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EXTENDING GOOD FAITH: DOES THE U.C.C. IMPOSE A DUTY OF GOOD FAITH NEGOTIATION UNDER CHANGED CIRCUMSTANCES?

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This Article will consider whether the courts have been overly rigid in their application of Uniform Commercial Code ("U.C.C." or the "Code") section 2-615¹ to situations where unexpected changes have rendered continued performance of a contract severely onerous for one party. Courts have imposed stringent requirements, particularly with respect to the unforeseeability of contingencies, before granting relief based on "commercial impracticability."²

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¹ U.C.C. § 2-615 (1978). Section 2-615 provides in pertinent part:

Except so far as a seller may have assumed a greater obligation . . . :

(a) Delay in delivery or non-delivery in whole or in part by a seller . . . is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.

Id. Although section 2-615 refers only to sellers, the protection of commercial impracticability is available to buyers as well. *See, e.g., International Minerals & Chem. Corp. v. Llano, Inc.*, 770 F.2d 879 (10th Cir. 1985), *cert. denied*, 106 S. Ct. 1196 (1986).

² *See infra* note 7 and accompanying text. Commercial impracticability under U.C.C. section 2-615 is analogous to common law concepts of "impossibility of performance" and "frustration of purpose," but distinguishable by "the commercial character of the criterion" utilized in the Code. U.C.C. § 2-615 official comment 3 (1978). *See infra* notes 4-6 and accompanying text (discussion of common law).

Section 2-615 appears to provide an "all or nothing" remedy: either performance is excused, or performance must be rendered despite increased severity. It has been argued that the U.C.C. should be interpreted to impose a good faith duty to negotiate a modification when an unanticipated event, beyond the control of either party, renders performance unduly burdensome.³

I. COMMERCIAL IMPRACTICABILITY UNDER THE CODE

At common law, when parties entered into a contract on the assumption that a certain thing or condition, essential to performance, would continue to be available, and neither party assumed the duty to insure its continued availability, the contract was conditioned on the continued existence of the thing or condition.⁴ If the condition failed, the parties were excused from performance.⁵

Under section 2-615, a party may be excused from performance if the performance has been rendered impracticable by the occurrence of a contingency, the non-occurrence of which was a basic assumption on which the contract was made. Thus, with some semantic differences, the U.C.C. has carried forward the common law basis for impossibility of performance—failure of an essential implied condition.⁶ The major obstacle facing a party seeking relief

³ See *infra* notes 10-15 and accompanying text (discussion of implied obligation of good faith).

⁴ *Texas Co. v. Hogarth Shipping Co.*, 256 U.S. 619, 629-30 (1921). Under English common law, parties were generally bound to perform in spite of changed circumstances. See *Paradine v. Jane*, 82 Eng. Rep. 897 (1647). However, certain circumstances would excuse performance. See, e.g., *Williams v. Lloyd*, 82 Eng. Rep. 95 (1629) (act of God); *Hyde v. Dean of Windsor*, 78 Eng. Rep. 798 (1597) (death of promisor); *Abbot of Westminster v. Clerke*, 73 Eng. Rep. 59 (1536). See also *Steers v. Leonard*, 20 Minn. 494 (1874) (early enunciation of American common law rule); *Taylor v. Caldwell*, 122 Eng. Rep. 309 (K.B. 1863) (common law doctrine of impossibility fully elaborated).

⁵ See *Texas Co.*, 256 U.S. at 629-30.

⁶ See *Aluminum Co. of America v. Essex Group, Inc.*, 499 F. Supp. 53, 73 (W.D. Pa. 1980). It has been noted that the Code does not speak in terms of assumption of risk by the promisor. E. FARNSWORTH, *CONTRACTS* § 9.6 (1982). Professor Farnsworth indicated that in order for performance to be excused under the Code, four conditions must be met: performance as agreed must be impracticable; the parties must have entered the contract with the basic assumption that the event which has occurred would not occur; the party seeking relief must be blameless; and the promisor must not have assumed a greater obligation than the law requires. *Id.*

Although section 2-615 avoids the language of risk assumption, it is still for the promisor to agree to bear the consequences of unforeseen events. A promisor can commit himself to doing the impossible, so long as he is aware of the factors which will make performance impossible and agrees to bear the risk that they might exist. See *RESTATEMENT (SECOND) OF CONTRACTS* § 261 comment a (1981); U.C.C. § 2-615 official comment 8 (1978).

because of commercial impracticability is the difficulty of showing that a contingency has occurred, "the non-occurrence of which was a basic assumption on which the contract was made."

Even where the burden is clearly excessive and the event unexpected, courts will seldom find the occurrence unforeseeable in the business setting. Wars, embargoes and governmental restrictions have all been declared "foreseeable" events, although they occurred years after execution of the contracts.⁷ Though the cost of buying and selling may escalate dramatically, the U.C.C. provides little remedy as currently interpreted.⁸ In fact, courts have held that, unless the agreement provides to the contrary, the promisor is presumed to have agreed to bear the risk of most contingencies, and to absorb any loss occasioned by unforeseen events.⁹ Consequently, there has been a tendency to draft long-term contracts which feature inflation fighting escalation clauses, tax adjustment provisions, and security against technological obsolescence, in addition to years of assured product delivery.

⁷ See *American Trading & Prod. Co. v. Shell Int'l Marine, Ltd.*, 453 F.2d 939 (2d Cir. 1972) (war); *Transatlantic Fin. Corp. v. United States*, 353 F.2d 312 (D.C. Cir. 1966) (same); *Missouri Pub. Serv. Co. v. Peabody Coal Co.*, 583 S.W.2d 721 (Mo. Ct. App.) (Arab oil embargo of 1973), *cert. denied*, 444 U.S. 865 (1979); *Security Sewage Equip. Co. v. McFerrer*, 14 Ohio St. 2d 251, 237 N.E.2d 898 (1968) (governmental action in rejection of plans for plant by department of health).

The closing of the Suez Canal because of war in the Middle East generated much litigation and increased shipping costs. See, e.g., *Transatlantic*, 363 F.2d 312; *American Trading*, 453 F.2d 939. Despite the fact that the parties had contemplated use of the Suez route, shipowners were not entitled to additional costs incurred in sailing around the Cape of Good Hope. See *Transatlantic*, 363 F.2d at 319-20. See generally Birmingham, *A Second Look at the Suez Canal Cases: Excuse for Nonperformance of Contractual Obligations in the Light of Economic Theory*, 20 HASTINGS L.J. 1393 (1969).

⁸ See U.C.C. § 2-615 official comment 4 (1978). The comment provides: "Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of performance." *Id.* See also *In re Westinghouse Elec. Corp. Uranium Contracts Litig.*: *Florida Power & Light Co. v. Westinghouse Elec. Corp.*, 517 F. Supp. 440 (E.D. Va. 1981). Westinghouse lost the ability to reprocess nuclear fuel after factoring the sale of reprocessed fuel into the price on a long-term supply contract for uranium. *Id.* at 449. See generally Eagan, *The Westinghouse Uranium Contracts: Commercial Impracticability and Related Matters*, 18 AM. BUS. L.J. 281 (1980) (analysis of litigation arising out of Westinghouse's refusal to deliver 70 million pounds of uranium under 27 fixed price contracts). *But see* *Aluminum Co. of America v. Essex Group, Inc.*, 499 F. Supp. 53, 74-76 (W.D. Pa. 1980) (sale of services case where Article 2 inapplicable, discussing § 2-615 and suggesting that greatly increased cost to seller is dispositive factor); *Mineral Parkland Co. v. Howard*, 172 Cal. 289, 156 P. 458 (1916) (pre-Code court declared duty to continue excavation of gravel at prohibitive cost discharged).

⁹ See *Northern Ind. Pub. Serv. Co. v. Carbon County Coal Co.*, 799 F.2d 265, 278 (7th Cir. 1986); *Eastern Air Lines v. McDonnell Douglas Corp.*, 532 F.2d 957, 991-92 (5th Cir. 1976).

II. DOES THE U.C.C. PROVIDE THE REMEDY OF REQUIRED NEGOTIATION?

Given the judiciary's penchant for finding drastic market price increases, wars, and technological difficulties to be foreseeable events, what are the victims of these catastrophes to do? Does the U.C.C.'s implied obligation of good faith and fair dealing in accordance with reasonable commercial standards¹⁰ require at least good faith negotiation toward modification? Official comment 6 to U.C.C. section 2-615 seems to imply an affirmative answer: "In situations in which neither sense nor justice is served by either answer when the issue is posed in flat terms of 'excuse' or 'no excuse,' *adjustment under the various provisions of this Article is necessary, especially the sections on good faith . . .*"¹¹

Two cases have directly considered this argument, while a third has done so indirectly. In the first case, *Missouri Public Service Co. v. Peabody Coal Co.*,¹² the defendant argued that the plaintiff had acted in bad faith by refusing to accede to price modifications when the price escalation provision in their contract failed to track inflation and the defendant faced greatly increased costs.¹³ The court rejected the defendant's theory, reasoning that "[w]here an enforceable, untainted contract exists, refusing modification of price and seeking specific performance of valid covenants does not constitute bad faith or breach of contract . . ."¹⁴

In the second case considering this argument directly, *Louisiana Power & Light Co. v. Allegheny Ludlum Industries*,¹⁵ the defendant relied on sharp price increases for raw materials and increased labor costs to establish a basis for commercial impracticability.¹⁶ As an additional defense, the defendant claimed that the refusal of the plaintiff to even consider a modification

¹⁰ See U.C.C. § 2-103(1)(b) (1978). This section provides: " 'Good faith' in the case of a merchant means honesty in fact and observance of reasonable commercial standards of fair dealing in the trade." *Id.* Comment 7 to section 2-615 cites commercial good faith as the basis to meet new conditions which go to convenience or collateral values, rather than to the commercial practicability of the main performance. See U.C.C. § 2-615 official comment 7 (1978).

¹¹ U.C.C. § 2-615 official comment 6 (1978) (emphasis added).

¹² 583 S.W.2d 721 (Mo. Ct. App.), *cert. denied*, 444 U.S. 865 (1979).

¹³ *Id.* at 724.

¹⁴ *Id.* at 725.

¹⁵ 517 F. Supp. 1319 (E.D. La. 1981).

¹⁶ *Id.* at 1324.

constituted bad faith.¹⁷ Rejecting the "duty to negotiate" theory in summary fashion, the court stated that "[t]here is no obligation imposed under law which would have required LP&L to engage in renegotiation or even discuss renegotiation of its contract. . . ."¹⁸

Most recently, the Court of Appeals of Idaho, in *Lawrance v. Elmore Bean Warehouse, Inc.*,¹⁹ while not directly presented with the "duty to negotiate" theory, chose to dismiss it *sub silentio*. In language well suited for the present consideration, the court, *sua sponte*, rejected on policy grounds any obligation to modify fixed price contracts for reasons not meeting the criteria of commercial impracticability:

The tough stance we are taking in this case is in view of the fact that virtually all contracts which are based upon a fixed price could be subject to modification if a change in the market price would occur. Interpreting the law as appellant suggests would invite countless suits by speculators in the market as well as by persons merely disappointed in their bargains. Few contractual agreements would be secure. As stated in comment 4 to I.C. § 28-2-615, an increase or decrease in prices, even a radical change, is just the thing that fixed price contracts are designed to protect against.²⁰

As these cases illustrate, the courts to date have refused to read official comment 6 to impose a duty to negotiate good faith modifications under drastically changed circumstances. The result is that the parties are left with the rigid "excuse" or "no excuse" alternatives which, it has been suggested, the U.C.C. was intended to mitigate.²¹

III. SHOULD THE U.C.C. BE READ TO REQUIRE A DUTY TO NEGOTIATE MODIFICATIONS?

The court in *Lawrance v. Elmore Bean Warehouse, Inc.* feared that any relaxation in the interpretation of U.C.C. section 2-615 "would invite countless suits by speculators in the market as

¹⁷ *Id.* at 1329.

¹⁸ *Id.*

¹⁹ 108 Idaho 892, 702 P.2d 930 (1985).

²⁰ *Id.* at 894, 702 P.2d at 933.

²¹ See U.C.C. § 2-615 official comment 6 (1978). See generally Wallach, *The Excuse Defense in the Law of Contracts: Judicial Frustration of the U.C.C. Attempt to Liberalize the Law of Commercial Impracticability*, 55 NOTRE DAME LAW. 203 (1979) (analysis of judicial barriers to impracticability defense).

well as by persons merely disappointed in their bargains."²² The major loosening of section 2-615 would be the replacement of the strict foreseeability rule with a standard of reasonable anticipation at the time of contracting. Where that reasonable anticipation is upended by severe and unexpected changes, commercial good faith would require an attempt to negotiate a modification.

While the current judicial approach sometimes produces harsh results, it is suggested that the existing authority should be followed. Reading a required duty to negotiate into the U.C.C. would destabilize commercial relations, particularly with respect to how parties allocate risk and handle anticipatory repudiations, and is, therefore, undesirable.

A. *The Concept of Risk Allocation Would Be Undermined*

In a business setting, the parties to a contract are presumed to have a high degree of awareness concerning the currents that may affect their trade.²³ Requiring the promisor to bear the burden of changed circumstances, unless unforeseeable, affords a clear bargaining standard and forces the parties to be vigilant at the time of contracting.

B. *The Concept of Anticipatory Repudiation Would Be Severely Weakened*

U.C.C. section 2-610 permits a party to cease performance and bring an immediate action for damages when there is a repudiation.²⁴ A repudiation consists of an overt communication of intention, or an action which renders performance impossible or demon-

²² 108 Idaho at 895, 702 P.2d at 933.

²³ See *United States v. Wegematic Corp.*, 360 F.2d 674 (2d Cir. 1966). When Wegematic was unable to deliver a computer system to the Federal Reserve Board because it failed to develop the required technology, the Government sued for damages. *Id.* at 675. The court stated: "We see no basis for thinking that when an electronics system is promoted by its manufacturer as a revolutionary breakthrough, the risk of the revolution's occurrence falls on the purchaser . . ." *Id.* at 676. It is reasonable to assume that, either the breakthrough has already occurred, or that the manufacturer is in a position to assure the purchaser that it will occur. See *id.*

²⁴ U.C.C. § 2-610 (1978). This section provides in pertinent part:

When either party repudiates the contract . . . the aggrieved party may

(a) for a commercially reasonable time await performance. . .

(b) resort to any remedy for breach . . .

(c) in either case suspend his own performance. . . .

Id.

strates a clear determination not to continue performance.²⁶ A mistaken interpretation of the contract does not constitute repudiation.²⁶ The party must manifest a clear and unequivocal intention not to perform in accordance with any interpretation but his own, or refuse to recognize the contractual requirements when informed of his error.²⁷

Under current law it is not a repudiation to request additional performance²⁸ or to indicate inability to perform.²⁹ If the U.C.C. imposed a duty of good faith negotiation, any party could decline to continue performance on the basis of changed conditions until negotiations were completed. By framing the refusal to perform in terms of allegiance to the results of negotiation, the promisee could be held at bay indefinitely with little right to rely on the anticipatory repudiation provisions.³⁰

IV. CONCLUSION

Negotiated modifications resulting from changed conditions are common place in the commercial arena. The party requesting modification will often use the leverage of withholding delivery or payment to buttress his request against the threat of suit for breach.³¹ At least one court has described this as a "fair method of

²⁶ See U.C.C. § 2-610 official comment 1 (1978).

²⁶ See *Commonwealth Edison Co. v. Decker Coal Co.*, 612 F. Supp. 978 (N.D. Ill. 1985). "A party that briefly errs in interpreting a contract while manifesting an intention to abide by its terms cannot be said to have clearly and unequivocally repudiated the contract." *Id.* at 982. See also 4 A. CORBIN, CORBIN ON CONTRACTS § 973 (1951 & Supp. 1984) (no breach unless repudiation definite and unequivocal).

²⁷ See *Commonwealth Edison Co.*, 612 F. Supp. at 982. *But see Unique Sys. v. Zotos Int'l*, 622 F.2d 373 (8th Cir. 1980) (buyer's insistence, without contractual right, on postponing purchases until an extensive market survey could be conducted amounted to anticipatory repudiation).

²⁸ See *Tenavision, Inc. v. Neuman*, 45 N.Y.2d 145, 379 N.E.2d 1166, 408 N.Y.S.2d 36 (1978) (unauthorized request by seller for a UCC-1 financing statement as a condition to delivery insufficient to constitute anticipatory repudiation).

²⁹ See *Phenix Nat'l Bank v. Waterbury*, 197 N.Y. 161, 90 N.E. 435 (1910) (discharge in bankruptcy not a repudiation of contract). However, under U.C.C. section 2-609, if one party has sufficient reason to doubt the other's ability to perform, he may be entitled to adequate assurances. See U.C.C. § 2-609 (1978); see generally 4 A. CORBIN, *supra* note 26, § 974.

³⁰ See *Louisiana Power & Light Co. v. Allegheny Ludlum Indus.*, 517 F. Supp. 1319, 1326 (E.D. La. 1981). If parties were able to hide behind commercial impracticability, "every seller or buyer caught in a burdensome position . . . would find it hard to resist the natural temptation to compel renegotiation of unprofitable contracts. . . ." *Id.*

³¹ See, e.g., *United States ex rel. Crane Co. v. Progressive Enter.*, 418 F. Supp. 662, 664 (E.D. Va. 1976) (sole supplier of equipment needed to meet obligation under secondary gov-

doing business in order to preserve the desirability of the relationship."³²

Given the difficulty of distinguishing economic blackmailers from the victims of unanticipated changes, it is submitted that stability in commercial contracts will best be served by leaving the parties with the terms of their bargains and recourse to the ample arsenal of U.C.C. provisions aimed at achieving an equitable outcome.

ernment contract demanded higher price than agreed upon from buyer).

³² *Id.*