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WHY FLEXIBILITY MATTERS: INEQUALITY AND CONTRACT PLURALISM

JEREMIAH A. HO*

ABSTRACT

In the decade since the Great Recession, various contract scholars have observed that one reason the financial crisis was so "great" was due in part to contract law—or, more precisely, the failures of contract law for not curbing the risky lending practices in the American housing market. However, there is another reason why contracts made that recession so great: contracts furthered inequality. In recent years, when economic inequality has become a dominant national conversation topic, we can see development of that inequality in the Great Recession. And indeed, contract law was complicit. While contractual flexibility and innovation were available to soften the blow of large commercial deals gone wrong during the crisis, residential mortgage defaults across the U.S. were subject to strict contractual formalism that led to severe consequences for those pursuing one of the hallmark prizes of the American Dream, homeownership. Specifically, mortgage default cases during the Great Recession featured commercial parties relying on the gravity of the Great Recession as the reason why their contract breaches ought to be excused through doctrines such as impracticability. Although impracticability defenses premised on economic changes are usually unconvincing, commercial claimants during the Great Recession had some surprising successes and advantages in taking such positions—including real estate mogul Donald Trump and his firm when they defaulted on a $640 million real estate loan with lender Deustche Bank. Meanwhile, hundreds of thousands of homeowners, whose abilities to honor their mortgage agreements were also hindered by the economic downturn, could not predicate their defaults on the crisis and get away with it. Instead, they were subject to rigid contract formalism. The entitlement to flexible and innovative excuse arguments seemed particularly exclusive to commercial claimants during

* Assistant Professor of Law, University of Massachusetts School of Law. First and foremost, I am grateful for the University of Massachusetts for funding this research. My thanks to Aditi Bagchi, Hanoch Dagan, Martjin Hesselink, and the participants of the contracts workshop at the University of Amsterdam Law School for comments on a previous draft of this project. Also, my deepest thanks go to Emma Wood, Jessica Dziedzic, Erica G. Sylvia, Marsha Sonner, and Liz Stuewe for research assistance. And lastly, I'd like to thank Senior Articles Editor, Judy Kang, and the staff and editors of the *U.C. Davis Business Law Journal*.

the Great Recession. And contract law helped sustain that exclusivity. Therein lies the inequality.

This Article's ultimate goal is not to argue, like others already have, for the efficacy of expanding contract excuse doctrines in significant times of crisis. Instead, the heart of this Article's investigation examines, using the example of impracticability arguments used during the Great Recession, why commercial parties had more access to flexibility in contracts than others in order to point out how it resonates societally for contracts. Modern contract law furthered inequality when it could have been more instrumental in advancing social mobility and economic opportunity. Thus, this Article's observations ultimately support the idea that rather than formalism, contract pluralism ought to be adopted in order to give contracts a more meaningful role in furthering a fair and just society.

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I. INTRODUCTION

A decade's time has passed since the crash of the American housing market and the rise of the ensuing financial crisis—the oft-referenced "Great Recession."[1] Precipitated in large part by the balloon and bust of artificial housing prices of the mid-2000s,[2] the reasons why financial experts worldwide bestowed the title of "greatness" on this particular recession likely had to do with several of its peculiar dimensions. On the surface, the immensity of the failure was staggering both at the ground-level, with risky behavior in the home financing market, and at higher levels as such behavior was incorporated precariously into the investment innovations based off home lending.[3] In between the litany of specifics was a narrative of horribles—inherent vices for economic disaster: subprime and predatory lending,[4] faulty collateralized debt,[5] defaults and foreclosures,[6] the bursting of inflated housing markets,[7] and banks that eventually needed to be bailed out.[8] Then, of course, beyond the news headlines, there were

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[1] *See, e.g.*, Catherine Rampell, *'Great Recession': A Brief Etymology*, N.Y. TIMES (Mar. 11, 2009), https://economix.blogs.nytimes.com/2009/03/11/great-recession-a-brief-etymology/?_r=0 (noting in 2009 that "[t]he title 'The Great Recession' seems to be gaining some currency"); *see also* Diane Whitmore Schanzenbach, Ryan Nunn, Lauren Bauer, David Boddy, & Greg Nantz, *Nine Facts about the Great Recession and the Tools for Fighting the Next Downturn*, THE HAMILTON PROJECT, THE BROOKINGS INSTITUTION (May 2016), https://www.brookings.edu/wp-content/uploads/2016/07/fiscal_facts.pdf. [hereinafter *Nine Facts*] (referring to the financial crisis that happened between December 2007 and June 2009 as the Great Recession). The authors here go on to compare history the Great Recession with four most recent recessions to illustrate the gravity of the crisis. *Id.*

[2] Franklin A. Gevurtz, *The Role of Corporate Law in Preventing A Financial Crisis: Reflections on in Re Citigroup Inc. Shareholder Derivative Litigation*, 23 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 113, 115 (2010) (listing the "bubble in housing prices in the United States" as one of the causes for the financial crisis).

[3] *See* Chad J. Pomeroy, *Well Enough Alone: Liability for Wrongful Foreclosure*, 68 ALA. L. REV. 943, 950 (2017) (footnotes omitted) ("The front end of the financial crisis, as broadly described above, is strongly associated with poor lending practices and the system that built up around those practices. The banks caused themselves (and, eventually, the entire global economic community) enormous harm by investing in debtors who were unlikely to repay and by building a significant part of their capital structure around those investments."); *see id.* at 951 (footnotes omitted) ("[D]uring the run-up to the Great Recession, banks packaged together their subprime loans into mortgage-backed securities and sold them to investors all over the world.").

[4] *See* Steve Denning, *Lest We Forget: Why We Had A Financial Crisis*, FORBES.COM (Nov. 22, 2011), https://www.forbes.com/sites/stevedenning/2011/11/22/5086/#73541f59f92f.

[5] *See* Adam Davidson, *How Wall Street Made The Mortgage Crisis Worse*, NPR (Aug, 27, 2010), http://www.npr.org/sections/money/2010/08/26/129454550/inside-the-sausage-factory-how-wall-street-made-the-financial-crisis-worse.

[6] *See* P. Gupta, *The American Dream Deferred: Contextualizing Property After the Foreclosure Crisis*, 73 MD. L. REV. 523 (2014).

[7] Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 N.C. BANKING INST. 5, 14 (2009).

[8] *Id.* at 77.

the ripple effects—first with domestic events, such as the rise of unemployment,[9] decrease in spending and retail,[10] and loss of wealth in the middle-class.[11] Then the ripple expanded globally, contributing, for example, to the slowdown of national economies in North and South America, Europe, Asia, the Middle East, and parts of Africa.[12] Thus, convincingly, the description of "greatness" placed on this recession was not hyperbolic. Had this recession been visible on a weather map, its stormy, cumulonimbus mass would have enveloped an economic landscape nearly as vast as the globe. Indeed, as the economic community regarded the forecast as beyond dim, any shelter from the harms of the Great Recession soon disappeared or very quickly became scarce. Not only had the crisis literally and figuratively torn the roofs off those living within the pursuit of homeownership, but world-wide the effects were similar with no safety in sight.[13] It is no wonder that then Federal Reserve Chairman, Alan Greenspan, had similarly likened this recession to a "once-in-a-lifetime credit tsunami" in a testimony before Congress in 2008.[14]

Since then, the economy of the twenty-first century has been recovering[15]—albeit slowly,[16] and with some observers, for a while, even controverting whether the crisis has really ended.[17] Still unresolved, however, is the bigger question concerning whether, economics aside, we have truly sobered

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[9] *Id.* at 76.
[10] *Id.* at 72.
[11] Jim Tankersley, *Why America's Middle Class is Lost*, WASH. POST (Dec. 12, 2014), http://www.washingtonpost.com/sf/business/2014/12/12/why-americas-middle-class-is-lost/?utm_term=.19362d3282d5.
[12] *E.g.*, Nouriel Roubini, *A Global Breakdown of Recession of 2009*, FORBES.COM (Jan. 15, 2009), https://www.forbes.com/2009/01/14/global-recession-2009-oped-cx_nr_0115roubini.html (citing effects of the Great Recession in each of the different regions in the world).
[13] *See id.*
[14] NPR, *Greenspan Calls Financial Crisis 'A Credit Tsunami,'* NPR (Oct. 23, 2008), http://www.npr.org/templates/story/story.php?storyId=96023610.
[15] *See, e.g.*, Eswar Prasad & Karim Foda, *The Global Economic Recovery Is for Real: Advanced Economies Are Settling into Reasonable Growth as Emerging Markets Rebound*, THE FINANCIAL TIMES (Apr. 16, 2017), https://www.ft.com/content/27bd72c8-2121-11e7-b7d3-163f5a7f229c?mhq5j=e2.
[16] *See Nine Facts*, *supra*, note 1, at 1 ("Not only was the Great Recession . . . deeper than any recent recession, but it took nearly four years for the economy to regain the prerecession GDP level—twice as long as for the 1981-82 recession."); *see also* Drew Desilver, *Five Years In, Recovery Still Underwhelms Compared with Previous Ones*, Pew Research Center (June 23, 2014), http://www.pewresearch.org/fact-tank/2014/06/23/five-years-in-recovery-still-underwhelms-compared-with-previous-ones ("[T]he current recovery is among the weakest on record, particularly given its duration.").
[17] *See, e.g.*, Josh Barro, *People Think We're in a Recession. Don't Blame Them.*, N.Y. TIMES (Mar. 14, 2014), https://economix.blogs.nytimes.com/2014/03/14/people-think-were-in-a-recession-dont-blame-them/ (mentioning a result of a NBC News/Wall Street Journal poll in 2014 that found "American adults found that 57 percent still think the economy is in recession.").

and wised up a decade later. This question appears to be one that remains to be answered through the politics of our current time. Interestingly, no strong, vibrant, and hardline consensus has really emerged to quell the query. While some of the political rhetoric during the post-recession has focused heavily on economic inequality,[18] no real dynamic political will has proved we ought not to venture back to the days of risky financial behavior.[19] In fact, the legislative agenda imposed by congressional conservatives after the 2016 U.S. presidential elections has been more decisive in undoing some of the regulatory protections that were enacted after the Great Recession, such as the *Dodd-Frank Act of 2010*[20] which restricted risky behavior by financial institutions—of the very type that had led to the Great Recession.[21] Ironically, some of the justifications put forth for undoing the Dodd-Frank Act have been that such regulations have prohibited post-recession growth of financial institutions.[22]

If one were to step back into the wreckage that represents the Great Recession and look at what exists underneath the collapsed structure of events—to lift up the figurative equivalence of fallen beams, cracked drywall, twisted broken glass, and metal in the failed transactions, practices, and innovations of parties (large financial institutions and millions of homeowners alike)—that archeology would be sobering. But doctrinally, we ought not to be surprised by what we would find either. Beneath the subprime lending, the buying and selling of homes, the mortgage-backed securities, the trading and eventual trenching of those securities, the defaults and foreclosures, the burst of the housing bubble, and the bailouts, we would discover something all-too familiar and perhaps slightly overlooked: We would find contracts amidst the rubble. After all, it was the use of contracts that facilitated lending,[23] helped securitize debt amongst

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[18] For instance, going into the 2016 U.S. presidential elections, income inequality and wealth distribution was a major campaign platform. *See, e.g.*, David Lauter, *Income Inequality Emerges as Key Issue in 2016 Presidential Campaign*, L.A. Times (Feb. 5, 2015), http://www.latimes.com/nation/la-na-campaign-income-20150205-story.html.

[19] *Accord* Justin Wolfers, *The Economy May Be Stuck in a Near-Zero World*, N.Y. TIMES (Apr. 7, 2017), https://www.nytimes.com/2017/04/07/upshot/the-economy-may-be-stuck-in-a-near-zero-world.html?_r=0 (urging the shift away from monetary changes at the Federal Reserve toward "reviv[ing] a more active role for fiscal policy—government spending and taxation—so that the government fills in for the missing stimulus when the Fed can't cut rates any longer.").

[20] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[21] Rachel Witkowski, *House Panel Approves Plan to Undo Parts of Dodd-Frank Financial Law*, THE WALL ST. J. (May 4, 2017), https://www.wsj.com/articles/house-panel-approves-plan-to-undo-parts-of-dodd-frank-financial-law-1493916205.

[22] *Id.*

[23] *See* Celeste M. Hammond & Ilaria Landini, *The Global Subprime Crisis as Explained by the Contrast Between American Contracts Law and Civil Law Countries' Laws, Practices, and Expectations in Real Estate Transactions*, 11 J. OF INT'L BUSINESS & L. 133 (2012).

banks,[24] and later enforced foreclosures.[25] Contracts lurked in the blueprints, architectures, and directives of such great failures. But these broken faulty promises were not, by themselves, the mere culprit or the ultimate cause. Digging even further beyond contracts, past that layer of sediment, we would find the animating forces of human behavior that was the instrument for collective opportunity and failure through contract. Thus, contract law and doctrine leading up to the economic crisis and then afterwards was a mere instrumentality—but an important one, no less. On the interpersonal level, contracts fueled human desire for homeownership—a cornerstone prize of the American Dream[26]—and yet simultaneously, it buttressed the foundation of what eventually became "too big to fail."[27] And when events deteriorated for the worst, the mandate of contracts guided the narrative responses of mass defaults and foreclosures. In a sense, contracts helped built the faulty house—or housing market—and contracts helped in the demolition. A cautionary dialectic resides in this narrative, one that reveals the imposing nature of contracting.

If we point to contract's complicity in the housing crisis, what does it say about our laws of contracting? That, perhaps, the uses of contract law by the financial sector in the early to mid-2000s reflect a moralization prompted by free markets and deregulation, rather than a morality that truly cares about the human and the interpersonal. And correspondingly, the formalism with which we presently know and experience in contract law played right into its uses and abuses at the time.[28] For some, that could be the blunt end of any further insight for contracts in the financial crisis. But there are those who posit that the studies about the role that contracts had in facilitating the conception, the construction, and the tear-down of the housing market have not been as extensive as they could have been.[29] George Cohen has observed that "[a]t the bottom of the financial

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[24] *Id.* at 146.

[25] *See, e.g.*, Chunlin Leonhard, *The Subprime Mortgage Crisis and the Economic Checks and Balances*, 31 BANKING & FIN. SERVS. POL'Y REP. 15, 16 (2012) ("These mortgages were full of 'booby traps and deceptions.' As a result, borrowers entered into costly loan contracts that they could not actually afford for very long, resulting in defaults and foreclosures that set off the financial crisis worldwide.") (footnote omitted).

[26] Ronnie Cohen & Shannon O'Byrne, *Burning Down the House: Law Emotion and the Subprime Mortgage Crisis*, 45 REAL PROP. TR. & EST. L.J. 677, 685 (2011).

[27] *See* Barney Frank, *'Too Big to Fail' is an Empty Phrase*, CHICAGO TRIBUNE (Mar. 18, 2006), http://www.chicagotribune.com/news/opinion/commentary/ct-bernie-sanders-too-big-to-fail-banks-20160318-story.html.

[28] Part of that formalism is prompted by our doctrinal regard for contract law as a form of strict liability. As the Restatement of Contracts (Second) notes, "[c]ontract liability is strict liability. . . . The obligor is therefore liable in damages for breach of contract even if he is without fault and even if circumstances have made the contract more burdensome or less desirable than he had anticipated." RESTATEMENT (SECOND) OF CONTRACTS ch. 11, intro. Note (1981).

[29] George M. Cohen, *The Financial Crisis and the Forgotten Law of Contracts*, 87 TUL. L. REV. 1, 2 (2012).

crisis lie failed contracts"[30] and "[y]et, to date, most discussions of possible responses to the financial crisis ignore contract law."[31] According to Cohen, the fact that the resolutions after the burst were more political rather than doctrinal suggests that some minds had been made up about what to do with contracts in the financial crisis—a kind of legal futility toward treating contract doctrine in any innovative way.[32] Contrary to that belief, Cohen himself pressed on and so have others. Likewise, this Article seeks to hone its glance also toward contract law in the Great Recession rather than ignore it.

If we continue to stand over the ruins of the economic crisis, it is not unreasonable to surmise, with ample resignation, that contract law was placed between efficiency and real solutions. But as brutal and imposing contract law appears to be, it ought to be forgiving as well. In the modern era of American contract doctrine, the efforts of legal realists in commercial law, the rise of doctrines promulgated by detrimental reliance and unconscionability, the influences of equity, and excuse through changed circumstances are all illustrations of less rigid, less formalist approaches to the rules of contracting. Contracts can be flexible. In a modern society that is fixated on a liberal project, contracts can be part of our conception of the good.

This Article's ultimate fixation is on the boundaries of contract law for its flexibility and innovation—particularly when it came to the missed opportunities for furthering that flexibility in cases of defaulting homeowners and foreclosures during the financial crisis. Contract law facilitated opportunity in building the events that led to the crisis—often in ways that perpetuated illegitimacy within home mortgage agreements and property ownership. Once the illegitimacy surfaced, however, contract law, through its enforcement of defaulting loans, also aided the immediate curtailing of opportunity. But in a recession, that was touted as so "great," was absolute liability of contracts truly the way to proceed?

Within commercial contract cases in the Great Recession, commercial parties, unlike residential home loan borrowers, could avert strict contract enforcement and use arguments for excusing breach in ways that would have traditionally been prohibited by most courts. Specifically, they relied on the "greatness" of the Great Recession to make claims that their non-performances in their existing multi-million dollar deals ought to be excused under the changed circumstance defenses, such as impracticability.[33] One example of such

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[30] *Id.* at 1.

[31] *Id.*

[32] *Id.* at 1-2 ("Discussions of the crisis tend to say little about contract law, because they simply assume that the contracts at issue should and will be strictly enforced; given that assumption, there is not much to say.").

[33] *See, e.g.*, Hoosier Energy Rural Elec. Co-op., Inc. v. John Hancock Life Ins. Co., 588 F. Supp. 2d 919, 924 (S.D. Ind. 2008), *aff'd but criticized*, Hoosier Energy Rural Elec. Co-op., Inc. v. John Hancock Life Ins. Co., 582 F.3d 721 (7th Cir. 2009) (holding that amongst other reasons, the

expansion of excusing a contract breach appeared in a commercial case involving then real estate developer Donald Trump after defaulting on a $640 million commercial property loan with Deutsche Bank.[34] Meanwhile, changed circumstances remained unavailable to the vast majority of homeowners facing defaults and foreclosures.[35] Their residential mortgage contracts were subject to contract formalism.

This Article explores the societal significance of this asymmetry in contract flexibility and how it contributed to an underlying inequality that is antithetical to notions of social justice for contract law. Specifically, it will examine how contracts, rather than fulfilling economic opportunity and self-determination, facilitated enormous disparity. Its promise, in other words, became its burden.

After this Part I Introduction, Part II will first establish the narrative of contracts as to its involvement in the U.S. housing market in the mid-2000s—specifically its use and function in lending practices that created the bubble in the housing market prior to the economic crisis, and later in the securitization of mortgages by financial institutions. Part II will also explore the potential for flexibility of the contract doctrine after the bubble burst and its missed opportunities. Then Part III will examine the expansion of the impracticability doctrine as an example of contract flexibility accessed by large commercial entities during the Great Recession. After that examination, Part IV will compare that expansion of impracticability in commercial contracts with the predicament of underwater homeowners who were not able to rely on excuse doctrines to deal with defaults. With that comparison, Part IV will observe that the externalities created by contract enforcement facilitated a vast inequality between wealthy commercial parties and individual homeowners. Such inequality amount to dignitary harms that warrant adoption of contract pluralism principles rather than formalism. Finally, the Article closes with concluding remarks in Part V. Hopefully, the sentiment becomes clear that perhaps in a modern society committed to a liberal project, more consideration is needed regarding our present contract doctrines as part of a conception of the good before the next global catastrophe arises.

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financial crisis "also appears to have made it impossible—or nearly impossible—for Hoosier Energy to find a substitute for Ambac with a sufficient rating, on time, and at any price.").

[34] Trump v. Deutsche Bank Tr. Co. Ams., 65 A.D.3d 1329 (N.Y. App. Div. 2009); *see also* Trump v. Deutsche Bank Tr. Co. Ams., Index No. 403012/09 (N.Y. Sup. Ct. 2009).

[35] *See* Meredith R. Miller, *Strategic Default: The Popularization of a Debate Among Contract Scholars*, 9 CORNELL REAL EST. REV. 32, 39 (2011). In her observations of the home loan crisis of the Great Recession, Miller observes that "the traditional defenses of mistake, fraud and impracticability or frustration of purpose are not an appropriate doctrinal fit to excuse the homeowners from paying the loans." *Id.*

II. CONTRACTS AND THE HOUSING CRISIS

By design, contract law was utilized at various points both commercially and residentially throughout the events of the Great Recession. This Part will track the contractual underpinnings of home mortgage loan agreements and the contract's crucial role in the subprime market.

A. Traditional Mortgage Financing

Despite the importance of deeds in transferring real estate, contracts also reside at the heart of the home purchase transactions.[36] In short, once buyers and sellers of property memorialize their agreement to purchase, typically these executory contracts facilitate the roles of both parties in the transactions and guide them through the various events that must occur before title to property passes hands.[37] The purchase and sales contract "defines the parties' rights and responsibilities with respect to the sale of the real property"[38] and helps clarify "whether the purchase and sale will take place, or whether it will be aborted because one of many contingencies contained in the contract cannot be met pursuant to the terms and conditions in the contract."[39] Specifically, some of these events might include verifying the seller's title, conducting satisfactory inspection of the property, and obtaining financing for the purchase through mortgage.[40] Hence, even though the "typical purchase and sale contract is temporally short-lived—typically lasting 30 to 90 days—it plays an integral part in the disposition of real property because of its definitional role."[41] The gravity of this contracting phase in real estate transactions is also felt, partly in a historical way, through the Statute of Frauds requirement on land-sale contracts, which requires evidence of

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[36] *See* ALEX M. JOHNSON, JR., UNDERSTANDING MODERN REAL ESTATE TRANSACTIONS 57 (3d. ed. 2012) ("When most people think about the agreements or contracts that are involved in purchasing real property, they think about the listing agreement with the broker and the dead that is executed at closing that transfers title of the real property from seller to buys. Rarely do they give much or anything thought to the most important agreement involved in the transaction, the standard real estate purchase and sale of the contract."); *see also* GEORGE LEFCOE, REAL ESTATE TRANSACTIONS, FINANCE, AND DEVELOPMENT 2 (6th ed. 2009) (breaking down the real estate transaction into three "Acts" and locates the contracting phrase, which includes mortgages entirely in "Act Two").

[37] *See* LEFCOE, *supra* note 36.

[38] JOHNSON, *supra* note 36, at 57.

[39] *Id.*

[40] LEFCOE, *supra* note 36, at 2. Lefcoe labels the period of contracting in a real estate transaction as the "executory period," in which "the buyer's offer is made contingent on her approval of a throughout physical inspection of the property and a title report" and "[t]he buyer's obligation to purchase may also be made contingent on receipt of suitable mortgage financing." *Id.*

[41] *Id.*

writing during the enforcement phase.[42] Another feature that underscores the importance of a purchase agreement contract is the fact that when real estate transactions go awry, "the purchase and sale contract is perhaps the most frequently litigated aspect of the typical residential real estate transaction."[43] All in all, such observations illustrate the general significance of contract law in facilitating and enforcing the purchase and sales of property between individual parties.

When it comes to financing the transaction through lending and mortgages—arguably "the most important and complex element of most transactions"[44]—contracting is instrumental because "[r]arely is real property purchased without the use of some type of financing."[45] Although one can recognize the specialized category that mortgage agreements occupy and view mortgages through property lenses, "mortgages involve contracts and are subject to the general law of contracts, unless that law is specifically displaced, for example, by statute."[46] In broad terms, the typical contracts perspective toward mortgages assesses the transaction as an agreement by a lender to loan a specific amount to the borrower in order to cover the price of the property. As Cohen explains, "[o]nce a lender makes the loan, the lender generally has no further contractual duties to the borrower; the borrower has duties of performance."[47] The borrower's performance involves payment for a specified length of time to the lender of the principal at the stipulated rate of interest.[48] The lender, however, hedges some of the risk of non-payment by obtaining a security interest in the property that was purchased by the borrower's loan amount.[49] In the event that the borrower fails to repay the loan—or in mortgage parlance, the borrower

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[42] *Id.* at 66-69 (reciting the brief history, requirements, and functions of the Statute of Frauds); *see also* E. ALLAN FARNSWORTH, CONTRACTS 366 (3d ed. 1999). Farnsworth notes that "[t]he land contract provision [of the Statute of Frauds] performs a significant channeling function, by furnishing a simple test of enforceability to mark off unenforceable agreements from enforceable ones. It is noteworthy that the most durable and well-regarded of the statute's provisions are those that fulfill more than just the original evidentiary purpose."

[43] JOHNSON, *supra* note 36, at 57.

[44] *Id.* at 119.

[45] *Id.*

[46] *See* Cohen, *supra* note 29, at 4 n.6.

[47] *Id.*

[48] *Id.* at 4-5.

[49] *See id.* at 5 (describing that "the lender bears the default risk" and how, *inter alia*, one of the ways to protect against such risk is "requiring collateral (for example, in a mortgage contract, the house)"); *see also* JOHNSON, *supra* note 36, at 120 ("The mortgage itself creates and grants the mortgagee a security interest in the borrower-mortgagor's real property."). Black's Law Dictionary defines "security interest" as "a property interest created by agreement or by operation of law to secure performance of an obligation, esp. repayment of a debt; specif., an int'rest in personal property or fixtures securing payment or performance of an obligation." BLACK'S LAW DICTIONARY 1562 (10th ed. 2014).

"defaults"—the lender has a claim for redress. The claim for redress is typically by a court order to foreclose on the interest in the property that the lender received as part of the loan agreement.[50] Of course, other ways in which lenders protect themselves from the danger associated with borrower defaults include the interest rate and the size of the down payment.[51]

Prior to the 1980s, mortgages associated with the financing of home purchases in the United States were traditionally long-term fixed-rate mortgages, in which interest rates were set or "fixed" at the outset of the loan, often with the ability by borrowers to refinance later.[52] Todd Zywicki's quick historiography of utilizing fixed-rate mortgages in American home-buying shows a curious account of their rise. Zywicki calls the thirty-year fixed rate mortgage "an accident of history, not a conscious policy choice"[53] and observes that they "arose as a desperate, government-motivated innovation during the Great Depression to reduce foreclosures by stretching out payment terms for a longer period to reduce monthly payments."[54] Originally, before the rise of long-term fixed-rate mortgages, home loans were shorter, typically between five to ten years.[55] Long-term fixed rate mortgages were unique to the United States, as other countries did not adopt this type of mortgage.[56] Part of the use of the long-term fixed-rate

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[50] LEFCOE, *supra* note 36, at 6 ("Defaulting mortgagors risk the mortgagee petitioning a court to order a foreclosure of the borrower's interest in the security property by public auction conducted by the sheriff.").

[51] Cohen, *supra* note 29, at 5.

[52] *See* JOHN W. REILLY, THE LANGUAGE OF REAL ESTATE 173 (3d. ed. 1989) (defining a fixed rate loan as "[a] loan with the same rate of interest for the life of the loan. Until the late 1970s and early 1980s, the fixed-rate loan was the usual type of real estate loan. With the arrival of highly volatile interest rates, lenders attempted to adjust interest rates with a variety of new and different loans. As the quasi-governmental agencies changed their guidelines, establishing a marketplace for these new adjustable rate loans, it became evident that the fixed-rate loan would be seen less and less in the real estate market."); Cohen, *supra* note 29, at 5-6 (explaining that in a fixed-rate mortgage, "[i]f interest rates fall, mortgage lenders bear the risk because mortgage contracts typically give borrowers the right to make payments early (prepayment right), including the right to pay off the entire loan. Thus borrowers have an incentive to refinance their mortgages when interest rates drop sufficiently, which deprives lenders of the higher interest payments at the initial rate."); Todd Zywicki, *The Behavioral Law and Economics of Fixed-Rate Mortgages (and Other Just-So Stories)*, 21 SUP. CT. ECON. REV. 157, 168-69 (2013) (footnote omitted) (noting that the U.S. is "almost alone in the world by including a standard provision in mortgage contracts that permits the borrower a unilateral prepayment option, and thus the option to refinance, at almost any time.").

[53] Zywicki, *supra* note 52, at 162.

[54] *Id.* (citing Richard K. Green and Susan M. Wachter, *The American Mortgage in Historical and International Context*, 19 J. ECON. PERSP. 93, 94 (2005)).

[55] *Id.*

[56] *Id.* at 164 (noting that "the United States is one of only two countries in the world with long-term fixed-rate mortgages and an unlimited right to repay without penalty").

mortgage was to deal with issues of risk-bearing by lenders that arose in the Great Depression.[57]

Prior to the Great Depression, lenders had little risk with short-term mortgages. If borrowers defaulted, lenders could sell off the property and recover any outstanding amount on the property.[58] However, real estate values had crashed by 50 percent or more during the Great Depression, making refinancing short-term mortgages difficult.[59] As a result, the U.S. government created programs to ameliorate the crisis and its risks for lenders; for instance, the creation of the Home Owner's Loan Corporation "raised funds to purchase defaulted mortgages from financial institutions and reinstated them, converting variable-rate, short-term, nonamortizing mortgages into fixed-rate, long-term (twenty-year), fully amortizing mortgages."[60] Also, "the FHA was introduced to provide mortgage insurance so that investors would be willing to buy these restructured mortgages from the government despite their now high loan-to-value ratios."[61] These programs ultimately became the federally-backed loan operations we have today.[62] In these ways, the long-term fixed-rate mortgage became the long-standing financing choice in which traditional loan agreements were molded for generations after the Great Depression.

B. Riskier Lending

The rise of adjustable-rate mortgages in the recent decades changed the risk-bearing relationship in the traditional fixed-rate mortgages from lender to borrower.[63] These devices allow for fluctuations in the interest rate during the length of the mortgage, according to conditions agreed to by the parties.[64] However, the benefits to adjustable-rate mortgages involve not only the shifting

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[57] *See id.* at 162 (quoting Green & Wachter, *supra* note 54, at 94).
[58] *Id.*
[59] *Id.*
[60] *Id.*
[61] *Id.* One other federal program created at this time — as that Zywicki mentions — is the Federal National Mortgage Association (FNMA). *Id.*
[62] *See id.* (noting that over time these "responses to the Great Depression evolved into the federal government-sponsored enterprise system of Fannie Mae, Freddie Mac, and Ginnie Mae.").
[63] *See* Cohen, *supra* note 29, at 5-6 ("Since the 1980s . . . lenders have been able to shift the risk of rising interest rates to borrowers by contracting for adjustable-rate mortgages for which the interest rate varies with a particular market rate of interest."); *see also* Lisa Prevost, *The Siren Call of the Adjustable-Rate Loan*, N.Y. TIMES (Aug. 22, 2013), http://www.nytimes.com/2013/08/25/realestate/the-siren-call-of-the-adjustable-rate-loan.html ("Adjustable loans, which are usually amortized over a 30-year term, carry greater risk for the borrower, because the rate may rise after an initial period of fixed interest.").
[64] *See* JOHNSON, *supra* note 36, at 139 (defining the adjustable-rate mortgage as "a financing device in which the interest rate of the mortgage may fluctuate throughout the duration of the mortgage pursuant to the terms and conditions set forth in the mortgage.").

of the risk-bearing of higher interest rates to the borrower, but also permits the borrower to reap the advantages if interest rates plunge.[65] Compared to the fixed-rate mortgages, there are advantages that adjustable fixed-rate mortgages can inherently offer. One of the most apparent advantage is the possible affordability of the loan because the borrower is not paying at a long-term interest rate that may be higher than actual market rates during the duration of the term.[66]

Innovations themselves are not necessarily dangerous things; rather the dangers exist in the way innovations are harnessed and used. And as one commentator on the financial crisis has noted, during the housing boom, "[i]nnovations in financial contracting also contributed to the expansion in demand for housing assets."[67] Thus, contract has its place as a tool for building the events that resulted in the Great Recession. But contractual innovations, such as lending innovations, were only made conducive by the historical and political context of the early 2000s. In the years leading to the rise of the housing market and subsequent financial crisis, certain combined political and economic events contributed to the increased dependency on innovative lending products that deviated from practices that had become more or less conventional after the Great Recession. First, gradual deregulation of the banking and finance industries starting in the 1970s and 1980s stimulated innovation more readily.[68] For example, Ronald Regan's presidency marked important deregulation changes for the lending industry:

> Under President Reagan, the Controller of Currency (OCC) in 1981 authorized national banks to offer adjustable-rate mortgages

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[65] *Id.* at 140 ("The rationale behind such apparently complicated devices is quite simple and reasonable. The use of an [adjustable-rate mortgage] shifts the risk of the possible higher interest rates during the term of the loan from the financial institution to the mortgagor. Similarly, it permits the mortgagor to benefit from declining interest rates.").

[66] *See, e.g.*, Prevost, *supra* note 63. As Prevost notes, "[u]sing an ARM can save the borrower thousands in interest payments during the teaser period, because the rate is lower than that of a fixed-rate product. And for the most qualified buyers, ARM rates on jumbo loans, or loans above $417,000, are even lower than rates on conforming loans." *Id.* In the article, Prevost quotes an example by Peter Grabel, a mortgage loan originator, to externalize the possible benefit for borrowers of the adjustable-rate mortgage: "According to Mr. Grabel's calculations, on a $417,000 loan, a seven-year ARM with an initial rate of 3.625 percent would save the borrower more than $20,000 in the first 10 years compared with a 30-year loan at a rate of 4.375 percent." *Id.* The benefits in the example rely on some assumptions: "His estimate assumes, however, that the initial ARM rate stays the same in Years 8, 9 and 10. And given that ARM indexes, too, are at historic lows, that may be an overly optimistic assumption going forward." *Id.*

[67] Robert E. Krainer, *The Consumer Financial Protection Bureau: A Five-Year Retrospective*, 10 U. ST. THOMAS J.L. & PUB. POL'Y 17, 20 (2015).

[68] Charles W. Murdock, *The Big Banks: Background, Deregulation, Financial Innovation and "Too Big To Fail,"* 90 DENV. U.L. REV. 505, 516-24 (2012). Murdock gives an extensive account of the political and economic reasons for deregulation, much of it is beyond the scope of this Article. *Id.*

> (ARMs), and Congress passed the Garn-St. Germain Depository Institutions Act of 1982, which further enabled savings and loan institutions to expand their lending activities into commercial lending and even junk bonds. The Act also authorized state-chartered banks to issue ARMs, putting them on parity with national banks, and gave the OCC the authority to lift restrictions on loan-to-value ratios, maturities, and amortization schedules. The Controller exercised this authority the following year.[69]

Such deregulation continued well into the Clinton Administration and into the 2000s.[70] Part of the lifting of restrictions in lending practices during this time led to trouble in the financial sector—for instance, with the disastrous savings and loan crisis in the late 1980s and early 1990s[71]—but also to the popularity of diversified lending markets that shifted away from traditional prime lending, such as the subprime markets.[72]

As the foundations of the housing crisis had been installed by the early 2000s because of deregulation, the rest of the conditions and events that created the housing boom were taking shape in the years leading up to the Great Recession. According to Dawinder Sidhu, "[s]everal factors created the conditions for a surge of mortgage contracts" that led eventually to the economic crisis.[73] All of these factors had underlying goals of encouraging homeownership and investment.[74] For examples, Sidhu cites that "[l]ow interest rates—designed in part to encourage economic activity in the aftermath of the September 11, 2001

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[69] *Id.* at 517.
[70] *Id.* at 519-24.
[71] *See id.* at 541.
[72] *See* KENNETH TEMKIN ET AL., U.S. DEP'T OF HOUSING AND URBAN DEV. OFFICE OF POL'Y DEV. AND RES., SUBPRIME MARKETS, THE ROLE OF GSES, AND RISK-BASED PRICING 9 (2002), http://www.huduser.org/Publications/pdf/subprime.pdf ("As prime refinance loan volumes fell after the Federal Reserve increased interest rates in 1994, originators sought other markets to serve—the subprime market was an obvious choice. Brokers and mortgage companies started to originate a larger number of subprime mortgages in 1994 as a means to maintain profits and utilize existing capacity."). The Consumer Financial Protection Bureau provides that "[a] subprime mortgage is generally a loan that is meant to be offered to prospective borrowers with impaired credit records. The higher interest rate is intended to compensate the lender for accepting the greater risk in lending to such borrowers. The interest rate on subprime and prime ARMs can rise significantly over time." *What Is a Subprime Mortgage*, CONSUMER FINANCIAL PROTECTION BUREAU, https://www.consumerfinance.gov/ask-cfpb/what-is-a-subprime-mortgage-en-110/ (last updated Feb. 24, 2017).
[73] Dawinder S. Sidhu, *A Crisis of Confidence and Legal Theory: Why the Economic Downturn Should Help Signal the End of the Doctrine of Efficient Breach*, 24 GEO. J. LEGAL ETHICS 357, 372 (2011).
[74] *Id.* ("The government's interest in expanding home ownership and the people's interest in getting in on rising home values contributed to an increased demand for housing.") (footnote omitted).

terrorist attacks—furthered the attractiveness of desire for homeownership."[75] During the same time, the lenders began to accommodate less traditional borrowers, invariably reaching for those who were willing to enter into subprime loans: "While some prospective homeowners undoubtedly qualified for and bought mortgages at the prime rates, others seeking property but unable to obtain such prime mortgages were offered and took subprime mortgage contracts, generally defined as loans sold to riskier borrowers at higher interest rates."[76] The implications of such expansion through the subprime markets meant that more individuals could enter into homeownership, but the realities of this accessibility meant more risk as well:

> [M]ortgages were available to individuals who had poor credit and were more likely to default on a loan at rates that pushed mortgage payments at the margins of or beyond what the individuals could realistically afford. Subprime mortgage contracts requiring borrowers to put little or no money down were particularly alluring, but they only exacerbated the likelihood of default. Borrowers did not have to meet a threshold of financial wherewithal, and the borrowers' personal investment into the property was limited and thus minimally deterred borrowers from walking away. Subprime activity was lacking other safeguards, as well. For example, lenders approved subprime loans without looking into a borrower's income or assets.[77]

As Charles Murdock notes, "the mortgage market of 2003-2007 bore little relations to the pre-2000 market. The number of subprime loans jumped from 456,631 in 2000 to 2,284,420 in 2005."[78] The same went for Alt-A loans—loans that did not require customary documentation—which rose from 78,183 to

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[75] *Id.* (citing Chad D. Emerson, A Troubled House of Cards: Examining How the Housing and Economic Recovery Act of 2008 Fails to Resolve the Foreclosure Crisis, 61 OKLA L. REV. 561, 567 (2008)).

[76] *Id.* (citing Arthur E. Wilmarth, Jr., *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 CONN. L. REV. 963, 1016 (2009)).

[77] *Id.* at 372-73 (citing Kurt Eggert, The Great Collapse: How Securitization Caused the Subprime Meltdown, 41 CONN. L. REV. 1257, 1272 (2009); Lauren E. Willis, Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price, 65 MD. L. REV. 707, 779 (2006); Jacob Werrett, Achieving Meaningful Mortgage Reform, 42 CONN. L. REV. 319, 323-24 (2009); Daniel J. Morrissey, The Road Not Taken: Rethinking Securities Regulation and the Case for Federal Merit Review, 44 U. RICH. L. REV. 647, 666 (2009)) (footnotes omitted).

[78] Murdock, *supra* note 68, at 525 (citing U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-848R, CHARACTERISTICS AND PERFORMANCE OF NONPRIME MORTGAGES 24 (2009) [hereinafter CHARACTERISTICS AND PERFORMANCE]).

1,447,782 between the same five-year period.[79] Risky innovations in lending abounded; for example, in addition to subprime lending and Alt-A loans, there was the use of pick-a-pay loans—which let borrowers pick the amount to pay, often resulting in negative amortization.[80] And it was in this period that the adjustable-rate mortgages "supplanted the traditional thirty-year fixed-payment mortgage."[81] Beyond these new variations in mortgage contracts, "[o]ther innovations include low down payments, various forms of back loading the mortgage contract, and adjustable rate mortgages, such as the 2/28 mortgage. The 2/28 mortgage offered the borrower a low fixed-rate for two years and then floated with some short-term rate . . . plus a risk premium."[82] All of these types of loans provided access for borrowers to homeownership: "These somewhat exotic contract forms, along with the encouragement of government policy, enabled many individuals who were unable to obtain a standard qualified mortgage to obtain the financing necessary to buy a home."[83] But the externality for home-buying accessibility was an inevitable moral hazard as the extreme rise in lending came also with shoddy protections in the making of these loans: "Mortgage lenders stopped verifying the borrower's financial information."[84]

Various commentators have noted the opportunistic motivations behind lenders' decisions to alter the practices of mortgage contracting to allow for such risky behavior. In the rhetorical way that Sidhu summarizes the risks, any justification would seem ludicrous:

> Why would lenders extend mortgage contracts to individuals who were bad credit risks, where the loan terms rendered loan satisfaction a modest prospect, where the borrowers did not have

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[79] *Id.* (citing CHARACTERISTICS AND PERFORMANCE, *supra* note 78, at 24).

[80] *Id.* ("Other products, such as pick-a-pay loans, came into the market. A pick-a-pay loan permitted a borrower to choose the amount of the mortgage payment, which could be even less than the accruing interest, thereby creating a negative amortization situation."). Amortization is "[t]he act or result of gradually extinguishing a debt." BLACK'S LAW DICTIONARY, *supra* note 49, at 103.

[81] Murdock, *supra* note 68, at 525. Murdock also notes that when interest rates on such adjustable-rate loans reset, borrowers were often unable to pay at the higher rate. *Id.* More specific statistics are found in The Financial Crisis Inquiry Commission's 2011 report, which states

> [a]n adjustable-rate mortgage (ARM) gave buyers even lower initial payments or made a larger house affordable—unless interest rates rose. In 2001, just 4% of prime borrowers with new mortgages chose ARMs; in 2003, 10% did. In 2004, the proportion rose to 21%. Among subprime borrowers, already heavy users of ARMs, it rose from around 60% to 76%.

FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT 85 (2011) [hereinafter FINANCIAL CRISIS INQUIRY REPORT] (footnotes omitted).

[82] Krainer, *supra* note 67, at 21.

[83] *Id.*

[84] Murdock, *supra* note 68, at 525.

> to meaningfully demonstrate their financial soundness, and where the lenders themselves seemingly turned a blind eye to the financial condition of the borrowers?[85]

But while the housing market was expanding and the corresponding lending market was also swelling, the gains from the volume of loans—albeit extremely risky loans—were seemingly exorbitant; lenders profited from high fees from borrowers in these subprime loans and from selling these loans off to be created by financial firms as securities, thus displacing the risk from themselves to financial investors on Wall Street: "Profits for mortgage lenders and investment bankers increased dramatically, as did CEO compensation, sales and finder commissions, and bonuses."[86] Opportunity overtook caution: "Rating agencies sold their AAA ratings to the investment bankers, who compensated the rating agencies handsomely for their ratings. Volume, not quality, was the touchstone. Everybody was making money hand over fist. Financial professionals apparently expected the joyride to go on forever."[87] The intricacies of the investment products that derived from mortgage contracts and their use during the Great Recession are beyond the scope of this Article. However, their increased popularity during that time has a background influence—perhaps ultimately undue pressure—on the direction in which the innovations of mortgage contracts served the American home loan market and how they contributed to the eventual crisis.

During the housing boom, "[s]everal of these factories were originating, packaging, securitizing and selling at the rate of $1 billion a day."[88] As a result, "[t]he quality control process failed at a variety of stages during the manufacturing, distribution and on-going servicing."[89] Part of the lack of quality control was due to the shifting of risks from the original lender to financial firms that securitized mortgage loans and then pooled them for investment purposes.

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85 *See, e.g.*, Sidhu, *supra* note 73, at 373.

86 Murdock, *supra* note 68, at 525; *see also* Sidhu, *supra* note 73, at 373. To answer his rhetorical question, Sidhu states:

> [q]uite simply, lenders charged significant fees to borrowers for originating subprime loans and subsequently sold the mortgages to Wall Street, which in turn created securities backed by these loans. Lenders not only made money in selling the loans, but did so by passing the risks associated with the subprime mortgages to financial investors. In short, loan "[o]riginators were hardly bothered by this lack of creditworthiness because they were able to sell the loans they made to promoters who bundled them to back [securities] that were sold by Wall Street firms."

Id. (footnotes omitted).

87 Murdock, *supra* note 68, at 525.

88 *Id* (citing *Hearing Before the Fin. Crisis Inquiry Comm'n*, 111th Cong. 2 (2010) (testimony of Keith Johnson, Former Pres., Clayton Holdings, Inc. & Wash. Mut.'s Long Beach Mortg.).

89 *Id.*

Traditionally, the credit-worthiness of borrowers was a concern for lending institutions because faulty assessment of a borrower's condition could backfire subsequently down the line.[90] However, the transient pace of loans that were sold quickly to become securitized—loans that had shoddy requirements to begin with—displaced the need for traditional protections.[91] In fact, several commentators have noted the "arms-length" transactional nature of these mortgage contracts and how it undermined risk-bearing during this period by upholding the dispassionate business aspects of such transactions, rather than instilling fiduciary relationships or some association based on confidence and trust.[92]

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[90] *See* Christopher K. Odinet, *Banks, Break-in, and Bad Actors in Mortgage Foreclosure*, 83 U. Cin. L. Rev. 1155, 1164-65 (2015).

[91] *Id.* at 1165

> But, with the ability to sell the loan immediately after making it, this borrower protection, originally built into the system of lending, was completely eviscerated. A bank need not worry about the quality of the borrower since a subsequent default would be someone else's problem. This was especially true since in the early years of adjustable rate subprime loans the borrower was indeed able to make the monthly payments. It would not be until about two to three years into the loan, when the originator bank had long since sold the loan to a third party, that the rate would adjust and become too high for the borrower to make the debt service.

(footnotes omitted).

[92] *See id.*

> And to add yet another defective wheel to the cart, the mortgage servicer who was charged with dealing with the borrower—including addressing any issues that may arise if the borrower became behind on his payments— was financially incentivized by virtue of the servicing agreement to work in favor of neither the interest of the borrower nor the owner of the loan.

see also

> A substantial factor bolstering the subprime mortgage crisis stems from the intrinsic nature of lending. Lenders and borrowers typically engage in arms-length business transactions where each side strives to advance its own interests since the creditor-borrower relationship does not generally constitute a fiduciary relationship requiring lenders to safeguard the borrowers' interests. In fact, in the loan underwriting process, lenders generally have no duty to refrain from making a loan if they arguably should know that the borrowers cannot repay the loan. This is in large part because a mortgage loan is recognized as 'a business transaction where each party seeks its own economic interest, rather than a relationship of trust and confidence.' While a lender has 'no judicially imposed duty to ensure a [borrower's] ability to repay the loan, most lenders, prior to the subprime mortgage boom, refused to make a loan in which the borrower's ability to repay was doubtful.

Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 N.C. BANKING INST. 5, 15-16 (2009) (quoting Frank A. Hirsch, Jr., *The Evolution of a Suitability Standard in the Mortgage Lending Industry: The Subprime Meltdown Fuels the Fire of Change*, 12 N.C. BANKING INST. 21, 22 (2008) (footnotes omitted).

Eventually, of course, the opportunistic use of mortgage contract innovations caught up with the realities of a housing market bolstered by unscrupulous lending practices of the financial institutions, irresponsible purchases, and the financing of homes by borrowers who could not keep up with the repayment terms they had bargained for.[93] The artificial rise in home prices fueled by the volume of demand and purchases overextended homebuyers when interest rates increased and prices of homes started to fall in 2006 and 2007, and many subprime borrowers could not refinance their loans.[94] The result was obviously harsh and catastrophic. The inherent weakness of innovations in mortgage contracts become apparent when their once-attractive terms and features—for instance, adjustable-rate mortgages—now proceeded to function with the hike in interest rates and the depreciation of home equity in falling housing prices. In addition, the execution of such financial innovations began to prove harmful as well: "When housing price appreciation began to slow, the consequences of weak underwriting, including little or no documentation and zero or minimal required payments, became obvious. Some homeowners unable to refinance began to default as their mortgage loans reset to high interest rates and payments or the amount of the loan exceeded the new lower market value of the home."[95] Just as lending had been voluminous, so was the threat of default: "Because [subprime borrowers] could not continue to enjoy their relatively low monthly payments, and because they could not sustain these now adjusted and much higher debt obligations, they defaulted *en masse*."[96] Of course, the recourse by those who had standing to enforce these loans was to foreclose on the unrecoverable debts: "In turn, banks—or, rather, their mortgage servicers—began to foreclose on these defaulted properties across the United States."[97] From here, what was sustained was not the innovative nature of contract drafting but the

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[93] *Id.* at 16 ("The events leading us to this point began many years ago, starting with lax and imprudent lending practices by banks and financial institutions, and furthered by borrowers buying houses they could not afford and taking out mortgages they could not pay.") (footnotes omitted).

[94] *See id.* at 17-18 ("One unfortunate consequence of the inflation of the housing market was that mortgage brokers came to view their loans as well-secured by the rising values of their real estate collateral and, therefore, failed to focus sufficiently on borrowers' ability to repay. Millions of homeowners took advantage of the interest rate drops to refinance their existing mortgages, but once interest rates began to rise and housing prices started to drop moderately in many parts of the United States in late 2006 and early 2007, refinancing became more difficult.") (footnotes omitted); *see also* Odinet, *supra* note 90, at 1165 ("This defective system, underpinned by greed and buttressed by artificial home prices, finally came crashing down beginning in 2006. As property values decreased, subprime borrowers, who up until now believed they could refinance their debt before the adjustable interest rates spiked, found themselves unable to do so.") (footnote omitted).

[95] Moran, *supra* note 7, at 18.

[96] Odinet, *supra* note 90, at 1165-66.

[97] *Id.*

harsh bite of the contract enforcement as financial institutions dealt with massive incidences of borrower breach.

C. Defaults and Foreclosures

Several possibilities generally exist that cause borrowers to default on their mortgage contracts. As Gerald Korngold has summarized, the specific reasons common among defaults during the financial crisis were the risk-heavy uses of the innovative lending contracts and practices that contributed to the rise of the housing market in the first place:

> Then came the mid-2000s when borrowers began defaulting on mortgage loans. This occurred for a variety of reasons: many of the latest borrowers were financially unsound and were soon unable to make the payments; low initial teaser rates of interest (offered by the banks on variable rate mortgages to attract borrowers) expired and were reset at higher rates; and the real estate market plateaued or even declined, so borrowers could not refinance their way out of trouble. Lenders began foreclosing, and properties did not sell well—or eventually at all—in the depressed and saturated market.[98]

Falling home prices contributed to situations in which many mortgages in the U.S. became "underwater," meaning the amount homeowners owed on their loans exceeded the value of their homes.[99] As cited by Brent White, toward the end of the Great Recession in 2009, "more than 34% of all mortgaged properties in the United States were 'underwater.' "[100] White's 2010 research lists stunning statistics of substantial and widespread percentages of mortgages in different regions around the country that exhibited negative equity.[101] These underwater

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[98] Gerald Korngold, *Legal and Policy Choices in the Aftermath of the Subprime and Mortgage Financing Crisis*, 60 S.C. L. REV. 727, 730-31 (2009) (citing Gretchen Morgenson, *Can These Mortgages Be Saved?*, N.Y. TIMES (Sept. 30, 2007), http://www.nytimes.com/2007/09/30/business/30country.html; Issue Brief, Ctr. for Responsible Lending, *CRA Is Not to Blame for the Mortgage Meltdown*, CTR. FOR RESPONSIBLE LENDING (Oct. 3, 2008), http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/cra-not-to-blame-for-crisis.pdf; Anthony Lendez & David Hille, *Is There a Legal Defense to the Mortgage Mess?: Litigation Arising from the Subprime Market Collapse Will Hinge on Lenders' Good Faith*, NAT'L L.J. (Apr. 21, 2008), at S1, S7).

[99] *See, e.g.*, Brent T. White, *Underwater and Not Walking Away: Shame, Fear, and the Social Management of the Housing Crisis*, 45 WAKE FOREST L. REV. 971 (2010) (defining "underwater" as "meaning that [borrowers] owe more than their homes are worth") (footnote omitted).

[100] *Id.* at 973 (citing Media Alert, First Am. CoreLogic, *First American CoreLogic Releases Q3 Negative Equity Data* (Nov. 24, 2009), http://www.loanperformance.com/infocenter/library/FACL_Negative_Equity_Media_Alert_Q3_ 112409_Final.pdf.)

[101] *See id.* at 973-79.

statistics—though at the tail-end of the Great Recession—seem to corroborate that the conditions for defaulting subprime borrowers, when refinancing was not available and continuing payment was improbable, were evident and ongoing. In March 2008, just a year prior to White's research, during the midst of the Great Recession, defaults on home mortgage contracts reached an apex—to a percentage that surpassed the percentages in 1979—because of the difficulties associated with adjustable-rate mortgages and partly with the subprime lending market.[102] In fact, of the defaults reported in this apex, the highest percentages of defaults were with adjustable-rate mortgages.[103] Even defaults in prime adjustable-rate mortgages increased dramatically—nearly doubling from 4.3 percent in 2006 to 8.1 percent.[104]

Contractually, the event of a mortgage default (i.e., breach) by a borrower triggers the enforcement rights by the lender.[105] In the typical default situation, several legal events may occur prior to foreclosure. A borrower may have the ability to cure the default and reinstate the mortgage within a short period of time;[106] the borrower's rights may be accelerated by the lender/mortgagee if default is not cured in the stipulated time frame;[107] additional opportunity may be given to cure default after acceleration;[108] and the prepayment clauses in the mortgage contract may be enforced.[109] If the borrower is unable to comply with the terms of the acceleration, her property interest is foreclosed.[110] Historically, there was one more resolution available to the defaulting borrower after foreclosure proceedings had begun: *equity of redemption*. Equity of redemption allowed equity courts to permit a defaulting borrower another opportunity to cure and redeem property interest from foreclosure within a period after the stipulated time so long as the borrower made the mortgagee whole, which allowed many foreclosure transactions to be set aside.[111] Modern foreclosure procedures, however, try to extinguish the borrower's equity of redemption after default and acceleration.[112] Partly because equity of redemption reflected the traditional

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[102] Vikas Bajaj, *Mortgage Defaults Reach a New High*, N.Y. TIMES (Mar. 6, 2008), http://www.nytimes.com/2008/03/06/business/06cnd-mortgage.html (citing report from the Mortgage Bankers Association during that time).
[103] *Id.*
[104] *Id.*
[105] JOHNSON, *supra* note 36, at 219-20.
[106] *Id.* at 220.
[107] *Id.*
[108] *Id.*
[109] *Id.*
[110] *Id.* at 221.
[111] *Id.* at 222.
[112] *Id.* at 223; *see also* Jesse G. Reyes, *The Swinging Pendulum of Equity: How History and Custom Shaped the Development of the Receivership Statute in Illinois*, 44 LOY. U. CHI. L.J. 1019, 1040 (2013) ("When a mortgagor becomes delinquent on the mortgage, one factor that affects the timeframe during which the mortgagee can foreclose is the redemption right.") (footnote omitted).

significance of equity within the realm of mortgages[113] and afforded borrowers "a measure of substantive fairness" when the mortgage contracts were enforced.[114] We can surmise this from historical reference because, absent the force of equity, mortgages had been historically—at least in England—enforced more strictly:

> Prior to the advent of Chancery, the courts of law stringently enforced the mortgage as it was written. In the event the mortgagor failed to satisfy the debt on the precise date and for the exact amount as set forth in the mortgage agreement, the mortgagee became the unconditional owner of the land.[115]

Accordingly, before the availability of foreclosure, "[i]n the event of a default, the mortgagor would irrevocably forfeit the land to the mortgagee. This rule was absolute; Thus, time was of the essence."[116]

In mortgage contracts, the specter of American contract law and its underscoring of freedom of contracting principles have resulted in strict enforcement of defaults.[117] As described by Nestor Davidson, "[f]rom the earliest history of mortgage law, lenders have had a tendency to invoke the hard edges of law's formal clarity[.]"[118] But defaulting borrowers would seek out tractability by "invok[ing] equity's flexibility to respond to the resulting unfairness."[119] Modern evolutions of American mortgage law limited some of equity's reach in foreclosure proceedings.[120] While financial and contractual innovations facilitated the housing boom of the 2000s and imparted flexibility on the market for both lenders and borrowers at the formation stage of mortgage contracts, that spirit of flexibility was absent when it came time to enforce delinquent mortgages during the financial crisis: "Today, lenders continue to have the arsenal of formalism at their grasp—setting and enforcing the terms of payment deadlines, filing requirements, servicing-related obligations (such as insurance), and other

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[113] *See* Reyes, *supra* note 112, at 1035-40. (providing a historical account of the equity of redemption from its origins in England to the United States.)

[114] Nestor M. Davidson, New Formalism in the Aftermath of the Housing Crisis, 93 B.U.L. REV. 389, 392 (2013).

[115] Reyes, *supra* note 112, at 1036.

[116] *Id.*

[117] Michael Giusto, *Mortgage Foreclosure for Secondary Breaches: A Practitioner's Guide to Defining "Security Impairment,"* 26 CARDOZO L. REV. 2563, 2572–74 (2005) ("The traditional power of the freedom of contract concept has been invoked in the context of mortgage foreclosures.") (discussing Graf v. Hope Building Corp., 171 N.E. 884 (N.Y. 1930), where "the New York Court of Appeals its support of freedom of contract in mortgage agreements, ordering strict enforcement of a debt acceleration provision for a failure to make a timely interest payment").

[118] Davidson, *supra* note 114, at 392.

[119] *Id.*

[120] JOHNSON, *supra* note 36, at 223.

requirements that reflect the approach of early lenders to law day."[121] Conversely, "[b]orrowers, prior to the housing crisis and since, continue to counter by invoking questions of fraud, usury, and similar substantive claims about the terms or conditions of lending, despite the rarity of decisions that validate these claims."[122] In the context of possible evolving property jurisprudence after the Great Recession, Davidson suggests that such strict adherence to mortgage agreements stemming from the Great Recession signals a new formalism in property law—specifically a formalism that "may leave a mortgage-distress system that is more attuned to procedural regularity than to substantive norms."[123] Of course, scholarly views about the interactions between procedural and substantive functions also have been made about contract law, with procedure often having a heavier emphasis.[124] Such observations also bring to mind H.L.A Hart's classification of contract law as occupying his category of secondary rules, rather than primary rules within his conception of law.[125] On the whole, procedural regularity is part of the classical theoretical interpretation of contracts: "Under the classical revival, formality reigns at two levels. First, the contract doctrine itself becomes more formal; ostensibly clear, rigid rules are favored over flexible standards. Second, the substance of the rules favors formality in contracting practices."[126] Translating that theoretical consideration to practice, some have noted that the job that courts frequently perform while enforcing contractual bargains is merely to "ensure procedural fair play, but nothing more."[127] Again, this position by courts reflects contract as a system or body of

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[121] Davidson, *supra* note 114, at 418.
[122] *Id.*
[123] *Id.* at 430.
[124] *See* Judith Resnik, *Procedure as Contract*, 80 NOTRE DAME L. REV. 593, 599 (2005) ("A good deal of the contemporary doctrine on Contract Procedure assumes the wholesale application of extant principles of contract law.").
[125] *See generally* H.L.A. HART, THE CONCEPT OF LAW 79-99 (1st ed. 1961); *see also* Mark Edwin Burge, *Too Clever by Half: Reflections on Perception, Legitimacy, and Choice of Law Under Revised Article 1 of the Uniform Commercial Code*, 6 WM. & MARY BUS. L. REV. 357, 393 (2015) ("Hart raised a dichotomy that is useful for present purposes: the separation of law into categories of primary rules and secondary rules. Primary rules are those that govern conduct by creating obligation to engage in or refrain from particular acts, such as the rules of criminal law and tort law. All other legal rules, in Hart's conception, are secondary rules. While secondary rules include matters of legal procedure—such as the process by which a legal rule comes to be recognized as valid law—secondary rules also include matters of private ordering and obligation, a category that includes the law of contracts.") (footnotes omitted) (citing H.L.A. HART, THE CONCEPT OF LAW 79-99 (1st ed. 1961)).
[126] Jay M. Feinman, *Un-Making Law: The Classical Revival in the Common Law*, 28 SEATTLE U. L. REV. 1, 16 (2004) [hereinafter Feinman, *Un-Making Law*].
[127] Clare Dalton, *An Essay in the Deconstruction of Contract Law*, 94 YALE L.J. 997, 1041 (1985)); Danielle Kie Hart, *Contract Formation and the Entrenchment of Power*, 41 LOY. U. CHI. L.J. 175, 186 (2009) (citing American Legal Realism 99 (William W. Fisher III, Morton J. Horwitz

law that predominantly serves to order the obligations and promises of contracting parties into their own privately created and enforceable laws.[128]

Davidson's idea of a kind of formalism being enforced during the 2008 housing crisis is shared by other scholars—not in property law particularly, but rather in the practical operations of contract doctrines during the crisis.[129] Such inclinations toward formalism during this time might have been, in part, due to the ongoing "revival" of formalism in contract law that had already been underway in scholarship and practice.[130] For instance, to underscore the same inflexibility during the enforcement of mortgage defaults in the Great Recession, Cohen specifically notes that "[d]iscussions on the crisis tend to say little about contract law, because they simply assume that the contracts at issue should and will be strictly enforced; given that assumption, there is not much more to say."[131] The underlying assumption in his observations is that "[t]he new formalism, apparently ascendant in the academy, already seems to have prevailed in the public realm despite the greatest economic catastrophe we have seen since the Great Depression."[132]

However, Cohen also posits that within the reality of defaults and foreclosures in the Great Recession, inflexibility and rigidity did not necessarily have to ascend to prominence—at least in the ultimate resort to contract law and doctrine. In his view, certain potentials of contract law have been ignored or "ha[d] just been forgotten."[133] To elaborate, he explains that "more precisely, contract law includes a number of *flexible* doctrines that lawyers and courts with sufficient imagination and boldness could use to address what is perhaps the biggest current problem resulting from the financial crisis: the huge number of past, existing, and potential foreclosures of underwater residential mortgages."[134] Cohen believes that "[a] cramped view of the contract doctrine" led to some

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& Thomas A. Reed eds. 1993); P. S. Atiyah, The Rise and Fall of Freedom of Contract 404 (1979); Feinman, *Un-Making Law*, *supra* note 126, at 111.

[128] Hart, *supra* note 127, at 185-86 (quoting Jay M. Feinman, *Critical Approaches to Contract Law*, 30 UCLA L. REV. 829, 831 (1983) (summarizing the way classicists approached contract law as empowering private parties to freely enter into agreements and contractual relations with little state regulations on substantive matters of those relations, to construct a set of private laws through such agreements as a result, which regulates contract law as a " 'field of private ordering' ").

[129] *See, e.g.*, Priya S. Gupta, *The American Dream, Deferred: Contextualizing Property after the Foreclosure Crisis*, 73 MD. L. REV. 523, 548 (2014) (discussing how the formalism of contract law limited rights of certain borrowers facing foreclosure) ("[N]ow that homeowners could be thought of as irresponsible investors and poor contract negotiators, their rights to their homes (investments) could be limited by the sanctity of contract with their banks. . . .").

[130] *See generally* Feinman, *Un-Making Law*, *supra* note 126.

[131] Cohen, *supra* note 29, at 3.

[132] *Id.*

[133] *Id.*

[134] *Id.* (emphasis added).

unpromising legislation solutions during the crisis,[135] and his assertion of possible flexibility sounds very much like Cohen is resorting to innovation on the back-end of contracts, when contractual relations go awry. Although Cohen cautions that "[c]ontract law is no panacea,"[136] he also proposes that "[c]ourt application and enforcement of contract law in individual mortgage cases, or perhaps even class actions, is probably not the best solution to the problem of mass foreclosures, *though it may well be better than what we have tried so far*."[137] Indeed, in his prediction, "cases arising out of the crisis and making their way through the court system are likely to test the assumption of strict contractual enforcement" and, on the whole, these cases might acknowledge that "the flexibility of contract law may foster a greater willingness to consider creative legislative solutions" as well.[138]

Of the flexibilities of contract law that Cohen sees as potentially helpful to defaulting borrowers, he specifically offers two categories: contract modification and doctrines that encompass excuse through changed circumstances, both of which could have been available absent a narrower approach to contract law.[139] The doctrines themselves are not necessarily new innovations to American contract law, and that is not Cohen's claim for innovation.[140] Rather, the innovation under Cohen's proposal is a broader approach to contract law that permits the use of such doctrines that otherwise would have been precluded under a stricter application of contract law.[141] Interestingly, Cohen does not expressly tether his argument for recalibrating the approach to contract law to some equitable principle or doctrine that would allow for the access to such flexibility—such as excuse or other contract doctrines that historically have roots in equity.[142] Instead, he justifies a broader application of contracts through the changes in risk-bearing that were made available because of the financial innovations at the outset of home purchases that eventually resulted

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135 *Id.*

136 *Id.*

137 *Id.* at 3-4 (emphasis added).

138 *Id.* at 4.

139 *See id.* (noting two themes: "interference with efficient contractual modification," as the first, and "exacerbation of and failure to protect contractual risk, implicat[ing] the excuse doctrines," as the second—that would be helpful in addressing solutions).

140 *Id.* at 3 (noting that contract law has existing "flexible doctrines" that are of use to practitioners and judges "with sufficient imagination and boldness" for solving the vast number of underwater foreclosures).

141 *See id.* at 4 (noting that "[a] cramped view of contract doctrine" may have affected some of the problem-solving regarding foreclosures during the financial crisis and that "recognizing the flexibility of contract law" may lead to helpful solutions); *see also id.* (noting that "the financial crisis raises novel, important, and interesting questions for contract law that scholars ought to be thinking about and debating" and introducing contract modifications and excuse doctrines as subject matters within contracts for such discussion).

142 *Id.*

in the housing crisis.[143] Essentially, the changes in risks demand an application of contracts that expand traditional, stricter notions of contract doctrines.[144] For instance, when he explains how excuse doctrines could be available, he observes that the conventional regard for contract law as "a strict liability system" has sustained a restraint on the use of excuse doctrines particularly in loan agreements, which is why arguments for excuse doctrines were not prevalent during the Great Recession.[145] Nevertheless, Cohen proposes, "if the purpose of excuse doctrines is to allocate unforeseen risks efficiently when courts have good reason to doubt that the parties have done so themselves, allowing excuse for underwater homeowners seems to fit this purpose quite well."[146] Changes in risk-bearing as a justification for permitting the use of contractual excuse seems to suggest that Cohen is advocating his flexible approach to contracts through efficiency and correcting the misallocation of risks. However, it seems as if equitable principles of fairness are lurking not far beneath the foundations of his argument when he further explains the root causes of misallocation of risks:

> Lenders engaged in conduct that they erroneously thought was reducing risk, when in fact it was exacerbating risk to themselves, to investors, and to homeowners. In effect, lenders succumbed to a classic moral hazard problem, similar to drivers who respond to mandatory seat belt laws, designed to reduce accident risk, by driving faster, thereby increasing accident risk. Thus lenders are most likely the superior risk bearers. If contract law is truly at odds with that conclusion, it would be surprising, or at least raise an interesting problem. But is it?[147]

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143 *See id.* at 10-19 (explaining his method of reaching his solutions, first beginning with "an examination of how financial wizardry changed the relevant risks").

144 *See id.* at 4 (noting in his thesis that the "broad and interrelated themes" of modification and excuse doctrines "aris[e] out of these changes" and that his research will later show "how these themes might play out under a variety of contract doctrines").

145 *See id.* at 46 ("It is easy to see why no one has tried to make this argument. Contract law has traditionally been understood as a strict liability system, with the availability of excuse severely restricted. Perhaps in no area are these principles more strictly followed than in debt (loan) and other financial contracts. Even the Great Depression did not lead courts to apply excuse doctrines to relieve contracting parties, including mortgage borrowers.") (citing RESTATEMENT (SECOND) OF CONTRACTS ch. 11, intro. note.; George M. Cohen, *The Fault That Lies Within Our Contract Law*, 107 MICH. L. REV. 1445 (2009); RICHARD E. SPEIDEL, CONTRACTS IN CRISES: EXCUSE DOCTRINE AND RETROSPECTIVE GOVERNMENT ACTS 102-03 (2007)).

146 Cohen, *supra* note 29, at 46.

147 *Id.* at 46-47 (citing Sam Peltzman, *The Effects of Automobile Safety Regulation*, 83 J. POL. ECON. 677 (1975); Richard A. Posner & Andrew M. Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83, 90 (1977); Miller, *supra* note 35, at 39 n.61, 42).

Although, for the most part, Cohen sustains his arguments based on efficient risk allocation—and thereby, situating his renovation for contracts on a law and economics sentiment—he does introduce a twinge of culpability, not always to the level of moral blameworthiness, but enough to take his reasoning beyond a pure mathematical, efficiency-based sense of justice:

> There is no question that subprime lenders could have taken a number of steps to reduce the risk that a large number of homeowners would find themselves underwater in their mortgages and unable to obtain a modification of those mortgages even if the benefits of those modifications exceeded their costs. *They could have maintained, rather than lowered, credit standards. They could have required larger down payments, rather than allowed smaller down payments. They could have been more skeptical in questioning the assumptions underlying their pricing models or in relying on the ratings of agencies. They could have structured securitizations to facilitate efficient modifications.*[148]

In his risk-allocation assessment, Cohen's comparison between the actual conduct of lenders to what they "could have" done seems to draw in a small hint of moral culpability or at least fairness, which partly aligns with how equitable principles are conventionally invoked. In the commentary about the Great Recession, Cohen does not appear as the lone voice in contracts scholarship suggesting doctrinal flexibility to help address the massive crumbling of home loans because of defaults. Some, like Cohen, urge the application of excuse doctrines, such as mistake, frustration of purpose, and impracticability. An increasing number of scholarly claims and recommendations like Cohen's have formed a small consensus that favors broadening the formalistic approach to contracts. Also, often in these concurring accounts, equity in mortgage contracts makes a comeback—not by revisiting doctrines of redemption—but specifically through contract law itself via excuse doctrines that had originated with the encroachment of equity in common law contract liability. Perhaps underlying these scholarly observations promoting flexibility and innovation, a bigger commentary exists over the force of contract law under a wholesale adherence to formalism. According to Miller, the inflexibility of contract law during the enforcement phase of mortgage defaults, in part, creates a "double standard" regarding the contract law's treatment of lenders and individual homeowners, and also "points to how the futility of a unifying theory of contract doctrine leads to law's pragmatism."[149] In her observations about formalism, in the context of strategic

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[148] Cohen, *supra* note 29, at 61-62 (emphasis added).
[149] Miller, *supra* note 35, at 41-42.

defaults during the Great Recession, Miller notes how such pragmatic renovations to approaching contract law would "potentially lead to [contract law's] very incoherence" as far as a theoretical reading of contract law within formalism.[150] After all, contract law has been historically recapitulated by the Latin phrase "*pacta sunda servanda,*" and that strict adherence has, in part, permitted the flourishing of law and economics, morality, and freedom of contract readings of contract law and doctrines. But perhaps redemption's erosion under a modern contracts regime is just the re-emergence of an apparent imbalance in default situations that requires mortgage contracts—ancient and modern—to embrace equity and flexibility to some degree. And pragmatism in contracts potentially leads us back to that equilibrium. Otherwise, a "double standard" will continue to perpetuate. However, such pragmatism must be specified and must avoid the usual distinctions of status-based differences of parties in ways that permit flexibility for some and not others.

Part III will examine specifically how this situation was made possible within a failed pragmatic approach through the use of changed circumstances and impracticability during the Great Recession. Although flexibility was possible in contract enforcement, it was denied to defaulting homeowners. Such a denial not only demonstrates the theoretical potential of contract law to be less formalistic and more forgiving, but also demonstrates how allowing some parties access to flexibility and not others easily engenders inequality on a cumulative scale. As the next part will show, even pragmatic considerations that allow flexibility in contracts can be abused. Flexibility is possible, but in the present application it is limited in a way that allows contracts to replicate inequality.

III. IMPRACTICABILITY AS FLEXIBILITY

A. History of the Impracticability Doctrine

Impracticability has its origins in building flexibility into contracts enforcement. At common law, the canonical cases in the development of the impossibility doctrine, and later, impracticability, did not emerge to excuse parties from liability until the mid-nineteenth century.[151] So, impracticability, like its sibling doctrines rooted in changed circumstances, is a relatively recent

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[150] *Id.* at 42.

[151] *See, e.g.*, Taylor v. Caldwell, (1863) 122 Eng. Rep. 309, 312 (Q.B.) 312 (excusing lessor's duty to lease his theater to tenants for concert performances after the theater burned down because "from the nature of the contract, it appears that the parties must from the beginning have known that [the contract] could not be fulfilled unless when the time for the fulfillment of the contract arrived some particular specified thing continued to exist, so that, when entering into the contract, they must have contemplated such continuing existence as the foundation of what was to be done").

addition to the longstanding rules of common law contract enforcement—rules that were, more or less, rigid in adherence toward liability for breach.[152]

Prior to the first reported impossibility case, *Taylor v. Caldwell*,[153] the doctrinal conceit in common law contracts was that, generally, few escape provisions existed for the unforeseen rise of an event that would affect the agreement in some way.[154] Recapitulated in the maxim "*pacta sunt servanda*" (that virtually, "agreements must be kept"[155]), the idea of absolute liability trumped any notion of how changes in circumstances could affect agreements.[156] The concept of absolute liability stood regardless of whether it made one party's performance untenable or disturbed the purpose of the agreement on the whole.[157] The unfairness of that situation in practice seemed to have been subordinated for the benefit of injecting predictability into agreed-upon contractual duties.[158]

But despite that stringent nature of absolute liability in contract enforcement, earlier common law courts did recognize certain situations where excuse was warranted. For instance, courts recognized situations where the promisor of a personal services contract subsequently died after the agreement was made, the operation of law interfered with performance, or the goods or the

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152 *See, e.g.*, Paradine v. Jane (1647) 82 Eng. Rep. 897, 898 (K.B.) 898 (observing that even where duties under a lease were breached by tenant because a war displaced the tenant off the premises, the tenant was liable because "when the party by his own contract creates a duty or charge upon himself, he is bound to make it good, if he may, notwithstanding any accident by inevitable necessity, because he might have provided against it by his contract").

153 Taylor, 122 Eng. Rep. at 309. Amongst scholars, Taylor v. Caldwell is known as the first case involving the impossibility defense. *See, e.g.*, Nancy Kim, *Mistakes, Changed Circumstances and Intent*, 56 U. KAN. L. REV. 473, 504 (2008) ("Taylor v. Caldwell []which has been recognized as the first case involving impossibility as a defense . . . .").

154 *See* JOHN EDWARD MURRAY, JR., MURRAY ON CONTRACTS § 113 (5th ed. 2011) [hereinafter MURRAY ON CONTRACTS] ("It is generally said that the early law of England, which was inclined to enforce a contract in accordance with its literal terms in all cases, took the uncompromising stand that neither impossibility, nor any change in circumstances, however extreme, would excuse performance of a promise.").

155 *Pacta sunt servanda*, BLACK'S LAW DICTIONARY 1109 (10th ed. 2014).

156 *See* MURRAY ON CONTRACTS, *supra* note 154, at § 113 ("To hold a promisor to the literal terms of his bargain is frequently to impose a burden upon him which neither he nor the promise had considered as a possibility.").

157 Aaron J. Wright, Note, *Rendered Impracticable: Behavioral Economics and the Impracticability Doctrine*, 26 CARDOZO L. REV. 2183, 2187 (2005) ("Embedded in early English common law was the rigid principle of *pacta sunt servanda*, which absolutely bound parties to contractual obligations. English courts generally refused to allow for excuse even when performance became impossible or frustrated by an unanticipated supervening event.") (footnotes omitted).

158 *See* MURRAY ON CONTRACTS, *supra* note 154, at § 113 ("While such a view promotes certainty and ease of application, it ignores the fact that human beings are of limited foresight."); *see also* JEFF FERRIELL, 13 UNDERSTANDING CONTRACTS § 13.03 (2d ed. 2010) (noting that cases that upheld absolute liability, such as *Paradine*, 82 Eng. Rep. at 897, "had the advantage of making the obligations of contracts reliable").

subject matter were destroyed and such destruction was not the promisor's fault.[159] Most of these exceptions to the general rule of absolute liability could be read as "supervening" events that permit a breaching party to be free from customary contractual liability.[160] Correspondingly, the use of supervening events suggests that courts allowed value judgments based on perceptions of fairness in adjudicating performance and breach disputes. Indeed, John Murray notes that when determining whether any of the three supervening exceptions applied to a case, "the tendency was to view the door closed, regardless of the hardship resulting to the promisor, *with only the most compelling, isolated exceptions*."[161] "[C]ompelling, isolated exceptions" implies that courts had discretion in contracts cases—a modicum of discretion that existed even if "[t]he challenge was to determine the limited exceptions to the otherwise firm general rule that performance is not excused, and the scope of these exceptions."[162] Likewise, there is almost a twinge of equity that informs the flexibility of courts determining supervening events in each of these exceptions. We can see a parallel of this implication later in the impracticability doctrine itself, "[w]here supervening events made performance excessively costly, the abhorrence of *forfeiture* induced courts to consider whether performance should be excused even though it was literally possible to perform."[163] Equity, incidentally, also abhors forfeiture[164] Therefore, it is likely that the three exceptions to absolute liability for contract breach was already destabilizing the harsh rule of *pacta sunt servanda*, long before the era where they influenced larger doctrinal changes. Ultimately, these exceptions based on supervening events were fissures in the wall of absolute contract liability that would gradually widen the scope of those exceptions into the modern concept of excuse.

The broadening of that scope occurred within situations involving supervening destruction of the contracts' subject matters. In 1863, *Taylor v. Caldwell* provided an exception that was doctrinally expanded to establish

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[159] MURRAY ON CONTRACTS, *supra* note 154, at § 113. Some scholarly resources report that courts saw a broader exception for destruction, not just limiting it to goods, but also to the subject matter of the deal. *See also* E. ALLAN FARNSWORTH, CONTRACTS § 9.5 (4th ed. 2004) [hereinafter FARNSWORTH, CONTRACTS].

[160] *See* FARNSWORTH, CONTRACTS, *supra* note 159, at § 9.5 (listing the three exceptions as "supervening illegality," "supervening death or disability," or "supervening destruction").

[161] *Accord* MURRAY ON CONTRACTS, *supra* note 154, at § 113[A] (emphasis added).

[162] *Id.*

[163] *Id.* at § 113[2].

[164] *See* 30A C.J.S. Equity § 69 ("Equity abhors forfeitures and will relieve against their enforcement where it is equitable to do so and there is no complete and adequate remedy at law.") (footnotes omitted) (citing cases).

impossibility as an excuse.[165] The case involved a four day lease of a music hall to exhibit a performance in exchange for payment of £100 at the end of each day.[166] But shortly before the first performance day, the music hall accidentally burned down.[167] The plaintiff, Taylor, then sued the owner of the music hall, Caldwell, for breach of contract, and sought damages for the expenses he put forth in preparation for the performances.[168] The court decided that Caldwell's duty to provide the music hall to Taylor was excused because "the parties contracted on the basis of the continued existence of the Music Hall at the time when the concerts were to be given; that being essential to their performance."[169] What was once a small exceptional crack to the otherwise fortressed wall of absolute liability became a larger fissure for those seeking excuse from contract breach. Specifically, the court's consideration here that the parties "must have contemplated"—or taken for granted—the ensuing existence of the music hall as a basic part of their contract seemed to be a paternalistic belief or discretion that the court had to exhibit in order to reach their decision.[170] It is this unusual level of speculation that prompts scholarly criticism of *Taylor* to call what the Court of Queen's Bench did here a "legal fiction."[171] But in terms of fairness, it likely would not have been fair and just to keep Caldwell on the hook for the contract when, through no fault of his own, he could no longer have physically performed his part of the deal. Perhaps the court was innovating flexibility in contracts based on practical realities of these parties' agreement with each other from some quasi-equitable perspective.[172]

The rationale in *Taylor* depended on the court's reading of an implied condition into the agreement; that the performance was contingent on the

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[165] FARNSWORTH, CONTRACTS, *supra* note 159, at § 113; *see also* MURRAY ON CONTRACTS, *supra* note 154, at § 113[A][1] ("The modern doctrine of impossibility of performance emerged from the case of Taylor v. Caldwell in 1863.") (footnote omitted).
[166] *Taylor*, 122 Eng. Rep. at 310.
[167] *Id.*
[168] *Id.*
[169] *Id.* at 314.
[170] *Id.* at 312.
[171] *See, e.g.*, Kevin M. Teeven, *Decline of Freedom of Contract Since the Emergence of the Modern Business Corporation*, 37 ST. LOUIS U. L.J. 117, 161 (1992) (noting that the Queen's bench "brought the civilian contemplation of the parties into Taylor v. Caldwell through the invention of the fiction of an implied condition").
[172] *Accord* Saul Litvinoff, *Force Majeure, Failure of Cause and Theorie De L'imprevision: Louisiana Law and Beyond*, 46 LA. L. REV. 1, 9-10 (1985) (noting that over the course of common law traditions in contract law, "*pacta sunt servanda* became such a strong principle that, at least in the common law legal world, courts were prepared to consider the obligations created by a contract as still standing despite the fact that their performance was physically impossible. It is clear that such a perception of a contract is too narrow and, since the decision in Taylor v. Caldwell, with varying results, English courts began recognizing the need to broaden that perception for the sake of fairness.") (footnote omitted).

continued existence of the venue.[173] Once the music hall burned down, the implied condition no longer existed and duties to perform were extinguished.[174] Although the court here observed that the parties made the deal based on some belief that the premises would continue to exist in order for performance to be fulfilled, the court was not deeming such contemplation to be an express part of their mutual assent. Instead, the court resorted to a general assumption that the parties would have made continued existence of the music hall an explicit condition had they "brought it to their minds."[175] Thus, they must have implied this condition when they executed their agreement. This reading of the circumstance was the beginning of a new principle. As Murray observes:

> [t]he court's analysis augured the modern formulation for the impossibility doctrine. Such a concept appeared radical in 1863. It is not remarkable that the court resorted to the fiction of an *implied condition*. A so-called implied-in-fact condition would suggest that the contract contains an unstated condition intended by the parties. . . . [H]owever, the court constructed a condition

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[173] *See Taylor*, 122 Eng. Rep. at 312 (discussing that "where, from the nature of the contract, it appears that the parties must from the beginning have known that it could not be fulfilled unless when the time for the fulfilment of the contract arrived some particular specified thing continued to exist, so that, when entering into the contract, they must have contemplated such continuing existence as the foundation of what was to be done; there, in the absence of any express or implied warranty that the thing shall exist, the contract is not to be construed as a positive contract, but as subject to an implied condition that the parties shall be excused in case, before breach, performance becomes impossible from the perishing of the thing without default of the contractor").

[174] *See id.* at 314 ("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 the performance.").

[175] *See id.* The Queen's Bench articulated the rule below:

> In none of these cases is the promise in words other than positive, nor is there any express stipulation that the destruction of the person or thing shall excuse the performance; but that excuse is by law implied, because from the nature of the contract it is apparent that the parties contracted on the basis of the continued existence of the particular person or chattel. In the present case, looking at the whole contract, we find that the parties contracted on the basis of the continued existence of the Music Hall at the time when the contracts were to be given; that being essential to their performance.
>
> We think, therefore, that the Music Hall having ceased to exist, without fault of either party, both parties are excused . . . .

Id. at 314-15.

> "implied-in-law" condition, to arrive at a result it deemed desirable on policy grounds.[176]

Apparently, this rationale by the Queen's Bench further cemented the doctrinal gaps between absolute liability in contract and the use of the three existing exceptions—supervening death, destruction of subject matter, and operation of law—by bolstering the reasoning using a heavy-handed reading of implied conditions that Taylor and Caldwell made in their contemplations regarding their lease of the music hall. Thus, in the context of the earlier exceptions to absolute liability for contract breach, *Taylor* strengthened these exceptions by inserting a rationale of implied-in-law conditions.[177]

Another approach to *Taylor* would de-emphasize implied conditions and instead focus more heavily on the continued existence of the music hall as a basic assumption of the parties at the time of formation.[178] In this way, the accidental fire was a supervening event, in which its non-occurrence was part of that basic assumption of continued existence. Thus, its occurrence, which rendered Caldwell's performance impossible, justifiably excused Caldwell from liability. This alternative approach emerged in later impossibility cases following *Taylor*, and was part of the development of the impossibility doctrine to render non-performance excusable.[179]

Other transformations occurred to bring about more flexibility in the doctrine of contracts. At some point, courts started to further widen the gap created by impossibility in the conventional stronghold of absolute liability by loosening the strict impossibility requirement to impracticability of performance as also a reason to excuse parties from liability.[180] Commentators have often attributed this shift to one 1916 California Supreme Court case, *Mineral Park Land Co. v. Howard*.[181] In that case, the defendant-contractor was excused from breach of a contract for extracting and transporting gravel from plaintiff's land

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[176] MURRAY ON CONTRACTS, *supra* note 154, at § 113[A][1] (referencing Oliver Wendel Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 466 (1897)).

[177] *Id.* at § 113 ("The early common law exceptions of death in personal contracts, destruction of the subject matter without the fault of the promisor and discharge of a duty by operation of law continued after 1863, but they were now supported by the implied condition analysis.").

[178] *See* FERRIELL, *supra* note 158, at § 13.03[a] ("A court considering the facts of Taylor v. Caldwell today would probably conclude that the continued existence of the theater had been a basic assumption of the parties to the contract.").

[179] *See id.* ("Modern decisions avoid using the [implied conditions] rationale, and . . . excuse due to changed circumstances depends on whether the nonoccurrence of the event with disrupted performance was a 'basic assumption' on which the contract was made.") (footnotes omitted).

[180] *See* Joseph M. Perillo, CALAMARI AND PERILLO ON CONTRACTS § 13.1 (5th ed. 2003) [hereinafter *Perillo*].

[181] Mineral Park Land Co. v. Howard, 156 P. 458 (Cal. 1916); *see also* MURRAY ON CONTRACTS, *supra* note 154 at § 113[A][2] (noting that Mineral Park Land Co. "is often viewed as the modern foundation of the doctrine of impossibility").

for the building of a bridge when it was found that a substantial portion of the gravel was underwater and could not be extracted without significant expense.[182] The transformative phrase from *Mineral Park Land Co.* occurred when the court conflated impossibility with impracticability in this case, opining that "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."[183] Another expansion of the doctrine, away from its original form in *Taylor*, was the acknowledgment of risk bearing and the view that changed circumstances impeding performance can also severely change the type of risks borne by parties in their basic assumptions underlying their agreement in ways that justify excuse. According to one court, "[i]t is implicit in the doctrine of impossibility . . . that certain risks are so unusual and have such severe consequences 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."[184] As a result, "[t]o require performance in that case would be to grant the promisee an advantage for which he could not be said to have bargained in making the contract."[185] In this way, the doctrine of impossibility evolved from implied-in-law conditions to risk bearing and eventually morphed into the doctrine of impracticability.

Today, impracticability excuses a breaching party from contract liability based on the failure of a basic assumption formed at the time of contracting—usually the non-occurrence of a supervening event—that subsequently renders performance by a faultless party too burdensome to continue. Compared to earlier incarnations and use of the impossibility doctrine, the impracticability doctrine furthers the development of flexibility in contract law by chipping away at some of the earlier boundaries of the contracts doctrine in pursuing a less constraining—and perhaps, more pragmatic—version of contract law: "The doctrine ultimately represents the ever-shifting line, drawn by 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."[186] In their respective realms, both the Uniform Commercial Code [hereinafter U.C.C.] and the Restatement (Second) of Contracts [hereinafter Restatement] recognize the impracticability doctrine for excusing parties' breach—with both versions possessing close similarities.[187] Nonetheless, along with their recognition of

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182 *Id.* at 458-60.
183 *Id.* at 460.
184 Mishara Const. Co. v. Transit-Mixed Concrete Corp., 310 N.E.2d 363, 367 (Mass. 1974).
185 *Id.*
186 *See* Transatlantic Fin. Corp. v. U.S., 363 F.2d 312, 315 (D.C. Cir. 1966) (discussing the evolution of impracticability).
187 *See Perillo*, *supra* note 180, at § 13.2 (discussing the similarities between U.C.C. § 2-615 and Restatement (SECOND) § 261).

frustration of purpose, both authorities illustrate how modern contract law needed to broaden concepts of breach and liability and, as a result, relied on doctrinal innovations to create a sense of flexibility and progression from traditional rules. Indeed, in the modern practice of commerce, the impracticability doctrine allows parties to access a less stringent contracts world because of such recognition for flexibility. Underlying such flexibility is a constant element of fairness involved in its application—perhaps continuing the fairness in which earlier impossibility cases, such as *Taylor*, used to render their decisions.[188] As E. Allan Farnsworth notes, impracticability "candidly recognizes that the judicial function is to determine whether, in the light of exceptional circumstances, justice requires a departure from the general rule that a promisor bears the risk of increased difficulty of performance."[189] In this way, impracticability is a consequence of the development of contractual flexibility that shifts away from the traditional approach of strict enforcement of contracts; and through its doctrinal evolution, contract disputes involving breach or non-performance are no longer as harsh and predictable, but they certainly have become more contextual.

B. Market Changes as Supervening Event

Although these excuse doctrines rooted in impossibility and impracticability have injected some flexibility in contracts and weakened the wall of absolute liability for breach, courts continue to apply these doctrines with caution and restraint. This is due to the assumption that the significance and the instrumentality of contracts would be subverted by every changed circumstance that comes along to add new burdens on performance.[190] Along this vein, one "off-limits" supervening event category affected by changed circumstances that has not traditionally received much success for discharging parties in impracticability has been that of changed economic and market conditions that makes performance onerous. Official Comment 4 to U.C.C. Section 2-615, on impracticability, states that

> [i]ncreased 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 itself a justification, for that is exactly the type of

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[188] *See* Richard S. Wirtz, *Revolting Developments*, 91 OR. L. REV. 325, 355 (2012) ("The law of impracticability, the courts and commentators say over and over, is rooted in considerations of fairness.") (footnote omitted).

[189] Farnsworth, *supra* note 42, at § 9.6.

[190] *See* FERRIELL, *supra* note 158, at § 13.03 ("The doctrines of impossibility, impracticability, and frustration of purpose must be carefully constrained if contracts are to retain their meaning and utility. If every change of circumstance that made performance more difficult, expensive, or disadvantageous provided an excuse for nonperformance, contracts would become meaningless.").

> business risk which business contracts made at fixed prices are intended to cover.[191]

Similarly, Restatement section 261 comment b also excludes such cases from generally excusing parties' nonperformance by preventing changed market conditions from being considered an event which supervenes the basic assumptions of the parties: "The continuation of existing market conditions and of the financial situation of the parties are ordinarily not such assumptions, so that mere market shifts or financial inability do not usually effect discharge under the rule."[192] According to some sources, it seems that changed market conditions could be a supervening event; however, in usual cases, it is not enough of a supervening event to warrant a relief based on impracticability.[193]

Regarding the Great Recession, this conventional view of impracticability makes this doctrine less salient for litigants trying to escape the liabilities of default because performance was made more difficult because of the 2008 economic crisis. For example, Danielle Kie Hart has reiterated the categorical harshness of using excuse doctrines to combat default issues during the housing crisis, in stating that "[i]t is black letter contract law that changes in a market do not affect the basic assumption on which contracts are made."[194] And yet, there are those who disagree and are not quite ready to shut out flexibility in the rule. For instance, Cohen underscores that, within the same part of comment b in Restatement Section 261 quoted above, "the Restatement explicitly leaves some wriggle room" regarding impracticability and changing market conditions.[195] Specifically, he notes two sentences from Section 261 comment b: "In borderline cases this [basic assumption that does not account for changed market conditions] is sufficiently flexible to take account of factors that bear on a just allocation of risk. The fact that the event was foreseeable, or even foreseen, does not necessarily compel a conclusion that its non-occurrence was not a basic assumption."[196] This particular declaration in Section 261 comment b leads Cohen to think that the categorical off-limits approach for applying

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[191] U.C.C. § 2-615 (2016) cmt. 4.

[192] RESTATEMENT (SECOND) OF CONTRACTS (1979) § 261 cmt. b (referencing *id.* at 261 cmt. c; *id.* at 265 cmt. a).

[193] *See, e.g.*, Farnsworth, *supra* note 42, at § 9.6 (noting that the U.C.C. gives an "ambivalent answer" as to how to determine increased costs as a reason for applying impracticability in a contract defense and that courts "have generally concluded that the additional expense, even if traceable to an identifiable supervening event, does not rise to the level of impracticability.").

[194] Danielle Kie Hart, *Contract Law Now Reality Meets Legal Fictions*, 41 U. BALT. L. REV. 1, 81 (2011).

[195] Cohen, *supra* note 29, at 55.

[196] RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 192.

impracticability in situations where changing economic and market conditions—such as the Great Recession—is a bit spurious.[197]

1. Aluminum Company of America v. Essex Group, Inc.[198]

To bolster Cohen's sentiment, there have been cases that have attempted to exercise that potential wriggle room in the impracticability doctrine by relying on changed market conditions as the supervening event that renders performance impracticable. The most well-known case that received favorable judicial treatment in this endeavor has been the 1980 federal district court case, *Aluminum Co. of America v. Essex Group, Inc.* Technically, the breaching party here, ALCOA, succeeded under an application of the mistake doctrine, but the court went further in its opinion to review changed market conditions as a supervening event for a favorable application of impracticability.[199] In the case itself, ALCOA contracted in 1967 with Essex to produce aluminum for Essex on a long-term basis with the agreed price of the aluminum associated with the price of the aluminum on Wholesale Price Index.[200] Despite both parties' original intentions that this formula would serve as an objective measure of increases in ALCOA's non-labor costs of producing the aluminum,[201] the index failed to accurately track the actual cost of production and ALCOA's costs were subject to increases in inflation due to OPEC hikes in oil prices and unanticipated pollution control expenses.[202] Accordingly, ALCOA's losses climbed from $3.4 million in 1977 to $8.6 million in 1989, and would have eventually climbed to a possible total loss of $75 million or more by the end the contract with Essex.[203] ALCOA subsequently sued to have the contract equitably modified and reformed.[204] While mutual mistake was the grounds that allowed the court to provide relief for ALCOA,[205] the court felt obliged to discuss its positions on ALCOA's predicament based on theories of impracticability and frustration of purpose,

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197 Cohen, *supra* note 29, at 55.
198 Aluminum Co. of America v. Essex Group, Inc., 499 F. Supp. 53 (W.D. Pa. 1980).
199 *Id.* at 70-76.
200 *Id.* at 56.
201 *See id.* ("ALCOA contends that this charge was intended by the parties to reflect actual changes in the cost of the non-labor items utilized by ALCOA in the production of aluminum from alumina at its Warrick, Indiana smelting plant. In count one of this suit ALCOA asserts that the WPI used in the Molten Metal Agreement was in fact incapable of reasonably reflecting changes in the non-labor costs at ALCOA's Warrick, Indiana smelting plant and has in fact failed to so reflect such changes.").
202 *Id.* at 58.
203 *Id.* at 56-59.
204 *Id.* at 57; *see also* Cohen, *supra* note 29, at 50 ("[ALCOA] went to court seeking equitable modification of the contract price.").
205 Aluminum Co. of America, 499 F. Supp. at 60-70.

which the court deemed as doctrines that "overlap in time" with mutual mistake.[206]

The court examined how the doctrine of impracticability likely would not excuse a breach due to a minor fluctuation of the market, but rather for "some unforeseen contingency which alters the essential nature of the performance."[207] Upon such examination, the court sided with ALCOA and its impracticability claim, citing that the market influences were great enough to fall within that unforeseen contingency.[208] Part of the court's rationale was based on weighing the gravity of burden and loss on ALCOA's continuing performance (here, in the tens of millions) because of the supervening changes in the marketplace stemming from OPEC and other controlling costs.[209] The court believed not only was there some authority and guidance from the U.C.C., Restatement, and others to direct its reasoning toward considering this change in market conditions as supervening, it also relied on some slippage from previous impossibility and impracticability cases that had precluded changed market forces from allowing the defense but still left room for flexibility—or perhaps, applying Cohen's words, "wriggle room."[210] In general, it seems that supervening changes in market forces can be enough to warrant impracticability if the focus loosens the restrictive take on risk allocations generally assumed between parties in fixed contracts as well as increases its take on the pragmatic effects—*i.e.* the severe losses and costs in a party's continued performance—of keeping parties tethered in an agreement affected by such market changes.[211] In illustrating its reasoning, the court's flexibility should not have been surprising given its favorable rendering of ALCOA's mutual mistake claim, but expected because of its explicit observation that the evolution of impracticability is only recent—implying an

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[206] *Id.* at 70-71.

[207] *Id.* at 74 (citing U.C.C. § 2-615 cmt. 4 (AM. LAW INST. & UNIF. LAW COMM'N 2017)).

[208] *Id.* at 76.

[209] *Id.* at 72-74.

[210] *Id.* at 72-73 (court discussing official commentary from the U.C.C. Restatement, and Corbin on Contracts as pertaining to when burden on performance is so out of the ordinary that it would render performance sufficiently impracticable); *see also id.* (court distinguishing ALCOA's burdens and losses as being more severe than previous unsuccessful cases of impossibility and/or impracticability based on changed market forces, such as Transatlantic Fin. Corp. v. U.S., 363 F.2d 312 (D.C.Cir.1966); Publicker Indus., Inc. v. Union Carbide Corp., 17 UCC Rep. Serv. 989 (E.D.Pa.1975); E. Air Lines, Inc. v. Gulf Oil Corp., 415 F. Supp. 429 (S.D. Fla. 1975); Maple Farms, Inc. v. City Sch. Dist., 352 N.Y.S.2d 784 (1974); Iowa Elec. Light & Power Co. v. Atlas Corp., 467 F. Supp. 129 (N.D. Iowa 1978)).

[211] *See id.* at 76 (distinguishing cases and finding that risk of a large variation between the index and actual costs due to changing market forces "was unforeseeable in a commercial sense and was not allocated to ALCOA in the contract"); *see also id.* at 73 (finding that "the increase in [ALCOA's] cost of performance is severe enough to warrant relief").

ongoing and still advancing nature.[212] And in this way, that "recent" evolution afforded some flexibility over formalism in ALCOA's case.

On the whole, most courts after the *ALCOA* decision have declined to follow its reasoning in regards to changed market conditions.[213] Commentators have also been vocal about its practical application and its place in the development of the doctrine in modern contract law.[214] But the case has yet to be overruled.[215] Indeed, while the appeal to the Third Circuit was pending, ALCOA and Essex settled the dispute and renegotiated their original agreement; the *ALCOA* holding was never put into effect.[216] For better or worse, however, the case offers a less restricting insight as to how a severe market fluctuation could render onerous the performance of one party in a long-term contract and allow flexibility to alleviate default—one that aims for developing flexibility within the permission of the doctrine.[217] Even scholars who may scorn the decision or downplay its precedential value have recognized the case for its innovation.[218] In this way, *ALCOA* and its regard for the impracticability doctrine bears continual revisiting by courts, practitioners, and scholars alike.

Unlike those who emphatically deny any wriggle room whatsoever for changed market conditions in the impracticability doctrine, and rejects such application to defaults in the Great Recession, Cohen finds contrariwise. Cohen

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[212] *See, e.g.*, *id.* at 73 ("The doctrine of impracticability of the new Restatement is one of recent evolution in the law.").

[213] *See* Cohen, *supra* note 29, at 52 (footnote omitted) ("ALCOA is a controversial decision; despite the great uproar (and, in some quarters, hope) when it was first decided, it has rarely been relied on by courts since, either in its expansive view of excuse doctrine or in its assertive approach to remedy.").

[214] *See, e.g.*, Jennifer Camero, *Mission Impracticable: The Impossibility of Commercial Impracticability*, 13 U.N.H.L. REV. 1, 26 (2015) (noting that, while in practice *ALCOA*'s equitable allocation of loss analysis has basis under U.C.C. section 2-615, "it is an unrealistic remedial framework."); *see also* John D. Wladis, *Impracticability As Risk Allocation: The Effect of Changed Circumstances Upon Contract Obligations for the Sale of Goods*, 22 GA. L. REV. 503, 586 n.333 (1988) (noting that with some scholars, "[t]he *Alcoa* opinion was characterized as having the precedential value of a law review article") [hereinafter Wladis].

[215] *See* Cohen, *supra* note 29, at 52 ("Nevertheless, ALCOA has never been overruled and remains available as a usable precedent, though of course it is only a district court opinion from a single jurisdiction.").

[216] *See* Wladis, *supra* note 214, at 586 n.333 (noting that as the case was being appealed to the Third Circuit, the parties settled prior to a decision); *see also* Stewart Macaulay, *An Empirical View of Contract*, 1985 WIS. L. REV. 465, 476 (1985) ("[T]he trial judge's decision never went into effect as the case was settled. The parties renegotiated their arrangement").

[217] Camero, *supra* note 214, at 26 (observing that the *ALCOA* court reached its decision with guidance and support from the U.C.C. on "us[ing] equitable principles in furtherance of commercial standards and good faith") (quoting U.C.C. § 2-615 cmt. 6 (AM. LAW INST. & UNIF. LAW COMM'N 2017)).

[218] *See, e.g.*, Macaulay, *supra* note 216, at 476 (calling the *ALCOA* decision and its results "innovative, and perhaps offensive").

finds that impracticability under Restatement 261's incarnation would have tolerated the crisis as a supervening event, enough to help establish impracticability. For instance, he notes that Section 261 focuses primarily on events rather than on risk allocation.[219] For that reason,

> "[i]f the relevant event, broadly defined, is the financial crisis, then that event involved the realization of multiple risks. Thus, not only did the financial crisis lead to declining home prices, but it also led to an economic downturn and high unemployment, making it difficult for many homeowners to make their loan payments."[220]

But comment b to Section 261 does inject risk allocation into the equation of assessing the parties' basic assumption, and thus, although risk might not have a predominant mentioning, it still has a place within the Restatement's impracticability rule.[221] Cohen's notice of risk assessment in Restatement § 261 is one reason why he finds *ALCOA* as a case expanding the wriggle room within impracticability:

> The ALCOA case . . . took advantage of the doctrinal flexibility and also found that performance had become impracticable because the nonoccurrence of the failure of the price index was a basic assumption on which the contract was made, and ALCOA did not assume the risk of deviation beyond the reasonable limits of risk.[222]

But that is not the only potential that Cohen sees in *ALCOA*. In the court's application of the mistake doctrine to excuse parties, he justifies the district court holding by understanding it through an equitable lenses—peering into a situation where ALCOA and Essex had mistakenly crafted and relied on an index that later did not match market conditions affected by OPEC, and presented Essex an opportunistic hand over ALCOA in Essex's long-term purchase of aluminum at a very advantageous fixed price.[223] That equitable perspective affords ALCOA

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[219] *See* Cohen, *supra* note 29, at 56 ("Section 261 does not talk in terms of risks, but in terms of an event.").

[220] *Id.*

[221] RESTATEMENT (SECOND) OF CONTRACTS § 261 cmt. b (AM. LAW INST. 1981) ("In borderline cases this criterion is sufficiently flexible to take account of factors that bear on a just allocation of risk.").

[222] Cohen, *supra* note 29, at 56 n.144.

[223] *Id.* at 51-52 ("As the market price of aluminum rose over the term of the contract, Essex resold millions of pounds of the aluminum it acquired from ALCOA on the open market, rather than using the aluminum internally, at a price greatly exceeding the price Essex paid to ALCOA. The court mentions this fact only to show how far the price index had strayed from market conditions. But if the court is correct that the purpose of the contract was to assure Essex of a long-term supply

flexibility in mistake and the other excuse doctrines, such as impracticability: "Understood this way, ALCOA is a case in which the court was willing to interpret the mistake doctrine (and the other excuse doctrines) broadly because Essex's relative fault was more blameworthy than ALCOA's."[224] Nevertheless, Cohen's observations here demonstrates that some tension exists between the traditional rule and the application of impracticability in situations arising from changed market conditions.

2. *Hoosier Energy Rural Electric Cooperative v. John Hancock Life Insurance Company*[225]

Although the doctrinal restraints for using impracticability with changed market conditions had staved off its uses by defaulting homeowners during the Great Recession, there was a case decided in 2008 that relied on impracticability based on the severity of the economic downturn. In *Hoosier Energy Rural Elec. Co-op., Inc. v. John Hancock Life Ins. Co.*, Hoosier Energy Rural Electric Cooperative ("Hoosier Energy") sued to enjoin John Hancock Life Insurance Company ("John Hancock") from asserting that Hoosier Energy defaulted on a lease deal that the two struck shortly before the Great Recession.[226] Hoosier relied on the impracticability defense and, like ALCOA, it was granted its relief based on impracticability.[227] In 2002, Hoosier Energy entered into a sale-in-lease-out ("SILO") transaction whereby Hoosier Energy leased specific assets at its electric generating plant to John Hancock Life Insurance ("John Hancock"). The transaction was for a sixty-three year term (which is past their useful life), and for

of aluminum for its own manufacturing operations, similar to a requirements contract, then significant reselling by Essex could be viewed as an opportunistic, bad faith attempt to take advantage of the then-favorable contract price, contrary to what the parties originally contemplated. It is one thing to argue that ALCOA should bear the risk of the flawed index it drafted; it is another to argue that ALCOA should bear the risk that Essex would opportunistically take advantage of ALCOA's miscalculation by taking more aluminum than it needed and reselling it") (footnotes omitted).

224 *Id.* at 52 (footnote omitted); *see also id.* ("What . . . is the proposition for which the case (at least according to its own reasoning) stands? One way to characterize ALCOA's holding is that when contracting parties rely on a sophisticated, but flawed, financial formula to make a long-term contract, and that formula fails for unforeseeable reasons to track economic conditions in the way that the parties expected, the court may use the mutual mistake doctrine to excuse performance and reformulate the contract terms to better match the underlying contractual assumptions.").

225 Hoosier Energy Rural Elec. Coop., Inc. v. John Hancock Life Ins. Co., 588 F. Supp. 2d 919 (S.D. Ind. 2008), *aff'd*, 582 F.3d 721 (7th Cir. 2009).

226 *Id.* at 921-22.

227 *Id.* at 921 (granting injunctive relief to Hoosier); *see also id.* at 931 ("Hoosier Energy would also have a reasonable likelihood of succeeding on the merits on its theory of temporary commercial impracticability.").

a one-time payment of $300 million.[228] Immediately, John Hancock leased back the same assets to Hoosier Energy for a thirty-year term in exchange for periodic lease payments.[229] Subsequently, Hoosier Energy saved nearly $20 million for the sixty-three year lease-out and deposited $278 million with various Ambac entities, which had commitments to make regular lease payments to John Hancock, on Hoosier Energy's behalf.[230]

The parties had intended for the SILO transaction to permit John Hancock to claim itself the "owner" of the plant for tax purposes.[89] As a result, John Hancock could then claim tax deductions in the tens of millions of dollars—which were deductions Hoosier Energy could not use because it, as a cooperative, did not profit significantly from selling electricity to its members.[231] But, because Hoosier Energy made additional payments to Ambac, it shored up the control Hoosier Energy would retain over its electricity generating plant.[232] During this time, the IRS had begun to stop allowing income tax deductions to participants in SILO transactions.[233] As a result, the SILO transaction between Hoosier Energy and John Hancock allegedly lacked economic substance; this is because Hoosier Energy would keep control of the plant while John Hancock would be without the rights, responsibilities, and risks usually connected to asset ownership.[234] In other words, this SILO transaction appeared to be an abusive tax shelter.[235]

If Hoosier Energy defaulted under the lease, the SILO transaction required Hoosier Energy to obtain a credit default swap ("CDS") from Ambac and provide it to John Hancock as further assurance of timely lease payments and protection..[236] Additionally, in the event that Hoosier Energy defaulted, John Hancock could seek from Ambac a termination payment and Ambac, accordingly, could purchase a "closely parallel" CDS contract from Hoosier Energy.[237] John Hancock would also receive a surety bond from Ambac.[238] John Hancock added further protections by requiring that the CDS be provided by a party with a credit rating no lower than "AA."[239] If Ambac's rating dipped under "AA," then Hoosier Energy would have sixty days to replace Ambac with another insurer that had a satisfying "AA" rating.[240] If Hoosier Energy did not do so, then

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228 *Id.* at 922.
229 *Id.*
230 *Id.*
231 *Id.*
232 *See id.* at 922-23.
233 *Id.* at 923.
234 *See id.* at 924, 927-28.
235 *Id.* at 923-24.
236 *Id.* at 922.
237 *Id.*
238 *Id.*
239 *See id.* at 922, 924.
240 *See id.* at 924.

John Hancock could declare that failure as a default and seek the termination payment from Ambac.[241] Furthermore, according to the logic of the SILO terms, Ambac could seek a substantial payment from Hoosier Energy under its parallel CDS contract.[242]

Then the mortgage crisis occurred, creating what the court called a "credit 'tsunami,' " (citing Alan Greenspan's famous words) fundamentally contributing to the downgrade of Ambac's credit rating in June 2008.[243] The credit crisis also "made it impossible—or nearly impossible—for Hoosier Energy to find a substitute for Ambac with a sufficient rating, on time, and at any price" within the required sixty days.[244] Hoosier Energy received a thirty-day extension, found a substitute for Ambac, and received an additional twenty-day extension despite requesting an additional ninety days to close the transaction.[245] Refusing to extend the time any further, John Hancock declared a default against Hoosier Energy and sought a $120 million termination payment from Ambac.[246] Because the termination payment by Ambac to John Hancock would have led to a similar payment obligation from Hoosier Energy, forcing it into bankruptcy,[247] the district court held that this bankruptcy would amount to an irreparable harm to Hoosier Energy's position.[248] The court also sided with Hoosier Energy's argument that the CDS contracts were part of an abusive and illegal SILO transaction that had no economic substance.[249] And because of the global credit crisis and the Great Recession, the court also found that Hoosier Energy could successfully assert a temporary commercial impracticability defense with respect to its obligation to secure the substitute CDS contract within the sixty-day term; so, Hoosier Energy should have been given more time.[250] As a result of these findings, the court granted Hoosier Energy's preliminary injunction claim to enjoin John Hancock and Ambac from asserting default and seeking termination payments.[251]

The district court's favorable reasoning for Hoosier Energy's temporary impracticability argument was based in part on the court's interpretation of the Great Recession's severity:

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241 *Id.* at 922.
242 *Id.*
243 *See id.* at 924.
244 *Id.*
245 *See id.* at 924-25.
246 *Id.* at 926.
247 Hoosier Energy Rural Elec. Coop. v. John Hancock Life Ins. Co., No. 1:08-cv-1560-DFH-DML, 2008 U.S. Dist. LEXIS 100353, at *3 (S.D. Ind. Dec. 11, 2008).
248 *Id.* at *13-14.
249 *See* Hoosier Energy Rural Elec. Coop., 588 F. Supp. 2d at 926-28.
250 *See id.* at 930-33.
251 *Id.* at 935.

> If the nature and scope of the credit crisis were more limited or a mere economic downturn, John Hancock's argument that the crisis was foreseeable or that Hoosier Energy should have protected itself better might be more persuasive. However, the credit crisis facing the world's economies in recent months is unprecedented and was not foretold by the world's preeminent economic experts. The crisis certainly was not anticipated in 2002, when the deal between Hoosier Energy, Ambac, and John Hancock was being finalized. Retrospect will not assist John Hancock here, nor will an assertion that it was Hoosier Energy's responsibility to prepare for and guard against any imaginable commercial calamity. After all, "foreseeable" is different from "conceivable."[252]

The court focused on the severity of the crisis rather than any existing risk allocation that the parties might have created in the SILO transaction against an event that might have caused Ambac's credit rating to dip and Hoosier Energy's difficulty in finding a timely replacement: "Hoosier Energy has come forward with evidence indicating that the obstacles it faced were not specific to Ambac but were the product of the credit crisis that effectively but temporarily froze the market for comparable credit products *at any price*."[253] Severity of the Great Recession seemed to override an assessment in calculating and allotting risk; rather, "[t]hose effects were not anticipated and could not have been guarded against."[254] This move toward emphasizing the gravity of the event as the reason to abandon evaluation of parties' risk allocation at the outset of the SILO transaction echoes Cohen's observation about the Restatement § 261's emphasis on supervening events rather than risks. Here, according to this court, the "credit tsunami" during the Great Recession was a market change that was supervening enough to render impracticability available to Hoosier Energy against a declaration of default.

However, on appeal to the Seventh Circuit, the Seventh Circuit did not favorably take the district court's temporary impracticability reasoning.[255] Unlike the district court, Judge Easterbrook's opinion lacked acknowledgement of the supervening nature of the 2008 credit crisis. There were certainly no tsunamis here in the Seventh Circuit's decision: "Downturns and cartels are types of things

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[252] *Id.* at 932 (quoting Specialty Tires of Am., Inc. v. CIT Grp./Equip, Fin., Inc., 82 F. Supp. 2d 434, 439 (W.D. Pa. 2000)) (citations omitted).
[253] *Id.*
[254] *Id.*
[255] *See* Hoosier Energy Rural Elec. Coop. v. John Hancock Life Ins. Co., 582 F.3d 721, 727-30 (7th Cir. 2009).

that happen, against which contracts can be designed."[256] Rather, Judge Easterbrook focused on risks, and that approach permitted him to cast a formalist hand in doubting the district court's application of impracticability based on economic and market changes. The significant part of a correct impracticability analysis—in Easterbrook's view—would have likely been the adherence to risk allocation of changed economic conditions:

> When they do happen, the contractual risk allocation must be enforced rather than set aside. The district court called the credit crunch of 2008 a "once-in-a-century" event. That's an overstatement (the Great Depression occurred within the last 100 years, and the 20th Century also saw financial crunches in 1973 and 1987), and also irrelevant. An insurer that sells hurricane or flood insurance against a "once in a century" catastrophe, or earthquake insurance in a city that rarely experiences tremblors, can't refuse to pay on the ground that, when a natural event devastates a city, its very improbability makes the contract unenforceable.[257]

Applying more heavily the risk allocation part of the impracticability calculation would shut down Hoosier Energy's claim that the substitute arrangement was legitimately impracticable due to the changed circumstances involving a global credit crisis because, as Easterbrook notes,

> [f]inancial distress could be and was foreseen; that's what the credit-default swap is all about. *But if no one could have foreseen the extent of the credit crunch in 2008*—and if it *really* made performance impossible, a subject on which the parties profoundly disagree—then the sort of argument that Hoosier Energy makes could satisfy the requirements [of impracticability under New York case law].[258]

Contrary to the district court decision in *Hoosier Energy*, the view here is that changed market conditions are always possible and so parties inherently bargain their terms according to that possibility.[259] If that is the case, then Easterbrook's logic seems to project that this basic assumption is always on the minds of the parties as they craft their terms in the agreement-making process, and that what

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256 *Id.* at 728.
257 *Id.*
258 *Id.* at 729 (emphasis added).
259 *Cf. Hoosier Energy*, 588 F. Supp. 2d. at 932 (noting the difference between foreseeable and conceivable and that "[i]f 'foreseeable' is equated with 'conceivable; nothing is unforeseeable") (quoting Specialty Tires of Am., Inc. v. CIT Group/Equip, Fin., Inc., 82 F. Supp. 2d 434, 439 (W.D. Pa. 2000)).

was foreseeable as far as the severity—or "the extent"—of the financial crisis was concerned in *Hoosier Energy* was the unknown. If Hoosier Energy could prove that the extent was not foreseeable, then impracticability would be available. Otherwise, a formalist approach should trump any equitable means for a party to avail itself to impracticability arguments when markets and economies drastically change.

It seems as if the tension between the district court and Seventh Circuit decisions here is about where to set the risk allocation. While perhaps the district court would rather have set aside risk allocation quickly and render the global credit crisis an event sufficiently supervening to allow flexibility,[260] the Seventh Circuit was not quite ready to give it up and instead places risk allocation not in the foreseeability of a global credit crisis in 2008 (because Easterbrook deems that this was foreseeable), but in whether its severity was foreseeable and continue the gamble there. Still, despite such heavy and nuanced criticism, Judge Easterbrook affirmed the lower court's decision, abiding by the deferential standard of review.[261]

In *Hoosier Energy*, it seems as if insisting on risk allocation serves the formalism's purpose in denying impracticability, while building up the severity of the crisis—in essence, establishing that it is sufficiently supervening—triggers equitable concerns and flexibility. Focusing on risk allocation promotes academic back-in-time exercises while equitable concerns are aimed more at pragmatically addressing the situation.

3. Trump v. Deutsche Bank Trust Co. Americas[262]

Another case, such as *Hoosier Energy*, that also took place during the time of the Great Recession, but hits closer to home in the real estate realm—albeit commercial, not residential—is one that involved real estate mogul and now U.S. president Donald Trump. In February 2005, Donald Trump and his real estate development company entered into two loan agreements—first, a construction loan agreement for $640 million from Deutsche Bank and a mezzanine loan for $130 million from Fortress Credit Corp.[263] The loans financed the building of a ninety-two story condo-hotel in downtown Chicago.[264] The

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[260] *See id.* ("Retrospect will not assist John Hancock here, nor will an assertion that it was Hoosier Energy's responsibility to prepare for and guard against any imaginable commercial calamity. After all, 'foreseeable' is different from 'conceivable.'").

[261] *Hoosier Energy*, 582 F.3d at 730 ("Because appellate review is deferential, the district court's understanding must prevail at the interlocutory stage.").

[262] Trump v. Deutsche Bank Trust Co. Americas No. 26841/08, 2008 WL 5789270 (N.Y. Sup. Ct. Queens Cnty. Dec. 4, 2008).

[263] Verified Complaint at paras. 23-25, 61-63, Trump v. Deutsche Bank Trust Co. Americas, No. 26841/08, 2008 WL 5789270 (N.Y. Sup. Ct. Queens Cnty. Nov. 3, 2008).

[264] *Id.* at paras. 56-57, 61.

original maturity date was May 7, 2008 and when Trump and his company could not repay the construction loans, he exercised a right to an extension with the lenders for another six months, extending it to November 2008.[265] Shortly before the November deadline, Trump and his company attempted to exercise a right to another extension, but the lenders rejected it.[266] Both Trump and the lenders sued in separate actions in New York state.[267]

The condo market remained in a deep slump through 2008, and by the time of the November extension deadline, sales of the prospective building units were stagnant and the lenders were not keen on making or refinancing the loans.[268] Deutsche Bank's lawsuit demanded that Trump fulfill a $40 million personal guaranty that he committed to for the timely payment of the construction loan.[269] Trump's lawsuit relied on an excuse argument that blamed the Great Recession for hindering the fulfillment of the bargain.[270] In detail, he invoked the force majeure clause in the construction loan agreement with Deutsche Bank, claiming that the Great Recession was a force majeure event that ultimately made it an impossibility to pay back the loan or honor other substitute transactions.[271]

Force majeure events—those "that can be neither anticipated nor controlled"[272] and "includes both acts of nature (e.g., floods and hurricanes) and acts of people (e.g., riots, strikes, and wars)"[273]—have significant presence in the impracticability doctrine. Both deal with changed circumstances excusing parties' performance in an agreement when performance becomes burdensome.[274] In

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265 *Id.* at paras. 81-82.
266 *Id.* at paras. 10, 83.
267 *See generally id.* at paras. 104-67 (Trump's Verified Complaint listing ten causes of actions); *see also* Deutsche Bank Trust Co. Americas v. Trump, No. 603483/08 (N.Y. Sup. Ct. Queens Cnty. 2008).
268 Verified Complaint at paras. 4-8, 79, Trump v. Deutsche Bank Trust Co. Americas, No. 26841/08, 2008 WL 5789270 (N.Y. Sup. Ct. Queens Cnty. Nov. 3, 2008); *see also* LAWRENCE A. CUNNINGHAM, CONTRACTS IN THE REAL WORLD: STORIES OF POPULAR CONTRACTS AND WHY THEY MATTER 81 (2d ed. 2012) ("By the end of 2008, Trump had only sold condos netting him $204 million, along with others under contract that would yield another $353 million.").
269 Memorandum of Law in Support of Plaintiff's Motion for Summary Judgment in Lieu of Complaint at 2-3, 13, Deutsche Bank Trust Co. Americas v. Trump, No. 603483/08 (N.Y. Sup. Ct. Queens Cnty. 2008).
270 Verified Complaint at 94, 98, 110-14, Trump v. Deutsche Bank Trust Co. Americas, No. 26841/08, 2008 WL 5789270 (N.Y. Sup. Ct. Queens Cnty. Nov. 3, 2008).
271 *Id.* at paras. 94, 98.
272 BLACK'S LAW DICTIONARY, *supra* note 155, at 761.
273 *Id.*
274 H. Ward Classen, *Judicial Intervention in Contractual Relationships Under the Uniform Commercial Code and Common Law*, 42 S.C. L. REV. 379, 399 (1991) ("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.") (footnote omitted).

addition, according to one source, their historical evolutions in the law are not so subtly intertwined: "Much of the jurisprudence surrounding the interpretation of *force majeure* clauses is rooted in the cases addressing the doctrines of impossibility and commercial impracticability (including Section 2-615 of the U.C.C.)."[275] Other studies comparing force majeure clauses and impracticability align with this observation by likening force majeure as a category of what eventually was the supervening force in impracticability:

> [Force majeure] started off as a contractual synonym for the general common law doctrine of (physical) impossibility. Force majeure was considered an excuse for nonperformance due to impossibility to perform. When there was an 'Act of God or the King's Enemies,' performance could not be completed and the promisor was held to be excused.[276]

At trial, the force majeure clause represents the parties' explicit risk allocation of a supervening event's occurrence; whereas parties without a force majeure clause would have to establish risk assessment as a fact to illustrate successfully that impracticability applied to their non-performance:

> The force majeure excuse arises directly from the contract between the parties and represents their agreement about how to allocate the risks of future adverse events. The section 2-615 excuse, on the other hand, arises from the statutory determination that because the parties did not allocate a particular risk, the court should perform that task for them by excusing a party.[277]

In that way, impracticability has been labeled as having a "gap-filling" function when compared to force majeure clauses.[278] A more subtle difference—and indeed an interesting one—arises in the way a court might treat a force majeure clause, which if valid and effectively invoked would be subject to formalist enforcement under *pact sunt servanda*. Meanwhile, a favorable finding of impracticability may have to rely on equitable principles. For instance, "[i]n a

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275 Jay D. Kelley, *So What's Your Excuse? An Analysis of Force Majeure Claims*, 2 TEX. J. OIL GAS & ENERGY L. 91, 93 (2007).

276 P.J.M. Declercq, *Modern Analysis of the Legal Effect of Force Majeure Clauses in Situations of Commercial Impracticability*, 15 J.L. & COM. 213, 214–15 (1995); *see also* William Cary Wright, *Force Majeure Delays*, 26 CONSTRUCTION L., 33, (2006) ("The doctrine of force majeure has developed, generally, from 'physical impossibility' to 'frustration of purpose' and more recently to 'commercial impracticability.'").

277 Christopher J. Costantini, Comment, *Allocating Risk in Take-or-Pay Contracts: Are Force Majeure and Commercial Impracticability the Same Defense?*, 42 SW. L.J. 1047, 1064 (1989) (footnotes omitted).

278 Declercq, *supra* note 276, at 229.

force majeure clause the parties have the ability to deal in their own way with problems caused by changed circumstances."[279] If an event arose within the clause and an affected party invoked it, the clause would be enforced. On the other hand, if parties without a force majeure clause claim excuse in a judicial proceeding, then a successful impracticability defense would promulgate flexibility and excuse from less stringent perspectives on contracts. For instance, "Section 2-615 embodies the policy that, when egregious and unforeseen circumstances exist, fairness dictates that the court excuse the burdened party."[280] In a case involving a force majeure clause, any similar impracticability-type decision-making regarding excuse might delay the enforcement of a force majeure clause if an interpretation problem arose over whether an event or effect is covered by one of the categories listed in a force majeure clause.[281] Otherwise, courts tend to confine enforcement of a force majeure clause to those events listed and will likely not create new categories.[282]

Trump's situation, in which he raised the financial crisis of the Great Recession as qualifying under the force majeure clause of the construction loan agreement with Deutsche Bank, falls somewhere between the categories above, but likely in its own category.[283] Specifically the complaint couches the financial crisis within the catch-all event category in the clause by directing attention to subsection (xi), allowing "any other event of circumstance not within the reasonable control of Borrower or any Trade Contractor."[284] Likely, this move was controversial—not only within impracticability cases as it harkens to non-standard cases, such as *ALCOA* and *Hoosier Energy*—but also as far as court interpretation of catch-all provisions in force majeure clauses goes. As one commentator has noted, "[t]he amount of detail included in the specific list of

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[279] *Id.*

[280] Costantini, *supra* note 277, at 1064 (referencing Transatlantic Fin. Corp., 363 F.2d at 315).

[281] *See* Declercq, *supra* note 276, at 226 ("When interpreting force majeure clauses which contain terms related to commercial impracticability, i.e., a 'failure of markets,' courts tend to look partly to the doctrine of commercial impracticability and then interpret the terms in the clause in a manner consistent with that doctrine."); s*ee also* Kelley, *supra* note 275, at 92 ("[A] court interpreting a *force majeure* clause may, in certain circumstances, impose requirements similar to those applicable to the common law and statutory excuses, even if a literal reading of the clause might lead to a different interpretation."); *see also id.* at 99 ("Texas courts have taken the approach that, in interpreting *force majeure* clauses, the actual terms of the clause are controlling, and only when those terms are vague will the courts turn to common law to fill in the gaps.") (referencing Sun Operating Ltd. P'ship v. Holt, 984 S.W.2d 277, 283 (Tex. App. 1998); Hydrocarbon Mgmt., Inc. v. Tracker Expl., Inc., 861 S.W.2d 427, 436 (Tex. App. 1993); Tex. City Ref. v. Conoco, Inc., 767 S.W.2d 183, 186 (Tex. App. 1989)).

[282] Wright, *supra* note 276, at 34 ("Although it is true that many force majeure clauses tend to include acts of man such as riots and wars, courts tend to narrowly interpret such language and limit its application to the events specifically listed.").

[283] Verified Complaint, *supra* note 263, at para. 87.

[284] *Id.*

events constituting *force majeure* is one of the most important considerations in drafting a *force majeure* clause because reliance on a catch-all phrase is generally more difficult and in some cases impossible."[285] The same commentator quoted a line of instruction regarding catch-all phrases in force majeure clauses from *Kel Kim Corporation v. Century Markets, Inc.*,[286] a notable New York precedent "analogous" to Trump's,[287] which states "[o]rdinarily, only if the *force majeure* clause specifically includes the event that actually prevents a party's performance will that party be excused."[288] Trump's force majeure clause did not include changes in the market or economic conditions as one of the listed categories.[289] Hence, there was a leap of imagination and interpretation required for succeeding on that claim. In fact, as Lawrence Cunningham observes, "[t]o make his claim persuasive, his loan agreement's force majeure clause would have to include something like: 'riots, insurrection, war, adverse weather, Acts of God, *national financial crisis of magnitude unprecedented in modern time*, or some other similar causes.' "[290] And Deutsche Bank's willingness to include that event would have been unlikely at the outset of the deal.[291] Interestingly, had Trump also alleged commercial impracticability in the alternative, and not merely excuse under the force majeure clause, he could have made the same arguments using the Great Recession and encountered more wiggle room in the adjudication.

Despite those challenges, Trump and his company made a force majeure claim hinged on the Great Recession and tried to access flexibility to excuse the defaulting behavior on the construction loan. Beyond alleging that his lenders had

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285 Kelley, *supra* note 275, at 98.

286 Kel Kim Corp. v. Cent. Mkts, Inc., 519 N.E.2d 295, 296 (N.Y. 1987).

287 *See* CUNNINGHAM, *supra* note 268, at 84 ("Donald Trump's position was analogous to Kel-Kim's.").

288 *Kel Kim Corp.*, 519 N.E.2d at 296 (citations omitted); *see also* Kelley, *supra* note 275, at 98-99 (quoting the same passage).

289 According to Trump's Verified Complaint, the following, other than the catch-all provision, are events under his force majeure clause:

> (i) acts of declared or undeclared war by a foreign enemy oi terrorist acts; (ii) riots, civil commotion or insurrection; (iii) casualty or condemnation; (iv) fire, floods, hurricanes or other casualty; (v) earthquakes; (vi) acts of God; (vii) governmental preemption. in the case of a national emergency; (viii) unavailability of labor or materials to the extent not within the reasonable control of Borrower or any Trade Contractor; (ix) strikes, lockouts or other labor trouble, (x) the suspension of governmental operations; which suspension affects real estate development in the City of Chicago generally and is not particular to Borrower or the Project.

Verified Complaint, *supra* note 263, para. 87; *see also* Exhibit 1 at 18, Notice of Motion for Summary Judgment in Lieu of Complaint, *Deutsche Bank Trust Co. Americas v. Trump* (N.Y. Sup. Ct. Queens Co. Nov. 26, 2008) (No. 603483/2008).

290 CUNNINGHAM, *supra* note 268, at 84.

291 *Id.* ("[B]anks do not agree to that kind of risk allocation.").

contributed to making his performance difficult,[292] the complaint relentlessly characterized the severity of the Great Recession to attempt a convincing narrative worthy of excuse. The complaint acknowledged that the Great Recession "ar[ose] from the unprecedented dysfunctionality and seizure of credit markets,"[293] and encompassed also "the sharp decline in real estate"[294] and "the unprecedented volatility of the stock market."[295] Like *Hoosier Energy*, the complaint here also quotes Alan Greenspan's infamous remark about the credit crisis as a " 'once-in-a-century credit tsunami' "[296] and slyly uses Deutsche Bank's own apocalyptic words about the Great Recession against the bank.[297] The complaint even alleges that the "severe downturn"[298] and "[t]hese highly adverse market conditions were compounded by the actions of Deutsche Bank and other institutional lenders, in creating the current financial crisis, which has sent the country and the world into the worst downward economic spiral since the Great Depression."[299] All of which were characteristics of a grave change in economic conditions that made his repayment and performance impossible.[300]

Eventually, the two competing lawsuits were merged into one.[301] But the case never went to trial; Trump "got accommodations from Deutsche Bank in the repayment schedule amid the Great Recession, stretching the case out through settlement in July 2010, after the financial storm passed."[302] One can speculate about the relative positions of Trump and the lenders and the reasons why they settled. A *New York Times* article on the dispute laid out some reasonable assumptions that risks to Deutsche Bank if construction was not completed would

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292 *See, e.g.*, Verified Complaint, *supra* note 263, at paras. 90-93.
293 *Id.* at para. 94.
294 *Id.* at para. 85.
295 *Id.*
296 *Id.* at para. 86.
297 *Id.* (noting that Great Recession was what Deutsche Bank had described as event where "the global financial system has been pushed to the brink of the collapse") (quotations omitted).
298 *Id.* at para. 79.
299 *Id.*
300 *Id.* at paras. 94-95, 98.
301 *See* Trump v. Deutsche Bank Trust Co. Americas, 887 N.Y.S.2d 121, 124 (App. Div. 2009) ("The Supreme Court, Queens County, directed the two actions to be jointly tried.").
302 CUNNINGHAM, *supra* note 268, at 84. This settlement later became part of a larger conflict of interest problem for Donald Trump after he became the 45th U.S. President in 2017. *See* Keri Geiger, Greg Farrell & Sarah Mulholland, *Trump May Have a $300 Million Conflict of Interest With Deutsche Bank*, BLOOMBERG (Dec. 22, 2016, 7:35 AM PST), https://www.bloomberg.com/news/articles/2016-12-22/deutsche-bank-s-reworking-a-big-trump-loan-as-inauguration-nears [hereinafter Geiger, et al.,]; *see also* Ben Protess, Jessica Silver-Greenberg & Jesse Drucker, *Big German Bank, Key to Trump's Finances*, Faces New Scrutiny, N.Y. TIMES (July 19, 2017), https://www.nytimes.com/2017/07/19/business/big-german-bank-key-to-trumps-finances-faces-new-scrutiny.html?_r=0.

make "[s]ome sort of settlement seem[] wise."[303] As the article noted further, Trump had an obligation of $40 million out of the $334 million outstanding on the loan, while the rest was owed by his development company and was not guaranteed personally by Trump.[304] Consequently,

> [i]f Mr. Trump was forced to pay the $40 million, he would be unlikely to permanently lose it, since his company would owe it to him. If the project went under, his claim would rank higher than the Fortress loan. Deutsche will make nothing from its investment in the junior loan if Mr. Trump does lose any money.[305]

These risks likely pressured Deutsche Bank to make efforts to complete the building project of property—even advancing $13 million to pay contractors while the suit was pending.[306] Curiosities will likely never cease over the merits of Trump's changed circumstances argument using the Great Recession to excuse his delay in repayment. The Great Recession has passed and envisioning the success of his force majeure defense seems analogous to an ex post dissection of risk allocation in the choice of terms parties had elected in negotiating a deal. We will never fully know how a court would have sided, but it certainly would have been quite the story: "If Mr. Trump manages to persuade a judge that the current crisis provides him with a good reason not to meet his obligations, he will have some great tales to tell in his next book."[307]

But Trump, characterized by Cunningham as a "prolific litigant,"[308] was utilizing contractual flexibility no differently than the litigants in *Hoosier Energy* and *ALCOA* in seeking to excuse his non-performance through changed market conditions; in fact, Trump invoked the exact same event that *Hoosier Energy* and invoking the same category of events that *ALCOA* had both relied on to respectively succeed. Not to mention, Trump's defense coincided with the bailouts of several major Wall Street Banks, all premised on the effects of the Great Recession and how they were "too big to fail."[309] That period might have been pragmatic and exceptional—and probably because of that, prone to some innovation. In providing commentary on applying *Hoosier Energy* to *Trump v. Deutsche Bank Trust Company*, Carlos Encinas explains how "Trump's force

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303 Floyd Norris, *Trump Sees Act of God in Recession*, N.Y. TIMES (Dec. 4, 2008), http://www.nytimes.com/2008/12/05/business/05norris.html.
304 *Id.*
305 *Id.*
306 *Id.*
307 *Id.*
308 CUNNINGHAM, *supra* note 268, at 81.
309 *See, e.g.*, Paul R. La Monica, *Lehman: Too Big to Fail?*, CNN MONEY (Sept. 10, 2008, 11:11 AM EDT), http://money.cnn.com/2008/09/10/markets/thebuzz/?postversion=2008091010 (discussing the bailout for Bear Stearns and predicting the same for Lehman Brothers).

majeure clause, and other similarly drafted force majeure clauses, could arguably permit the borrower to use an economic downturn or economic downturn-related event such as the 2008 credit crisis as a basis for invoking force majeure, thereby temporarily excusing the borrower's repayment of loan funds."[310] Generally, that premise relies on innovation and pragmatism:

> Several reasons may explain the previous inattention to economic downturns and economic downturn-related events in force majeure clauses. One reason could be the relative novelty of the idea. [*Trump v. Deutsche Bank Trust Company*] appears to be the first lawsuit in which a party uses an economic downturn or economic downturn-related event to claim force majeure under a CRE loan agreement. The reason could also be mere practicability; the terms economic downturn, economic crisis, and recession are so amorphous that even economists cannot say with certainty what they mean in real terms.[311]

As Encinas' study moves into further details, the possibility of Trump prevailing on his excuse theory, based fundamentally on the Great Recession, seems probable considering the case's resemblance to *Hoosier Energy*. Both cases also evade some of the constraints of New York state precedent surrounding force majeure clauses and impossibility, allowing flexibility and innovation to effectuate the wiggle room in the wall of absolute liability—indeed, room big enough to craft an escape for both Hoosier Energy and, likely, Trump.

Two reasons help illuminate the innovations that *Hoosier Energy* provides in contrast to the existing doctrine on market fluctuations and impracticability. First, unlike prevailing New York cases, *Hoosier Energy* factually took place within a market change that was "unprecedented."[312] Specifically, compared to the insurance crisis in the leading case, *Kel Kim*, the Great Recession in *Hoosier* was indeed "far greater and far more unexpected."[313] Secondly, unlike prevailing New York cases, where the defendants sought longer lasting relief from excuse through changed market conditions, the relief sought in *Hoosier* was temporary.[314] Both these reasons seemingly contribute to a more favorable view of excuse through changed market conditions in *Hoosier* versus existing New York case law.

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310 Carlos A. Encinas, *Clause Majeure?: Can a Borrower Use an Economic Downturn or Economic Downturn-Related Event to Invoke the Force Majeure Clause in Its Commercial Real Estate Loan Documents?*, 45 REAL PROP. TR. & EST. L.J. 731, 735 (2011).
311 *Id.* at 735-36.
312 *Id.* at 759-61.
313 *Id.* at 760.
314 *Id.* at 761-62.

Similarly, *Trump v. Deutsche Bank Trust Company* exhibits differences from how New York state would have customarily treated force majeure cases premised on changed market conditions. Generally, force majeure clauses in New York state are construed with the same narrowness as impracticability and impossibility.[315] Similar to other jurisdictions, in New York "a court may find an implicit force majeure event exists if the clause contains a catchall phrase, but the interpretation of such clauses must be 'confined to things of the same kind or nature as the particular matters mentioned.' "[316] Between the events listed in the construction loan agreement's force majeure clause, its exceptions,[317] and the use of the broader descriptive words and phrases in the catch-all provision, the force majeure clause in *Trump* differs enough from the clause in leading New York precedent to allow a more expansive construction of the force majeure clause - placing the Great Recession within the catch-all.[318] In regards to wording, it is both the words "any" and "reasonable" included in the phrase from Trump's force majeure class—"any other event or circumstance not within the reasonable control of Borrower"—versus the absence of such words in the clause at issue in *Kel Kim* ("or other similar causes beyond the control of such party") that factually distinguishes *Trump* from the more restrictive leading New York precedent.[319] With the exceptions, the articulation of the "four specific exceptions bolster the argument that the parties meant the catchall, with the modifier 'any,' to be expansive."[320] Moreover, as Encinas notes, the force majeure clause differs from other force majeure clauses in similar New York cases rejecting economic

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[315] *Id.* at 763.

[316] *Id.* (quoting Kel Kim Corp. v. Cent. Mkts., Inc., 519 N.E.2d 295, 297 (N.Y. 1987)).

[317] The four exceptions in the force majeure clause in *Trump v. Deutsche Bank Trust Co. America* are delineated as follows:

> "Force Majeure Event" shall not include (A) inefficiencies on the part of any Borrower Party, Construction Manager, Architect, Design Architect, Engineer, any Trade Contractor or any design professional; (B) late performance caused by failure to hire an adequate number of Trade Contractors, supervisors and/or laborers or by failure to order supplies and material in an orderly or timely fashion; (C) any cause or occurrence which any Borrower Party, Construction Manager, Architect, Design Architect, Engineer, Trade Contractor or design professional could reasonably control or circumvent; and (D) delays, stoppage or any other interference with the construction of the Improvements caused by insolvency, bankruptcy or any lack of funds of Construction Manager, any Trade Contractor or any Borrower Party.

See Encinas, *supra* note 310, at 764. Complaint at para. 87, Trump v. Deutsche Bank Tr. Co. Americas (N.Y. Sup. Ct. Queens Co. Nov. 3, 2008) (No. 26841/2008); *see also* Exhibit 1 at 18, Notice of Motion for Summary Judgment in Lieu of Complaint, Deutsche Bank Trust Co. Americas v. Trump (N.Y. Sup. Ct. Queens Co. Nov. 26, 2008) (No. 603483/2008).

[318] Encinas, *supra* note 310, at 762-66.

[319] *Id.* at 765-68.

[320] *Id.* at 766.

downturn as part of a catch-all provision because the reach and effects of the Great Recession that Trump articulated exceeded what prior claimants had argued.[321]

Henceforth, *Hoosier Energy* and *Trump*—both cases stemming from the same era, relying on New York law, and invoking the Great Recession as a changed circumstance to excuse non-performance—exhibit basic factual and circumstantial attributes that distinguish themselves from corresponding precedents that appear more restrictive. As stated above, since New York cases construing force majeure clauses would also resort to the manners in which impracticability and impossibility would be construed, it would seem fitting that *Hoosier Energy* would have relevance in a court's reading of the force majeure clause in *Trump*. Applying *Hoosier Energy* to *Trump* in this way could provide reasons why a court would side with Trump insofar as changed market conditions excusing his delay in repaying Deutsche Bank. First, *Hoosier* would prompt another reading in *Trump* that the Great Recession was meant to be included in the catch-all provision. As noted above, the combination of an expansive catch-all event (*i.e.* "any other event or circumstance not within the reasonable control of Borrower") with the four exceptions suggests that Trump and his lenders "intended the force majeure clause to cover foreseeable events."[322] *Hoosier Energy* then, with its regard for the Great Recession as "unprecedented," would provide *Trump* with "some precedent for finding that the national-turned-global credit crisis, which was related to a major economic downturn in the United States, was both unforeseeable and of sufficient magnitude to likely provide a basis for relief under the theory of temporary commercial impracticability."[323] In effect, extending *Hoosier Energy*'s analysis of the Great Recession to the *Trump* case would render a likely finding that the force majeure clause covered the severe economic downturn that Trump articulated. Furthermore, *Hoosier Energy* and *Trump* both sought temporary relief, rather than a more permanent excuse, and *Hoosier Energy* provides some precedent for temporary excuse based on the Great Recession.[324] Lastly, both borrowers in *Hoosier Energy* and in *Trump* asserted that they were acting in good faith to make sure they had "done virtually

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[321] *Id.* at 767 (distinguishing *Trump v. Deutsche Bank* from *Urban Archeology* "because Trump was not merely asserting that the economic downturn and credit crisis caused him financial hardship or 'a lack of funds,' but rather, he asserted that said events caused 'the unprecedented dysfunctionality and seizure of the credit markets,' which in turn made it impossible or nearly impossible for Trump to refinance his construction loans or for potential buyers to purchase units in the project with credit."); *see id.* at 767-68 (distinguishing *Trump v. Deutsche Bank* from *Route 6 Outparcels* because Trump's inability to repay the loan was not the result of poor risk allocation but a result of the severity of the credit markets).

[322] Encinas, *supra* note 310, at 763, 769.

[323] *Id.* at 769.

[324] *Id.* at 769-70.

everything possible to perform" before defaulting.[325] Again, such circumstances distinguish both cases from the leading New York cases and suggest a more flexible decision in *Trump* by a New York court than the more restrictive decisions in prior New York cases.[326] Certainly, we will never know what the outcome of the *Trump* case would have been, but because of *Hoosier* and the similarities between force majeure and impracticability, speculation favorable to Trump shows how he could have likely prevailed.

Of course, all of these observations in this singular study of *Hoosier Energy* and *Trump* are relegated to addressing the use of severe economic crisis for expanding the excuse doctrines in impracticability and force majeure claims *within the context of commercial real estate loans.*[327] What about recourses for the kind of flexibility and innovation based on changed market conditions that Cohen recommends, and that has been demonstrated by *ALCOA*, *Hoosier Energy*, and *Trump* for defaulting homeowners during the Great Recession? Would they be able to utilize the Great Recession in the same way? In other words, would the circumstances of their loans avail them to similar excuse defenses based on establishing that a market change as severe as the Great Recession to be the supervening event that renders performance impracticable? In this context, Cohen's observation of the defaulting homeowner from an equitable perspective seems to beckon the answer to the question as yes:

> In the mortgage context, the financial institutions behind the subprime mortgage market expansion not only had control over, but also exacerbated, the risks identified above. They established a system of securitization, resecuritization, and CDSs that ultimately destabilized the economy and contributed to a nationwide and global recession, as well as massive defaults on mortgages. They made it more likely that mortgages would end up underwater by lowering required down payments, which increased leverage and helped fuel the unsustainable housing price bubble. And they created a massive agency problem by putting inadequately monitored and controlled servicers, with weak incentives and authority to respond to the crisis by making efficient modifications, in charge of modifications. None of these actions would be a breach of the original mortgage contract between the homeowner and the originating lender. *The financial crisis thus presents an opportunity for a court to find an exception*

325 *Id.* at 770.
326 *See id.* at 770-71.
327 *See id.* at 772-75 (proposing approaches learned from *Trump* in crafting force majeure clauses in CRE loans).

> *to the general rule that financial hardship and market instability are not grounds for excuse.*[328]

Similarly, Miller has suggested that "[t]o the extent that the debate has been framed as one of individual morality, perhaps the response of contract doctrine should be an amendment of the current doctrine of excuse, so that homeowners would not be technically in breach of contract in the first place."[329] As a result, "[t]his would force contract law to address whether the homeowners or lenders should bear the risk of the systemic failures that lead to the crisis."[330] Had that been so, then the backdoor that was possible for Trump to temporarily escape the liability of his non-performance could have had potential for the underwater homeowner who had begun to fall behind in payments in 2008.

If there was one sentiment that both Trump and Deutsche Bank agreed with during their Great Recession litigation, it was the absolution of homeowners for defaulting on their residential mortgages. While it is not surprising to learn that "Deutsche Bank thinks the idea that an economic downturn should free people from the obligation to pay their debts is laughable,"[331] it is curious that when Trump was posed in an interview with a hypothetical situation of "remorseful condominium buyers" using the Great Recession as an excuse to walk away from their home purchases, he, like Deutsche Bank, disapproved.[332] But his reasoning seemed less categorical than Deutsche Bank's, only because home buyers lacked his force majeure clause.[333]

Cunningham has noted the same discrepancy between Trump and the "millions of other American borrowers [who] struggled to repay their real estate loans" during the Great Recession.[334] Although Cunningham disagrees with a favorable reading of the force majeure clause in *Trump*,[335] he gets to the actual crux of the difference between Trump and the defaulting homeowner in the Great Recession:

> The difference between Trump and mortgage borrowers was not the contracts or contract law, *but scale*. Banks compete vigorously to get Trump's billions in business; they care proportionately less about individual loans in the hundreds of thousands of dollars.

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[328] Cohen, *supra* note 29, at 57 (emphasis added).
[329] Miller, *supra* note 35, at 42.
[330] *Id.*
[331] Norris, *supra* note 303.
[332] *Id.*
[333] *Id.*
[334] CUNNINGHAM, *supra* note 268, at 84.
[335] *Id.* at 85.

> Thus, banks have an incentive to settle their dispute with him and permit a change in his payment schedule.[336]

Essentially, Cunningham points to an inequality at the surface of any comparison between the Trumps and Hoosier Energies of the world, on the one hand, and the vast number of defaulting homeowners in the Great Recession, on the other. That inequality, however, has deeper more profound significance for contract law as a cumulative externality. Part IV will explore such observations more deeply.

IV. FLEXIBILITY MATTERS

So far, this Article has involved itself descriptively on the possibilities of bringing the impracticability doctrine, and its stipulated force majeure variant, closer to accepting the conditions of a severe market change for rendering contractual performance impracticable. However, the purpose of such focus has been to illuminate the flexible innovations of contracts considering its formalist treatment during a worldwide economic crisis, such as the Great Recession. Of course, the efficacy of expanding the impracticability in this way is a completely different matter. First, there is the unknown question of further negative impacts on the economy, the American housing industry, and banking institutions in 2008 from widespread effects of excusing non-performance (even temporarily), if defaulting homeowners could have relied on impracticability in droves. Secondly, despite the vast light cast on the behavior of banks and lenders—both with flagrant lending practices at the rise of the housing bubble and later with risky securitization schemes—there is also room to blame homeowners who had taken advantage of the subprime mortgage market, sometimes fraudulently, to finance their home purchases.

This Article's ultimate goal is not to argue, like others such as Cohen have, for the viability of expanding contract doctrine in significant times of crisis. Cohen and others, as well as the cases discussed in Part III, have demonstrated such flexible "wriggle room" and innovation in contracts doctrine can, and in *Hoosier Energy*'s case, did take place. Instead, the heart of the investigation in this Part IV section examines, in terms of excusing breaching parties from their contractual duties during the Great Recession, why certain parties had more access to flexibility in contracts than others in order to point out that significance and how it resonates societally for contracts on the whole.

A. Entitlements and Spillovers

While the parties in *Hoosier Energy* and *Trump* were able to make excuse arguments based on the economic downturn respectively with enough persuasion

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[336] *Id.* (emphasis added).

to successfully garner favor in court or to change existing arrangements and benefit from a reprieve through settlement, a double standard arises within the basis of contracts when we consider that contemporaneously the same sort of excuse and impracticability argument—essentially the same flexibility—would not have been available for residential homeowners in default on their loans. Overall, from a contracts perspective, flexibility and innovation in terms of fixing their mortgage contracts seemed to have evaded homeowners in crisis during the Great Recession.[337] This was even so, when "residential foreclosures were the face of the subprime crisis."[338] Mercy or forgiveness in contracts was apparently not easy to come by for defaulting homeowners: "[C]onsiderable intervention by judicial equity in the foreclosure process was possible but unrealized."[339]

Several dimensions might explain and reinforce the reluctance for exploring contractual flexibility to help homeowners in residential loan defaults and foreclosures during the Great Recession. The first might involve the economics and pragmatism of the judicial process itself, such as the costs associated with litigation. Steven Bender observes that "borrowers strapped for cash and often unemployed, struggled to find lawyers, particularly when equitable remedies normally did not involve some financial recovery from which the lawyer might draw a contingency fee."[340] Also, the likelihood of reported cases detailing the specifics of lender misbehavior might have directed lenders to settle, modify, or engage in other transactions that averted flexibility.[341] Predictability might be another, as lawyers at the time seemed to prefer "arguing Main Street laws to stave off many subprime foreclosures, rather than resorting to the limited and more case-specific applications of equity that often required some lender misconduct."[342] Incidentally, this strategy did have a benefit in that lenders were often negligent in pursuing foreclosures, delaying numerous foreclosures.[343] Also, Bender notes that perspectives about the bench's rising conservativism

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[337] *See* Cohen, *supra* note 29, at 2-3 ("[M]ost discussions of possible responses to the financial crisis ignore contract law. Legal scholars have generally offered legislative solutions. And proposals for judicial involvement, most notably the settlement state attorneys general and several banks recently concluded for various alleged fraudulent and abusive practices, do not focus on ordinary contract law. Discussions of the crisis tend to say little about contract law, because they simply assume that the contracts at issue should and will be strictly enforced; given that assumption, there is not much more to say") (footnotes omitted).

[338] Steven W. Bender, *Equity in Times of Mortgage Crisis*, 48 REAL PROP. TR. & EST. L.J. 543, 600 (2014).

[339] *Id.* at 600-01.

[340] *Id.* at 601.

[341] *See id.* ("Equitable victories at the trial court level may be unreported and may have helped prompt settlements through loan modifications, forbearance, or short sales, rather than the lender risking an unfavorable reported decision on appeal—particularly where the lender or foreclosure claimant is accused of inequitable behavior.").

[342] *Id.* (footnote omitted).

[343] *Id.* (footnote omitted).

during this time might also have interfered with innovative and creative lawyering.[344]

Another dimension might be made from the straightforward observation, that in contrast to the average American homeowner in loan default during the Great Recession, contract breach situations in cases such as *ALCOA*, *Hoosier Energy*, and *Trump* involved large corporate entities (or in the case of *Trump*, entities and a real estate mogul) with considerable financial means entering in long-term complex commercial agreements that reaped significant commercial implications. *ALCOA* had its aluminum production and sale. *Hoosier Energy* had its tax shelter. *Trump* had its ninety-two-story condominium project in downtown Chicago. In contrast, the parties in residential home loans typically were not large commercial or exorbitantly wealthy entities, and were usually borrowing not singly to invest in their property purchase, but also to enjoy as residences. Moreover, the negotiation process between these loans differed because of the size and scope of the transaction: "Residential borrowers, particularly for securitized loans, are handed take-it-or-leave-it loan documents, whereas commercial borrowers often have the benefit of both legal counsel at the drafting stage and the leverage to negotiate favorable terms, such as nonrecourse provisions, that can supply protection in the event of default."[345] And yet, Bender urges that "[s]pecifically, courts should afford residential borrowers greater relief than commercial borrowers."[346] This assertion depends, in part, on the observation that unlike commercial loans, "[r]esidential borrowers gain additional standing with longevity of tenure at their residence, and also when the subject of foreclosure is their principal residence rather than an investment property or a vacation home."[347] Hence, Bender believes that their access to flexibility was well deserved: "Borrowers who remain in their residence rather than abandon the property have the highest claim to equity."[348]

In the failed transactions of *ALCOA*, *Hoosier Energy*, and *Trump*, each breaching party's commercial nature and the financial heft entitled them to enter into complicated commercial agreements with other large institutions, with millions of dollars at stake. The ALCOA-Essex deal was basically a long-term purchase deal of aluminum worth hundreds of millions.[349] The transaction between Hoosier Energy and John Hancock was a sale-in, lease-out agreement—

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[344] *Id.* ("Finally, with the increasing conservatism of judges, some may have perceived equitable intervention as judicial policy making to be avoided given the strong presence of legislation in dictating the foreclosure process.").

[345] *Id.* at 602 (footnote omitted).

[346] *Id.*

[347] *Id.*

[348] *Id.*

[349] *See ALCOA*, 499 F.Supp. at 59 (Judge Teitelbaum noted in his opinion that losses to ALCOA from 1977 to 1978 alone were $75 million.).

albeit an illegal one—worth tens of millions at the very least.[350] And Trump and Deutsche Bank had essentially a commercial construction loan valued at over $640 million.[351] Their commercial nature and the high sums of money involved entitled these borrowers to such complex agreements, likely involving some high-stakes lawyering and negotiations—and in Hoosier Energy's case even effectuated a tax shelter to benefit the co-op—reflecting their enormous buying power at stake in these deals.

In this way, it is not astonishing that their failures would also be complicated and have large consequences as well—that there would be symmetry in varying degrees in each of these cases. The harms caused by potential forfeiture of these deals because of breach demonstrated the adage, "The bigger they are, the harder they fall"—or perhaps more aptly in a financial crisis, "Too big to fail."[352] However, at the threshold of failure, their original entitlement provides a spillover to another entitlement in the adjudication process: their ability to rely on flexibility and innovation in the contract doctrine. Here, each of these commercial claimants could make relatively convincing arguments to expand existing excuse doctrine considering specific and profound changes in market and economic conditions. Essentially, Cunningham is correct; unlike residential borrowers, the difference in the *Trump* loan versus home financial loans is *scale*.[353] The same could be said about the transactions in *ALCOA* and *Hoosier Energy*. In court proceedings, the financial size of these agreements entitled the breaching parties to creative and innovative ways to use the contract doctrine for excuse and relief. What this illustration shows is that during the Great Recession, large commercial contracts, such as those involved in *Hoosier Energy* and *Trump*, seemed to have an edge on something that the individual homeowner defaulting on her residential mortgage in 2008 likely did not have. The spillover here is demonstrated by the way in which one entitlement, that the borrowers in *Hoosier Energy* and *Trump* had, to sophisticated commercial

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350 Gretchen Morgenson, *Just Call This Deal Hoosier Baroque*, N.Y. TIMES (Dec. 20, 2008), http://www.nytimes.com/2008/12/21/business/21gret.html (detailing that Hancock paid $300 million to Hoosier in the deal and Hoosier retained $20 million while giving the rest to Ambac).

351 *See* Geiger, et al., *supra* note 302 ("In 2005, the [Deutsche Bank] approved a $640 million construction loan so Trump could build his name-sake tower in Chicago. The tower, with dozens of multimillion-dollar condos, broke ground at the height of the real-estate boom. As the project neared completion, the financial crisis hit, sending the global real-estate market crashing. And when part of the loan came due, rather than pay it, Trump sued a lending consortium led by Deutsche Bank for $3 billion.").

352 Scholarly examples of the use of the phrase to describe events in the financial crisis abound in the literature. *See, e.g.*, Lawrence A. Cunningham, *Too Big to Fail: Moral Hazard in Auditing and the Need to Restructure the Industry Before it Unravels*, 106 COLUM. L. REV. 1698 (2006); Alison M. Hashmall, *After the Fall: A New Framework to Regulate "Too Big to Fail" Non-Bank Financial Institutions*, 85 N.Y.U. L. REV. 829 (2010).

353 CUNNINGHAM, *supra* note 268, at 85.

contracts consequently accessed another entitlement, the flexibility and innovation in contract excuse doctrine. Whereas the parties to commercial contracts in *Hoosier Energy* and *Trump* could try to argue that the Great Recession made their nonperformance impracticable and thus excusable, the homeowner facing default and foreclosure appeared to have less of an advantage in making that argument. The homeowner was stuck with formalism and the strict enforcement of their mortgage contracts. She could not have bought her way to innovation and flexibility in contracts to keep her home loans afloat during that financial tsunami. Meanwhile, Hoosier Energy and Trump seemed figuratively to have managed to survive on what expensive houseboat money could afford.

B. Cumulative Externality

What does this disparity signify? Viewing the situation from both a contractual vantage and on the interpersonal one, any significance is minimal if the comparison is only between what one defaulting homeowner could not get away with in terms of flexibility in light of what a commercial party, like Hoosier Energy or Trump—or even ALCOA—could in a severe economic downturn. On that narrow level, strict enforcement and absolute liability seem to make sense in the homeowner's default situation. Invoking *pact sunt servanda* would be the predictable thing to do in a defaulting situation. A deal's a deal. Whereas any of the three excuse cases from Part III would share less resemblance with the case of a defaulting homeowner because of the nature and size of the category of the transactions.

When this illustration emphasizes the Great Recession as the articulated reason for breach in the case of *Hoosier Energy*, *Trump*, and the individual homeowner—or a severe change in economic and market conditions for *ALCOA*—some commonality is established. Nevertheless, not much meaning results if it merely involves one homeowner who is shut out of the type of excuse defense that the commercial parties in breach could conversely access. That sentiment would derive naturally from knowing that there are certain moral considerations that contract law has often dodged in its modern treatment. For instance, some developments in contract law tend to evade considerations of constraint and altruism in furtherance of advancing self-interest to the fullest.[354] Modern contract law's tendencies to help parties skew away from such considerations were, according to Chunlin Leonard, part of contract law's role in the Great Recession:

> [C]ontract law played an enabling, albeit hidden, role in the subprime mortgage crisis. Contract law facilitated the subprime

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[354] *See, e.g.*, Chunlin Leonhard, *Subprime Mortgages and the Case for Broadening the Duty of Good Faith*, 45 U.S.F. L. REV. 621, 622 (2011).

> mortgage crisis in two ways. First, contract law's *laissez faire* paradigm has incentivized contractual parties to pursue their self-interests while failing to provide any constraint on excessive pursuit of self-interests. Second, the current contract law paradigm has also contributed to the subprime mortgage crisis by having nurtured a business culture of everyone for themselves.[355]

Subscribing to contract law's ability to encourage self-interested maximization leads to a willingness to accept that contract law objectifies such maximization in every promised agreement—thus, creating its own peculiar morality. This would justify disparities between different contracts by scope and nature of the transaction.[356] Under this approach, the individual homeowner's mortgage default case would take lower priority or significance compared to the juggernaut breaches represented by *Hoosier Energy*, *Trump*, and *ALCOA*.

So if this dominating perspective does not bring about any resonance in the comparisons between the individual homeowner in breach of her residential mortgage contract during the Great Recession and the commercial parties, like Hoosier Energy and Trump who were advantageously relying on the Great Recession to excuse their breach, what could possibly elevate any critical and meaningful scrutiny regarding the inflexibility of contract law in home mortgage contracts during this economic downturn? How do we make this comparison more compelling as an indictment that such different results for flexibility matter in our modern-day contract law system?

Perhaps the approach involves externalities. First, it can be understood that the likely formalistic application of contract enforcement upon the single homeowner in default during the Great Recession versus the spillover access to innovation and flexibility in contracts in the large financial and commercial cases during the same time reveal externalities based on the scale of the transactions. In *Hoosier Energy* and *Trump*, the capability to argue and use the Great Recession as a reason for excuse seems like it would be a positive externality because merely having access to flexibility seemed to have benefitted both Hoosier Energy and Trump respectively. Conversely, the small likelihood that an individual homeowner's defense to default could have utilized the Great Recession to begin with would be an externality in a negative sense because the scale and nature of the contract probably foreclosed success on this strategy.

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[355] *Id.* at 622 (footnote omitted).

[356] *See id.* ("Contract law's failure to provide any checks and balances stems from its hands-off approach, built upon unwarranted assumptions of rational parties acting on their own behalf and bargaining at arms' length to maximize their own expected utility."); *see also id.* ("Contract law's general tolerance of parties' single-minded pursuit of self-interest has led to a "moral deficit.") (referencing JOSEPH E. STIGLITZ, FREEFALL: AMERICA, FREE MARKETS, AND THE SINKING OF THE WORLD ECONOMY 278 (2010)).

Couching the results between non-performance in commercial and non-commercial residential contracts as externalities focuses less on the formalist and the self-interested maximization approaches that would not acknowledge any insightful disparity.

But that still leaves the question of scale. In a sense, superficially, this mentioning of scale revives Cunningham's remark about the differences between mortgage borrowers and Trump's construction loan.[357] His reference to scale was directed to the money involved in these respective transactions: "Banks compete vigorously to get Trump's billions in business; they care proportionately less about individual loans in the hundreds of thousands of dollars. Thus, banks have an incentive to settle their dispute with him and permit a change in his payment schedule."[358] Cunningham was emphasizing the financial investment of a residential mortgage versus the size of the Deutsche Bank loan that Trump executed and then later defaulted on. On that narrow comparison, the perspective on disparity is small and justifiable on what Leonhard had observed about contract law's immediate tendencies.

Perhaps however, in terms of scale, if the externalities are added to Cunningham's comparison via scale, we finally get to some sort of significant societal meaning. Comparing just the Trump contract to one homeowner contract might be misleading. After all, the Great Recession was not merely predicated upon a housing crisis based on a single homeowner default tied to one subprime mortgage loan. It was *en masse*. In this way, the disparity in positive and negative externalities does not merely exist between these commercial cases and the individual homeowner. More correctly, scale needs to be brought in and the comparison ought to be viewed in terms of a wide national swath of residential mortgage defaults, not just a single hypothetical one. Consequently, the resonance of the negative externality in home mortgage contract defaults ought to arise from a cumulative perspective.[359] It is not just one homeowner who likely was shut out

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[357] CUNNINGHAM, *supra* note 268, at 85.

[358] *Id.*

[359] Aditi Bagchi, *Unequal Promises*, 72 U. PITT. L. REV. 467, 493 (2011). In a similar vein to the inequality established in this article, Aditi Bagchi has established a similar concept of inequality awareness through cumulative disparity of high to low experiences in other commercial contracts based on the value and expectations of those contracts:

> The disparity in the sense of entitlement that results from these diverging experiences in the consumer marketplace is problematic because it affects not just any of the primary goods utilized by individuals in their pursuit of the good life, but one of the most fundamental of the primary goods: individuals' sense of self. It is of greater concern than disparities in other resources that might be useful in the pursuit of one's conception of the good because sense of self motivates the formation of such a conception.

from such flexibility and innovation in contract doctrine, but a widespread group of affected homeowners in the U.S. at the time.

When viewed as a cumulative externality, the disparity here between the Hoosier Energies and Trumps of the world, who could better access flexibility to defend their breaches, and defaulting homeowners, who could not, hopefully become more significant. It makes more stinging Donald Trump's personal interview statement about why he ought to be excused from his construction loan, but not any buyers of his condominiums who might contemporaneously have suffered difficulties repaying their loans when we view the disparity as a cumulative externality. It stirs up an awareness of inequality that our contracts system and the adherence to formalism had produced against U.S. homebuyers in comparison to commercial parties and the flexibility afforded to their contracts of scale.

C. Inequality Awareness

In light of the cumulative externality and the ensuing inequality awareness reached in the previous subsection regarding disparities between treatment of home mortgage contracts and commercial contracts, Cohen's reflection that failed contracts were at the crux of the housing crisis stands more critically as a synecdoche for the failure of contracting both before and after the global economic crisis.[360] Other commentators on the 2008 housing crisis have remarked that "[f]or its part, contract law strips emotion out of contracts and chooses abstraction instead"[361] and this tendency was seemingly externalized into the types of arms-length contracting behavior in home loan transactions that contributed to such prevalent failure that precipitated the housing crisis.[362] But it is at the point of failure that the ideas and assumptions are challenged and often fine-tuned. The inequality awareness brought by viewing, as a cumulative externality, the improbability of defaulting home loan borrowers to rely on excuse defenses based on hardships caused by the Great Recession — while the opposite was true of parties in large commercial contracts — illustrates a dysfunction of modern contract law for some of the societal purposes it serves.

Without normative critique here in light of how contract law would deal with another future crisis, this cumulative externality leaves unresolved some further observations that the rigidity and formalism in contract enforcement

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Id. This article has applied Bagchi's approach to viewing contract inequality based on disparities on a cumulative level to the enforcement of contracts, residential versus commercial, in the Great Recession.

360 *See* Cohen, *supra* note 29, at 2-3.

361 Ronnie Cohen & Shannon O'Byrne, *Law, Emotion, and the Subprime Mortgage Crisis*, 29 GPSOLO 1, at 66 (2012).

362 *See id.*

during the Great Recession led to some severe injustice, and not merely on the financial front. First, one could interpret that the cumulative externality, involving tens of thousands of mortgage defaults and foreclosures on single family homes, is an indictment upon an entire class of homebuyers on their contractual worthiness. This inference is possible because, for whatever economic or financial reason, they took risks in bargaining within the subprime and alternative mortgage options available when purchasing homes and later when the housing bubble burst, they were not able to hold up their ends of the bargain. They could not compete within a system in which lenders were much more sophisticated at the outset and commercial parties, such as Hoosier Energy, Trump, and ALCOA, had abilities to use flexibility by pointing to economic downturns to achieve some relief. Crudely put, contract law treats parties unequally and, in this case, condemns those who are subsequently unable to abide by their contracts because they cannot argue flexibly to defend them from foreclosures.

A related premise that has been discussed numerously — and especially within a subset of defaulting borrowers, who strategically defaulted and "walked away" from their underwater home mortgages — has been the immoral and opportunistic take on these particular homeowners for breaching their promises and obligations because the Great Recession made it financially and equitably onerous, even though they could have stayed in. Brent White crystallized the debate in a series of scholarly articles shortly after the Great Recession: the push-pull between formalist justifications based on morality of promises, economic maximization arguments, and risk allocations again signal the problems arising from the societal resonance we can extrapolate on modern contracting. The debate informed not just the failure of contracting, but also the pluralist meanings in modern contracts. The morality angle could also apply to homeowners who, unlike strategic defaulters, had no choice but to default on their loan repayments. Comparatively, it has a less opportunistic connotation on these defaulting borrowers and may focus on the risks they voluntarily took in securing financing, but nevertheless, a negative sting on their contractual worthiness still exists.

More profoundly, the inequality awareness gathered from this cumulative externality also could deepen the sense of indignity upon defaulting borrowers, beyond contractual unworthiness, that directly undermines their collective and individual self-worth. This interpretation alone is a consequence of overstating the above conclusion regarding contractual unworthiness. However, that overstatement can be minimized and counterbalanced once the subject matter of these mortgage contracts enters the observation: the single-family home. The symbolism of American homeownership cannot be underscored more heavily as an extension of personal wealth, status, and materialism for the individual,[363] as

[363] *See* Katherine M. Vail, *Saving the American Dream: The Legalization of the Tiny House Movement*, 54 U. LOUISVILLE L. REV. 357, 360-61 (2016) ("Once Americans embraced the idea of

well as a representation of prosperity in the aggregate.[364] That symbolism is part of the American identity: "For American families, the desire to own a home is 'almost a genetic yearning . . . to claim and fence and demarcate our dwellings, physically and legally, from others.'"[365] It also tracks the historical narrative of the United States: "Since the founding of the American colonies, homeownership has been a predominant feature of the national psyche. Owning a home is the American Dream, the predominant symbol of family prosperity and success."[366] All of this shares some alignment with property law theories on the notion of homeownership and how it affects American ideas of citizenship with the rights and entitlements involved: "This idea of homeownership has become so entrenched in the American psyche that it has effectively become a 'presumed right and privilege' and has 'embedded [itself] in the American consciousness.'"[367] For better or worse, whether morally or politically justified, the sense of homeownership in America achieves respectability:

> The assumption that homeowners are (much) better local citizens dominates property theory and legal scholarship to date without serious critique. The claimed "citizenship effects" of homeownership comprise a constellation of positive externalities, including local contribution and investment, political participation, neighboring, and collective action, as well as gains to prosperity and stability from industrious and content citizens. There are two influential accounts of how homeownership produces this breadth of citizenship benefits. In the first account, homeownership is morally and psychologically transformative. Ownership and the act of becoming an owner inculcate prosocial behavior and "citizenship virtue," which generalizes across civic and social behavior. In the second account, the investment stake

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homeownership as a symbol of status and success in society, they began increasing the size of their homes to further elevate their status.").

364 *See* THOMAS M. SHAPIRO, THE HIDDEN COST OF BEING AFRICAN AMERICAN: HOW WEALTH PERPETUATES INEQUALITY 10 (2004) (notes how homeownership was braided together with the sense of economic prosperity amongst the middle-class after World War II).

365 Heather K. Way, *Informal Homeownership in the United States and the Law*, 29 ST. LOUIS U. PUB. L. REV. 113, 126 (2009) (quoting Nicolas P. Retsinas & Eric S. Belsky, *Examining the Unexamined Goal*, *in* LOW-INCOME HOMEOWNERSHIP: EXAMINING THE UNEXAMINED GOAL 11 (2002)).

366 *Id.* (footnotes omitted).

367 Nathan Torok & Mark Torok, *What Happened to the American Dream? An Analysis of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Its Effect on Home Ownership*, 17 SCHOLAR: ST. MARY'S L. REV. & SOC. JUST. 95, 97 (2015) (quoting Michael A. Stegman, Joanna Brownstein, & Kenneth Tempkin, Home Ownership and Family Wealth in the United States, in HOUSING AND FAMILY WEALTH: COMPARATIVE INTERNATIONAL PERSPECTIVES 86, 86 (Ray Forrest & Alan Murie eds., 1995)).

> in the owned home (and by some accounts the high-risk, undiversified nature of that interest) motivate socially beneficial local participation and contribution.[368]

Although dignity through respectability is problematic,[369] this idea of homeownership has a dignifying effect that raises self-worth in the United States. In this way,

> [t]o fail to treat someone's home with the respect that it deserves is to seriously insult their sense of dignity and self-worth. Far more than they expect to be free from any state interference in their use and enjoyment of their homes, people expect their homes and their homeownership to be treated with the respect and dignity appropriate to the significance it has in their lives.[370]

Not to mention that a home provides shelter — a fundamental necessity — which alone carries with it dignity issues if it is denied to an individual.[371]

The decline in certain cities and neighborhoods — with foreclosed homes resulting from the Great Recession — is an embodiment of all of this societal indignity in light of the cumulative externality resulting, in part, from the harsh rigidity of contracts. Compared to the flexibility and innovation that commercial contracts permit parties, the formalist approach to contract doctrine in residential mortgage contracts during that time seems to be complicit in two endeavors. First, it replicates an existing hierarchy animated by values that inherently cherish wealth maximization as both its teleological good and as its means of mobility

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[368] Stephanie M. Stern, *Reassessing the Citizen Virtues of Homeownership*, 111 COLUM. L. REV. 890, 890-91 (2011) (footnotes omitted).

[369] *See generally* Jeremiah A. Ho, *Find Out What It Means to Me: The Politics of Respect and Dignity in Sexual Orientation Antidiscrimination*, 2017 UTAH L. REV. 463 (2017) (arguing that respectability is a problematic means of obtaining dignity and leveraging for full sexual orientation antidiscrimination after the marriage equality cases at the Supreme Court).

[370] Eduardo M. Peñalver, *Property Metaphors and Kelo v. New London: Two Views of the Castle*, 74 FORDHAM L. REV. 2971, 2975 (2006).

[371] Human rights rhetoric has recognized that there is a right to shelter this intertwined with human dignity. For instance, Article 25 of the Universal Declaration of Human Rights states:

> Everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, *housing* and medical care and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control.

Universal Declaration of Human Rights, G.A. Res. 217A, Art. 25 U.N. GAOR, 3d Sess., 1st plen. mtg., U.N. Doc A/810 (Dec. 12, 1948) http://www.un.org/Overview/rights.html (emphasis added). In addition, "[r]eferences to human dignity and social progress permeated the UDHR, but the most explicit proclamations of economic and social rights can be found in Articles 22 through 26." Katherine Barrett Wiik, *Justice for America's Homeless Children: Cultivating A Child's Right to Shelter in the United States*, 35 WM. MITCHELL L. REV. 875, 918 (2009).

along the striations of that hierarchy. We see this in the wealth of the parties involved in *ALCOA*, *Hoosier Energy*, and *Trump*. We also see this perhaps in the commercial purposes of the transactions of *ALCOA*, *Hoosier Energy*, and *Trump* as opposed to the goal of the average mortgage agreement: to finance the purchase of a single-family home. Secondly, contract law seems to discriminate between these different classes of contracts — and, correspondingly, parties — certain flexibilities and innovations are allowed for one "higher" category of transactions, but not another. The entitlement spillovers of the commercial contracts would underscore and elucidate that hierarchy. Moreover, the cumulative externalities created by the spillovers would reveal where the discrimination results — upon the dignity of the homeowners. In the wreckage of the housing crisis, what the shards and broken material tell us about contract law is the extent it facilitated inequality in the lives of those who subscribed to home buying and used contracts to finance their purchases.

D. Contract Pluralism

If contract law is helpful to us, then it ought to be instrumental in helping us pursue that conception of the good. In some ways, contract law accomplished this in the years that created the housing bubble in the United States. As we have observed, contract law was part of homeownership; it facilitated transfer of title and helped finance home purchases. But the innovative and risky ways it did so in the fine print not only helped contribute to a falsity about housing prices nationwide, it also led to financial abuse premised on the materialistic attraction of home-buying. The unbridled innovations utilized in drafting mortgage agreements eventually subverted a genuine ability for people to engage in pursuing a common and symbolic good. It was invariably unjust. And when the bubble burst, contract law and formalism denied homeowners the ability to resolve their situations, while those who had entitlements to flexibility had the possibility to revise their predicaments. Unsurprisingly then, along this narrative, contract law brought about the ominous greatness of the Great Recession.

Perhaps normatively we ought to be skeptical about strict formalism and embrace some more workable approaches to contract law. Formalism has its virtues in the application of contract rules. Yet, if practiced too legalistically and universally, certain unjust situations — as this Article has attempted to demonstrate — may cause larger societal harm than personal harm. Flexibility in the enforcement of contracts allows for the ability to address global catastrophes and sustain an appropriate level of contract justice. Otherwise, our contracts system does not really value the personal and the humane; it values ideas, such as wealth accumulation, and has been commandeered by neo-liberalist virtues.

To arrive at a more meaningful contractual approach that could have regulated or avoided cumulative externalities that were socially and economically unequal, we must acknowledge the connection between home buying and contracts. The cultural and material significance of homeownership as part of the American Dream reflects a national identity to which many U.S. homebuyers generally subscribe. That image of homeownership as being "American" is so strong that one can view the act of pursuing homeownership as a type of self-determination or self-authorship. This role of homeownership as part of an individual's self-authorship within a collective, cultural identity resembles what political theorists might call a "cultural right."[372] Thus, home buying is not just about purchasing a dwelling, it is part of self-invention; indeed, an act that people collectively in this country consider "all-American." As Eric Mitnick has noted, "one of the principal ways in which individuals define themselves is through social attachments."[373] As such, there is self-authorship in the act of buying a home, if doing so allows one to access that American identity and status. From the standpoint of theorists who highly regard individual autonomy as a driving force in liberalism, self-authorship — as Mitnick also notes — is one of liberalism's central commitments.[374] In particular, self-authorship is part of an individual's constitutive autonomy.[375] In this way, "insofar as membership in a particular cultural group may constitute an aspect of identity, rights that respect such cultural attachments serve rather directly to protect crucial individual interests."[376] That process is more complicated than it reads because "liberal theorists envision even constitutive ends and attachments as subject to critical reflection and revision."[377]

If indeed homeownership — as part of the American Dream concept — is one way in which individuals in the United States engage in self-authorship, then both culturally and individually, "contract [law] is a vehicle for individual self-determination."[378] It facilitates the fulfilment of cultural rights and self-determination partly through the voluntary freedom of contracting that has been classically recognized in our system. But with the addition of home buying as culturally significant to one's membership in the American national identity, contract law can also further one's constitutive autonomy if that voluntariness then accesses self-authorship. Hence, contractual autonomy is not just about freedom; for one's identity, it can also possess a constitutive function.

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372 Eric J. Mitnick, *Individual Vulnerability and Cultural Transformation*, 101 MICH. L. REV. 1635, 1640-41 (2003).

373 *Id.* at 1638 ("[C]ultural rights merely vest on the basis of cultural membership, and most such rights (for example, language rights, rights freely to practice one's religion) vest legally in *individuals* rather than in any collective entity.") (footnote omitted).

374 *Id.* at 1640.

375 *Id.* at 1641.

376 *Id.*

377 *Id.*

378 Bertram Lomfeld & Dan Wielsch, *The Public Dimension of Contract: Contractual Pluralism Beyond Privity*, LAW & CONTEMP. PROBS., 2013, at i, iv.

As we have seen, however, the process of formalism in contract enforcement can also subordinate autonomy when contracts fail. That might be acceptable or tolerable if all contracts during the Great Recession had been subordinated in this way. However, Hoosier Energy (and Donald Trump) sustained the ability to salvage efficiency through excuse while defaulting homebuyers could not. The utility of contract law and doctrine thus ought to have potential beyond arms-length transactions. Perhaps a strict adherence to contract formalism then actually stifles and paternalizes contract law from its potential.

To rectify this tension, courts would have to first recognize inequality as well as constitutive autonomy in the context of such home purchase and finance transactions. In doing so, courts would thus highlight the cultural significance of home buying and perhaps underscore residential mortgage contracts as part of self-authorship. After those initial steps, courts could then better see that the process of contract enforcement can overburden the autonomy of homebuyers unfairly — especially when comparing defaulting homeowners to Hoosier Energy's successful impracticability defense based on the Great Recession. Perhaps that comparison would make the equitable argument for flexibility and lead to a more just and redemptive place if constitutive autonomy indeed allows for self-authorship and revision.

After recognizing constitutive autonomy in home buying, courts could add another layer of reasoning against strict formalism by using contractual pluralism to reach a more flexible result. Courts ought to approach pluralism in contracts more readily by acknowledging that there is no unifying theory of contract law. Instead, contract law is and has always been dialectical in nature.[379] In this way, courts could adopt pluralism to engage in more flexible decision-making. According to Leon Trakman,

> [p]luralist theories of contracting do not endorse a "super" value, but instead acknowledge a plurality of values that are commensurable or incommensurable with one another according to the contractual context. Decision agents—typically courts—use that pluralism to identify and rank the intensity of plural preferences and apply them through a process of practical reason in order to reach prudential decisions about the formation of contracts.[380]

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[379] Emily M.S. Houh, Sketches of A Redemptive Theory of Contract, 66 HASTINGS L.J. 951, 959 (2015).

[380] Leon Trakman, *Pluralism in Contract Law*, 58 BUFF. L. REV. 1031, 1033-34 (2010); *see id.* at 1034 ("For example, judges rank values like liberty to contract and equality in contracting on a ranking scale in which they pay due cognizance to continuing and discontinuing moral, political and cultural values. They analyze those values through a process of practical reason through which

Meredith Miller echoes this sentiment that pluralism recognizes competing values and that contract law is not normatively or descriptively regarded by adherence to one value.[381] With the dominance of formalism, she notes that one consequential issue is that it "elevates the content of the parties' written contract (its form) over any concerns for normative values or societal notions of fairness."[382] Using a form of pluralism, courts then could rely on context to achieve a situation in which competing values allow flexibility for both commercial agreements and residential mortgage contracts. In relaying one method of plurality theorized by Ethan Leib, Miller notes a fallacy Leib observed — that dominating single theories of contract usually fail in their attempts to articulate a unifying contract theory, and instead they often exclude or "box out" certain subcategories of contracts.[383] But an approach steeped in contractual pluralism would find that "these sub-categorizations could be used as a way to prioritize competing principles. For example, contracts between organizations would be governed by efficiency over autonomy concerns. Contracts between individuals would be governed by autonomy principles before efficiency concerns."[384] Pluralism could have separated Hoosier Energy and Trump from residential homeowners, but would also raise the importance of residential home loan contracts for flexible resolutions based on autonomy in a large financial crisis.

After all, the dialectical nature of contract law leads to the realization that contracts "should not be viewed in absolute terms, as only formalistic or only equitable."[385] Rather, contract law "should provide both a degree of certainness and predictability, as well as a degree of fairness and justice. There is room in contract law for objectivism, subjectivism, economic efficiency, and community standards of fair and just practices."[386] This kind of broad conception of contract law is what ultimately led scholars such as Bertram Lomfeld and Dan Wielsch to exclaim that "[c]ontract is the legal heart of social pluralism."[387] By valuing certain competing norms over others in the context of contract breaches during the Great Recession and inequality awareness, courts would have to realize that the practice of not addressing excuse for a vast majority of individual homeowners sustained that inequality. Thus, pluralism could have assisted in

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they assimilate competing and supporting propositions in arriving at preferred determinations about the formation of a contract.") (footnotes omitted)).

381 Meredith R. Miller, *Party Sophistication and Value Pluralism in Contract*, 29 TOURO L. REV. 659, 662 (2013).

382 *Id.* at 664-65.

383 *Id.* at 670 (noting Leib's point that "theories that 'box out' entire types of contracts fail to offer a general theory of contracts").

384 *Id.* (footnotes omitted).

385 Houh, *supra* note 379, at 959.

386 *Id.*

387 Lomfeld & Wielsch, *supra* note 378, at ii.

accessing flexibility — and should in future circumstances of contractual inequality.

Applied this way, courts could have maintained the importance of contracts as self-authorship in the context of homeownership and equitably addressed mortgage arrangements that ended badly in the Great Recession. Courts would then have realized that the inequality of not addressing excuse for residential home loan defaults is more harmful once people's dignity and autonomy are involved. Using pluralism, such values could be held in the same importance as the scale and values of efficiency that propelled commercial agreements during that time. After all, constitutive autonomy and self-authorship would seem to imply that there is room in contracts for revision.

V. Conclusion

Within the mortgage default context, the inequality awareness this Article observes will hopefully bring more weight to the normative solutions that Miller, Cohen, and others have proposed to allow changed market conditions to broaden the use of contract excuse doctrines. These solutions may provide an exception or a clearer opportunity for some equitable considerations to be permitted to homeowners as well as the Hoosier Energy, Trump, and ALCOA-like giants of commercial agreements.[388] More broadly, the inequality awareness this Article observes should also direct attention and critical scrutiny to pondering what future circumstances might hold for the present state of contract doctrines, especially in large catastrophes of its own making.

The more we move away from focusing on the mere ideas that contract law ought to embrace and shift to theorizing contract law's ability to further self-realization, the closer we will be to arriving at a contracting system that not only recognizes human failure — and failings — but also addresses them justly, provides appropriate redemptive opportunities that self-authorship affords, and highlights the beliefs that modern liberal societies hold. We live by contracts. So rather than having been a homewrecker of sorts, perhaps contracts, during the Great Recession, could have emphasized the humans living inside these homes.

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[388] *See, e.g.*, Miller, *supra* note 35, at 42.