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Of Expectations, Incomplete Contracting, and the Bargain Principle

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In the bargain theory of contract, an executory contract is an exchange by at least two parties of present promises to render future performance. Each party is assumed to view the performance that she undertakes as the price of the performance undertaken by the other. If they satisfy the required legal formalities,[1] such exchanges of promises are usually enforceable to the extent of the value of the promised performance—the expectation measure. This value is the difference between the market price for the promised performance at the time of breach and the price placed upon that performance by the contract. Although the view of contract as a bargained-for exchange is under attack on certain fronts,[2] it is commonly accepted.[3] Accordingly, I accept it as a premise

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1. Examples of such formalities are the Statute of Frauds, the requirement of consideration, etc.

2. These attacks take two forms. The first questions whether contract can or should be described as a bargained-for exchange of promises. *See, e.g.*, C. FRIED, CONTRACT AS PROMISE 5-6 (1981) (defining contractual obligation, that is, the right to impose obligations on oneself, as a moral implication of liberal individualism. This explanation also implies enforcement through a subjective measure of damages because it is based upon the freely assumed obligation of the individual); Dalton, *An Essay in the Deconstruction of Contract Doctrine*, 94 YALE L.J. 997, 1073 (1985) (bargain

in this Article.

Under the bargain theory, a contract is formed when the parties to it freely consent[4] to undertake duties to each other. It is this mutual consent that binds the promisor to the promisee and provides the legal basis for the enforcement of the contract. However, the doctrines of contract enforcement fail to reflect this consensual basis because the determination of contractual duties rests upon unrealistic assumptions about bargaining behavior and risk allocation. The classical ideal posits a highly unlikely model—complete risk allocation at the time of contract formation—and develops doctrine governing contract enforcement and damages accordingly.

Under the consent model of bargain, the enforcement of unallocated obligations is justified by the assumption that contracting parties should fully consider and allocate all risks. Enforcement of contracts under the classical ideal would have several important and useful consequences: A presumption of complete allocation provides a bright line standard that is easily and thus consistently applied by the courts. Consistent application in turn guides the conduct of contracting parties, especially at the point of performance, thus enhancing contractual stability. If the underlying premise of complete contracting is unrealistic, however, enforcement of contractual duties derived from such a model of bargaining behavior has a serious flaw. Contracting parties are frequently required to perform obligations to which they never really consented.[5] Enforcing unallocated obligations is a redistributional act[6] by the courts, which may be used to

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theory fails to resolve "the uncertainty created by the underlying problems of knowledge and power.").

The second seeks to identify classes of contract to which the bargain theory is inapplicable. *See, e.g.*, Eisenberg, *The Bargain Principle and its Limits*, 95 HARV. L. REV. 741 (1982) (applicability of bargain theory limited in situations involving either a lack of a perfectly competitive market, or wholly executory contracts). I will not deal with the problems raised by the writers of articles on mass and form contracts; these problems are no different under the regime I discuss in this paper.

3. *See, e.g.*, 1 A. CORBIN, CORBIN ON CONTRACTS § 116 (1963); E.A. FARNSWORTH, CONTRACTS § 2.2 (1982).

4. There has been debate as to whether consent had to be objective (manifested by the parties' actions) or subjective (based on the parties' actual or subjective intentions). The objective standard generally is applied today. *See* E.A. FARNSWORTH, *supra* note 3, § 3-6.

5. *See, e.g.*, Peerless Casualty Co. v. Weymouth Gardens, Inc., 215 F. 2d 362, 364 (1st Cir. 1954) ("an increase in costs caused by the unexpected outbreak of a war does not . . . [end] the obligation of a valid contract . . ."); Paradine v. Jane, Aleyn 26, 27, 82 Eng. Rep. 897 (K.B. 1647)

6. Enforcing unallocated benefits or losses is redistributional because the court must allocate them according to its own notions of justice or policy, rather than according to how the parties would have chosen to distribute them. Because the court's choice is unlikely to reflect the parties' preferences, the court will almost certainly effect a transfer of wealth from one to the other. *See, e.g.*, Schwartz, *Sales Law and Inflation*, 50 S. CAL. L. REV. 1, 8-11 (1976) (demonstrating that if the parties have assumed the risk of inflation within certain boundaries, outside the allocated range an act either to enforce or excuse is necessarily distributional). *See generally* C. FRIED, *supra* note 2, at 57-73 (discussing how losses should be allocated in cases involving mistake, frustration or impossibility); Hurst, *Freedom of Contract in an Unstable Economy: Judicial Reallocation of*

further a variety of public goals, but does not contribute to achieving the goals of the bargain principle.

For many centuries, however, the classical ideal of complete contracting has been relaxed by "excuse" doctrines. In the classical theories of excuse, the party seeking excuse had as a threshold requirement to point to a "fact" or "event" that was "unforeseen and unforeseeable" at the time of contracting and show that the event caused a severe disruption of the contract.[7] The court then decided whether the fact was sufficiently unknown or the event so outlandish that it was appropriately ignored at the time the bargain was struck. If it was, the court then decided whether the disruption was sufficiently severe to warrant relief.[8]

The requirement of an "unforeseen and unforeseeable" event is clearly a recognition of the fact that people cannot make complete allocations. Current trends seek to expand greatly the areas in which "relief" is available for incomplete contracting. This can be seen in the attempts to expand the availability of the excuse doctrines,[9] the greater willingness

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Contractual Risks Under U.C.C. 2-615, 54 N.C.L. REV. 545 (1976) (arguing that the impossibility of performance provisions of the U.C.C. give courts too much discretion in deciding whether to "excuse" performance).

7. For the impossibility excuse a plaintiff had to point to the occurrence of an unforeseen "event." Examples include the passage of a statute making the promised performance illegal, Louisville & N.R.R. v. Motley, 219 U.S. 467 (1911), the death or incapacity of the promisor, Buccini v. Paterno Constr. Co., 253 N.Y. 256, 170 N.E. 910 (1930), and the destruction of a thing necessary for the promised performance, Taylor v. Caldwell, 3 B.& S. 826, 122 Eng. Rep. 309 (K.B. 1863).

Excuse for frustration depended upon a plaintiff showing the intervention of an event that makes the contract valueless. *See, e.g.*, Krell v. Henry, 2 K.B. 740 (C.A. 1903) (plaintiff excused from contract to lease a room from which plaintiff intended to watch coronation parade when coronation postponed). The added requirement of unforeseeability creeps in because the plaintiff must show that she did not assume the risk of the event, and this often hinges on foreseeability. *See, e.g.*, Gold v. Salem Lutheran Home Ass'n., 53 Cal. 2d 289, 291, 347 P.2d 687, 689 (1959) (frustration is no defense if the intervening event is reasonably foreseeable).

Excuse on grounds of mistake requires the plaintiff to identify a fact mistaken to both parties at the time of the exchange and which materially alters the values exchanged. *See, e.g.*, Sherwood v. Walker, 66 Mich. 568, 33 N.W. 919 (1887) (cow believed to be barren was in fact with calf, making her 10 times more valuable than thought).

For a detailed discussion of the excuse doctrines of impossibility, frustration and mistake, *see infra* notes 135-63 and accompanying text.

8. In cases of mistake the plaintiff had to "show that the resulting imbalance in the agreed exchange is so severe that he can not be required to carry it out." RESTATEMENT (SECOND) OF CONTRACTS § 152 comment c (1979). *See also* Swift Canadian Co. v. Banet 224 F.2d 36 (3d Cir. 1955) (contract for the sale of pelts intended by the plaintiff, with the seller's knowledge, for shipment to the United States enforceable despite the intervening passage of United States import restrictions on pelts because the plaintiff had other markets). Impossibilty required a showing that the promised performance had become extremely onerous, *see, e.g.*, Gulf Oil Corp. v. Federal Power Comm'n, 563 F.2d 588, 599 (3d Cir. 1977), *cert. denied*, 434 U.S. 1062 (1978) (cost of performance must "become so excessive and unreasonable that the failure to excuse performance would result in grave injustice").

9. *See, e.g.*, U.C.C. § 2-615 & comments (1978) (nonperformance excused by commercial impracticability). Courts have been reluctant to accept the invitation to relax the standards for excuse. *See* Speidel, *Excusable Non-Performance In Sales Contracts: Some Thoughts About Risk*

to "imply" terms and conditions in contracts,[10] and most importantly, in the accelerating trend to make modifications freely available.[11]

In the modern theories of excuse and modification, the necessary precondition to relief is an event that was unforeseen at the time the contract was entered into.[12] These theories are a reasonable and welcome response to the recognition of incomplete contracting.[13] But no one has suggested that unforeseeability is a sufficient condition. Even the most liberal proponents of modification would condition relief further. Moreover, no one has suggested that a party has a *right* to modification when faced with unanticipated, or unallocated, risks. In all cases in which admittedly "unanticipated" events occur, a party must either satisfy the stringent conditions for relief under the excuse doctrines, or win her partner's consent to a modification allocating the unanticipated risk. Even when there is consensual modification, she will usually be required to satisfy further requirements before the modification will be enforced by the courts.[14] Thus, the premise underlying enforcement on grounds of consent is that of complete contracting, whereas the justification underlying—but not mandating—relief, whether by modification or by excuse, is the recognition of incompleteness. This basic inconsistency between the premises underlying enforcement under the bargain principle and relief for incomplete contracting has been exacerbated by the current trend towards relaxed standards for modification and excuse.

This increased incoherence might not in itself be sufficient to force a reevaluation of the underlying models of bargain. After all, increased sensitivity to incomplete contracting increases the likelihood that contract doctrine as a whole reflects the realities of bargaining. Accordingly,

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Management, 32 S.C.L. REV. 241, 258-71 (1980); Comment, *Contractual Flexibility in a Volatile Economy: Saving U.C.C. § 2-615 From the Common Law*, 72 NW. U.L. REV. 1032 (1978).

10. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979) (implied duty of good faith and fair dealing); U.C.C. § 1-203 (1978) (implied duty of good faith); U.C.C. § 2-207(3) (1978) (providing that where conduct establishes a contract between parties, missing terms may be supplied).

11. *See infra* text accompanying notes 172-83.

12. There is some flexibility in the requirement of unforeseeability in the *Restatement*, which suggests that enforceable modifications may sometimes be premised upon unallocated, although foreseen, events: "The reason for modification must rest in circumstances not anticipated as part of the context in which the contract was made, but a frustrating event may be unanticipated for this purpose if it was not adequately covered, even though it was foreseen as a remote possibility." RESTATEMENT (SECOND) OF CONTRACTS § 89 comment b (1979). However, it is unclear how far the "foreseen but unallocated" exception extends.

13. The doctrines of excuse are incompatible with both the premise of complete contracting and the consent rationale underlying bargain theory. If a risk is unknowable at the time the contract is entered into, the parties cannot have allocated it except in the broad sense that they are aware that the future is uncertain, and "consent" to the allocations made by the laws governing contracts. By conditioning relief further, courts often enforce contracts in the face of unknowable risk. Such enforcement cannot be justified as consensual.

14. *See infra* text accompanying notes 179-200.

the results under this mix of enforcement and relief will more closely approximate the subjective expectations of the contracting parties. If it were possible to retain the benefits attendant upon the classical model under current doctrine, the changes would have a net beneficial effect.

Unfortunately, the expansion of the doctrines of excuse and modification has brought a concomitant loss in contractual stability and certainty.[15] More importantly, the modern trend to make modification freely available threatens to embroil the courts in precisely the types of inquiry that the old rules sought to avoid.[16] Thus, the very strengths of the classical doctrine are undermined by the developing responses to incompleteness. In addition, it is difficult, if not impossible, for contracting parties to cure the effects of uncertainty by careful drafting, because in the transition from the almost total allocation regime of the classical doctrine to the much more liberal recognition of incompleteness, the bargaining model has remained constant. Parties are assumed—and instructed—to think of their universe of risk as a sum of discrete events.

Thus current theory starts from a model of the contracting process in which parties have allocated all events by the terms of the contract. Doctrines of excuse and modification seek to develop principled ways of determining which risk-events will serve as grounds for excuse, and which risk-events may be reallocated by mutual consent. For any risk-event to qualify for relief it must be unforeseeable, and hence unallocated. As a result, current contract doctrine is inconsistent in its approach to incomplete contracting, and incompatible with the goals of the bargain principle. Furthermore, examination of current doctrine reveals several additional flaws.

First, if we start the analysis under the presumption that allocations should be complete, the recognition that an allocation was not made has no operative significance in itself. Relief from incomplete contracting becomes a matter of grace or generosity. Thus, we are free to condition relief as we choose. The usual condition to relief is that a plaintiff must be faced with losses attributable to increased costs of performing the contract.[17] This is an irrational ground if based on sympathy for the loser;

15. This proposition needs empirical proof, but it is intuitively plausible that the likelihood of modification will increase as the probability of its enforcement increases, and that the amount of litigation will increase accordingly. *See* Levie, *The Interpretation of Contracts in New York Under the Uniform Commercial Code,* 10 N.Y.L.F. 350, 355 (1964) (attempts at modification currently involved in a large percentage of contract disputes); *see also* Berman, *Excuse for Nonperformance in the Light of Contract Practices in International Trade,* 63 COLUM. L. REV. 1413, 1437-1439 (1963) (a plea for limited use of excuse doctrine in international commercial contracts because of the problems of uncertainty).

16. Courts would be required to make several factual determinations on an ad hoc basis. *See infra* notes 176-208 and accompanying text.

17. "Loss" is defined as the increased cost of performance, without consideration of the lost

relief based on sympathy would be better focused on other factors, including how the contractual loss would affect the parties' net wealth, and what the parties' preferences and needs are.[18] Moreover, this narrow view of "losses" as increases in the cost of performance, without including losses due to opportunity costs, allows a party to keep the proceeds of a contract that turns out to be exceptionally beneficial.[19]

Second, if all events are presumed to be explicitly or implicitly allocated in the contract, finding an event not covered by the contract is tantamount to finding that the event is an excuse for nonperformance. The remedy then is to treat the parties as if their contractual obligations do not extend to the situation. The excused party may then walk away from the contract, leaving the other party with no rights at all. This outcome is not necessary but it becomes compelling when the premise of eventizing is added to the model of complete contracting.[20] The net effect of this rule is that the stakes become very high as one or the other of the parties will be forced to bear fully the risks of the contract.

Finally, current excuse and modification doctrines require courts to scrutinize ex post the events that lead to the disruption when deciding if the conditions at the time of breach warrant relief. The standards used in this process are riddled with uncertainty.[21] Thus, once contractual difficulties have arisen, contracting parties cannot predict with certainty

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opportunity costs. Thus, an unexpected increase in cost of raw materials would count as a loss to the Seller but an unexpected increase in the good's market price would not. This distinction is often explained on the grounds that changes in the market are precisely the type of risks contracts are meant to allocate. This justification, of course, ignores the fact that the increase in cost of raw materials is also a market risk, and that the increase in a good's market price may well be traced to similar types of disruption. Similarly, a commitment to pay money can never rise to the status of a "loss" because it never results in an increased cost of performance. *See* discussion *infra* at notes 143-49 and accompanying text.

18. Schwartz, *supra* note 6, at 6-8.

19. *See infra* text accompanying notes 150, 205-08.

20. If contracts are interpreted as though the parties considered each event and either factored it into the price or conditioned their obligation to perform upon its occurrence, a decision to discharge the promisor from the consequences of a costly, low-probability event appears to avoid the redistributional issues that result from a decision to adjust the price. Obviously, a court is extremely unlikely to hit upon the exact figure that would have been chosen by the parties. On the other hand, a decision to excuse is one the parties might, and arguably would, choose themselves in a model of almost complete eventizing, where the effect on the price of low probability, high-cost risks is difficult to evaluate. Courts, therefore, have tended to obscure the redistributional nature of the relief in cases of unallocated risk-events by using legal fictions that suggest that the court is merely identifying and implementing a condition the parties would themselves impose upon the promised performance. Examples of such fictions are found in the doctrines of implied conditions and presumed intent. *See* C. FRIED, *supra* note 2, at 58-61; Farnsworth, *Disputes Over Omission in Contracts,* 68 COLUM. L. REV. 860, 884-87 (1968). For a discussion of the reasons for the reluctance of courts to ground their decisions explicitly upon such faetors as fairness, see generally Kronman, *Contract Law and Distributive Justice,* 89 YALE L. J. 472 (1980); Summers, *Two Types of Substantive Reasons: The Core of a Theory of Common-Law Justification,* 63 CORNELL L. REV. 707 (1978).

21. *See infra* text accompanying notes 135-200.

whether a court will excuse performance or enforce a modification. This uncertainty, coupled with the high stakes over which the disputes arise, probably increases the likelihood that contracting parties will resort to litigation rather than resolving problems cooperatively.[22]

The inconsistency in current contract doctrine can be cured in one of two ways. We could return to the classical ideal and insist on complete risk allocation, allow no excuse for incompleteness, and either allow all modifications[23] or none. This alternative would leave a consistent model of complete contracting and increase certainty in the law and stability in contractual relations. But if the underlying premise of complete contracting is unrealistic—and I believe it is—contractual duties would fail to reflect the subjective expectations of the contracting parties.

Alternatively, we could reformulate the doctrines of enforcement to take account of incomplete contracting. Modification and excuse doctrine, if still appropriate, would be based on factors other than incompleteness. Contract enforcement that acknowledges incomplete contracting would inject greater uncertainty into contractual relationships than that under the classical ideal. But, the outcomes under doctrine based on incomplete contracting would more closely approach the allocations made by the parties—and hence their subjective expectations—thereby enhancing our ability to achieve the goals of the bargain principle.

I suggest that the premise of incomplete contracting should be the fundamental premise about the contracting process. The premise underlying current contract enforcement doctrines—that parties should and do foresee and allocate all possible risks—is false. Several factors, notably the limited computational capacity of the parties and the costs of complete forecasting, suggest that complete contracting is neither possible nor desirable.[24] The inquiry, therefore, must focus on whether we should

22. Some commentators argue that the likelihood of litigation increases as the parties differ in their relative assessments of the outcome of litigation and as the stakes increase relative to the cost of litigation. *See* Priest & Klein, *The Selection of Disputes for Litigation,* 13 J. LEGAL STUD. 1 (1984). When the law is extremely uncertain, parties are likely to evaluate their chances of success differently. Moreover, in cases of excuse, the stakes are by definition very high.

23. Modification would be treated as terminations of one contract followed by the adoption of a new one. *See, e.g.,* Watkins & Son, Inc. v. Carrig, 91 N.H. 459, 21 A.2d 591 (1941) (rescission of original agreement coupled with new agreement to perform original obligation enforced).

24. While the view that contracts are necessarily incomplete is noncontroversial, contracts scholarship has taken two distinct paths. One branch of scholarship assumes that parties have access to complete information about the contingencies and legal rules that affect their relationship. Parties are assumed to be able to allocate all risks at the time of contracting, and are prevented from writing complete contracts only by the cost of actually negotiating and writing the governing terms. In this tradition the function of contract rules is to provide default terms that a majority of parties would have chosen, thus reducing the cost of contracting by only requiring parties to write terms when they wish to deviate from the norm. *See, e.g.,* Goetz & Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligations,* 69 VA. L. REV. 967, 971 (1983); *see also supra* note 25. Under

presume that allocation is complete, or whether we should attempt to discover what allocations the parties have actually made, and enforce those only.

In this Article, I will suggest a theory of bargain based on the premise that parties assume a truncated risk distribution when they negotiate. I also suggest that they think mainly in terms of price and formulate notions of the most likely and maximum values of the contract, with perhaps a small degree of eventizing of major idiosyncratic upheavals. Based on this model I develop a theory that determines the risks consented to at the time of contract formation and the agreed-upon range of values allocated in the contract. Under this theory, if the value of the contract at the time of dispute is outside the agreed-upon range, the parties are entitled to their expectations based on that range, leaving an excess to distribute. Next I suggest some possible criteria for allocating that excess. Viewed in this light, the current doctrines of impossibility, mistake, and modification merge into the enforcement question of whether the value of the contract at the time of enforcement is within the range of values assented to.

My objectives in developing such a model are threefold. First, I believe that in order to achieve the goals of the bargain principle, contract enforcement must try to adhere as closely as possible to the wishes of the parties at the point where they entered into their contract. Second, a model based upon a more realistic view of the bargaining process—or more easily copied by contracting parties—enhances the likelihood that the contracting parties will generate shared expectations about the contract, another important requirement for achieving the goals of the bargain principle. By asking parties to define their undertaking in terms of variations in the market price at the time of enforcement rather than by a

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this view, while the contract is incomplete, the contract as supplemented with the underlying contract rules represents a complete allocation made by the parties. For a theoretical defense of this view of contract, even in the light of an explicit recognition of parties' incapacity to foretell future events, see Gillette, *Commercial Rationality and The Duty to Adjust Long-Term Contracts*, 69 MINN. L. REV. 521 (1985). I find this view unpersuasive in light of the empirical data on parties' unawareness of governing legal rules, *see infra* note 83, and the extreme difficulty of making accurate predictions. Moreover, given the complexity and uncertainty of the rules governing excuse and modification, it is hard to believe that they represent the default rules of choice for bargaining parties.

The other branch of scholarship assumes that in some relationships uncertainty and complexity prevent parties from specifying the details of their relationships. This scholarship has focused in large part on attempting to devise strategies to encourage cooperative behavior in the relationship. *See, e.g.*, MacNeil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical and Relational Contract Law*, 72 NW. U. L. REV. 854 (1978); Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233 (1979). While I agree with its basic premise, this "relational" contract literature tends to focus on the relationships in which parties are aware that they will be faced with the problems created by their limited ability to specify when they initially enter into their relationship. I believe that the problem of incompleteness is endemic to all contracts.

multiplicity of events, we reduce the number of parameters the parties must consider to one. Finally, a system that gives parties incentives to cooperate, to define, and to modify their relationships is preferable to the current winner-take-all system, which places a premium on litigation.

I begin in Part I by setting forth two imaginary models of contracting, one that presupposes complete contracting, and one that begins from the premise that the parties bargain based on a truncated risk distribution with price as the variable. My purpose is to demonstrate that the two models have quite different consequences for the development of doctrine. Expectation enforcement in a complete contracting model only requires interpretation of the contract. Under an incomplete contracting model, expectation enforcement requires determination of two potentially complicated issues: the exact risk distribution made by the parties and the distribution of unallocated excess.

In Part II, I argue that the bargain principle can only be satisfied if the parties to an agreement develop shared expectations regarding the outcomes of their agreement and contract law enforces those expectations. To be true to the bargain principle, the doctrines of contract enforcement must be based on a realistic model of bargain. If contracts are usually incomplete, expectation enforcement must be based upon a model of incomplete rather than complete contracting, unless the costs of an incomplete model are prohibitive. Finally, I develop a set of criteria that contract doctrine must satisfy if it is to further the goals of the bargain principle and minimize the costs of contracting.

In Part III, I use the criteria developed in Part II to develop a model of bargain based upon incomplete contracting and a suggested scheme of enforcement. Although that scheme has the problems discussed in Part I, I shall suggest strategies to minimize the costs generated by those problems. I then compare this scheme of contract enforcement with the regime of complete contracting.

In Part IV, I discuss the current state of expectation enforcement. Instead of the idealized complete allocation regime described in Part I, the present regime consists of a combination of enforcement, excuse, and modification doctrines. I develop the argument that the enforcement doctrine is inconsistent with the doctrines of excuse and modification because the former is justified by the presumption of completeness while the latter depend upon a presumption of incompleteness. I also examine the argument that both undermine the goals of the bargain principle. Finally, I examine other flaws in current doctrine and compare the system of contract enforcement I developed in Part II with the current state of contract law. I hope to convince the reader that the problems with current doctrine are sufficiently significant to warrant changing to a sys-

tem of contract law in which the premise of incomplete contracting underlies doctrines of relief and enforcement.

I
THE DOCTRINAL IMPLICATIONS OF INCOMPLETE VS. COMPLETE CONTRACTING

The essential difference between parties' expectations under a regime of complete rather than incomplete contracting is that under the former, expectations are assumed to exist as to all possible outcomes, whereas under the latter, expectations are formed only within a limited range of contract outcomes. Thus a system of enforcement of parties' expectations for incomplete contracts must provide for determining the range of allocated outcomes and for distributing unallocated outcomes.

To illustrate, consider a Seller S who contracts, at T_1, with a Buyer B for the sale of one widget for delivery at T_2, nine months from the date of contract formation. Based on experience, S estimates the cost of supplying the widget (that is, her actual costs of acquiring or making the widget, plus delivery costs) to be $80. S must also attempt to predict the nine month market price for widgets. Assume that S's estimate of the most likely market price is $100. These figures can be derived in two ways:

First, S might attempt to predict every event that would affect her ability to acquire (or produce) and deliver the widget. She would then attempt to deal with each event in her contract with B, either by writing an excusing clause for that event, or by allocating it in the contract by including it in the price term. To include the event in the price term, S would have to evaluate the effect of the event on her performance. She would have to estimate the probability that the event will take place and the additional cost she would face if it did. She would then discount the additional cost by the probability of the occurrence of the event.[25] I will refer to this approach, which presupposes complete contracting, as the eventizing model.

Alternatively, S might take a much less ambitious approach to setting the terms of her contract with B. Rather than attempt to predict all future events, S might rely on the information she already has, or can easily acquire. She would then consider the risks of which she is already aware and investigate those whose consequences she particularly fears. She might, for example, simply look at the recent price history of the widget market and her own cost history. She would also look at trends

25. For a detailed examination of the process of decision making under uncertainty see H. RAIFFA, DECISION ANALYSIS: INTRODUCTORY LECTURES ON CHOICES UNDER UNCERTAINTY (1970).

in cost and market price and make simple extrapolations into the next nine months to determine the probable range of values assumed under her contract with B. She would also list some events that appear probable at T_1, or as to which she is particularly risk averse. I will refer to this approach as the experience model, and develop it in more detail below.[26] Under this model S does not consider, or attempt to consider, the whole universe of risk. Rather she derives her predictions from a truncated distribution of risk. Thus, the allocation of risk is incomplete.

In either scenario, S is aware that her true cost might deviate from $80. However, her estimates of the possible variation—hence the risk she is assuming—would be quite different under the two models. If S is assumed to attempt to foresee and quantify every possible future risk (including, I assume, the risk of failing to foresee some risks) S's cost distribution—the range of possible values for the cost and their probabilities—would be practically unbounded.[27] Similarly, the distribution of possible market prices would also be from close to $0 to infinity. Because the likelihood of the extremes of the distributions occurring is very slight, S may not believe that she will be called upon to supply the widget for $100 when the market price has risen to $1000; but she has considered the risk and accepted it. If it actually occurs, she could be said to have gambled on its nonoccurrence and lost.

Assuming, however, that S uses her experiences, she would believe that the cost will vary between bounds established by her cost history—as long as it has not been fluctuating wildly. Assume that the cost could be as low as $75, or as high as $85. Similarly, the experience model would give a truncated distribution of the possible variation in market price. Assume that the estimated distribution under the experience model ranges from a low of $95 to a high of $110.[28]

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26. *See infra* Part III.

27. On the one hand S could find a widget, reducing her cost to $0. On the other hand, the supply of raw materials for widgets could dry up completely in which case her cost approaches infinity.

28. In the back of her mind, S would also be aware of the general uncertainties of life. If she knew about the system of contract enforcement, she would also know that she bears the risk of uncertainty. But this type of general awareness of uncertainty falls far short of the intelligent appraisal and allocation of known risk which is necessary to achieve the goals of the bargain principle. Therefore it should not be included in the estimate of party expectations. *See infra* note 152.

Professor Gillette argues that even if the parties cannot foretell the future accurately, they can foretell the existence of uncertainty and plan rationally to estimate and control the consequences. *See* Gillette, *supra* note 24, at 524. He argues that rational planners will attempt to eliminate only those risks and uncertainties—foreseeable or unforseeable—which can be eliminated at a cost less than the perceived cost of the uncertainty. He therefore suggests that the absence of a term covering an event is no indication of whether the parties reached a rational decisional allocation as regards that event. *Id.* at 533-35. Since parties can make rational decisions in the face of uncertainty, contracts should be enforced with a presumption of completeness. Such enforcement, he suggests, is

B plays the same game—with one difference: *B* has no interest in *S*'s costs, except insofar as they may limit the best bargain *B* can strike. *B* might want to have some idea of *S*'s costs, but is unlikely to form any serious expectations about them. Instead, *B*'s expectations are centered around the nine month market price for widgets. Assume that *B* predicts either an unbounded, most-likely price of $100, under the eventizing model, or a most-likely price of $100 with variation between $95 and $110, under the experience model.[29] Based on these projections, *S* and *B* set a price at delivery of $100.[30]

Thus, the parties' expectations and assumptions of risk[31] regarding the contract at the time of its formation may be presented as follows. "Value of contract" is defined as the difference between the value set by the contract for the promised performance, and the market value of that performance.[32]

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morally just, *id.* at 571-75, and provides appropriate incentives to contracting parties to use best efforts to reach complete allocations. *Id.* at 545.

Professor Gillette does not argue that parties can predict the future accurately. He argues rather that parties can make decisions about uncertain future conditions, which are rational when viewed from an ex ante perspective.

In the case of most contracts that do not involve large sums, I believe that parties neither know the legal rules, nor do they expressly consider possible strategies to deal with uncertainty. They are simply aware that generalized uncertainty exists, and ignore it. In the context in which they deal, this might be a rational cost decision. But it by no means follows that the loss must therefore lie where it falls. The fact that both parties decide that it would be irrational to allocate the cost of a particular event ex ante does not mean that they have allocated it where it falls. Moreover, in these classes of cases, the parties' response to uncertainty is unlikely to be affected by such a legal rule. One approach which is responsive to Professor Gillette's concerns is to develop rules that enhance the parties' ability to allocate uncertainty by simplifying and reducing the cost of allocation. This may be done by moving from a focus on events to a focus on profit and loss.

Professor Gillette is more convincing in the cases with which he is primarily concerned—long-term contracts involving substantial sums of money. There, his behavioral assumptions about decisionmaking and the influence of legal rules upon decisionmaking are more likely to be met. But the fact that parties can make rational decisions about uncertainty ex ante when thay have to does not mean that they would choose to do so, especially when such decisions are unlikely to be optimal ex post—a possibility which Profesor Gillette acknowledges. *Id.* at 545. Allocative decisions about generalized uncertainty are unlikely to be optimal. Nor do I see that it is worthwhile to encourage parties to expend resources to force them to make such suboptimal allocations. A system that would allow them to make only allocations that they believe to be optimal ex ante, and allow ex post allocation of other outcomes, would be preferable.

29. These numbers were randomly selected to illustrate the differences between the two approaches to bargaining behavior; they have no inherent significance. For simplicity, I have also used identical predicted values for *S* and *B*. Although varying values would complicate the analysis and make it more difficult to satisfy simultaneously the expectations of *S* and *B*, the basic analysis would remain the same.

30. The actual price set would be a reflection not only of their predictions, but also of their relative bargaining strengths.

31. An additional limit on losses assumed may be available in bankruptcy if a contracting party qualifies.

32. So, for example, if the contract price for the widget is $100 and the market price at T_2 is $110, the value of the contract is $10 to *B*, and -$10 to *S*.

TABLE I
PARTY EX ANTE RISK ASSUMPTIONS

Contract sale price $100

Complete Contracting: EVENTIZING MODEL			
S:	LOW	EXPECTED VALUE	HIGH
assumed range, cost	0	80	infinite
assumed range, market price	0	100	infinite
assumed range, profit on cost	−infinity (cost infinite)	20 (100-80)	100 (cost 0)
assumed range, value of contract	−infinity (mkt price infinite)	0 (100-100)	+100 (lowest mkt price=0)
B:			
assumed range, mkt price	0	100	infinite
assumed range, value of contract	−100 (mkt price 0)	0	infinite (mkt price infinite)
Incomplete Contracting: EXPERIENCE MODEL			
S:			
assumed range, cost	75	80	85
assumed range, mkt price	95	100	110
assumed range profit on cost	10 (95-85)	20 (100-80)	35 (110-75)
assumed range, value of contract	−10 (100-110)	0 (100-100)	+5 (100-95)
B:			
assumed range, mkt price	95	100	110
assumed range, value of contract	−5 (95-100)	0 (100-100)	+10 (110-100)

If at the time of performance, T_2, S's costs fall between $75 and $85, and the market price for widgets falls between $95 and $110, the parties' expectations about the risks they were willing to bear are fulfilled under both models. At one extreme, although S might have considered it highly unlikely that her costs would escalate to $85 while the market price dropped to $95, she nevertheless did consider, accept, and get paid for that risk. If, however, either the actual value of S's costs or widget market prices at T_2 fall outside the ranges estimated by S and B at T_1 under the experience model, the two models have significantly different consequences. In the complete-allocation eventizing model, all T_2 outcomes are within the assumed allocations of risk. In the incomplete-allocation experience model, T_2 outcomes can fall outside the assumed allocations of risk. That creates unallocated contract surplus—contract values outside the range of allocation made by the parties—at T_2. To illustrate, I will conclude this Part with a discussion of two examples.

Case 1: The Cost Rise Case

In this scenario, S's T_2 costs increase to $110, and the widget market price is $110.

Because the contract price is $100, B has a contract value gain of $10, while S has a contract value loss of $10. These contract values are within the range of the parties' expectations under both models because they fall within the ranges of -$10 to $5 for S, and -$5 to +$10 for B. In addition, S will have a loss on cost. Under the experience model, she would not have expected or assumed that result. Under the eventizing model she would have foreseen it as a possibility, however remote, and assumed the risk of its occurrence.

Under the eventizing model, the expectations of both S and B can clearly be satisfied by enforcing the contract at the price stated. It should also be clear that this is always true, as long as we retain the model in its pure form and assume that all risks have been allocated completely by the contract terms.

Given S's costs, under the experience model it is impossible to find a T_2 widget price that allows both B and S to fall within their assumed ranges of risk. S expects a profit of at least $10 on cost. Instead, she will have a loss of $10 on cost. In order for S to achieve a $10 profit on cost, the contract must be enforced at $120. But a contract price of $120 would leave B with a contract value of −$10 ($110 − $120), which is outside the range of his assumed risk on contract values of -$5 to $10. This price would also give S an unexpectedly high contract value of $10 ($120 − $110). Thus, S's expected gain on cost can only be achieved at the cost of not enforcing party expectations as to contract values. S might argue, however, that the parties' ex ante allocations can be best approximated by enforcing the agreement at a price of $115. This would give S a profit of $5 on cost—still outside the range of assumed risk, but better than no profit at all. B would receive a contract loss of $5, which is within the range of B's assumed range of risk on contract value.

I am opposed to that solution for three reasons. First, it is extremely unlikely that B had any expectations about S's costs. Second, B did not expect to pay a price that exceeds both the market price and the contract price. Third, S is in the best position to control her costs. It cannot be efficient to subsidize what appear to be excessive costs. After all, the market price usually reflects the average cost of supplying a widget, plus a profit.

Thus, recoguition of incomplete contracting between B and S also requires recognition that T_2 outcomes may be unallocated. Accordingly, enforcement under an incomplete contracting model requires more than

the determination and enforcement of the parties' T_1 allocation. It also requires an exercise of judgment on the part of the enforcer.

Case 2: The Market Windfall Case

Under this scenario, S's T_2 costs are \$80, but the market price for widgets has risen to \$200.

Once again, there is little difficulty under a pure eventizing model. B and S foresaw this possibility, assumed the risk of its occurrence, and set the price accordingly. We have only to enforce the agreement.

Life is more complicated under the experience model. S will now make her expected profit on cost. But neither S nor B anticipated or bargained over a contractual value of \$100. S anticipated and bargained over a minimum contract value of $-\$10$, while B anticipated and bargained over a maximum contract value of \$10. Thus, their agreed-upon allocation of contract value is a guide to the allocation of no more than \$10 out of the true contract value of \$100. There is, therefore, a contractual excess of \$90 to allocate. It by no means follows that B is entitled to the total excess amount, because he would receive a great deal more than he paid for, and S would give up a great deal more than she agreed to pay. If the contract does not provide an algorithm for the division of the excess, doctrine based on this model must provide one—as a matter of law, not as a matter of consent.

The preceding examples indicate that a model that assumes that all risks have been allocated at T_1—the eventizing model—will lead to results that are radically different from those obtained under a model that presumes that parties have allocated only a portion of the entire universe of risk—the experience model. Furthermore, it is clear that an incomplete model creates ex post allocation problems when T_2 events are outside the range of allocated risk.

II
THE BARGAIN PRINCIPLE AND ITS REQUIREMENTS

Enforcement of expectations and subjective risk allocation under a truncated distribution model such as the experience model presents many more complex problems than those posed by enforcement under a complete distribution model such as the eventizing model. Unless other factors compel the choice of a truncated model, the choice of a complete distribution model is doctrinally preferable because of its certainty of result and administrative ease. I suggest that the compelling reasons to recognize incomplete contracting, and base contract doctrine on a truncated distribution model, are provided by the very social objectives that

lead us to recognize and enforce contracts—the goals of the bargain principle.

Contracts are usually enforced by awarding the disappointed party a sum of money equal to the difference between the market price of the promised performance at T_2 [33] and the price set in the contract for that performance at T_1. Although this "expectation" measure is described as a subjective measure of damages, it is actually an objective standard based upon a model of complete contracting:

First, it is objective because it is calculated from the T_2 market price without considering what risks the parties thought they were assuming at T_1. Second, it presumes completeness because it is calculated from the T_2 market price without considering changes in market conditions between T_1 and T_2. Thus, all conditions are presumably allocated either explicitly in the contract or implicitly in the price term.

Of course, if the parties are presumed to specify completely and allocate all risks, the "expectation" measure would indeed reflect the parties' subjective expectations when they entered their contract. In that case, the contracting model upon which the current "expectation" measure of damages is based is the same as the eventizing model set forth in Part I.

But the bargain principle requires that contracts be enforced to the extent of the parties' actual allocations when they entered the contract. The current system of contract enforcement—by the "expectation" measure—will further the goals ascribed to the bargain principle only if we believe that, in general, parties write complete contracts. If, on the other hand, we believe that contracts are usually incomplete, the bargain principle requires that the law of contract enforcement reflect that incompleteness of allocation. It is currently widely accepted that contracting is rarely, if ever, complete.[34] This suggests that developing incomplete models of bargain upon which to base the doctrines of contract enforcement is a more realistic approach.

Under bargain theory, the expectation measure of damages is usually justified in one or more of three ways.[35] First, it obviates the chance of judicially created forced sales. Neither party can object if a bargain is

33. For the purposes of calculating damages, T_2 is usually set at the time the promisee learns of the breach, *see, e.g.*, U.C.C. § 2-713(1) (1978), because when the promisee hears of the breach, she may immediately replace the promised performance on the market. To allow her to wait until the time set for performance would allow her a period during which she may speculate on the market at the promisor's expense.

34. The belief is reflected in several contract doctrines. *See, e.g.*, Farnsworth, *supra* note 20 (implied terms, constructive conditions, impossibility, and frustration are responses to incomplete contracting). For a more extensive discussion of the excuse and modification doctrines, see *infra* notes 135-209 and accompanying text. Unfortunately, recognition of incomplete contracting has not yet led courts or commentators to question the basic structure of contract remedies.

35. *See* Eisenberg, *supra* note 2, at 745-46.

enforced in the amounts agreed to by the parties. If, on the other hand, a bargain is reviewed for fairness and enforced at an objective but lower price, we cannot be sure that the defendant would have agreed to perform. Similarly, if a bargain is enforced at an objective but higher price, we cannot be sure that the plaintiff would have wanted the performance at the higher price.

Second, a rule that secures expectations will serve to encourage credit transactions, while not unduly discouraging the making of promises. An actor's willingness to rely on a promise depends to some degree on the likelihood it will be kept. In addition, the extent to which an actor is punished for the failure to keep a promise will affect the level of promise making. The damage measure must be large enough to encourage reliance, while remaining sufficiently small not to depress promise making unduly. An expectation measure of damages will tend to just replace the value of the promised performance.[36] Thus it encourages reliance and minimizes the adverse impact on promise making. If we seek to facilitate planning behavior, a rule ensuring that people receive what they expect is appropriate. Even the expectation measure does not adequately replace a promised performance when the costs of litigation are considered.[37]

Finally, the expectation measure may be justified as a means of ensuring that resources are allocated to their highest valued uses. The expectation measure allows S to divert the performance she has promised to B to other buyers if she compensates B for B's loss.[38] Thus S will divert her performance only when she sees a net benefit in doing so—that is, when the other buyer is willing to pay (thus valuing S's services) more than B. Prices may thus be set by trading between buyers and sellers, with the uses to which goods are consigned determined by the users' willingness to pay.

An examination of these justifications reveals that it is the bargainers' subjective values at the time they enter into their agreement that serve to effectuate the goals enumerated above.[39] It is S's T_1 valuation of

36. *Id.* at 746.

37. The costs of attorneys' fees and delay are normally not compensable. Some commentators argue that the litigation cost of establishing damages is one reason that parties provide for liquidated damages in their contracts. *See* Goetz & Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554, 559 (1977).

38. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS ch. 16 reporter's introductory note (1979).

39. It is interesting to speculate upon the relation between the nature of the consent required and the goals of the bargain principle. Clearly the forced-sale and efficient-resource-allocation rationales for the bargain theory require that the consent be subjective. It is less clear whether an objective or subjective standard would best serve the goals of facilitating credit transactions and forward planning. A subjective standard would lend certainty as to whether one is bound oneself,

B's performance which *S* considers in deciding whether *S*'s own performance is a worthwhile trade, and it is her subjective T_1 evaluation of her own proposed performance that she will weigh. Thus it is only by requiring of *S* only what she thought the value of her performance to be and by giving to *S* at least what she evaluated *B*'s performance to be that we obviate the danger of a forced sale of *S*'s promised performance. Similarly, the security of credit transactions would be enhanced by ensuring that the parties receive exactly what they thought they would—or at least what they expected to get at no more than the price they expected to pay. Finally, it is the subjective values that *S* and *B* place on the promised performances at T_1 that ensure the efficient distribution of resources.[40]

But if contract is to satisfy the goals discussed above, *S* and *B*'s expectations must be congruent. The rationales that require that we give *S* her subjective values apply equally to *B*. Where *S* and *B* have identical valuations—or know and accept the fact that their expectations diverge because they evaluate contract risks differently—the expectations of both can be simultaneously satisfied. But where their expectations diverge—and they are unaware of that divergence—it may not be possible to satisfy *S* and *B* simultaneously.[41] Thus, for the bargain principle to accomplish its hoped for goals, the parties must share (or knowingly accept divergent) expectations for the future contract value. Although administrative costs might force us to choose a "second best" strategy,[42] the

but create great uncertainty as to whether the other party will be bound, and hence as to whether there is a contract. This might enhance one's willingness to enter into contract negotiations (because one is less likely to find oneself in a commitment unwittingly), but would discourage planning behavior and reliance on the other party's commitment. An objective standard would tend to have the opposite consequences. Overall, an objective standard would probably be more favorable to bargain principle goals because it is more certain and less prone to manipulation. Currently, contract law accepts the objective standard.

40. It can be argued that the choice between subjective and objective values will not affect the allocation of the good to its highest valued use, but will determine whether *S* or *B* will receive the higher price for it. After all, if *B* receives the good and values it at a lower price than someone else (including *S*), he can always sell it. If we ignore transaction costs, the goods will eventually reach their highest valued uses. That argument is quite general, and can be used to attack any proposed remedy. It suggests that the economic consequences of contract remedies are mainly to be found in the transaction costs of arranging additional trades, and in the effects on transactions, discussed herein. *See supra* text accompanying notes 36-38.

41. This is implicitly recognized in doctrines that deny *S* any subjective expectations that are "unforeseeable" to *B*. *See infra* note 54. Because *S* cannot be satisfied without infringing on *B*'s expectations, an enforcement scheme based on expectations is forced to choose between *S* and *B*.

42. For enforcement purposes, an objective valuation of a contract may be considered to be such a "second best" strategy. If the parties have failed to specify their subjective evaluations, the best guess at T_2 as to those numbers might be the objective values. Moreover, when they have failed to specify their subjective expectations about the agreement at T_1, each party has no indication of the subjective valuation placed on her performance by the other party. An objective valuation is the one she is most likely to equate with the other's expectations. In addition, the choice of an objective standard reduces the need for costly evidentiary proceedings and the likelihood of fraud. Such

goals of the bargain principle are not furthered by holding a party to a performance she did not consent to undertake at T_1 or by giving her excess contract values that she did not expect to receive.[43] Thus, the bargain principle requires that the focus for both bargaining and the remedies for breach be the identification and definition of shared expectations. If contract doctrine is to further the goals of the bargain theory, it must be formulated to enhance our ability to meet those requirements.[44]

The bargain theory, then, requires that contract doctrine be formulated to determine and enforce the parties' subjective T_1 expectations as closely as possible. To do so, doctrines of enforcement must be based upon realistic models of bargaining. It is generally accepted that complete contracting does not occur. Moreover, much of current contract doctrine is adjusting to the effects of incomplete contracting. As I shall argue, these adjustments, painted against an enforcement premise of complete contracting, have created incoherence and chaos in current contract doctrine.[45] As a result, there is a need to develop a model of contracting that will replace the premise of complete contracting underlying current enforcement doctrine with one based on incomplete contracting. Any alternative approach must satisfy, at a minimum, the following criteria:

1. It must enhance the values of the bargain theory by allowing the enforcer to approximate the ideal of allocating contract values according to the parties' subjective T_1 allocations.

2. It must devise a model of bargaining that will permit parties to develop and define shared expectations about risk allocations.

3. It must be an easy—and cheap—model for contracting parties to follow.

4. It must minimize problems of proof because they create uncertainty.[46]

5. It must minimize incentives for litigation. Litigation is expen-

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rationalizations, however, fail to cover the situation in which the T_2 contract values are disproportionately divergent from "objective" evaluations at T_1—as would be the case in most situations of excuse.

43. Other goals might be served by this type of regulatory approach to contract enforcement. They are not, however, within the scope of this Article.

44. Some commentators have argued that the "expectation" measure of damages does not adequately replace the promised performance because it fails to take account of idiosyncratic values, thus implicitly recognizing the importance of enforcing subjective expectations. *See, e.g.*, Goetz & Scott, *supra* note 37, at 557; Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351, 363 (1978). Surprisingly, I have been unable to find any observations concerning the connection between bargain principle objectives, subjective enforcement, and the problems of incomplete allocations.

45. *See infra* notes 233-36 and accompanying text.

46. Complex problems of proof can have several unfortunate and costly effects. They increase the costs of each individual determination and increase the likelihood of error in the final result. The probability of error in the final result creates incentives for strategic behavior and leads to contract instability. This in turn leads to increased administrative costs as the number of contested cases

sive and increases the possibility of error and thus cost in terms of judicial reallocations.

III
TOWARDS A MODEL OF INCOMPLETE CONTRACTING: THE EXPERIENCE MODEL

If contract doctrine is to further the goals of the bargain principle, it must be formulated to enforce the parties' subjective T_1 expectations. In particular, enforcement must reflect the reality of incomplete contracting. This Part develops a model of bargaining based upon incomplete contracting, the experience model. Although enforcement under the experience model does have the problems inherent in an incomplete-contracting model, I suggest strategies to minimize the costs of such problems. I then use the criteria developed in Part II to compare the scheme of enforcement under the experience model with the regime of complete contracting.

I suggest that contracting parties will—and should—focus on the information they have to make simple extrapolations about the risks they are assuming by entering into the contract. I also suggest that they will have, or can easily be made to formulate, shared expectations about the contract as long as they are instructed to do so in terms of their primary preoccupation at the time of contracting, T_1—the profit they expect to make or the maximum loss they are willing to assume.[47] They might also be aware of certain risks to which they are particularly averse[48] and specifically allocate them in the contract. If a risk is not referred to in the contract, it cannot be presumed to have been allocated by the parties at all[49] except in so far as the risk affects the distribution of market price.

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increases. In addition, each erroneous determination undermines our bargain theory objective of enforcing subjective expectations.

47. Many classes of agreement do not fit into this model and cannot be simplified in this manner. Some examples are the contracts between: a builder and a homeowner (although the builder focuses on profit and loss, the homeowner has more personal objectives); a painter and a collector, or an orchestra and a commissioned composer (artistic values predominate on both sides). Where idiosyncratic matters of taste predominate, there may be no option other than to precisely specify expectations in terms of events.

48. An example of such risk averseness might be a clause limiting *B*'s obligation to buy the widget to the situations where *B* is able to enter into a supply contract with *B*'s expected customer, *C*.

49. *See* Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1174 (1983) for a similar attempt to focus enforcement decisions on the subjective terms of bargains in the case of adhesion contracts. Rakoff suggests that terms in adhesion contracts be separated into "visible" terms—terms "for which a large proportion of adherents . . . may be expected to have shopped"—such as the price term—to which the normal rules of contract should be applied, and all the others. *Id.* at 1251. As to the others, Rakoff argues that different rules, based upon policies other than bargain, should apply. *Id.* at 1261-83.

A. *The Experience Model of Bargain*

Consider Seller S from Part I, who contracts with Buyer B to sell a widget nine months from the date of contract formation. B and S are likely to base their negotiations on easily accessible information they actually have at T_1. This will primarily be information formulated from their experience and knowledge about the markets in which they participate at T_1.[50]

Based on her own experiences, S estimates her cost of performance at $80. She is also aware that historically this figure has varied between $75 and $85. With more effort, S can generate market data about the nine month forward price for widgets over some past period. She might also be aware of certain catastrophic possibilities (acts of God, labor

50. These data are summarized in Table I, *supra* p. 1135 which is reprinted here for convenience. (Assume, for ease of discussion, that the widget market has been relatively stable. While the contrary assumption will affect the margin of uncertainty in the risks assumed, it should not affect the analysis.)

Table I
PARTY EX ANTE RISK ASSUMPTIONS

Contract sale price $100

Complete Contracting: EVENTIZING MODEL			
S:	LOW	EXPECTED VALUE	HIGH
assumed range, cost	0	80	infinite
assumed range, market price	0	100	infinite
assumed range, profit on cost	−infinity (cost infinite)	20 (100-80)	100 (cost 0)
assumed range, value of contract	−infinity (mkt price infinite)	0 (100-100)	+100 (lowest mkt price=0)
B:			
assumed range, mkt price	0	100	infinite
assumed range, value of contract	−100 (mkt price 0)	0	infinite (mkt price infinite)
Incomplete Contracting: EXPERIENCE MODEL			
S:			
assumed range, cost	75	80	85
assumed range, mkt price	85	100	110
assumed range profit on cost	10 (95-85)	20 (100-80)	35 (110-75)
assumed range, value of contract	−10 (100-110)	0 (100-100)	+5 (100-95)
B:			
assumed range, mkt price	95	100	110
assumed range, value of contract	−5 (95-100)	0 (100-100)	+10 (110-100)

interruptions, etc.). *S* must attempt to convert this information into a best estimate of price variance over the future, and possibly provide excuse clauses in her contract with *B*.

1. *S* knows from experience that the nine-month market price for widgets has varied between $95 and $110.[51] She also knows that it has usually been about $100, and that $95 aud $110 were rare events.[52]

2. *S* would, or should, have more accurate information about her costs. Over the periods she considers relevant, she knows that her usual cost has been $80; she is also aware that this has fluctuated between $75 and $85, both extremes being rare events.

3. *B*'s market information would be similar to *S*'s. Unless *S* or *B* are in gross error, their figures will not vary much, presuming they have been trading on the same market. For simplicity let us assume they are the same.

4. Since they would both have current market information the current forward price for widgets should be at or about $100. (If it is not, either the parties are in error, or information of a future event must have influenced the nine-month price. In the latter case, *S* and *B* should inquire further.)[53]

5. *B* knows the uses he plans to make of the widget. *S* does not and cannot know this unless *B* informs her.[54]

6. Similarly, *B* does not know, unless *S* informs him, about *S*'s costs. Nor is he likely to care, except that this might place a bottom value on the price he might hope to negotiate.

7. *S* might know of, and want to protect herself against, certain risk events—for example, her factory burning down. If so, she will put in an excuse clause, most likely with a price reduction.

Based on these "facts" and assumptions, *B* and *S* contract for *S* to supply *B* with a widget in nine months at $100. What are the expecta-

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51. I have chosen these numbers arbitrarily to demonstrate the model. The values are not essential to its validity.

52. *B* and *S* would believe that they have covered all the "normal" risks of entering into a widget contract. They would also be aware that catastrophe might strike—but as one of the general and unquantifiable uncertainties of life.

53. Because we have assumed that *S* and *B* have dealt for some time, and the price has remained in the range near $100 for that time, the price range for widgets must be and remain stable—unless new market effects are predicted.

54. This is why *B*'s damages are limited to those *S* knew about, or could have foreseen. Hadley v. Baxendale, 156 Eng. Rep. 145 (Ex. 1854); U.C.C. § 2-715(2)(a) (1978); RESTATEMENT (SECOND) OF CONTRACTS § 351 (1979). Otherwise *S* lacks the information either to protect herself or to make rational choices about breach. Oddly enough, the same limitations are not applied to the conditions under which *S* may plead excuse on the grounds of cost increases. In this case *S* cannot inform *B* of all the "unforeseeable" events that would render her performance "commercially infeasible." But it would not be unreasonable to require *S* to tell *B* of the costs she expects, or at least the maximum costs she is willing to assume and notify *B* as soon as circumstances warrant, to allow *B* to arrange a substitute.

tions of the parties at T_1? What did S and B think they were buying? What duties did they believe they were assuming?

B. *Expectations of* S *and* B

S "expects" to supply B, and B "expects" to be supplied with a widget in nine months, and both "expect" B to pay $100. In the traditional world of contracts, this is the totality of their expectations. Any deviation from this scenario is outside their expectations—whether caused by "unforeseen" events or not—and must be remedied by "expectation" damages, calculated from the full T_2 market price, or the performance must be "excused" by the court in order to further other social purposes.[55]

Within the context of their negotiation, however, the parties' actual expectations are much more limited because they are based on assumptions about the world at T_2 that may or may not be accurate. If these assumptions are included in the derivation of party expectations, the T_1 world would look like the following:[56]

1. S's T_1 Expectations

1. S expects to supply B with a widget at T_2.
2. S also anticipates a possible range of outcomes at T_2. S expects a profit based on cost, with a probable value of $20, but within a possible range of $10 to $35.[57]
3. S expects that her contract will have a value of $0 at T_2—that is, the T_2 market price of widgets will exactly equal the contract price. S also knows that widget prices have fluctuated, and might do so in the interval between T_1 and T_2, resulting in a possible range of contract values between -$10 and $5 (that is, the market price might be as high as $10 above her contract price, or as low as $5 below).
4. S expects to achieve these goals with a contract price of $100.

2. B's T_1 Expectations

1. B expects to get a widget from S at T_2.
2. B also expects that his contract will have a value of $0 at T_2 but

55. *See infra* notes 129-31 & 140-44 and accompanying text.

56. Table I, *supra* pp. 1135 & 1143, might be of assistance to the reader.

57. It is a well-accepted truism that S "expected" to make a profit and that because a contracting party may always correctly claim that she entered into the contract "expecting" to make a profit, this type of "expectation" should have no legal significance. But in the experience model, that is not S's claim. She may well have hoped to make a profit, but she realizes that the variance in costs and market price might cause her to suffer a loss, even if the event is unlikely. Unlike the eventizing model, however, she would expect outer bounds, both on her possible losses and profits.

he is aware that possible price fluctuations between T_1 and T_2 create the possibility of contract values between −$5 and $10.

3. *B* expects to achieve these goals with a contract price of $100.

In short, by setting the price at $100 *S* does not expect to make more on cost than $35, or less than $10. She certainly does not expect to lose on cost. Rather, she expects to break even on cost of performance, although she might be lucky and make as much as $5. She knows that she stands to lose as much as $10 as a cost of performance, but is willing to take a small risk in order to obtain a reliable buyer at T_2 for her widget.

B also expects to break even at a price of $100, but feels he might, if extremely lucky, do as well as $10. He also knows that he might, if extremely unlucky, face a cost of performance of as much as $5, but he is willing to risk that for a secure source of a widget at T_2.

Do *B* and *S* have any other expectations? I believe that they do. Based on their predictions, *B* and *S* generate expectations about the contract to each other.

3. S's *Expectations with Respect to* B

If *S* thought about it, and she must to generate her own profit/loss data on the probable contract value, she would expect that *B*'s profit on the contract is the mirror image of the value to her—most likely $0, but with a possible range between −$5 and $10.

4. B's *Expectations with Respect to* S

B would have little reason to think, or care, about *S*'s costs,[58] except as a possible lower bound on the contract price he can negotiate. He also cannot know or care about *S*'s profit on cost. He might not care about *S*'s market profit—the value of the contract to *S*—but he will have expectations about it based on his own profit/loss projections. He would expect *S*'s contract value to lie between −$10 and $5, with a probable

58. *B* cannot have any explicit expectations about *S*'s costs because *B* has no access to the information necessary to generate such expectations. Usually, only *S* has access to her own cost data. *B* cannot know this data unless informed by *S*. *B* would, of course, assume that *S* would not enter into the contract unless *S* found it advantageous to do so. Although *B* would conclude that *S* would profit in some manner from their contract, *B* need not necessarily assume that *S* will make a profit on cost. *S* might have other motivations such as developing business relations and expertise for the future which would make a loss on cost worthwhile.

Of course, *B* would be aware that *S* has limitations on cost losses that she is willing to assume. It might be argued that at least this nebulous expectation should be factored into the analysis. This would lead to some situations in which *B* will be obliged to share *S*'s unexpected cost increases. As I argue below, opening the door to consideration of *S*'s costs would have significant consequences to the efficiency of the contract enforcement system. *See infra* notes 99-105 and accompanying text. As a result, I do not favor the recognition of *B*'s nebulous expectations regarding *S*'s costs.

value of $0.[59]

We are concerned here with B's expectations about S's market profit, and not with S's expectations about her own market profit. Because S's projected market profit is determined at T_1 by subtracting the anticipated T_2 market price from the contract price, B's expectations about S's market profit will be identical to S's only if B and S make identical T_1 projections about T_2 market prices.

These data may be summarized as follows:

TABLE II

T_1 Anticipated Outcomes, Experience Model

Contract Price	$100	$100	$100
S: assumed range of outcome of:	LOW	EXPECTED VALUE	HIGH
cost	75	80	85
mkt price	95	100	110
profit on cost	10	20	35
value of contract to *S*	−10	0	+5
value of contract to *B*	−5	0	+10
B: assumed ranges of outcome of			
mkt price	95	100	110
value of contract to *B*	−5	0	+10
value of contract to *S*	−10	0	+5

This model of bargaining is therefore based on several assumptions. First, neither party accepted an "absolute duty," or unlimited risks and liabilities. Nor do they believe that the other party did so.[60] In fact, both parties view the risk, to both, in a truncated form. The extent of the truncation depends on the amount of information each individual has at T_1, including information acquired through experience, research, or other methods.

Second, where markets exist for the contract goods, the parties' risk analysis is more likely to proceed by way of an analysis of the past mar-

59. I stress again that I have chosen the range of expectations on the T_2 market price to be the same for S and B for ease of analysis. It is quite likely that the ranges will vary somewhat, depending on both the difference between the parties' past experiences of the market, and probably more significantly, on their projections for T_2. This will complicate the analysis, but does no damage to the central thesis.

60. I am aware that this assumption will be difficult for most of my colleagues to accept because it goes against traditional teaching insofar as current doctrine enforces contracts with the expectation measure of damages. As the discussions of mistake, commercial impracticability, and modification demonstrate, however, iconoclasts are by no means as iconoclastic as they believe about "absolute" duties. They, too, assume that risks are truncated. They simply prefer a scheme where the degree of truncation is determined ex post by the court and used as an excusing condition rather than ex ante by the parties and used to limit their exposure to damages as in the scheme suggested in this Article. Moreover, if we apply the objective rationality test of contractual consent—that is, "would a reasonable person either accept or believe that the promisor agreed to accept undiscussed risks that are extremely costly?"—the outcome is unlikely to be yes in all cases.

ket trends and projection of those trends into the future than by a detailed examination of risk-events. Where markets do not exist for the contract goods, parties may rely more on individual experience and perhaps attempt a greater analysis of catastrophic excuse events.[61]

Third, the risk allocations are more likely to be considered and discussed as dollar spreads—that is, how much *S* or *B* stands to lose or how much each hopes to make—than by a detailed examination of risk-events—for example, will *S* bear the loss if a hailstone hits the widget on the way to the market, or will *B*? I suggest that exposure to loss or gain is the central preoccupation of trading parties, and they can better answer the question of how much risk they are willing to assume in terms of exposure than in terms of the risk-events they will accept.[62] Moreover, most risk-events will be difficult to translate into price and profit information. This difficulty is greater where the event is more unlikely—and hence there is less experience in predicting either its frequency or its probable cost. Markets are unlikely to fare much better in this endeavor than individuals. Thus, the experience model reduces the presumed axes of bargain, unless the parties specify otherwise, to the one predominant concern of the parties—the amount of profit or loss assumed by the contracting partners.

Even under this model catastrophic events to which the parties, based on their individual experiences, are particularly sensitive will be eventized as limiting duties in the contract.[63] Events not mentioned are simply not allocated as events, although the resultant contract values are at least partially allocated by the contract.

I have also assumed that parties consider and define their profit and loss risks in terms of deviations from the market price rather than in terms of their actual profit on cost. One might agree that the profit on cost is the more relevant parameter: many contracts are, in fact, written in terms of profit on cost.[64] There are significant reasons, however, why

61. There are cases in which neither markets nor experience exist in the contract goods. This occurs for example, in the marketing of a new invention or the creation of a new business. *See, e.g.*, Benham v. World Airways, Inc., 432 F.2d 359 (9th Cir. 1970). Here, parties and courts have little to guide their estimates of the range of possible contract risk at T_1. These are precisely the cases in which the parties have the best notice that the possible range of risk, and the need for allocation in the contract, is great. If the parties fail to specify their own allocations, courts are likely to find that the range of risk allocated by the contract price is very great.

62. Some risk-events might be simple and expedient to allocate in the contract if an insurer—an expert in quantifying, costing and spreading that particular risk—is available. In this case, the cost of the event to the contracting party is specified ex ante. But insurance contracts are often written with liability limits. An insurer's determination of such limits is exactly analogous to contract interpretation under the experience model.

63. The availability of insurance for a particular risk-event might be one factor that would influence parties specifically to allocate that risk-event in their contract.

64. The cost-plus contract is a prime example of the importance of this parameter and of the problems associated with its use.

this variable is not the optimal one for most parties, and even more important administrative reasons why contracts written in terms of profit should not be encouraged.[65] Contractual obligations defined in terms of profit on cost give rise to the potential for strategic behavior and moral hazards to the parties. As S's costs are generally within her control, S would face the temptation to exaggerate her costs. B would require access to information about S's costs, and expertise about S's type of business, in order to police them adequately. S faces the same problems about B's costs. This would give rise to many disputes in which the courts would find themselves in the position of referees. This not only increases cost through increases in litigation, but courts are unlikely to be good forums for the resolution of disputes about whether the costs of a particular business are or are not excessive. Therefore, as an objective measure of, but very good proxy for, profit on cost, parties can be asked to define their subjective assumptions of the range of risk as a function of the deviation of the contract price from the market price at the time of enforcement, T_2.

C. *Contract Enforcement Under the Experience Model*

I have already shown that the bargain principle requires that the parties' subjective expectations at T_1 be enforced.[66] If consent to the bargain struck at T_1 is the basis for enforcement of the contract at T_2, congruence would demand that it also govern enforcement doctrine at T_2. Thus, it behooves us to ask what constitutes the contract as envisaged by the parties, and to enforce those elements that were truly bargained for and freely entered into. Significant consequences follow for the doctrines of contract enforcement if a subjective view of contract enforcement is applied to the incomplete model of contracting. The rest of this Part is devoted to developing and applying a system of enforcement under the experience model. It will become apparent that the experience model, unlike the complete contracting model, allows parties to develop and enforce shared expectations about their bargain. Although the costs of the experience model will be seen to exceed those of a complete contracting model, several strategies can be developed to minimize these costs.

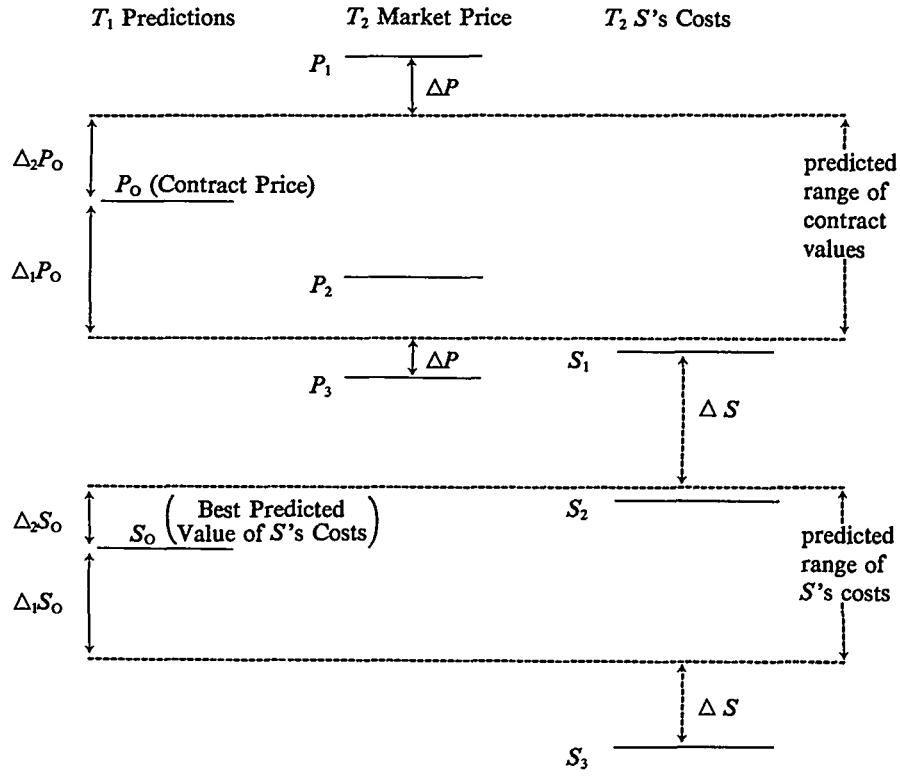
Enforcement under the experience model endeavors to provide remedies that satisfy, as closely as possible, the parties' T_1 expectations.

65. Indeed, these reasons may be significant enough to question whether the cost-plus type contract should be enforceable as such in a system of contract where the initial risk allocation is presumed to be incomplete and parties are already protected from being saddled with enormous exposures.

66. *See supra* text accompanying notes 33-40.

Figure I

Possible T_2 Outcomes



Examination of B and S's T_1 expectations[67] allows us to construct the possible outcomes at T_2.

At T_1, S and B expected a (most-likely) T_2 market price of \$100 (P_0, the contract price), but also thought the range of possible T_2 market prices was between \$95 and \$110. S also assumed that while her most likely cost would be \$80 (S_0), the possible range in cost ($S_0 + \Delta_1 S_0$, $S_0 + \Delta_2 S_0$) would be \$75 to \$85. Thus, four doctrinally significant T_2 outcomes are possible. The T_2 market price could either lie within or outside the range anticipated and allocated by the contract. Similarly, the T_2 cost to S could either lie within or outside her anticipated range of outcomes.

This is represented in Figure I, where P_0 is the contract price and $\Delta_1 P_0$ and $\Delta_2 P_0$ are the anticipated variance about P_0; P_1, P_2, and P_3 repre-

67. *See* Table II, *supra*, at text accompanying note 60.

sent the three possible outcomes in T_2 market price that lie above, within, and below the anticipated range of market prices; S_0 is the best predicted value of S's costs, $\Delta_1 S_0$ and $\Delta_2 S_0$ represents the total T_1 predicted range of S's T_2 costs, and S_1, S_2, and S_3 are the actual T_2 outcomes (S_2 within, S_1 above, and S_3 below the anticipated range of T_2 cost).

The contracting parties' T_1 predictions can err in two ways. The parties may fail to consider T_2 outcomes that lie outside a given range—that is, they may truncate the probability distribution. They also may err as to the shape of the probability distribution, thinking that certain outcomes are more or less likely than they really are. Because both types of error affect the allocations made at T_1, it may be argued that an enforcement scheme that attempts to discover and enforce the parties' T_1 allocations must consider both the range of risk and the probability distribution assumed by the parties.

While this proposal has merit, the scheme that follows focuses on the range of assumed obligations and iguores errors in the exact distribution of risks allocated in the contract. This is appropriate for two reasons. First, it would be unworkable to allow parties to litigate ex post the exact distribution they assumed ex ante. Unless parties are required to include within their contracts the exact distribution of outcomes they are assuming, the potential for conflict within every contract is overwhelming. Moreover, even if parties could be convinced to specify predicted distributions, one would need to determine ex post the "correct" distribution and possibly whether a particular outcome would have occurred even if the likelihood of its occurrence was exactly what the parties assumed.[68] Secondly, I believe that the focus on the range of outcomes is fair. Even if the parties assumed the exact distribution incorrectly, they knew that within the allocated range there was some probability of the particular risk's occurrence, and they willingly assumed it. It does not seem unfair, or unduly disruptive of parties' expectations, to enforce the range of risk where the parties assumed some probability of particular outcomes within the range.

Iguoring for the time being the complications caused by the expectations created by S's cost projections, the diagram shows that the experience model predicts two possible T_2 outcomes that require remedies: one where T_1 expectations are fulfilled by T_2 conditions, and one when T_2 conditions are outside the range of T_1 expectations.

68. For example, assume that B and S assumed that the probability of the T_2 price being $108 was .1. If the price at T_2 is $108, should S be allowed to argue that the real probability of a $108 price was higher, and hence the contract price was too low? To entertain this argument, we would need to determine at T_2 the real probability distribution, its deviation from the distribution assumed at T_1, and we may even face a causation issue—whether the event would have occurred if the probability really had been .1. The administrative costs and uncertainty that this inquiry entails would appear prohibitive.

1. Case 1: The Party Expectation Case

T_2 conditions lie within the range allocated at T_1.

In the simplest case, the conditions at T_2 lie within the range of risks assumed by the parties at T_1 and allocated by the contract. This occurs when the T_2 market price lies within the uncertainty margins assumed by the parties at T_1, and is represented in the diagram by P_2:

$$P_0 - \Delta_1 P_0 \leq P_2 \leq P_0 + \Delta_2 P_0$$

That is, in our example the T_2 market price lies between $95 and $110.

Here the experience model adds nothing to current practice: the parties' expectations are best satisfied by enforcing the contract at the T_1 contract price, P_0.[69]

2. Case 2: The Partial Allocation Case

T_2 conditions lie outside the range allocated at T_1.

In the second case, T_2 conditions are outside the range of outcomes allocated by the T_1 contract. The contract terms therefore cannot completely specify the allocation of the T_2 contract surplus. This occurs when the T_2 market price is either above or below the range anticipated at T_1—in our example when the T_2 market price is below $95 or above $110. In these cases there is an excess contract value, ΔP (positive or negative), which from the T_1 perspective represents an unallocated windfall. (A positive value represents a winning contract to B but a losing one for S, and vice versa.)

Several responses might be appropriate in this situation:

1. Free B and S of their contractual obligations at T_2.

Because the contract did not cover the situation at T_2, it can be argued that the contract does not extend to the T_2 regime, and thus B and S have no obligations under it at T_2. This is analogous to finding that the range of party expectations conditions T_2 performance. It also is equivalent to allocating the entire contract value to S.

2. Enforce the contract at the price of P_0 at T_2.

Here we ignore the actual risks assumed by the parties at T_1 and assume that they undertook to perform at the stated T_1 contract price P_0, irrespective of the T_2 market price. This is equivalent to allocating the entire contract value to B.

3. Enforce the contract—but only to the extent that it covers the T_2 circumstances.

We could enforce the contract at the price of P_0—but only as to the range of allocated contract values, $P_0 - \Delta_1 P_0$ to $P_0 + \Delta_2 P_0$, thus leaving an

69. As discussed earlier, if we choose to enforce allocations based on the exact distribution assumed by the parties, they would be free to argue mistake as to the distribution, even within the allocated range. *See supra* note 68 and accompanying text.

excess contract value, ΔP, to be allocated between the parties in some other manner.

At this point the experience model's logic and results diverge from the rationale and practice of current contract doctrine. Under current doctrine, the contract is either enforced at T_2 as though the T_2 conditions were allocated by the T_1 contract (option two), or the aberrant T_2 market price is treated as an excusing condition or event and the contract is not enforced at all (option one).[70] Unless the contracting parties actually considered and allocated the event in the same manner as current contract doctrine dictates, the law will not enforce the parties' subjective T_1 expectations and will frustrate the goals of the bargain principle.

If we examine the expectations generated by the experience model,[71] however, the price is treated not as an absolute measure of the parties' expectations and risk allocations but as an instrumental variable. The parties' expectations are defined in terms of the profit they hope to make and the losses they are willing to assume. The price term is selected by them at T_1 to effectuate these goals. Viewed in this light, the all-or-nothing character of the current eventizing model is the least likely to approximate the parties' shared T_1 expectations. The experience model, which seeks to determine and enforce the parties' subjective evaluations, requires an alteruate approach. Parties' expectations can be more closely approximated by adjusting the T_2 price term and enforcing the contract than they can be by allocating the full contract value to one party.

To illustrate, consider the case in which the T_2 market price is \$140. If the entire contract value is given to *B*—suppose the contract is enforced under current doctrine—*B,* who at best expected to gain a maximum contract value of \$10, gains a contract value of \$40. *S,* who at most expected to risk a low contract value of -\$10, now faces a T_2 value of -\$40. This is the most extreme disruption of expectations and hence contrary to the goals of the bargain theory. The experience model reveals the unfairness of this allocation when we consider each party's expectations as to the contract's value to the other. At T_1, *B* did not expect *S* to perform a contract in which she would lose \$40. Nor can he be assumed to have paid for it. On the other hand, refusal to enforce the contract results in the same type of irrationality and unfairly injures *B*'s expectations. To most closely approach *B* and *S*'s shared T_1 expectations, the experience model must follow the strategy of option three above. The contract should be enforced to the extent that it goverus, not all or nothing, leaving an excess of ΔP to be allocated by other criteria.

70. This can happen either because the contract is explicitly made dependent upon the T_2 price, or more likely, because of an implicit excusing event. *See infra* note 153 and accompanying text.

71. *See* Table 2, *supra* at text accompanying note 60.

Thus, the contract would be enforced at a price of $100 to a maximum T_2 price of $110. The excess contract value of $30 must then be allocated by the court.

If contract enforcement is to proceed in this manner, it is clear that the values $\Delta_1 P_0$ and $\Delta_2 P_0$, the ranges of uncertainty in the price assumed by the parties, must be determined at T_2. Moreover, strategies must be devised to distribute the excess, ΔP, at T_2.

a. Determining $\Delta_1 P_0$ and $\Delta_2 P_0$.

Enforcement under the experience model requires knowledge of the values not only of the contract price, P_0, and the T_2 market price P_1, P_2, or P_3, but also the range of price uncertainty assumed in the contract ($\Delta_1 P_0$ and $\Delta_2 P_0$). Ideally, the parties would explicitly define these values in the contract, even providing schemes to divide any excess T_2 contract value.[72] Explicit consideration of these parameters at T_1 would also serve to encourage parties to develop shared expectations, an important requirement for enforcement in the bargain theory of contract.[73] Incentives must be provided to encourage parties to develop shared expectations. I argue below that the experience model's focus on one parameter, price, and its relation to market values simplifies the bargaining process[74]

72. If one party suggests a range of allocated values and schemes to distribute excess values the other(s) probably will consider those contract terms more carefully than they do now when given the standard boilerplate contract excuses. Inclusion of such profit and loss margin terms will lead to more reasoned and informed contracting since a party presented with an extreme range of profit or loss can be expected to ask the other for information. This may mean that it will be more difficult to agree, but it is counterproductive to encourage bargain-making at the cost of reasoned bargain-making. The more interesting question is what to make of a contract with exceptionally large ranges or excesses allocated largely in one party's favor. This might signal that some form of overreaching has occurred. But what if there have been no procedural irregularities and the contract reflects inequality of bargaining power? This raises the problem of price unconscionability, a problem outside the scope of this Article. Still, the experience model would confront courts with bargaining power issues much more directly than does current doctrine.

73. *See supra* text accompanying notes 41-44.

74. Contract doctrine may account for why parties currently fail to do just this. We find an attempt to do this—shaped by current doctrine—in variable price terms such as escalator clauses. Moreover, during the inflation of the 1970's many sellers apparently refused to perform unless contract prices were renegotiated—and many buyers were both sympathetic and acquiescent. Apparently, the parties never intended sellers to assume such inflation risks, but never anticipated their occurrence. *See* Wall St. J., Mar. 26, 1974, at 1, col. 6, *supra* note 233. Some hardship clauses now incorporate a renegotiation requirement in extreme conditions, with provision for a third-party arbitrator in case the parties fail to agree. This is particularly common in international trade agreements. The International Chamber of Commerce (ICC) has promulgated rules governing applications for "adaptations" (contract renegotiation). The ICC suggests such arbitrations are needed in several situations including those where (1) the parties "have deferred the insertion of a particular clause . . . [because], for instance, . . . the contracting parties, at the time the contract is signed, do not have enough information on a given . . . yardstick which would determine the price . . ."; and (2) "where the parties have included a clause aimed at making it possible to adapt their contract to changing circumstances which could upset the equilibrium of their agreement . . . . This type of situation is notably covered by the 'hardship' clause, and brings about essentially a

compared to current contract doctrine which forces the parties to foresee and allocate numerous specific risk events.[75] Nevertheless, where the parties fail to specify allocated ranges, it will devolve upon the court to determine at T_2 what these values were at T_1.

The cost of determining the range of unallocated contract values could be very high.[76] The best evidence of the subjective values that the parties placed upon the range of uncertainty at T_1 would be the price data they actually used and the range of possible prices generated from the data. This approach does have several pitfalls however. First, there is the obvious danger of inaccurate or fraudulent data. Second, if the parties use idiosyncratic data to generate their profit and loss expectations, they are unlikely to achieve shared expectations. Finally, the determination of allocated ranges could require extensive litigation, although for reasons discussed below this is not likely.[77] Nevertheless, the subjective data are the most appropriate form of evidence regarding margins of price uncertainty, especially where market prices are difficult to determine at T_1.[78]

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renegotiation . . . of the contract . . . ." INTERNATIONAL CHAMBER OF COMMERCE, PUB. NO. 326, ADAPTATION OF CONTRACTS 7 (1978). The ICC has yet to receive any requests for their "adaptation" procedure.

75. *See infra* text accompanying notes 228-35.

76. Professor Schwartz has recognized that parties might negotiate contract prices under the assumption that inflation will remain within a certain range. Schwartz, *supra* note 6, at 12. He therefore claims that a seller might "deserve" to be excused if unexpected inflation pushes the market price beyond a certain figure. *Id.* at 16. As Professor Schwartz assumes traditional remedies, his choices are limited to enforcement—which entails undeserved losses to seller and undeserved gains to the buyer in inflationary periods—and excuse—which entails undeserved gains to the seller and undeserved losses to the buyer. *Id.* at 10. He concludes that excuse ought to be granted when it would minimize undeserved gains and losses. *Id.* at 8-9. Nevertheless, Professor Schwartz argues that excuse is unsatisfactory because of the resultant effect on contract stability: determining the percentage of the rise in price attributable to "unexpected" inflation simply would be too difficult and uncertain. He argues that uncertainty would create incentives to breach rather than perform. In reaching the conclusion that determining the unallocated range of a particular event would be unpredictable and difficult, Professor Schwartz identifies three problems: (1) ascertaining the expected price fluctuation range attributable to that event; (2) deciding whether the cause of the market advance was foreseeable; and (3) ascertaining whether that cause was principally responsible for the advance. *Id.* at 12, 13, 16. Thus, Professor Schwartz requires the court to determine the range of inflation that was foreseeable and hence allocated in the price as well as the extent to which the price rise was caused by inflation and hence the amount of price increase attributable to "unexpected" inflations. Not surprisingly, Professor Schwartz concludes that this exercise is too uncertain and difficult. *Id.* at 8-19.

The problem with Professor Schwartz's approach is that he retains the notion that risks should be identified with risk-events. Thus, he must determine the relationship between the rise in price, the predictable rise attributable to each foreseeable event, and that attributable to unforeseeable events. The experience model, however, does not attempt such eventizing. In the experience model, the court only has to determine the range of allocated price and the T_2 price. It does not require the court to determine the causes of the increases.

77. *See infra* text accompanying notes 87-88.

78. *S* may proffer evidence of her cost and return on cost expectations. For reasons explained in greater detail below, we should be extremely reluctant to allow litigatiou of matters dealing with

A more promising approach, which would substantially decrease the cost of the determination, is to use objectively verifiable data to generate the values of $\Delta_1 P_0$ and $\Delta_2 P_0$, unless the parties can negate the presumption that they followed this procedure. The most instructive data for this purpose, the data that the parties are most likely to have used themselves to gauge their exposure at the contract price, are the historical variances in market price.[79] The relevant period should vary depending upon the relative market stability and price trends of the contract good. This data would be similar for all contracts of a particular type, and one might use, as a first approximation, values determined in other suits involving similar contracts.

b. Distributing ΔP.

A model of bargaining that recognizes that promises are made within boundaries of risk offers no gnidance about how to allocate excess contract values in those situations in which the value of the contract at T_2 lies outside the range expected and allocated by the parties at T_1. This contrasts sharply with enforcement based upon a complete contracting model under which, for any state of the world at T_2, courts need only "interpret" the T_1 contract and enforce the allocations made by the contract. In the experience model, when T_2 conditions lie below or above[80] the T_1 range of assumed outcomes, there is an excess contract value, ΔP (positive or negative) that is unallocated by the T_1 agreement.[81] Such a model, therefore, must include some method for the distribution of this ΔP.

There are many possible methods of distributing ΔP, depending on the goals that the system is meant to achieve and the reasons for the

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S's costs. *See infra* text accompanying notes 100-05. At the least, we should require that a consideration of *S*'s costs be based upon an explicitly shared decision by *S* and *B* at T_1 to make this factor relevant to the contractual allocation of risks. Although this limitation might sacrifice our ability to determine and enforce *S*'s subjective expectations to some degree, a contrary rule would entail a sacrifice of our objective to generate and enforce shared expecatations. This is because *B* normally has little knowledge of, or interest in, *S*'s costs. Moreover, allowing *S* to introduce the subject of her costs would result in significant sacrifices in efficiency.

79. The type of contract at issue is obviously an important factor in determining the allocated ranges. While the focus on long-term market price variance would be appropriate for large classes of cases, it would be less useful for contracts whose function is to shift low-probability, high-effect risks. Insurance contracts are a prime example. Other classes of cases where courts should assume that parties intended to allocate much larger risks than indicated by market variance would be those involving commodity futures, stock options, and other speculative contracts.

80. Here, again, the experience model yields results different from both the model of complete contracting and current doctrines recognizing incomplete contracting. Under current doctrines, unexpected events must induce rises in market price before they may justify excuse or modification. *See infra* text accompanying notes 135-49 on excuse; text accompanying notes 186 & 200 on modification.

81. For a more detailed discussion, see *supra* text accompanying notes 85-96.

surplus. Some options would require courts to perform significant fact finding functions and/or policy determinations, incurring significant costs. At least one option, however, that of dividing the surplus between B and S, appears both to be fair to the parties and to minimize the cost of distributing ΔP. The remainder of this Section discusses a few of the possible methods of distributing the surplus.

There are many reasons why an excess value could occur, ranging from "true" price increases—which could have many causes, such as changes in the market structure, changes in the supply or demand for widgets—to "false" price increases—increases which reflect decreases in the value of money (inflation). Each of these situations presents the experience model with a slightly different problem. We start, as before, by comparing the T_2 situation to the parties' T_1 expectations of contractual outcomes.

Case 2a: The Inflation Case

The price rise, ΔP, is attributable to inflation. Here, the entire price increase is caused solely by changes in the parties' chosen scale variable, the dollar. Thus, if widgets sell for \$120 at T_2, and \$10 are attributable to inflation, S's expectation of the \$110 contract value can be achieved only at \$120. Similarly, B's expectations of the value of the contract to himself and S at \$110 can only be achieved at a price of \$120. It follows, therefore, that S should be entitled to the entire excess.

Unfortunately, the situation is not so simple. This case focuses on an event and, to some extent, its foreseeability. It is certain that the T_1 allocation, made solely in terms of price, must have included some element of the risk of inflation. We would have to attempt to discover how much of the inflation was allocated under the price, and allow B this increment. The remainder, the truly unforeseen and unallocated inflation, should belong to S. Such a division would be extremely difficult to do, however.[82] It is exactly this type of analysis—necessary under the current eventizing model—that the experience model seeks to replace. This might be the one case, however, where little else can be done since it is an event that affects the value of the scale variable itself.

Case 2b: The Windfall Case

In this case, the change is a true price increase to \$110 + ΔP or decrease to \$95 − ΔP.

What are the expectations here? In the case of the price rise, both S

82. Indeed it would be very difficult even to determine which portion of a price increase is allocable to inflation, let alone to discriminate between "foreseen" and "unforeseen" price changes attributable to inflation. *See* Schwartz, *supra* note 6, at 12, 13.

and B's expectations of their returns on market price are satisfied by the first $110.

Similarly, in the case of the price decrease, S's maximum expectation of return on market would be satisfied by a T_2 market price of $95. Moreover S never expected B to be saddled with a market loss greater than the difference between the contract price of $100 and a T_2 market price of $95. B's maximum assumed loss is also reached at the $95 T_2 price.

Thus, in both cases, for the next ΔP, neither S nor B had any expectations as to this wholly unanticipated bonus. Expectations here, if any, are created by the law that assigns the right to the excess and in all probability are created ex post, when the parties start to bicker over the bonanza.[83] Under the current eventizing model, parties are assumed to have foreseen and allocated ΔP through the price term. In the case of the price rise, for example, B may stand to gain a bonanza unless S can escape the contract[84] or gain B's consent to an enforceable modification that allocates the excess.[85]

The experience model, on the other hand, recognizes that the ΔP represents an excess and unanticipated contract value, which must now be allocated between the parties. Because the actual terms of the contract provide no guidance to the allocation of the excess, we must evolve doctrine to do so. There are several possible choices.

i. The True Contractarian Response: Seek the Most Probable T_1 *Allocation.* The true contractarian would view the contract and the evidence of S and B's T_1 bargaining and would attempt to determine how S and B in their ex ante positions would have divided ΔP if they had known that it might exist. This is a difficult exercise because it depends on such factors as the parties' relative bargaining strengths and risk preferences. Moreover, it is unclear whether the risk allocations at the value anticipated in the contract should hold for amounts above the contract range.[86] What is almost certain is that the entire risk has not been allo-

83. Credible empirical evidence suggests that when business people negotiate and enter into contracts, they tend to concentrate on specifying the particulars of perfomance and to ignore the legal consequences of a breach. *See* Macaulay, *Non-Contractual Relations in Business: A Preliminary Study,* 28 AM. SOC. REV. 55, 60 (1963).

84. S may avoid the contract by denying consent, relying on legal technicalities, or, where costs have risen, invoking excuse. A classic example of a technical escape route for unwilling sellers in rising markets can be found in the Statute of Frauds. *See* the cases discussed in Note, *Promissory Estoppel, Equitable Estoppel and Farmer as a Merchant: The 1973 Grain Cases and the UCC Statute of Frauds,* 1977 UTAH L. REV. 59.

85. On whether a modification is enforceable, see *infra* text accompanying notes 187-94 & 207-09.

86. Risk preferences might well vary with exposure to loss or gain. One might seek guidance from the "usage of trade" concept, U.C.C. §§ 1-205(2), 1-205(3) to see how similarly situated businesses have chosen to allocate similar excesses, if such data exists.

cated to one or the other of the parties, for no payment has been made for this risk.

ii. A Modified Contractarian Response: Divide ΔP *Equally Between* S *and* B. If the contract between S and B is seen as a type of partnership, it would be fair to allocate ΔP equally between the parties.[87] After all, B and S were both responsible for their joint decision to produce, trade, and value the widget as they did. Since they are equal partners in the T_1 contract decisions, it is fair to require them to share equally the consequences of their decisions. Moreover, a rule dividing ΔP equally would provide certainty in the rule of decision and avoid winner-take-all incentives, except those found in the uncertainty in the value of the ranges of the allocated contract value, $\Delta_1 P_0$ and $\Delta_2 P_0$. This combination of certainty in decision rule and a limited scope for winner-take-all behavior would encourage parties to view the contract as a shared venture, and to cooperate and settle their differences at T_2 without recourse to the courts.[88]

Of course, one hopes that a rule dividing ΔP equally would encourage the parties to renegotiate their agreement to allocate any excess by removing the incentives of the current system, which bestows the full benefit of the contract, including the unbargained for contract value, on either S or B. When S and B act ex ante under legal advice, this scheme also encourages them to include a range of allocations of contract value. A range of value surely is easier to specify completely than an elaborate anticipation and allocation of risk-events.

iii. Encourage Bargaining Efficiency and Complete Contracting. If one of the goals of this system of contract interpretation and allocation is to encourage contracting parties to specify completely contractual allocations—that is to form and specify expectations for the entire range of contract values—one might place the entire risk of unallocated excesses on the party who was best able, and yet failed, to perform this exercise.[89] One might, for example, burden the party with the best access to legal

87. Other writers have justified the sharing of risks between contract parties on the ground that a contract is a partnership of sorts. For example:

> "A contractual relation is a good example of a concrete relation that may give rise to a more focused duty to share another's good or ill fortune. The relation is, after all, freely chosen. Indeed this is the same idea as that the contractual parties are in a common enterprise—an enterprise they chose to enter."

FRIED, *supra* note 2, at 73.

88. On litigation incentives created by uncertainty in the decision rule, see Priest & Klein, *supra* note 22.

89. This approach is analogous to the suggestion in tort law that losses be allocated to the cheapest cost avoider; that is, to the party who "is in the best position to make the cost-benefit analysis between accident costs and accident avoidance costs and to act on that decision once it is made." Calabresi & Hirschoff, *Towards a Test for Strict Liability in Torts*, 81 YALE L.J. 1055, 1060 (1972).

counsel with the duty to specify completely,[90] or one might leave the allocations as they currently exist—namely, S takes all risks of a positive ΔP and B takes all risks of negative contract values.[91]

The latter efficiency rationale is especially unattractive because there is empirical proof that most businesses do not use legal counsel or turn to legal rules for guidance until after contracts have failed in some manner.[92] Those that do tend to be the larger and more affluent businesses. In short, the change in the law to more realistic patterns would benefit the grain elevator, and not the farmer. Moreover, where the parties have not defined their expectations, sufficient incentive to do so can be provided by the added uncertainty inherent in determining their expectations in a lawsuit.[93] Furthermore, in a scheme in which the surplus, ΔP, is divided equally, both parties have an incentive to initiate alternate distribution schemes.

iv. Encourage Competitive Market Structures. If the price increase for widgets is caused by changes in the market structure, the excess value could be awarded in a manner that would encourage competitive markets in widgets. For example, if the rise in widget prices reflects monopolistic profits because S drove her competitors out of business by price-cutting and subsequently raised her prices, it might be appropriate to award the excess to B. There are many problems with this criterion.

Often it is impossible to determine whether markets are competitive. Courts are particularly inefficient monitors, and the needed market data, in all probability, would terribly complicate what began as a simple contract suit.[94] Of course, as all widget sales contracts would be affected similarly, one determination of monopolistic profit probably would be sufficient to govern all T_2 suits, but this gain notwithstanding, the net gain of such a rule in promoting efficient markets is likely to be marginal because it only affects unallocated excesses. S would, as far as contract

90. Note that the parties are not being asked to specify completely risk-events—just to specify the monetary division scheme for contract values.

91. *See supra* text accompanying notes 69-72.

92. Macaulay, *supra* note 83, at 60.

93. As in the event of a failure to specify the ranges of expected values, S or B would be required to prove the bounds that the parties had placed on $100, and the court would be likely to set conservative values on uncertainty margins. In the experience model, the assumption would be that such bounds did exist, and S or B could introduce evidence (such as market data) to establish what the bounds were.

94. Courts recognize their limited ability to analyze market structures. This accounts in large part for the adoption of per se rules in antitrust:

> Whether or not we would decide this case the same way under the rule of reason used by the District Court is irrelevant to the issue before us. The fact is that courts are of limited utility in examining difficult economic problems. Our inability to weigh, in any meaningful sense, destruction of competition in one sector of the economy against promotion of competition in another sector is one important reason we have formulated per se rules.

United States v. Topco Assoc., 405 U.S. 596, 609-10 (1972) (footnotes omitted).

law goes, keep all allocated excesses and contract values—including monopolistic profits in contracts made after the monopolistic pricing commenced. It would appear to be a rare case where the advantages of such a rule would outweigh its negative effects.

v. Encourage Economic Efficiency. Encouraging economic efficiency requires a determination of why the price rise occurred and an efficient allocation of contract excess values. For example, if the price of widgets has escalated because of increased demand due to the announcement of a new use for widgets discovered in *S*'s research laboratory, it might be appropriate to award the excess to *S*.[95] On the other hand, if the price increase is caused by import restrictions on a imported raw material and one of the contracting parties has a significantly better ability to find a substitute for that material, or for the widget, the excess might be awarded to the other party. This again is an extremely difficult determination in the vast majority of cases, and one that courts are ill-equipped to make.

This is not an exhaustive survey of the ways in which ΔP might be allocated, although it does suggest some possibilities. If the contract is viewed as a purely private law, the most obvious and appealing solution is to share ΔP equally between the parties. Nevertheless, because ΔP is a bounty, it should be legitimate, even under the principles of contract law, to allocate ΔP so as to promote policies, such as economic efficiency. This is not a new suggestion; several commentators have argued that the common law doctrines of mistake and impossibility either were, or should be, developed to further the goal of economic efficiency.[96] Furthermore, as I have demonstrated, these doctrines result in distributive effects unanticipated by the parties under any credible model of contractual behavior.

c. *The Problem of Seller's Costs*

As we have seen, *S* will almost certainly have expectations about her costs and about her return on cost. So far we have ignored this set of expectations. Including them in the analysis of enforcement in the experience model could have significant consequences in several important cases, becauses *S* could claim that her expectations on cost are entitled to

95. Absent information problems and transaction costs, the widget would always be transferred to its highest and best use: If *B* obtained the widget, he would use it or resell it to another consumer who valued it more highly. *S* also would sell to the highest bidder. What is at issue is not whether the widget would reach its highest valued use, but rather, who receives the benefit.

96. *See, e.g.*, Posner & Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83 (1977); Kronman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. LEGAL STUD. 1 (1978) (both arguing that courts should promote efficiency by imposing the risk of mistake on the better information gatherer).

protection. Let us start with the problem that is most often encountered in the current system of contract enforcement—the case where S's costs rise.

i. S's costs increase above the range she expected at T_1. S expected at T_1 that her costs would be S_0 with some range of variance, $\Delta_1 S_0$ and $\Delta_2 S_0$. She finds at T_2 that they are above this range, in the situation defined by S_1.[97] There are three possible variants of this case, depending upon whether the T_2 market price is at (P_2), above (P_1), or below (P_3) the anticipated T_1 price range. Initially, take the case in which the price (P_2) lies within the expected range. Under the experience model, some of the parties' T_1 expectations are realized, and some frustrated, at T_2. As we have seen before, B normally would neither know nor care about S's return on cost. S normally would not have to produce a widget; she simply would be obliged to give B a market remedy, which is therefore the true measure of her contractual obligation.[98] If we refer to Table 2,[99] we see that:

S's actual T_2 position

—as regards her return on cost is outside the assumed range of risk at T_1; —as regards her return on market price is within the assumed range of risk at T_1; —as regards B's return on market price is within the assumed range of risk at T_1.

B's expectation

—as regards his return on market price is within the assumed range of risk at T_1; —as regards S's return on market price is within the assumed range of risk at T_1.

We see, therefore, that all T_2 outcomes are within the allocated range of risk, both as to party expectations about themselves and as to the other contracting party, except for S's unilateral assumption regarding her return on cost. Should S be entitled to a remedy? Depending on the actual market price at T_2—and hence the T_2 value of the contract to S and B—S might make the following argument:

If the market price stays within the range anticipated by B but exceeds his expected value—say it goes to $107—the court could shift some or all of the value of the contract to S, allowing S some relief, while still permitting B to enjoy his T_1 expectations. S would argue that the

97. *See supra* text following note 67 and Figure I, *supra* at p. 1150.

98. Some excuse doctrine to the contrary, S's costs normally cannot escalate beyond the cost of arranging a substitute market transaction. It also is unlikely that costs can escalate without affecting the market, unless the escalating event is idiosyncratic to S (for example, her widget factory burns down), the market demand for widgets drops unexpectedly (suppose widgets are banned by the government), or the supply of widgets suddenly increases from sources that do not face similar costs (imagine that American widgets face skyrocketing energy costs, but Taiwanese imports are unaffected because they are produced labor intensively).

99. *See supra* text preceding note 60.

contract remedy should attempt to create T_2 outcomes that bring both parties, simultaneously, as close as possible to the ranges of risk they assumed at T_1. So, for example, if S's costs rise to the market price, \$107, S might argue that a price of \$107 is optimal because it places both S and B at their expected value for the contract, while reducing S's loss to \$0, which, although a lower profit on cost than she expected, brings her actual T_2 outcome closer to her expected T_2 outcome.

This argument could be made with even greater force when S's cost increase coincides with a market price that exceeds the maximum anticipated range of T_2 market price, \$110 (S_1, P_1). Here, \$110 satisfies all shared expectations, but leaves an excess value, as to which the parties had no T_1 expectations. Here, any expectations arise in response to the law that assigns the right to the excess, and in all probability arise ex post when the parties start to bicker over the bonanza. S's anticipated return on cost, the only unsatisfied expectation in this hypothetical, might or might not be satisfied, depending on the size and allocation of the excess.

We might now be able to satisfy S's expectation of her return on cost without doing violence to B's T_1 expectations. Let us assume that the market has risen to \$140, while S's costs have risen to \$110. There are no expectations for the ΔP, \$30, while S faces costs \$25 greater than her highest anticipated cost. Allocating \$25 of the excess to S would fulfill all party expectations, and still leave an excess of \$10 to divide in some way. If the rise were only to \$130, the entire \$20 excess might be given to S, still leaving B with his expectations intact.

While this solution, which produces contractual outcomes most closely approximating all party expectations, is attractive, it entails two problems. First, any system of relief based on S's, or B's, costs gives rise to serious efficiency and evidentiary problems. S's cost accountings are within her control and are notoriously difficult, costly, and time consuming to verify. Moreover, S is in the best position to predict her own costs, and there might be economic reasons for placing on S the bulk of any loss occasioned by her miscalculation. This argument loses its force where B is privy to S's cost estimates and the overrun is the result of events beyond S's control.

Secondly, requiring B to shoulder some of S's downside risks seems fair only if B is allowed to share in the gains when S faces unanticipatedly low costs—although we might also limit B's right to share to cases where the market drops below the expected range.[100] This seems less acceptable, both in terms of fairness and efficiency. Perhaps the gain in fulfilling party expectations is not worth these costs, especially since the experience model affords S some protection by entitling her to share in the

100. *See infra* text accompanying notes 107-11.

excess. There also is a strong argument for restricting the factors governing relief to *shared* expectations because the recognition of these expectations furthers the goals of the bargain principle.[101] As previously discussed,[102] B usually would have no expectations as to S's costs.

Two elements of the foregoing analysis warrant repeating: First, we are discussing *only* the division of the excess. B would always be entitled to his expectation—that is, to purchase from S at a price at least $10 below the market—and S would never be fully excused from the contract. Second, S's performance cost cannot exceed market price.[103]

The final case in this group is one in which S's increased costs coincide with a drop in market prices (S_1, P_3). Here, S would be urging B to dip into his pocket to share S's costs when B also is facing a losing contract; there is a negative ΔP to allocate. For all the reasons discussed earlier, B should not be asked to share S's costs. Moreover, here it is S who receives her maximum anticipated profit on the contract, and B who loses. It seems even more unfair to ask B to underwrite some of S's cost increases, further thwarting his expectations in a case in which he has no control over S's costs. Furthermore, this would stimulate inefficient behavior: by offering to shift some of S's costs to B, S would be encouraged to continue producing widgets in a falling market at increasing cost.

There are several reasons for rejecting S's argument for enforcement of her cost expectations when the market price drops. First, a system of relief based on the experience model should focus on generating T_2 outcomes as close as possible to those anticipated by the parties at T_1. Because B has no expectations as to S's costs, there is no reason to ask B to share in S's costs where S's market expectations are fulfilled. Prudential and efficiency concerns also support rejection of S's claims where S's costs are rising in a falling market. Where S is in control of her costs it is inefficient to assure her that excessive costs that in all likelihood are idiosyncratic[104] will be subsidized by others.

One might have more sympathy for S's argument if market forces united to force widget production costs up while undermining S's ability to pass those costs along in higher prices, but here, again, prudential considerations intervene. S controls both her costs and her cost data; her control of her cost data places B in an unfair evidentiary position. Litigating cost accountings is difficult and expensive.[105] Any attempt by S to

101. *See supra* text accompanying notes 41-44.

102. *See supra* text preceding note 29.

103. S's costs would also include possible delivery costs.

104. In only a limited number of market situations will falling market prices be coupled with a general increase in widget production costs. This could happen, however, if there were a sharp drop in demand for widgets.

105. This has led some contracting parties to look for external indices that will be good proxies

force a consideration of her cost expectations should therefore be disallowed.

ii. S*'s costs drop below the range she expected at* T_1. *B* might make a similar claim about his right to share in an unanticipated excess if *S*'s costs drop. This is the mirror image of the case in which *S*'s costs rise and occurs when *S*'s T_2 costs fall to S_3. Here, *B* might argue that the parties' expectations as to T_2 outcomes could be better fulfilled by reducing the contract price, especially if the T_2 market price is below the contract price. For example, if the T_2 price is $95 and *S*'s costs are $60, reducing the contract price to $95 would yield *S* a profit on cost of $35 and value of contract of $0 and give *B* a contract value of $0.[106] *S* therefore would still receive her maximum expected return on cost, while both *B* and *S* would realize their expected contract values.

Although this outcome might come closer to the possible outcomes envisaged at T_1 by *S* and *B* independently, if we look at shared expectations, we see that *B* had no expectations as to *S*'s costs. *B* was therefore not required to share in *S*'s downside risks as to costs, and he equally should not be entitled to any part of *S*'s upside gains.[107]

B's strongest argument could be made when a fall in *S*'s costs coincides with a market that falls below the expected T_2 range because *B* is then relying on shared expectations. In Table 2 we saw that *S* had expectations as to *B*'s value of contract: *B* might argue that *S*'s unallocated excess return on cost should first be allocated to bring *B*'s value of contract to the lowest mutually anticipated value, that is, to -$5. Although this may be a sympathetic argument, relief should be denied for the evidentiary and administrative reasons discussed earlier.

B's bid to share in *S*'s cost decrease is a claim that is never made under current doctrine,[108] nor would it succeed. Even if *B* secured *S*'s consent to a modification, it is unlikely that the drop in *S*'s costs would be an event sufficient to justify the modification in court. *B* would certainly be unable to prevail on any excuse doctrine[109] because his only

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for cost data. Such indices can be very difficult to identify. *See, e.g.*, discussion of Aluminum Co. of Am. v. Essex Group, Inc., 499 F. Supp. 53 (W.D. Pa. 1980), *infra* at text accompanying notes 215-20.

106. *See supra* Table 2, at text preceding note 60.

107. Here, as in the Cost-Rise case, efficiency and evidentiary reasons also suggest that *S* must bear the full risk of her own costs. Equally, in certain market conditions, it might be appropriate to grant *B* some of the reduced costs (where *S* has monopolistic market power, for example). But these outcomes further social goals unrelated to the bargain theory.

108. Such demands may be made in actual business practice. They would not, however, be made to courts, which have not hinted that such arguments would be well received.

109. In terms of excuse doctrines, the event does not affect *B*'s performance (frustration and impossibility) or, where the market price is unaffected, the value of *S*'s performance (mistake). *See* discussion of standards for excuse *infra* at text accompanying notes 135-49. As regards modification, unless *S*'s agreement could be found to be self-interested, it is unlikely to be found in

obligation is to pay money. Yet, if we force B to share S's unforeseen and uncontrollable cost increases by excusing S from performance[110] or enforcing modifications of the contract,[111] as we currently do, it is hard to see why B should not also be entitled to share in S's unforeseen and uncontrolled cost decreases. Such a denial seems especially unfair because S's only duty—like B's—is to pay money damages based on T_2 market prices, except in those rare situations where S could be compelled to give specific performance. Yet, impracticability has never been confined to situations where S would be subject to specific performance. The current doctrine is thus truly unfair because it is formulated under an unrealistic view of the facts.

D. Enforcement: The Experience Model Appraised

If we recall the reasons underlying the development of an alternate system of contract enforcement based on incomplete contracting, we can appraise the advantages and disadvantages of an enforcement system based on the experience model. Part II argued that the goals of the bargain principle can only be achieved if contract remedies enforce the parties' subjective T_1 expectations. This can only occur if remedies are based upon a realistic model of the bargaining process. Complete contracting, the underlying model of the current system of expectation enforcement, is an admittedly unrealistic model of the bargaining process. Thus, enforcement based upon a model of complete contracting can only be justified if the costs of an incomplete model outweigh the benefits it offers by allowing us to determine and enforce the subjective expectations of the bargaining parties.

In this Part I have developed an alternative system of contract enforcement based upon an alternative model of bargaining—the experience model premised on incomplete contracting. I have also examined some of its major costs and suggested strategies to reduce those costs. I shall now evaluate the experience model according to the criteria developed in Part II.[112] There I argued that doctrine in accordance with the bargain principle must: (1) enforce contracts with the subjective allocations made by the parties at T_1; (2) allow parties to develop and define shared expectations as to risk allocations; (3) be inexpensive and easy to implement; (4) minimize problems of proof; and (5) minimize incentives for litigation.

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good faith (the U.C.C. standard), or fair and equitable (the *Restatement* standard) because its only purpose would be to exploit S's good fortune, and not to alleviate B's bad. *See infra* text accompanying notes 176-201.

110. *See infra* notes 135-49 and accompanying text.

111. *See infra* notes 177-201 and accompanying text.

112. These criteria are set forth *supra* at p. 1141-42.

The experience model of bargain is well suited to allow parties to develop and define shared understandings about the extent of their contractual obligations. The enforcement system based on the experience model is designed to approximate closely the subjective allocations made by the contracting parties. The disadvantages of this system are already clear. Since it is premised upon the assumption that all contracts are incomplete, it inverts the current presumption that obtains in contract interpretation and enforcement that all T_2 outcomes, unless the contract specifically provides otherwise, are provided for by the price term of the T_1 contract. Instead, it presumes that unless an outcome is specifically allocated in the T_1 contract, it is not provided for by the terms of the T_1 agreement. Thus, the enforcement system would often be required to determine the ranges of allocated values and to generate criteria for distributing excess, unallocated values. The former requirement raises evidentiary problems, which if incorrectly resolved, might lead to great costs—both administrative and in terms of uncertainty and instability of contractual relationships; the latter requires the courts to engage in distributive decisionmaking.[113]

The major advantage of the experience model lies in its explicit recognition that contracting is incomplete. It then attempts to develop a model of bargaining that most closely resembles the way in which parties actually form expectations in a contractual setting. If contracting is usually incomplete, both an explicit recognition of this fact and a legal model of the way in which this incompleteness occurs must exist if we are to enforce contracts based upon party expectations. I argne below that the current system, based on the premise of complete contracting at T_1 but with ex post eventizing at T_2 to determine whether parties may modify or be excused from their T_1 undertaking leads to inconsistent results[114] that

113. Therc are other costs that would be associated with a change from the current enforcement system to one based on the experience model. How should we treat contracts entered into before the change? Should we grandfather them in some way or may they be renegotiated? The classic example would be home mortgages eutered into in the 1950's and 1960's, at interest rates of 4%. Clearly the parties never anticipated that inflation would push the cost of money into the brackets reached in the late 1970's and early 1980's. I prefer to cover these cases under the new system: after all, as a matter of contract, I see no reason to enforce the contracts at rates beyond any party expectations. Homeowner expectations that they could continue to pay what now appears on the current market to be minimal payments are created ex post. While one might well favor rescuing those homeowners on low and fixed incomes, it is not clear that the costs of rescue should fall entirely on those who—and those who cannot afford to—buy houses at rates inflated to cover the losses caused by these losing loans.

A second class of problems would confront industries that service the current system of contract enforcement. Insurance is a prime example. Insurance is now written to cover risk events. Although insurance would survive in an incomplete system of enforcement, because parties would still be able to write clauses for some events, it would also have to respond to risks created by market shifts. Parties would probably continue to ueed insurance, but insurance practices would have to adjust to predict and quantify, or offset, market shifts.

114. I shall demonstrate that contractual obligations are currently seen as absolute duties

fail adequately to reflect the parties' expectations.[115] In addition, these results seem unfair when viewed from the perspective of the parties' T_1 expectations.[116]

The experience model starts by attempting to define how parties actually bargain at T_1 using the information they are likely to have at T_1, and then attempts to define and enforce expectations generated at T_1 in that context. In doing so, it makes assumptions about the parties' primary interests and sources of information. In short, the model attempts to view the bargain from a T_1 perspective, the perspective the parties had when they defined their obligations and expectations. This T_1 perspective is then used to generate enforcement criteria based on party expectations. This creates the need for schemes to distribute unallocated surplus, and it is by no means certain that these schemes will mirror those the parties would have chosen at T_1. But the parties' T_1 expectations will be enforced. One may argue that the particular assumptions used to generate the model are unrealistic, but the methodology should survive alternate and more accurate assumptions.

The second major advantage of the experience model appears at first blush to contradict the premise of the first. The system promotes the contracting parties' ability to allocate risks more fully at T_1 and thereby reduces the problems of enforcement uncertainty and the need for distributive decisionmaking by the courts. This appears inconsistent with the premise of incomplete contracting, but in fact this model simplifies bargaining by relieving the parties of the burden of predicting at T_1 the world at T_2. The model suggests that contracting parties attempt to define only the price, the variance in market price they anticipate, and such excusing T_2 conditions as especially concern them. They can then devise formulae to divide the excess values without attempting to predict T_2 outcomes in terms of events, but only in terms of divergence of T_2 market price from anticipated values. The model does not ask that they predict the causes of such divergences but only asks them to think about and decide at T_1 how to divide such excess values at T_2. As I discuss in Part IV, this is in contrast with present contract law, which instructs parties to provide for the range of situations in which their performance is excused. It is surely easier and less expensive for the parties to define

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conditioned on events, with the same event variously considered sufficiently unforeseeable for excuse, insufficiently unforeseeable for excuse, sufficiently unforeseeable for modification but not excuse, and so on. *See infra* notes 135-49 & 180-201 and accompanying text.

115. Party expectations are not effectuated by absolutely enforcing obligations in the face of unforeseen events.

116. Examples of such unfairness are the disparate treatment of (1) B and S when they both face increased costs under the contract and (2) cost increases as opposed to windfall profits. Also unfair are the requirement of consent for modification, even when the modification is made to respond to unforeseen and hence unallocated events, and the winner-take-all quality of excuse.

the extent of the loss they are willing to assume than to specify the various T_2 conditions under which they will not perform at all. Moreover, at T_1 the parties' central concern is more likely to be price risks than a list of excuses.

It is true that parties could now write contracts along these lines and that such contracts would be enforced. That they do not might suggest that the experience model is an unrealistic view of bargaining. In the vast number of cases where contracts are extensively negotiated, however, the terms that are not of primary concern at T_1—unlike the price term—are dictated by lawyers. This community has been educated in, and responds to, the current legal system. A change in doctrine would lead lawyers to change the way they write contracts and to allocate contract excesses in conformity with the new system. Moreover, contracting parties are unlikely to allow their lawyers to define for them the range of risk—in profit and loss—allocated by the contract. This is in sharp contrast to current practice in which lawyers routinely add laundry lists of excusing conditions to contracts. In short, the allocations of price are likely to be subject to far more scrutiny and analysis by the parties than the excuse and force majeure clauses that lawyers currently add to contracts.

Finally, a system along the lines of the experience model should minimize incentives to litigate if the excess contract value is divided equally between the parties. Under the proposed model, the incentive to litigate is confined to the values of $\Delta_1 P_0$ and $\Delta_2 P_0$[117] since the winner's take is limited to $\Delta_1 P_0$ or $\Delta_2 P_0$. Because the remainder, ΔP, is divided, the incentive to gamble is contained in only $\Delta_1 P_0$ and $\Delta_2 P_0$. If, as suggested earlier, this value is determined on objective and easily accessible criteria, such as the variance of market values for some period prior to T_1, the parties should be able to predict it prior to litigation, promoting party resolution of conflict.[118]

If the baseline of appraisal for an alternative approach to contract enforcement is set by the current system, however, enforcement based upon the experience model allows us to approach more closely enforcement of subjective party values with little, if any, sacrifice in contractual certainty.

The next Part evaluates current contract doctrine. It argues that the current system of contract enforcement proceeds by way of a fiction of complete allocation while the doctrines of excuse and modification provide limited avenues for redressing losses created by incomplete alloca-

117. That is, in the value of the boundary line separating the region of contract values allocated by the parties and the region where the bounty is to be divided.

118. If $\Delta_1 P_0$ and $\Delta_2 P_0$ are routinely judged to be very large and based on individual subjective evidence, this benefit would largely disappear.

tions. As a result, legally enforceable contractual duties often bear little resemblance to the parties' allocations. At the same time, the increasing availability of excuse and modification, the uncertain applicability of these doctrines, and the strong incentives to litigate created by the current winner-take-all approach to contract remedies have severely undermined contractual stability and certainty. In addition, courts have become mired in difficult factual determinations: whether events were or were not foreseeable at T_1; whether S's costs have risen beyond reasonable variations; whether allocations made in modifications are "fair and reasonable"; or whether modifications were secured through duress.

Viewed from this perspective, $\Delta_1 P_0$ and $\Delta_2 P_0$ are easier to determine than many factual determinations made by the courts today, because those values most likely are driven by pre-T_1 market conditions. Moreover, once a court accepts that a contract is incomplete—that an event was unforeseen—by imposing further conditions on relief, the court is necessarily engaged in distributive decisionmaking. This is precisely the situation that now obtains under present contract law. Thus while a projected problem of distributive decisionmaking is of legitimate concern, it is not as great a departure from current decisionmaking as it might appear.

IV
INCOMPLETENESS AND CURRENT DOCTRINE: ENFORCEMENT, EXCUSE AND MODIFICATION

In the last Part we saw that contract doctrine premised on a model of incomplete risk allocation allows contract enforcement to better approach the parties' T_1 allocations—as long as the model of incomplete allocation is a realistic description of how the parties bargain. Thus, such a system of contract enforcement would promote the goals of the bargain principle. Any system premised on incomplete contracting must, however, provide schemes for determining the actual range of risk covered by an agreement and for allocating excess values when contract outcomes fall outside the contractually allocated ranges. These requirements engender problems of proof—and hence some uncertainty in the extent of contractual rights and obligations—and the need for distributive decisionmaking by the courts.[119]

In order to fully compare these benefits and problems with those of current contract doctrine, this Part revisits examples discussed in Part III, and considers how they might be treated under current doctrine. Under current doctrine, for B and S to appraise their contractual rights and duties at T_2, they must determine how three sets of contract doctrine

119. *See supra* note 113 and accompanying text.

apply to their case: (1) In general, their contracts will be enforced by an expectation measure of damages; (2) excuse doctrine might allow either party to escape otherwise enforceable contractual obligations by judicial intervention; (3) modification might permit them to change otherwise enforceable contractual obligations by mutual consent.

This Part first examines S's rights and options under the current system of enforcement, excuse, and modification. It considers the possible analyses of the two examples set forth in Part I, the Cost Rise[120] and the Market Windfall[121] cases. In the Cost Rise case, the contract value at T_2 lies within the range of T_1 allocated values, but S faces costs higher than she anticipated at T_1. In the Market Windfall case, S's costs are within her anticipated range, but the contract value at T_2 lies well above the range of contract values allocated by the T_1 contract. Enforcement based on the experience model would deny S relief in the Cost Rise case—the contract value is within the allocated range, and there were no shared expectations as to S's costs—but S would be entitled to an equal share in the bonanza in the Market Windfall case.[122] Current doctrine yields opposite results. S has no chance of obtaining relief in the Market Windfall case, whatever the reason for the windfall. In the Cost Rise case, however, S might obtain relief—either under the doctrines of excuse or, more likely, modification—if she can prove that her increased costs are attributable to an event that the parties did not anticipate at T_1, and therefore as to which the T_1 contract is incomplete.

In exploring S's rights and obligations under current doctrine I develop the argument, suggested earlier, that current enforcement doctrine is premised on a model of contracting that presumes that contractual allocations are complete. The enforcing court is obliged simply to interpret the T_1 contract and enforce the parties' allocations. I shall refer to this presumption of complete contracting as the classical ideal. Against this background premise of complete allocation, the doctrines of excuse and modification provide relief for incompleteness in situations in which the party petitioning for relief can (1) show that the incomplete allocation is attributable to a particular, unallocated event and (2) satisfy additional conditions placed upon relief.[123]

The combined doctrines of enforcement, excuse, and modification are inconsistent with each other and with the underlying justifications for enforcement—consent and the bargain principle. Parties are often

120. The Cost Rise case is set out *supra* pp. 1136-37.

121. The Market Windfall case is set out *supra* pp. 1137.

122. Contractual outcomes under the experience model are developed *supra* pp. 1156-58 & 1161-66.

123. For discussions of the doctrine of excuse, see *infra* text accompanying notes 135-54; for a discussion of modification, see *infra* text accompanying notes 173-208.

refused relief even when they can point to an unallocated event. Thus, they are required to perform in situations to which their consent did not extend. Moreover, in deciding which party must bear the risk of an unallocated event, the court is necessarily engaging in distributional decisionmaking.[124] In addition, the combination of the doctrines of modification and excuse posit a highly unrealistic mechanism for bargaining—eventizing.[125]

Finally, I compare the current system of enforcement, excuse, and modification to the system of enforcement developed in the experience model. I show that current doctrine, based on the eventizing model of bargaining described above, is unlikely to lead contracting parties to develop shared expectations as to their contract or to the enforcement of subjective party expectations. Furthermore, excuse and modification doctrines are expanding because of a perceived need to respond to the reality of incomplete contracting. But these expanding doctrines threaten contractual stability and increasingly involve the courts in difficult and costly factual determinations.[126] Compared to the current system of contract enforcement, a system based upon the experience model offers a greater possibility of enforcing subjective expectations and achieving bargain principle objectives, with little or no increase in cost.

A. S's Rights Under Current Contract Doctrine

Assume that *S* would prefer either to be released from, or to renegotiate, her obligation to *B* in the Cost Rise and Market Windfall cases.

(1) In the Cost Rise case, the contract value is within the range of allocated values of the contract, although *S* is in a losing contract (the T_2 market price is $110, the contract price is $100); however, *S*'s costs have risen at T_2 to $110, while *S*'s predicted range of her costs was $75 to $85.[127]

(2) In the Market Windfall case, the contract value at T_2 is $100

124. The court is enforcing obligations and forcing one party to perform for the benefit of another where there has been no consent to the obligation. *See infra* notes 151-52 and accompanying text.

125. In eventizing, parties are presumed to think of the world of risk in terms of risk-events, assigning probabilities and costs to each event. *See infra* notes 228-29 and accompanying text.

126. For excuse, courts are required to determine ex post whether certain events were "foreseeable" ex ante and whether cost rises attributable to "unforeseeable" events are sufficiently high to justify releasing the parties from contractual obligations. *See infra* text accompanying notes 135-49. For modification, courts are required to determine whether the changes were made in response to "unforeseeable" events and whether they are "good faith" or "fair and equitable" responses to cost increases caused by "unforeseeable" events. *See infra* notes 174-208 and accompanying text.

127. In the experience model, *S* would be forced to perform at the contract price. The contract value is within the allocated range, and *B* had no expectations as regards *S*'s costs. *See supra* pp. 1166-67.

(the market for widgets has risen to $200, the contract price is $100); this contract value is well beyond the allocated range of contract values, -$5 to $10.[128]

To determine her rights under current law, *S* would first determine how bargains are enforced, to see whether her T_2 obligation to *B* is affected by her contract's silence as to risks she is unwilling to assume at T_2. *S* would discover that, without *B*'s consent to a change, she is limited to the doctrines of classical contract theory—the doctrines of enforcement and excuse.

I. Classical Theory: Absolute Liability with Limited Excuse

a. The Classical Ideal: The Paradigm for Enforcement

Under the classical ideal, *S* cannot obtain relief from enforcement in either the Cost Rise or Market Windfall cases. *S* and *B* are presumed to have made an absolute commitment defined by their agreement. All uncertainties are to be provided for at T_1, and it is assumed that the allocation of any risk affecting the contract at T_2 can be discovered by interpreting the contract terms entered into at T_1.[129] Thus, unless *S* can convince a court that the terms of her contract explicitly or implicitly limit her duty to perform under the conditions at T_2, she will be liable to *B* for "expectation" damages—the difference between the T_2 market price and the contract price for the widget. *S* would find it almost impossible to convince a court that her duty was impliedly conditioned on market conditions, though she might, if rarely, convince a court that her duty was impliedly conditioned on the nonoccurrence of some extremely unlikely event.[130] In the Cost Rise case, *S* would be presumed to have assumed all the risks of supplying the widget for $100; if her costs are to be relevant, *S* must anticipate this at T_1 and expressly provide for it in the contract by limiting her duty, for example, or by setting the price as a function of cost. Nor would the Market Windfall case present a different

128. In the experience model, *S* would be entitled to share equally in the unallocated excess of $90. Neither *B* nor *S* had T_1 expectations as to the excess, and it was not a part of the T_1 bargain. *See supra* pp. 1157-59.

129. "[B]ut 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." Paradine v. Jane, Aleyn 26, 27, 82 Eng. Rep. 897, 897 (K.B. 1647). This strict construction of contractual completeness may still be encountered from time to time: "At the time of entering the contract, [salvager] did not see fit to relieve himself from liability for his failure to perform by reason of any subsequent difficulty .... Not having done so, he is now obligated to perform the contract according to its terms ...." Wills v. Shockley, 52 Del. 295, 297, 157 A.2d 252, 253 (Del. Super. Ct. 1960).

130. *See* Farnsworth, *supra* note 20, at 884-87. This argument merges into the doctrines of impossibility. *See, e.g.*, Transatlantic Financing Corp. v. United States, 363 F.2d 312, 315 (D.C. Cir. 1966) (performance rendered impracticable but not impossible); Patterson, *Constructive Conditions in Contracts*, 42 COLUM. L. REV. 903, 943-54 (1942).

problem in this austere world. If S wished to hedge her bets against the market, she should have done so explicitly in the contract.

In short, the classical ideal presumes complete contracting and thus generates the same consequences as the eventizing model. In reaching this result, the classical ideal does not presuppose, or need, any model of bargaining behavior. Because it posits complete contracting, which requires that answers to all questions about performance be sought within the contract terms themselves, it has no need to develop a model of contracting behavior. Under the classical ideal, it is the words and terms of the contract, and not how or why those terms were reached, which govern enforcement.[131]

The classical ideal does not claim to be a realistic model of bargain, though it does have several advantages. First, it may be preferable to have a system of enforcement in which a court simply has to inspect an agreement to determine all contract outcomes. This arrangement obviates any necessity for a court to use its discretion to redistribute contract values between the parties—to "make the bargain" for the parties. Second, if the classical ideal of completeness is routinely applied, parties are forewarned. The rule will then, it is presumed, provide parties with salutary incentive to write contracts that are as complete as possible, enhancing the possibility that any contract will provide for the risk at issue. Finally, as long as courts do not imply conditions to excess, the fiction of complete contracting provides certainty to contractual relations. In our example, S could, with a fair degree of certainty, predict at T_2 that her contract will be enforced in both the Cost Rise and Market Windfall cases. She would, therefore, have little incentive to refuse to perform or litigate.

The classical ideal of complete risk allocation persists as the paradigm for enforcement.[132] Enforcement usually is rationalized on the grounds that the parties "agreed" to perform, and that they "should have foreseen" that they would be called upon to do so under the circumstances as they actually exist at T_2.[133] S, therefore, is presumed to have consented at T_1 to perform under any state of the world at T_2, as long as a given condition at T_2 is not specifically excluded by the terms of the

131. What the parties do when they bargain at T_1 may still be relevant to the interpretation of contract terms. *See* U.C.C. § 1-201(3) (1978) ("'Agreement' means the bargain of the parties in fact as found in their language or by implication from other circumstances . . . ."); Farnsworth, *supra* note 20, at 870-73.

132. Courts today enforce contracts by the expectation measure of damages in situations in which the parties admittedly failed to foresee and allocate T_2 conditions in their T_1 contracts.

133. *See, e.g.*, Maple Farms, Inc. v. City School Dist., 76 Misc. 2d 1080, 352 N.Y.S.2d 784 (Sup. Ct. 1974) (contract for sale of milk not made impracticable by government-mandated price increase); Peerless Casualty Co. v. Weymouth Gardens, 215 F.2d 362 (1st Cir. 1954) (contractor's breach not excused by economic dislocations caused by war).

agreement. Thus, the contractual duty is rationalized as consensual—even where parties admittedly have failed to allocate an outcome. Such rationalization requires the fiction, or premise, that contracts are complete.

b. Classical Theory with Excuse: Eventizing

Once S determines that her T_1 assumptions about possible T_2 outcomes have no significance within the doctrines of enforcement, she might have recourse to the classical doctrines of excuse. Until recently these were her only hope for relief; today modification may also be available.[134] But the classical excuse doctrines remain S's only avenues for relief if B refuses to modify the T_1 obligations to comport with the realities of the situation at T_2. Then, when S finds herself in the situations of the Cost Rise or Market Windfall cases, the doctrines of mistake and impossibility are the only avenues of relief.

i. Mistake. Under the doctrine of mistake, S must show that (1) both parties were mistaken about a material fact at T_1 that resulted in the loss[135] or (2) S was mistaken about a material fact, and B accepted S's offer with knowledge of S's mistake.[136] In the Cost Rise case S might argue that she needed a new technology in order to manufacture a widget and at T_1 both she and B thought it was available. Alternatively, she might claim that B knew that S believed the technology was available, while B was aware that it was unavailable. In either case S must show that her costs increased as a result of the unavailability of the new technology.[137]

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134. *See infra* text accompanying notes 205-09.

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

RESTATEMENT (SECOND) OF CONTRACTS § 152(1) (1979).

136. Where a mistake of one party at the time a contract was made as to a basic assumption on which he made the contract has a material effect on the agreed exchange of performances that is adverse to him, the contract is voidable by him if he does not bear the risk of the mistake . . . and (a) the effect of the mistake is such that enforcement of the contract would be unconscionable, or (b) the other party had reason to know of the mistake or his fault caused the mistake.

Id. § 153.

137. Usually S must show that the mistake makes the deal materially more advantageous to B and less advantageous to S. Without some indication in the contract that the parties intended to create a variable price contract, a mere market price rise would not be a sufficient demonstration. The court must be convinced that B was "unjustly enriched" by the mistake, and price rises are usually considered part of S's assumed risks. For example, Aluminum Co. of America v. Essex Group, 499 F. Supp. 53 (W.D. Pa. 1980), considered S to have met this burden when its costs rose dramatically, and the contract attempted to peg the price to costs but used the wrong index. Where there has been no attempt to provide for cost increases in the contract, relief for dramatic cost increases is refused. In re Westinghouse Elec. Corp., 517 F. Supp. 440, 458 (E.D. Va. 1981). The court distinguished *ALCOA* on the grounds that to the "extent that Alcoa was disadvantaged by the

To invoke this defense, S must point to some fact that was incorrectly ascertained at T_1. In theory at least, she could not point to risks that eventuate afterwards. She may not, for example, rely on a later change in availability and price of materials needed to fabricate widgets. Recent cases have tended to blur this distinction by suggesting that at T_1 S was "mistaken," having incorrectly assumed that the needed material would be available later.[138] But even the broadest reading of the mistake doctrine has not extended it to situations in which the "mistake" is about the T_2 market value of the widgets. S is, therefore, unlikely to prevail under a mistake theory in the Market Windfall case unless she can show that both she and B were mistaken at T_1 as to the nature of the widget and that it was more valuable at T_1 than she or B suspected.[139]

ii. Impossibility. S may also argue that her cost increases in the Cost Rise case or the market price rise in the Market Windfall case make her performance impossible or, in the language of the Uniform Commercial Code, commercially impracticable.[140] To succeed she must show that the event that makes her performance "impossible" was unforeseeable[141] at T_1 and that it would greatly, perhaps even catastrophically,

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mistake, Essex was enriched," while Westinghouse's increased cost of performance caused losses to Westinghouse, but it in no way enriched the defendant.

138. *See, e.g., ALCOA*, 499 F. Supp. at 63-64 (where parties chose the WPI to reflect cost increases over the lifetime of long-term contract and it failed to do so, they made mistake of fact rather than erroneous prediction). *But see* Leasco Corp. v. Taussig, 473 F.2d 777 (2d Cir. 1972) (where parties entered contract for sale of a business under the assumption that it would earn $200,000 that year, fact that it lost $12,000 not grounds for rescission for mistake; parties merely made poor prediction).

139. Sherwood v. Walker, 66 Mich. 568, 33 N.W. 919 (1887).

140.

> Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.

RESTATEMENT (SECOND) OF CONTRACTS § 261 (1979).

> [E]xcept so far as a seller may have assumed a greater obligation . . . (a) Delay in delivery or non-delivery in whole or in part by a seller . . . is not a breach of his duty under a contract for sale if performance as agreed had been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made . . . .

U.C.C. § 2-615(a) (1976).

141. Comment 1 to U.C.C. § 2-615 suggests that an unforeseen, rather than unforeseeable event, is sufficient. However, the suggestion that subjective allocations are central is undercut by comment 8 to U.C.C. § 2-615, which uses an objective standard to determine if the seller undertook a "greater obligation":

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

increase her costs.[142] Implicit is the requirement that the event directly interfere with the manner in which S intended to fulfill her agreement. Until recently, then, the argument that a price rise alone could create impossibility was unacceptable.[143] Because S would almost never be required to give B specific performance, the distinction between increased cost and manner of performance seems particularly arbitrary.[144] Generally, S's liability is limited to the payment of market damages—which simply increases S's cost of performance.

Thus, in the Cost Rise case S might be excused on the grounds of impossibility if (1) the court determined that a rise in S's cost of performance of $25 is sufficiently severe (this is unlikely but possible)[145] and (2) the cost rise is attributable to some event that was unforeseeable at T_1. For instance, S may be excused if the rise in cost of performance is attributable to a scarcity in raw materials caused by an unexpected outbreak of war. Excuse will not be granted, however, if the rise in raw material costs was unanticipated at T_1, but S cannot point to an event that caused the unexpected rise. S obviously cannot be excused on the grounds of impossibility in the Market Windfall case. In the Market Windfall case, S has suffered no cost increases; her "losses" are opportunity cost losses caused by the unexpectedly high market price for widgets at the time of performance.

U.C.C. § 2-615 comment 8 (1976).

When the requirement that the event must be a "contingency the non-occurrence of which was a basic assumption of the contract" is added to the confusion, courts have on the whole decided that the event must be unforeseeable. *See,* Mishara Constr. Co. v. Transit-Mixed Concrete Corp., 365 Mass. 122, 129, 310 N.E. 2d 363, 367 (1974); Comment, *Contractual Flexibility in a Volatile Economy: Saving U.C.C. Section 2-615 from the Common Law,* 72 NW. U.L. REV. 1032, 1042-56 (1978).

Similarly, the *Restatement* provides for the possibility of excuse for subjectively unallocated risks: "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." RESTATEMENT (SECOND) OF CONTRACTS § 261 comment b (1979). Again, courts are not eager to avail themselves of this invitation.

142. *See, e.g.,* Gulf Oil Corp. v. F.P.C., 563 F.2d 588, 599 (3d Cir. 1977), *reh'g denied,* 435 U.S. 981 (1978), *cert. denied,* 434 U.S. 1062 (1978) (has the "cost of performance . . . in fact become so excessive and unreasonable that the failure to excuse performance would result in grave injustice?"); Mishara Constr. Co., 365 Mass. at 128, 310 N.E.2d at 366 (is increase in expense or difficulty "drastic?").

143. *See, e.g.,* Iowa Elec. & Power Co. v. Atlas Corp., 467 F. Supp. 129, (N.D. Iowa 1978) (rampant inflation, although degree and amount unforeseeable, did not make performance impracticable: Seller was in the best position to pass on costs) *rev'd on other grounds,* 603 F.2d 1301 (8th Cir. 1979); Swift Textile, Inc. v. Lawson, 135 Ga. App. 799, 219 S.E. 2d 167 (1975) (broker held to have assumed the risk that supplier-contract would be breached after a tripling in the price of the contract goods; as long as goods were available on market, cover not impracticable). For a rare case to the contrary, see Mineral Park Land Co. v. Howard, 172 Cal. 289, 156 P. 458 (1916) (excavation contract discharged when further earth and gravel could be removed only at a prohibitive cost).

144. For example, if S was a manufacturer she might escape by proving that her factory was demolished by fire. Yet, in most cases B does not require S to produce a widget in any particular way—S could overcome her "impossible performance" problem simply by buying on the market!

145. S assumed her costs would lie between $75 and $85; they are in fact $110, leading to an increase above her range of $25. *See infra* pp. 1133-36.

B, too, has excuse doctrines available if he finds himself in an unexpectedly onerous contract at T_2. If the widget was severely overvalued at T_1 he also may invoke the doctrine of mistake. Similarly, *B* may invoke the doctrine of impossibility if his cost of performance vastly increased at T_2. Because *B*'s duty under the contract usually consists of the payment of a sum of money, however, he usually will be unable to rely on impossibility. Money payment is always considered legally possible short of bankruptcy. This underscores the inconsistency of allowing *S* a remedy for impossibility, where *S*'s real liability is for a money judgment.

iii. Frustration. *B* may, however, be able to invoke the doctrine of frustration. To succeed in a claim of frustration, *B* must show that (1) some event[146] substantially frustrated his principal purpose in entering into the T_1 contract;[147] (2) at T_1 both he and *S* made the basic assumption that the event would not occur; (3) he is without fault as to the frustration; and (4) he did not assume a greater obligation than that imposed by law.[148] Excuse on the grounds of frustration is particularly difficult to achieve. Requirement four is a major stumbling block because foreseeability of the precipitating event is often a key factor. If the event was foreseeable, *B* will find it especially difficult to show that he did not assume a "greater obligation."[149]

A cursory inspection of the available excuse doctrines reveals four facts. First, because proof of hardship if the contract were enforced is a key to relief, the excuse doctrines are simply unavailable in Market Windfall type situations. In that case, *S*'s injury results from an enormous increase in the value of the contract and not from increased out-of-pocket costs. This dichotomy has persisted to this day. Commentators arguing for more liberal excuse doctrines limit their suggestions to cases of unexpectedly high costs of performance. None would extend the excuse doctrines to situations of unfairly one-sided allocation of unanticipatedly high contractual values.[150]

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146. *B* may also point to some "fact" if he invokes the excuse of "existing" frustration. *See* E.A. FARNSWORTH, *supra* note 3.

147. "Substantial frustration" is a very difficult requirement to meet because courts broadly construe a party's "principal purpose" and require that the contract become almost valueless. *See, e.g.*, Swift Canadian Co. v. Banet, 224 F.2d 36 (3d Cir. 1955) (excuse on grounds of frustration refused where (1) sales contract recognized purchase of pelts was for purpose of shipping to United States, (2) import regulations changed to prevent shipment, but (3) other markets existed).

148. For more complete discussion of frustration, see E.A. FARNSWORTH, *supra* note 3, at §§ 9.7-9.9.

149. *See, e.g.*, Gold v. Salem Lutheran Home Ass'n, 53 Cal. 2d 289, 291, 347 P.2d 687, 689 (1959) (executors unable to cancel contract made by decedent and retrieve lump sum $8,500 payment to nursing home when decedent died three days after making payment and moving to nursing home on trial basis because his death, at age 84, was foreseeable). *But see* West Los Angeles Inst. for Cancer Research v. Mayer, 366 F.2d 220 (9th Cir. 1966) (foreseeability alone insufficient to defeat excuse on grounds of frustration, if parties did not intend promisor to assume the risk).

150. Loss is never defined to include opportunity costs. *See supra* note 17. Only Professor

Secondly, these doctrines recognize that contracting is not complete at T_1, because all are based on the idea that something was either mistakenly perceived or not foreseen at the time of contract formation. Once incomplete allocation is conceded, we must either limit enforcement to what parties actually consented to or impose allocations based on nonconsensual factors[151] as a matter of legal duty. If the latter approach is taken, the court is engaged in redistributional activity. For example, if courts recognize that an event was unforeseen at T_1, it follows that the event is unallocated in the T_1 contract. If courts require parties to "perform" in such admittedly unallocated circumstances, they are imposing nonconsensual duties upon the parties. Thus, one party is forced by the court to perform a duty for the benefit of the other.[152]

Thirdly, successfully invoking excuse doctrine leads to one party's complete discharge from the contract and the other's loss of all benefit from the contract.[153] Thus, if S can show that her new costs would be $200, B will lose the rights he would have had if the costs were $100. In essence, the contract is read as if it included a clause limiting S's obliga-

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Schwartz has noted the similarity between these two types of "loss" and argued that they should be treated similarly. Schwartz, *Sales Law and Inflations, supra* note 6, at 4-5. However, Professor Schwartz only considers excuse for disruptions caused by inflation; he concludes that excuse should not be available.

151. These may include the need for contractual stability, economic efficiency, or minimizing litigation. Some commentators have justified excuse doctrine on just these grounds. *See, e.g.*, Kronman, *supra* note 96, at 2-9 (1978) (goal is to encourage generation of information, hence reducing risk of mistake); Macaulay, *Justice Traynor and the Law of Contracts,* 13 STAN. L. REV. 812, 815 (1961) (goal is to minimize hardship); Posner & Rosenfield, *supra* note 96, at 88-89 (objective is to supply allocations parties would have agreed upon, to minimize costs of negotiation, and increase efficiency); Sirianni, *The Developing Law of Contractual Impraticability and Impossibility: Part II,* 14 U.C.C. L.J. 140, 165 (1981) (excuse should be used only to minimize adverse effect of performance on third parties).

152. Of course, if the contracting parties are aware of the legal rules at the time they enter into their contract, they may contract around them. Because legal rules confer rights on the parties, the rules would affect the initial bargaining positions of the parties and hence contract outcomes. It may also be argued that if parties are aware of the legal rules, they have consented to all allocations made by the legal rules—including those made in the light of extreme, unallocated circumstances. After all, everyone is aware of the existence of uncertainty and the possibility of disaster. Thus, the doctrines of excuse would be consistent with the consent justification of enforcement.

These arguments are somewhat undercut by the empirical evidence that contracting parties are often unaware of the legal rules of contract. *See* Friedman & Macaulay, *Contract Law and Contract Teaching: Past, Present and Future,* 1967 WIS. L. REV. 805. Although it is true that parties are aware that life's uncertainties have a finite chance of upsetting expectations about contract outcomes, there is a qualitative difference between a conscious evaluation of particular risks, and a fatalistic acceptance of general uncertainty. The former—a cognitive evaluation of the contractual exchange—is the type of evaluative pricing decision that furthers the goals of the bargain principle, the latter does not. *See* L. FULLER & M. EISENBERG, BASIC CONTRACT LAW, 848-52 (4th ed. 1981) (one must distinguish between a conscious state with an awareness of alternatives, and a psychological state that does not have such an awareness of alternatives).

153. In cases of mistake the remedy is rescission. For other types of excuse, the excused party can walk away from the contract. Both the *Restatement* and U.C.C. provide more flexibility. *See infra* notes 158, 213.

tion under certain events, rather than by limiting her liability for damages. Up to a certain figure S will be fully liable, and beyond it she has no liability whatsoever.

Finally, these doctrines presuppose a particular model of bargaining behavior. Each scrutinizes the contract at T_2 to determine which events have caused the disruptions and whether they could have been foreseen at T_1. This is an ex post attempt to predict ex ante rationality. The model suggests that at T_1 parties should attempt to identify and quantify future events. This is not unlike the eventizing model—but with some truncation of risk based on whether particular risk-events would (1) create certain types of loss and (2) be unlikely when judged from an ex post perspective.

The inconsistency between the excuse doctrines and the presumption of complete contracting can be understood by courts' unwillingness to adhere to the extreme view of absolute contractual obligation when it threatens exceptionally harsh results. When one party can point to a dire loss she would face in fulfilling her obligations under the contract, and it is apparent that the initial bargain could not have intended such results, the doctrines of excuse provide some measure of relief.

But courts are quick to point out that the function of the excuse doctrines cannot be to rescue people from the consequences of their own stupidity. The doctrines are not to be available simply because the contract is found to be highly unprofitable at T_2.[154] After all, excusing one party from performing a contract operates to deprive the other of her bargain. Courts and commentators are therefore faced with developing a coherent theory for determining which types of losses merit excuse, and which are simply bad bargains with which the parties must live. From this quest emerges the second major limitation on relief from a losing contract: the requirement that an event or set of facts be unknowable or unknown at T_1.

The requirement that a particular unforeseen event change the value of the contract has persisted and is now invoked as a limiting condition to other doctrines, such as modification, which qualify the classical requirement of absolute duty. Of course the requirement makes sense. It implicitly recognizes the obvious fact that people do not make complete allocations. It is fairer, then, to deprive someone of a performance when an allocation was not made by the contract and, therefore, she has neither bargained nor paid for the performance. But the notion of an unallocated event, and hence the doctrine of excuse, is obviously incompatible with the premise of complete contracting.

154. Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co., 508 F.2d 283, 293 (7th Cir. 1974) ("The (mere) fact that performance has become economically burdensome or unattractive is not sufficient for performance to be excused.").

Less obvious is that excuse doctrines are equally inconsistent with the enforcement of duties based upon consent. After all, if the enforcement of contractual duties is justified by the consent of the parties, once we find that a condition was unknowable at T_1, why does this not end the inquiry? The risk is not part of the contract as assumed by the parties; why condition relief further? Indeed, why call it "relief"? This is not to say that there might not be other reasons or grounds to enforce duties which were not allocated at T_1. It is simply to say that such duties cannot be justified as consensual.[155]

The underlying premise of complete allocations remained during the creation and expansion of the excuse doctrines, and it remains today. Note that this premise does not require courts or commentators to limit the excuse doctrines by the demand of unforeseeability. Under a regime of presumed completeness, failure to provide for a contingency is a failure by the parties to write contracts as the law requires them to do. Courts' "rescues" of parties from this default are acts of grace which may be conditioned in ways that reflect social policy. Thus, any extreme change in contract value might be as deserving of the courts' grace as loss from a particular event.[156] External changes affecting the nature of parties' positions might be similarly deserving.[157] Moreover, the courts need not fashion all-or-nothing remedies that place the full onus of the failure on one party.[158] They may instead fashion a remedy of enforced modification—reformation—that gives to one party at least a part of the gain and mitigates the loss to the other. Once we recognize the redistributional nature of the relief, this might in fact be viewed as a less extreme

155. Consent does exist in the broadest sense that the parties have accepted the underlying legal rules governing contracts. This type of "consent," however, does not advance the goals of expectation enforcement. *See supra* note 152. Once we accept the unforeseeability of certain conditions at T_1, requiring one party to perform under the unallocated circumstances is tantamount to requiring that party to bestow a benefit upon the other. These are redistributional decisions. *See supra* text accompanying notes 151-52.

156. These may include unexplained market shifts or shifts caused by circumstances that do not qualify as "events" for the purposes of excuse, for example, the discovery of new uses for widgets or of widget-substitutes.

157. For instance, one party may suffer major dislocations in net wealth. In the extreme case, this results in a different kind of excuse—bankruptcy.

158. Many commentators, and now the *Restatement,* have suggested that the remedy for excuse be modified so that the burden is shared between the contracting parties. Suggestions include the idea of protecting the promisee's reliance, Fuller & Perdue, *The Reliance Interest in Contract Damages,* 46 YALE L.J. 373, 379-82 (1936), court-enforced specific performance with price adjusted to reflect increases in cost and appropriate profit, Schmitt & Pasterczyck, *Specific Performance Under the Uniform Commercial Code—Will Liberalism Prevail?* 26 DE PAUL L. REV. 54, 66-76 (1976), and judicial strategies to force parties in long-term contracts to adjust their relationships, Speidel, *Excusable Nonperformance in Sales Contracts: Some Thoughts about Risk Management,* 32 S.C.L. REV. 241, 276-79 (1980).

The *Restatement* would allow courts to "grant relief on such terms as justice requires" if necessary to "avoid injustice." RESTATEMENT (SECOND) OF CONTRACTS § 272 (1979).

interference with private allocations because at T_1, parties are unlikely to have chosen to allocate the rise in contract value fully to one or other with no change in the price.

Courts, however, have retained an inconsistent approach to enforcement and excuse. By retaining the fiction of complete contracting they hope to retain the benefits of certainty and administrative ease. But they also recognize incomplete contracting in order to provide relief under extreme conditions where they feel that "enforcing" the contract is unfair. The theory developed in response to this dichotomy, eventizing, reflects the underlying tension. This theory presumes that parties predict and quantify the effects of every possible event that might influence contractual behavior. Occasionally, an event so outlandish might occur that no one could possibly have foreseen it at T_1. In this case the bargain will not be enforced if that event results in some specific types of loss.[159] This limited recognition of incomplete contracting allows courts to continue the fiction that these limited incursions are not redistributional.

To this day the doctrines of excuse are limited in their applicability and use. Much ink has been expended in arguing for alternative and expanded doctrines of excuse for incomplete allocations. Unfortunately, every suggestion creates doctrine that again severely constrains the applicability of the excuse doctrines.[160] In large part this is because commentators, courts, and codes all retain the eventizing model of bargaining. Their inquiry focuses on what events ought to qualify for excuse or on the extent of loss to be required. As a result, cases and commentary alike

159. The particular types of required loss vary with each doctrine and are discussed *supra* text accompanying notes 135-49.

160. For example, Professors White and Summers recognize that U.C.C. § 2-615 expands excuse for impracticability beyond that available for common law impossibility. They go on to read in a requirement of nnforeseeability, and conclude:

> As commerce grows more sophisticated and multinational it becomes more vulnerable to disruption from embargos, wars, and revolutions in countries producing natural resources. It is paradoxical that with each disruption, subsequent disruptions become more foreseeable and therefore less likely to provide a basis for escape from a contract under section 2-615. No one remotely related to the petroleum or uranium industry will be able to argue persuasively for the foreseeable future that he should be freed from his contract obligation because of an unforeseen rise in price or cost. If anything is certain and foreseeable, it is that prices in those markets will experience periodic radical changes.
>
> We would not argue that a seller should never be excused from his obligations because of cost increases, however we agree with the thrust of the cases discussed above. In our judgment an increase in price, even a radical increase in price, is the thing that contracts are designed to protect against. Because of that and because the experience of the last ten years has made such cost changes more foreseeable than formerly, we do not oppose the hard nosed decisions thus far.

J. WHITE & R. SUMMERS, THE UNIFORM COMMERCIAL CODE § 3-9, at 133 (2d ed. 1980)

Professor Speidel examines the effect of placing the risk of the excusing event on the superior risk bearer; then excuse would be available if the promisee is the superior risk bearer. He concludes that this would usually be the seller, except in unusual cases such as where the seller is inexperienced and sells to a sophisticated buyer, or the buyer has the ability to diversify his sources of the contract goods. *See supra* note 9.

are confused and without reasoned analysis of when a circumstance or event qualifies for excuse.[161]

In fact, excuse is rarely available.[162] While limited to the doctrines of enforcement and excuse, contract doctrine was very close to the eventizing world of Part I and shared both its virtues and vices. On the one hand, contracts tended to be stable and outcomes certain. Incentives to litigate were minimized unless parties could attack the enforceability of the contract itself.[163] On the other hand, the operative model of almost complete allocation and eventizing was highly unrealistic. Contractual outcomes, while predictable, rarely reflected the parties' subjective T_1 allocations. Hence, they were unlikely to achieve the goals of the bargain principle. This world of contract doctrine, however, no longer obtains because of the modern trend towards expanded availability of consensual contract modification.

2. *The Modern Twist: Modification by Mutual Consent*

As demonstrated, the situations in which S or B may appeal to excuse doctrines are limited. Yet, at least theoretically, contracts are consensual arrangements. May S gain release or renegotiate the contract price by appealing to her contractual partner? The enforceability of such consensual modifications poses serious doctrinal and practical problems.

Consider again the problem facing B and S in the Cost Rise case.[164] At T_1, B and S set the widget contract price at $100, both assuming the risk that the T_2 widget price could at most rise to $110 (incomplete contracting/experience model) or to any price (complete contracting/eventizing model). In short, both B and S assume that the T_2 contract

161. In spite of attempts by all of the contract buffs and even in the face of eloquent and persuasive general statements, it remains impossible to predict with accuracy how the law will apply to a variety of relatively common cases. Both the cases and the Code commentary are full of weasel words such as "severe" shortage, "marked" increase, "basic" assumptions, and so on. Anyone who has concluded his first year contracts course in confusion about the doctrine of impossibility and has since had difficulty mastering § 2-615 or has found that the cases somehow slip through his fingers when he tries to apply them to new situations, may take modest comfort in knowing that he is in good company.
J. WHITE & R. SUMMERS, *supra* note 160, § 3-9, at 127.

162. The excuse doctrines are also often limited to precisely those situations in which the parties can best protect themselves. Impossibility, for example, is available for the nonexistence of a thing crucial to performance. *See supra* note 140. Yet, this is exactly the situation in which parties can cover their risks through insurance or a force majeure clause. On the other hand, it is almost impossible to adequately cover catastrophic inflations, except through escalator clauses with their attendant costs. Excuse is unavailable in such cases. Similarly, it is odd to allow excuse for mistake of a fact in existence at the time of contracting (and, in theory, discoverable by the parties) but refuse relief if the "fact" is held to be a "prediction" and unascertainable at the time of contracting. *See supra* note 138.

163. Attacks on enforceability are not uncommon and generally focus on formal requirements such as the Statute of Frauds or consideration. *See supra* note 84.

164. *See supra* p. 1136-37.

value will be at least the difference between the T_2 market and contract prices for widgets, bounded by the risks assumed at T_1.[165]

Assume that the T_2 market price has risen to $110. What incentives would S and B have at T_2 if modifications were freely enforceable? B has a contract value of $10 to protect. If S suggests that she might be unable to perform unless B consents to an increase in price, B may refuse and resort to litigation to collect his expectation damages. In this proceeding, B will have to bear the cost of his attorney and other litigation costs.[166] Assume that this "litigation surplus" is $2. B therefore has an incentive to agree to modifications that raise the price by less than $2. As the suggested modification price diverges from $102, B receives greater and greater incentives to arrange alternatives and resort to litigation.[167]

At lower contract values S will have an incentive to hold B up to the extent of the $2. She has a disincentive to go much above this figure because she too will face litigation costs, reputational damage, and an increasing chance of resistance from B. The incentive to modify will again increase in the region of very high contract values if S can also point to losses occasioned by certain events. In this region the stakes are high. S has a credible threat of invoking excuse doctrine and if successful will win the entire contract value.[168]

Historically, contract doctrine has been sensitive to the problem that the existence of the contract itself creates value that can be exploited by either party. The preexisting duty rule was formulated to minimize this incentive. The rule, which survives to some extent, declares that any consensual arrangement attempting to modify only one party's obligations under a contract is void because it lacks consideration.[169] This is consistent with the underlying premise of complete risk allocation.

165. The contract could have a greater value than this to B or S if the existence of the contract allows one party to gain specialized knowledge about the other and that knowledge has value to the parties. For example, B might learn about S's operations between T_1 and T_2. This knowledge might be useless in regard to other possible trading partners, but might make the relationship with B more valuable to S than one with a new partner who would need time to gain this information.

166. These would include any delay in the receipt of his money-damages. B also faces the risk of an adverse decision. In particular, he would find it difficult to be reimbursed for more subjective evaluations of S's performance. *See supra* note 44.

167. Of course, if B regularly trades in markets in which his craven behavior in agreeing to modifications of amounts less than the litigation surplus becomes known, B might well prefer to litigate even small sums as a deterrent. I will include this in the litigation surplus.

168. The likelihood of litigation increases as the parties' evaluation of the outcome of litigation diverges. *Supra* note 22. The excuse doctrines have defied analysis and there is general agreement about the unpredictability of outcomes in excuse cases. J. WHITE & R. SUMMERS, *supra* note 160, at 54. Thus, it is extremely probable that the parties will reach different evaluations of the possible outcomes in excuse cases, and the stakes in excuse cases are necessarily high.

169. Alaska Packers' Ass'n. v. Domenico, 117 F. 99 (9th Cir. 1902) (seamen negotiating higher wages); Rexite Casting Co. v. Midwest Mower Corp., 267 S.W.2d 327 (Mo. Ct. App. 1954) (B agrees to pay more for specially manufactured goods).

Because parties were assumed to have allocated all risks at T_1, it followed that S was attempting to modify the duty she had undertaken—or to extract from B a higher price for the same duty—without any penalty, thus breaching her initial contract.

Of course, any reciprocal modification of rights and duties, however small, would satisfy the preexisting duty and consideration doctrines and render the modification effective.[170] After all, any exchange of new obligations at T_2 satisfied the consideration requirement and the fairness of the terms of the exchange was insulated from court scrutiny.[171]

In addition, courts became increasingly sensitive to a perceived need for flexibility in contractual relations to permit adjustment for changing conditions. Courts manipulated the consideration doctrine to allow the enforcement of modifications. In time, the consideration line of reasoning was pushed to its limit by decisions that created a presumption that any "fair" modification could be interpreted as a mutual revocation of the initial contract, followed by a new exchange of promises. This "new" contract could differ from the initial one by the modification of duties on one side alone![172]

Not surprisingly, this triumph of form over substance served neither the purpose of allowing "good" modifications to occur nor of disallowing "bad" ones; nor did it define a coherent theory to differentiate the "good" from the "bad" modification. After all, once we assume that S accepted an unlimited risk, she will be viewed as attempting to escape, once the going gets tough, from a duty she imposed upon herself.

Much criticism has been directed to this extraordinary set of doctrines. There is also an increasing awareness that contracting parties should have the right to adjust their relationship to changing needs.[173]

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170. For example, partial payment of a debt would discharge the entire debt if made at a different place from that set in the original contract. Foakes v. Beer, 9 App. Cas. 605 (1884) Similarly, modifications were enforceable if preceded by a mutual rescission of the old contract if neither party had fully performed and rescission was followed by a "new" exchange of mutual obligations—even if one side performed no more than the original duty. Schwartzreich v. Bauman-Basch, Inc., 231 N.Y. 196, 131 N.E. 887 (1921) (employer and employee rescinded old contract and created enforceable new contract at higher salary).

171. B could contest the new obligation by arguing that the modification was secured through duress. This claim was extremely limited because of its economic character. Economic duress has presented difficult conceptual problems. In a free enterprise society, an offer may itself be regarded as a form of economic duress (as offeror "threatens" not to give offeree performance unless offeree consents to offeror's terms) yet such "threats" are not improper. In addition, as people threatened with economic harm may resist and sue for damages, which are in theory fully compensatory, it is difficult to determine whether the plaintiff should have resisted the threat. Thus, in early common law economic duress was not recognized. The concept has expanded since, but is still limited. *See generally* Dalzell, *Duress by Economic Pressure I,* 20 N.C.L. REV. 237 (1942); Dawson, *Economic Duress-An Essay in Perspective,* 45 MICH. L. REV. 253 (1947).

172. Watkins & Son, Inc. v. Carrig, 91 N.H. 459, 21 A.2d 591 (1941) (modification of excavation contract enforceable although no explicit rescission).

173. *Id.; see, e.g.,* 2 S. WILLISTON, SALES § 12-4 (4th ed. 1974); Patterson, *An Apology for*

Much thought has been given to devising strategies to provide adequate flexibility in the law to allow for ongoing adjustments. In attempting to develop a coherent theory to separate the "deserving" from the "opportunistic" modification, commentators and courts have looked to the limitations placed upon excuse. Thus "deserving" modifications are those that (1) respond to unallocated events and (2) are made in response to increased costs of performance. Because modifications are enforceable at much lower thresholds of loss, they are far more prevalent than the cases of excuse.[174] Thus modification doctrine not only maintains the inconsistencies of doctrine that recognizes incompleteness and yet enforces unallocated duties on the grounds of "consent": modification doctrine also exacerbates the underlying tension because of its potential reach. Moreover, expanded modification doctrine undercuts the advantages of the classical doctrine. Expanded access to modification threatens contractual stability and involves the courts in many complex and uncertain factual determinations.[175]

Both the *Restatement* and Article 2 of the U.C.C. seek to expand the parties' ability to adjust ongoing contractual relations to changing needs[176] while prohibiting changes that exploit the contractual relationship.[177] Under either, the party seeking a modification must first obtain the consent of her partner. Thus, *B* must consent to any change and the

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Consideration, 58 COLUM. L. REV. 929 (1958). For literature focusing on the need for flexibility in long-term contracts see also, Macneil, *supra* note 24 (Relational values predominate in long-term contract: hence legal rules should encourage parties to preserve the relationship.)

174. "[M]odification and waiver provide a large portion of the disputes litigated in commercial cases." Levie, *supra* note 15, at 355; "The foregoing subsections of 2-209 [dealing with modification] are of immense practical significance. This is partly because the occasions and pressures for contract changes are numerous and diverse." J. WHITE & R. SUMMERS, *supra note* 160, § 1-5, at 37.

175. Courts must determine whether the parties acted in good faith, or whether modifications are "fair and equitable" responses to "unforeseen circumstances" on a case by case basis. This could create a high degree of uncertainty in outcomes, and hence lead to contractual instability. *Infra notes* 179-86, 189-201.

176. Section 89] relates primarily to adjustments in ongoing transactions. Like offers and guaranties, such adjustments are ancillary to exchanges and have some of the same presumptive utility . . . . Indeed, paragraph (a) deals with bargains which are without consideration only because of the rule that performance of a legal duty to the promisor is not consideration.

RESTATEMENT (SECOND) OF CONTRACTS § 89 comment a (1979). "[Section 2-209] seeks to protect and make effective all necessary and desirable modifieations of sales contracts without regard to the technicalities which at present hamper such adjustments." U.C.C. § 2-209 comment 1 (1978).

177. The limitation to a modification which is fair and equitable goes beyond absence of coercion and requires an objectively demonstrable reason for seeking a modifieation. . . . When such a reason is present, the relative financial strength of the parties . . . and other circumstances may be relevant to show or negate imposition or unfair surprise.

RESTATEMENT (SECOND) OF CONTRACTS § 89 comment b (1979). "However, modifications made [under § 2-209] must meet the test of good faith imposed by this Act. The effective use of bad faith to escape performance on the original terms is barred and the extortion of a modification without legitimate commercial reason is ineffective as a violation of the duty of good faith." U.C.C. § 2-209 comment 2.

consent must not be "coerced". "Coercion" would include the traditional forms of duress and additional constraints on enforceability[178] would encompass ideas of economic compulsion as well.

Beyond this, other conditions may have to be satisfied before a consensual change may be enforced by the courts. The *Restatement* and the U.C.C. take different approaches to the problem. The U.C.C. simply imposes its overarching obligation of "good faith" on modifications and leaves the content of good faith to be determined on a case by case basis. Under the *Restatement*, an enforceable modification requires (1) mutual consent and (2) a "fair and equitable" response to (3) "unanticipated circumstances."[179] While there is general agreement that any "unanticipated circumstance" sufficient to trigger one of the excuse doctrines would be sufficient to render a modification enforceable,[180] it is also generally agreed that section 89(a) of the *Restatement* allows modifications beyond that narrow range.[181] Indeed, comment b suggests that an event might support an enforceable modification "if it was not adequately covered, even though it was foreseen as a remote possibility."[182] Beyond this, there is little guidance about what qualifies as an "unanticipated circumstance" meriting relief. Nor is there guidance about what constitutes a "fair and equitable" allocation of the unallocated risk—although it is clear that the *Restatement* anticipates court scrutiny of the T_2 allocation.[183]

Courts and commentators have attempted to separate the proper from the improper modification by applying the three pronged *Restatement* test. First, *B* must give his consent to the modification. This inquiry is in large part directed to the question of duress or coercion. Often the suggestion is that *B* must have had access to market substitutes

178. *See infra* notes 184-86, 194-200.

179. "A promise modifying a duty under a contract not fully performed on either side is binding (a) if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made; . . . ." RESTATEMENT (SECOND) OF CONTRACTS § 89(a) (1979).

180. *See id.* (forebearing from asserting a defense is consideration if defense is either valid or doubtful because of factual or legal uncertainty). Indeed, the first Restatment reflected the position that the initial contract may be terminated only when intervening events would justify excuse under impossibility. RESTATEMENT (FIRST) CONTRACTS § 76 illustration 8 (1932).

181. Hillman, *Contract Modification Under the Restatement (Second) of Contracts*, 67 CORNELL L. REV. 680, 693 (1982).

182. The limitation to a modification which is 'fair and equitable' goes beyond absence of coercion and requires an objectively demonstrable reason for seeking modification. . . . The reason for modification must rest in circumstances not anticipated as part of the context in which the contract was made, but a frustrating event may be unanticipated for this purpose if it was not adequately covered, even though it was foreseen as a remote possibility.

RESTATEMENT (SECOND) OF CONTRACTS § 89 comment b (1979).

183. Illustrations 1-5 to § 89 are illuminating in this regard. In each enforceable modification, the modified price is either determined to be "reasonable" or the increase in price is equal to or less than the additional cost of performance.

at a price not disproportionate to the contract price.[184] Secondly, inquiry is directed to the nature of the "unanticipated event" and whether at T_1 S could have foreseen it. S is usually held to an objective standard although the *Restatement* suggests that even foreseen events might support modifications.[185] Finally, the modified allocation is scrutinized to determine if it is a "fair and equitable" response to the unforeseen event. Usually, S can only charge B for additional out-of-pocket loss incurred in performing the contract under the unforeseen circumstances.[186]

No one has questioned why S is obliged to satisfy additional requirements once she has shown that the event was "unforeseen" and hence unallocated in the T_1 contract.[187] Why must S perform once we determine the risk was not allocated to her in the contract? And why must she be limited to her out-of-pocket loss after she and B agree to allocate the risk?

If the U.C.C. provisions do not apply because the widget is not a "good" as defined by the U.C.C., S cannot allocate the contract surplus with B's consent in the Market Windfall case because she is not attempting to allocate out-of-pocket loss. Thus, in the Market Windfall case, where by hypothesis the outcome is beyond the range of either party's T_1 allocations, modification doctrine would offer no relief. In the Cost Rise case, where the contract values are within the T_1 allocations, S will probably be able to enforce a modification once B consents, provided that S ties the cost increase to an "event." Because B has a contract profit to protect, he has an incentive to consent to any modification less than his projected litigation costs.[188]

In contrast, the U.C.C. simply abolishes the requirement of consideration for modifications[189] and makes no attempt to define the dividing line between enforceable and unenforceable modifications beyond requiring "good faith" and "legitimate commercial reason."[190] It is not clear

184. *See* RESTATEMENT (SECOND) OF CONTRACTS § 89 illustrations 1-5 (1979); Hillman, *supra* note 181, at 681-84.

185. It is often impossible to determine what will pass muster as an "unanticipated" circumstance. The illustrations to § 89 are themselves unhelpful and cases usually state simply that the circumstances are unanticipated. *See, e.g.*, Angel v. Murray, 113 R.I. 482, 495, 322 A.2d 630, 637 (1974).

186. RESTATEMENT (SECOND) OF CONTRACTS § 89 illustrations 1-5 (1979).

187. It is rational to scrutinize the modification's allocation because S might try to reallocate the litigation surplus in addition to the windfall surplus.

188. In the Cost Rise case, B has a contract value of $10 to protect. If the litigation costs are less than $10, B will agree to a modification of up to the litigation cost. *See supra* text accompanying notes 164-67.

189. "An agreement modifying a contract within this Article needs no consideration to be binding." U.C.C. § 2-209(1) (1978).

190. For a discussion of the good faith requirement, see U.C.C. § 2-209 comment 2 (1978). Comment 2 continues: "The test of 'good faith' between merchants or as against merchants includes observance of reasonable commercial standards of fair dealing in the trade." *Id.*

whether the modification, even if triggered by reasons meeting the nebulous "good faith" test, must then be scrutinized for fairness as required by the *Restatement*.

Cases arising under the U.C.C. have done little as a whole to clarify the situation.[191] Many courts simply ignore the "good faith" requirement and invoke section 2-209 for the proposition that modifications do not need consideration. These courts conclude that where the parties consent to a change, the modification is enforceable with no more.[192] Where the "good faith" issue is addressed, it is as often applied to the promisor as it is to the party seeking modification. Courts will inquire whether the promisor consented in order to induce the promisee to perform as promised without intending to actually honor the modification.[193] When the "good faith" test is applied to the promisee, courts often fail to address the issue intelligently. At best, good faith is equated with lack of coercion, often emerging as a separate inquiry into whether the promisee extorted the modification by exerting some form of duress.[194]

Commentators on the U.C.C.'s modification provisions in general approve of the focus on duress or coercion as the keystone of enforceability of modification. Thus, Professors White and Summers would focus on overreaching, that is, "extortion," "profiteering," and "chiseling."[195] Professor Hillman suggests that "the issue of free assent is at the core," and the crux of the "good faith" test should be an inquiry into whether the promisor was coerced into making the modification.[196] He suggests that rules paralleling the common law rules governing economic duress should govern the enforceability of modifications under section 2-209(1).[197]

To determine the requirements of "good faith" under the duress

191. For cases dealing with modifications under U.C.C. § 2-209, see the extensive collection and discussion of cases in Hillman, *Policing Contract Modifications under the U.C.C.: Good Faith and the Doctrine of Economic Duress,* 64 IOWA L. REV. 849 (1979).

192. Barnwell & Hays v. Sloan, 564 F.2d 254, 256 (8th Cir. 1977). While Skinner v. Tober Foreign Motors, Inc. 345 Mass. 429, 187 N.E.2d 669 (1963), made similar statements, enough facts were discussed to suggest the court would have found good faith. Note, however, that no windfall-type cases have arisen; all involve increased costs.

193. *See, e.g.,* United States *ex rel.* Crane Co. v. Progressive Enterprises, Inc., 19 U.C.C. Rep. 1306 (E.D. Va. 1976) (court enforced modification on the grounds that promisor accepted the modification without protest although never intending to live by it so that timely delivery of goods was ensured); *see also* Ralston Purina Co. v. McNabb, 381 F. Supp. 181 (W.D. Tenn. 1974) (when breach inevitable in rising market, modifications extending time for performance were bad faith attempts to increase damages; although modification enforceable, court would measure damages at time set by old contract).

194. *E.g., Progressive Enterprises, Inc.,* 19 U.C.C. Rep. at 1306.

195. J. WHITE & R. SUMMERS, *supra* note 160, § 1-5 at 46.

196. Hillman, *supra* note 191, at 880.

197. *Id.* at 880-81.

interpretation, once again the suggestion is that the modification must be made in response to an unforeseen event.[198] Overreaching or economic duress are signalled by the magnitude of the attempted modification and by the promisor's lack of access to market substitutes at, or close to, the market price.[199] An important factor in determining "good faith" is whether the modification is sought in response to threatened out-of-pocket loss.[200]

It is apparent that the standards for enforceability of modifications favor small reallocations and discourage large ones. As modifications increase in magnitude or attempt larger T_2 allocations, they are more likely to trigger judicial suspicion. Moreover, the larger the attempted reallocation of risk the less likely that there will be market substitutes at or near the contract price. After all, most attempted reallocations reflect either an increased cost of performance or an increased contract value. Both increased costs of performance and increased contract values are likely to reflect an increased T_2 market price for the promised performance. Substitutes can only be obtained at the T_2 market price. A situation might be envisaged in which the modification is triggered by an idiosyncratic problem of S, for instance, unusually high costs. These situations are rare, however, and consent by B to share S's misfortunes rare indeed.[201] The greater the contract value the less likely that B will surrender his "rights" without protest or some form of threat by S. If the stakes are high enough, most relationships are worth risking—and the less S will accomplish by asking nicely!

A scheme that favors small modifications and disfavors large ones is comprehensible if it is assumed that at T_1 S consented to assume almost unbounded risks, as in the eventizing model. If we allow for the possibility that S negotiated under the assumption that the risk distribution was truncated, however, the justice of viewing large modifications with

198. The test of 'good faith'. . . may in some situations require an objectively demonstrable reason for seeking a modification. But such matters as a market shift which makes performance come to involve a loss may provide such a reason even though there is no such unforeseen difficulty as would make out a legal excuse from performance [for impractibility].

U.C.C. § 2-209 comment 2 (1978).

199. *E.g.*, J. WHITE & R. SUMMERS, *supra* note 160; Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666, 675-76 (1963); Hillman, *supra* note 191, at 886-93 (rebuttable presumption of duress arises if modification results in net loss to promisor).

200. *See*, U.C.C. § 2-209 comment 2 (1978); J. WHITE & R. SUMMERS, *supra* note 160. § 1-5 at 47. ("The profiteer is one who takes unfair advantage of market shift to exact a price adjustment that will enhance his profit on the contract (as opposed merely to enabling him to maintain his original profit"); Farnsworth, *supra* note 199, at 675-76; Hillman, *supra* note 191.

201. The suggestion that B would consent freely is particularly odd in this case because market substitutes at the contract price will be available only if S's problem is idiosyncratic. In such situations B's consent to increases are likely to signal an attempt by S to reallocate either the litigation surplus or idiosyncratic relational surplus. *See supra* note 165.

greater suspicion than small ones is perverse indeed. If parties are presumed to bargain over a limited range of risk, a small modification is more likely to be an attempt to shift allocated risk than a large one. Small modifications are also likely to be an attempt to exploit litigation surplus.[202] Large modifications—which almost inevitably are responses to large market shifts[203]—are more likely to be attempts to allocate contract values outside the range of T_1 allocations.[204] Of course, one party might be trying not only to allocate the excess contract value (ΔP), but also the litigation surplus.

Thus in both the Cost Rise and Market Windfall cases S must first win B's consent to any change. This is true even if the risk was unallocated at T_1. Secondly, S must satisfy any other conditions imposed on the enforceability of modifications. Under the U.C.C. she must show that she was acting in "good faith." Although most courts have so far ignored this requirement a few have attempted to enforce it. To the extent that they do, S is likely to have to show that the modification is sought in response to unexpected losses[205] or that B consented freely to the change out of his best interests.[206] It is unlikely that a modification in response to Market Windfall type situations will pass muster.[207] (In short, S must claim that she would suffer a loss of at least some magnitude if the contract were enforced with the T_1 terms.) If courts were to include the *Restatement* requirement in their inquiry, S would also be required to prove that the T_2 allocation was "fair and equitable" in substance. No criteria have been developed for this scrutiny, although it has been suggested that the value of the modification to S should not exceed

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202. Because B has to bear his own litigation costs, he might prefer to agree to modifications that are smaller than those expenses. This would allow S to hold B up to that figure. *See supra* text accompanying notes 166-68.

203. S is unlikely to attempt a large increase in price unless the market has risen because B could refuse the modification and profit by buying on the market.

204. If parties are presumed to allocate a range of values about the contract price, the values close to the contract price are more likely to be within the allocated range than values that lie far from the contract price.

205. *See, e.g.*, United States *ex rel.* Crane v. Progressive Enterprises Inc., 19 U.C.C. Rep. 1306, 1308 (E.D. Va. 1976) (seller's cost increase justified request for modification of price).

206. *See, e.g.*, Skinner v. Tober Foreign Motors, Inc., 345 Mass. 429, 430-31, 187 N.E.2d 669, 670 (1963). While the court fails explicitly to discuss the good faith issue, it discusses sufficient facts to suggest that the seller of an airplane consented to modification of payment terms because the airplane developed engine trouble immediately after the sale and the buyers would have been unable to meet the initial payment terms and repair the plane. The seller consented to modification in order to prevent the return of the plane.

207.

> Suppose that a merchant seller in a rising market refuses to perform for no other reason than to extort a higher price from the buyer who desperately needs goods that are in short supply. Such a modification of price would be ineffective because . . . the seller . . . has presumably not met even the subjective test of 'honesty in fact'.

Farnsworth, *supra* note 199, at 675.

the threatened increase in costs.[208]

3. *Reformation*

What, then, is the fate of the promisor who can neither get consent to a modification nor show losses and contractual difficulties sufficient to trigger the excuse doctrines? Is there some way in which the unfortunate S may obtain a reformation of the contract without B's consent? The short answer is no. Contract reformation is usually limited to situations in which a written document fails accurately to embody the intentions of the contracting parties. Reformation is not available in situations where one party seeks to allocate new risks, unallocated at T_1.[209]

Recently this approach has been criticized with regard to long-term contracts. Commentators suggest that long-term obligations increase the risk of incomplete presentation.[210] The longer the term, the more likely that unforeseen and unplanned-for events will occur before the contract expires. Long-term contracts also increase the magnitude of losses to one party and unexpected gains to the other.[211] Traditional remedies simply

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208. *See* J. WHITE & R. SUMMERS, *supra* note 160, at 54.

209.

> The province of reformation is to make a writing express the agreement that the parties intended it should. Under the rule stated in this Section, reformation is available when the parties, having [expressed an agreement in] . . . writing, fail to express it correctly in the writing. Their mistake is one as to expression—one that relates to the contents or effect of the writing that is intended to express their agreement—and the appropriate remedy is reformation of that writing properly to reflect their agreement.

RESTATEMENT (SECOND) OF CONTRACTS § 155 comment a (1979).

210. Presentiate—"[t]o make or render present in place or time; to cause to be perceived or realized as present" 8 OXFORD ENGLISH DICTIONARY 1306 (1933). Thus:

> Presentiation is a way of looking at things in which a person perceives the effect of the future on the present. It is a reeognition that the course of the future is so unalterably bound by present conditions that the future has been brought effectively into the present so that it may be dealt with just as if it were in fact the present. Thus, the presentiation of a transaction involves restricting its expected future effects to those defined in the present, *i.e.*, at the inception of the transaction.

Macneil, *supra* note 173, at 863 (footnote omitted).

211. Of course, where the current almost pure "eventizing" model is used and "foreseeability" is the erux of the issue, rather than the parties' allocations, parties in long-term contraets are both more alert to the possibility that upsetting events might oceur, and more likely to provide for them. Although they may be unable to predict the exact event, it may not be unreasonable to expect (or even require) them to build in flexibility, *see, e.g.*, discussion of international trade contracts, *supra* note 74, or to include the boundaries of their risk assumptions. In fact, long-term contracts are more likely to have flexible terms such as escalator clauses. Curiously, *ALCOA* had just such terms which nevertheless failed to serve their intended function.

A short-term contract, on the other hand, is more likely to have "unforeseen" events disrupt party expectations, precisely because the parties are unlikely to focus attention on the possibility of change in the interval between T_1 and T_2. Moreover, it is not likely that the costs of an exhaustive analysis of disrupting events will be justified by its benefits. Of course, the incident losses may be lower and perhaps make judicial intervention unnecessary. But if loss is the rationale for the decision to intervene, the focus of the inquiry should be directed at the losses generated by the upsetting risk, and not on the "foreseeability" or "unforeseeability" of the event at T_1.

shift the risks of the contract between the parties: *S* will either have to perform at the contract price and fully absorb the effects of unexpected contract risks, or she will be allowed to walk away from the contract, not only leaving *B* to absorb fully the unexpected effects but also depriving *B* of the benefits of the initial bargain.[212] Because traditional remedies result in unfairness to one party or the other, many commentators see a need for a new, flexible remedy that would operate to share the benefits/losses between the parties.[213]

At least one court has addressed the problem by reforming the contract to distribute the losses between the parties.[214] In *Aluminum Co. of America v. Essex Group, Inc.,*[215] ALCOA and Essex had entered into a twenty-year contract requiring ALCOA to smelt aluminum ore, supplied by Essex, and hold it in the molten state for delivery to Essex. This service's price was governed by an elaborate escalator clause pegged to three variables: ALCOA's hourly labor costs, a construction cost index, and the wholesale price index for industrial commodities. The price index—WPI-IC—was chosen as a factor because both parties believed that the WPI-IC historically matched the non-labor costs. Further, the parties expected ALCOA's profits to vary between one and seven cents per pound.[216]

Unfortunately, ALCOA's principal non-labor cost, electricity, was dramatically and adversely affected by the OPEC oil embargo and the resultant energy crisis. The WPI-IC failed to reflect accurately this changing cost, and eight years after entering its contract ALCOA found itself out of pocket at ever increasing rates. Finally, ALCOA sought relief from the contract in the Federal District Court for the Western District of Pennsylvania.[217]

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212. *See supra* text accompanying notes 151-53.

213. *See, e.g.,* Mueller, *Contract Remedies: Business Fact and Legal Fantasy,* 1967 WIS. L. REV. 833, 836-37 (1967); Schmitt & Pasterczyk, *supra* note 158, at 72-76. (If buyers cannot cover courts should order specific performance rather than excuse sellers, but with an adjustment of price term). Schmitt and Pasterczyk suggest that the power to reform contracts is found in U.C.C. § 2-615, comment 6, and in general equitable principles. Schmitt & Pasterczyk, *supra* note 158, at 72-76. Similar discretion to impose fair terms upon discharge for impracticability may be found in RESTATEMENT (SECOND) OF CONTRACTS § 272(2) (1979). Speidel, *supra* note 9, at 275-79 (in long-term contracts, efficiency might be served by granting specific performance and compelling reformation of price term); Note, *Apportioning Loss After Discharge of a Burdensome Contract: A Statutory Solution,* 69 YALE L.J. 1054 (1960) (Losses should be apportioned between the parties upon discharge of contract).

214. While a few courts have agreed, *see* National Presto Indus., Inc. v. United States, 338 F.2d 99 (Ct. Cl. 1964), *cert. denied,* 380 U.S. 962 (1965) (in government contract, court made plaintiff and defendant split the costs), the majority have refused to reform the terms of a contract. *See, e.g.,* Iowa Elec. Light & Power Co. v. Atlas Corp., 467 F. Supp. 129 (N.D. Iowa 1978) (adjustment unavailable—impossible to determine price).

215. 499 F. Supp. 53 (W.D. Pa. 1980).

216. *Id.* at 58.

217. *Id.* at 58-59.

Judge Teitelbaum found that both parties had intended that the WPI-IC be an accurate indicator of ALCOA's non-labor costs. Thus, he reasoned, there was a mutual, material mistake of fact justifying relief.[218] Turning to the question of remedy, he observed that the traditional remedies of either full enforcement or rescission would result in a windfall for one or other of the parties.[219] The case therefore fell within "the more general rules of equitable restitution," which are aimed at preventing unjust enrichment. He concluded that "equitable reformation" was "essential to avoid injustice" and modified the price escalator clause to allow ALCOA the lesser of ALCOA's anticipated profit or the contract ceiling price.[220]

It is worth noting that in *ALCOA* Judge Teitelbaum found excuse for both mistake and impossibility,[221] but concluded that the appropriate remedy was to reform the contract and preserve both the relationship and, as far as possible, the parties' expectations. He was also aware that his was a novel solution, and suggested that it should be limited, in the interests of contractual stability, to situations satisfying two criteria:

> 1. In the contract, the parties expressly evidence a desire to limit their risks.[222]
>
> 2. One party suffers severe out of pocket losses, as judged by the attempted allocation of risk.[223]

The court explicitly bifurcates the treatment of disappointed expectations, according to whether they result in increased cost of performance or increased contract value. "This sort of disappointment [from increased contract value] seems less serious and relief from it seems more destructive of contract expectations . . . ."[224]

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218. *Id.* at 61-65. On peculiar "mistake" reasoning of this kind see *supra* notes 137-38 and accompanying text.

219. *Id.* at 79.

220. *Id.* at 78-80.

221. The court found that ALCOA was entitled to relief on the grounds of both impracticability and frustration, in a sequence of contorted reasoning. *See id.* at 70-78.

222. This is a generous reading. It appears from the court's reasoning that parties must expressly seek to limit the particular risk, but choose a method that fails. *See id.* at 92. But the holding is broader because the court found the risk sought to be limited to be quite a broad category—"cost"— rather than the cost of electricity.

223. *Id.*

224. *Id.* at 92. Note that in *ALCOA* two sophisticated parties spent time and effort formulating the limitation-of-risk clauses in a major business relationship. It may be argued that under traditional doctrine these are precisely the type of negotiators who least need help from the courts. The risk that eventually upset the calculations constituted ALCOA's second largest cost, and in eventizing jargon, it was a risk the parties "could or should have foreseen." Where there is so much at stake, it is more likely that the costs of requiring ex ante risk analysis are justified. Yet it is clear that the court would limit intervention to the type of case in which parties explicitly attempt to allocate a particular risk, the allocation involves large amounts, and it fails.

Even the "new spirit" of *ALCOA*[225] would not advocate reformation if the facts were that:

1. ALCOA attempted expressly to provide for the upward adjustment of price in order to benefit from upward market shifts and make increased profit.

2. The allocation failed to achieve its goal because, as in the actual case, the parties failed to choose the appropriate indicator.

3. The price of aluminum rose dramatically, resulting in the lowest expected profit for ALCOA, but yielded windfall profits to its trading partner.[226]

Thus, a promisor who is unable to obtain consensual modification is also extremely unlikely to get reformation; the promisor is more likely to obtain rescission on the grounds of excuse—and that as we have seen is rare indeed. So, S might be able to enforce a modification if she wins B's consent in the Cost Rise case. If she is unable to achieve B's consent, she will in all probability be forced to shoulder a loss, even if it was unallocated at T_1, unless she can convince a court that the loss event was sufficiently freakish ("unforeseeable") and the cost of performance sufficiently increased. Moreover, none of the doctrines that provide relief from incomplete contracting will serve the promisor who seeks to share a windfall profit. Even if she wins consent she will be unable to get relief in the Market Windfall case.[227] Without consent, no doctrine offers relief even for admittedly unforeseen—and hence unallocated—rises in the value of the contract.

B. Current Doctrine: The Partial Eventizing Model

In generating the experience model I made guesses about the sources and types of information upon which B and S are likely to rely

225. Note, *Equitable Reformation of Long-Term Contracts—The "New Spirit" of ALCOA,* 1982 UTAH L. REV. 985 (1982).

226. Judge Teitelbaum's innovative decision never went into effect. The case was settled when a federal appellate court, during oral argument, voiced its doubts about the lower court's decision. *See* Dawson, *Judicial Revision of Frustrated Contracts: The United States,* 64 B.U.L. REV. 1, 28 (1984).

ALCOA has spawned a considerable body of literature. Some commentators have voiced doubts about the ability of courts or third parties to reform contractual obligations. *See, e.g., id.* at 36-37; Goldberg, *Price Adjustments in Long-Term Contracts,* 1985 WIS. L. REV. 527. The latter is especially interesting because, in part, Professor Goldberg's criticism is that parties' attempts to index prices would be directed to the opportunity costs of performing the contract rather than profit on cost. *Id.* at 531-33, 536-37.

Others approve of the spirit of Alcoa's approach to the problem, when limited to long-term contracts, but disagree with its particulars. *See, e.g.,* Speidel, *Court-Imposed Price Adjustments Under Long-Term Supply Contracts,* 76 NW. U.L. REV. 369 (1984) (arguing that relational as opposed to efficiency considerations predominate in long-term contracts, hence mandatory price adjustment for unexpected circumstances is justified; but courts should impose a duty to bargain in good faith ex post over unexpected gains and losses, and court-imposed price adjustment is justified only for breach of that duty).

227. *See supra* text accompanying notes 198-200.

when they enter their contract. I argued that their information is primarily formulated from experience and knowledge about the markets in which they participate.[228] If they take their cue from current doctrine, *B* and *S* would believe that they must attempt to convert their information into predictions about the future price and a set of excusing events. They might attempt to make the prediction as follows:

> 1. Attempt to predict each event that might affect costs and the market price. Examples of such events might be events that might affect the price and/or availability of raw materials or of energy such as labor unrest; government action such as price regulation or import restrictions; international effects such as currency rate fluctuations; market effects such as new uses for widgets or widget substitutes; and idiosyncratic possibilities such as *S*'s or *B*'s own factory burning down.[229]
>
> 2. Predict the effect that each event will have on the price of the finished widget. *S* might also need to do this for her own costs if her costs do not parallel those of other market suppliers—if, for example, she uses upstate New York electricity for energy, while competitors use natural gas.
>
> 3. Develop a discount rate for each event, which reflects the probability of its occurring, or write an excuse clause for it.

Even a cursory glance at this scheme should serve to illustrate the problems with such a model of negotiating behavior. First, it is practically impossible given limited rationality and imperfect information to generate a catalogue of all possible events.[230] Second, it is even less possible, for the same reasons, to generate information sufficient to discount each event, especially as they get more remote. Third, even if it were humanly possible to predict and accurately discount all contingent events that might affect the value of the contract, it would be prohibitively costly in time and resources.[231] I would argue further that it is wasteful and thus not in the best interest of society as a whole to encourage indi-

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228. *See supra* text accompanying notes 50-54.

229. Although this list might sound fanciful, it is culled from modification and impossibility cases. Each of these "events" has been pleaded as an "unforeseeable" event, most being rejected by the courts as a basis for excuse on the grounds that they were foreseeable at T_1. *See, e.g.*, Amtorg Trading Corp. v. Miehle Printing Press & Mfg. Co., 206 F.2d 103 (2d Cir. 1953) (governmental regulations prohibiting export of printing presses to U.S.S.R. insufficient to excuse Soviet-owned corporation buying for export to U.S.S.R.); Eastern Air Lines v. Gulf Oil Corp., 415 F. Supp. 429, 441-42 (S.D. Fla. 1975) ("energy crisis" and resultant government price controls foreseeable); Mishara Constr. Co. Inc. v. Transit-Mixed Concrete Corp., 365 Mass. 122, 310 N.E.2d 363, 367-68 (1974) (interesting discussion of foreseeability of labor problems for excuse, although court decides question is for jury).

230. This is generally accepted and has led some scholars to suggest that it is these failures in contracting that lead to alternate forms of organization. *See, e.g.*, O. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS (1975).

231. *ALCOA* is a good example of the cost and futility of making such an attempt. As noted before, the more a contract is worth and the more it is likely to be affected by future events, the more worthwhile the costs of such an analysis become. Yet, it is precisely for long-term contracts that

vidual negotiators to go through this exercise. In the rare instances in which parties are willing to expend the effort required by the eventizing model, the result would most likely be an irrational and wasteful allocation of resources. Moreover, the process is likely to result in loss-spreading formulae which are unlikely to be the most appropriate to the T_2 situation. The best time to determine the allocations of unusual losses is at the time at which they occur. Information is likely to be most complete and speculation least necessary at that point.[232]

Finally, and of prime importance if contract theory is to further the goals upon which the bargain theory is premised, the model of complete contracting is not realistic. If the model is neither a good reflection of how parties negotiate nor a good guide of how they ought to negotiate, interpretations of a contract based upon eventizing are unlikely to determine accurately the obligations actually ("subjectively") undertaken by S and B. Thus, enforcement of the duties determined under this model are not likely to reflect those actually undertaken by S and B. Moreover, because the parties are not able to specify in advance the extent of their undertaking in every T_2 eventuality, a model of complete contracting based upon eventizing is unlikely to guide parties to develop mutual understandings of each others' obligations—and hence shared expectations about the contract.

As used by the courts, a model of complete contracting based upon eventizing will lead to the inclusion of contract terms that waste negotiation resources in futile or formal attempts to satisfy the law. This model is, therefore, unlikely to further the policies underlying the enforcement of bargains. An unrealistic model of how parties bargain must necessarily compromise the remedies that flow from it. Our view of what parties "expect" is likely to be only as realistic as our model of how they behave.

Of course, if contract law went no further, it would be identical to the eventizing model set forth in Part I, and would share its advantages. Contractual outcomes under the law would be certain once the state of the world at T_2 became known. Hence the costs of litigation and judicial discretion would be minimized—a gain, although purchased at the price

commentators and judges alike are most discontented with the ex ante allocation rules. Perhaps this is a recognition of the futility of the exercise.

232. The costs of allowing readjustment at T_2, especially if the parties invoke judicial supervision, might justify a rule requiring complete allocations at T_1. This is a forceful argument as long as the parties really are treated as though allocation was complete—as was the case before the standards for modification and excuse were relaxed. Currently the only cases that cannot invoke judicial supervision are probably those in which one party fails to win the consent of the other to an ex post change, and also cannot plead excuse. This is probably limited to cases of windfall contract values, where neither B nor S can point to losses. Because most cases can invoke judicial supervision for some type of remedy, administrative costs and the costs of uncertainty in transactions are already high, and it is reasonable to look for more realistic standards to govern judicial intervention. For the prevalence of litigation about modification, see *supra* note 15.

of the goals of the bargain principle. But the advantage of certainty has been deeply undercut by the expanding modification and excuse doctrines, which implicitly recognize the inevitability of incomplete contracting—the "unforeseeable" event—without examining the reasons for and extent of the problem.[233] Nor has there been an appreciation of the degree to which the doctrines of excuse and modification compromise the enforcement premise of complete contracting.

Thus, the current state of contract doctrine is based on a partial eventizing model. Parties are presumed, and encouraged, to model their conduct and contracts on a complete eventizing model, but we recognize that they often fail in their efforts. Moreover, we recognize that the parties must fail in their efforts to write complete contracts.[234] The legal and doctrinal issue, then, becomes one of determining which unallocated risks are entitled to relief, rather than one of determining whether risks have or have not been allocated by the parties. The focus of current doctrine is to seek out those failures to allocate which are "unavoidable" and redress *only* "losses"[235] caused by these failures.

This partial eventizing model, although more sensitive to reality than the complete eventizing model, inevitably results in contracts in which the parties fail to consider and allocate many of their risks. Hence, courts compel parties to assume risks they never consented to or lose the benefit of bargains they paid for. The incentives given by doctrines that address the problems of incomplete contracting are structured to force people into a mode of contracting behavior that is costly, difficult, and ultimately doomed to failure. Moreover, where parties fail to make complete allocations, the current system of assumed complete contracting coupled with excuse and modification doctrines premised on eventizing creates a system of bonanzas that are distributed with a high degree of uncertainty. Worse, it provides strong incentives for buyers with the largest windfalls to refuse to accomodate their partners.

The problems of the current approach may be solved in two ways.

233. At least in times of major market upheavals, there are indications that the norm of contract stability is even more illusory than the foregoing discussion of excuse and modification suggests. There is evidence that during the inflation of the 1970's suppliers simply ceased to honor fixed price terms and refused to perform unless prices were adjusted. Buyers often consented because they agreed that the old terms were unfair, and/or they feared poor service and loss of good will. *See Broken Promises: Many Contracts Now Aren't Worth Paper They're Printed On,* Wall St. J., Mar. 26, 1974, at 1, col. 6. The article suggests that different industries reacted differently to the suppliers' demands. This raises the issue of whether U.C.C. § 2-615 comment 4 might give suppliers in an industry a right to renegotiation when the practice of renegotiation of contracts in that industry is widespread.

234. What is the distinction otherwise between a reasonable failure to foresee, and an "unreasonable" one?

235. "Losses" is used in the narrowest sense and includes only actual cost of performance, not opportunity costs or losses in the value of the contract. Note also that these losses need not be large, if *S* can win *B*'s consent to a modification to cover the increased costs.

We may retreat to the classical ideal of complete allocations, the eventizing model, and achieve certainty and contractual stability. Parties would be held to the terms of their contracts no matter what the conditions at T_2. Of course, there might still be excuse doctrines to provide remedies for other types of problems, for instance bankruptcy, a remedy for poverty.[236] But the certainty purchased by this model would be purchased at a price. Certainty would be achieved at the cost of the goals of the bargain principle. Because there is little doubt that complete contracting cannot occur, contracts would be enforced in a manner not calculated to enforce subjective expectations.

The alternate approach, which I favor, accepts the fact of incomplete contracting and formulates contract doctrine in the face of that recognition. The experience model developed in Part III is one example of how that approach might be pursued.

A doctrine of enforcement derived from the experience model, or some other model premised on the assumption of incomplete contracting, would do a better job of implementing the bargain principle. Such an approach starts by attempting to describe how parties bargain and the information they have access to; it then allows the legal system to determine and enforce subjective expectations. Moreover, the experience model attempts to direct parties to reduce the complexity of contract specifications to a few variables and asks them to focus on the range of monetary risk they are willing to assume. A simple directive such as this is easily and inexpensively implemented and would result in contracts that are far more complete in terms of enforcement possibilities than those that are written today.

Where parties fail to make complete allocations, the uncertainty over the ranges of allocated contract values under the experience model would generate incentives to litigate, but the incentive would be greatly reduced from the all-or-nothing remedy because the winner would only take all to the tune of $\Delta_1 P_0$ or $\Delta_2 P_0$. If, as discussed earlier,[237] these values are determined from objective and easily accessible criteria, the parties should be able to predict them prior to litigation and resolve the conflict. Outcomes under the experience model are fairer in that all unallocated risks are treated alike and shared: losses, here, would include opportunity costs. Precipitous rises in the market would be treated exactly like precipitous falls. Unlike current doctrine, under the proposed model all parties would have equal incentives to think about and allocate risk.

It is undoubtedly true that once we accept that contracts are incom-

236. For example, remedies might be formulated to respond to the availability of other mechanisms of loss shifting such as insurance.

237. *Supra* text accompanying notes 117-18.

plete, courts will have to engage in factual determinations about when risks have not been allocated. In the experience model, courts would engage in determining the values of $\Delta_1 P_0$ and $\Delta_2 P_0$. Under current doctrine, they must determine whether events were foreseeable at T_1, S's costs have risen beyond reasonable variations, allocations made in modifications are "fair and equitable," or duress was used to secure modifications. It is not immediately apparent that the latter inquiry is more certain and less cumbersome than the former.

CONCLUSION

The justifications most commonly given for enforcing contracts by the expectation measure of damages are those of the bargain principle. In enforcing contracts, courts do no more than require contracting parties to fulfill obligations the parties voluntarily undertook. Enforcing such voluntarily assumed obligations allows private transactions to value resources and assigns resources to their most valued uses. Enforcement by the expectation measure also allows contracting parties to plan and rely on the promised performances.

To actually achieve these objectives, contracts must be enforced to the extent of the subjective allocations made by the parties when they enter their contract. Moreover, the subjective allocations of the parties to a contract must be congruent because it will otherwise be impossible to simultaneously satisfy all sets of subjective expectations. Thus, the goals of the bargain principle can only be met if the parties develop shared expectations about the outcomes of their contract, and the system of enforcement determines and enforces those subjective expectations. This can only occur if enforcement is based upon a realistic model of bargaining.

The current system of contract enforcement comprises a bundle of three sets of doctrines. Unless a contract provides explicitly that a party's performance is conditioned upon the state of the world at the time of performance, the doctrine of enforcement would award a measure of damages equal to the difference between the market price of the promised performance at the time of the breach and the contract price. Doctrines of excuse then rescue contracting parties from extreme losses in the face of unanticipated events; doctrines of modification allow contracting parties to escape from losses in the face of unanticipated events as long as they can win the consent of their contracting partners.

The doctrine of enforcement can be justified on a consent principle only by the presumption that contracts are complete. "Expectations" are defined by the express conditions of the contract, and the market price at the time of performance. Thus, parties must be assumed to include and factor into the contract price all possible risks that can affect the market

at the time of performance but as to which the contract is otherwise silent. While the enforcement doctrine has the advantages of certainty and predictability, it is not based upon a realistic appraisal of how parties bargain. Thus enforcement under this model of completeness is extremely unlikely to further the goals of the bargain principle. The doctrines of excuse and modification were formulated to respond to the shortcomings of the enforcement premise of completeness. Thus, they offer relief in some—but not all—instances when the parties can show that the risks at T_2 were not allocated in their initial contract. Unfortunately, when viewed as a composite system with the expectation enforcement doctrine, the doctrines of excuse and modification are inconsistent with the consent justifications of the bargain principle. Once it is determined that consent to the initial bargain did not extend to the circumstances at the time of performance, the bargain principle suggests that a party cannot be forced to perform an obligation to which her consent did not extend. Thus, the consent rationale of the bargain principle would not allow relief to be conditioned further once it is determined that the initial bargain did not extend to the circumstances at the time relief is sought. In particular, it is inconsistent to enforce contracts in such circumstances by the "expectation" measure of damages. Moreover, the types of factual determinations that courts are called upon to make in deciding to whom to allocate an unallocated risk inject great uncertainties into the enforcement system. In addition, the doctrines of excuse and modification presuppose an unrealistic model of bargaining. Parties are assumed—and guided—to think of risk as a set of discrete and quantifiable events. It is expensive and difficult for parties to attempt to adjust their behavior to this eventizing ideal.

In sum, the current system of contract enforcement is unrealistic and often enforces obligations not assumed by the parties. For guidance, it posits a model of bargaining behavior that cannot be implemented by bargaining parties. It is unpredictable and costly. It is, therefore, unlikely to achieve the objectives ascribed to the bargain principle.

The current system is ripe for change. One approach is to attempt to achieve the objectives of the bargain principle by creating an enforcement system more in tune with the realities of the contracting process. This would mean that the model for enforcement must be based upon incomplete contracting. Of course this would create costs for enforcement. Once we recognize that contracts are incomplete, the enforcement system must determine and enforce the actual allocations made by the parties, and provide schemes to allocate unallocated risks. In the process, there will be some loss in certainty and some cost in making the determinations. It is not clear, however, that these costs will exceed the costs of the enforcement system currently employed. In this Article, I

have described one possible model of bargain based on incomplete contracting. Costs can be reduced by basing enforcement on a model of bargain easily implemented by contracting parties. For example, parties can be made to think of risk in terms of only one parameter, price, and its variance from the market price. In addition, incentives to litigate can be minimized by sharing unallocated excesses equally between the contracting partners.

The other alternative is to return to the system of enforcement with expectation damages as currently calculated, but with no doctrines of excuse or modification for incompleteness. This system would have the great advantages of certainty and ease of administration. Unfortunately, it would have the great cost of being a totally unrealistic model of bargain, and hence be unable to achieve the goals of the bargain principle.

Unfortunately, the current system shares the disadvantages of both approaches. It incurs the costs of an incomplete model because courts must make factual determinations of great complexity. At the same time the current system does not attempt to discover and enforce the allocations actually made by the parties. Thus, it also fails to achieve the goals of the bargain principle. I suggest that it is too costly—in terms of contractual stability and bargain principle goals—to keep the premise of completeness for the calculation of expectation damages, while simultaneously attempting to expand the areas in which contract doctrine provides relief for certain selected aspects of incomplete contracting.

Appendix of Symbols

P_0	Contract price.
$\Delta_1 P_0$ & $\Delta_2 P_0$	Anticipated upper and lower ranges of price variance.
P_1, P_2, P_3	Possible T_2 outcomes of market price.
ΔP	Excess contract value.
S_0	Anticipated value of S's costs.
$\Delta_1 S_0$ & $\Delta_2 S_0$	Anticipated upper and lower ranges of variance in S's costs.
S_1, S_2, S_3	Possible T_2 outcomes in S's costs.