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## UCC § 2-615: SHARP INFLATIONARY INCREASES IN COST AS EXCUSE FROM PERFORMANCE OF CONTRACT

### I. Introduction

At a time when the wholesale price index is increasing at the rate of nearly 20 percent per year<sup>1</sup> and some individual commodity price indexes are increasing at an even faster rate,<sup>2</sup> sellers who have negotiated fixed price, long-term contracts may find performance at the agreed price increasingly impracticable, perhaps in some cases, to the point of financial disaster. Consider the plight of the supplier whose costs of production depend heavily upon the costs of coal, petroleum products, metal products, lumber, farm products, or any other commodity in short supply. Suppose either that he is locked into a major five-, ten-, or twenty-year contract in which he agreed to supply goods at a fixed price or that the contract contains a price escalator clause which proves to be completely inadequate to reflect the seller's actual cost increase.<sup>3</sup> Consider a seller whose costs relative to price may be expected to rise 50, 100, or 200 percent over the course of a long-term contract.<sup>4</sup> With a 25 or 50 percent projected markup, performance of the contract over a course of years would cause substantial losses, perhaps even financial ruin. The buyer, on the other hand, may have an extremely lucrative contract when the general market for the seller's goods rises to reflect the true costs of producing those goods.

With increasing frequency, it may become necessary to consider whether sharp inflationary increases in cost can be sufficient to excuse a seller from

<sup>1</sup> Between July, 1973, and July, 1974, the wholesale price index advanced 20 percent. Between August, 1973, and August, 1974, it advanced 18 percent. U.S. DEP'T OF COMMERCE, BUSINESS STATISTICS 3 (September 27, 1974).

<sup>2</sup> The following are some of the more extreme increases in the individual commodity indexes between 1972 and June, 1974: petroleum products, 113 percent; coal, 66 percent; inedible fats and oils, 212 percent; nonferrous metals, 72 percent; farm products, 34 percent; grain, 118 percent; lumber, 38 percent; iron and steel, 38 percent. U.S. DEP'T OF COMMERCE, SURVEY OF CURRENT BUSINESS S-9 (July, 1974).

<sup>3</sup> The price escalator clause may have projected an arbitrary 2 or 3 percent price increase per year; or it may have been based upon the wrong type of price indexes; or it may fail to reflect particular circumstances of the individual seller, for example, a shutdown of one of his major sources of supply which forces him to purchase his raw materials at exorbitant prices in a market where most of the available supply has already been claimed.

<sup>4</sup> The following table illustrates the way in which a continuing high rate of inflation can cause substantial increases in cost over the course of a long-term contract.

Cost increase/year	Price increase/year (Price escalation clause)	Total increase after X years relative to price increase		
		2 yrs.	5 yrs.	10 yrs.
10%	----	21%	61%	160%
20%	----	44%	150%	520%
50%	----	125%	660%	5700%
10%	3%	14%	39%	94%
20%	3%	36%	116%	360%
20%	10%	19%	55%	138%
50%	10%	85%	370%	2000%

Thus, with a 20 percent per year increase in cost and a 10 percent per year increase in price, costs would increase 150 percent (2.5 times) over the course of five years and price would increase 61 percent (1.61 times). In terms of percentage increases, the seller would be in the same position as if price had been fixed and costs had increased 55 percent.

performance at the agreed price.<sup>5</sup> Under the Uniform Commercial Code § 2-615, a seller, "unless he has assumed a greater obligation," is excused from his contractual obligations if performance "has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made."<sup>6</sup> Three issues are involved: (1) Under what circumstances does a seller assume a "greater obligation" to bear the risks of inflationary cost increases? (2) When are increases in cost sufficient to make performance "impracticable"? (3) Is an inflationary increase in cost "a contingency the nonoccurrence of which was a basic assumption on which the contract was made"?<sup>7</sup>

## II. A Greater Obligation of Risk

In the absence of any agreement by which the seller expressly assumes a "greater obligation" to bear the risks of increases in the cost of his performance, he may still in two respects impliedly assume a greater obligation. First, he will assume a "greater obligation" than the buyer to bear the ordinary risks inherent in his promise. Second, he may assume an even "greater obligation" than this ordinary assumption of risk because of the circumstances in which the contract was made.

The first and more important respect in which the seller assumes a greater obligation of risk follows from a principle which goes to the very heart of contract law: the promisor assumes the risks of his promise. As Justice Holmes stated in *Day v. United States*:<sup>8</sup> "One who makes a contract never can be absolutely certain that he will be able to perform it when the time comes, and the very

5 One of the first decisions to consider the possibility of excuse because of a sharp inflationary increase in cost was handed down just recently by a lower New York court. In *Maple Farms, Inc. v. City School Dist.*, 76 Misc.2d 1080, 352 N.Y.S.2d 784 (Sup. Ct. 1974), a dairy sought excuse from its obligation to deliver milk to the Elmira school district when its costs increased 23 percent from June to December, 1973.

6 The entire text of UNIFORM COMMERCIAL CODE § 2-615 reads as follows:

### Excuse by Failure of Presupposed Conditions

Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:

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

7 See *Transatlantic Financing Corp. v. United States*, 363 F.2d 312, 315 (D.C. Cir. 1966), where the court analyzed § 2-615 in terms of these same three issues. *But see* note 77, *infra*.

8 245 U.S. 159 (1917).

essence of it is that he takes the risk within the limits of his undertaking."<sup>9</sup> The very purpose of a contract is to bind the respective parties to fulfil their promises and to assume the risks inherent in that fulfillment. Justice Traynor noted in *Lloyd v. Murphy*<sup>10</sup> that "the purpose of a contract is to place the risks of performance upon the promisor."<sup>11</sup> Or, as the court also stated in *McCulloch v. Liguori*:<sup>12</sup> "[A] person contracting with eyes open and aware of the facts is presumed to undertake performance at the risk of interference from agencies not expressly provided against."<sup>13</sup>

The doctrine of excuse, then, stands as an exception to basic principles of contract law; in fact, it was not recognized at all by the early common law.<sup>14</sup> Later decisions, unwilling to enforce contractual obligations which became onerous under changed circumstances but also unwilling to "excuse" performance, granted relief by imputing an "implied condition" to performance.<sup>15</sup> Thus, an obligation to pay exorbitant rents for the use of a flat was excused for failure of an "implied condition" that the coronation procession of King Edward VII be held in view of the apartment.<sup>16</sup> So also, a contractual obligation to lease a music hall was construed as contingent upon the implied condition that the hall not be destroyed by fire.<sup>17</sup>

More thoughtful opinions recognized that this "implied condition" was simply a judicial construction designed to reach a just result without undermining basic contract theory.<sup>18</sup> Others treated the implied condition as something proceeding from the actual intention of the parties.<sup>19</sup> Given that the parties did not make an express agreement allocating the risks of unforeseen contingencies, what would have been their reasonable expectations had they considered them?<sup>20</sup> Unfortunately, this implied condition theory was often based upon a complete fiction,<sup>21</sup> whether recognized or not; the parties actually may have had completely different expectations as to who should bear extraordinary risks.<sup>22</sup>

The Uniform Commercial Code, more interested in furthering "commercial standards," "equitable principles," and "good faith"<sup>23</sup> than in safeguarding legal fictions, makes excuse available in situations where "performance has become commercially impracticable because of unforeseen supervening circumstances

9 *Id.* at 161.

10 25 Cal.2d 48, 153 P.2d 47 (1944).

11 *Id.* at 54, 153 P.2d at 50.

12 88 Cal.App.2d 366, 199 P.2d 25 (1948).

13 *Id.* at 373, 199 P.2d at 30.

14 Annot., 84 A.L.R.2d 12, 22 (1962).

15 *Id.* at 21-24, 50-55.

16 *Krell v. Henry*, [1903] 2 K.B. 740 (C.A.).

17 *Taylor v. Caldwell*, 122 Eng. Rep. 309 (K.B. 1863).

18 *See Kinzer Constr. Co. v. State*, 125 N.Y.S. 46, 54-55 (Ct. Cl. 1910), *aff'd*, 145 App. Div. 41, 129 N.Y.S. 567 (1911), *aff'd*, 204 N.Y. 381, 97 N.E. 871 (1912); 6 WILLISTON, CONTRACTS § 1937 (rev. ed. 1938).

19 *See, e.g., Leonard v. Autocar Sales & Serv. Co.*, 392 Ill. 82, 64 N.E.2d 477 (1945), *cert. denied*, 327 U.S. 804 (1946).

20 *Cf. Lloyd v. Murphy*, 25 Cal.2d 48, 54, 153 P.2d 47, 50 (1944).

21 *See Transatlantic Financing Corp. v. United States*, 363 F.2d 312, 315 (D.C. Cir. 1966).

22 *See Ocean Tramp Tankers Corp. v. V/O Sovfracht (The Eugenia)*, [1964] 2 Q.B. 226, 238-39 (C.A. 1963).

23 UNIFORM COMMERCIAL CODE § 2-615, Comment 6.

not within the contemplation of the parties at the time of contracting."<sup>24</sup> Although the Code language itself is broad and indefinite, § 2-615 does appear to give some content to the "reasonable expectations" which may be imputed to the parties. Rather than focusing upon some fictional mental conditions of the parties, § 2-615 appears to attach primary importance to the more objective criteria of practicability and foreseeability.

The second respect in which a seller may assume a "greater obligation" of risk applies to those situations in which he would otherwise be excused because unforeseen contingencies have made his performance impracticable, but where he has expressly or impliedly assumed the obligation to bear extraordinary risks.<sup>25</sup> In *Transatlantic Financing Corp. v. United States*,<sup>26</sup> for example, the court construed Transatlantic's claim for excuse due to the sudden closing of the Suez Canal in "stricter terms" because the "surrounding circumstances . . . [indicated] a willingness by Transatlantic to assume abnormal risks."<sup>27</sup> In *United States v. Wegematic Corp.*,<sup>28</sup> the court held that Wegematic, by its representations to the government, had assumed the risk that it could engineer a "revolutionary breakthrough" in the computer industry.<sup>29</sup> Again, in *Security Sewage Equipment v. McFerren*,<sup>30</sup> Security contracted to sell a sewage treatment plant to a real estate developer and then sought excuse when the State Department of Health required substantial modification of the plant; in holding that Security had assumed the risk that its plans would not be approved by the Department of Health, the court noted that "Security, by the nature of its business, possessed superior knowledge of the requirements of the Department of Health."<sup>31</sup>

The negotiation discussions between the parties also might have some bearing on the seller's assumption of risk. Where price agreement was reached only after the laborious and careful negotiation of a complex price escalation provision, it would appear that the seller would have a greater obligation to abide by that price than where it was fixed by an almost casual reference to the prevailing market price. The relative bargaining strengths of the two parties also might serve to affect the seller's assumption of risk.<sup>32</sup>

The seller, then, may expressly assume a greater obligation to bear extraordinary risks or he may impliedly assume such an obligation because of the circumstances in which the contract was made. This assumption of risk, however, must be considered in close connection with the unforeseen supervening

24 *Id.*, Comment 1. Some courts may continue to analyze excuse under the implied condition theory even with the Code. See *Low's Ezy-Fry Potato Co. v. J. A. Wood Co.*, 26 A.D. 583 (Dep't Agriculture 1967).

25 UNIFORM COMMERCIAL CODE § 2-615, Comment 8 states:

The provisions of this section are made subject to assumption of greater liability by agreement and such agreement is to be found not only in the expressed terms of the contract but in the circumstances surrounding the contracting, in trade usage and the like.

26 363 F.2d 312 (D.C. Cir. 1966).

27 *Id.* at 319.

28 360 F.2d 674 (2d Cir. 1966).

29 *Id.* at 676.

30 14 Ohio St.2d 251, 237 N.E.2d 898 (1968).

31 *Id.* at 253, 237 N.E.2d at 900.

32 *Cf. Lloyd v. Murphy*, 25 Cal.2d 48, 54, 153 P.2d 47, 50 (1944), where the court stated that the "relation of the parties" is a factor to be considered in determining where the burden of risk falls.

circumstances which might make performance impracticable. On the one hand, these supervening circumstances may be so extreme as to excuse performance even where the seller has made a written agreement to the contrary.<sup>33</sup> On the other hand, the supervening circumstances may be insufficient to excuse a seller who has assumed no extraordinary risks at all. Even absent the assumption of a "greater obligation" by the seller, he will not be excused unless he can show both that his performance is "impracticable" and that sharp inflationary cost increases are "contingencies the nonoccurrence of which was a basic assumption on which the contract was made."<sup>34</sup>

### III. Impracticability Due to Increased Cost

Under the Uniform Commercial Code, the seller is excused when unforeseen contingencies make his performance "impracticable"; it is not necessary that these contingencies make his performance "impossible" or that they serve "to frustrate the venture."<sup>35</sup> The test is one of commercial impracticability and the statutory provision is intended to further "the general policy of this Act to use equitable principles in furtherance of commercial standards and good faith."<sup>36</sup>

In line with the more liberal pre-Code cases,<sup>37</sup> the Official Comment to § 2-615 indicates that performance may be made impracticable by sharp increases in cost.<sup>38</sup> But "increased cost alone does not excuse performance" unless it is sufficient to "alter the essential nature of the performance."<sup>39</sup> The leading case of *Mineral Park Land Co. v. Howard*<sup>40</sup> illustrates the type of extreme impracticability which almost certainly would be excused under § 2-615. The defendant construction company in that case contracted to haul over 100,000 cubic yards of gravel and earth from the plaintiff's land at specified rates. Although there was enough gravel and earth on the plaintiff's land to meet the terms of the contract, about 50,000 cubic yards were under the water level and could have been removed only at an expense of 10 or 12 times the usual cost. The California

33 Uniform Commercial Code § 2-615, Comment 8 states:

Generally, express agreements as to exemptions designed to enlarge upon or supplant the provisions of this section are to be read in the light of mercantile sense and reason, for this section itself sets up the commercial standard for normal and reasonable interpretation and provides a minimum beyond which agreement may not go.

See HAWKLAND, *The Energy Crisis and Section 2-615 of the Uniform Commercial Code*, 79 COM. L. J. 75 (1974).

34 UNIFORM COMMERCIAL CODE § 2-615.

35 *Id.*, Comment 3.

36 *Id.*, Comment 6.

37 See Annot., 84 A.L.R.2d 12, 60-62 (1962).

38 UNIFORM COMMERCIAL CODE § 2-615, Comment 4.

39 *Id.* Comment 4 reads as follows:

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

40 172 Cal. 289, 156 P. 458 (1916).

Supreme Court held that the defendant was excused for failing to remove the 50,000 cubic yards under water on the grounds of "impossibility": "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."<sup>41</sup>

With less extreme cost increases, however, courts have been reluctant to find excuse. In another leading case from California, *Lloyd v. Murphy*,<sup>42</sup> Justice Traynor held that the mere fact that unforeseen contingencies make performance difficult, expensive, or even unprofitable does not excuse performance.<sup>43</sup> In *Lloyd*, the defendant leased an auto showroom for the purpose of selling new cars. When the government ordered that the sale of new autos be discontinued in 1942, the defendant invoked the doctrine of commercial frustration and refused to pay the rent. The court upheld the lease: "Laws or other governmental acts that make performance unprofitable or more difficult or expensive do not excuse the duty to perform a contractual obligation."<sup>44</sup> The standard, said the court, was whether the unanticipated circumstance had made performance "vitally different from what was reasonably to be expected."<sup>45</sup>

The Restatement of Contracts likewise took the liberal position that excessive cost can be sufficient to excuse performance but, like the cases, extended excuse only to situations of "impracticability because of extreme and unreasonable difficulty, expense, injury or loss involved."<sup>46</sup> This "extreme and unreasonable" standard set forth by the Restatement has probably been the prevailing and most commonly applied standard by which impracticability due to increased cost has been measured.<sup>47</sup> More importantly, the few cases decided under § 2-615 have continued to apply this standard and have refused to find impracticability where the cost increase did not involve an "extreme and unreasonable" or an "excessive and unreasonable" expense.<sup>48</sup> The Code comment to § 2-615, however, uses language more moderate than "extreme and unreasonable"; it suggests that performance may become impracticable when an unforeseen contingency causes a "marked increase" in cost.<sup>49</sup>

What might an "extreme and unreasonable" or "marked increase" in cost be? By way of illustration, the Restatement of Contracts gives tenfold and fiftyfold increases in cost as examples of what is "extreme and unreasonable."<sup>50</sup> The *Mineral Park* case found an increase of 10 or 12 times unreasonable.<sup>51</sup> In *City of*

41 *Id.* at 293, 156 P. at 460. Compare with the decision in *Ballou v. Basic Constr. Co.*, 407 F.2d 1137, 1141 (4th Cir. 1969), where the court held that performance could be excused only if there was "objective impossibility."

42 25 Cal.2d 48, 153 P.2d 47 (1944).

43 *Id.* at 55, 153 P.2d at 51.

44 *Id.*

45 *Id.* at 54, 153 P.2d at 50. See also 6 WILLISTON, CONTRACTS § 1963, at 5511 (rev.ed. 1938), where the same standard was suggested.

46 RESTATEMENT OF CONTRACTS § 454 (1932). It should be noted that when the Restatement spoke of "extreme and unreasonable difficulty, expense, or injury," it was not defining "impracticability" but rather the older and more restrictive standard of "impossibility."

47 See Annot., 84 A.L.R.2d 12, 61 (1962).

48 See *American Trading & Prod. Corp. v. Shell Int'l Mar. Ltd.*, 453 F.2d 939, 942 (2d Cir. 1972); *Natus Corp. v. United States*, 371 F.2d 450, 456 (Ct. Cl. 1967); *Northern Corp. v. Chugach Elec. Ass'n.*, 518 P.2d 76, 81 (Alaska 1974); *Portland Section of Council of Jewish Women v. Sisters of Charity*, 513 P.2d 1183, 1188 (Or. 1973).

49 UNIFORM COMMERCIAL CODE § 2-615, Comment 4.

50 RESTATEMENT OF CONTRACTS § 460, Illustrations 2 and 3 (1932).

51 172 Cal. 289, 156 P. 458.

*Vernon v. City of Los Angeles*,<sup>52</sup> the court excused Los Angeles from performance of a contract to dispose of Vernon's sewage for which Vernon was apparently paying over \$100,000 per year. Continued performance would have involved construction of a \$41 million sewage plant with yearly operating costs of \$500,000.<sup>53</sup> The much more recent case of *Northern Corp. v. Chugach Elec. Ass'n*<sup>54</sup> found a 93 percent cost increase impracticable.<sup>55</sup> In that case the court found that the parties had expressly contemplated that a contractor would haul the rock for a dam reconstruction by truck across the frozen lake behind the dam. When repeated unsuccessful efforts to truck the rock across the lake finally resulted in loss of life, the court held that performance as contemplated was "impossible" and that the contractor did not have to incur the nearly double expenses of hauling the rock by barge.<sup>56</sup>

On the other hand, the courts of appeal in *Transatlantic*<sup>57</sup> and *American Trading & Prod. Corp. v. Shell Int'l Marine Ltd.*<sup>58</sup> held that 14 percent and 30 percent cost increases were not sufficient to constitute commercial impracticability. In addition, both cited with approval the two leading English cases in which the courts had refused to excuse performance and in which more extreme cost increases were involved.<sup>59</sup> *Ocean Tramp Tankers Corp. v. V/O Sovfracht (The Eugenia)*<sup>60</sup> indicated that a cost increase of approximately 45 percent did not constitute grounds for frustration.<sup>61</sup> In *Tsakiroglou & Co. v. Noble Thorl G.m.b.H.*,<sup>62</sup> the House of Lords refused to excuse performance although costs were doubled as a result of the Suez closing.<sup>63</sup> In accord, *Maple Farms v. City School Dist.*<sup>64</sup> held on summary judgment that a 23 percent increase in the price of milk between June and December of 1973 did not make performance impracticable. And in *Portland Section of Council of Jewish Women v. Sisters of Charity*,<sup>65</sup> the court held that it was not impracticable for a hospital to continue to provide a ward bed for Jewish patients in return for a \$5,000 payment made in 1927, even though the maintenance of a hospital bed was costing as much as \$140 per day:

We hold that the hazards of increasing expenses attributable to inflation and new techniques were ones that should and could have been guarded against

52 45 Cal.2d 710, 290 P.2d 841 (1956).

53 *Id.* at 718-19, 290 P.2d at 846. It is not clear from the court's decision whether the \$41 million sewage plant would also serve the City of Los Angeles itself or whether it would have to be built exclusively for the use of Vernon. In any case, the court stated that the difference between the cost and the contract price was "completely disproportionate." *Id.* at 720, 290 P.2d at 847.

54 518 P.2d 76 (Alaska 1974).

55 *Id.* at 80 n.3.

56 *Id.* at 80-82.

57 363 F.2d at 319.

58 453 F.2d at 942. The court in *American Trading* also noted that the parties had agreed upon a price 75 percent higher than the prevailing rate schedule. *Id.* at 941.

59 *Id.* at 942; 363 F.2d at 319 n.14.

60 [1964] 2 Q.B. 226 (C.A. 1963).

61 *Id.* at 233.

62 [1960] 2 Q.B. 318, *aff'd*, [1962] A.C., 93 (1961).

63 *Id.* at 348.

64 76 Misc.2d 1080, 352 N.Y.S.2d 784 (Sup. Ct. 1974).

65 513 P.2d 1183 (Or. 1973).



and that the hardship has not become so extreme as to have been beyond any reasonable contemplation of the parties.<sup>66</sup>

And in a recent study of the problem by the Practising Law Institute,<sup>67</sup> Professor James White concluded that even an unforeseen tenfold cost increase should not excuse the seller: "Increase in price, even rather radical increase in price, is a thing contracts are designed to protect against."<sup>68</sup>

Thus, on the basis of dictum in *Transatlantic* and *American Trading*, one might say that a doubling in cost will be insufficient to trigger impracticability.<sup>69</sup> On the other hand, the holding in *Northern* may indicate that a 90 percent cost increase can make performance impracticable;<sup>70</sup> this holding, however, may be limited to the particular facts of the case, where the parties had clearly contemplated a manner of performance which became physically impossible. Given the present state of the law, the attempt to establish percentage guidelines for cost increases which will pinpoint the numerical boundaries of "impracticability" could impute a precision which simply does not exist.<sup>71</sup>

When interpreted in light of such other broad and indefinite standards as "equitable principles," "commercial standards," and "good faith,"<sup>72</sup> "impracticability" will be "an ever-shifting line, drawn by courts hopefully responsive to commercial practices and mores."<sup>73</sup> In the absence of controlling precedent, there is always room for a seller to argue that even a 50 percent or less increase in cost was "unreasonable" or "marked" and that prevailing "commercial standards" in an unstable economy require excuse. But in view of the reluctance with which courts have traditionally abrogated contractual obligations, it appears unlikely that a 50 percent or even a 100 percent cost increase ordinarily would constitute impracticability.

#### IV. The Foreseeability of Inflationary Increases in Cost

In order for a seller to be excused from the terms of a contract, it is not sufficient that his performance be "impracticable"; in addition, performance must be made impracticable "by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made."<sup>74</sup> A seller may claim, of course, that he contracted under the "basic assumption" that his costs would not increase, say, 50 percent and that he would never have made the contract had he foreseen this contingency. Superficially, such an argu-

66 *Id.* at 1189. The court also attached great importance to the facts that the hospital's gross yearly receipts were \$12 million and that the hospital had traditionally provided the bed as a charity to poor and needy persons.

67 WHITE, *Impossibility, Impracticability, and Supervening Illegality, in BREACH OF CONTRACT IN A SHORTAGE ECONOMY* 9 (1974) [hereinafter cited as WHITE].

68 *Id.* at 19-20. In light of the cases discussed above, this view seems somewhat extreme; nevertheless, it may be taken as illustrative of the proposition that the obligations of contracts should not be lightly abrogated.

69 See note 59 *supra* and accompanying text.

70 See note 55 *supra* and accompanying text.

71 Moreover, much necessarily depends upon the circumstances of the individual parties. The duration and the importance of the contract, the degree of loss which performance would cause to the seller, the relative abilities of either party to absorb increasing prices all make a given percentage increase more or less impracticable.

72 UNIFORM COMMERCIAL CODE § 2-615, Comment 6.

73 *Transatlantic Financing Corp. v. United States*, 363 F.2d 312, 315 (D.C. Cir. 1966).

74 UNIFORM COMMERCIAL CODE § 2-615.

ment may seem convincing, but it really says no more than that the seller made the assumption that he was negotiating a profitable contract. This assumption is implicit in all contracts including virtually all the bad deals ever made. A more reasonable analysis of the "basic assumption" language would be to ask whether the contingencies were "unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting."<sup>75</sup> Again, "commercial standards" and "good faith" must be used.

For a contingency to be foreseeable,<sup>76</sup> it is not necessary that it be likely to occur. For example, the court in *Transatlantic*, working with § 2-615, held that the closing of the Suez Canal was foreseeable:

We know or may safely assume that the parties were aware, as were most commercial men with interests affected by the Suez situation, see *The Eugenia supra*, that the Canal might become a dangerous area. No doubt the tension affected freight rates, and it is arguable that the risk of closure became part of the dickered terms.<sup>77</sup>

In *Glenn R. Sewell Sheet Metal, Inc. v. Loverde*,<sup>78</sup> the court held that the lessee of a trailer park should have foreseen "that cesspool systems do not last forever and that when the septic system failed public sewer connections would be required."<sup>79</sup> In *West Los Angeles Institute v. Mayer*,<sup>80</sup> the court held that an adverse Internal Revenue Service ruling on a sale and leaseback arrangement was foreseeable.

In *Madeirense Do Brasil S/A v. Stulman-Emrich Lumber Co.*<sup>81</sup> the court held that it was foreseeable in January, 1941, that there would be a lack of ships due to World War II. In *Aristocrat Highway Display v. Stricklin*,<sup>82</sup> the court held it foreseeable in October 1941 that the United States would become involved in World War II and that neon signs might be prohibited as a result. So also, in *Glen Falls Indemnity Co. v. Perscallo*,<sup>83</sup> the court found that "[f]or months before Pearl Harbor any American citizen should have been able to foresee the imminence of war with the Axis Powers."<sup>84</sup> *Lloyd v. Murphy*,<sup>85</sup>

<sup>75</sup> *Id.*, Comment 1.

<sup>76</sup> Like the cases, this note uses the terms "foreseen" and "foreseeable" interchangeably. It should be recognized, however, that these terms may set somewhat different standards.

<sup>77</sup> 363 F.2d at 318. Although the court in *Transatlantic* devoted considerable attention to the issue of foreseeability and clearly considered it a major factor in determining whether performance should be excused, it considered the foreseeability issue not in connection with the "basic assumption" language of the Code, as this Note does, but rather in connection with the assumption of the risk issue previously discussed. Thus, although *Transatlantic* held that the Suez closing was foreseeable, it also held that it was "something unexpected" and therefore "a contingency the non-occurrence of which was a basic assumption on which the contract was made." *Id.* at 315-16. Since sellers never "expect" that their performance will be impracticable, however, this approach would automatically make any impracticable contingency also a "contingency the non-occurrence of which was a basic assumption on which the contract was made"; hence this complex statutory language would be superfluous. As long as the court believes that unforeseeability is necessary for excuse, it would appear logical to consider it in connection with the "basic assumption" language of the Code.

<sup>78</sup> 70 Cal.2d 666, 451 P.2d 721, 75 Cal. Rptr. 889 (1969).

<sup>79</sup> *Id.* at 676, 451 P.2d at 727, 75 Cal. Rptr. at 895.

<sup>80</sup> 366 F.2d 220 (9th Cir. 1966).

<sup>81</sup> 147 F.2d 399 (2d Cir. 1945).

<sup>82</sup> 68 Cal. App.2d 788, 157 P.2d 880 (1945).

<sup>83</sup> 96 Cal. App.2d 799, 216 P.2d 567 (1950).

<sup>84</sup> *Id.* at 802, 216 P.2d at 570.

<sup>85</sup> 25 Cal.2d 48, 55-56, 153 P.2d 47, 51 (1944).

discussed earlier, likewise held that contingencies resulting from World War II were foreseeable.

In discussing the foreseeability issue in the study sponsored by the Practicing Law Institute, Professor White suggests that it may be foreseeable in 1974 that copper may be hard to buy because of political unrest in Peru and Chile, that there may be an Arab oil embargo in 1984, or that a supplier as solvent as Texaco may go bankrupt.<sup>86</sup> The fact that the parties made no express provision for the contingency does not necessarily mean that they contracted on the assumption that it would not occur. As the court stated in *Transatlantic*: "Parties to a contract are not always able to provide for all of the possibilities of which they are aware, sometimes because they cannot agree, often simply because they are too busy."<sup>87</sup>

Although there have been virtually no litigated cases which have turned upon the foreseeability of sharp inflationary increases in cost, by analogy with the Suez and World War II cases, it would appear that the general 10 to 15 percent inflation of today was at least as foreseeable in the 1960's or even the 1950's as was the occurrence of the Suez closing and World War II.<sup>88</sup> For parties contracting in 1974 and 1975, what range of future inflation is foreseeable? The monthly increases in the wholesale price index during July and August 1974 were both at an annual rate of well over 40 percent.<sup>89</sup> Is a 40 or 50 percent general inflation "unforeseeable"? In light of the experience of some other countries, is a 100 or 200 percent per year general inflation unforeseeable and "not within the contemplation of the parties at the time of contracting"?<sup>90</sup> Further, might not a major depression followed by deflation also be foreseeable?

Even where cost increases are so "marked" or "unreasonable" as to make performance impracticable, in many industries, particularly those where shortages are greatest and cost increases most severe, these marked increases may have been foreseeable when the contract was made. In such cases the Code, glossed by the traditional weight of authority, does not support a claim for excuse and the seller is obliged to perform his obligations, impracticable as this performance may be. Since the seller is ordinarily presumed to assume the risks inherent in his promise, the language of *Lloyd v. Murphy*<sup>91</sup> would appear applicable to those situations in which sharp cost increases were foreseeable: ". . . [T]here should have been provision for it in the contract, and the absence of such a provision gives rise to the inference that the risk was assumed."<sup>92</sup>

### V. A Good Faith Obligation to Accept Price Adjustment?

The traditional but sparse authority of the decided cases may be summarized as follows. Increased costs will excuse a seller from performance only when the

86 WHITE, *supra* note 67, at 16, 18-19.

87 363 F.2d at 318.

88 See *Maple Farms, Inc. v. City School Dist.*, 76 Misc.2d 1080, 1084, 352 N.Y.S.2d 784, 789 (Sup. Ct. 1974), where the court held that a 23 percent increase in the price of milk over a six-month period was foreseeable.

89 U.S. DEP'T OF COMMERCE, BUSINESS STATISTICS 3 (Sept. 27, 1974).

90 UNIFORM COMMERCIAL CODE § 2-615, Comment 1.

91 25 Cal.2d 48, 153 P.2d 47 (1944).

92 *Id.* at 54, 153 P.2d at 50.

increases are "extreme," "excessive," "unreasonable," and probably more than double. In addition, the increases, no matter how extreme, must have been "unforeseen" and "not within the contemplation of the parties at the time of contracting." Finally, the seller must not have expressly or impliedly assumed a "greater obligation" to bear such unforeseen, extreme cost increases.<sup>93</sup>

Section 2-615, however, provides room for a broader, more liberal interpretation than that suggested by the few cases which have considered it. The statute itself uses only the broad and elastic terms "impracticable" and "basic assumption" rather than the more strict terms "extreme and unreasonable" and "unforeseeable." These later standards have their origins in pre-Code law which followed the older and more restrictive doctrines of impossibility and commercial frustration.<sup>94</sup>

This more restrictive, traditional interpretation may circumvent the purpose of § 2-615: to substitute "commercial standards," "equitable principles," and "good faith"<sup>95</sup> for a legalistic construction of contracts. Particularly in the case of long-term contracts, where the parties may have been dealing with each other for years or even for generations, it may be expected that reasonable businessmen will be willing to spread the risks and the losses which result from unstable economic conditions. It may be expected that sellers routinely will "pass on" at least part of their increases in cost and it may be regarded as a breach of good faith to respond to this practice with a lawsuit to enforce the terms of a contract made several years back.

The average businessman may think that he has a legal right to have contracts enforced to the letter, regardless of how difficult performance becomes. The same businessman, however, routinely may "waive" this "legal right" on the theory that "these are rough times and I may need help myself some day." Where the willingness to accept contract-breaking price increases becomes common practice, businessmen may continue to think that they are simply waiving their legal rights as a matter of helpfulness and good will; courts, however, ought to pay less attention to the businessman's opinion of what the law is and more attention to the commercial practice which he actually follows.<sup>96</sup>

The Code Comment suggests one manner by which additional flexibility might be achieved without departing from the traditional standards applicable to excuse:

In situations in which neither sense nor justice is served by either answer when the issue is posed in flat terms of "excuse" or "no excuse," adjustment under the various provisions of this Article is necessary, especially the sections on good faith, on insecurity and assurance and on the reading of all the provisions in the light of their purposes, and the general policy of the

93 In addition, the party seeking excuse has the burden of proof on the issues of practicability and foreseeability. *See, e.g., Ocean Air Tradeways, Inc. v. Arkay Realty Corp.*, 480 F.2d 1112, 1117 (9th Cir. 1973).

94 *See* Annot., 84 A.L.R.2d 12 (1962).

95 UNIFORM COMMERCIAL CODE § 2-615, Comment 6.

96 *See* UNIFORM COMMERCIAL CODE § 1-102(2):

Underlying purposes and policies of this Act are

- (a) to simplify, clarify and modernize the law governing commercial transactions;
- (b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;

Act to use equitable principles in furtherance of commercial standards and good faith.<sup>97</sup>

In other words, there may be many situations which are not quite so extreme as to constitute grounds for excuse but where commercial standards and good faith require price adjustment. The seller would not be excused from performance or given an opportunity to abandon his obligations toward the buyer in favor of someone else.<sup>98</sup> So also, he would not be given the opportunity to flout commercial expectations by "passing on" any sort of price miscalculation which he may have made. But where other commercial men in similar circumstances actually are making price adjustments, he would have the right in good faith to make the same type of adjustments.<sup>99</sup>

This right to make price adjustment would have greatest applicability in situations where costs have increased 50, 100, or 200 percent, where the increases may have been foreseeable to some debatable extent, and where the seller may have assumed a "greater obligation" of risk to some extent. In this rather large grey area in which it is simply unclear whether traditional precedent supports a claim for excuse, the seller ought to be able to follow the practice of other commercial men who are in similar situations. If he can show that others are renegotiating price or accepting contract-breaking price increases, then the court, in this wide area of uncertainty, ought to accept the prevailing commercial practice as determinative.<sup>100</sup>

Although this price adjustment approach has not been followed by any of the reported cases to date, this may be explained by the fact that widespread sharp inflationary cost increases are unprecedented phenomena of the past year. One might argue that this approach would greatly weaken that basic principle of contract law that the promisor assumes the risks of his promise, and that an easier opportunity for price adjustment would increase litigation and undermine the fundamental expectation that contracts will be honored according to their terms. By requiring that any claim for price adjustment be based upon the actual prevailing commercial standards of the marketplace, however, this approach would not run counter to commercial standards but rather implement them in individual cases where a purchaser is intent upon making his good deal "stick." The obligation to accept price adjustment in good faith, therefore, should not be seen as a new doctrine in place of excuse but rather as a means for injecting greater flexibility into the traditional approach and bringing it into greater conformity with commercial standards.

*John B. Haley*

97 UNIFORM COMMERCIAL CODE § 2-615, Comment 6.

98 See *City of Vernon v. City of Los Angeles*, 45 Cal.2d 710, 721, 290 P.2d 841, 847 (1955); compare with *Transatlantic Financing Corp. v. United States*, 363 F.2d 312, 320 (D.C. Cir. 1966), where the court stated, "When performance of a contract is deemed impossible it is a nullity."

99 UNIFORM COMMERCIAL CODE § 1-203 provides, "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." Between merchants this requires the observance of "reasonable commercial standards of fair dealing in the trade." *Id.*, Comment.

100 See UNIFORM COMMERCIAL CODE § 2-305, which authorizes courts to enforce contracts even where nothing is said as to price or where the parties fail to agree on price. In such cases, "the price is a reasonable price at the time of delivery" as determined in "good faith." *Id.*