties.

If Buyer brought a breach of contract action against Seller, Buyer would certainly argue that the agreement's *force majeure* clause did not apply. If the drought had not occurred, Seller would still have been unable to fulfill its obligations under the agreement. Seller's performance was directly limited by its inability to grow Vidalia onions. Seller most likely would argue that, although it was unable to grow Valdalia onions on its own property, it would have been able to purchase Vidalia onions on the open market to meet its contractual obligations if not for the drought. A court might fail to allow the rescission of the contract based on the agreement's *force majeure* clause unless the court accepted Seller's argument that, but for the drought, it could have met its contractual obligations.

IV. ECONOMIC IMPACT OF JUDICIAL INTERVENTION

The continued restrictive use of the doctrines of commercial impracticability, frustration, mistake, and *force majeure* is compelled by the tenets of contract law and the economic structure of this country. Case law, as evolved from the common law of a capitalist society, allows the implementation of such doctrines only in egregious cases. To do otherwise is contrary to the principles of traditional legal reasoning, which hold contracting parties to the benefit or burden for which they have contracted.[121]

121. Wheeling Valley Coal Corp. v. Mead, 186 F.2d 219, 222 (4th Cir. 1950) (the court defined *force majeure*, as it relates to coal mining, as "things which directly and of themselves prevent the carrying on of mining operations, not acts or causes which in conjunction with others merely render such operations unprofitable.").

The reluctance to implement these doctrines ensures the sanctity of contractual agreements. Contractual agreements provide needed stability in America's economic markets. Contract law cannot be subject to the capricious interpretation of a complaining party. By accepting greater use of these doctrines, courts threaten the economic stability created by long-term contracts.[122]

Businesses undertake long-range strategic planning based on the security provided by their long-term contracts. If a business could not enforce its long-term agreements, it would not be able to rely on its long-range planning to function efficiently. Corporations rely on long-term agreements to provide certainty and stability in their operations and planning. Without the protections offered by existing contract law, all parties relying on long-term contracts would suffer serious economic disruptions to their business.

To understand the theoretical effects of a more activist judiciary, assume that courts expanded the practice of intervening to rescind or reform contracts in the event of unforeseen economic fluctuations. Commercial parties would become hesitant to enter into long-term contracts if they thought such contracts would be rescinded or reformed if the terms of the contract became too onerous on the other party. Contracts of shorter duration would become more prevalent because, theoretically, a shorter time-frame would limit the risk to each party and be more acceptable to the judiciary.

Because a manufacturer could not guarantee a stable price for its raw materials over a long period of time, it would bear a much higher degree of risk. This risk would directly impact its operations and would likely lead to increased prices of its products for the purchaser. The manufacturer would become much more sensitive to small shocks in the price of its raw materials and would be unable to limit its risks through long-term contracts. Furthermore, it would be unable to maintain a stable price for its goods if it were continually subject to price changes in its raw materials. Recurrent price changes would also prevent a manufacturer from making the assumptions necessary to undertake long-term planning.

Given an increase in the price of its raw materials, a manufacturer would be forced to act in one of two ways. It could either raise the prices of its products or lower its profit margin. If the manufacturer raised its prices, it might lose market share depending on the elasticity of its product. The possibility exists, however, that the manufacturer would be unable to do either and still remain profitable. In either situ-

122. *See, e.g.*, Northern Ill. Gas Co. v. Energy Coop., Inc., 122 Ill. App. 3d 940, 952, 461 N.E.2d 1049, 1059 (1984) (noting that providing relief to parties who suffer from a change in market prices would abolish contract law).

ation, society would bear the burden of increased prices and possibly increased unemployment if the manufacturer were forced out of business.

To argue that the failure of the manufacturer's business can be justified because it was "inefficient" is flawed because the nation's economy does not operate in a perfectly competitive market.[123] If the manufacturer raises its prices, society as a whole will be forced to pay a greater price for the same goods. If the manufacturer ceases to conduct business because it is no longer able to do so profitably, unemployment will increase and competition will decrease.

Golsen v. ONG Western, Inc.[124] provides an illustration of the problems that might arise if courts adopt a more aggressive approach toward intervention. In *Golsen* the owners of a natural gas well sued to enforce the "take or pay" clause[125] in their contract with ONG. The contract required ONG to purchase all of the gas produced by the Golsen well for a period of fifteen years and to pay for the gas even if ONG did not "take" it.[126] During the term of the contract the market for natural gas became extremely volatile and made it unprofitable for ONG to purchase the gas. ONG claimed that it should be excused from performing its contractual obligations under the language of the contract's *force majeure* clause.[127]

The trial court held that the *force majeure* clause excused ONG from its obligation to pay for the gas not taken.[128] The court concluded that a significant decrease in demand for gas by ONG's customers over

123. A perfectly competitive market would require (1) all buyers and sellers to have equal access to information and be aware of all market conditions, (2) all products to be homogenous, (3) all producers to be small enough so as not to influence price or manipulate the market, and (4) all parts to be free to enter or leave the market (*i.e.*, no entry or exit barriers). REYNOLDS, MACROECONOMICS 4 (3d ed. 1979).

124. 756 P.2d 1209 (Okla. 1988).

125. A "take or pay" clause is found in many oil and natural gas purchase agreements. It requires the purchaser to take a certain amount of gas or oil, or pay for the oil or gas if he does not take it. The seller is guaranteed a stream of revenue, and the purchaser is assured a source of oil or gas. The purchaser bears the risk of market demand. A "take or pay" clause ensures that the seller will receive the agreed upon price for the contract quantity each year. *See, e.g.*, Universal Resources Corp. v. Panhandle E. Pipe Line Co., 813 F.2d 77, 80 (5th Cir. 1987); Day v. Tenneco, Inc., 696 F. Supp. 233, 234 (S.D. Miss. 1988). These contracts compensate the seller for being ready to deliver the maximum quantity of oil or gas at all times, and they protect the seller against a requirements contract in which the buyer's demands were too low. *See* International Minerals Chem. Corp. v. Llano, Inc., 770 F.2d 879, 882 (10th Cir. 1985), *cert. denied*, 475 U.S. 1015 (1986). *See generally* 4 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 724.5 (1988).

126. *Golsen*, 756 P.2d at 1210.

127. *Id.* at 1210-11.

128. *Id.* at 1210.

a two year period, constituted events of *force majeure*.[129] The court recognized ONG's inability to sell the gas at a profit as an act of *force majeure* and expanded the traditional meaning of the term.[130]

On appeal, the Oklahoma Supreme Court reversed and remanded the lower court's decision.[131] The supreme court strongly rejected the lower court's application of the doctrine of *force majeure* and stated that the inability of ONG to sell the gas at a profit was not within the realm of *force majeure*.[132]

When the court interpreted the *force majeure* clause within the agreement, the court cautioned that any repugnancy should be reconciled, if possible, "by such an interpretation as will give some effect to the repugnant clause which is subordinate to the general intent and purposes of the whole contract."[133] In *Golsen*, ONG's interpretation of the *force majeure* clause was repugnant to the general meaning of the contract.[134] The central object of the agreement was to buy and sell gas, and the take or pay provisions were integral to it. ONG, the purchaser, obtained a steady source of gas at a fixed price while Golsen, the seller, obtained a sure market for its gas. The seller agreed to forego selling gas to other purchasers in return for ONG's promise to pay for the gas even if ONG did not take it.

The *Golsen* court, recognized the incentives for both parties, and held that "[a] particular clause will not control if it is violative of the parties' general intent even though persuasive in isolation."[135] Thus, an expansive interpretation of the *force majeure* clause was not proper because it would have contravened the express purpose of the contract.

In evaluating the application of these doctrines to a particular situation, courts place emphasis on whether the supervening event was unforeseen.[136] "Unforeseen" is defined as "not expected."[137] The *Gulf* court also required that the event occur infrequently.[138] Thus, a hurri-

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129. *Id.* at 1211-12.

130. Profitability has not been a traditional justification for invoking the doctrine of *force majeure*. *See id.* at 1212; *cf.* Morrison v. W.L. Green Comm'n Co., 61 Okla. 287, 161 P. 218 (1916) (evidence indicating expense as the reason for nonperformance may be included). A *force majeure* clause is rarely intended by the parties to address "market forces" and in such cases, a direct reference is made to them.

131. *Golsen*, 756 P.2d at 1220.

132. *Id.* at 1212-13 (citing RESTATEMENT OF CONTRACTS § 455 (1932)).

133. *Id.* at 1213.

134. *Id.*

135. *Id.* at 1214 (citing United States *ex rel.* Bachman & Keffer Constr. Co. v. H. G. Cozad Constr. Co., 324 F.2d 617 (10th Cir. 1963)).

136. For a discussion of impracticability, see *supra* text accompanying notes 27-28; for a discussion of frustration of purpose, see *supra* text accompanying note 58.

137. BLACK'S LAW DICTIONARY 1530 (6th ed. 1990).

138. Gulf Oil Corp. v. Federal Energy Regulatory Comm'n, 706 F.2d 444, 453-54 (3d

cane in October in Florida would not be considered an act of *force majeure*, but a hurricane in Alaska would. This is the case with economic fluctuations. Economic fluctuations, such as recessions and corresponding upswings, have long been recognized as cyclical.[139] These changes, while unpredictable, are not unforeseen and are to be expected. Even assuming that such changes are unforeseen, they are not infrequent so they fail to meet the definition provided in *Gulf*.

The cyclical nature of the economy in both the United States and in the world arguably should bar the application of such doctrines to economic fluctuations.[140] Viewed in conjunction with the imprecise and uncertain nature of economic forecasting, the cyclical nature of the economy makes the term "economic force majeure" an oxymoron. Recognized unpredictability cannot be unforeseen.

Because the economy fluctuates, even major changes in the economic climate do not necessarily justify judicial intervention.[141] This irreconcilable contradiction between impracticability, frustration, and mistake, and the cyclical nature of the economy, dictates the rejection of the broader application of these doctrines. Economic fluctuations have not traditionally been included within the commonly accepted meaning of such doctrines because their repetitious nature prevents them from being considered unforeseen. Accordingly, a broader interpretation to include them should specifically be agreed to by the contracting parties before they can be applied. If a contract's *force majeure* clause does not include a provision regarding economic fluctuations, it must be presumed that the parties intended to assign risk through the pricing mechanism contained in the agreement.[142]

Foster v. Atlantic Refining Co. dealt with the issue of foreseeability.[143] In *Foster* the court denied an oil company's motion to rescind a royalty contract because it did not contain a price escalation clause.[144] The court noted that if a party can perform the obligated action, the party will be held responsible even though performance may become

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Cir. 1983), *cert. denied*, 464 U.S. 1038 (1984).

139. *See, e.g.*, M. EDGMEND, MACROECONOMICS THEORY AND POLICY 369-72 (1979).

140. *Id.*; *see also Gulf Oil Corp.*, 706 F.2d at 453-54 (it is possible to describe accurately an event at its initial occurrence as unforeseeable, and later, because of the regularity with which it occurs, to find that such a description no longer applies).

141. *See* Eastern Air Lines, Inc. v. Gulf Oil Corp., 415 F. Supp. 429, 441-42 (S.D. Fla. 1975) (economic instability in the oil industry is foreseeable); Groseth Int'l, Inc. v. Tenneco, Inc., 410 N.W.2d 159, 167 (S.D. 1987) (economic depression in the agriculture economy is foreseeable).

142. *See* Foster v. Atlantic Ref. Co., 329 F.2d 485 (5th Cir. 1964) (by failing to include adjustment mechanism in contract, a party assumed the risk that price increases would adversely affect its ability to perform).

143. *Id.*

144. *Id.* at 489.

difficult or impossible.[145] This is true especially when the party "might have foreseen the difficulty and impossibility."[146] Such reasoning restricts the use of these doctrines to very limited situations.

In evaluating whether an event is foreseeable, it is necessary to distinguish between whether an event is foreseeable and whether it is contemplated. To prevent the possible invocation of the doctrines of impracticability, mistake, frustration, and *force majeure*, an event must only have been foreseeable, regardless of whether it was actually contemplated by the parties.[147] This lesser standard arguably makes it much more difficult to invoke these doctrines because fluctuations in market price are reasonably foreseeable.

These fluctuations that create the element of risk serve as the motivating force for entering into long-term contracts. All contracts involve risk. Risk is inherent in their nature. A fixed-price contract explicitly allocates the element of risk between contracting parties.[148] The seller bears the risk that the underlying commodity will increase in price, forcing the sale below the existing market price. The purchaser, on the other hand, bears the risk that falling prices will result in an obligation to purchase the commodities above the existing market price.[149] The contract price reflects the degree of risk borne by either party.[150]

Arguably, the purpose of a contract is the allocation and shifting of risk.[151] Absent evidence to the contrary, the promisor is responsible for bearing any loss resulting from an inability to forecast future market conditions accurately.[152] The promisor's failure to provide contractual protections against that risk is considered an unconditional obliga-

145. *Id.*

146. *Id.* (*quoting* Ellwood v. Nutex Oil Co., 148 S.W.2d 862, 864 (Tex. Civ. App. 1941)).

147. *See* Eastern Air Lines, Inc. v. McDonnell Douglas Corp., 532 F.2d 957, 991-92 (5th Cir. 1976) (promisor presumed to have agreed to bear loss occasioned by event foreseeable at time of contracting) (citing Lloyd v. Murphy, 25 Cal. 2d 48, 54, 153 P.2d 47, 50 (1944)).

148. Northern Ind. Pub. Serv. v. Carbon County Coal Co., 799 F.2d 265, 278 (7th Cir. 1986).

149. *Id.*

150. *Id.*

151. Aluminum Co. of Am. v. Essex Group, Inc., 499 F. Supp. 53, 61 (W.D. Pa. 1980).

152. *See* Sabine Corp. v. ONG W., Inc., 725 F. Supp. 1157, 1179 (W.D. Okla. 1989); *cf.* John Deere Leasing Co. v. Blubaugh, 636 F. Supp. 1569, 1572 (D. Kan. 1986) ("A general principle of contract law is that competent parties may make contracts on their own terms, provided such contracts are neither illegal nor contrary to public policy and in the absence of fraud, mistake or duress, a party who has entered into such a contract is bound thereby.").

tion to perform.[153]

Negotiating parties are expected to recognize that market conditions are volatile and subject to change.[154] Although one party may have assumed a risk associated with the transaction, it was free to allocate the risk to willing third parties.

Parties that do not wish to assume risk can limit their potential liability through a number of contractual methods available in a free market economy. For example, one method to limit potential liability is to obtain puts,[155] calls,[156] or other protective measures.[157] Parties may not only provide for the risk of the underlying transaction, they can also minimize tangential risks.[158] The economic cost of such measures is usually quite small in light of the risk avoided.

The ability of a party to control its risk justifies limiting judicial intervention to only the most egregious situations. Not only have courts recognized the ability of a party to limit its risk, but in order to recover under these doctrines, some have imposed the requirement that a party must have attempted to limit its risk.[159] Such reasoning correctly limits the recovery of a party that fails to take reasonably prudent measures to protect its interests. To do otherwise would reward negligence, because the injured party could seek to recover de-

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153. Waldinger Corp. v. CRS Group Eng'rs, Inc., 775 F.2d 781, 786 (7th Cir. 1985) ("If the risk of the occurrence of the contingency was foreseeable, that risk is tacitly assigned to the seller."); Eastern Airlines, Inc. v. McDonnell Douglas Corp., 532 F.2d 957, 992 (5th Cir. 1976); Eastern Airlines, Inc. v. Gulf Oil Corp., 415 F. Supp. 429, 441 (S.D. Fla. 1975); Barbarossa-Sons, Inc. v. Iten Chevrolet, Inc., 265 N.W.2d 655, 659-61 (Minn. 1978).

154. Northern Ill. Gas Co. v. Energy Coop., Inc., 122 Ill. App. 3d 940, 952, 461 N.E.2d 1049, 1059 (1984).

155. A "put" option is the right, but not the obligation, to sell a particular commodity at a set time in the future at a set price. BLACK'S LAW DICTIONARY 1237 (6th ed. 1990).

156. A "call" option is the right, but not the obligation, to buy a particular commodity at a set time in the future at a set price. BLACK'S LAW DICTIONARY 204 (6th ed. 1990).

157. These may include, but are not necessarily limited to, insurance, subcontracting a party's obligations under the contract, arbitrage, and if applicable, buying and selling commodity futures agreements. One widely recognized risk limiting device is "price indexing," which can be tailored to any situation. *See, e.g.*, Aluminum Co. of Am. v. Essex Group, Inc., 499 F. Supp. 53, 63 (W.D. Pa. 1980).

158. Tangential risks, although incidental to the object of the contract, could seriously affect the contracting parties. The most prevalent of such risks is the risk of currency fluctuations when one pays in a foreign currency. If the exchange rate fluctuates and the contract price remains constant, the buyer or seller's profit margin could be significantly increased or decreased depending on the direction of fluctuation.

159. *See* Eastern Air Lines, Inc. v. McDonnell Douglas Corp., 532 F.2d 957 (5th Cir. 1976); *see also* Madeirense Do Brasil. S/A v. Stulman-Emrick Lumber Co., 147 F.2d 399, 403 (2d Cir.) *cert. denied*, 325 U.S. 861 (1945); Lloyd v. Murphy, 25 Cal. 2d 48, 54, 153 P.2d 47, 50 (1944) (Traynor, J.); McCulloch v. Liguori, 88 Cal. App. 2d 366, 373, 199 P.2d 25, 30-31 (1948).

spite its own inaction.

The corollary to this reasoning is that a party which undertakes reasonable actions to protect its interests will be protected from those events it did not reasonably foresee. Under no circumstances, when risks are foreseeable, should a court rewrite a contract to achieve what it believes is an equitable result.[160] Presumably, the parties enjoyed equal bargaining positions when they negotiated and executed the contract. A buyer has the right to rely on the seller to supply the contracted goods regardless of any price change.[161]

V. The Reasonably Prudent Person Standard

In evaluating an alleged event of economic fluctuation to determine whether judicial intervention is justifiable, courts should utilize a "reasonably prudent person" standard. Such a standard would go beyond a "reasonable man" standard,[162] to hold contracting parties to the standards of a reasonably prudent person. Thus, contracting parties would be expected to adhere to the standards of an individual experienced in a specific type of business.[163]

The acceptance of a reasonably prudent person standard in long-term contractual agreements is analogous to the existing use of such a standard in securities law and negligence cases. The reasonably prudent person standard is a logical extension of the "ordinarily prudent person" standard provided for under the Revised Model Business Cor-

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160. Interpetrol Bermuda Ltd. v. Kaiser Aluminum Int'l Corp., 719 F.2d 992, 999 (9th Cir. 1983) ("[I]t would violate fundamental principles of contract law to use section 2-615 of the U.C.C. to rewrite the contract to which the parties agreed."); *see also* Morgan v. Mobil Oil Corp., 726 F.2d 1474, 1477 (10th Cir. 1984); 3 A. Corbin, Corbin on Contracts § 598 (1960); Restatement (Second) of Contracts § 261 (1981).

161. Eastern Air Lines, Inc. v. Gulf Oil Corp., 415 F. Supp. 429, 439 (S.D. Fla. 1975); *see also* Neal-Cooper Grain Co. v. Texas Gulf Sulfur Co., 508 F.2d 283, 293-94 (7th Cir. 1974); American Trading and Prod. Corp. v. Shell Int'l Marine Ltd., 453 F.2d 939, 942 (2d Cir. 1972); United States v. Wegematic Corp., 360 F.2d 674 (2d Cir. 1966); Whitlock Corp. v. United States, 159 F. Supp. 602, 606 (Ct. Cl.), *cert. denied*, 358 U.S. 815 (1958); Perry v. Champlain Oil Co., 101 N.H. 97, 99, 134 A.2d 65, 66 (1957); Maple Farms, Inc. v. City School Dist., 76 Misc. 2d 1080, 352 N.Y.S.2d 784 (Sup. Ct. 1974).

162. A defendant must meet the "reasonable man" standard to avoid liability in a negligence action. It requires an individual to exercise the same degree of care and caution as a "reasonable man" under all of the same circumstances, including the foreseeability of harm to the individual. *See generally* W. Keeton, D. Dobbs, R. Keeton & D. Owen, Prosser and Keeton on Torts § 32, at 173-93 (5th ed. 1984).

163. *See* Challenger Minerals, Inc., No. 84-C-357-E, slip op. at 15 (N.D. Okla. Sept. 9, 1986) (the negotiating parties are expected to have an awareness of market conditions as changeable rather than stable); *see also* Coquina Oil v. Transwestern Pipeline Co., No. 86-562-M Civil, slip. op. at 14 (D.N.M. Sept. 19, 1986).

poration Act (RMBCA)[164] and the reasonable man standard utilized in other areas of the law.

Under the RMBCA, a corporation's directors are held to the standard of care of an ordinarily prudent person in a like position under similar circumstances.[165] Several cases have held this standard to be the same standard of care used by the director to conduct his own personal business.[166]

The official comment to section 8.30 of the Model Business Corporation Act, which discusses the phrase "ordinarily prudent person," recognizes that it "embodies long traditions of common law."[167] Thus it is a standard on which directors can be easily judged. This reasoning applies to long-term contracts for which a reasonably prudent person standard can be applied easily. In contrast, an "ordinarily prudent businessman" standard reflects an undefined degree of expertise that cannot be articulated.[168] An "ordinarily prudent person" standard does not reflect any lesser standard, because the official comment acknowledges the requirement that a director be innovative as well as possess common sense, practical wisdom, and informed judgment.[169]

These attributes are analogous to contracting parties because they must possess the foresight, common sense, practical wisdom, and informed judgment to take all reasonable action to limit potential losses. Thus, although an individual may lack expertise or business experience in a particular area, the individual will not be excused form exercising the level of common sense, practical wisdom, and informed judgment exercised by an ordinarily prudent person.[170]

Closely analogous to these standards is the reasonable man standard utilized in securities law to determine whether a fact or piece of information is material.[171] To determine whether a fact is material, the court considers whether a reasonable man would attach importance to a particular fact in making his investment decision.[172] The courts do not use a reasonable businessman standard, but rather ask what an ordinarily prudent and reasonable person would think is important.

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164. REVISED MODEL BUSINESS CORP. ACT § 8.30(a)(2) (1984).

165. *Id.*

166. Schein v. Caesar's World, Inc., 491 F.2d 17 (5th Cir.), *cert. denied*, 419 U.S. 838 (1974); *In re* Illinois Valley Acceptance Corp., 531 F. Supp. 737 (N.D. Ill. 1982); Harman v. Willbern, 374 F. Supp. 1149 (D. Kan. 1974), *aff'd*, 520 F.2d 1333 (10th Cir. 1975).

167. REVISED MODEL BUSINESS CORP. ACT § 8.30 official comment.

168. *Id.*

169. *Id.*

170. *Id.*

171. *See* Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972); SEC v. Texas Gulf Sulphur Co., 312 F. Supp. 77 (S.D.N.Y. 1970), *aff'd and rev'd on other grounds*, 446 F.2d 1301 (2d Cir.), *on remand*, 331 F. Supp. 671, *cert. denied*, 404 U.S. 1005 (1971).

172. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

The use of this standard helps to avoid problems in interpretation. The judge can use settled case law, and the jury can use its perception, to determine liability. A simple and well-articulated standard allows for ease of use.

The use of this standard is also justified by the use of the reasonable man standard in negligence cases. Under tort law, the reasonable man standard is used to determine whether the individual seeking recovery discharged his duty to exercise reasonable care for his own safety.[173] This is directly analogous to the situation presented by contracting parties. Did the entity seeking recovery exercise due care to limit its contractual risks? If it did not act in a reasonably prudent manner or as a reasonably prudent person, it should not be entitled to recover. In both negligence actions and contractual obligations, a party seeking recovery would be held to the same standard. This would create one consistent standard that would transcend several areas of the law. By recognizing such a standard, courts would avoid inconsistent applications of the law that result in inequitable results.

In business transactions, commercial parties have often been imputed to have a greater degree of knowledge, or sophistication, than consumers and have been held to a higher standard. This is consistent with the new standard. Individuals operating in the business world should take the same precautions to limit their risk as do all reasonable persons. To do otherwise risks contradicting traditional legal reasoning.

A reasonably prudent person standard would incorporate traditional reasoning, utilizing these standards in closely analogous areas. At least one decision has equated a reasonably prudent man standard with an ordinary prudent man standard, strongly implying that the two are synonymous.[174]

Each of these standards is objective in nature and seeks to draw upon well-developed common law, thereby avoiding interpretations in judgment. A reasonably prudent person standard attempts to avoid problems that may arise when an individual lacks business experience or expertise in a particular area. Under this proposed standard, existing case law would not excuse an individual from exercising common sense and informed judgment.[175] Finally, an objective standard, such as a reasonably prudent man standard, allows easy application and review. A court would compare the actions taken by the party seeking rescission to those that would have been taken by a reasonably prudent

173. B&B Insulation, Inc. v. Occupational Safety & Health Review Comm'n, 583 F.2d 1364, 1370 (5th Cir. 1978).

174. Missouri, Ky. & Tenn. Ry. v. Hannig, 91 Tex. 347, 43 S.W. 508 (1897).

175. *See, e.g.*, REVISED MODEL BUSINESS CORP. ACT § 8.30 official comment (1984).

person. The inquiry would focus primarily on whether the impact of an intervening event could have been avoided or foreseen by a reasonably prudent person.

For example, businessmen selling products abroad are often exposed to a currency risk because payment in a foreign currency will take place sometime after delivery in the future. The businessman bears the risk that the foreign currency may depreciate against the dollar, thereby reducing or even eliminating his profit. A reasonably prudent person will protect himself against any possible depreciation, or increase his contract price to reflect the risk of such depreciation. It is extremely unlikely that a businessman would be able to avoid his contractual obligations through economic *force majeure*, commercial impracticability, mistake, frustration, or any other legal theory because of his failure to cover his currency risk. The reasonably prudent person standard is an equitable model that recognizes the protections identified by the Restatement, U.C.C., and existing case law. At the same time, it requires the parties to protect themselves and encourages them to think about the economic assumptions underlying their agreement. Such expectations are reasonable, being founded upon the business practices of a reasonably prudent person. Therefore, adoption of the standard would eliminate frivolous claims while allowing parties to recover for truly unforeseeable events.

A reasonably prudent person standard can also be applied easily by the judiciary. The standard is based on common sense. The court would only have to consider one question: What actions would a reasonably prudent person take to protect his interests under the agreement in issue? The test is straightforward and uncomplicated. By closely reviewing the actions the party took to protect itself in light of the existing dangers, the court can easily determine whether the party acted in a reasonably prudent manner.

VI. AVOIDANCE OF JUDICIAL INTERVENTION

To limit judicial intervention, contracting parties can undertake a number of actions to ensure the sanctity of their agreement. When one drafts an agreement, he should include specific language that will limit the judiciary's discretion.

Existing case law has upheld the right of contracting parties to draft specific and detailed *force majeure* clauses that reflect the nuances of their specific transactions.[176] By specifically defining the

176. *See, e.g.*, Interpetrol Bermuda Ltd. v. Kaiser Aluminum Int'l Corp., 719 F.2d 992, 997 (9th Cir. 1983); Gulf Oil Corp. v. Federal Power Comm'n, 563 F.2d 588, 601 (3d Cir. 1977), *cert. denied*, 434 U.S. 1062 (1978); Tomlinson v. Wander Seed & Bulb Co.,

meaning and application of a contract's *force majeure* clause, courts will be reluctant to impose a broader meaning.[177] Courts also tend to give effect to specific exculpations contained in a *force majeure* clause rather than more general language contained in the same clause.[178] Consequently, every *force majeure* clause should be drafted tightly and include a disclaimer that the clause does not excuse performance for unforeseen changes in the economic assumptions underlying the transaction.[179]

Every contract should also contain language which clearly states that the pricing provisions of the agreement reflect the allocation and acceptance of risk by one or both parties. By including such a statement the parties will negate the requirements under U.C.C. section 2-

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177 Cal. App. 2d 462, 2 Cal. Rptr. 310 (1960); *cf.* S.L. Jones & Co. v. Bond, 191 Cal. 551, 555, 217 P. 725, 727 (1923) (nonperformance not excused when the party could have drafted an exculpatory provision into the contract but failed to do so).

Courts have generally rejected, however, the ability of the parties to waive the protections provided by the U.C.C. if such a waiver would deny a party reasonable protection. *See, e.g.*, Chemetron Corp. v. McLouth Steel Corp., 381 F. Supp. 245, 250 (N.D. Ill. 1974). Nevertheless, at least two circuits have allowed contracting parties to provide for exemptions broader than those provided for under § 2-615 of the U.C.C. *See Interpetrol Bermuda*, 719 F.2d at 999; Eastern Air Lines, Inc. v. McDonnell Douglas Corp., 532 F.2d 957, 991 (5th Cir. 1976). *See also* Olson v. Spitzer, 257 N.W.2d 459 (S.D. 1977). *See generally* Hawkland, *The Energy Crisis and Section 2-615 of the Uniform Commercial Code*, 79 COM. L.J. 75 (1974). Some *force majeure* clauses have been limited by U.C.C. § 1-102(3), § 1-203, and § 2-302, which prohibit clauses that are manifestly unreasonable, in bad faith, or unconscionable. *See, e.g., Interpetrol Bermuda*, 719 F.2d at 1000 n.9; *Eastern Airlines*, 532 F.2d at 991 n.96; Transatlantic Fin. Corp. v. United States, 363 F.2d 312, 315 n.3 (D.C. Cir. 1966).

The courts and one commentator have concluded that any exculpatory provisions must be specific. Those described in general terms have been held to excuse only unforeseen events that make performance impracticable. *See* Vernon Lumber Corp. v. Harcen Constr. Co., 60 F. Supp. 555, 558 (E.D.N.Y. 1945), *aff'd on other grounds*, 155 F.2d 348 (2d Cir. 1946); Inter-Coast Steamship Co. v. Seaboard Transp. Co., 291 F. 13 (1st Cir. 1923); 6 A. CORBIN, CORBIN ON CONTRACTS § 1342, at 409 (1962).

177. Benson Mineral Group, Inc. v. Northern Natural Gas Co., No. 86-1903, slip op. at 15 (D. Kan. Apr. 29, 1986) ("When several specific contingencies which will excuse nonperformance are named in a contract, only the named contingencies will excuse nonperformance."); City of Topeka v. Industrial Gas Co., 135 Kan. 646, 651, 11 P.2d 1034, 1037, *cert. denied*, 287 U.S. 658 (1932).

178. Gulf Oil Corp. v. Federal Power Comm'n, 563 F.2d 588, 601 (3d Cir. 1977), *cert. denied*, 434 U.S. 1062 (1978).

179. Drafters might include language such as:

> Under no circumstances shall any changes foreseen or unforeseen in the assumptions underlying the objectives of this Agreement, including but not limited to the assumptions underlying the pricing or pricing mechanism of this Agreement including currency fluctuations, delay, or excuse either party's performance, hereunder, nor shall any such event or events be considered an event of *force majeure*.

615 that the parties had not allocated the element of risk in the transaction.[180]

Finally, the author should, if practically and legally appropriate, include specific language removing the parties from interpretations provided by the U.C.C. With skillful drafting, the party at risk can attempt to create a "seamless" shield against potential intervention. At the same time, it may limit fruitless and potentially costly litigation.

VII. CONCLUSION

The doctrines of commercial impracticability, frustration, mistake, and *force majeure* have received greater attention for potentially broader application in recent years because of uncertainty and instability in certain segments of the economy.[181] Courts reluctance to use these doctrines to a greater extent is a reflection of traditional legal reasoning. A strict interpretation regarding the implementation of these doctrines protects the sanctity of contractual relationships while ensuring economic stability in much of the business community.

Judicial intervention in contractual relationships arose as a means to protect contracting parties in certain limited "unforeseen" situations in which one party's loss was much greater than the negotiated risk. All contractual relationships, however, involve an element of risk, that the underlying object of the agreement will change in value. Judicially imposed solutions were never intended to address recognizable changes in the economy, and courts should not expand the application of these doctrines to allow contracting parties to escape their contractually mandated obligations.

When parties enter into an agreement, they allocate risk through the pricing of the contract, even though such allocation may not be specifically stated in the agreement.[182] If a party desires to reduce its exposure, it can do so through a number of economic vehicles. Under no circumstances, however, should courts alter the element of risk in long-term agreements when the parties have already allocated the risk between themselves.

180. *See* U.C.C. § 2-615 (1988).

181. *See, e.g., Exxon's Use of Force Majeure to Reduce Deliveries is Debatable, Experts Say*, Wall St. J., Apr. 7, 1989, at A9, col. 1.

182. Aluminum Co. of Am. v. Essex Group, Inc., 499 F. Supp. 53, 61 (W.D. Pa. 1980).