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Commercial Hardship and the Discharge of Contractual Obligations Under American and British Law

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NOTES

COMMERCIAL HARDSHIP AND THE DISCHARGE OF CONTRACTUAL OBLIGATIONS UNDER AMERICAN AND BRITISH LAW

I. INTRODUCTION

In 1917, Justice Holmes noted as follows: "One who makes a contract never can be absolutely certain that he will be able to perform it when the time comes, and the very essence of it is that he takes the risk within the limits of his undertaking."[1] This single statement summarizes the contours of a problem that both United States and English courts have struggled with for centuries. This struggle, unfortunately, has not resulted in the development of a "coherent positive theory consistent with the typical outcomes in the recurring cases."[2] Most contracts entail future performance, and uncertainty necessarily comes with an obligation to be performed in the future. This uncertainty creates risks, and a fundamental purpose of contracts is the allocation of risks between the parties to an exchange. In every contract the promisor accepts the risk that he will not be able to perform in accordance with the terms of the agreement.[3] The determination of the extent and nature of the promisor's risk has perplexed the courts.

There are several doctrines under which contractual obligations have been judicially discharged.[4] This Note will examine the

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1. Day v. United States, 245 U.S. 159, 161 (1917).

2. Posner & Rosenfield, *Impossibility and Related Doctrines: An Economic Analysis*, 6 J. LEGAL STUD. 83, 84 (1976). [Hereinafter cited as Posner & Rosenfield]. In Housing Authority v. East Tennessee Light and Power Co., 183 Va. 64, 72, 31 S.E.2d 273, 276 (1944), the court stated that "[t]he conclusions reached in the decided cases are not harmonious, due, perhaps in part, to the multitude of circumstances or conditions under which the question was presented. It is impossible to state a general rule which will be applicable to all classes of cases."

3. In Lloyd v. Murphy, 25 Cal.2d 48, 51, 153 P.2d 47, 50 (1944), Justice Traynor observed that "[t]he purpose of a contract is to place the risks of performance upon the promisor . . . ."

4. Contractual obligations have been discharged under the "traditional" doctrine of impossibility, the doctrine of frustration of purpose, and the doctrine of *force majeur*. The "traditional" doctrine of impossibility may be invoked when

United States doctrine of commercial impracticability or commercial impossibility[5] and the English doctrine of frustration of contract or frustration of the commercial objective.[6] The focus of this Note therefore is on those situations in which discharge from contractual obligations is sought because of supervening economic hardship. Part II provides a brief historical account of the development of the English common law doctrine of impossibility. Part III traces the development of the United States concept of commercial impossibility and commercial impracticability from the

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one or both of the contracted performances have become literally impossible, either by the destruction of the specific subject matter, the death of a necessary person, or the nonexistence of the specifically contemplated means of performance. *See* 6 A. CORBIN, CONTRACTS § 1321 (rev. ed. 1962). Although some authorities treat unreasonable and excessive increases in the cost of performance under the doctrine of impossibility, *e.g.*, RESTATEMENT OF CONTRACTS § 454 (1932), the modern trend, followed in this writing, analyzes such cases under the heading of "commercial impracticability" or "commercial impossibility." *See* U.C.C. § 2-615 (1978 version); RESTATEMENT (SECOND) OF CONTRACTS § 281 (Tent. Draft No. 9, 1974).

The doctrine of frustration of purpose under United States law refers to situations in which the contracted performance is possible, but the original intentions of either the promisor or promisee will not be achieved by performance. In order for discharge to result, the purpose for which a party contracted must have been known to both sides and the party requesting discharge must not have been at fault in causing the frustrating event. *See* 6 A. CORBIN, CONTRACTS § 1322 (rev. ed. 1962); RESTATEMENT OF CONTRACTS § 288 (1932).

Another doctrrine of dicharge is *force majeure,* which applies when an unforeseen, supervening event renders performance of contractual obligations impossible. The concept includes physical impossibility (act of God) and legal impossibility (acts by foreign or domestic governments). Although originally a civil law concept, *force majeure* has received considerable treatment by both United States and English courts, primarily because it is a standard exemption clause in commercial contracts. *See* Squillante & Congalton, *Force Majeure,* 80 COM. L.J. 4 (1975) [hereinafter cited as Squillante & Congalton].

Some scholars suggest that there is no functional justification for distinguishing among the various doctrines of contractual discharge. In each case, the basic issue is the same: "to decide who should bear the loss resulting from an event that has rendered performance by one party uneconomical." Posner & Rosenfield, *supra* note 2, at 86.

5. Some authorities place "commercial impossibility" under the traditional impossibility doctrine. Since the purpose of this Note is to focus on commercial hardship, commercial impossibility is treated separately.

6. The English doctrine of frustration is substantially similar to the United States doctrine of impossibility. *See* Transatlantic Financing Corp. v. United States, 363 F.2d 312 (D.C. Cir. 1966). Thus, frustration of the commercial objective is similar to the United States doctrine of commercial impossibility.

early case law to the adoption and application of the Uniform Commercial Code. Part IV reviews the English doctrine of frustration, in which strict language is employed when dealing with the discharge of contractual obligations on commercial hardship grounds. In conclusion, Part V compares the United States and English doctrines and discusses the potential pitfalls presented by differences in the terminology and concepts for parties involved in international contracts.

II. Early Common Law In England

Paradine v. Jane[7] reflects the early common law position that a party is liable in damages for failure to perform his contractual obligations, even if performance is rendered impossible or if the purpose for which a party entered the contract is frustrated.[8] This is commonly referred to as the doctrine of absolute performance. In *Paradine,* which involved an action to recover unpaid rent, the court dismissed defendant's plea that he had been dispossessed of the leased premises by the armed invasion of an alien army and therefore could not collect the rents and profits normally derived from the land. According to the court: "[W]hen the party by his own contract created a duty or charge upon himself, he is bound to make it good, if he may, notwithstanding accident by inevitable necessity, because he might have provided against it by his contract."[9] Despite earlier cases that recognized excuses for nonperformance,[10] the rule of absolute performance, as represented in *Paradine v. Jane,* became firmly embedded in English law by the beginning of the 19th century.[11]

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7. 82 Eng. Rep. 897 (K.B. 1647).

8. *See* Hurst, *Freedom of Contract in An Unstable Economy: Judicial Reallocation of Contractual Risks Under UCC Section 2-615,* 54 N.C. L. Rev. 545, 549 (1976) [hereinafter cited as Hurst]. Schmitt & Wollschlager, *Section 2-615 "Commercial Impracticability"—Making the Impracticable Practicable,* 81 Com. C.J. 9, 10 (1976) [hereinafter cited as Schmitt & Wollschlager].

9. 82 Eng. Rep. at 897.

10. Abbott of Westminster v. Clerke, 73 Eng. Rep. 59 (K.B. 1536) (illegality due to subsequent act of Parliament); Hyde v. Dean & Canons of Windsor, 78 Eng. Rep. 798 (K.B. 1597) (death of party to personal service contract); and Williams v. Lloyd, 82 Eng. Rep. 95 (K.B. 1628) (destruction of chattel that was specific subject matter of bailment contract).

11. *See* Serjent Williams's note to *Walton v. Waterhouse,* 85 Eng. Rep. 1233, 1234 (K.B. 1684). Williams quoted the following dictum from *Paradine v. Jane:* "[I]f a lessee covenant to repair a house, though it be burnt by lightning or

In 1863 *Taylor v. Caldwell*[12] explicity recognized the defense of impossibility. *Taylor* concerned a party who had rented a music hall and subsequently sued the owner for damages[13] for breach of contract when the hall was destroyed by fire. The court first noted that there could have been an express provision in the contract stipulating which party should bear the loss resulting from such a disaster.[14] Absent an allocation of loss by the parties themselves, the court found it necessary to imply an allocating provision in furtherance of the intention of the parties.[15] Thus, the owner's nonperformance was excused on the basis of an implied condition: "The principle seems to us to be that, in contracts in which the performance depends on the continued existence of a given person or thing, a condition is implied that the impossibility of performance arising from the perishing of the person or thing shall excuse performance."[16]

A later case stemming from the cancellation of the coronation of King Edward VII expanded the doctrine of impossibility of performance enunciated in *Taylor*. In *Krell v. Henry*,[17] a prospective viewer of the coronation was relieved of his obligation to pay an inflated rental fee for a strategically located flat. The court in *Krell* implied the existence of a particular "state of things," namely, the occurrence of the coronation, as a condition in the contract. Consequently, the "non-existence of the state of things assumed by both contracting parties as the foundation of the contract" rendered the contract impossible of performance.[18]

By the beginning of the 20th century, therefore, the defense of impossibility was available to discharge a party from his obligation to perform under a contract. A showing of actual impossibil-

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thrown down by enemies, yet he is bound to repair it." Williams quoted this without reciting the facts of the case, and for a good part of the nineteenth century it was assumed that *Paradine* involved a covenant by a tenant to rebuild. *See* KESSLER & GILMORE, CONTRACTS, CASES AND MATERIALS, 758 n.6 (2d ed. 1976).

12. 122 Eng. Rep. 309 (K.B. 1863).

13. The plaintiff sued for lost profits and expenses incurred in preparing for the concerts.

14. 122 Eng. Rep. at 312.

15. The term "frustration" came into general use in English courts soon after *Krell v. Henry*. *See* KESSLER & GILMORE, *supra* note 11, 788 n.1.

16. 122 Eng. Rep. at 314.

17. [1903] 2 K.B. 740.

18. *Id.* at 749.

ity was required in order to invoke the defense. There were four generally recognized situations when the defense of impossibility would excuse performance: (1) impossibility due to a change in law—legal impossibility;[19] (2) impossibliiy due to the death or illness of a party who contracted to perform personal services;[20] (3) impossibility due to the destruction of the subject matter of the contract;[21] and (4) impossibility due to the failure of some specified means of performance.[22] As the twentieth century and its commercial development progressed, courts were asked to expand the doctrine of impossibility to cover situations when performance, although physically possible, had been rendered economically unfeasible or impracticable due to an unforeseeable increase in costs. The courts, especially in the United States, were not totally unresponsive.

III. COMMERCIAL IMPOSSIBILITY/IMPRACTICABILITY UNDER UNITED STATES LAW

United States courts initially adhered to the requirement of literal impossibility. In *The Harriman*[23] the Supreme Court stated the American rule of discharge as follows:

> The principle deductible from the authorities is, that if what is agreed to be done is possible and lawful, it must be done. Difficulty or improbability of accomplishing the undertaking will not avail the defendant. It must be shown that the thing cannot by any means be affected. Nothing short of this will excuse performance.[24]

This Part traces the expansion of the doctrine of literal impossibility in the United States. The evolution of the doctrine of impossibility culminated with the enactment of the Uniform Commercial Code (U.C.C.), which injected the doctrine of commercial impracticability by statute into United States law. Because the adoption of the U.C.C. and its rule of commercial impracticability

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19. RESTATEMENT OF CONTRACTS § 458 (1932); 6 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1938 (rev. ed. 1978) [hereinafter cited as WILLISTON].

20. RESTATEMENT OF CONTRACTS § 459 (1932); WILLISTON, *supra* note 19, § 1940.

21. Taylor v. Caldwell, 122 Eng. Rep. 309 (K.B. 1863); RESTATEMENT OF CONTRACTS § 460 (1932).

22. RESTATEMENT OF CONTRACTS § 460-61 (1932); WILLISTON, *supra* note 19, § 1948.

23. 76 U.S. (9 Wall.) 161 (1869).

24. *Id.* at 172. *See also* Beebe v. Johnson, 19 Wend. 500 (N.Y. Sup. Ct. 1838).

clarified and codified a caselaw trend, this Part separately traces the development of the doctrines of commercial impossibility and impracticability in the common law and the U.C.C.

A. *Common Law Context*

Mineral Park Land Co. v. Howard[25] was the first United States case to excuse nonperformance on grounds of commercial impracticability. Defendants had contracted to take all the gravel and dirt needed for certain work from plaintiff's land, at a price of five cents per cubic yard. After removing only half of the allotted earth from plaintiff's property, defendants acquired the rest elsewhere after discovering that the remaining dirt and gravel was below water level and would cost ten to twelve times more per yard to remove. Plaintiff sued to recover damages for breach of contract; defendant claimed impracticability. Clearly, the taking of more dirt and gravel was not literally impossible. Defendant could have used the wet gravel after drying it at a "prohibitive" cost. The California Supreme Court excused defendant's nonperformance of the contract:

> A thing is impossible in legal contemplation when it is not practicable; and a thing is impracticable when it can only be done at an excessive and unreasonable cost. We do not mean to intimate that the defendants could excuse themselves by showing the existence of conditions which would make the performance of their obligation more expensive than they had anticipated, or which would entail a loss upon them. But, where the difference in cost is so great as here, and has the effect, as found, of making performance impracticable, the situation is not different from that of a total absence of earth and gravel.[26]

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25. 172 Cal. 289, 156 P. 458 (1916).

26. *Id.* at 293, 156 P. at 460. It is arguable that the court's discharge of performance on grounds of impracticability was an alternative holding. Before discussing the impossibility issue, the court reiterated the principle that when performance depends on the existence of specific circumstances, and such conditions were an assumed basis of the agreement, performance is excused to the extent that the circumstances cease to exist. The court then concluded that according to the following analysis discharge was justified: the parties assumed that there was enough gravel and dirt to fulfill defendant's needs; there was a practical and reasonable determination of whether enough gravel and dirt was available; gravel and dirt that only could be removed at a prohibitive cost was not in legal contemplation available; therefore the unavailability of gravel and dirt prevented defendant's performance.

Relieving a party of his contractual obligations because of the unreasonable and excessive cost of performance was a novel approach for the California court in 1916. At the time, it was not widely followed in other jurisdictions.[27]

In 1932, however, the American Law Institute apparently adopted the *Mineral Park* decision in its newly published RESTATEMENT OF THE LAW OF CONTRACTS. Section 454 of the RESTATEMENT defines impossibility as including "not only strict impossibility but impracticability because of extreme hardship and unreasonable difficulty, expense, injury or loss involved."[28] The impossibility must stem from facts that the promisor had no reason to anticipate and for which the promisor is not responsible. The RESTATEMENT goes to great length to point out that nothing short of "extreme" hardship and "unreasonable" expense will excuse nonperformance. Comment (a) to section 454 states that mere unanticipated difficulty does not fall within the RESTATEMENT's definition of impossibility. Section 467 states that unanticipated difficulty which renders performance more burdensome or expensive does not discharge one's contractual obligations.[29]

The RESTATEMENT nevertheless recognized impracticability resulting from supervening economic hardship as a ground for the discharge of a promisor's contractual obligations. For the doctrine to apply, the hardship involved must be extreme and the increase in the cost of performance must be unreasonable. According to the California Supreme Court, a ten or twelve-fold cost increase is sufficient; the RESTATEMENT suggests that a ten-fold increase in cost would suffice, while a mere "large" cost increase would not.[30]Professor Williston stated the problem in the following manner:

> The true distinction is not between difficulty and impossibility. As has been seen, a man may contract to do what is impossible, as

27. Nickham & Burton Coal Co. v. Minnesota Coal Co., 7 F.2d 873 (7th Cir. 1925); Ess-Air Knitting Mills v. Fishcer, 132 Md. 1, 103 A. 91 (Ct. App. 1918); Piaggio v. Somerville, 199 Miss. 6, 80 So. 342 (1919); Learned v. Holbrook, 87 Or. 576, 170 P. 530 (1918).

28. RESTATEMENT OF CONTRACTS § 454 (1932).

29. RESTATEMENT OF CONTRACTS § 467 (1932) reads as follows: "Except to the extent required by the rules stated in §§ 455-466, facts existing when a bargain is made or occurring thereafter making performance of a promise more difficult or expensive than the parties anticipate, do not prevent a duty from arising or discharge a duty that has arisen."

30. RESTATEMENT OF CONTRACTS §§ 460, Illustration 2, 467 Illustration 4.

> well as what is difficult. The important question is whether an unanticipated circumstance, the risk of which should not fairly be thrown upon the promisor, has made performance of the promise vitally different from what was reasonably expected.[31]

However the issue was phrased, the courts generally proved reluctant to excuse a party's nonperformance on grounds of economic or commercial hardship.

In contracts between wholesalers and dealers for the future sale and delivery of agricultural products and other commodities, the courts consistently refused to grant discharge.[32] In a typical case, *Wilson & Co. v. Fremont Cake & Metal Co.*,[33] the Nebraska Supreme Court refused to discharge a party from a contract for the sale and delivery of soybean oil due to an "abnormal" rise in the price of soybean products caused by war and unusual trade conditions. According to the court, an obligor is not released from the binding effect of a contract because it turns out to be difficult or burdensome to perform, whether such difficulties were foreseeable or not.[34]

The courts also quickly rejected defenses of impossibility and impracticability raised by parties who contracted to design, manufacture, and deliver technologically advanced equipment, but who subsequently encountered difficulties in development and production.[35] Despite the increased cost that in some cases prevented economically feasible performance, the manufacturers were deemed to have assumed the risk of technological breakthrough and/or impossibility.[36]

Those who sought relief from contractual obligations on the basis of financial or economic hardship were usually unsuccessful. In

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31. WILLISTON, *supra* note 19, § 1963.

32. A discharge was usually granted, however, when a party to the contract was a farmer and his crop was destroyed. Squillante v. California Lands, Inc. , 5 Cal. App.2d 89, 42 P.2d 81 (1935). *See also* Dillon v. United States, 156 F. Supp. 719 (Ct. Cl. 1957); Posner & Rosenfield, *supra* note 2, at 106; RESTATEMENT OF CONTRACTS § 460, Illustration 5.

33. 153 Neb. 160, 43 N.W.2d 657 (1950).

34. *Id.* at 168, 43 N.W.2d at 666-67.

35. United States v. Wegematic Corporation, 360 F.2d 674 (2d Cir. 1966); Austin Company v. United States, 314 F.2d 518 (Ct. Cl.1963).

36. *Id. But cf.* National Presto Industries, Inc. v. United States, 338 F.2d 99 (Ct. Cl. 1964), *cert. denied,* 380 U.S. 962 (1965) (court ruled that there was mutual mistake; specific risk was allocated to neither party and the court apportioned the loss).

Whitlock Corp. v. United States,[37] the insolvency of a subcontractor forced the plaintiff, a general contractor, to obtain component parts elsewhere at "greater" expense. This additional expense did not render the contract impossible of performance. In *Consolidated Airborne Systems, Inc. v. United States*,[38] the court refused to discharge a party from its contractual obligations even though the party claimed that attempted performance would render it "hopelessly" insolvent.[39] In *Natus Corporation v. United States*,[40] a manufacturer based its impracticability defense to contractual supply obligations on the fact that mass production techniques could not be used as originally contemplated. Instead, a slower, costlier method of production had to be employed. The court stated that performance of a contract is impracticable only when "the attendant cost of performance bespeaks commercial senselessness."[41] In the court's view, the manufacturer did not prove that performance would be economically unrealistic; it only showed that an anticipated profit margin would be unattainable. Therefore, performance under the contract was not impracticable.[42] A similar result was reached in *Schaefer v. Sunset Packing Co.*,[43] when discharge was denied even though a doubling in the cost of performance would have rendered the contract unprofitable. Financial difficulties stemming from a general business depression or recession were also held to be an inadequate excuse for nonperformance.[44]

While recognizing that the common law doctrine of impossibil-

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37. 159 F. Supp. 602 (Ct. Cl. 1958).

38. 348 F.2d 941 (Ct. Cl. 1965).

39. Corbin points out that such a claim concerns a subjective impossibility, for which no discharge is granted. 6 A. CORBIN, CONTRACTS § 1332 (rev. ed. 1962).

40. 371 F.2d 450 (Ct. Cl. 1967).

41. *Id.* at 457.

42. *See also* Ballou v. Basic Construction Co., 407 F.2d 1137 (4th Cir. 1969) (court held that difficulties that consumed anticipated profit margin afforded no excuse).

43. 256 Or. 539, 474 P.2d 529 (1970) (laborers recruited by defendant failed to arrive, replacements were offered at higher price).

44. Monolith Portland Cement Co. v. Douglas Oil, 303 F.2d 176 (9th Cir. 1962) (purchaser's contracted obligation to buy a specified quantity of fuel oil for use in its cement factory not discharged by fact that recession greatly reduced demand for cement); Levy Plumbing Co. v. Standart Sanitary Mfg. Co., 68 S.W.2d 273 (Tex. Civ. App. 1933) (inability to obtain bank loan because of depression no excuse for failure to pay note when due).

ity included "impracticability because of extreme hardship," most courts were extremely reluctant to grant a party relief from a contract that could be performed, but only at an unexpected increase in expense.[45] The courts required a cost increase that could be classified as "extreme and unreasonable" or "excessive and unreasonable" before it would discharge contractual obligations.[46] Mere unanticipated difficulties or increased expense making performance under the contract more burdensome or unprofitable were no excuse. The extreme hardship had to be such that would alter the essential nature of the contracted performance.[47] Factors often considered determinative by courts included both the foreseeability of difficulties causing the economic hardship and whether the parties contemplated the difficulties at the time of contracting.[48] If foreseeable or within the parties' contemplation, the risk of the difficulties arising was deemed to have been assumed by the promisor, unless the contract provided otherwise.[49] Courts adopting this approach took the view that a promisor is able to protect himself against foreseeable events by means of an express provision in the agreement. If a party is aware of the possibility of an event's occurrence and does not contractually protect himself from that likelihood, the risk of its occurrence is "within the limits of the undertaking." The choice between either maintaining contractual liability or dissolving the contract usually determined which party would bear the financial burden. The courts were inclined to hold the promisor to his undertaking regardless of his loss.

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45. One notable exception is City of Vernon v. City of Los Angeles, 45 Cal.2d 710, 290 P.2d 841 (1955). Los Angeles had contracted to receive and dispose of a stated amount of sewage from the city of Vernon for agreed compensation. By a judgment in an action to abate a nuisance, Los Angeles was required to build a new sewage disposal plant. Los Angeles was held discharged from its contractual duty to Vernon on the ground of increased cost of performance due to the court order. The new plant would cost approximately forty-one million dollars; Vernon paid thirty-six thousand dollars as its share of the cost of constructing the original system.

46. Natus Corp. v. United States, 371 F.2d 450, 456 (Ct. Cl. 1967); Dillon v. United States, 156 F. Supp. 719, 722 (Ct. Cl. 1957).

47. Natus Corp. v. United States, 371 F.2d 450, 456 (Ct. Cl. 1967); WILLISTON, *supra* note 19, § 1963.

48. Dillon v. United States, 156 F. Supp. 719 (Ct. Cl. 1957).

49. *See* Portland Sec. of the Council of Jewish Women v. Sisters of Charity, 513 P.2d 1183 (1973).

B. *U.C.C. Context*

Section 2-615 of the Uniform Commercial Code embodies the modern doctrine of commercial impracticability.[50] This section discharges a seller's[51] contractual duty to deliver goods when performance has been rendered commercially impracticable "because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting."[52] The test of "commercial" impracticability is intended to emphasize the commercial character of the criterion by which nonperformance is excused.[53] In order to invoke section 2-615, a party must demonstrate that performance was rendered impracticable by the occurrence of a contingency, despite the fact that the nonoccurrence of the event was a basic assumption on which the contract was made. According to the Massachusetts Supreme Court, the U.C.C. test of commercial impracticability did not radically depart from the common law of contracts, which had already assumed that circumstances drastically increasing the cost of performance could fall within the ambit of impossibility.[54] Others felt that the Code's complete abandonment of impossibility as the

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50. U.C.C. § 2-615 states as follows:

> Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance: (a) Delay in delivery or non-delivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.
>
> (b) Where the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable.
>
> (c) The seller must notify the buyer seasonably that there will be delay or non-delivery and, when allocation is required under paragraph (b), of the estimated quota thus made available for the buyer.

51. Although section 2-615 only mentions sellers, some commentators think the defense would also be available to buyers. Hurst, *supra* note 8, at 555; Comment, 51 TEMP. L.Q. 518 (1978).

52. U.C.C. § 2-615, comment 1.

53. *Id.* comment 3.

54. Mishara Const. Co., Inc. v. Transit-Mixed Con. Corp., 365 Mass. 122, 127-8, 310 N.E.2d 363, 366 (1974).

standard of commercial impracticability indicated a more lenient rule of discharge.[55] Although the U.C.C. does contain potentially broad language for discharging contractual obligations, in practice courts have adhered to the common law reluctance to excuse nonperformance when commercial hardship is involved.

During the first few years of the U.C.C., few cases were brought under the Code's test of commercial impracticability. Writing in 1974, one commentator claimed that only five cases had been decided using section 2-615. As a result of recent political and economic upheavals, including the growing cartels of raw material suppliers in the third world, the energy crisis, and a domestic inflation rate of between seven and twelve percent (with the price increases for some individual commodities far in excess of the general rate),[56] section 2-615 is increasingly being invoked by parties seeking relief from economically burdensome commercial contracts.

The first requirement for section 2-615 relief is that performance of the contract must have rendered performance impracticable. Comment four provides the only interpretive assistance pertaining to the term impracticable as used in article 2:

> 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 supplies due to a contingency . . . 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.[57]

Thus, increased cost alone is no excuse for nonperformance; one must allege that some contingency led to the increased expense. The occurrence of such a contingency is necessary because the

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55. Hurst, *supra* note 8, at 554.

56. For example, between July 1973, and July 1974, the wholesale price index advanced 20 percent. Between August 1973 and August 1974, it advanced 18 percent. U.S. Dept. of Commerce, Business Statistics 3 (September 17, 1974). Between June 1972 and June 1974, petroleum products increased 114 percent, coal increased 66 percent, farm products increased 34 percent, and lumber increased 38 percent. U.S. Dept. of Commerce, Survey of Business S-9 (July 1974).

57. U.C.C. § 2-615, comment 4 (emphasis added).

alleged economic hardship must result from a cause other than the promisor's bad business judgment. Since the rise or collapse in a market is a risk that underlies every contract for future performance, no relief will be granted when a judgment pertaining to the profitability of a contract proves wrong.[58]

Once a contingency is alleged, comment four indicates that the cost increase resulting therefrom must be "marked" or of such a nature that it "alter[s] the essential nature of performance" in order to render performance impracticable. These are not necessarily identical standards. The latter formulation suggests the "excessive and unreasonable" and "extreme and unreasonable" criterion employed by the courts under the strict common law doctrine of impossibility.[59] A "marked" increase, on the other hand, would seem to require a lesser showing. The word "marked" is more akin to the terms significant or substantial than to excessive, extreme, or unreasonable. The courts followed the common law interpretation and adopted the more stringent approach to determining impracticability.[60] As of March 1979, no party had successfully invoked the defense of impracticability.

In *Transatlantic Financing Corporation v. United States*,[61] one of the first cases to interpret the doctrine of impracticability in section 2-615, the court stated that even if the other elements of the defense were satisfied, a fourteen percent increase[62] in the cost of performing a charter-party due to the closing of the Suez

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58. In Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co., 508 F.2d 283, 294 (7th Cir. 1974), the court stated as follows:

> We will not allow a party to a contract to escape a bad bargain merely because it is burdensome. After one party has entered a contract for supply, he ceases to look for other sources and does not enter other contracts. To make duplicate arrangements for supply under such circumstances might assure the delivery of the material desired but also might well be productive of double liability and inability to dispose of the double deliveries. Barring circumstances not existent here, the buyer has a right to rely on the party to the contract to supply him with goods regardless of what happens to the market price.That is the purpose for which such contracts are made.

59. *See* note 46 *supra* and accompanying text.

60. Gulf Oil Corp. v. F.P.C., 563 F.2d 588, 599 (3rd Cir. 1977) (excessive and unreasonable); American Trading and Production Corp. v. Shell International Marine Ltd., 453 F.2d 939, 942 (2d Cir. 1972) (extreme and unreasonable). *See also* Schmitt and Wolschlager, *supra* note 8, at 10-12.

61. 363 F.2d 312 (D.C. Cir. 1966).

62. There was a $43,970 cost increase in a contract for $305,845. *Id.* at 319.

Canal did not amount to impraticability. According to the court, in order to justify relief, "there must be more of a variance between expected costs and the cost of performing by an alternative than is present in this case.[63] In *Maple Farms Inc. v. School District of the City of Elmira,*[64] a twenty three percent increase in the cost of performing a contract to supply milk, due to a rise in the cost of raw milk and an increase in transportation costs, was held insufficient to constitute impracticability. The court in *Maple Farms* noted the difficulty in defining impracticability: "There is no precise point, through such could conceivably be reached, at which an increase in the price of raw goods above the norm would be so disproportionate to the risks assumed as to amount to 'impracticability' in a commercial sense."[65] In *American Trading and Production Corp. v. Shell International Marine Ltd.,*[66] commercial impracticability was not established even though a one-third increase in the cost of performance was alleged. In *Publicker Industries v. Union Carbide Corp.,*[67] a sixty percent cost increase did not amount to impracticability. The court observed that it was unaware of any cases holding that something less than a one-hundred percent cost increase rendered a seller's performance impracticable.

A case that should be of special interest to any large vertically integrated corporation intending to assert the section 2-615 doctrine of impracticability is *Eastern Air Lines v. Gulf Oil Corp.*[68] In that case, Gulf claimed that the quadrupling of oil prices by the Organization of Petroleum Exporting Countries (OPEC) in 1973 rendered performance of its contract with Eastern Air Lines impracticable. In 1972, Gulf contracted to supply Eastern Air Lines with certain amounts of jet fuel for five years. The evidence produced regarding costs of performing under the contract included intra-company profits derived as oil moved from Gulf's overseas and domestic production "departments" to its refining "department." Although Gulf claimed commercial impracticability in its contract with Eastern Air Lines, its overseas subsidiaries enjoyed substantial profits, which were included in the average

63. *Id.*
64. 76 Misc.2d 1080, 352 N.Y.S.2d 784 (Sup. Ct. 1974).
65. *Id.* at 1087, 352 N.Y.S.2d at 790.
66. 453 F.2d 939 (2d Cir. 1972).
67. 17 U.C.C. REP. SERV. 989 (E.D. Pa. 1975).
68. 415 F. Supp. 429 (S.D. Fla. 1975).

crude oil costs of which Gulf complained. The court thus rejected Gulf's claim of impracticability:

> [T]hese are not the kinds of "costs" against which to measure hardship, real or imagined, under the Uniform Commercial Code. Under no theory of law can it be held that Gulf is guaranteed preservation of its intra-company profits, moving from the left-hand to the right-hand, as one Gulf witness put it. The burden is upon Gulf to show what its real costs are, not its "costs" inflated by internal profits at various levels of the manufacturing process and located in various countries.[69]

The court in *Eastern Air Lines* also doubted whether hardship could be established in light of the twenty-five percent profit increase earned by Gulf in 1974. Therefore, the approach taken by the court could cause problems for a vertically integrated corporation on two fronts: (1) the difficulties of meeting the burden of proving "actual" costs when intra-company operations are involved,[70] and (2) the likelihood that a court will look to overall company profitability to determine if commercial hardship would result from the enforcement of a particular contract.[71]

The second requirement under section 2-615 states that the increase in cost must result from the occurrence of a contingency. The official commentary to the section mentions such contingencies as war, embargo, local crop failure, and the unforeseen shutdown of major sources of supply.[72] Comment two specifically states that the drafters deliberately refrained from any attempt to exhaustively list the contingencies contemplated by the section. The closing of the Suez Canal,[73] the Arab oil embargo,[74] the

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69. *Id.* at 441.

70. Gulf's witnesses testified that they could not compute the company's "real" costs. *Id.* at 440.

71. For example, Westinghouse Electric Corporation is presently litigating its claim of impracticality with respect to fixed price contracts to deliver 70 million pounds of uranium. *See, e.g.*, 405 F. Supp. 316 (Jud. Panel Multidistrict Lit. 1975). *See also* Joskow, *Commercial Impossibility, The Uranium Market and the Westinghouse Case*, 6 J. LEGAL STUD. 119 (1977). On April 12, 1979, Westinghouse reported a 26 percent increase in first quarter earnings. Wall St. J., April 12, 1979, at 4, col.1. On April 17, it announced plans to settle the uranium-supply contract dispute with the party claiming the largest amount of damages. Wall. St. J., April 17, 1979, at 2, col.2.

72. U.C.C. § 2-615, comment 4.

73. American Trading and Prod. Corp. v. Shell Int'l Marine Ltd., 453 F.2d 939 (2d Cir. 1972).

energy crisis,[75] and the sale of wheat to Russia[76] have been recognized as contingencies under section 2-615. The occurrence of a contingency is easy to allege and the courts are quick to accept it.[77] The contingency, however, is often used for the purpose of analyzing and rejecting another element of the defense.[78] Nevertheless, some event[79] other than those business factors that are commercially expected to affect performance under a contract (*e.g.*, market fluctuation) must cause the cost increase.[80] The occurrence of the contingency, however, cannot be the fault of the party claiming impracticability.[81]

The final requirement for the successful invocation of section 2-615 states that the nonoccurrence of the contingency must be a basic assumption upon which the contract was made. Foreseeability and the circumstances within the parties contemplation at the time of contracting can enter into the analysis at two different junctions. First, these factors can be used to reject a party's assertion that the nonoccurrence of a contingency was a basic assumption implied in the contract. Thus, one court doubted whether an increase in the price of Arab oil one year after the contract was a "contingency the nonoccurrence of which was a basic assumption on which the contract was made."[82] Second, if there is an affirmative response to the inquiry, the fundamental question of risk al-

74. Eastern Air Lines, Inc. v. Gulf Oil Corp., 415 F. Supp. 429 (S.D. Fla. 1975).

75. Publicker Indus. v. Union Carbide Corp., 17 U.C.C. REP. SERV. 989 (E.D. Pa. 1975).

76. Transatlantic Financing Corp. v. United States, 363 F.2d 312 (D.C. Cir. 1966); Maple Farms Inc. v. School Dist. of Elmira, 76 Misc.2d 1080, 352 N.Y.S.2d 784 (Sup. Ct. 1974).

77. In Gay v. Seafarer Fiberglass Yachts, Inc., 14 U.C.C. REP. SERV. 1335 (N.Y. Sup. Ct. 1974) the defendant claimed performance of a contract to build a yacht had been rendered impracticable due to oil and energy shortage. Plaintiff's motion for summary judgment was denied.

78. *See, e.g.*, Maple Farms Inc. v. School Dist. of Elmira, 76 Misc.2d 1080, 352 N.Y.S.2d 784 (Sup. Ct. 1974).

79. In *Transatlantic Financing*, a contingency was defined as an unexpected event. 363 F.2d at 315.

80. A cost increase attributable to the other party's activities is not a contingency and does not permit discharge. Hancock Paper Co. v. Champion Int'l Corp., 424 F. Supp. 285 (E.D. Pa. 1976).

81. Chemetron Corp. v. McLouth Steel Corp., 381 F. Supp. 245 (N.D. Ill. 1974).

82. Publicker Indus. v. Union Carbide Corp., 17 U.C.C. REP. SERV. 989, 993 (E.D. Pa. 1975).

location still remains. If the nonoccurrence of the event was a basic assumption under which both parties contracted, the courts must then decide who should be assigned the risk upon its occurrence.[83] As the court stated in *Mishara Construction Co., Inc. v. Transit-Mixed Concrete Corp.*:

> The rule is essentially aimed at the distribution of certain kinds of risks in the contractual relationship. By directing the inquiry to the time when the contract was first made, we really seek to determine whether the risk of the intervening circumstance was one which the parties may be taken to have assigned between themselves. It is, of course, the very essence of contract that it is directed at the elimination of some risks for each party in exchange for others. Each receives the certainty of price, quantity, and time, and assumes the risk of changing market prices, superior opportunity, or added costs. It is implicit in the doctrine . . . that certain risks are so unusual that they must have been beyond the scope of the assignment of risks inherent in the contract, that is beyond the agreement made by the parties.[84]

According to the court in *Transatlantic Financing Corp. v. United States*, proof that the risk has been allocated may be express, implied from the agreement, or found in the surrounding circumstances, including custom and usages of trade.[85] The decisions have failed to provide clear guidelines for determining when the risk of a contingency's occurrence has been allocated to one of the parties to a contract. In *Transatlantic Financing*, the court remarked that the process involves "the ever shifting line, drawn by the courts hopefully responsive to commercial practices and mores, at which the community's interest in having contracts enforced according to their terms is outweighed by the commercial senselessness of requiring performance."[86]

Some courts adopt the presumption that if contingency was foreseeable when the contract was made, the lack of an appropriate contractual provision to discharge performance indicates that the promisor implicitly agreed to assume the consequences of the occurrence of the event.[87] Thus, in *Eastern Air Lines v. Gulf Oil*

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83. Henszey, *U.C.C. Section 2-615 - Does "Impracticable" Mean Impossible?*, 10 U.C.C. L.J. 107, 114 (1977).

84. 365 Mass. at 128, 310 N.E.2d at 367.

85. 363 F.2d at 316. *See also* U.C.C. § 2-615, comment 8.

86. 363 F.2d at 315.

87. "[B]ecause the purpose of a contract is to place the reasonable risk of

Corp., the court stated that events in the Middle East in 1972 were sufficiently foreseeable to result in the expectation that a sophisticated party would have contractually guarded against the possibility of price increases and supply interruptions.[88] According to the court: "If a contingency is foreseeable, it and its consequences are taken out of the scope of U.C.C. § 2-615, because the party disadvantaged by fruition of the contingency might have protected itself in his contract."[89] In *Maple Farms*, a party was held to have assumed the risk of a substantial or abnormal rise in costs because it entered a milk supply contract at a time when the price of raw milk had risen ten percent in the previous six month period and when general inflation plagued the economy.[90]

Analyzing the foreseeability of an event in order to allocate the risk of its occurrence may prove to be a difficult task. A risk may be foreseeable but only indirectly related to the promisor's performance.[91] All contingencies in retrospect can appear to have been reasonably foreseeable. Moreover, parties to a contract do not always provide for all possibilities of which they are aware. Judge J. Skelly Wright in *Transatlantic Financing* did not believe that foreseeability "or even the recognition of a risk" should prove determinative of its allocation.[92] Judge Wright stated that if an event was foreseeable it is probative but not conclusive of the allocation of risk.[93] Under the *Transatlantic Financing* decision, if a contingency were foreseeable, the question of impracticability should be judged by stricter standards.[94]

The excuse for nonperformance available under section 2-615 is subject to the assumption of a greater obligation by the seller. A party can assume the risk that its performance under a contract will be rendered commercially impracticable.[95] Thus, by warranting performance under a contract, a party has been held to have

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performance on the promisor, he is presumed, in the absence of evidence to the contrary, to have agreed to bear any loss occasioned by an event which was foreseeable at the time of contracting." Eastern Air Lines, Inc. v. McDonnell Douglas Corp., 532 F.2d 957 (5th Cir. 1976).

88. 415 F. Supp. at 441.
89. *Id.*
90. 76 Misc.2d at 1085, 352 N.Y.S.2d at 789-90.
91. *See* Hurst, *supra* note 8, at 567-70.
92. 363 F.2d at 318.
93. *Id.*
94. *Id.* at 319.
95. Gold Kist, Inc. v. J. W. Stokes, 138 Ga. App. 482, 226 S.E.2d 268 (1976).

assumed all risks of future cost increases, thereby precluding a defense of impracticability.[96] Similarly, another court held that an affirmative provision in a contract that requires the seller to pay stipulated damages upon the occurrence of an event that renders performance impossible implies that a breach of contract is conceded under such conditions.[97] Such an absolute assumption of the risks of performance, however, could be attacked under U.C.C. § 1-302,[98] the Code's provision regarding unconscionability.

The American Law Institute's proposed Restatement (Second) of Contracts adopts the U.C.C. doctrine of commercial impracticability.[99] A supervening event, the nonoccurrence of which was a basic assumption upon which both parties contracted, can discharge performance under a contract. According to the American Law Institute, the fact that an event was foreseeable or foreseen is significant only to suggest that its nonoccurrence was a basic assumption.[100] This foreseeability should be considered along with the relative bargaining positions of the parties and the effectiveness of the market in spreading risks. Mere changes in the degree of difficulty or expense due to increased wages, prices of raw materials, or costs of construction do not amount to impracticability "unless well beyond the normal range."[101] Finally, a party can agree to perform in spite of an impracticability that would otherwise justify nonperformance.

IV. Frustration of Contract—English Law

According to English law, either supervening impossibility or impracticability of performance operates to discharge contractual obligations under the doctrine of frustration of contract. The doctrine is often phrased in terms of frustration of the commercial

96. In Gulf Oil Corp. v. F.P.C., 563 F.2d 588, 599, (3d Cir. 1977), the court stated that "[t]he defense of impracticability is inconsistent with an express warranty."

97. 138 Ga. App. at 485, 226 S.E.2d at 270.

98. U.C.C. § 2-302.

99. Restatement (Second) of Contracts § 281 (Tent. Draft No. 9, 1974).

100. The comments to the proposed Restatement point out that even if foreseen, the parties might not have thought the event significant enough to be included in the contract.

101. Restatement (Second) of Contracts, § 281, comment d (Tent. Draft No. 9, 1974).

object of the adventure.[102] According to Lord Wright, "the fuller and more accurate phrase is frustration of the adventure or of the commercial or practical purpose of the contract."[103]

When parties seek relief from contractual obligations because of the commercial hardships involved in rendering performance, English courts are as reluctant as their United States counterparts to acquiesce. In general, nonperformance is not excused because of the increased cost of performance resulting from unforeseen events. Under English law, parties desiring relief from their contractual obligations in the event of changed economic conditions must so stipulate in their agreement. The rule of *Paradine v. Jane* and the deep-rooted notion of sanctity of contract" are still very evident in the modern English doctrine of frustration.

The English doctrine of frustration of contract evolved in a series of cases dealing with problems of delay in the performance of a charter party that arose from blockade,[104] running aground,[105] and congestion at the docks.[106] These cases stand for the proposition that inordinate delays that defeat and destroy the object of a commercial adventure and for which neither party is responsible discharges performance under the contract. These were apparently the first English decisions to excuse a party even though performance did not appear to be physically impossible.

In *F.A. Tamplin Steamship Company v. Anglo-Mexican Petroleum Products,*[107] the House of Lords refused to excuse performance of the remaining three years of a five year charter party even though the English government had requisitioned the ship at the outbreak of World War I.[108] The House of Lords used the *Krell v. Henry*[109] formulation of the *Taylor v. Caldwell* rule of discharge:[110]

> A court can and ought to examine the contract and the circumstances in which it was made, not of course to vary, but only to

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102. Joseph Constatine Steamship Line, Ltd. v. Imperial Smelting Corporation, Ltd., [1942] A.C. 154, 180-81 (House of Lords).

103. *Id.* at 182.

104. Geipel v. Smith, L.R. 7 Q.B. 404 (1872).

105. Jackson v. Union Marine Ins. Co., L.R. 10 C.P. 125 (Exch. Ch. 1874).

106. Dahl v. Nelson, Donkin, & Co., 6 App. Cas. 38 (1881).

107. [1916] 2 A.C. 397 (House of Lords).

108. In *Tamplin,* the shipowner sought discharge because the charterer received higher rates from the British Government. *Id.* at 399.

109. [1903] 2 K.B. 740.

110. *See* text accompanying notes 8-18, *supra.*

> explain it, in order to see whether or not from the nature of it the parties must have made their bargain on the footing that a particular thing or state of things would continue to exist. And if they must have done so, then a term to that effect will be implied, though it not be expressed in the contract.[111]

The adjudicatory body chose the term "frustration of the adventure" to describe the rationale for the discharge and viewed the earlier inordinate delay cases as precedent.[112]

Although the *Tamplin* decision explicitly recognized frustration as a defense to nonperformance of a contract, the courts in subsequent cases debated the proper theoretical basis of the defense. *Joseph Constantine Steamship Line, Ltd. v. Imperial Smelting Corp., Ltd.*[113] illustrates the major theories. In *Joseph Constantine* a boiler explosion just before the loading of a ship under charter prevented the voyage within a reasonable time. Frustration of the contract was admitted; the issue before the House of Lords was whether or not the party claiming frustration had the affirmative duty of proving its lack of fault in causing the frustrating event. While answering the question in the negative, the House of Lords engaged in a theoretical examination of the doctrine itself.

According to Viscount Simon, frustration is best explained on the basis of an implied term. The circumstances surrounding the making of the contract and the contractual language itself should be considered. A court must then decide whether an additional term should be implied from the express terms of the contract that could result in termination of the agreement.[114] Lord Wright espoused the view that frustration involved the "true construction" of a contract in order to determine whether an obligation was absolute or qualified.[115] In Lord Wright's opinion, a court does not alter or modify the contract but rather attempts to determine what the parties as reasonable men should have intended. According to Lord Wright:

> The essential feature of the rule is that the court construes the contract, having regard both to its language, its nature and the circumstances, as meaning that it depended for its operation on the

111. [1916] 2 A.C. at 403.
112. *Id.* at 403-04.
113. [1942] A.C. 154 (House of Lords).
114. *Id.* at 163-64.
115. *Id.* at 185.

> existence or occurrence of a particular object or state of things, as its basis or foundation.[116]

Lord Maugham expressed the opinion that regardless of whether the doctrine is explained on the basis of an implied term or as a matter of true construction, it is ultimately based on the presumed common intention of the parties.[117]

The controversy over the theoretical basis of frustration eventually subsided. Later opinions put to rest the notion that the implied term theory provided a realistic explanation of the doctrine.[118] Judges in subsequent cases tended to agree that the doctrine depended on the true construction of the terms of the contract and of the relevant surrounding circumstances at the time of contracting.[119] Having recognized frustration as an excuse for nonperformance, it became necessary to give some content and meaning to the doctrine. This was accomplished on a case by case basis.

Some of the basic principles of the doctrine of frustration were set out in *British Movietonews, Ltd. v. London and District Cinemas, Ltd.*[120] At the outset of World War II certain film distributors contracted to supply newsreels to various movie theatres. Wartime shortages and the Cinematographic Film (Control) Order of 1943 [Order][121] cut the supply of film to the distributors by one third. In order to adjust their obligations accordingly, the distributors and exhibitors entered into a supplemental agreement, which *inter alia,* provided that the contract as amended would remain in force until the Order expired. The wartime Act pursuant to which the Order was initially issued expired, but due to the postwar economic dislocations the Order remained in force under another act. The exhibitors claimed that they could terminate the agreement because they had never contemplated that the Order would survive the wartime conditions. The Court of Appeals ruled that the contract had been frustrated as a result of

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116. *Id.* at 187.

117. *Id.* at 171.

118. *See, e.g.,* Davis Contractors, Ltd. v. Fareham Urban District Council, [1956] 2 All E.R. 145, 152-56 (Lord Reid's opinion).

119. *See, e.g., id.;* British Movietonews, Ltd. v. London and District Cinemas, Ltd., [1951] 2 All E.R. 617.

120. [1950] 2 All E.R. 390, *rev'd,* [1951] 2 All E.R. 617.

121. *Id.* at 391-92.

an uncontemplated turn of events.[122] Since the parties had not contemplated that the Order would last beyond the war, the terms could not bind them in peacetime. According to Denning, L.J., in frustration cases the courts exercise a qualifying power in order to do what is just and reasonable given a new situation.[123]

The House of Lords overruled the Appeals Court. Viscount Simon expressed unease with the suggestion that an "uncontemplated turn of events" is sufficient to frustrate a contract, despite the lack of a frustrating event. Simon pointed out that parties to contracts that involve future performance are frequently faced with an unanticipated turn of events, such as a wholly abnormal rise or fall in prices or a sudden depreciation of currency. These events, however, do not affect the bargain struck by the parties. In Viscount Simon's view, "Only when it is evident to a court, after considering the terms of the contract, in the light of the circumstances existing when it was made, that the parties never agreed to be bound in the *fundamentally different situation* which has *unexpectedly emerged,* does a contract cease to be binding."[124] Viscount Simon did not believe that the postwar continuation of the Order was a fundamentally different situation.

Davis Contractors, Ltd. v. Fareham Urban District Council[125] provides a further elucidation of the doctrine of frustration. In July 1946, Davis Contractors, Ltd. contracted with a local housing authority to build seventy-eight houses within a period of eight months. As a result of postwar economic problems, an adequate supply of both materials and skilled labor was unavailable.[126] Consequently, the contract took twenty-two months to complete. The contractor alleged that the contract had been frustrated and sued in *quantum meruit* to recover £17,651—its costs above the contract price. The House of Lords rejected the claim.

Viscount Simon first observed that disappointed expectations do not lead to frustrated contracts; the fact that a job cannot be completed within an expected time and price affords no grounds for discharge. He then remarked that if the true purpose of frus-

122. *Id.* at 395-96.

123. *Id.* at 395.

124. [1951] 2 All E.R. at 625.

125. [1956] 2 All E.R. 145.

126. The contractors unsuccessfully tried to expand the contract by incorporating a letter stating that performance was subject to the availability of supplies and labor. *Id.* at 147.

tration is to offer relief to parties when an unexpected event makes it unjust to hold them to their bargain, the doctrine must be kept "within very narrow limits."[127] Simon questioned whether the factual setting of *Davis* contained an "unexpected disruptive event"[128] which put an end to the contract, and concluded his opinion with the proposition that an "unexpected turn of events"[129] that renders performance under a contract more onerous than contemplated provides no basis for a finding of frustration. Lord Morton expressed similar views concerning the necessity of a frustrating event. According to Lord Morton, in order for frustration to apply there must be some definite date from which time it can be said that the contract was terminated.[130] Having found no such date, and thus no frustrating event, there were no grounds on which to hold the contract frustrated.

In *Davis,* Lord Reid stated that frustration involves the "termination of an agreement by operation of law on the emergence of a fundamentally different situation."[131] If it appears that the new situation is fundamentally different from that contemplated by the parties, so that the contract is not "wide enough to apply to the new situation,"[132] the contract is frustrated. *Davis* did not involve such a fundamental difference in situations. Before concluding his opinion, Lord Reid engaged in a brief analysis of assumption of the risk. A contractor who undertakes to complete a job for a definite sum assumes numerous risks, including the possibility that his costs will be greater or less than expected. A situation may arise, however, that renders performance under a contract so different from anything contemplated by the parties that the risk of its occurrence was not assumed by the promisor.[133] In *Davis,* performance under the contract was merely more onerous than expected. Lord Somervell undertook a similar assumption of the risk approach. In his opinion, any builder who contracts to finish a building by a certain date inherently assumes the risk of a shortage of skilled labor and material.[134]

Perhaps the most complete articulation of the frustration doc-

127. *Id.* at 150.
128. *Id.*
129. *Id.* at 151.
130. *Id.*
131. *Id.* at 155.
132. *Id.* at 154.
133. *Id.* at 155-56.
134. *Id.* at 163.

trine was provided by Lord Radcliffe: "[F]rustration occurs whenever the law recognizes that, without fault of either party, a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract."[135] The occurrence of an unexpected, frustrating event that "changes the face of things"[136] is required. Hardship, inconvenience, and material loss do not amount to frustration. There must be such a change in the "significance of the obligation"[137] that performance would be different than that for which the parties contracted. The foreseeability of an event, according to Lord Radcliffe, precludes a finding of frustration.[138] If an event could reasonably have been foreseen by the parties, it should have been the subject of an express contractual stipulation.

From the foregoing examination of English case law, a basic outline of the doctrine of frustration can be discerned. The occurrence of an unexpected, frustrating event is a prerequisite to a finding of frustration. If there is a frustrating event, its effect must be such that would render performance "fundamentally" or "radically" different from that undertaken in the contract. Hardship resulting from increased expense, inconvenience, loss, or other difficulties that render performance more onerous than expected provide no grounds for discharge under frustration. The foreseeability of an alleged frustrating event can be crucial. If an event was foreseen or foreseeable, the parties assume the risk of its occurrence. If relief is to be available in that situation, the contract must so provide.

The next significant group of cases dealing with frustration arose due to events in the Middle East. The Egyptian government, having nationalized the Suez Canal on July 26, 1956, ordered the Canal closed on November 2, 1956, following attacks on Egyptian territory by Israeli, French, and British forces. By November 7 more than forty sunken ships blocked the Canal. These events affected many commercial contracts. Four litigated cases, commonly referred to as the Suez cases, received particular attention.

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135. *Id.* at 160.
136. *Id.*
137. *Id.*
138. *Id.* at 161.

In *Carapanayoti & Co. Ltd. v. E.T. Green Ltd.*,[139] a contract was entered into on September 6, 1956, whereby sellers agreed to sell cottonseed cake for shipment from Port Sudan during October/November at seller's option, C.I.F. Belfast. When the Suez Canal closed, the sellers informed the buyers that they were unable to fulfill their contract. The buyers sued for breach and the sellers claimed the contract had been frustrated. The Court of Appeals held the contract frustrated, even though the sellers could have shipped the goods via the Cape of Good Hope. According to Justice McNair, shipment around the Cape of Good Hope would involve a fundamentally different obligation not contemplated at the time of contracting. McNair recognized that the increase in freight cost, due to the longer trip around the Cape, did not frustrate the contract: "[M]ere commercial unprofitableness does not justify frustration, especially in a speculative forward contract . . . . "[140] The continued availability of the Suez route, however, was viewed as a fundamental assumption upon which the contract was made.[141] Its closing therefore "transmuted the seller's obligation into an obligation of a different kind."[142]

Carapanayoti was expressly overruled by the House of Lords in *Tsakiroglou & Co., Ltd. v. Noblee & Thorl Gmbh*,[143] which involved a C.I.F. contract for the sale of Sudanese groundnuts. Viscount Simonds quickly dismissed the notion that shipment via the Suez Canal was a fundamental assumption upon which *both* parties contracted. Since the sale involved a C.I.F. contract, Simonds doubted the buyers cared by which route the nuts arrived.[144] Simonds then reasserted the principle that an increase in expense is not a cause for frustration.[145] Performance under the contract must be "fundamentally altered" or "radically different" in order to justify discharge. Simonds stated that the doctrine of frustration must be applied within "very narrow limits" and the instant case fell short of satisfying the necessary conditions.[146] In

139. [1959] 1 Q.B. 131.
140. *Id.* at 148.
141. *Id.* at 149.
142. *Id.* at 148.
143. [1961] 2 All E.R. 179.
144. *Accord, id.* at 188-89 (Radcliffe, L.J.); *id.* at 192-93 (Hodson, L.J.).
145. Viscount Simonds stated that "[t]he seller may be put to greater cost; his profit may be reduced or even disappear. But it hardly needs reasserting that an increase of expense is not a ground of frustration . . . ." *Id.* at 184.
146. *Id.*

Lord Reid's view, the trip around the Cape of Good Hope was both practical, because the goods would not be damaged either by the increased travelling time or by the crossing of the equator twice, and reasonable, which must be judged as of the time of performance. Since counsel failed to contend that performance was frustrated by the increased expense caused by the longer voyage, Lord Reid did not find it necessary to discuss the possible result had the increase in freight reached "an astronomical figure."[147] According to Lord Hodson, even if shipment via the Suez Canal had been contemplated by the parties at the time of contracting, the parties had not necessarily assumed that the contract would be terminated if an alternative route were available.[148] None of the Lords thought that the closure of the Canal rendered performance under a C.I.F. contract "fundamentally" or "radically" different.

The two other frustration cases stemming from the closure of the Suez Canal involved contracts of charter parties. In *Societe Franco Tunisienne D'Armement v. Didemar S.P.A. (The Massalia)*,[149] shipowners chartered their vessel for the carriage of iron ore from the east coast of India to Genoa, Italy. The charter party was dated October 18, 1956. When the Canal was closed in November, the vessel travelled to its destination via the Cape of Good Hope.[150] After the voyage, the shipowners brought suit in *quantum meruit* for the sixty-four percent increased cost of transportation, claiming that the Canal's closure frustrated the charter party. Justice Pearson held for the shipowners. Since the charter party was entered into at a time when reasonable persons were or should have been aware of the potential for conflict in the Suez area, he first dealt with the issue of foreseeability. Pearson stated that the foreseeability of an event's occurrence does not preclude frustration of contract:

> [I]t must often happen that contracting parties appreciate a possibility but do not provide for it in their contract. They cannot provide for every possible event, and the particular event concerned may appear to them to be unlikely, or they may be unable

147. *Id.* at 186; *see also id.* at 192 (Hodson, L.J.).

148. *Id.* at 191-92 (Hodson, L.J.).

149. [1961] 2 Q.B. 278.

150. Before travelling around the cape of Good Hope, the shipowners notified the charterers that they considered the contract frustrated and would later seek compensation for the added expense.

> to work out the consequences of it, or may be unable to agree on the provisions to be made with regard to it, or they may simply take the chance that it may occur and frustrate their contract.[151]

According to Justice Pearson, the foreseeability of an event is one of the surrounding circumstances that should be taken into account. Foreseeability should be given probative weight according to the degree of probability or improbatility. Pearson treated passage through the Suez Canal as a fundamental assumption upon which the parties contracted.[152] Comparing the trip around the Cape of Good Hope with that through the Canal, Pearson concluded that the Canal's closure rendered performance of the charter party a fundamentally different obligation.[153]

The finding of frustration in the case above was overruled by *Ocean Tramp Tankers Corp. v. V/O Sovfracht, (The Eugenia),*[154] which involved a charter party for the shipment of goods from a port in the Black Sea to the coast of India. The charterers, claiming that the charter party had been frustrated by the blockage of the Canal, refused to undertake the voyage. The owners treated the charterers' conduct as repudiation and sued for damages. Again the foreseeability of the frustrating event was an issue. Although both sides foresaw the possibility of the Canal's closure and suggested terms to meet that contingency, no agreement was reached.[155] According to Lord Denning, it is not essential that the new situation be "unforeseen," "uncontemplated," or "unexpected." The only essential element in frustration is that the parties make no provision for the event in their contract.[156] Once it is

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151. [1961] 2 Q.B. 278, 299.

152. He based this conclusion on a clause in the contract that required the ship captain to telegraph the shippers on "passing Suez Canal." *Id.* at 303.

153. *Id.* at 306-07.

154. [1964] 2 Q.B. 226 (C.A.).

155. "That meant that, if the canal were to be closed, they would, 'leave it to the lawyers to sort out.'" *Id.* at 234.

156. Lord Denning explained as follows:

> It has frequently been said that the doctrine of frustration only applies when the new situation is "unforeseen" or "unexpected" or "uncontemplated," as if that were an essential feature. But it is not so. The only thing that is essential is that the parties should have made no provision for it in their contract. The only relevance of it being "unforeseen" is this: If the parties did not foresee anything of the kind happening, you can readily infer they have made no provision for it: whereas, if they did foresee it, you would expect them to make provision for it. But cases have occurred where the parties have foreseen the danger ahead, and yet made

determined that there is no governing contractual stipulation, the new situation must be compared with the situation for which the parties did provide to see if there is a "radical" difference. The fact that performance is rendered more onerous or expensive is not sufficient to bring about frustration. "[I]t must be positively unjust to hold the parties bound."[157] In Denning's opinion, the difference between travelling through the Suez Canal and around the Cape of Good Hope was not radical enough to produce frustration.[158] The only significant differences were in time and expense. The goods would not be adversely affected by the longer voyage, and the vessel and crew were at all times fit to proceed around the Cape. There was no obligation to travel through the Canal, and Justice Pearson's conclusions to the contrary were overruled.[159]

The Suez cases did not alter the basic formulation of the doctrine of frustration. A frustrating event and "fundamentally" or "radically" different obligations were required. The Suez cases, however, did modify the function of foreseeability within the doctrine's framework. Instead of being determinative of frustration, as earlier cases suggested,[160] the foreseeability of a frustrating event's occurrence was only one of the factors to be considered when deciding the fundamental difference in performance. The Suez cases also demonstrate the difficulties inherent in the doctrine's application to specific cases and the potential for varying results.

Amalgamated Investment & Property Co., Ltd. v. John Walker & Sons, Ltd.[161] contains a more recent discussion of the frustration doctrine. Defendant-owner John Walker & Sons, Ltd. proposed to sell certain commercial property and advertised it as suitable for occupation and industrial development. In July 1973 plaintiff agreed, subject to contract, to purchase the property for £1,710,000. Defendant was aware at all times that plaintiff wished to redevelop the property, although planning permission from the authorities would have to be obtained. On September 25, 1973,

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no provision for it in the contract.
Id. at 239.

157. *Id.*

158. Travel time involved 108 days through the Canal versus 138 days around the Cape.

159. *Id.* at 241.

160. *See* note 138 *supra* and accompanying text.

161. [1976] 3 All E.R. 509.

the parties signed a contract of sale.[162] On September 26 the Department of the Environment informed the defendants that the property had been included in the statutory list of buildings of special architectual or historical interest. The value of the property without redevelopment potential was £210,000—a difference of £1,500,000. The Court of Appeals rejected plaintiff's contention that the contract had been frustrated.

The court utilized an assumption of the risk analysis in deciding that performance was not rendered fundamentally different from that undertaken by the contract. Defendant had contracted both to sell the property for the agreed price and to produce good title. Plaintiff agreed to pay a specified price in return for the conveyance of a piece of commercial property. Defendant assumed the risk that the building might be listed, thereby endangering the chances of obtaining planning permission. These risks, foreseeable by all reasonable persons, are by custom assumed by purchasers. Performance under the contract, therefore, would be carried out according to the promise agreed upon by the purchaser and the vendor.

V. Comparison and Conclusion

The United States doctrine of commercial impracticability and the English doctrine of frustration essentially deal with the allocation of risks associated with the performance of a contract between a promisor and promisee. Both United States and English jurisprudence recognize that the promisor does not assume all risks inherent in performance of a contract. Both legal systems, however, do begin with the assumption that contracts voluntarily entered into should be enforced according to their terms. The doctrines of impracticability and frustration represent an attempted articulation of a rule which determines when the consequences of certain unexpected occurrences that vitally affect performance should not be borne by the promisor alone. The struggle is between the need for contractual flexibility to allow for unforeseen contingencies and the need for contractual stability to bind future performance.

In order to discharge contractual obligations on the ground of commercial hardship, there must be some factor *dehors* the com-

162. *Id.* at 510. Unknown to the parties at that time, the government had decided to list the property as being of architectual or historical interest.

mercial parameters of the contract that is alleged to have caused the impracticability or frustration. Under English law it is necessary to have a "frustrating event." The Uniform Commercial Code requires one to allege the occurrence of a contingency. Each law contains basically the same requirement and each is intended to serve the same purpose. Under both doctrines an increase in cost alone is insufficient to obtain relief from contractual obligations. The hardship must stem from some cause other than those factors commercially expected to affect performance under a contract.[163] Thus, under either doctrine, a rise or collapse in a market does not provide grounds for discharge because fixed price business contracts are intended to cover such possibilities.

Next, under the English doctrine of frustration, performance must be rendered fundamentally or radically different from that undertaken by the contract. The U.C.C. rule of discharge requires that performance is rendered impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption upon which the parties contracted. In both doctrines the notion of basic assumptions is important. In order for performance to be fundamentally different from that undertaken in the contract, certain basic assumptions common to both parties must never materialize, or in the alternative, must be shattered. The significant difference between the doctrines is illustrated by the United States requirement that performance must be rendered impracticable and the English requirement that performance must be rendered fundamentally or radically different. The use of the word impracticable is intended to emphasize the commercial nature of the criterion by which performance is excused. United States courts realize that once the other elements of the rule are satisfied, a cost increase can be grounds for relief from contractual obligations. It is the extent of the requisite increase that is questioned. Under the English doctrine of frustration it is unclear whether any cost increase can render performance fundamentally or radically different. Some English judges have suggested that an "astronomical" cost increase might arguably satisfy a claim of frustration. Certainly, impracticability under United States standards can be reached before cost increases are astronomical. While the United States courts use a ten-fold cost increase as the

163. *E.g.*, Intertrader S.A. v. Lesieus-Tourteaux S.A.R.L., [1977] 2 Q.B. 146 (Comm. Ct.) (mere reduction in the availability of supplies resulting from commonplace events did not amount to frustration of contract).

clear case of an impracticability, English courts speak in terms of a hundred-fold increase as an example of the term astronomical.[164] The fundamental difference embodied in the English doctrine pertains to the physical aspects of performance, *e.g.*, whether goods would be adversely affected by performance under the new situation or whether personal safety would be jeopardized.[165] By definition, the United States doctrine of discharge focuses on the commercial aspects of the hardship.

Another potential difference in the doctrines involves the issue of foreseeability. The current United States view is that foreseeability is only one factor to be considered when deciding whether the rule of discharge applies. This is in accord with Judge J. Skelly Wright's opinion in *Transatlantic Financing.* Some United States courts, however, adhere to the position that the foreseeability of an event is determinative of the allocation of the risk of that event's occurrence. If foreseeable, the parties are deemed to have assumed the risk of the event's occurrence and the only available relief must be contractually provided.

An additional potential advantage under the U.C.C. rule of commercial impracticability is found in comment six to section 2-615, which reads as follows:

> In situations in which neither sense nor justice is served by either answer when the issue is posed in flat terms of "excuse" or "no excuse," adjustment under the various provisions of this Article is necessary, expecially the sections on good faith, on insecurity and assurance and on the reading of all provisions in the light of their purposes, and the general policy of this Act to use equitable principles in furtherance of commercial standards and good faith.[166]

Although this provision has not been judicially applied to date, it is available should a court be confronted with a borderline case in which neither discharge nor enforcement seems just. No such option is to be found under present English law. The Law Reform (Frustrated Contracts) Act, 1943,[167] provides for the equitable apportionment of expenses between parties, but only after the contract has been frustrated.

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164. *See* Brauer & Co., Ltd. v. James Clard, Ltd., [1952] All E.R. 497, 501 (C.A.).

165. *See, e.g.*, Tsakiroglow & Co., Ltd. v. Noblee & Lord GmbH, [1961] 2 All E.R. 179.

166. U.C.C. § 2-615, comment 6.

167. 6 & 7 Geo. 6 c. 40.

The United States doctrine of commercial impracticability clearly offers a supplier under a fixed priced contract theoretically greater protection from supervening commercial hardship. In practice, however, the doctrines have achieved similar results: both United States and English courts are reluctant to grant relief from contractual obligations based on the adverse economics of performance. Under either United States or English law, the best protection is that explicitly contracted for by the parties themselves. Yet one United States decision has effectively questioned the value of such self-help.

In *Publicker Industries Inc. v. Union Carbide Corp.*,[168] a contract to supply certain petrochemicals contained a price escalator provision. The supplier claimed impracticability of performance when the escalator clause failed to reflect the increases in the price of oil due to events in the Middle East. According to the court, the existence of a specific provision, the effect of which placed a ceiling on contract price increases, impelled the conclusion that the risk of a substantial and unforeseen rise in cost would be borne by the seller. Consequently, by contractually providing for reasonable cost increases, the supplier was precluded from obtaining relief from an unreasonable cost increase. If this decision were followed, it would discourage parties from attempting to deal with contingencies that might affect their performance under the contract. Contractual provisions that save the courts and the parties time and expense should be encouraged. Thus, the Fifth Circuit in *Eastern Air Lines, Inc. v. McDonnell Douglas Corp.*[169] held that the inclusion of an excuse clause in a contract does not preclude the protections available under U.C.C. section 2-615.

If a contract is to be governed by either English or United States law, a provision should be included stating that should performance under the contract continue after the occurrence of a contingency or frustrating event, and pending negotiation or arbitration, the promisor reserves all rights to subsequently claim impracticability or frustration in legal proceedings. According to some courts in both England and the United States, impracticability or frustration terminates an agreement. Continued performance under the contract is viewed as inconsistent with a claim of

168. 17 U.C.C. REP. SERV. 989 (E.D. Pa. 1975).
169. 532 F.2d 957 (5th Cir. 1976).

frustration or impracticability.[170]

Finally, it should be noted that one commentator has suggested that international contracts should be governed by a particularly strict standard of discharge.[171] According to this point of view, parties to international contracts usually insert special clauses to cover the most varied type of extraordinary risks, and they assume that the promisor bears the risk of events not specifically included. Furthermore, because parties to international contracts are generally subjects of diverse systems of national law, they will rely more heavily on the terms of their contract than upon the general legal doctrine prevailing in one country or another. Therefore, when the parties include special clauses defining under what circumstances performance shall be excused, the courts should not intervene with their own peculiar rules of discharge.

Parties to an international contract, however, usually stipulate which nation's laws, including the concomitant rule of contractual discharge, is to govern the contract. The parties' choice of law should be made with a view to the leniency of the standard of discharge. If so, the intentions of the parties regarding the allocation of risk will not be thwarted.

John J. Gorman

170. Transatlantic Financing Corporation v. United States, 363 F.2d 312, 320 (2d Cir. 1966); Davis Contractors, Ltd. v. Fareham Urban District Council, [1956] 2 All E.R. 145, 155.

171. Berman, *Excuse for Nonperformance in the Light of Contract Practices in International Trade*, 63 COLUM. L. REV. 1413 (1963).