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Mistake, Frustration, and the Windfall Principle of Contract Remedies

by

ANDREW KULL*

I. Introduction

The problems we call “mistake” and “frustration” are described in contract doctrine as if they were exceptional conditions, when in fact they are endemic to the bargain transaction. They are ordinarily treated as separate topics, when in fact they represent aspects of the same phenomenon. And while mistake and frustration are traditionally thought to constitute grounds for relief from contractual obligation, a more accurate generalization is that a court finding mistake or frustration will deny relief, whether it is being asked to force a transaction ahead or to undo one that has been wholly or partially performed.

A substantial body of case law supports an important but unacknowledged rule of contract doctrine: that the proper legal response to certain problems resulting from contracts that are “incomplete” or “not fully specified” is to leave the parties alone. Such a rule stands in sharp contrast to the usual prescription of modern commentary, which recom-

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1. “Mistake” of the kind to be discussed is the so-called mutual mistake “of value, or as to factors that affect value,” 3 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 605 (1960), epitomized by the supposed mistake of Sherwood and Walker regarding the fertility of a cow. See Sherwood v. Walker, 66 Mich. 568, 33 N.W. 919 (1887). The term “frustration” is employed here in its English usage, by which the one word conveniently encompasses the promisor’s claim that his performance has been rendered “impossible” or “impracticable,” as well as the converse claim (the American “frustration”) that his performance should be excused because the bargained-for counterperformance has lost its value to him.
mends that "gaps" in contracts be "filled" by judicial intervention to serve a variety of social ends. The question thus arises whether the traditional rule may not serve the same or equally valuable ends with equal or greater efficiency.

This Article proposes (1) a unified conceptual model for describing the problem of mistake and frustration; (2) a hypothesis about the case law; (3) a review of the case law to defend the hypothesis; and (4) an argument against the prevailing academic conception that sees a mistaken or frustrated contract as an occasion for judicial intervention in the form of "gap-filling."

(1) The Model

Mistake and frustration are the rule, not the exception, and they are two names for the same problem. We may hypothesize perfect knowledge about the present moment but not about the future. Every contract is influenced by a "mutual mistake" as to the proposed exchange of values, if only because present values inescapably reflect projected but unknowable future values. Every agreement is to some extent "frustrated" in that the precise cost and value of either side's performance can never be known in advance. We form contracts in the knowledge that our information is imperfect, and we do not expect to anticipate with exactness the precise cost or value, at the time of performance, of what we are either to give or to receive. At a profounder level than that addressed by the American Law Institute, every party to a contract "is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the [transaction] relates"; being human, he necessarily "treats his limited knowledge as sufficient."

The observation that there is a close relation between the rules affording relief from contractual liability by reason of mutual mistake on the one hand and frustration on the other is now a commonplace. Both doctrines are fundamentally concerned with the contractual allocation of risk. The risk in either case involves the potential disparity between the

2. RESTATMENT (SECOND) OF CONTRACTS § 154(b) (1979).
4. See, e.g., CHARLES FRIED, CONTRACT AS PROMISE 59-60 (1981); MICHAEL J. TREBILCOCK, THE LIMITS OF FREEDOM OF CONTRACT ch. 5 ("Symmetric Information Imperfections") (forthcoming); Edwin W. Patterson, The Apportionment of Business Risks Through Legal Devices, 24 COLUM. L. REV. 335, 342-45, 355-57 (1924). These authors recognize that both mistake and frustration are problems of risk allocation. It is a standard premise of mod-
terms of the exchange as envisioned at the time of contract formation and the terms of the same exchange as subsequently perceived in light of greater information. While this much is common ground, or nearly so, the fact that "mistake" and "frustration" have become logically and functionally indistinguishable has not generally been appreciated. Whether from lack of curiosity or merely from habit, judges and writers continue to defer to a supposed distinction between the doctrines—the idea that mistake relates to a misapprehension about existing circumstances, while frustration arises from a failure to anticipate supervening events.5 But in the present state of the law, with excuse available on the same terms in either circumstance,6 this is a distinction without a difference.7

5. See, e.g., Restatement (Second) of Contracts § 151 cmt. a (1979) (to constitute "mistake," an erroneous belief "must relate to the facts as they exist at the time of the making of the contract," and "[a] party's prediction or judgment as to events to occur in the future, even if erroneous, is not a 'mistake' as that word is defined here").

6. Compare Restatement (Second) of Contracts § 152 cmt. b (1979) (relief for mutual mistake as to "basic assumption") with id. § 261 cmt. b (relief for supervening impracticability belying a "basic assumption" on which both parties made the contract).

7. The traditional mistake-frustration distinction survives from an era in which the classification had legal consequences. In a legal system where a mistake as to value or "quality" would never void a contract, and where the only unforeseen contingency that would excuse performance was logical or physical impossibility, the distinction between a mistake as to existing facts and a faulty prediction was a natural one to draw. A mistake as to existing facts might merit judicial scrutiny because of its potential to inhibit contract formation or enforceability. Thus a mutual mistake, in the traditional definition, might prevent formation of a contract by obstructing a meeting of the minds. E.g., Raffles v. Wichelhaus, 159 Eng. Rep. 375, 376 (Ex. 1864). Alternatively, it might result in an agreement unenforceable by reason of some intrinsic impossibility or some fatal equivocation in its terms. See, e.g., Allen v. Hammond, 36 U.S. (11 Pet.) 63, 64-65 (1837) (contract of employment to perform work already done); Scott v. Coulson, 2 Ch. 249, 253 (C.A. 1903) (contract of insurance on the life of a person already dead); Couturier v. Hastie, 10 Eng. Rep. 1065, 1069 (1856) (contract for sale of goods that have already been sold). A mistake as to future contingencies could have no such consequences. While it might indeed have formed the basis of the bargain, it was not a reason for which the bargain would ever be set aside: the implicit rule of such famous cases as Paradine v. Jane, 82 Eng. Rep. 897 (K.B. 1647), and Hall v. Wright, 120 Eng. Rep. 695 (Ex. Ch. 1859), is that parties allocate the risk of all future contingencies when they make their contract. Accordingly, one way to enforce a rule of nearly strict liability in contract was to deny that this sort of mistake was in legal signification a "mistake." A party complaining that circumstances had not turned out the way the bargainers had anticipated was remitted to the separate doctrine reserved for such cases, the threshold to which was the narrow but intelligible test of supervening impossibility. See Taylor v. Caldwell, 122 Eng. Rep. 309, 313 (Q.B. 1863) (reviewing the circumstances—chiefly the death or incapacity of someone engaged to perform personal services—in which supervening impossibility was early recognized as a defense to contractual liability).

As the scope of excuse expanded to its present dimensions, becoming available on a show-
A unified model of the mistake-frustration problem begins with the recognition that some disparity between anticipation and realization is an inevitable incident of every contractual exchange, and that the risk of such disparity is usually allocated by the express or implied terms of the contract. In the vast majority of cases the disparity simply passes unnoticed; unless it surpasses the bargained-for uncertainties of human existence, it will not give rise to complaint. The risk of loss from the ebb and flow of costs and values is ordinarily allocated, by a contractual term "implied in fact," to the party on whom it falls. One who seeks relief from contractual obligation on the ground of mistake or frustration is complaining that he suffers the disadvantage of an exceptional disparity, the risk of which was not allocated by the parties. The rejoinder by the party opposing discharge or avoidance (whether or not so expressed) is invariably that the risk of the disparity complained of was allocated by contract to the party complaining. A judgment that a contract is "void for mistake" or "frustrated" represents a determination that the risk of the disparity in question was not allocated to either party, expressly or by implication.

The magnitude of the contractual disappointment that will be perceived to have been implicitly allocated on this basis is a function of "the changing practices of men and . . . their judgment as to what makes most strongly for human prosperity," 6 CORBIN supra note 1, § 1361, and of the idiosyncracies of judicial appreciation. A dramatic increase in the cost of performance is plainly more likely today than it was a hundred years ago to afford possible grounds for relief; but the intriguing question of why the law should have developed in the direction of greater leniency—with its correlative, the impossible question of how much disparity is too much—this Article does not attempt to answer.

In other words, the response of the opposing party might be either "the risk of this outcome was allocated to you," or "the disparity you're complaining about is not sufficiently grave to warrant relief," or "the revealed disparity does not contravene a 'basic assumption' on which we contracted." But the last two responses are both functionally equivalent to an assertion that the risk of the disparity was implicitly allocated to the party on whom it might fall, in other words to the party seeking discharge.
(2) The Hypothesis

It will be easier to state the hypothesis of the argument if we are clear about what it is not. This Article does not address the legal issue typically litigated in mistake and frustration cases: how to decide whether or not the risk of a particular disparity, once its existence has been revealed, has been allocated by the parties. Nor does it address the question that preoccupies most of the economics-based commentary on the subject: whether, and for what classes of cases, a rule permitting discharge for mistake or frustration is efficient as compared with a rule of strict liability. Rather, this Article inquires what it is that courts actually do when they conclude (correctly or not) that a particular contract is either void for mistake or frustrated—when they conclude, in other words, that the risk of the disparity complained of was not allocated by the contracting parties.

Our hypothesis is that the characteristic and traditional response of our legal system to cases of mistaken and frustrated contracts is neither to relieve the disadvantaged party nor to assign the loss to the superior risk bearer, but to leave things alone. The party who has balked at performing will not be forced to proceed, but the completed exchange will not be recalled. Walker will not be forced to deliver to Sherwood a breeding cow sold for the price of beef; but neither will Wood be allowed to recover the yellow diamond, already delivered, unwittingly sold to Boynton for the price of a topaz. Where an exchange has been interrupted after part performance—the usual case in the context of frustra-

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10. The factual issue of risk allocation is, appropriately, the central concern of contract litigation in which a party seeks discharge by reason of mistake or frustration, and the search for methods to guide this inquiry accounts for most of the traditional law on the subject. See, e.g., Restatement (Second) of Contracts § 154 (1979) ("When a Party Bears the Risk of a Mistake"); 13 Samuel Williston, Williston on Contracts § 1543A (Walter H.E. Jaeger ed., 3d ed. 1970) ("The Risk of Mistake May Be Assumed by Contract"); id. § 1544 ("Mistake Must Relate to Fundamental Assumption"). The question has been illuminated by more recent, economics-oriented investigation as well. See Victor P. Goldberg, Impossibility and Related Excuses, 144 J. Institutional & Theoretical Econ. 100, 101 (1988) (investigating "why reasonable businessmen would choose to excuse performance for some changed circumstances, but not others"); George G. Triantis, Contractual Allocation of Unknown Risks: The Search for Justifications for the Doctrine of Commercial Impracticability, — U. Toronto L.J. — (forthcoming 1992) (arguing that contracting parties can and do allocate risks even of unforeseen contingencies).


tion—courts following the traditional rule will not intervene to readjust the allocation of losses that chance and the parties’ agreement have created. Persons hiring rooms from which to view a coronation procession will be excused by the king’s indisposition from paying any balance of the price not yet due; but they will not be allowed to recover sums already paid at the time the ceremony is canceled.\(^{13}\)

The principle of inertia that frequently seems to guide the remedies for mutual mistake and frustration may seem harsh in some particular applications, but it is neither arbitrary nor illogical. Disparities between anticipation and realization in contractual exchange, the risk of which has not been allocated by the parties, are in the nature of “windfalls” (including those, carrying adverse consequences, that might more properly be described as “casualties”). The law will not act to enforce such windfalls—to compel an exchange on terms that were not bargained for—because its objective is limited to giving effect to the parties’ agreement. But if the parties have not allocated the risk of a particular windfall or casualty to one of them, neither have they allocated it to the other. There is thus no basis in their bargain on which to justify a court’s intervention to shift windfall benefits and burdens in either direction. As a matter of social utility, excluding for the moment considerations of fairness, it will ordinarily be a matter of indifference whether the windfall cost or benefit, once realized, falls to A or to B. Reallocation after the event thus involves significant administrative costs while achieving no compelling social advantage. The judicial disposition to let windfalls lie—to answer the claim of mistake or frustration by confirming the status quo—is here referred to as the “windfall principle.”

(3) The Evidence of the Case Law

Part II of this Article surveys cases of mistake and frustration in a variety of contexts to indicate both the broad applicability of the windfall principle and the limits of its influence. The exploration of the cases moves from the simpler issues of rescission for mutual mistake—where the windfall principle is still a highly accurate predictor of outcomes—to the more complex problem of assigning losses from frustrated contracts. The paradigm of the windfall resolution of this problem is presented by the well-known Coronation Cases; the antecedents, rationale, and subsequent rejection of this familiar legal monument are accordingly examined in some detail. Readers whose primary interest is in the theoretical implications of the windfall principle, rather than its past or present stand-

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13. The Coronation Cases are discussed infra at 22-28.
ing in American and English law, may want to skip to the argument of Part III as soon as they have seen how the principle operates in its prototypical applications.

(4) The Argument

Viewed as a conscious policy preference, rather than as evidence of laziness or moral weakness, the windfall principle implicates fundamental issues in the law of contracts. Its source is found in the individualistic conception of contractual obligation as something exclusively defined by the voluntary undertakings of the parties. It reflects, as well, the traditional skepticism of the common law toward the likelihood of increasing justice by requiring that casualty losses be shared.

These underlying implications of the old windfall cases make them pertinent to the modern debate over judicial remedies for frustrated contracts. Rigorously applied, the windfall principle requires that losses to the parties under a frustrated contract be left to lie where they fall. A rule to this effect, announced and consistently applied in England from 1867 to 1942 and followed occasionally in American jurisdictions, was widely criticized as harsh and unjust. Its eventual abandonment by the English courts confirmed the modern preference for a higher degree of judicial intervention to shift casualty losses.

The assumption that judges in these cases can improve on the imperfect results of private ordering currently attracts a curious mixture of support. The ordinary view of judicial reallocation sees the courts as imposing a distribution of losses that is fairer than the parties to a contract could hope to achieve by ex-ante negotiations. At the same time, law and economics observers, while skeptical of the notion that one distribution of losses could be fairer than another, have tended to favor an interventionist judicial role in contract interpretation as a means of achieving various efficiencies. The principal economics-based prescription for frustrated contracts has been that judges capture for the parties the gains associated with efficient risk spreading. Under either approach, the contemporary formulation of the problem sees the frustrated contract as "incomplete," in that it did not define expressly the obligations of the parties upon the occurrence of the frustrating event, and thus assigns to the court the task of supplying a "gap-filling" term.

14. See infra at 28-33.
15. See infra notes 121-130 and accompanying text.
16. This common view finds expression in a number of forms. See, e.g., statements quoted infra text accompanying notes 130, 141, and 172.
The case law underlying the windfall principle challenges these justifications for judicial intervention. The cases remind us of the advantages of "rule-oriented methods" over "cost-benefit or balancing methods" for resolving contractual disputes. Rules that induce and facilitate the private, ex-ante disposition of losses associated with frustrated contracts may be more efficient than rules that permit or require the same disposition to be made by ex-post judicial intervention. Moreover, the cases illuminate the fact that the gaps perceived in frustrated contracts are created only by the availability of judicial intervention to fill them. Under a windfall regime, but not otherwise, contracting parties not only have the means to allocate all the risks of frustration they think it worthwhile to identify, but are actually obliged to allocate the incidence of the resulting loss should the contract be frustrated.

The discussion in Part III criticizes the standard arguments for judicial gap-filling as a remedy for frustrated contracts, suggesting that they fail to take account of the peculiar nature of the gaps that give rise to mistake or frustration. It is simply not possible to devise a default rule that will yield a usable, contractual allocation of risks not identified by the parties. A rule that invites parties to externalize the costs of risk allocation by leaving the consequences of unallocated risks to be determined ex-post by the judicial system is possible and may even be desirable, but it cannot be defended by the usual analogy to "off-the-rack" contract terms. Furthermore, the standard economic justification for judicial intervention in the aftermath of frustration—the realization of efficiency gains from allocating risk to the least-cost risk bearer—is inherently unachievable, because a pre-existing allocation of risks cannot be affected one way or the other by what is inevitably, ex-post, merely a redistribution of losses.

Proponents of judicial intervention are accordingly remitted to the more elusive standard of fairness. To justify the judicial allocation of frustration losses we must be satisfied not only that the resulting gain in fairness is worth the expenditure of judicial resources, but that a regime holding out the possibility of judicially determined fairness is preferable to one in which contracting parties have both the power and the responsibility to determine the consequences of their own bargains. The choice here lies between conflicting moral claims that would be incommensurable even if they were quantifiable. The legal tradition constituting the windfall principle may nevertheless help to illuminate a conflict that it cannot resolve.

II. The Windfall Principle

Walker agreed to sell Sherwood a purebred cow named “Rose 2d of Aberlone” for a price approximating her value as beef, both parties believing (as the court supposed) that the cow was infertile. Prior to delivery it was determined by the seller’s agent that the cow was with calf. The animal’s value, in light of this information, was approximately ten times the contract price.\(^{19}\) The court held, in a suit by the buyer for replevin, that the contract could be avoided by the seller upon proof of the mutual mistake. Such a mistake, the court explained, “was not of the mere quality of the animal, but went to the very nature of the thing.”\(^{20}\)

Wood sold to Boynton the jeweler, for one dollar, a straw-colored stone about the size of a canary’s egg. The seller had been informed, and both parties believed at the time of the sale, that the stone was probably a topaz. Some time after delivery and payment the stone was found to be an uncut diamond worth about $700.\(^{21}\) The court held, in a suit by the seller for replevin, that the contract could not be avoided by the seller notwithstanding proof of the mutual mistake. In the absence of fraud on the one hand or warranty on the other, the court explained, neither seller nor buyer could rescind a sale because the “character or value” of the thing sold turned out to be different from what had been supposed.\(^{22}\)

A favorite exercise of first-year contracts teachers is to ask students how the holdings in Sherwood v. Walker and Wood v. Boynton might be reconciled. There is only one good answer.\(^{23}\) It is hinted at in some of the casebooks,\(^{24}\) but is scarcely acknowledged in the cases, the treatises,\

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20. Id. at 577, 33 N.W. at 923. On the facts of the case it is difficult to believe that the mistake can have been shared by the buyer. Sherwood was a banker and gentleman farmer; he appears to have been interested in acquiring polled Angus breeding stock, not beef in wholesale quantities. But this view of the facts, reflected in the dissenting opinion, see id. at 580, 33 N.W. at 925, makes Sherwood v. Walker an entirely different case, one involving unilateral rather than mutual mistake. Every reference to Sherwood v. Walker in this discussion treats it as a case of mutual mistake, however contrary to fact this assumption may be.
22. Id. at 271, 25 N.W. at 44.
23. It is sometimes suggested that something in the circumstances of the transaction between Wood and Boynton made it appropriate to find that the seller in that case bore the risk of the disparity; for example, that Wood elected to sell the stone in “conscious ignorance” of its precise nature. This would presumably be the explanation of the American Law Institute. See E. Allan Farnsworth, Contracts § 9.3, at 515-21 (2d ed. 1990); cf. Restatement of Restitution § 12 cmt. c, illus. 9 (1936).
The good answer is that in each case, when it appeared that the contract of sale was premised on a mutual mistake as to the value of the goods, the disputed property was left where it was. When the mistake was discovered before delivery, the cow stayed with the seller; but when new information as to value became known some time after performance had been completed, the diamond stayed with the buyer. A court, these cases suggest, will not require performance of a contract that is shown to rest on a significant mutual mistake as to value; but neither will it grant rescission if the same contract has already been performed.

The two decisions, in isolation, make no more than a curious contrast. But cases in which one party to a contract seeks relief by reason of mistake or frustration are frequently resolved by what is in effect a decision to leave things alone. The operation of this "windfall principle" may be observed in a variety of related modes.

First, cases in which a party seeks rescission of a contract on the grounds of mutual mistake, as in the cow and diamond cases, are most often decided in whatever manner leaves the parties free of further obligations to each other, whether by way of performance or restitution. Because a principle of inertia is not an acknowledged part of our law of contracts, these outcomes are necessarily announced by finding "mistake" or "no mistake," as the case may be, or by finding that the risk of the loss complained of had been assumed by the plaintiff. The windfall principle predicts the outcome of such cases by inquiring whether the obligations of the parties remain executory at the time of suit: the execu-

25. English judges occasionally acknowledge that the availability of relief for mistake or frustration depends on whether, or how recently, the contract has been performed. See, e.g., cases cited infra note 50. Considering the circumstances under which a contract for the sale of land might be avoided for mutual mistake, Professor Palmer concedes that "[o]ther factors must be taken into account, for example, whether a deed has been delivered or the contract is still executory." 2 GEORGE E. PALMER, LAW OF RESTITUTION § 12.2, at 538 (1978) (citing Enequist v. Bemis, 115 Vt. 209, 55 A.2d 617 (1947)). The most forthright among the treatise-writers is Professor Hunter, who observes of Wood and Sherwood that "[p]erhaps one of the most telling differences in the two cases is timing." HOWARD O. HUNTER, MODERN LAW OF CONTRACTS: BREACH AND REMEDIES ¶ 12.02[3][c] (1986). By contrast, the discussion of relief for mutual mistake in the second Restatement of Contracts contains no suggestion that "timing" could have anything to do with it.

26. Although the inquiry into risk allocation is here argued to be the only analytically coherent way to resolve these disputes, a given holding that "plaintiff assumed the risk" may still be giving effect to what is fundamentally a windfall disposition. The distinction is obviously an elusive one. The characterization of any such decision as a windfall case depends on one's appreciation of the circumstances and of the likelihood that the same plaintiff would have been found to have assumed the same risk had the same transaction been challenged when executory rather than executed (or vice-versa).
tory contract is much more likely to be rescinded. In the relatively rare cases where mistake is asserted after part performance, the windfall outcome is less clearly predictable; although there are mistake cases in which the parties have been permitted to walk away from a partially completed transaction with no obligation of restitution.

Similarly, the windfall principle predicts what might seem obvious: that a claim of frustration is far more likely to succeed if interposed before performance has been completed rather than after. In the typical case where frustration is asserted after part performance, the windfall principle predicts and justifies the standard rule by which executory obligations are discharged without calling into question the validity of obligations already performed.

Finally, because it typically denies all relief in cases of interrupted performance, the windfall principle embodies the teaching (familiar from *Paradine v. Jane*) that casualty losses falling in the vicinity of a contractual relationship should be left as chance and the parties' agreement may have distributed them, not reallocated by law in the interest of the "fairness" associated with loss sharing. The line of decisions (chiefly English) that culminated in the well-known Coronation Cases applied this doctrine to frustrated contracts by denying recovery for the cost or value of a party's performance prior to discharge. Severely criticized and eventually repudiated, this traditional application of the windfall principle nevertheless elucidates both the problem of contractual risk allocation and the available means for assigning losses that the parties have not expressly allocated themselves. The rejection of the windfall rule in this narrow but highly significant context leads directly to the modern debate over judicial intervention to supplement contracts deemed "incomplete."

An account of the role of the windfall principle in the decisions must be suggestive rather than rigorous. Even the paradigm instance of its operation—the contrasting results in *Wood* and *Sherwood*—proves nothing unless we assume that the mistakes in the two cases were comparable and, further, that both cases were correctly decided. Strictly comparable cases can be constructed only by hypothesis.

27. *See infra* Part II.A.
28. *See infra* Part II.C.
29. *See infra* notes 84-87 and accompanying text.
31. *See infra* at 28-33.
32. Had Rose 2d of Aberlone surprised her new owner by producing a calf the following spring, the same mutual mistake would surely not have been found to justify rescission; nor is it at all likely that Wood would have been obliged to part with the diamond had it been learned...
poses that the windfall principle is an invariable rule of decision, nor that the principle operates in isolation from other considerations. Its more modest contention is that the windfall principle affords an instructive and relatively reliable explanation of outcomes in a variety of situations involving mistake and frustration. The windfall decisions may be profitably analyzed, not as the product of outmoded judicial reticence, but as evidence of a conscious preference for resolving the problems arising from supposedly incomplete contractual arrangements by reliance on private ordering rather than judicial intervention.

The following discussion offers an illustrative sampling of the effects of the windfall principle, proceeding from the simpler problems of rescission to the more complex issues of shifting losses from frustrated contracts. For convenience of reference and to accommodate the language of the decisions, the cases are organized according to the traditional, though functionally indistinguishable, categories of “mistake” and “frustration.” A further division, more pertinent to the thesis of the present investigation, separates those cases in which a party seeks rescission or discharge either before or after performance from those in which the defense to liability is asserted in the course of performance.

A. Mistake, Asserted Before or After Performance

The cases granting or denying rescission for mutual mistake, exemplified by Sherwood v. Walker and Wood v. Boynton, leave a pronounced impression that the courts are manipulating doctrine in adherence to an unacknowledged rule of decision. Whereas the mistake about the cow “went to the very nature of the thing” (rescission), the very similar mistake about the stone involved merely its “character or value” (no rescission). It is true that the purported distinction now tends to be described differently. Judges formerly distinguished between mistakes that related to the “identity” of a thing as opposed to its “attributes”; encouraged by the Restatement, they now inquire whether the mistake is one that affects “a basic assumption on which the contract was made.” The modern

prior to delivery what kind of stone it was. These conclusions seem reasonably safe, despite the absence of any such qualification to the avowed reasoning of the two decisions.

33. An alternative explanation of every decision finding or denying the existence of mistake or frustration is that the outcome respects an implicit contractual allocation of risks discerned by the court—whether correctly or incorrectly, and whether or not this ground of decision is acknowledged in the opinion.

34. Restatement (Second) of Contracts § 152 (1979).
version is less quaint but no less conclusory. The evident advantage of either formula is that it permits a given case to be decided either way.

The traditional approach to the problem derives from a nineteenth-century securities case, *Kennedy v. Panama Mail Co.*, where a prospectus offering shares in a shipping company contained an innocent but material misstatement about the company's business prospects. A subscriber for shares (on a partly paid basis) sought rescission of his contract and the return of moneys paid; the company counterclaimed for the next installment of the subscription price. The Court of Queen's Bench held that the availability of rescission depended on whether the difference between the shares as they were in light of the true facts, and the shares as they would have been had the facts been as described, was "a difference in substance in the nature of the thing." The rule stated by Justice Blackburn, citing Roman law authority, was that "if there be misapprehension as to the substance of the thing there is no contract; but if it be only a difference in some quality or accident, even though the misapprehension may have been the actuating motive to the purchaser, yet the contract remains binding."

This nineteenth-century judicial Platonism has proved surprisingly resilient as an explanation of results that are notably inconsistent. Neither the traditional inquiry into "quality" versus "identity," nor the Restatement's test of "basic assumption," permits any suggestion that the time at which a mistake is discovered should be relevant to the availability of rescission. Yet an otherwise erratic pattern of decisions, finding "mistake" or "no mistake" on seemingly similar facts, is greatly clarified if we look in each case to see how far the contract had been performed at

35. To illustrate the meaning of such a "basic assumption," the American Law Institute suggests the following:

A contracts to assign to B for $100 a $10,000 debt owed to A by C, who is insolvent. Both A and B believe that the debt is unsecured and is therefore, virtually worthless, but in fact it is secured by stock worth approximately $5,000. The contract is voidable by A.

*Id.* cmt. b, illus. 5. (A Reporter's note suggests "cf. Sherwood v. Walker.") A may rescind, in other words, because the value of the debt is a "basic assumption" on which the parties contracted—like the fertility of Rose 2d of Aberlone. *But cf.* (as the Reporter, to his credit, also suggests) Hecht v. Batcheller, 147 Mass. 335, 17 N.E. 651 (1888), where the court refused to rescind the *fully executed* sale of a promissory note, the maker of which (unknown to buyer and seller) previously had become insolvent, explaining that the mutual mistake of the parties "affects the value of the note, and not its identity." *Id.* at 339, 17 N.E. at 653.


37. *Id.* at 586.

38. *Id.* at 588. Recission was denied on the ground that the shares—which were evidently trading at £5, compared to an aggregate issue price of £7—were "in substance those [plaintiff] applied for." *Id.* at 589.
the time of suit. A bull, believed to be capable of breeding but unable to serve in that capacity, was determined to be “a bull in name only” (buyer rejects animal, seller brings action for the price). Yet a mistake about the identity of a thoroughbred horse, sold at auction in the belief that he was a different animal, was found not to be such “as to make the subject-matter of the actual contract essentially different from what the parties believed it to be” (buyer seeks rescission after delivery and payment). The parties’ ignorance of defalcations reducing the assets of a bank was a mutual mistake without which their contract for the sale of its shares “would never have been entered into” (buyer seeks rescission prior to closing). But a mistaken belief that shares of stock in a bank were worth at least $136 each, when defalcations unknown to buyer or seller had reduced their true value to $60, was not a mistake “as to identity or existence” but one “relating merely to the attributes, quality or value of the subject” (buyer seeks rescission following delivery and payment).

The parties’ mistaken belief that a parcel of land would not permit on-site sewage disposal, a fact significantly reducing its value, did not “materially affect the agreed performances of the parties” (seller seeks reformation or rescission three years after sale). On the other hand, the parties’ ignorance of a possible zoning change interfering with the buyer’s intended use of the property was ground for rescission because it constituted “a basic assumption on which the contract was made” (buyer seeks rescission prior to closing).

This tendency to leave the parties in statu quo is particularly noticeable in the English mistake cases, epitomized by the well-known decision of the House of Lords in Bell v. Lever Bros. Lever Brothers had paid substantial sums to settle the remaining term of its employment contracts with two employees whose services it no longer required. Four months after the payments were made, the company discovered that its former employees had engaged in misconduct that, had it come to light prior to the settlement, would have justified their dismissal for cause. Lever Brothers sued for rescission of the settlement agreements and return of

39. Cotter v. Luckie, 1918 N.Z.L.R. 811, 816-17 (Sup. Ct.) (distinguishing the case of a horse sold with or without warranty, inasmuch as “[a] horse is a horse even if unsound”).
the amounts paid, claiming that the agreements had been fraudulently induced or, in the alternative, that they had been entered into under a mistake of fact. A jury found that the employees had committed no fraud, and that at the time of negotiating the agreements they had not been aware of their liability to dismissal for cause.46 The case was treated in the House of Lords as one involving a mutual mistake as to a fundamental assumption: namely, that Lever Brothers would not have been entitled to terminate the contracts except pursuant to a settlement agreement.47

Applied to these intriguing facts, the familiar distinction between identity and attributes relied upon by Lord Atkin seems more than usually unhelpful:

I feel the weight of the plaintiffs' contention that a contract immediately determinable is a different thing from a contract for an unexpired term . . . . But, on the whole, I have come to the conclusion that it would be wrong to decide that an agreement to terminate a definite specified contract is void if it turns out that the agreement had already been broken and could have been terminated otherwise. The contract released is the identical contract in both cases, and the party paying for release gets exactly what he bargains for.48

The real explanation of the decision in Bell v. Lever Bros. is surely the windfall principle. This seems reasonably clear if we compare the case to a hypothetical variant in which Lever Brothers agrees in March to make settlement payments in June, but discovers its employees' misdeeds in April. It seems safe to predict that the employees, promptly dismissed for cause, would not thereafter prevail in a suit to recover payments due under the agreement.49

46. Id. at 162-64.
47. Id. at 191, 205, 216-17.
48. Id. at 223-24.
49. The disposition of English mistake cases along inertial or windfall lines was greatly facilitated by Lord Justice Denning in Solle v. Butcher, [1950] 1 K.B. 671 (C.A. 1949). Dissatisfied with the narrow, allegedly "legal" rule of Bell v. Lever Brothers, Lord Justice Denning revived an antecedent line of authority which, he asserted, afforded a more liberal, "equitable" rule to govern cases of mutual mistake. According to the equitable rule, a contract not void for mistake at law might nevertheless be set aside in equity "if the parties were under a common misapprehension either as to facts or as to their relative and respective rights, provided that the misapprehension was fundamental and that the party seeking to set it aside was not himself at fault." Id. at 693. The new rule was readily received—being easier to satisfy than Lord Atkin's, and allowing considerably more discretion to judges—and it has served as the basis of subsequent English decisions allowing rescission for mistake. See, e.g., Grist v. Bailey, 1967 Ch. 532 (1966) (rescission, prior to conveyance, of contract for the sale of a house, the price having been fixed in mistaken belief that property was subject to an existing tenancy; decision based on liberal "equitable," as opposed to strict "legal," rule of mistake).

The invocation of equitable principles and the implicit appeal to judicial discretion have tended in the English cases to legitimize the grant or denial of rescission based on precisely
Subsequent English mistake cases are consistently decided in accordance with the windfall principle, although the critical relationship of the time at which a mistake is discovered to the availability of the defense is not always acknowledged.\textsuperscript{50} The mistake at issue in \textit{Magee v. Pennine Insurance Co.}\textsuperscript{51} presents an unusually close counterpart to \textit{Bell v. Lever Bros.}, with the exception of the stage in the transaction at which it was discovered. An insurance company entered into an agreement for the settlement of a policyholder's claim, both parties being unaware that the company had a defense to liability on the policy.\textsuperscript{52} Discovering the relevant facts before payment was made, the company sought to avoid the settlement agreement for mutual mistake. The close analogy to the facts of \textit{Bell v. Lever Bros.} suggests that the company's promise to make payment in settlement should be binding, and the trial judge so held.\textsuperscript{53} Nevertheless, the Court of Appeal reversed the judgment, holding that it was proper to set aside the settlement agreement under the more liberal "equitable" rule.\textsuperscript{54} Neither member of the majority explained how the mistake in \textit{Magee} could be distinguished from the mistake in \textit{Bell v. Lever Bros.} and the same development may be observed in the more recent American decisions. See, e.g., Lenawee County Bd. of Health v. Messerly, 417 Mich. 17, 331 N.W.2d 203 (1982). Criticizing its venerable holding in \textit{Sherwood v. Walker}, the Michigan court rejected a suit for rescission of a completed conveyance of land, notwithstanding the parties' mutual mistake as to what it found to be "fundamental . . . assumptions" having a "material" effect on the agreed exchange of performances, principally on the ground that rescission, as "an equitable remedy which is granted only in the sound discretion of the court," was not "reasonable and just under all the surrounding circumstances" of the case. Id. at 30-32, 331 N.W.2d at 210.

\textsuperscript{50} In Leaf v. International Galleries, [1950] 2 K.B. 86 (C.A.), the court denied rescission to a plaintiff who discovered, five years after purchasing it, that a view of Salisbury Cathedral described as a Constable was not in fact the work of that artist. Yet "[c]learly if, before he had taken delivery of the picture, [plaintiff] had obtained other advice and come to the conclusion that the picture was not a Constable, it would have been open to him to rescind." Id. at 92 (Jenkins, L.J., concurring). Unwilling to leave the result on that common sense basis, the Master of the Rolls (Lord Evershed) explained that "it remains true to say that the plaintiff still has the article which he contracted to buy. The difference is no doubt considerable, but it is, as Denning L.J. has observed, a difference in quality and value rather than in the substance of the thing itself." Id. at 94. Compare Lord Justice Denning's more candid statement in \textit{Oscar Chess Ltd. v. Williams}, [1957] 1 W.L.R. 370 (C.A. 1956): "If the buyer had come promptly, he might have succeeded in getting the whole transaction set aside in equity on the ground of this mistake: see \textit{Solle v. Butcher}; but he did not do so and it is now too late for him to do it: see \textit{Leaf v. International Galleries}." Id. at 373-74 (footnotes omitted).

\textsuperscript{51} [1969] 2 Q.B. 507 (C.A).

\textsuperscript{52} It was conceded on appeal that innocent, material misstatements made by the insured in his original application for insurance entitled the company to deny coverage. Premiums had been paid regularly under a succession of renewal policies. The trial court found no evidence of fraud or conscious misrepresentation. \textit{Id.} at 512-14.

\textsuperscript{53} \textit{Id.} at 514.

\textsuperscript{54} \textit{Id.} at 514-15; see supra note 49.
Bros.; nor did they acknowledge that the clearest difference between the cases was simply whether or not the disputed payment had already been made.\textsuperscript{55}

B. Frustration, Asserted Before or After Performance

The most basic example of frustration prior to performance, so firmly rooted in the law of sales that its windfall character is hardly recognized, is the rule that the destruction of specific goods prior to delivery discharges the obligations of both buyer and seller.\textsuperscript{56} By extension, the rule holds generally that the destruction (without fault) prior to performance of anything essential to performance discharges both parties. This is the sort of "impossibility" associated with \textit{Taylor v. Caldwell},\textsuperscript{57} where the owner of a music hall was held not liable to the impresario to whom he had rented it when, just prior to the engagement, the building was destroyed by fire.\textsuperscript{58} It follows that a contract for the sale of a crop to be grown on a particular tract of land is discharged when the crop fails;\textsuperscript{59} that a contract to repair a building is discharged when the building is destroyed;\textsuperscript{60} and that a contract to drive logs downstream at a certain time of year is discharged when the stream dries up as a result of a drought.\textsuperscript{61}

The traditional explanation of these results, promulgated by Justice Blackburn in \textit{Taylor v. Caldwell}, is that the parties' obligations in each

\textsuperscript{55} Admittedly, some mutual mistake cases are not decided along windfall lines. In \textit{Farhat v. Rassey}, 295 Mich. 349, 294 N.W. 707 (1940), plaintiff accepted $1,400 in settlement of his claims against defendants, both parties being unaware that, a few hours earlier, the judge to whom their suit was being tried had filed a written opinion in which he found plaintiff entitled to $3,933. The settlement agreement was reduced to writing and signed, and a check delivered to plaintiff's attorney, before this fact was known. \textit{Id.} at 350, 294 N.W. at 707. Rescission of the settlement agreement was granted on the basis of mutual mistake. \textit{Id.} at 352, 294 N.W. at 708. The decision in \textit{Farhat} may reflect a prejudice in favor of professional over private dispute resolution, at least where the expenditure of judicial resources has already been made. Compare Holmes's suggestion that a wager on a past horse race should be binding on the parties. \textit{Oliver Wendell Holmes, The Common Law} 304 (1881).

\textsuperscript{56} \textit{See}, e.g., U.C.C. § 2-613 (1988).


\textsuperscript{58} \textit{Id.} at 312, 315. In \textit{Taylor v. Caldwell}, plaintiffs were denied recovery for reliance losses (preperformance expenditures); defendant was left with the loss of his building; both parties lost the benefit of their bargain. The result is fully consistent with the rule, developed in subsequent English cases, that losses under a frustrated contract remain where they fall. \textit{See infra} notes 79-85, 98-112 and accompanying text.


\textsuperscript{60} Matthews Constr. Co. v. Brady, 104 N.J.L. 438, 442, 140 A. 433, 433-35 (1928).

such case are impliedly conditioned on the continued existence of the necessary subject matter. It is, of course, an explanation that effectively removes such cases from the category of frustration. Since the obligations imposed by the bargain are contingent, in this view, upon a condition that has failed, there remains nothing to discharge. The long-standing criticism of Blackburn's explanation is that it makes outcomes depend on "implied terms" to which the parties manifestly never turned their minds.62

If the cases involving destroyed subject matter are viewed as cases of frustration and not of implied conditions, the windfall nature of the rule that destruction equals discharge becomes evident. The result of the rule is that the seller loses his goods; each party loses the benefit of his bargain; and each party bears his own reliance losses. There is no guarantee that such an outcome will be "fair." Even without comparing the parties' disappointed expectations or consequential damages, it should be evident that one or the other may have made substantial expenditures in preparation for the anticipated exchange; so that the frustration of the contract, for which neither is responsible, may have far graver consequences for one party than for the other. The unequal incidence of similar hardships in other contexts of contractual frustration has been thought to invite judicial intervention to impose a sharing of losses.63

Claims of frustration asserted after performance has been completed are understandably rare, since the party complaining of a disparity will normally balk at beginning performance (in which event the argument is likely to be phrased in terms of mistake) or else stop in the middle. It can be predicted, on the basis of the windfall principle, that even a plausible claim of frustration asserted with respect to a contract that has been fully performed is almost certain to fail.64

62. The second Restatement "rejects" the analysis of frustration according to which "there is an 'implied term' of the contract that such extraordinary circumstances will not occur," preferring the approach of U.C.C. § 2-615 "under which the central inquiry is whether the non-occurrence of the circumstance was a 'basic assumption on which the contract was made.'" The Reporter concedes, however, that "[i]n order for the parties to have had such a 'basic assumption' it is not necessary for them to have been conscious of alternatives." 2 RESTATEMENT (SECOND) OF CONTRACTS 310-11 (1979) (introductory note to ch. 11). It is not clear that an analysis in terms of unconscious "basic assumptions" represents much of an advance over "implied terms" of which the parties were equally unaware.

63. See the discussion of the Fibrosa case, infra notes 121-126 and accompanying text.

64. The extraordinary decision in National Presto Indus. v. United States, 338 F.2d 99 (Ct. Cl. 1964) (remanding case for reformation), cert. denied, 380 U.S. 962 (1965), serves as the exception that proves the rule. While the analysis in National Presto is phrased in terms of "mutual mistake" (a supposed mistake about the feasibility of a manufacturing process), the circumstances of the case (supplier's disappointment at increased costs) more readily suggest
The proposition is amply borne out by a number of well-known cases that arose in consequence of the closing of the Suez Canal, first in 1956 and again in 1967. In one case presenting typical facts, a vessel was chartered on March 23, 1967 for a voyage from Beaumont/Smiths Bluff, Texas to Bombay. The customary route for that voyage was through the Suez Canal, and the freight rate was calculated accordingly. The vessel sailed on May 15. On June 5, when the Suez Canal was closed to navigation as a result of the Arab-Israeli war, the ship had crossed the Atlantic and the Mediterranean to a point only eighty-four miles from the northern entrance to the Canal. Under the circumstances, the ship had no practical alternative but to change course:

The vessel proceeded westward, back through the Straits of Gibraltar and around the Cape and eventually arrived in Bombay on July 15th (some 30 days later than initially expected), traveling a total of 18,055 miles instead of the 9,709 miles which it would have sailed had the Canal been open. The owner billed $131,978.44 as extra compensation, which the charterer refused to pay.

The theory underlying the owner's claims was a recovery in quantum meruit, on the premise that the original charter party had been frustrated and thereby discharged.

In cases such as this, where voyages were already under way at the time the Canal was closed, English and American courts were unanimous in rejecting the claim of frustration, no matter how burdensome the shipowner's additional cost of performance. In a footnote to one of the decisions, Judge Friendly stated that "no vessels which left port before the 1967 crisis were permitted to recover any surcharge for making the longer trip around the Cape of Good Hope." No contrary result is discoverable for the 1956 crisis.

The typical claim of commercial impracticability. That being so, the Court of Claims' holding amounts to discharge for frustration after plaintiff has completed performance.

66. Id. at 940.
67. Id.
68. Id. at 941.
69. The American cases, in addition to American Trading, are Transatlantic Fin. Corp. v. United States, 363 F.2d 312 (D.C. Cir. 1966), and Hellenic Lines v. United States, 512 F.2d 1196 (2d Cir. 1975). The rule was established in England by Ocean Tramp Tankers Corp. v. V/O Sovfracht (The Eugenia), [1964] 2 Q.B. 226 (C.A. 1963), and confirmed (on facts more closely analogous to those of the American cases) in Palmco Shipping, Inc. v. Continental Ore Corp. (The "Captain George K."). [1970] 2 Lloyd's Rep. 21 (Q.B. 1969).
71. The negative implication of Judge Friendly's statement—that vessels that had not yet
C. Mistake, Asserted in the Course of Performance

The logic of the windfall principle suggests that if discharge by reason of mistake or frustration will operate to interrupt a contract in the course of performance, the proper remedy is to leave the parties where they stand—neither requiring them to continue nor attempting restitution for part performance on either side. The contract interrupted in the course of performance is the typical setting of the claim of frustration, and cases involving part performance are relatively infrequent where the claim of discharge is based on mistake. Those that do occur include textbook examples of the judicial inclination to let losses lie where they fall.\textsuperscript{72}

One context in which interrupted performance can be attributed to mutual mistake involves mineral leases. The lessee in the typical case has agreed to pay a stated royalty per ton of minerals extracted, with a minimum annual payment for a stated number of years; payments have been made for some portion of the lease term when the leased deposits are unexpectedly exhausted. If relief is granted on the grounds of mutual mistake, the normal remedy is a partial rescission, discharging the obligations of both parties with respect to the remaining lease term only.\textsuperscript{73} It is easier to see why such a disposition makes sense than it is to explain, without reference to the windfall principle, how the parties' mutual mis-

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\textsuperscript{72} In Clayburg v. Whitt, 171 N.W.2d 623 (Iowa 1969), a contract for the sale of shares in a grain elevator company was challenged on the grounds of mutual mistake as to (1) the quantities of grain in storage and (2) the accuracy of the company's financial statements. Sellers sued for the $60,000 unpaid balance of the purchase price; buyers counter-claimed for rescission and return of a $25,000 down-payment. \textit{Id.} at 624. Finding that “[s]everal people made many mistakes,” the court denied all relief, stating that “equity should do nothing to help any of the parties out of a bad deal.” \textit{Id.} at 633. \textit{Cf.} Anderco, Inc. v. Buildex Design, Inc., 538 F. Supp. 1139, 1142 (D.D.C. 1982) (denying recovery to both parties following part performance of construction “contract” that parties mistakenly believed they had entered into).

take as to a basic assumption results in a contract that is part valid and part void.\textsuperscript{74}

One of the most celebrated mistake cases, \textit{Smith v. Zimbalist},\textsuperscript{75} presents a contract of sale interrupted after part performance and (reading between the lines) a "windfall" disposition. Zimbalist, a renowned concert violinist, purchased from Smith two violins that Zimbalist identified, and both parties mistakenly regarded, as the work of Stradivari and Guarneri. Smith was a collector, not a dealer, and the trial court found as a fact that he had made no representation or warranty as to the provenance of the violins. Zimbalist took the violins, paying $2,000 down and promising to pay a balance of $6,000 in monthly installments. Smith agreed that Zimbalist might exchange the instruments in question "for any others in my collection should he so desire." Subsequent inquiry established "by a preponderance of evidence," though expert opinion was apparently divided, that the violins were imitations worth at most $300. Smith sued to recover the unpaid balance of the contract price. The trial court gave judgment for Zimbalist on the ground of mutual mistake.\textsuperscript{76}

Although plausible grounds might have been adduced in \textit{Smith v. Zimbalist} either for unwinding the transaction or for pushing it forward, both trial and appellate courts seem to have left the parties precisely where they stood. Zimbalist, who was doubtless embarrassed by the affair, does not appear to have asserted any counterclaim. Still, if the contract was void for mistake (and all the more if Smith gave an implied warranty), it is curious to see no reference in the opinion to Zimbalist's right to restitution of the $2,000 already paid. Conversely, it would have been reasonable to see an express but limited warranty in Smith's promise to let Zimbalist exchange the violins for any others in the collection. On this view of the matter, the risk of inauthenticity was allocated, and a remedy provided, by an agreement of the parties that the court had only to enforce. Instead, regarding the contract as void for mistake, the

\textsuperscript{74} In Mineral Park Land Co. v. Howard, 172 Cal. 289, 156 P. 458 (1916), the court discharged the obligations of a contractor who removed only half the agreed-upon amount of gravel because the rest turned out to be under water. While the decision is commonly cited as the source of the "commercial impracticability" standard, see, e.g., John E. Murray, Jr., \textit{Contracts: Cases and Materials} 618 (4th ed. 1991), the reasoning of mutual mistake (i.e., a mistake as to the quantity of gravel recoverable by ordinary means) was given equal prominence in the opinion. \textit{Mineral Park}, 172 Cal. at 292-93, 156 P. 459-60. The difficulty of deciding whether the problem in \textit{Mineral Park} stemmed from a mistaken assumption about geology (existing fact) or about the likely cost of performance (prediction) illustrates the arbitrary nature of the traditional categories.

\textsuperscript{75} 2 Cal. App. 2d 324, 38 P.2d 170 (1934).

\textsuperscript{76} \textit{Id.} at 325-27, 38 P.2d at 170-71. The trial court judgment was affirmed on appeal, though apparently on a theory of implied warranty. \textit{Id.} at 333, 38 P.2d at 174.
courts left the windfall loss to be shared by the parties as chance had already determined. This is as it should be, since if the claim of a seller's warranty is rigorously excluded, the facts of the case afford no more basis for readjusting the incidence of the loss than if the same loss had fallen either all to Smith (supposing his prized violins had been identified as worthless fakes the day before Zimbalist came to see them) or all to Zimbalist (supposing the same discovery after delivery and payment were complete).

D. Frustration, Asserted in the Course of Performance

The coronation of King Edward VII was to be celebrated by processions through the streets of London on June 26 and 27, 1902, with a naval review and "illumination of the fleet" to be held at Spithead (near the Isle of Wight) on June 28. Many contracts were entered into in anticipation of these festivities. Some owners or tenants of property commanding a good view of the parade route hired out rooms at high prices; others built grandstands, had tickets printed and sold seats; shipowners chartered vessels to organizers of pleasure cruises, who offered the public the opportunity to observe the naval exercises. Many of those hiring rooms or chartering ships subsequently contracted with caterers to supply refreshments to their paying or invited guests. The contracts memorializing these arrangements employed a predictable variety of payment terms: some required full payment in advance, others payment in installments, with final payment due in some cases on the day of the great event and in others some time before. Few of them contained any provision to govern the rights of the parties in the event the celebrations did not take place.

On June 25 it was announced that because of the King's illness the processions and naval review would be canceled. The resulting litigation—a handful of decisions known collectively as the "Coronation Cases"—is best known today as a landmark in the liberalizing process by which an older and narrower defense of "impossibility" expanded to include modern-day "frustration" and "impracticability." But the sig-

77. See generally R.G. McElroy & Glanville Williams, The Coronation Cases, 4 MOD. L. REV. 241 (1941). Additional background information may be gleaned from the opinions in the Coronation Cases themselves. McElroy and Williams identify and cite eleven Coronation Cases, id. nn.18-21.

78. The principal holding of the best known of the Coronation Cases, Krell v. Henry, [1903] 2 K.B. 740 (C.A.), was that the cancellation of the processions discharged defendant's obligation to pay the balance due under a contract for the hire of rooms from which to observe them. The significance of the decision lay in the ground on which it was based by Lord Justice Vaughan Williams: not that performance had been rendered objectively impossible, but that
nificance of the Coronation Cases for the exploration of the windfall principle lies in their treatment of the restitution problems created by the various contracts under which money had been paid in advance in anticipation of an event that was now not going to take place.

The terms of the transaction in Chandler v. Webster, the principal decision on this aspect of the problem, were set forth in a letter of confirmation written by the plaintiff on June 10: "I beg to confirm my purchase of the first-floor room of the Electric Lighting Board at 7, Pall Mall, to view the procession on Thursday, June 26, for the sum of £141 15s., which amount is now due." The amount of £100 had been paid at the time the cancellation of the procession was announced. Plaintiff sued to recover this amount, on a theory of failure of consideration; defendant counter-claimed for the unpaid balance of £41 15s. The Court of Appeal held for defendant on both claims. This result is fully in accordance with the windfall principle, since recovery of the unpaid balance depended on a finding that it was due and payable before the procession was canceled.

The allocation of windfall losses in Chandler v. Webster and the other Coronation Cases is simple and symmetrical. Amounts due and payable prior to the time at which a contract is frustrated remain due; if previously paid, they cannot be recovered. Liability for any payment

"the object of the contract was frustrated by the non-happening of the coronation." Id. at 754. The rationale was unnecessarily broad. Krell v. Henry might have been decided the same way, with less damage to existing doctrine, by observing that the subject matter of the contract (rooms from which a coronation procession might be viewed on June 26 and 27) had been destroyed, as surely as was the music hall in Taylor v. Caldwell, thereby discharging both parties from further performance as in the case of destruction of specific goods. Lord Justice Vaughan Williams preferred to explain the decision by an interpretation of Taylor v. Caldwell according to which the parties' obligations are discharged when a "state of things or condition" with respect to which they have implicitly contracted "fails and prevents the achievement of that which was, in the contemplation of both parties, the foundation of the contract." Id. As observed in a well-known commentary, "the fiction of Taylor v. Caldwell" (as to the existence of implied conditions excusing performance) was thereafter "without limit." McElroy & Williams, supra note 77, at 252.

80. Id. at 494.
81. Id. at 501-02.
82. The action for amounts due but unpaid at the moment of frustration must be allowed if the courts are to avoid a rule favoring the dilatory over the conscientious debtor. More importantly, enforcement of the matured obligation, though it might seem inconsistent with a principle favoring judicial inertia, gives effect to the parties' privately negotiated, ex-ante allocation of the incidence of possible loss should their contract be frustrated. See infra at 49-52.
The incidence of the casualty—the dead-weight loss resulting from the King's illness—is left to be apportioned exclusively as a function of the parties' private arrangements. A passage in the opinion of Collins, Master of the Rolls, became known as "the Rule of Chandler v. Webster":

[W]here, from causes outside the volition of the parties, something which was the basis of, or essential to the fulfilment of, the contract, has become impossible, so that, from the time when the fact of that impossibility has been ascertained, the contract can no further be performed by either party, it remains a perfectly good contract up to that point, and everything previously done in pursuance of it must be treated as rightly done, but the parties are both discharged from further performance of it. . . . The rule adopted by the Courts in such cases is I think to some extent an arbitrary one, the reason for its adoption being that it is really impossible in such cases to work out with any certainty what the rights of the parties in the event which has happened should be. Time has elapsed, and the position of both parties may have been more or less altered, and it is impossible to adjust or ascertain the rights of the parties with exactitude. That being so, the law treats everything that has already been done in pursuance of the contract as validly done, but relieves the parties of further responsibility under it. 85

Applied to run-of-the-mill frustration cases, in which parties not infrequently walk away from a deal after part performance on either side, Collins's explanation appears both insightful and noncontroversial. When the remaining term of a lease is discharged because the building has been destroyed by fire, 86 or a contractor is permitted to cut short his

1902) (same). Krell v. Henry originally involved a counterclaim by the defendant for return of his down payment. By the time the case reached the Court of Appeal this counterclaim had been withdrawn, perhaps in recognition of the contrary course of decisions. Krell, [1903] 2 K.B. at 754. By contrast, sums paid at a time when the processions had already been canceled, but before that fact was publicly known, were held recoverable on a theory of pre-existing impossibility or mutual mistake. See Griffith v. Brymer, 19 T.L.R. 434, 434 (K.B. 1903); cf. Clark v. Lindsay, 19 T.L.R. 202, 203 (K.B. 1903). These decisions were influenced by the traditional rule according to which money paid for something that had ceased to exist was recoverable as on a failure of consideration. See, in particular, Strickland v. Turner, 155 Eng. Rep. 919 (Ex. 1852), which allowed recovery of the purchase price of an existing annuity on the life of a third person who, unknown to the parties in England, had died in Australia during the negotiation of the transaction. Id. at 924. The timing of the transaction in Griffith arguably made the case one of strict failure of consideration (as Chandler, it will be argued, was not), thereby justifying restitution in the former case but not in the latter.

84. Krell, [1903] 2 K.B. at 754.
performance because the work has become too expensive to continue, the law's disinclination to compel any more elaborate accounting between the parties fits Collins's description precisely. This quick, rough-justice means of sending the parties on their way seems so natural that its windfall character may pass unnoticed.

In the context of the Coronation Cases, however, where its application seemed to award an undeserved gain to owners of rooms at the expense of disappointed hirers, this statement of the law was regarded as little short of barbaric. When the House of Lords later interpreted Scottish law to permit recovery of an installment payment under a frustrated contract—distinguishing, without reexamining, the contrary English authorities—the rule of Chandler v. Webster was described as a maxim for "tricksters, gamblers, and thieves," leading to "monstrous" results, according to which

innocent loss may and must be endured by the one party, and unearned aggrandisement may and must be secured at his expense to the other party. . . .

No doubt the adjustment of rights after the occurrence of disturbances, interruptions, or calamities, is in many cases a difficult task. But the law of Scotland does not throw up its hands in despair in consequence, and leave the task alone.

Chandler v. Webster was subsequently disapproved by the House of Lords and further interred by Act of Parliament.

The usual reaction to Chandler v. Webster is that it is unfair to be required to pay to see a procession that will no longer take place, and that anyone receiving such a payment is being unjustly enriched. The

87. See Mineral Park Land Co. v. Howard, 172 Cal. 289, 293, 156 P. 458, 459-60 (1916). Compare Richardson Lumber Co. v. Hoey, 219 Mich. 643, 189 N.W. 923 (1922), involving the sale of a specified lot of railroad ties to be loaded and removed by the buyer. Buyer had taken only a portion when the remainder was destroyed by fire; he tendered payment for this quantity only. Although the court found that title to the entire lot had already passed, it held (by a tenuous theory of mutual mistake) that the buyer was entitled to a partial rescission, excusing payment for the ties destroyed by fire. Id. at 646-50, 189 N.W. at 924-25.

88. Given the option, at the outset, of contracting for the part performance that frustration will in fact leave them, it is by no means clear that the parties would make their deal on the same terms, or indeed at all. Moreover, were the parties to become aware, prior to performance, of the circumstances by which their existing contract would later be "frustrated," the party adversely affected could presumably obtain rescission on the grounds of mutual mistake or existing impossibility. Analytical consistency might suggest that a frustrated contract be regarded as void ab initio (as if the mistake had been discovered prior to performance), leaving the parties to pursue cross-claims in restitution for benefits respectively conferred. The fact that the law does not proceed in this fashion shows the influence of the windfall principle.

89. Cantiare San Rocco, S.A. v. Clyde Shipbuilding & Eng'g Co., 1924 App. Cas. 226, 258-60 (Scot. 1923) (Lord Shaw of Dunfermline).

90. See infra notes 121-128 and accompanying text.
position of the common law is that no one is unjustly enriched by the mere circumstance that a casualty bears more heavily on one party to a contract than on another, and that there is no greater justice to be had by adjusting the burden between the parties. The traditional rule is hard and counterintuitive, but not necessarily wrong. The controversy surrounding the Coronation Cases is fundamentally a dispute over the appropriate threshold for judicial intervention to shift losses.

To understand Chandler v. Webster we must recognize the sense in which the proprietor of the premises, though allowed to retain a benefit at the expense of the other party, was nevertheless not unjustly enriched. When the coronation processions were first announced, the fortunate tenants of No. 7, Pall Mall, like everyone else in London with a good view of the route, suddenly owned a valuable asset that they might consume themselves (by watching the processions) or sell. Though this asset came to them by the purest windfall, it was entitled to no less protection than any other species of property. When the processions were canceled, everyone in London who by then had the right to watch them—whether that right had been obtained by luck, or whether it had been bought and paid for—suffered the same casualty loss. Anyone who had paid £100 to hire someone else's rooms obviously suffered a loss of £100, but so did every proprietor of comparable rooms who had not sold his rights—either because he was going to enjoy the procession himself (at an opportunity cost of £100 pounds) or because he intended to sell at a later date. The incidence of the casualty, consisting in the destruction of a transferable asset, was simply an application of the rule res perit domino: the loss from the destruction of property is for the account of the owner. The determination of who "owned" the opportunity to view the procession was a function of chance (the timing of the King's illness) and of the allocation of the risk of loss effected by the parties' payment terms.

The implicit logic of Chandler v. Webster recalls Paradine v. Jane,91 where a tenant was held liable for rent on land from which he had been forcibly expelled by the royalist army during the English Civil War. The strongest reason for the holding is not the fictitious rule that contractual liability is absolute; nor even the more vital idea that a person wishing to undertake a qualified obligation should write his own conditions since "the law [will] not protect him beyond his own agreement."92 The best explanation is that the tenant, as temporary owner of the premises, has both "the advantage of casual profits" and "the hazard of casual losses" for the duration of the lease term, since he stands precisely in the position

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92. Id. at 898.
of the owner of the fee had there been no lease. The tenant’s loss, in this view, is no more unfair than any other destruction of property (by unavoidable casualty) occurring shortly after its purchase from the prior owner; and there is no more reason to shift it in the one case than in the other.

Paradine v. Jane is made easier to explain by the traditional concepts of property law, according to which the tenant is in truth the “owner” of the property for a term of years; but the lesson it teaches about “casual losses” is in no way dependent on the specialized law of estates. The relation of landlord and tenant is merely one familiar example of circumstances linking two parties in a contractual relation in such a way that if one suffers a casualty related to the subject matter of their bargain, the other may be thought to be under some obligation to share the loss. The idea that it is somehow not fair to require the tenant to pay rent for land from which he has been forcibly expelled by a third party, and the idea that the plaintiff in Chandler v. Webster should not be held to his contract for the hiring of a room from which no procession will be visible, are thus fundamentally the same; but such circumstances are by no means limited to the context of leases and licenses of real property. The same impulse lies behind the rule of law that allows a recovery to the worker who has expended time and materials in constructing an addition to a building, under a contract calling for payment on completion, only to see the building destroyed before the completion of his undertaking; or (conversely) to the owner who has paid in advance, in full, for the same work of construction.

Long before the Coronation Cases, the decision whether or not to allow recovery in such circumstances was recognized as a choice that could reasonably be made either way. The divergent tendencies of the civil and the common law on this question marked one of the characteristic differences between the two legal systems. In deciding that the casualty to leased property would be left to fall pro tanto on the tenant, the common law rejected the uniform civil law tradition that abated the rent even for such seemingly lesser casualties as the failure of a crop or the destruction of a building. Underlying the civil law rule was the reason-

93. Id.
94. Professor Fried offers an explicit defense of “the principle of sharing” as the source of remedies for frustrated contracts, arguing that the parties to a contract are “joined in a common enterprise, [with] some obligation to share unexpected benefits and losses in the case of an accident in the course of that enterprise.” FRIED, supra note 4, at 72.
95. Dig. 19.2.15 (Ulpian, Ad Edictum 32) offers examples of casualties said to justify a whole or partial remission of rent. The rule was uniformly adopted in civil law jurisdictions. See, e.g., CODE CIVIL [C. CIV.] art. 1722 (France); LA. CIV. CODE ANN. art. 2697 (West
able proposition that the landlord's undertaking, intrinsic to the lease transaction, was to afford the tenant not the bare title but the enjoyment ordinarily to be expected from the leased property. The contrasting common law rule did not controvert this proposition so much as it advanced a contrary insight, no less reasonable: that outside the agreement of the parties there could be no just basis for interfering with the natural incidence, inherently fortuitous, of the casualty loss.

In the generation before Chandler v. Webster, the rigorous application of this antirestitutionary logic had, on full consideration, been confirmed as English law. In Appleby v. Myers, plaintiffs, a firm of engineers, had contracted to erect a steam engine and associated machinery on the defendant's premises. The work to be done was specifically described under ten headings, with a price expressly stated for each; the total contract price amounted to £459, payable on completion. When the work was nearly finished, an accidental fire resulted in the total destruction of defendant's premises, including the work in progress. Plaintiffs sought to recover £419 on account of work done and materials provided. The question submitted to the court was whether, under these circumstances, the plaintiffs were entitled to recover the whole or any portion of the contract price.

On the first hearing of the case, in the Court of Common Pleas, plaintiffs obtained judgment for a part of the contract price proportional to the extent of the work done. The theory of the decision, not very satisfactory, was that there was an implied promise by the defendant to provide and maintain the buildings where the machinery was to be er-

1952); George J. Bell, Principles of the Law of Scotland § 1208 (W. Guthrie 10th ed. 1899).

96. "[O]portere enim agrum praestari conductor, ut fruipossit." ("For the nature of the lease transaction is such that] the land is to be furnished to the lessee for his use and enjoyment.") Dig. at 19.2.15.2. The logic of the modern, lease-as-contract decisions in landlord-tenant cases is not fundamentally different. See, e.g., Javins v. First Nat'l Realty Corp., 428 F.2d 1071, 1074 (D.C. Cir.) (in modern lease transaction, tenants seek not "an interest in land" but "a well known package of goods and services"), cert. denied, 400 U.S. 925 (1970).

97. A frequent observation was that the tenant lost his term while the landlord lost his reversion: The reason in equity is, that in case of the destruction of the property, the loss of the rent must fall somewhere, and there is no more equity that the landlord should bear it than the tenant, when the tenant has expressly agreed to pay it, and when the landlord must bear the loss of the property destroyed. Equity considers the calamity mutual.

White v. Molyneux, 2 Ga. 124, 127 (1847).

98. 1 L.R.-C.P. 615 (1866), rev'd, 2 L.R.-C.P. 651 (Ex. Ch. 1867).

99. Id. at 621.

100. Id.
Defending this judgment on appeal, counsel for plaintiffs sought safer but still precarious ground. The "true principle" explaining the liability of the owner, they asserted, was an implied promise, not to maintain the premises where work was to be done, but to pay for work done and materials supplied in the event performance of the contract should be prevented by *vis major*. In support of this contention counsel appealed frankly to the civil law authorities, offering lengthy citations to the *Digest*, to Pothier, and to contemporary commentators on the French civil code. The Exchequer Chamber, per Justice Blackburn, declined altogether to entertain this view of the question. While a contract to do work and supply materials might be (and frequently was) made on a basis that entitled the contractor to recover for the value of each part accomplished, without regard to the completion of the whole, the court found evidence of a contrary intention in the understanding that payment would be due only on completion of the work. "[T]here is nothing to render it either illegal or absurd in the workman to agree to complete the whole, and be paid when the whole is complete, and not till then: and we think the plaintiffs in the present case had entered into such a contract." On this view of the case, performance of the contract had been interrupted by a supervening casualty, the risk of which had not been allocated by the parties' express or implied undertakings. As in *Paradine v. Jane*, the fortuitous incidence of the loss would be left undisturbed:

> We think that where, as in the present case, the premises are destroyed without fault on either side, it is a misfortune equally affecting both parties; excusing both from further performance of the contract, but giving a cause of action to neither.

The converse of *Appleby v. Myers*, and a closer analogy to the problem addressed in *Chandler v. Webster*, is the case in which a plaintiff seeks to recover sums paid in advance after the defendant's performance

101. *Id.* at 622.
102. 2 L.R.-C.P. at 653-57. Counsel's impressive display of learning is at least partly explained by the contemporary popularity of *Story on Bailments*, in which many of the authorities were collected. Following the authority of the *Digest*, Story analyzed these cases of supervening casualty (which we classify today within the subjects of contract and restitution) in terms of the Roman law of "Locatio Operis, or the Hiring of Labor and Services." *See* JOSEPH STORY, *COMMENTARIES ON THE LAW OF BAILMENTS* §§ 421, 426-27 (5th ed. 1851).
103. As the author of the opinions in *Taylor v. Caldwell* (discussed supra text accompanying notes 57-62), *Kennedy v. Panama Mail Co.* (discussed supra text accompanying notes 36-38) and *Appleby v. Meyers*, Sir Colin Blackburn of the Court of Queen's Bench appears to have shaped almost single-handedly the rules of mistake and frustration for the classical era of contract law.
104. *Appleby*, 2 L.R.-C.P. at 660.
105. *Id.* at 659.
has been discharged by supervening casualty. Recovery was denied in this situation in two leading cases: *Whincup v. Hughes*\(^{106}\) and *Anglo-Egyptian Navigation Co. v. Rennie*\(^{107}\). In *Whincup*, plaintiff apprenticed his son to a watchmaker for a six-year term, paying the full premium of £25 in advance; after furnishing the first year of instruction, the master died. In *Anglo-Egyptian*, defendants (a firm of engineers) agreed to construct and install new boilers on plaintiff's steamship, for a price payable in installments. When the greater part of the price had been paid, and the greater part of the work had been done (but before the boilers had been installed in the ship), the vessel was lost at sea. It was held in both cases that the contract was frustrated after part performance: specifically, that the performing party's remaining obligation was discharged by supervening impossibility. In both cases, the Court of Common Pleas denied any recovery to plaintiffs for money had and received. Thus the watchmaker's estate was under no obligation to refund any part of the £25 premium; and the engineers presumably enjoyed a windfall from the resale of the valuable boilers, since they had already received installment payments nearly equivalent to the cost of the work done.

The decisions may appear surprising today, but their reasoning is instructive. In both cases the judges were reluctant to calculate the cost or value of the part performance because of the impossibility of doing so with precision. The court in *Whincup* stressed the difficulty of apportioning the apprentice's premium between the periods before and after the master's death. A simple pro rata calculation was unacceptable unless the consideration was "in its nature apportionable"; this was not the case here, since the apprentice would presumably cost the master more trouble, with less reward, at the outset of the relationship.\(^{108}\) In *Anglo-Egyptian*, where the commercial subject matter might be thought capable of easier valuation, the court still balked at the task: the boilers "may have been either of more or less value" than the installments paid in respect thereof, "or of more or less profit or loss relatively to the rest of the subject-matter of the contract."\(^{109}\)

By modern standards, this reluctance to appraise on the ground that the appraisal cannot be made with precision looks excessively fastidious. But the judges of the Court of Common Pleas were pursuing an alternative approach to the problem, one that obviated any need for judicial valuation and its attendant imperfections. The undisturbed allocation of

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106. 6 L.R.-C.P. 78 (1871).
107. 10 L.R.-C.P. 271 (1875).
108. *Whincup*, 6 L.R.-C.P. at 81, 86.
loss from either of these frustrated contracts was unimpeachably just if it could be viewed as the product of the parties’ agreement. It could be so viewed if the parties were merely presumed to know what they were doing. Thus the articles of apprenticeship contained no provision for repayment of the premium in the event of the death of either master or apprentice, though such a term could easily have been included. The contract was therefore to be read as assigning to the plaintiff the entire risk of frustration from either cause.110 Similarly, the court construed the contract in Anglo-Egyptian as providing that title to the boilers should not pass until they were actually installed in the vessel, as against the plaintiff’s contention that title passed as each boiler was certified to meet specifications and paid for.111 The effect of this provision, under a legal regime excluding judicial intervention to reapportion losses incident to a frustrated contract, was to provide the performing party with nearly complete security against any loss from the interruption of the contract prior to full performance; excluding, for example, any risk that his expenses and ratable profit might outrun the installments already paid at any point. The resulting protection is close to what a performing party would obtain by insisting on full and nonrefundable payment in advance. Such generous protection for performing parties may be unusual, but there is nothing unreasonable about it if we can assume it is what the parties intended.

The results strike us as harsh because we doubt that the paying parties in these cases intended to offer such generous guarantees. But the Court of Common Pleas was announcing what would today be called a “default rule” for the guidance of other contracting parties in the future. The rule was a very simple one: courts would not intervene to shift gains and losses from a frustrated contract. The result was that the allocation of such gains and losses would necessarily be a function of the parties’ contract; which the parties, knowing the rule, were thus made free to specify however and to whatever extent they might wish. The judges insisted, in short, that the ultimate outcome be exclusively a function of the parties’ private arrangements; and they appear to have realized that they could achieve this result only by excluding the possibility of judicial intervention.112

110. Whincup, 6 L.R.-C.P. at 83-84, 85.  
111. Anglo-Egyptian, 10 L.R.-C.P. at 283; cf. Anglo-Egyptian Navigation Co. v. Rennie, 10 L.R.-C.P. 571 (Ex. Ch. 1875).  
112. In effect, the method of the Court of Common Pleas in all three cases—Appleby, Whincup, and Anglo-Egyptian—was simply to deny that the contracts contained “gaps” needing to be filled by judicial intervention. If a legal regime excludes by presumption the possibility of “incomplete” contracts, the result is a default rule that losses of this kind will lie where
The English rule for regulating the consequences of frustrated contracts, "stated broadly" in a Massachusetts decision of 1891, was thus "that the loss must remain where it first falls, and that neither of the parties can recover of the other for anything done under the contract." Most American jurisdictions (Massachusetts included) disapproved the English rule, at least where it operated to deny recovery to builders and engineers whose work was interrupted by the destruction of the defendant's premises. The majority American rule clearly favored contractors over owners in these disputes, perhaps because owners were more likely to be insured against the loss; though the courts' reluctance to acknowledge that the fact of insurance had anything to do with the outcome left the reasoning of the opinions somewhat thin. In the minority of American jurisdictions willing to leave these losses where they first fell, both the authority and the reasoning of the English cases were clearly influential.

they fall in the absence of some contractual allocation. The effect of such a default rule is to oblige contracting parties (whether they wish to or not) to allocate for themselves both the identifiable risks of frustration, and the incidence of loss should the contract be frustrated nevertheless. See infra Part III.(C).


114. See Annotation, Who Must Bear the Loss from Destruction of or Damage to Building During Performance of Building Contract, Without Fault of Either Party, 53 A.L.R. 103, 116-28 (1928); authorities cited infra note 118.

115. In Butterfield, for many years the leading American case, a passing remark at the end of the opinion reveals that the real parties in interest were the builder and the owner's insurers. 153 Mass. at 524, 27 N.E. at 669. Butterfield advanced the view that upon the discharge by supervening impossibility of a contract for the construction of a hotel, to which both the owner and the builder were to contribute work and materials, there was "an implied assumpsit for what has properly been done by either of them; the law dealing with it as done at the request of another, and creating a liability to pay for it its value." Id. at 523, 27 N.E. at 669.

116. The leading case for the minority rule is Krause v. Board of Trustees, 162 Ind. 278, 70 N.E. 264 (1904), involving a contract to construct an annex to a building that was later destroyed by fire. On the issue of restitution for the builder's partial performance the Indiana court rejected Butterfield v. Byron in favor of Appleby v. Meyers, approving the following statement from a contemporary treatise: "In a case of this nature, the defendant [owner] receives no benefit, and if he is equally blameless and irresponsible for the accident by which the property is destroyed, why should not the law leave the parties as it finds them, and let each suffer his own loss?" Id. at 296-97, 70 N.E. at 270 (quoting 15 AMERICAN & ENGLISH ENCYCLOPEDIA OF LAW 1090 (2d ed. 1900)). For modern Indiana authority see Hipskind Heating & Plumbing Co. v. General Indus., 136 Ind. App. 647, 194 N.E.2d 733 (1963), transfer denied, 246 Ind. 215, 204 N.E.2d 339 (1965). See also Taulbee v. McCarty, 144 Ky. 199, 137 S.W. 1045 (1911) (contract to raise house and insert new foundation; no recovery for partial performance prior to destruction by casualty); Siegel, Cooper & Co. v. Eaton & Prince Co., 165 Ill. 550, 46 N.E. 449 (1897) (installation of elevator); Brumby v. Smith, 3 Ala. 123 (1841) (carpentry work on a house destroyed by fire); cf. Automobile Ins. Co. v. Model Family Laundries, 133 Conn. 433, 440, 52 A.2d 137, 139 (1947) (denying recovery for storage of fur coat during period prior to destruction of coat by fire).
In nonbuilding cases, where insurance is less obviously a factor, the American decisions on the consequences of frustration offer some pleasing illustrations of the windfall principle. But the overall weight of American authority unquestionably favors a more liberal allowance of restitution to adjust the losses attendant upon frustrated contracts.

Many of the decisions in this category may be reconciled with the windfall principle because they arise in circumstances where the alternative to restitution is prima facie unjust enrichment. It is relatively easy to justify recovery for partial performance of a contract for personal services that has been interrupted by the death of the performing party; or for the value of benefits already conferred when the return performance agreed upon becomes illegal or impossible. By contrast, if the first party to a frustrated contract has conferred a benefit and the second party has partly performed, or has incurred expenses preparatory to performance, the extent of unjust enrichment (if any) will be highly problematic. The windfall principle of the traditional common law resolves this difficulty by denying restitution, leaving the parties to their own allocation of frustration losses through such devices as progress or installment payments. The more liberal, restitutionary tendencies of the modern decisions support a higher degree of judicial intervention, shift-

117. In Shear v. Wright, 60 Mich. 159, 26 N.W. 871 (1886), plaintiff sold a bull calf for $10, of which defendant paid $6 in cash; the balance was payable in the form of breeding services to be performed by the calf when grown. Before this could occur, the calf died. Held, in a suit to recover the $4 balance, that "the contract was released by the impossibility of performance," id. at 161, 26 N.W. at 872, making a homely but accurate analogy to Krell v. Henry. See also Perlee v. Jeffcott, 89 N.J.L. 34, 97 A. 789 (1916) (denying recovery of balance due on an option to purchase a farm, the buildings having been destroyed during the option term, purportedly on the authority of the Coronation Cases). A better and more recent analogy to the Coronation Cases appears in Alabama Football, Inc. v. Wright, 452 F. Supp. 182 (N.D. Tex. 1977), aff'd, 607 F.2d 1004 (5th Cir. 1979). Finding that a professional football contract was frustrated by the failure of the league in which the player was to be employed, the court denied both the employer's claim for restitution of a bonus paid upon the signing of the contract and the player's counterclaim for breach. Id. at 185.

118. See generally 6 CORBIN, supra note 1, §§ 1370-1372; PALMER, supra note 25, § 7.1. The preference for restitution in this context has had the consistent support of the American Law Institute. See RESTATEMENT OF CONTRACTS § 468 (1932); RESTATEMENT OF RESTITUTION § 108(c) (1936); RESTATEMENT (SECOND) OF CONTRACTS § 377 (1979).

119. See PALMER, supra note 25, § 7.7, and cases cited therein.

120. See Louisville & N.R.R. v. Crowe, 156 Ky. 27, 160 S.W. 759 (1913) (railroad promises annual pass for life in exchange for easement; issuance of such passes later prohibited by act of Congress; landowner allowed restitution for value of easement, less value of passes previously issued). For a surprising instance of contrary authority see Gold v. Salem Lutheran Home Ass'n, 53 Cal. 2d 289, 347 P.2d 687, 1 Cal. Rptr. 343 (1959), holding that a contract for lifetime nursing home care (in effect, an annuity) to commence in futuro was not frustrated by the death of the annuitant prior to the commencement date, and therefore that the price paid in advance could not be recovered. Id. at 291-92, 347 P.2d at 689, 1 Cal. Rptr. at 345.
ing losses to achieve a more equitable sharing of burdens by the parties. The question ultimately to be considered is whether this expenditure of judicial resources is worthwhile.

The majority of American jurisdictions have long answered this question in the affirmative. In England, where the contrary answer had deeper support in the cases, formal adherence to the windfall principle was ended by the decision of the House of Lords in *Fibrosa S.A. v. Fairbarn Lawson Combe Barbour, Ltd.*, in which *Chandler v. Webster* was expressly disapproved.

In July 1939, plaintiff, a Polish textile manufacturer, ordered certain flax-hackling machines to be constructed and installed by defendant, an English maker of textile machinery. The contract price was £4,800, c.i.f. Gdynia, payable one-third with order and the balance against shipping documents. Defendant received an initial payment of £1,000 (instead of the £1,600 actually due). In September 1939, after the German invasion of Poland, plaintiff’s agents wrote defendant observing that full performance of the contract had been rendered impossible and requesting the return of the initial payment. Defendant refused, stating that considerable work had already been done on the machines and offering to reconsider the matter after the war. After unsuccessful negotiations, plaintiff brought suit seeking damages for breach of contract, specific performance, or return of the £1,000 previously paid. Defendant’s position was that the contract was frustrated, and that under the rule of *Chandler v. Webster* it was not obligated to repay the money. The trial court’s judgment for defendant on both points was affirmed by the Court of Appeal. Both courts observed that *Chandler v. Webster* was binding authority on the issue of restitution, at least until such time as the House of Lords might “find themselves able to . . . substitute a rule like the more civilized rule of Roman and Scottish law.”

The House of Lords declined to follow *Chandler v. Webster* and ordered restitution of the plaintiff’s down payment, explaining that the facts of the case presented “a typical case of a total failure of considera-

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121. 1943 App. Cas. 32 (1942).
122. Longstanding dissatisfaction with “the Rule in *Chandler v. Webster*”—the rule that “the loss lies where it falls” when a contract is discharged by frustration—was crystallized in 1939 by a report of the Law Revision Committee recommending its abrogation by statute. LAW REVISION COMM., SEVENTH INTERIM REPORT, 1939, Cmd. 6009. The wartime Parliament had as yet taken no action on this proposal when the *Fibrosa* case put the question before the House of Lords.
tion,"124 giving rise to a right of restitution under “ordinary and accepted rules of law.”125 The result, it was acknowledged, did not necessarily do justice to the parties: the defendants would have been obliged to refund the down payment even if they had already expended a greater sum in the course of part performance. The “more civilized rule” that was wanted, in the view of their Lordships, was that judges be authorized to assess the value of performance on either side so as to enforce an equitable composition. In the view of the House of Lords, however, judicial authority to effect any such equitable apportionment could only be conferred by statute.126

The choice made in English law some fifty years ago was thus to replace the rule of the Coronation Cases with the standards of the Law Reform (Frustrated Contracts) Act, 1943.127 The Act provides that if a contract is frustrated, amounts previously paid and the value of other benefits conferred shall be recoverable, subject to possible set-off in respect of expenses incurred and benefits conferred by the other party. The critical determinations and calculations are remitted to the standard of what the court considers just, “having regard to all the circumstances of the case.”128 The charge to do justice under the circumstances is a familiar one to readers of the second Restatement. Indeed, it is the hallmark of a modern law of contracts in which the certainty of expectations essential to private ordering is abandoned in favor of flexible standards, to be applied through judicial discretion in the interest of justice.129

125. Id. at 74 (opinion of Lord Roche). Chandler v. Webster, in this view, was no more than a curious aberration, since “there was never a clearer case [than Chandler v. Webster] of money paid for a consideration which had entirely failed.” Id. at 60 (Lord Macmillan). It has already been suggested that this is not an accurate characterization of Chandler v. Webster, see supra text preceding note 91; a similar objection might be made to the idea that plaintiff Fibrosa received nothing under its contract. Even were it so, to describe Fibrosa as an instance of the “ordinary rule” whereby money previously paid may be recovered upon a “total failure of consideration” puts a questionable gloss on the ordinary rule. Restitution because of “failure of consideration” usually involves a defendant who obtains money in advance and then breaches his contract. See Fibrosa, 1943 App. Cas. at 82-83 (opinion of Lord Porter).
126. See Fibrosa, 1943 App. Cas. at 49-50 (opinion of Viscount Simon, L.C.); id. at 72 (opinion of Lord Wright). Lord Wright was chairman of the Law Revision Committee whose report, supra note 122, recommended legislation to abolish the rule of Chandler v. Webster.
127. 6 & 7 Geo. 6, ch. 40.
128. Id. § 1(2).
129. A striking example of the same general development, applied to the subject matter of the present article, may be seen in the Contractual Mistakes Act 1977, No. 54, N.Z. Stat. 567, extending to cases of “mistake” the approach of the English Frustrated Contracts Act. In order to grant relief under New Zealand’s Contractual Mistakes Act, a court must find, inter alia, that:
The decision by which the House of Lords dismissed Chandler v. Webster scarcely adverted to the fundamental issues involved. Lord Wright nevertheless approached the heart of the matter when, referring to the view that the law of frustration "is explained in theory as a condition or term of the contract implied by the law ab initio," he added the following comment:

I do not see any objection to this mode of expression so long as it is understood that what is implied is what the court thinks the parties ought to have agreed on the basis of what is fair and reasonable, not what as individuals they would or might have agreed. "It is," said Lord Sumner, "irrespective of the individuals concerned, their temperaments and failings, their interest and circumstances." The court is thus taken to assume the rôle of the reasonable man, and decides what the reasonable man would regard as just on the facts of the case. The hypothetical "reasonable man" is personified by the court itself. It is the court which decides.130

The implications of these suggestions carry much further than the decision in Fibrosa or even the Frustrated Contracts Act. Where they lead if taken to an extreme may be seen in a modern decision on commercial impracticability, the celebrated Alcoa case.131 There, the parties entered into a long-term contract by which Alcoa agreed to carry out the smelting or conversion of large volumes of minerals to be supplied by Essex. The price for Alcoa's services was fixed by an elaborate indexing clause. Despite Alcoa's efforts, however, the indexing provision did not satisfactorily reflect increased costs actually experienced; after several profitable years, Alcoa's performance under the contract turned sharply unprofitable.132 Alcoa brought suit for an "equitable modification of the contract price," based on allegations of "mutual mistake of fact, unilat-

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Id. § 6(1)(b). Where relief is authorized, "[t]he Court shall have discretion to make such order as it thinks just." Id. § 7(3).

130. Fibrosa, 1943 App. Cas. at 70-71 (quoting Hirji Mulji v. Cheong Yue Steamship Co., 1926 App. Cas. 497, 510 (P.C.)). Lord Wright's statement reiterated earlier published views. "This whole doctrine of frustration has been described as a reading into the contract of implied terms to give effect to the intention of the parties. It would be truer to say that the Court in the absence of express intention of the parties determines what is just." Lord Wright of Durley, Legal Essays and Addresses 258 (1939).


132. "Beginning in 1973, OPEC actions to increase oil prices and unanticipated pollution control costs greatly increased ALCOA's electricity costs . . . . As a result, ALCOA's produc-
eral mistake of fact, unconscionability, frustration of purpose, and commercial impracticability."\textsuperscript{133}

In view of the careful attention of the parties in Alcoa to the negotiation of a price-indexing term, the claim that the risk of the resulting price disparity was not contractually allocated is difficult to swallow. The court nevertheless so held, finding that Alcoa was "entitled to some form of relief" on the grounds of mutual mistake, impracticability, and frustration of purpose.\textsuperscript{134} On the facts of the case, a finding of excuse on any of these grounds (let alone all three) makes the decision a notable one; but its real interest lies in the remedy ordered by the court.

The usual remedy for mistake or frustration—discharge from the obligation of future performance—was something Alcoa could scarcely ask for. Alcoa’s claim for relief depended on the assertion that the contract as written imposed on it an inequitable burden. Yet performance of the contract to the date of trial, over a period of eleven years, had left Alcoa a substantial net profit.\textsuperscript{135} What Alcoa hoped for was not to discharge the contract, but to make future performance less burdensome. Failing to obtain the other party’s agreement to an amendment, Alcoa asked the court for an "equitable modification."\textsuperscript{136} The court obliged, replacing the price term with a cost-plus formula of its own.\textsuperscript{137}

On the assumption that the contract was in fact frustrated by Alcoa’s increased costs, the relief granted—while innovative—can be justified in terms of the principles advocated by Lord Wright in Fibrosa. If the remedy for frustration is truly to be determined by the court “on the basis of what is fair and reasonable, not what as individuals [the parties] would or might have agreed,”\textsuperscript{139} it is not obvious why that remedy should be limited to discharge, or discharge plus restitution, or even discharge plus restitution plus recovery for reliance expenditures. The resolution costs rose greatly and unforeseeably beyond the indexed increase in the contract price.”\textsuperscript{Alcoa, 499 F. Supp. at 58.}

\textsuperscript{133} Id. at 57. The original term of the contract was fifteen years; Essex had an option to extend for a further five years. The court found that “without judicial relief or economic changes which are not presently foreseeable,” Alcoa stood to lose “in excess of $75,000,000 out of pocket” over the ten remaining years of the extended contract term. Id. at 57-59.

\textsuperscript{134} Id. at 70.

\textsuperscript{135} See id. at 59 (Table I).

\textsuperscript{136} Id. at 57.

\textsuperscript{137} See id. at 78-80.

\textsuperscript{138} To justify the remedy in Alcoa, as did the court, as an instance of contractual “reformation” for mutual mistake is to rewrite the law of the subject. “Reformation is not a proper remedy for the enforcement of terms to which the defendant never assented; it is a remedy the purpose of which is to make a mistaken writing conform to antecedent expressions on which the parties agreed.” 3 CORBIN, supra note 1, § 614.

\textsuperscript{139} Supra note 130.
suit in Alcoa is only remotely a function of the parties' own agreement; but if the court can really write a better contract with the benefit of hindsight, we must decide whether there are persuasive reasons why it should refrain from doing so.

The traditional objection, the "hoary maxim" that courts will not make a contract for the parties, was dismissed in Alcoa as one of the "half-remembered truths and remembered half-truths from the venerated first-year course in Contract Law."140 The author of the opinion, Judge Teitelbaum, insisted that courts can and do make contracts for the parties, and on a proper occasion should do so:

[While the Court willingly concedes that the managements of ALCOA and Essex are better able to conduct their business than is the Court, in this dispute the Court has information from hindsight far superior to that which the parties had when they made their contract. The parties may both be better served by an informed judicial decision based on the known circumstances than by a decision wrenched from words of the contract which were not chosen with a prevision of today's circumstances.]

The comparative advantage of hindsight over foresight makes an extremely powerful claim. By traditional standards it proves too much, since there are few contracts that could not be improved by the courts if "fairness" (with the benefit of hindsight) is accepted as the measure. Yet the fundamental impulse behind the Alcoa decision—the reluctance to entrust serious economic consequences to the parties' imperfect ordering of their future relations—is recognizably the basis of more sophisticated modern arguments for judicial intervention. It is to these arguments that we now turn.

III. The Trouble With "Gap-Filling"

It might reasonably be asked why the law of contracts allows discharge for mistake or frustration in the first place. The doctrine is best explained as a judicial refusal to enforce contracts beyond their original limits.142 Common sense sets limits to a promise, even where contractual language does not. Though a promise is expressed in unqualified terms, a person does not normally mean to bind himself to do the impossible, or to persevere when performance proves to be materially different from

140. Alcoa, 499 F. Supp. at 91.
141. Id.
142. The more traditional view, stemming from Taylor v. Caldwell, would treat the availability of discharge for mistake or frustration as an implied term of the contract. For examples of this theme see the discussion supra note 62 and text accompanying notes 57-62, 101. Once the availability of relief has been judicially announced, it may alternatively be regarded as a common-law "default rule" with reference to which the parties are deemed to contract.
what both parties anticipated at the time of formation. Faced with the adverse consequences of such a disparity, even a person who has previously regarded his promise as unconditional is likely to protest that he never promised to do that. Judges at one time gave this instinctive pleading a Virgilian paraphrase: *non haec in foedera veni*. The force of the implicit claim is hard to deny: I did not mean my promise to extend to this circumstance; nor did you so understand it; to give it that effect would therefore be to enforce a contract different from the one we actually made.

There is an obvious and critical difference between the plea *non haec in foedera veni*—denying one's obligation to perform under the circumstances prevailing—and the claim that the risk of the disparity in question was allocated by contract to the other party. The former entitles a party not to proceed; it takes the latter, however, to found a claim in restitution based on one's performance or part performance of a mistaken or frustrated contract. But the mistaken or frustrated contract results, *ex hypothesi*, from a risk the parties failed to allocate; to assign that risk to either party by legal process would amount to enforcing a contract different from the one that was actually made. If a court is unwilling to do this, it must let the loss from the unallocated risk lie where it falls. In this view, Walker did not agree to deliver Rose 2d if she turned out to be with calf; therefore the law will not compel him to do so. But neither did Boynton agree to make restitution of the topaz if it proved to be a diamond, since the risk of mistake on this point was not allocated to the buyer; nor did Fairbairn agree to refund Fibrosa's initial payment if war should make it impossible to deliver flax-hackling machines. A decision denying restitution in the latter two cases could therefore be adequately explained by a rule forbidding courts to make contracts for the parties.

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143. Aeneas, who has just announced that he is leaving her, protests to the outraged Dido: "*nec coniugis umquam / praetendi taedas, aut haec in foedera veni*" ("but I never said anything about marriage"). *Virgil, Aeneid* iv. 337-39. The phrase appears in judicial opinions to give point to the idea that one is not bound by a promise substantially different from one he has in fact made. "*[A]ny variation in the agreement to which the surety has subscribed ... will discharge the surety, upon the principle of the maxim *non haec in foedera veni*." Smith v. United States, 69 U.S. (2 Wall.) 219, 237 (1865). On the judicial use of this tag see Max Radin, *ergilius Iurisconsultus*, 15 CLASSICAL J. 304 (1920).

144. Recent economic analysis questions whether any rule allowing discharge of contractual obligations for mistake or frustration (as opposed to an unqualified rule of damages for nonperformance) is consistent with efficient risk-bearing by contracting parties. See Sykes, *supra* note 11, at 93; White, *supra* note 11, at 374-76. Assuming the validity of the economic demonstration, however, the argument then is that efficient transactions should be compelled whether or not they are, by traditional standards, the voluntary undertakings of the parties. A requirement of efficient outcomes independent of individual volition might as easily compel efficient transactions between strangers.
Losses or windfall gains will lie where they fall for the simple reason that the parties have not agreed upon an appropriate loss-shifting mechanism and the court has no standards by which to choose one.\(^{145}\)

The windfall result might thus be justified as one consequence, among others, of an absolute requirement that judges cease judging when they reach the boundaries of the parties' agreement—although that agreement will inevitably be incomplete in some respects, more or less significant. There is a substantial theoretical argument to be made in support of such a requirement, rooted in the individualistic tradition that sees the distinctive quality of contractual obligation in the fact that it is self-imposed. Judges do not write contracts for the parties, in this view, not from hoary superstition but because to do so results in the enforcement, presumptively illegitimate, of a nonconsensual exchange.

Modern contract law perceives so many countervailing considerations to the individualistic tradition that the freely negotiated, self-imposed obligation has become a genuine rarity. If the windfall principle depended for its vitality on this absolute conception of freedom of contract it would be of little practical significance. Yet the windfall principle still decides cases; and its insights are highly pertinent to the choice of optimal legal rules for the problems of mistake and frustration. The modern question it poses is whether, in the context of mistake and frustration, judicial intervention to reform or supplement privately negotiated terms has the same justification that it may be conceded to have in the context of other contract disputes. A number of considerations suggest that it does not.

\(^{145}\) The objection is sometimes made that a rule disfavoring judicial intervention cannot serve as a principled basis for resolving these issues because a decision to let the loss lie is itself an intervention. Thus Professor Fried has written that

it is just the point that on the issues in question [the unallocated risks] the parties had no will at all, so that any resolution of the problem is necessarily imposed by the court. In short there has just been an accident, and any resolution of the accident is a kind of judgment, a kind of intervention.

FRIED, supra note 4, at 65. A court asked to hear a lawsuit must issue some sort of order, but there is a manifest difference between an order directing the parties to shift losses and an order declining to do so. The latter is not "intervention," at least in the usual sense, because it leaves undisturbed a distribution of gains and losses produced by chance and by relevant provisions of the parties' agreement, such as the payment terms. The windfall distribution of frustration losses is not something as to which the parties "had no will at all"; it is a function of their agreement and (under a windfall regime) will be the object of more or less conscious bargaining. See the further discussion infra notes 167-170 and accompanying text.
A. The Questionable Significance of the Outcome

By comparison with most disputed issues of contract law, the direct social interest in the outcome of cases of mistake and frustration is relatively slight. The primary justification for devoting public resources to the resolution of contract disputes must be the great social utility derived from the enforcement of enforceable promises; yet here the problem arises precisely because no pertinent promise has been made.

The discovery that a cow thought to be barren is with calf, or that a supposed topaz is a diamond, is a clear gain to society; but whether the property acquires its greater value in the hands of one person or another will normally be a matter of complete social indifference. Neither buyer nor seller has an inherently superior claim to the added value, and the very fact that the entitlement is contested is itself a matter of the purest chance.\textsuperscript{146} There is an obvious social interest in enforcing the parties' own allocation of the benefit, awarding the fertile cow or the diamond to the party who had bargained for the chance of it; but that allocation, ex hypothesi, has not been made. Any step to shift these "windfall" gains from one party to another—sending the sheriff to fetch the cow or to reclaim the diamond—would therefore involve dead-weight social costs that judges rightly choose not to incur.

The incentive to intervene seems stronger if the windfall is a negative quantity, though why this should be so is not entirely clear. That one party to a contract should suffer the whole of a casualty loss is more likely to seem harsh or unfair than that he should enjoy the whole of a windfall gain. Even so, the common law has traditionally viewed the shifting or sharing of losses, in the absence of extrinsic liability, as both unproductive and unjustifiable.\textsuperscript{147} The law has no rules that permit it to order loss-sharing for its own sake, and no standards that would enable it to do so justly.

\textsuperscript{146} Had the new information in either case been available earlier, the disputed bargains would not have been made; were it discovered significantly later, no attempt would be made to avoid either transaction. When an item of property suddenly increases in value, our normal expectation is that the benefit accrues to its owner; when value decreases, the identical (converse) rule is that \textit{res perit domino}. Thus a sudden change in value—windfall or casualty—gives rise to a dispute only when it occurs in awkward proximity to a transfer of ownership. It is a precondition of cases like \textit{Wood} and \textit{Sherwood} that new information affecting value become available between the time of contracting and the time of delivery or, at the latest, promptly after delivery. In the same way, cases of frustration typically arise when new information as to the cost or value of performance becomes available after contract formation but before performance has begun, or else during the course of performance.

\textsuperscript{147} "In general it is not plain that a man's misfortunes or necessities will justify his shifting the damages to his neighbor's shoulders." Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 416 (1922) (Holmes, J.).
Intuitive standards of "fairness" may suggest that a loss be borne by the rich rather than the poor; by the many rather than the few; by both parties to the contract rather than one alone. Such answers have little appeal to most economists, since the same considerations might justify a much broader program of wealth redistribution. The law and economics case for judicial intervention to adjust frustrated contracts has focused instead on what is at best a secondary objective of contract law: the choice of legal rules that will induce efficient risk spreading by contracting parties. Yet the remedy commonly proposed seems incapable of furthering even this relatively modest goal.

B. The Peculiar Intractability of Mistake and Frustration

Arguments in favor of judicial intervention to reform or supplement privately negotiated agreements rest on a number of assertions that are more or less plausible in the context of other issues of contractual interpretation. They fail, or they are at least distinctly less persuasive, when applied to the problem of mistake and frustration. In particular, it is highly unsatisfactory to analyze judicial remedies for mistake and frustration as an instance of the gap-filling function of contract law and interpretation without acknowledging the distinctive quality of these gaps. To the extent that mistake and frustration result from contractual gaps, the way the gaps are formed makes them peculiarly difficult to fill. The usual prescription, which is that courts supply the term the parties would have chosen for themselves were there no transaction costs, is unavailing in this context. Even if the forgone private choice could be identified with confidence, which it cannot, the effect of private choice in this context—the allocation of a risk of disparity—can no longer be achieved ex post, when the risk has already materialized into an economic loss. The law and economics recommendation, that courts reconstruct hypothetical risk allocations by identifying superior risk bearers, affords circums tantial evidence as to the parties' intent but not a remedy for frustrated contracts.

The contrast between the windfall rule of Chandler v. Webster and a rule of judicial intervention to shift losses from frustrated contracts affords a particularly clear illustration of the basic choice to be made in selecting rules by which to interpret contracts. One alternative favors bright-line rules of maximum predictability, which the parties may either contract around or adopt for their own purposes. The other alternative sacrifices the certainty of expectations that facilitates private ordering in favor of ad hoc intervention to serve social goals: in the present context these are likely to be identified as either "fairness" or "efficiency."
choice between private and judicial allocation of losses is very sharply drawn in this context, because the availability of judicial intervention actually destroys the mechanism that makes the private allocation possible. A rule that losses will lie where they fall enables contracting parties to make their own allocation, not only of the risks of potential disparities (thereby avoiding frustration), but of the losses to be incurred should their contract be frustrated by the realization of a risk they neglect (or choose not) to allocate. This private allocation of frustration losses, which is displaced by a rule permitting judicial intervention, is examined more closely in the succeeding section.148

A common presumption sees a contract as "incomplete" if it fails to address specifically any ground of subsequent dispute. All contracts are potentially "incomplete" in this sense, a circumstance that may be explained in terms of transaction costs149 or simple human fallibility. The most common defense of judicial intervention asserts that a court-supplied clause, properly chosen, can rectify an omission by providing the term the parties would have negotiated if they had thought about it.150 So conceived, the judicial role comes very close to enforcing the parties' own agreement rather than writing one for them. The only problem is whether the question of what the parties "would have done" can be reliably answered.

The idea that incomplete contracts result from transaction costs leads to a related conception, that the court's role in dealing with gaps is to design suitable default rules (in the manner of U.C.C. provisions), to govern both the case at bar and future contracts unless varied by express agreement. The standard approach to the choice of default rules recommends that they be those the parties to a typical contract would be most likely to select for themselves. This view looks to the economies to be realized by contracting parties, who will negotiate fewer tailor-made provisions when they may, if they choose, incorporate off-the-rack terms by

148. See infra Part III.C.

149. See Lewis A. Kornhauser, An Introduction to the Economic Analysis of Contract Remedies, 57 U. COLO. L. REV. 683, 691-92 (1986) ("If negotiation were costless, the parties would draft complete contracts that defined the terms of performance under every possible contingency.").

150. "The task for a court asked to apply a contract to a contingency that the parties did not foresee is to imagine how the parties would have provided for the contingency if it had occurred to them to do so." RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 4.1, at 82 (3d ed. 1986). "Ambiguities and gaps in contracts should be resolved by finding what the parties would have bargained for had they addressed the matter explicitly at the time." National Distillers & Chem. Corp. v. First Nat'l Bank, 804 F.2d 978, 982 (7th Cir. 1986) (Easterbrook, J.).
saying nothing at all. But this standard prescription for judicial intervention confronts distinctive difficulties when used to fill the most visible and interesting sort of contractual gaps, those that result in mistaken and frustrated contracts.

The suggestion that a court fill a gap in a contract by supplying the term the parties would have chosen themselves is feasible only if the unanswered question is one that most parties similarly situated would answer the same way most of the time. If the parties have not specified a time for performance, a court serves efficiency goals if, in the absence of contrary indications, it supplies a term calling for performance within a reasonable time. Default terms actually employed by the courts rarely depart from this comfortable level of generalization. But the commonsense reasoning that permits a court to supplement a contract in this manner is powerless to answer the question, incomparably more complex, of how the parties would have allocated the risk of a particular frustrating circumstance that they chose not to address in their agreement.

151. Judge Posner asserts that a function of contract law generally is “to economize on transaction costs by supplying standard contract terms that the parties would otherwise have to adopt by express agreement.” POSNER, supra note 150, § 14.3, at 372. See also Charles J. Goetz & Robert E. Scott, The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms, 73 CAL. L. REV. 261, 270 (1985) (“[A] key purpose of state-supplied terms is to save parties from the necessity of formulating a complete set of express conditions for contingencies that may be difficult to anticipate, or are at least easily overlooked.”); Kornhauser, supra note 149, at 692 (“[T]he efficient gap-filling rule is that rule which most closely corresponds to the term which the majority of bargainers would choose for themselves.”) Anthony T. Kronman, Paternalism and the Law of Contracts, 92 YALE L.J. 763, 766 (1983) (“[L]egally-implied provisions establish a set of ready-made contract terms, and whenever the parties would have included similar provisions in their agreement, they are made better off by being spared the time and expense of having to do so.”). In the Alcoa decision, Judge Teitelbaum defended his readiness to furnish “an appropriate remedy when a prudently drafted long term contract goes badly awry” by urging that parties would otherwise “needlessly suffer the delay and expense of ever more detailed and sophisticated drafting in an attempt to approximate by agreement what the law could readily furnish by general rule.” Aluminum Co. of Am. v. Essex Group, 499 F. Supp. 53, 89 (W.D. Pa. 1980).

A sharply contrasting view of the proper choice of default rules sees them as the means to influence bargaining behavior. The law might impose a “penalty” default rule—a contract term likely to be unacceptable to one or both parties—to govern some incident of the contract as to which specific negotiation was particularly desirable. See Ian Ayres & Robert V. Gertner, Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules, 99 YALE L.J. 87, 95-107 (1989).

152. See U.C.C. § 2-309 (1978). The rule was not, of course, a statutory innovation. See, e.g., Roberts v. Mazepa Mill Co., 30 Minn. 413, 415-16, 15 N.W. 680, 681 (1883).

153. The available evidence suggests that the parties considered the costs of negotiating an allocation of the risk in question to outweigh the benefits. See Clayton P. Gillette, Commercial Rationality and the Duty to Adjust Long-Term Contracts, 69 MINN. L. REV. 521, 336-37 (1985) (“[C]ommercial actors may exclude a risk from their completed contract not because
The seemingly insuperable difficulty of divining the parties' unex-
pressed ex-ante preferences might appear to be resolved if we could iden-
tify a universal principle by which all contracting parties, properly
informed, would choose to allocate those risks of mistake and frustration
not otherwise addressed by their agreement. Thus Posner and Rosenfield
proposed, in a well known article, that judges allocate the risk of a frus-
trating circumstance by assigning it to the party determined to be the
superior risk bearer.154 Because the superior risk bearer is the party who
can bear the risk in question at lower cost, allocation of the risk to him is
in the economic interest of both parties; it is therefore the informed
choice of all parties for all risks.

The relationship between superior risk bearing and risk allocation
provides an important insight, but commentators have not generally been
clear about its implications. Where the difference in the parties' risk-
bearing capacity is sufficiently pronounced, an identification of the supe-
rior risk bearer may enable us to reconstruct an allocation of risks that
was an implicit (i.e., actual and intended) part of their agreement. In-
deed, the idea that risk bearing will serve as a guide to the intent of the
parties appears to have been the principal claim of Posner and Rosen-
field.155 If the owner of a building has insurance covering the value of
repairs or additions while work is in progress, and the builder's interest is
uninsurable, a court might reasonably conclude that the risk of destruc-
tion prior to completion was implicitly allocated to the owner even if his
contract with the builder says nothing about it. But the status of eco-
nomic analysis in this example is merely that of any other circumstantial
evidence as to the parties' intent; and if we can properly identify a con-
tractual allocation of the risk, by inquiring into risk-bearing capacity or
any other evidence, the contract is not frustrated.

the risk was beyond their contemplation but because they considered it and decided that inclu-
sion was not worth the commensurate cost.

154. The "superior (more efficient) risk bearer" is either the party "in a better position to
prevent the risk from materializing" or else the lower-cost insurer. Posner & Rosenfield, supra
note 3, at 90-91.

155. The authors' initial premise is that "the purpose of contract law is to effectuate the
desires of the contracting parties"; in this undertaking "[t]he inquiry [into superior risk bear-
ing] is merely an aid to interpretation." Id. at 89-90. Compare the more recent statement by
Judge Posner that "impossibility and related doctrines are devices for shifting risk in accord-
ance with the parties' presumed intentions." Northern Ind. Pub. Serv. Co. v. Carbon County
Coal Co., 799 F.2d 265, 278 (7th Cir. 1986). In the earlier article, however, the authors draw
no apparent distinction between an allocation of risks that is implicit in the parties' agreement
and an allocation the parties would have made, had they made one. The distinction is critical,
because it marks the difference between a contract that is frustrated and a contract that may be
enforced according to its terms.
The assertion that risk-bearing capacity should influence the choice of remedies for frustrated contracts necessarily implies, therefore, that a judicial allocation to the superior risk bearer can substitute for a contractual allocation the parties did not make for themselves. This contention overlooks the simple but critical fact that the contract comes before the court only after the risk of the allegedly frustrating disparity has materialized. The parties' neglected opportunity to make an ex-ante allocation of risks has been irretrievably lost. Instead, a court confronted with an allegedly frustrated contract (which it may enforce or discharge on whatever terms it chooses) is necessarily limited to an ex-post allocation of losses. Superior risk-bearing capacity does not indicate superior loss-bearing capacity, which by one standard economic premise cannot be determined at all. The very different suggestion that frustration losses be judicially assigned on the explicit basis of loss-bearing capacity draws its assumptions less from microeconomics than from considerations of fairness.

The judicial assignment of frustration losses to superior risk bearers might nevertheless be thought desirable for its influence on future transactions. Because parties in a costless negotiation would assign every risk to the superior risk bearer, a default rule to this effect might appear to permit savings on transaction costs while encouraging the efficient allocation of risks. But compared to the alternatives—one possibility being the rule that the loss lies where it falls—a default rule based on an after-the-fact judicial assessment of risk-bearing capacity is singularly unappealing. Its effect would be to cause parties to assign every risk of a frustrating event, not otherwise allocated by their contract, to that party determined by a court (after the frustration of the contract) to have been the superior risk bearer with respect to that risk. This is an off-the-rack term that no rational contracting party would willingly adopt, given the near impossibility of predicting which party would later be found by the court to have been the superior risk bearer.

156. The assumption that each person's marginal utility of wealth decreases with greater wealth does not permit us to compare the marginal utilities of different people, whatever their respective wealth at the time of comparison. See Alan Schwartz, Sales Law and Inflations, 50 S. Cal. L. Rev. 1, 6-8 (1976) (judicial process unsuited to draw "comparisons respecting relative satisfaction"). The absence of economic criteria for loss-sharing has led a number of commentators to advocate simply that frustration losses be allocated to the parties pro rata. See Dan B. Dobbs, Remedies § 4.5, at 268-69 & n. 24 (1973); Trebikcock, supra note 4.

157. See Roscoe Pound, Introduction to the Philosophy of Law 162-63 (2d ed. 1954) (contrasting the traditional "[b]elief in the obligatory force of contracts and respect for the given word" with "an idea we may see at work in the law of legal liability everywhere . . ., a humanitarian idea of lifting or shifting burdens and losses so as to put them upon those better able to bear them").
court to have been the superior risk bearer with respect to the risk in question.

Risk-bearing capacity is ordinarily understood to include, not merely the parties' relative aversion to risk (in itself a condition that real-world courts can scarcely ascertain), but also their relative capacity to avoid a given risk or to insure against it, by self-insurance or otherwise. These are conditions that depend on the nature of the risk in question, so that the superior risk bearer with respect to a given risk frequently cannot be identified, even theoretically, until the nature of the risk is known. But the function of a default term in this context is to allocate unidentified risks, many of them "unforeseeable" in common parlance. Moreover, even if the nature of certain classes of unidentified risks could be accurately identified in advance, the determination of superior risk-bearing capacity depends on so many additional variables, many of them difficult to establish conclusively, that it will normally be impossible for contracting parties to predict with confidence how a future court might decide the issue. Superior risk-bearing capacity as determined after the fact by judges is therefore a default term that conveys no usable information to the parties; and an uninformative default term cannot be the source of any economies from superior risk spreading.

The imposition of a default term whose effect is uncertain will not reduce transaction costs. On the contrary, it will increase them: parties will attempt to exclude by contract the added uncertainty of unpredictable judicial intervention. Where they fail to do so, the uncertainty of outcomes under any such legal rule will encourage litigation. Nor can a default term yielding unpredictable results produce more efficient risk spreading, since increased efficiencies can only be realized when each party knows which risks he will bear. But it is precisely where a risk-bearing advantage is clear enough to be recognized that the parties are most likely to allocate it as an express or implied term of the contract. Such risks will therefore not be assigned by the default rule, whatever it may be. While the sheer in terrorem effect of an unpredictable default rule would presumably encourage a greater investment by the parties in

158. The essential unpredictability of this determination, even when made by experts, may be observed in the seemingly arbitrary identification of superior risk bearers by Posner and Rosenfield in their discussion of case-law examples. See Posner & Rosenfield, supra note 3, at 100-08.

159. See Sykes, supra note 11, at 72-73 (consequences of "vague and unpredictable rules" for the contracting process include "incompatible expectations about the outcome of dispute resolution").
contractual negotiation and specific risk allocation, this result is not a distinctive advantage of the rule under consideration.160

The same difficulty attends the attempt to construct a default rule allocating the risk of frustration on any other theory of what most parties might otherwise choose to negotiate for themselves. Empirical or "socio logical" data161 will not support any explanation of how parties would normally prefer to assign a class of risks that by definition they do not think it worthwhile to assign to either party. Standards for choosing a default rule that might, at least in theory, be superimposed on the parties' lack of awareness—such as efficiency or fairness, if we could agree on what they required—are incapable of replicating the results of even an idealized ex-ante choice, because the fact of allocation induces changes in ex-ante behavior that cannot be recaptured ex-post. The party who "would have" been allocated the risk of the frustrating event would also have tried to avoid it, or would have purchased insurance against it; and these irretrievable possibilities bring down the hypothetical house of cards. The root of the difficulty is the logical impossibility of accommodating ex-post information without altering the ex-ante world, reminiscent of the problem facing back-to-the-future time-travelers who find themselves powerless to intervene in those events that history has noticed.

It is thus possible to formulate a default rule for the unallocated risk of disparity only if we vary the usual assumption about the function of default rules, which is that they imitate and supplement the private, ex-ante definition of contractual rights and duties. Conceivably, the default rule most parties might prefer (or the rule that society should impose) is one reading as follows: "In the event of the frustration of this agreement, any resulting gains or losses not specifically allocated herein shall be apportioned by a court of competent jurisdiction on such terms as justice may require." This is, in effect, the default rule recommended by the


161. See Richard Craswell, Contract Law, Default Rules, and the Philosophy of Promising, 88 Mich. L. REV. 489, 505-08 (1989) (discussing the possibility of "a sociological inquiry into the actual practices and customs" of contracting parties as a possible source of legitimate "background rules").
Restatement,162 defended by distinguished commentators,163 and applied in a case like Alcoa.164

The propriety or desirability of such a rule can only be determined by comparing its benefits in terms of superior loss-sharing (however these might be defined) to its costs under different headings: the cost to individual freedom of substituting "balancing" for "rule-oriented" methods of resolving disputes;165 and the inefficient inducement to contracting parties to externalize transaction costs that would otherwise be for their own account.166 What is clear, at least, is that such a default rule cannot be justified by the usual efficiency-based analogy to U.C.C. provisions and standard-form contracts. Rather than facilitating the private allocation of risks, it invites contracting parties to opt for a judicial allocation of losses. As we have seen, the latter is no substitute for the former.

C. The Displaced Private Allocation

A legal regime that leaves losses from frustration to lie where they fall—as was clearly understood to be the case in England, from Appleby v. Meyers to Fibrosa—is one under which the parties to any contract allocate two levels of risks. To the extent they think it worthwhile, the parties allocate the risks of various frustrating circumstances, either

162. See Restatement (Second) of Contracts § 272 (1979).
163. See, e.g., Fried, supra note 4, at 69-73.
164. Discussed supra at 36-38.
165. See generally Rizzo, supra note 18. In a recent article, Professor Craswell canvasses the possibility that the choice of "background rules" be made "in favor of the rule that best serves some substantive moral value," such as the value of "individual liberty or autonomy" frequently associated with philosophical justifications of the institution of contract itself. Craswell, supra note 161, at 511, 514-16. He suggests that "autonomy-based theories," which naturally insist that parties be left free to set rules for themselves, are of little help "where the parties have not specified the rule they prefer," since "any default rule would . . . be consistent with individual freedom, as long as the parties are allowed to change the rule by appropriate language." Id. at 515. The observation is made in the context of default rules that supply a substantive term. If the default rule operates instead to relieve the parties of responsibility for determining a given incident of their relationship, substituting judicial intervention as a preferred solution, the infringement of individualistic values seems clear.
166. The allocation of risks is a cost of contracting, whether measured in negotiating expenses or judicial resources. Ordinary economic considerations clearly dictate that this cost be borne by the parties unless the courts enjoy some very significant comparative advantage in performing the task. By requiring the parties to allocate unforeseeable risks for themselves, we cause the decision about the level of resources to be invested in risk allocation to be decided by those persons who have the best information on the subject and who, because they themselves will make the investment, are directly interested in finding the efficient answer to the question. By contrast, a system that permits contracting parties to leave the consequences of frustration to be fixed by the courts encourages them to pass on to society generally what would otherwise be a cost of doing business. If ex-ante and ex-post risk allocation were really equivalent, there would be no justification for allowing the parties to leave the task to the courts.
specifically or through such broad-brush devices as force majeure clauses. Those specific risks that the parties either do not recognize or do not choose to allocate comprise the residual risk that the contract will eventually be frustrated for one reason or another. The risk of frustration, in this sense, is a risk the parties bear jointly. By contrast, the incidence of the loss that may be attendant upon frustration is the subject of a second allocation. Against the background of a default rule that the loss from frustration will be left to lie where it falls, familiar techniques enable the parties to shift or share the incidence of such losses as simply or as elaborately as they choose. If this legal rule is replaced by one under which courts determine the consequences of frustration, the result is not to fill gaps in the contract, but to create them.

The ex-ante allocation of losses from frustration operates chiefly by adjusting the advantage or disadvantage to either party from an unexpected interruption of contractual performance. The basic mechanism for shifting such losses, employed to some extent in most contracts, is simply the payment term: payment in advance versus payment on delivery, with the intermediate possibilities of installment payments, progress payments, and the like, all of which may be made subject to such further conditions as the parties choose. Expressed more generally, the incidence of losses from frustration will be a function of the timing and conditions of each party's obligations to perform. On the facts of Fibrosa, for example, the loss caused by the frustrating event that later discharged the contract had been clearly allocated between the parties as a function of the payment terms. Fractration loss early in the course of performance was assigned entirely to the buyer; frustration loss just before completion was assigned preponderantly to the seller. The allocation was somewhat crude, but that is presumably because the parties saw no advantage in negotiating a more complex one. The contractual devices

167. Posner and Rosenfield note that contractual payment terms serve many purposes "unrelated to the provision of insurance against an event that may prevent completion of performance"; they conclude from this that "there can be no presumption that prepayment is intended to compensate the performing party for the risk of such an event." Posner & Rosenfield, supra note 3, at 116. But the bargaining over a payment term (or any other term of a contract) necessarily comprehends all aspects of the parties' relationship that the term is perceived to affect. To the extent that a contracting party recognizes any possibility of receiving less than the full performance promised to him (the risk of default by the other party will normally loom larger than the risk of frustration), one of several motives in seeking the promised performance sooner rather than later will inevitably be to protect himself against an interruption of performance before completion.

168. Buyer was to pay one-third with the order and the balance against shipping documents. See Fibrosa S.A. v. Fairbairn Lawson Combe Barbour, Ltd., 1943 App. Cas. 32, 34 (1942).

169. The allocation might easily have been cruder still, assigning the whole risk of frustra-
for allocating such losses are intuitively understood and limited only by the energies of draftsmen. They can and will be refined as far as the parties deem appropriate. 170

The residual allocation of frustration losses produced by these devices in the context of a windfall rule is neither artificial nor arbitrary. It is a result chosen by the parties, not in the tautological sense that it is demonstrably a function of a privately chosen term but in a broader sense that allows us to describe its consequences as consciously self-imposed. In real-world negotiation, the possibility of frustration may be remote from the minds of the parties, but the risk of interrupted performance (presumably from the other party's default) is ever present. The parties are also well aware that the courts provide no effective relief for most contractual defaults. A's realistic expectation is therefore that, in the event B ceases to perform and the parties are unable to negotiate a settlement, A's best recourse will frequently be to walk away from the deal without seeking or obtaining judicial intervention. Should such an event come to pass, the circumstances of the parties will be precisely the same as if their contract had been interrupted by frustration under a legal regime denying judicial intervention. In everyday negotiation, therefore, each party seeks to shift the incidence of the same kinds of losses as those resulting from a frustrated contract, using devices designed to safeguard against the consequences of default. The greater the possibility of B's ceasing to perform, the more strongly A will bargain to receive B's performance before his own is due. The contractual allocation of potential frustration losses is not only theoretically possible, it is effectively being made all the time. 171

170. A variety of "ex ante allocational devices" suggested by Professor Gillette might be available to supplement the performance-based devices considered in the text. See Gillette, supra note 153, at 559-67.

171. Compare Professor Goldberg's observations on the significance of payment terms: Prepayment should not be viewed as mere happenstance. . . . Contracting parties might find any particular contingency too remote to worry about. Nonetheless, a sensible rule for them to adopt is that there are a large number of reasons why a particular contract might not be completed and one way to protect one's interests is to assure that at each point in time, the performance rendered and compensation received are not too far out of whack. By ordering restitution or attempting an independent assessment of reliance losses, courts undo the balancing of interests achieved by the parties.

Goldberg, supra note 10, at 113-14 (footnote omitted).
The possibility of a comprehensive ex-ante allocation of frustration risks—one that includes both the risk of various frustrating circumstances and the incidence of loss should the contract nevertheless be frustrated—depends on the courts’ refusal to shift those losses when they occur. Conversely, it is only by holding out the promise of judicial intervention to adjust losses *ex aequo et bono* that courts relieve the parties of the need to address the distribution of these losses in the context of their agreement. A rule that losses lie where they fall actually compels the parties to allocate such losses ex-ante, including losses from risks described as “unforeseeable”; while a rule permitting judicial intervention and loss sharing makes it impossible for them to do so.

Discussing the problem of mistake and frustration—which he sees as requiring an exception to an autonomy-based theory of contractual obligation—Professor Fried writes that “[t]he court cannot enforce the will of the parties because there are no concordant wills. Judgment must therefore be based on principles external to the will of the parties.” But if we deny judicial intervention to adjust the consequences of frustration, Fried’s conclusion does not follow. When it is perceived that the incidence of frustration losses is a function of something so central to the bargain, and so consciously negotiated, as the timing and conditions of each party’s obligations to perform, and that the parties have limitless freedom to adjust and qualify that incidence as they see fit, it can hardly be maintained that any adjustment of frustration losses is necessarily based on “principles external to the will of the parties.” Because the insistence on private, ex-ante allocation provides what is at least a coherent alternative, the argument for judicial intervention to adjust these losses must stand on its own merits.

When a court formulates a restitutionary or loss-sharing remedy for a frustrated contract, the suggestion that it is enforcing the contract the parties would have made is no more than a polite fiction. The reconstruction of an ex-ante allocation of risks is an impossible task, and the true answer to that hypothetical question is not what the court is looking for anyway. The distribution of losses that the court finds undesirable, thereby justifying its decision to intervene, is frequently the direct result of the contract the parties did in fact make. Thus the frustration loss in

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172. FRIED, supra note 4, at 60.

173. Parties who negotiate the allocation of remote risks do not always agree to share them equitably. Accurate disposition of these losses on the basis of clauses that parties “would have written” might therefore impose crippling losses on parties who “would have” agreed to bear what they judged (correctly or otherwise) to be trivial risks in exchange for some more immediate advantage in negotiation.
Fibrosa was assigned entirely to the buyer (assuming the seller was made whole by the retention of the initial payment) by terms of the contract that, though implied, were clear and unequivocal. The anticipated loss in Alcoa looks very much as if it was assigned to the plaintiff by an elaborately negotiated pricing clause—a clause that contained no protection against the resulting disparity because the plaintiff considered that risk too remote to warrant drafting against. The problem in either case is not that a loss was not allocated by the parties but that the results of that allocation proved unacceptable in the view of the court.

The judicial allocation of frustration losses ex-post does not derive from contractual obligation, but rather supplants it. The loss is adjusted, not (as in contract) as a function of the parties' self-interested calculations and luck, but according to external standards that may include simple fairness, or a "principle of sharing," or the avoidance of injustice, or other concerns more frankly paternalistic:

Corporate managers are fiduciaries. Law, founded on good sense, requires them to act with care in the management of businesses owned by other people. . . . Courts must consider the fiduciary duty of management and the established practice of risk limitation in interpreting contracts and in the application of contract doctrines such as mistake, frustration and impracticability. Corporate managers should not gamble with corporate funds. . . . Courts should not presume that they do, nor should they frame rules founded on such a presumption.

The idea here is that contracts are too important to be left to the parties.

174. The complex price term in Alcoa was drafted by the plaintiff for its own protection: ALCOA's management was equally attentive to risk limitation. They went so far as to retain the noted economist Dr. Alan Greenspan as a consultant to advise them on the drafting of an objective pricing formula. They selected the [index] as a pricing element for this long term contract only after they assured themselves that it had closely tracked ALCOA's non-labor production costs for many years in the past and was highly likely to continue to do so in the future. In the context of the formation of the contract, it is untenable to argue that ALCOA implicitly or expressly assumed a limitless, if highly improbable, risk. On this record, the absence of an express floor limitation can only be understood to imply that the parties deemed the risk too remote and their meaning too clear to trifle with additional negotiation and drafting.

Aluminum Co. of Am. v. Essex Group, 499 F. Supp. 53, 69 (W.D. Pa. 1980) (emphasis added). By its very plausible reconstruction of the circumstances of the negotiation, the court refutes its own contention that Alcoa could not have assumed a large (not limitless), "highly improbable" risk. On the contrary, that is precisely what Alcoa appears to have done.

175. See FRIED, supra note 4, at 70-73.


178. For a more measured discussion of the argument for judicial adjustment of frustration losses to protect third parties, see Gillette, supra note 153, at 582-85.
The argument for judicial intervention frequently regards the parties to a frustrated contract as if they were joint victims of a contractual accident, with no more opportunity to adjust losses by prior agreement than the parties to an automobile accident. In the absence of any other guiding principle, it follows that their losses should be adjusted in the interests of fairness, loss splitting, and the public interest generally. The windfall rule that would let such losses lie denies that any of these interests may be confidently served except by the enforcement of freely negotiated bargains. The choice is ultimately a moral and political one, between rules that require people to provide for themselves and rules that permit judges to intervene when people do not provide for themselves well enough. The old cases supporting the windfall principle rest on a conception of individual autonomy and responsibility that at many points does not square with modern assumptions. They serve to remind us nevertheless that the powers of private ex-ante allocation may be greater, and those of ex-post judicial allocation may be less, than is currently recognized even in the law and economics commentary on the subject.

IV. Conclusion

The contract doctrines of “mutual mistake” and “frustration” (including impossibility, commercial impracticability, and so forth) are attempts to deal with a single problem: the inevitable disparity between the terms of an exchange as contemplated by the parties at the moment of contract formation and the terms of the same exchange as subsequently perceived in the light of additional information. The various tests by which courts purport to grant or withhold rescission on these grounds may be reduced to a single inquiry: whether the risk of the disparity complained of was expressly or impliedly allocated by the contract.

Once that determination has been made, the focus shifts to what has been the concern of this Article: what it is that courts actually do when they encounter what they take to be an unallocated disparity. A wide range of cases, arising in the various contexts of mutual mistake and frustration, suggests that the characteristic response of our courts is to confirm the parties in statu quo, granting relief to neither. Rescission for mistake is thus granted or denied depending on whether the contract is

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179. “Sharing applies where there are no rights to respect. It is the principle that would apply if a group of us were to land together on some new planet. It is peculiarly appropriate to filling the gaps in agreements, to picking up after contractual accidents.” FRIED, supra note 4, at 71 (footnote omitted).
executory or executed. Applied to the problem of partial performance, the windfall principle embodies the former English rule that losses from frustrated contracts will lie where they fall. The English courts' adoption and subsequent rejection of an explicit windfall rule to govern these cases, seen in the light of more recent decisions, serves to identify the outer limits of the windfall principle in modern law and, conversely, the limits of present-day judicial forbearance.

Substantial case law supporting the old proposition that "the loss lies where it falls" reminds us that losses from "contractual accidents" may be effectively allocated by means other than judicial intervention. A legal rule foreclosing intervention not only permits, it actually obliges the parties to allocate the incidence of loss from frustration as a function of their ex-ante negotiation. Conversely, the mere possibility of ex-post judicial intervention to reform or supplement their private agreement makes it impossible for them to do so.

While the law and economics commentary has been notably sympathetic to judicial intervention in this context, the usual efficiency-based arguments do not withstand examination. No set of judicially imposed default rules can usefully allocate unidentified risks; nor can judges do anything to optimize risk spreading by their ex-post reallocation of losses. Approaching the problem from a different perspective, those commentators who set a high value on contractual fairness at least need make no theoretical apology for supporting judicial intervention to pick up and redistribute the pieces after a "contractual accident." But such a procedure is extremely expensive, and the value of the additional fairness is difficult to measure. One of the costs, in what must inevitably be a very complex accounting, is the loss of another kind of fairness: the fairness that exists whenever the outcome of a private transaction is exclusively a function of the parties' voluntary agreement.