

Fordham Law School

## FLASH: The Fordham Law Archive of Scholarship and History

---

Faculty Scholarship

---

2022

### Retrospective Risk Allocation

Aditi Bagchi

Follow this and additional works at: [https://ir.lawnet.fordham.edu/faculty\\_scholarship](https://ir.lawnet.fordham.edu/faculty_scholarship)



Part of the [Law Commons](#)

---

# RETROSPECTIVE RISK ALLOCATION

ADITI BAGCHI\*

## I

### INTRODUCTION

The COVID-19 pandemic presented many contracting parties with new problems. One basic question many parties faced was whether either or both parties were excused from performance, and if so, for how long and with what consequence for the other party. Some contracts were clear about how pandemic-related risks were allocated between the parties. But most contracts were not as clear because there was little indication to parties that detailed drafting would be worthwhile. Thus, even if a contract included a force majeure clause or a material adverse change clause, it might not have specified criteria sufficient to decide whether a party could walk away from a contract altogether, merely suspend performance temporarily, which dates of 2020 and 2021 qualified as “pandemic dates,” or whether refunds were due for prepaid goods or services.

However novel and unexpected the circumstances of the pandemic, courts have long been in the business of assigning risk to contracting parties after the fact. In theory, courts need only read the contract and enforce the risk allocation to which the parties themselves committed. In order to decide whether a party is excused from performance or entitled to restitution, courts might look to a contractual clause. But often the clause does not unambiguously state the respective entitlements of the parties. The court must interpret the clause to decide whether it excuses performance or not. Absent a clause aiming to assign pandemic risks, the court can rely on the doctrine of impracticability. Whether performance is excused because of changed circumstances will raise the same questions about how the parties intended to allocate risk.

In practice, the vast majority of suits settle out of court. For this reason, we do not yet have a developed “pandemic” caselaw revealing how courts will assign risk. However, we can expect that courts are called upon to resolve disputes when it is unclear how the contract assigns risk or whether the pandemic renders performance impracticable and the parties are unable to negotiate a resolution on their own. Again, in principle, courts can rely on the standard toolbox for interpretation. Besides close reading of the relevant text and how it fits into the structure of the agreement as a whole, in the event of ambiguity, courts can consider extrinsic evidence indicating how parties in the industry might have

---

Copyright © 2022 by Aditi Bagchi.

This Article is also available online at <http://lcp.law.duke.edu/>.

\* Professor of Law at Fordham University. Many thanks to Mark Gergen for his comments about an earlier draft of this article. Thanks to Jonathan Lipson and Rachel Rebouché for inviting me to participate in this symposium, and for their comments as well.

expected risk to be allocated, or how the parties at hand envisioned the contingency would be handled. Alas, even this expanded set of tools does not always clearly answer how parties expected risk to be allocated or to what they agreed with respect to risk allocation.

Without decipherable direction from the parties, courts enter the realm of reconstructing the bargain on hypothetical terms. Without direct evidence of the parties' intentions, courts ask what the parties would have done. This question is itself ambiguous. The question could turn on a reconstruction of the bargain struck by these particular parties or by similarly situated parties. And the question might turn on what cognitively limited, i.e., actual parties might have done, or it might speculate about the choices of rational people under conditions of uncertainty.<sup>1</sup>

Many scholars and courts would ask what the most reasonable allocation would have been, on the assumption that this is equivalent to asking what similarly situated parties would have rationally chosen to do. That inquiry turns on several factors, including which party is in a better position to prevent losses, bear losses, and assess or insure against potential losses *ex ante*. Parties may submit evidence to assist the court in arriving at a "reasonable" risk allocation, but there is no determinate method at this stage either.

Courts—not to mention litigants and prospective litigants—could use more clarity on how to best assign risk to parties after the fact when the contract does not speak unambiguously. In this article, I do not attempt to resolve all the present uncertainties, but I ask two questions that the recent pandemic makes especially salient. First, *should courts consider some facts unavailable to parties at the time of contract but which plausibly would have altered their contract design?* I will argue that they should take new information into account. I focus on a particular use that new information might serve—realizing a principle of risk-sharing implicit in contracts with respect to unassigned risks. The pandemic and the problems it created for contracting parties helps to show how courts are situated to vindicate risk-sharing in ways that are implied but cannot be fully detailed by parties at the time of contract with respect to poorly conceived contingencies. Risk-sharing should be operationalized differently in hindsight than at the drafting stage because many, if not most, parties would want courts to use information that has come to light in the course of performance.

The power of hindsight poses a second question for courts. *Should courts consider public policy pursued by regulators during or after an unforeseen contingency like the pandemic?* I will argue that they should do so only sparingly. Paradoxically, courts should be less attentive to public policy enacted after a

---

1. See David Charny, *Hypothetical Bargains: The Normative Structure of Contract Interpretation*, 89 MICH. L. REV. 1815, 1821 (1991) (“[T]here are four approaches to hypothetical bargains along these dimensions: I: choose the best rule for this transaction type (general and idealizing); II: choose the rule that *these particular parties* most likely would have negotiated to (particular and nonidealizing); III: choose the rule that parties in this situation would have chosen if they were rational and perfectly informed (particular and idealizing); IV: choose the rule that parties to this transaction type would most likely choose in the general run of situations (general and nonidealizing).”).

contingency has arisen that does not squarely address how an agreement should be enforced. While courts obviously should enforce any new statutes or regulations that impose boundaries on contracts, in the context of interpretation, courts should be more attentive to public policy *predating* the crisis. It is more appropriate for courts to flexibly decipher regulatory norms drafted without specific knowledge of the relevant contingency because regulators could not have enacted rules more clearly on point.

The article will proceed as follows. Part II will describe the current state of doctrine and scholarly understanding as to how courts allocate risk between parties, especially when a written agreement does not address the matter clearly. Part III will address the first question posed above and argue that courts should give parties the benefit of hindsight rather than retrench their ignorance of future contingencies. I turn to the second question above in Part IV, arguing that courts should be more flexible in their application of pre-pandemic regulatory constraints than in their application of post-pandemic public policy.

## II

### ASSIGNING CONTRACTUAL RISK

Courts assign risk in at least two ways. First, courts interpret ambiguous terms that do not clearly assign risk on their face. Second, when there is no clause purporting to assign risk, courts apply background doctrines that can excuse a party from performance. Several doctrines might serve that function. I will focus on impracticability, which excuses a party when its performance is not feasible.<sup>2</sup> Impossibility is functionally identical except that it purports to hold the party seeking relief to the higher bar of actual impossibility. Frustration of purpose excuses a party who can no longer attain the benefit that motivated the contract for her.<sup>3</sup> Mistake can also excuse a party if a “basic assumption” turns out to be false and renders the contract unduly burdensome.<sup>4</sup> Risk allocation in the context of contract interpretation and excuse turn out not to be so different in many cases.

Interpretation of contract language, on the one hand, and application of background doctrines like impracticability, on the other, *can* follow quite distinct analytic paths if parties have drafted language that can meaningfully steer the

---

2. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 261 (AM. L. INST. 1981) [hereinafter RESTATEMENT] (“Where, after a contract is made, a party’s performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.”).

3. See, e.g., *id.* § 265 (“Where, after a contract is made, a party’s principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary.”).

4. See, e.g., *id.* § 152 (“(1) Where a mistake of both parties at the time a contract was made as to a basic assumption on which the contract was made has a material effect on the agreed exchange of performances, the contract is voidable by the adversely affected party unless he bears the risk of the mistake under the rule stated in § 154.”).

court. That is, contract language expressly listing the contingency at issue as one excusing a party from performance could give the court useful direction. When parties have clearly indicated that one set of contingencies has been assigned to the buyer and another set to the seller, courts rarely have grounds to resist the bargain freely made. But parties often do not attempt to assign risks in this way. Even when there is some attempt to direct certain categories of risk in one direction or another, textual risk allocations are frequently—and foreseeably—ambiguous as to exactly what should happen in the event things go wrong.

This is because even force majeure clauses and material adverse change clauses leave considerable room for uncertainty. The pandemic might well qualify as an “Act of God” under many force majeure clauses.<sup>5</sup> But it is not always clear at which point a party qualified. The pandemic raged across the globe, and even within the United States, differently. Parties could be located in regions with limited direct public health crises but still suffer from effects of the pandemic on upstream suppliers. It is not obvious that a supply disruption that involves a pandemic somewhere on earth qualifies under a force majeure clause any more than a hurricane that affects a supplier, but not a contracting party directly, excuses the contracting party. Moreover, the time parameters of the pandemic are unclear. For some readers, the pandemic is ongoing. For others, it ended with the lifting of a local mask mandate. There is no clear duration—certainly not one specified by any reference to a pandemic in an agreement. A force majeure clause might also be ambiguous because it does not make clear whether its effect is to suspend a performance obligation or entitle a party to walk away from an agreement completely. No doubt, there are other potential ambiguities not contemplated here.

Going forward, it is conceivable that parties will include language addressing more specifically what each party’s rights and obligations will be in a variety of scenarios involving a public health crisis. But after September 11, 2001, parties did not begin consistently to detail their obligations under a variety of scenarios involving terrorism. While parties might be more likely to list terrorism as a qualifying event under a force majeure clause—or to carve it out of a material adverse effect clause—contract language rarely attempts to give complete direction to courts. If there is one lesson to derive from events like September 11 or the recent pandemic, it is that we cannot contemplate all the ways in which a general contingency like “terrorism” or “pandemic” will affect us, and it is not worth trying.<sup>6</sup> The transactional costs of detailed drafting will not pay off; they may even backfire if they preempt judicial reasoning about risk allocation with

---

5. Andrew A. Schwartz, *Contracts and COVID-19*, 73 STAN. L. REV. ONLINE 48, 58 (2020) (predicting that the “pandemic will likely qualify as Act of God” under force majeure clauses), <https://www.stanfordlawreview.org/online/contracts-and-covid-19/> [<https://perma.cc/FXP9-GF9E>].

6. See Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1092 (1981) (“In conventional contracts, the parties generally are able to reduce performance standards to rather specific obligations. By contrast, relational contracts create unique, interdependent relationships, wherein unknown contingencies or the intricacy of the required responses may prevent the specification of precise performance standards.”).

directions from the parties that do not apply as the parties intended.

Parties behaved reasonably when they did not draft contracts pre-COVID-19 that anticipated the potential losses associated with COVID-19. It will be reasonable if they fail to do so in the future. No doubt some parties will undertake to be very precise about which losses each party will bear in a variety of scenarios. In other cases, it will be up to courts to interpret ambiguous clauses and assign the risks associated with a given contingency among the parties. But if the parties have not directed the court as to how risks should be allocated, and there is no evidence clarifying their background assumptions, how will courts proceed?<sup>7</sup> The standard account by now is that the court should attempt to reconstruct the bargain made by the parties, filling in gaps left by the parties. Some scholars suggest that courts do and should assume, in this reconstruction exercise, that parties allocated the risk to the superior risk bearer.<sup>8</sup> The recommended exercise asks how parties would have assigned a risk if they had foreseen the particular risk that materialized. It does not ask how parties would have allocated that particular risk if they had anticipated the infinite *range* of risks their actual agreement failed to address. Because the way parties handle one kind of risk might turn on how they handle others, these two exercises could not be expected consistently to deliver the same result. I return to this point in Part III.

Identifying the superior risk bearer lies at the heart of impracticability analyses as well.<sup>9</sup> Initially, impossibility or impracticability appears to turn on foreseeability.<sup>10</sup> But the foreseeability analysis does not get one far. Most

---

7. See, e.g., Leon E. Trakman, *Winner Take Some: Loss Sharing and Commercial Impracticability*, 69 MINN. L. REV. 471, 478 (1985) (arguing against the assignment of loss to one party based on “fictions in the ‘construction’ of contractual intention” since courts “cannot determine realistically what the ‘basic assumptions’ of the parties were at the time of contracting.”).

8. See, e.g., Jody P. Kraus & Robert E. Scott, *The Case Against Equity in American Contract Law*, 93 S. CAL. L. REV. 1323, 1341 (2020) (“Based on the parties’ presumed intent to maximize the expected value of their contracts, courts assigned to the promisor, by default, the risks associated with any performance under the contract, because courts implicitly presumed that the promisor was better able to reduce the expected losses caused by unanticipated contingencies.”); Jim Rossi, *The Common Law “Duty to Serve” and Protection of Consumers in an Age of Competitive Retail Public Utility Restructuring*, 51 VAND. L. REV. 1233, 1271 (1998) (describing the use of superior risk-bearer analysis in the context of enforcing utility agreements).

9. See Christopher J. Bruce, *An Economic Analysis of the Impossibility Doctrine*, 11 J. LEGAL STUD. 311, 312 (1982) (“[L]iability should be placed on that party which could have obtained insurance against the costs of nonperformance at the lesser cost.”). *But see* Daniel T. Ostas, *Postmodern Economic Analysis of Law: Extending the Pragmatic Visions of Richard A. Posner*, 36 AM. BUS. L.J. 193, 234–35 (1998) (outlining the practical difficulties of determining which party can bear risk more efficiently); Sheldon W. Halpern, *Application of the Doctrine of Commercial Impracticability: Searching for the “Wisdom of Solomon”*, 135 U. PA. L. REV. 1123, 1160–61 (1987) (“One must question whether the parties themselves, let alone the courts, are equipped to make an analysis of the efficiency-relevant circumstances as they existed at the inception of the transaction. Such an analysis would seem to amount to little more than conjecture when used to determine how the parties would have handled the risk of the disruptive event had they been aware of it.”); Shirley R. Brener, *Outgrowing Impossibility: Examining the Impossibility Doctrine in the Wake of Hurricane Katrina*, 56 EMORY L.J. 461, 473–74, 493–94 (2006) (noting that, in reality, it may be unclear which party can efficiently bear risk, if any).

10. See *Waldinger Corp. v. CRS Grp. Eng’rs, Inc., Clark Dietz Div.*, 775 F.2d 781, 786 (7th Cir. 1985) (“The applicability of the defense of commercial impracticability, then, turns largely on foreseeability.”);

contingencies can be cast in a way that is foreseeable in some sense. Certainly, most of the contingencies that are commonly the basis for impracticability, such as fire or natural disasters, are foreseeable in that parties know they can happen.<sup>11</sup> A pandemic is similarly foreseeable at this level of generality. But while the parties may be able to foresee the contingency itself, they cannot foresee the myriad ways in which it might disrupt the performance or value of the contract for each party.

Since thinking in terms of foreseeability does not help us to identify the situations when a party should be excused, legal economists in particular have recommended the same solution that courts are invited to apply in the context of interpretation, when guidance from parties has run out. Richard Posner and Andrew Rosenfield argued that the superior risk bearer should be assigned risk by default in the context of impracticability as well. The superior risk bearer is the party that can efficiently prevent or mitigate harm, or at least insure against it. She can better insure either because she can appraise risk or because she faces lower transaction costs, including an ability to diversify and thereby pool risk.<sup>12</sup> In principle, the doctrine only operates when there is no evidence of party intent, so it does not excuse parties when there is reason to think that the parties intended to be held to performance. Of course, the license to speculate about risk allocation can be abused and some scholars are skeptical that courts are so parsimonious in practice.<sup>13</sup> In theory, though, courts rely on their judgment about optimal risk allocation only when the parties are silent. Again, courts at this point attempt to identify the superior risk bearer on the assumption that the parties would have allocated the risk to that party if they had known it was worth assigning the risk and its attendant losses.<sup>14</sup> The doctrine does not produce consistent results because, in reality, it is not easy to know who the superior risk

---

Bank of Am., N.A. v. Shelbourne Dev. Grp., Inc., 732 F. Supp. 2d 809, 827 (N.D. Ill. 2010) (“The viability of this affirmative defense depends on whether the economic downturn was foreseeable.”); E. Capitol View Cmty. Dev. Corp., Inc. v. Robinson, 941 A.2d 1036, 1039 n.5 (D.C. 2008) (“(2) the circumstances which made performance impossible were not reasonably foreseeable at the time the contract was made.”); Kel Kim Corp. v. Cent. Mkts., Inc., 519 N.E.2d 295, 296 (N.Y. 1987) (citing 407 E. 61st Garage, Inc. v. Savoy Fifth Ave. Corp., 244 N.E.2d 37, 42 (N.Y. 1968); Ogdensburg Urb. Renewal Agency v. Moroney, 345 N.Y.S.2d 169, 171 (N.Y. App. Div. 1973) (“[T]he impossibility must be produced by an unanticipated event that could not have been foreseen or guarded against in the contract.”)).

11. See John D. Wladis, *Impracticability as Risk Allocation: Changed Circumstances upon Contract Obligations for the Sale of Goods*, 22 GA. L. REV. 503, 576 (1988) (describing the “limited view of contractual risk assumption intended to be adopted by section 2-615” as encompassing only contingencies that are “virtually certain to occur”).

12. See Richard A. Posner & Andrew M. Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83, 91–92 (1977).

13. See Kraus & Scott, *supra* note 8, at 1328 (“[E]x post doctrines rest on the premise that enforcing agreements according to the parties’ intent at formation can be individually unjust, even if the parties agreed to them under free and fair conditions.”); Thomas R. Hurst, *Freedom of Contract in an Unstable Economy: Judicial Reallocation of Contractual Risks Under UCC. 2-615*, 54 N.C. L. REV. 545, 549 (1976) (arguing that the impossibility of performance provisions of the U.C.C. give courts too much discretion in deciding whether to ‘excuse’ performance).

14. See RESTATEMENT, *supra* note 2, § 154 (“A party bears the risk of mistake when . . . (c) the risk is allocated to him by the court on the ground that it is reasonable in the circumstances to do so.”).

bearer is even in hindsight.<sup>15</sup> The exercise is even more speculative at the moment of contract formation.

### III

#### RISK ALLOCATION IN HINDSIGHT

Speculating subsequent to disaster about how parties should have assigned risk before disaster ensued is a backward-looking exercise, and it carries the risks typical of one. We generally consider it a risk of retrospective judgments that they incorporate information people did not have when they made the relevant choices. Even when a plane crashes, we know that getting on the plane was not really a bad choice, as long as there was no advance indication that it would crash. If a person crosses the street at an intersection relying on a walk signal alone, we might fault her more than we should because we now know a car came barreling around the turn without respecting her right of way.

Should we similarly worry about courts taking into account information about contingencies a contract did not fully address, including whether those contingencies actually materialized? At first blush, this appears analogous. Courts should not be judging parties' drafting based on information unavailable to the parties. In fact, many contracts would be bizarre and incoherent if all subsequent facts had been known at the time of drafting. Many contracts are intended precisely to allocate the risk of future events; if there was no uncertainty about those events, there would be no reason to enter the agreement.

I will argue, however, that we should be careful not to conflate hindsight bias and *hindsight learning*. While contracts are usually driven by parties' interest in managing certain uncertainties, they are not intended to manage all uncertainties; reading them with some knowledge that the parties themselves did not have does not always make them incoherent. On the contrary, reading contracts with hindsight can make them more sensible.

#### A. Reconstructing The Bargain, Not The Term

Courts are not in the business of judging parties' drafting practices. When those practices provide insufficient direction about what the parties owe each other, the court effectively supplements their drafting by supplying a default. The relevant question is thus whether parties would want the court to take into account information they did not have in assigning risk between parties. Is this a case of potential hindsight bias, or a case of potentially granting the parties a

---

15. See Mark P. Gergen, *A Defense of Judicial Reconstruction of Contracts*, 71 IND. L.J. 45, 53 (1995) (“[R]espectable authority exists for the conflicting positions that excuse is automatic or, contrastingly, rare if” neither the parties nor the law allocated an unforeseeable risk.); see also *id.* at 54 (“The usual economic argument for the impracticability doctrine, which is to allocate the risk of a loss to the best loss avoider or best insurer, is unpersuasive because excuse is too uncertain in such cases for the doctrine to positively influence the parties’ behavior in taking precautions against risk.”). While at least part of the problem is that courts do not consistently and expressly attempt to identify the superior risk bearer, the analysis for identifying the superior risk bearer does not direct to a clear answer in many cases.



second-best version of their inevitable wish that they had known more and earlier?

It will depend on the type of information at issue. But there is at least some information a court can use to achieve the risk distribution the parties contemplated in ways that the parties could not have done at formation. When parties are silent about the assignment of a risk, courts cannot infer that parties would have wanted to assign the risk to one party at all.<sup>16</sup> On the contrary, if risk is truly unassigned, it is left in common. This is less surprising when we consider that, while the court concerns itself with the *one* materialized risk, unassigned risks actually comprise a substantial pool of risks. Some of those risks will fall in the first instance on one party's head, while others will fall into the lap of the other party. Leaving an unspecified and probably only dimly conceived set of risks unassigned effectively shares exposure. One could read the equitable distribution of risk as fleeting. Perhaps parties wished for an equitable distribution of risk just as parties to a coin toss only wish the coin toss to be conducted fairly but fully anticipate the winner will take all. But people do not ordinarily use coin tosses to manage consequential affairs. The more plausible default reading should be that parties want to evenly divide dimly perceived risk.<sup>17</sup> Once risk has materialized, attempting to carve the mud cake equitably between the parties actualizes the sharing norm better than allowing it to sit with one party. Assigning an unassigned risk to one party unjustifiably converts one drop in a common risk pool into a calamity for one party and a potential windfall for the other.

Certainly, this is not true of all risks. Some risks are not only better borne by one party, but the parties *know it*. If the parties know that risk is most cheaply borne by one party and assign it to her, the court need not resist. Indeed, if the court is confident that the parties should have known that a risk was best borne by one party, the risk should be assigned to her. More generally, risk-sharing is proffered here only as a default that applies absent a reliable basis for assigning a particular risk to one party or the other. But it is not enough for a court to conclude that one party is probably the superior risk-bearer. In many, if not most

---

16. See Subha Narasimhan, *Of Expectations, Incomplete Contracting, and the Bargain Principle*, 74 CALIF. L. REV. 1123, 1124–25 (1986) (“Enforcing unallocated obligations is a redistributive act by the courts, which may be used to further a variety of public goals, but does not contribute to achieving the goals of the bargain principle.”); Andrew Kull, *Mistake, Frustration, and the Windfall Principle of Contract Remedies*, 43 HASTINGS L.J. 1, 6 (1991) (“[I]f 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.”); Robert A. Hillman, *Court Adjustment of Long-Term Contracts: An Analysis Under Modern Contract Law*, 1987 DUKE L.J. 1, 15 (1987) (“If parties explicitly or implicitly agree not to deal with such a problem because it is too remote, too costly to provide for, or too likely to upset the deal, there is little reason based on the agreement for placing the risk solely on either party.”).

17. See Robert E. Scott, *Conflict and Cooperation in Long-Term Contracts*, 75 CALIF. L. REV. 2005, 2019 (1987) (“If the contingency is truly ‘unforeseeable,’ such that its probabilities or its effects cannot be assessed, then a risk-sharing rule generally will be preferred to either extreme of excuse or strict performance . . .”).

cases, the various factors that speak to optimal risk allocation cut in different directions, and while there might be a truth of the matter, the parties were not in a position to know how best to manage certain risks. Even if courts were to muddle through the speculative and indeterminate exercise of identifying the optimal risk-bearer, a judge's conclusions about that narrow question can give her no confidence that the parties' allocation would not have been different had they assigned any or all of the myriad of other risks that the court does not have cause to assign retroactively.

Consider a three-year supply contract for 100 widgets per month at the price of \$100 per month. In mid-March 2020, the widget supplier is no longer able to operate its factory. But the Buyer uses widgets to produce outdoor furniture and, beginning in June 2020, experiences a surge in demand. Other buyers with which Seller is in contract, however, use its widgets for production that is likewise halted or delayed and no longer wish to buy from Seller. Those other buyers come to an amicable resolution with Seller to cancel their agreements. However, the Buyer in this contract wants its widgets more than ever. It would be prepared to pay a premium for widgets—either to seller or another supplier—but Seller is unable to secure a workforce in order to produce, and Buyer cannot secure supply from an alternative widget manufacturer at less than twice the contract price.

The contract between Seller and Buyer contains a generic force majeure clause that relieves seller of liability for any delay in delivery that is the result of a pandemic. Buyer argues, however, that there were only two nonfatal cases of COVID-19 in the region in which Seller's factory was located and that there was no government directive limiting the factory's operation until May 1. The May 1 government order that applied to Seller did not prohibit operation; it merely required that it operate at 25% capacity. Thus, Buyer argues that Seller should have met all delivery obligations until May 1 and should have delivered goods with some delay after that date and throughout the summer. The government directive limiting the factory's operation was lifted on August 30, so Buyer further argues that Seller should have resumed timely deliveries beginning in September. Finally, Buyer argues that the force majeure clause only excuses Seller for late delivery. Buyer claims Seller is liable for normal damages in the event of failure to deliver altogether, and that delay beyond a reasonable period qualifies as breach.

Seller argues that most of its employees were unwilling to report to work, and it therefore had to operate below 25% capacity from March 2020 to date. Seller argues it was in any event within its rights to adjust its operation as it saw fit on health grounds. After all, Seller points out, there were thousands of cases of COVID-19 in the state and the nation was clearly in a state of emergency, irrespective of local public health conditions. Moreover, Seller argues that if it met the requirements of the force majeure clause at any point, the contract was cancelled at that time and it has no duty to resume deliveries at a later point without negotiation of a new contract.

Let us assume that direct communications between Seller and Buyer do not shed light on how they would have answered the question of whether and when Seller was excused from delivery, and whether Seller remains under any ongoing duty to Buyer to supply widgets. What kinds of questions might a court ask to decide whether Seller was excused from supplying to Buyer and for how long? As the literature on impracticability advises, the question of foreseeability, which is sometimes thought to anchor the inquiry, does not get us far. It is clear that there is some sense in which the parties understood that a pandemic was possible, inasmuch as they processed the standard language that they employed in their force majeure clause. It is also likely that the parties did not foresee how the pandemic would affect each of them, i.e., that it would result in a surge in Buyer's demand and a sharp decline in Seller's supply.

A court might then turn to the question of which party was in a better position to bear the risk. It does not appear on the stipulated facts that either party was in a position to prevent or mitigate the disruptions resulting from the pandemic—there was no reason to think that Seller should have, for example, automated production to a higher degree, or that Buyer should have vertically integrated to ensure its own widget supply. These precautions have many implications separate from their effect on COVID-19-related risks; those other effects overwhelm COVID-19-related considerations. Assuming they are the best available precautions, they are too far-fetched for the court to set out to motivate them by way of *ex post* contract interpretation.

Without reliable information about the potential effects of a pandemic, it is also unlikely that either party could efficiently insure against its prospective harms to their business. At least, there is no reason to think one party can insure better than the other. There is, in fact, probably not much party conduct either at the time of contract or over the course of performance that warrants a judicial incentive or disincentive. The relevant conduct that the court might shape is actually *ex post* conduct, that is, conduct after the pandemic has struck.

In particular, courts might consciously facilitate renegotiation. Renegotiation can harness parties' knowledge of possibilities going forward and their respective valuations of those possibilities. Renegotiation *also* allows a more equitable assignment of losses than the binary choice of finding excuse or no excuse. In reality, the finding of excuse or no excuse is not wholly binary because the court could find that Seller is liable for some but not all the damages that Buyer seeks.<sup>18</sup> Such a finding would be arbitrary, though, if motivated solely by a desire to force the parties to share losses. Under prevailing doctrine, the court's allocation should be grounded in some analysis of how the parties would have wanted the losses to be distributed *ex ante* if they had anticipated the events that transpired

---

18. See, e.g., *In re Hitz Rest. Grp.*, 616 B.R. 374, 378–79 (Bankr. N.D. Ill. 2020) (pro-rating rent to reflect that the restaurant was not permitted to offer dining services but could still operate delivery and take-out); see also Trakman, *supra* note 7, at 484 (“Questions concerning the permissible extent of relief should therefore be resolved by deciding the proportions in which each party should assume responsibility for the ultimate loss.”).

down the road. A court that concludes that the parties implicitly intended a risk to be shared must apply the impracticability doctrine; read a force majeure clause in novel fashion to avoid directing all the losses to one party; or otherwise offer temporary relief in the form of a stay.

A court can more nimbly achieve risk-sharing by encouraging renegotiation. While the behind-the-scenes details of ongoing pandemic litigation are difficult to uncover systematically, the slow speed and unpredictable quality of court adjudication of pandemic-related disputes might actually achieve that result. Courts could more directly encourage negotiated risk-sharing by making clear that they will consider the same array of *ex post* facts that parties bring to renegotiation, including, for example, the magnitude of losses or profits incurred by each party, even when those do not plausibly explain the meaning of any contract term.

Again, reconstruction inevitably involves taking into account some facts of which the parties were unaware at the time of contract. After all, no one proposes that courts attempt to reconstruct a complete bargain including merely the risk allocation at issue. That is, theoretically, the court could attempt to make a more complete bargain for parties assigning *all* kinds of risks the parties failed to assign, including ones never materialized. Of course, in practice, the court only answers the question it must answer; it only attends to risks that, with the benefit of hindsight, it knows to have materialized.

We should worry that assigning only this particular risk skews the allocation. After all, it might be that the most efficient allocation assigns one set of risks to the buyer and another to the seller not because either is the superior risk-bearer for her assigned risks but because the parties are comparably situated to manage those risks, and splitting them down the middle is the cheapest from a drafting perspective. (Consider, for example, language that allows either party to seek a 7-day extension.) It is unlikely that parties would be so symmetrically situated *vis-à-vis* a range of risks. But it is entirely likely that neither parties nor courts would have information sufficient to know which party is the superior risk bearer and how much each should be willing to pay to avoid various risks. The apparently arbitrary but at least even-handed manner of handling prospective risk through default sharing is not implausible once overarching epistemic constraints are taken into account. Equal division of risks *per se* is not a method open to the court, however, because it has no occasion to assign a large set of prospective risks. The court cannot divide up the risks after the fact as if it were attempting to complete the contract instead of filling a particular gap. Instead, the court is forced to undertake the speculative exercise of identifying the superior risk bearer with respect to the one materialized risk, an exercise the parties declined to undertake even if they contemplated and sought to manage a given set of risks.

Turning back to the hypothetical, the court is in the unenviable position of assigning the risk if a national public health emergency impairs Seller's supply while Buyer faces increased demand and is not prepared to release Seller—an

exercise I have suggested is necessary only because it operates *ex post*. In July 2021, should the court consider that the pandemic has lasted fifteen months and may continue in some form? Should the court consider that vaccines became widely available in spring 2021 and federal agencies issued guidance permitting employers like Seller to require vaccination among their employees? Should the court factor in that other domestic sellers began manufacturing widgets at pre-pandemic rates by November 2021 or that international shipments of widgets remain heavily delayed?

Yes—the answers to all these questions inform the reasonable resolution of the dispute between Buyer and Seller. Using those facts allows hindsight learning; it does not introduce hindsight bias. Those facts inform, for example, the magnitude of the risk to Seller of being held to the terms of the original contract, and the risk to Buyer of Seller walking away from the contract. They inform the alternatives available to Buyer. A court might be more likely to release Seller from the agreement in light of the duration of the pandemic or Buyer's access to new supplies over time. Or a court might be less likely to release Seller from the agreement since other suppliers have managed to resume operations, perhaps by requiring vaccination of their employees. Because none of these facts were available to parties at the time of contract, it is almost inconceivable that parties would plan at such a granular level. The parties did not contemplate one way or the other how these details would inform their respective rights under the agreement. The court can benefit the parties by striking a more nuanced balance than the parties plausibly could have struck *ex ante*.

## B. Encouraging Renegotiation

One might argue instead that the best way to take advantage of the new information available is for the parties themselves to arrive at a negotiated solution. That is true. As suggested above, the courts might make successful renegotiation more likely if their decision criteria better track the driving considerations in such negotiations. The prospects of successful renegotiation are enhanced when parties can expect courts to impose risk-sharing because it narrows the bargaining range that the parties must ultimately close.

Courts could go further and impose a duty to bargain in good faith.<sup>19</sup> This would be a startling departure from existing doctrine, not only in the context of impracticability, but also in contract law more broadly. There is a delimited set of contexts in which private parties are subject to a duty to negotiate in good faith, such as in the context of collective bargaining, bankruptcy, and connections between telecommunication systems. In ordinary contracts, the duty is recognized only when the parties assumed it themselves through contract. Should courts operationalize risk-sharing by reading ambiguous contract conditions as giving rise to a duty to negotiate resolution in good faith? The implication would be that parties intended to assume a duty to renegotiate in the event of

---

19. Thanks to Mark Gergen for this suggestion.

unforeseen contingencies.

While there is much to like about such a proposal, the costs of imposing a duty to negotiate in good faith in exigent circumstances probably exceed the expected gains. While private renegotiation is often desirable, courts are often tasked with assigning the risk *ex post* precisely because the transactions costs of negotiating a resolution are sometimes very high. Parties are not only locked in bilateral monopoly with respect to the renegotiation, but they may face a substantial bargaining range due to the magnitude of the shock, even while the bargaining parameters remain hazy because the shock is ongoing and unprecedented. Should the court require the parties to negotiate in good faith, they would force those transactions costs onto parties without ensuring any payoff by way of a superior resolution; after all, bargaining regularly fails even when subject to a duty to bargain in good faith. If the parties are poised for successful negotiation, they are already well-motivated to succeed in light of litigation costs, including error costs. The court might attempt to minimize bargaining costs altogether by imposing a clear and predictable decision rule that clearly favors one party over the other. But such a resolution encourages negotiation without risk-sharing. When there is no superior risk bearer whose conduct should be adjusted *ex ante*, risk-sharing is not only desirable,<sup>20</sup> but is *in the spirit of the actual agreement that left risks unassigned*. Only a decision rule that the parties anticipate will carve up the risks among the parties encourages the parties to undertake such carving by their own hands, by way of a negotiated settlement, without forcing the costs of negotiation even where it is likely to fail.

Again, if parties could have identified all the risks they faced *ex ante* with specificity, they might have shared risk by dividing risks between the parties. In many cases, this is just what they do. For some well-understood or sufficiently probable risks, parties work out which party will bear losses, and courts should respect their allocation. Some other risks are so obviously properly assigned to one party that it is plausible the allocation was assumed in fact; in these cases, too, courts should abide by parties' expectations.<sup>21</sup> But there are plenty of risks parties do not assign, and it is implausible to imagine that they did. Probably

---

20. It might be that risk-sharing is a worthy principle independent of whether the parties appeared to have intended it. *See* Gergen, *supra* note 15, at 55 (articulating and defending principle of "loss alignment"). In this article, I defend a risk-sharing default as an interpretation of contractual silence, or the absence of a clear allocation of a given risk to one party rather than the other. Moderating the losses associated with one materialized risk is the *ex post* counterpart to *ex ante* silence about a set of risks.

21. My argument is that equitable risk-sharing in hindsight looks different from and properly takes a different form than the risk-sharing implied by contractual silence. It suggests that courts should realize risk-sharing through a resolution that divides losses between the parties through entitlements which can be adjusted through negotiation. Robert Hillman argues that parties are subject to an affirmative duty to adjust to unexpected contingencies. His position is conceptually and functionally distinct. *See* Hillman, *supra* note 16, at 17 ("In a gap situation, where the parties' agreement does not justify a refusal to adjust and where both parties have strong contradictory interests, it would be better to recognize a duty to adjust and enforce the duty through appropriate remedies."). I do not argue that there is a duty to adjust, only that as a matter of reconstruction, a pool of unidentified and unassigned risks properly translates into sharing one fully realized risk from within that set, with the benefit of hindsight.

because they cannot identify such risks or do not find it worthwhile to try, parties leave a set of unspecified risks in a common pool, a kind of space in limbo. By the time one of those risks materializes and the obligations of the parties must be settled by a court, risk sharing can no longer take that form of pooling. To achieve the risk sharing implied by parties through their silence, courts should divide the losses associated with the one realized contingency between the parties.

In the hypothetical above, the court might excuse Seller entirely through November 2021 and then hold Seller accountable for all damages accrued after. Alternatively, the court could plausibly excuse Seller for delays through November 2021 but still hold Seller responsible for ultimately delivering widgets due before that date. But the court might further hold that the contract was constructively cancelled when delayed deliveries accumulated up to that point, so Seller has no obligations for orders that would have been delivered past November 2021. The contract and its force majeure clause are reasonably susceptible to either of these readings. Either of these readings avoids placing pandemic losses entirely at the foot of one party, a result that there is no indication that the parties intended.<sup>22</sup> If either Buyer or Seller command the bargaining power to transfer risk entirely onto the other, they can draft a force majeure clause achieving that result. But courts should not impose this asymmetrical result based on a dubious and speculative superior risk bearer analysis when, on its face, the contract does not direct or even anticipate such an imbalanced result.

The choice the court makes among reasonable interpretations is properly informed by what transpired after the contract was formed. The court effectively uses knowledge gained by hindsight to achieve the equitable division for which contractual silence plausibly aimed. Risks that neither party is uniquely positioned to control or insure are effectively shared by contractual silence; both parties are subject to a range of risks. While parties indicate sharing by leaving both parties equally vulnerable to the unknown, risk sharing after the fact is achieved not by dividing the pool of risks, but by dividing the fallout of a single risk. Courts can assist parties by dividing the fallout. Doing so effectively sets the parties up to adjust the division as they see fit to reflect their superior information about how they price the entitlements and obligations they are assigned by the court. Going forward, parties averse to the risk-sharing default can choose to direct courts differently, either by assigning a larger range of risks expressly or drafting force majeure clauses that are categorical in the excuse they offer or withhold.

---

22. David Hoffman and Cathy Hwang observe that courts seem to want to avoid placing the burden of COVID-19 on the “weaker party.” David. A. Hoffman & Cathy Hwang, *The Social Cost of Contract*, 121 COLUM. L. REV. 979, 1004 (2021). While the examples they consider are not commercial contracts, their observations can also be explained by a reluctance to place all losses on one party who might appear weaker in some cases because they appear more vulnerable to pandemic-related losses.

## IV

## NEW POLICY NORMS

Pandemics result in learning not only by contracting parties and courts but also by policymakers. The COVID-19 pandemic resulted in legislative and administrative agency activity at all levels of government. The federal government invested in vaccines and pumped money into the economy through small business loans and extended unemployment. The Center for Disease Control and Prevention (CDC) issued guidance as to what activity was considered safe, including how businesses should conduct themselves to maintain safe work environments. State and local governments issued their own rules and guidance, sometimes at odds with the federal rules and guidance.

Should courts consider the public policy pursued by various regulators during an unforeseen contingency like the pandemic? Even if no local ordinance prohibits the operation of Seller in the above example, it would be hard for a court to ignore guidance from the CDC discouraging businesses from operating if they are unable to comply with certain social distancing requirements. Similarly, even if no federal law dictates courts to distort contracts in order to keep small businesses afloat, a court might be loath to exacerbate economic crisis by throwing Seller into bankruptcy in favor of a thriving business like the Buyer who appears to be enjoying a windfall in connection with a national calamity. Arguably, public policy in favor of temporary business closings and exceptional economic policies favoring business survival represent new learning, too. Courts would be stubborn to eschew such learning and proceed as if they were not acting against the backdrop of those policies.<sup>23</sup>

As I have argued elsewhere, it is incumbent on courts to consider the public policy norms that were the backdrop against which a contract was formed.<sup>24</sup> Parties are obligated to comply with background law, and courts should presume they intended to do so; their agreements should be read to render them compliant, where terms are ambiguous. Where public policy norms apply somewhat obliquely, courts might need to extrapolate from norms that were not designed to address the crisis at hand. For example, if there is a United States Equal Employment Opportunity Commission (EEOC) guidance that prohibits termination of employees who have legitimate grounds for fearing that reporting to work will endanger their lives, or National Labor Relations Board (NLRB) caselaw indicating that employers are entitled to suspend employment, overriding collective bargaining procedures on public health grounds, then those pre-existing norms should be extended to bear on the circumstances of COVID-19. Policymakers who announced those norms could not have anticipated

---

23. See *Dixon v. Wells Fargo Bank, N.A.*, 798 F. Supp. 2d 336, 349 (D. Mass. 2011) (noting the importance of considering the national foreclosure crisis when deciding whether Wells Fargo was estopped from foreclosing based on default it had induced).

24. See Aditi Bagchi, *Other People's Contracts*, 32 YALE J. ON REG. 211, 255 (2015) (“[C]ontract law, in keeping with its position within private law, should limit not just the harms imposed by contracting parties on each other but also the harms jointly imposed by contracting parties on third party losers.”).



COVID-19 any more than contracting parties could have. Legislative and administrative bodies cannot costlessly update their policies in response to the pandemic any more than contracting parties can swiftly renegotiate their agreements. Courts play an important role in attempting to faithfully apply democratically adopted policies. Legislatures and administrative agencies can issue new policies in due course, perhaps even reacting to judicial activity. But until there is reason to believe the legislature has rejected a natural application of an existing legal norm, courts should read contracts as bounded by and consistent with public policy on the books.

The same logic does not extend to policy issued once the pandemic has begun. Unless the court addresses a fact pattern that is so unique it was outside the contemplation of regulators—and in the rapidly evolving context of a national emergency, such facts may indeed arise—courts have to assume that policymakers chose to draw boundaries around their policies as they did. If they wished to prohibit employers from operating during COVID-19, there were multiple levels of government empowered to do it. In our running example, policymakers have discouraged employers from bringing employees back into workplaces *and policymakers have declined to prohibit their return*. Whether the balance they struck was optimal, and regardless of whether any given judge might endorse it, the boundaries authorizing policymakers' choice to draw around new legal norms are no less binding on courts than the affirmative elements of those new norms. It would be improper, on these facts, for courts to excuse a seller from performance in order to discourage return to work. It is not for the courts to extend public policy in the name of COVID-19 when the policy was itself adopted in response to COVID-19.

Why treat the new policy norm more narrowly than ones adopted before the pandemic? The new policy already reflects learning based on the facts of the pandemic. Any additional policy norms articulated by the court are likely to reflect new judgments—or distinct preferences—rather than new facts of which the court plausibly concludes that the legislative and executive branches were unaware. Even if individual judges are suspicious of the political economy behind the particular contours of pandemic policy, it is judicial overreach to attempt to correct for the deficits of the legislative process by imposing policies previously rejected by the government bodies authorized to enact them. A court that considers new facts parties did not have access to at the time of contract, under certain circumstances, can be characterized as updating obligations based on hindsight learning. A court imposing policy preferences beyond those apparent in recent legislation acts instead on disagreement.

Applying legal norms on the books at the time of contract more expansively than contemporaneous responses to public policy has the sanguine effect of enforcing contracts in a manner consistent with party expectations. Legislation and regulations passed to mitigate the fallout from the pandemic have the advantage of responding directly to the crisis at hand. But parties likely would have behaved differently if they anticipated not only the pandemic but the

governmental response to it. Infusing ex post policy into the contract will often be incongruous with the animating purposes of a contract. We cannot reasonably presume that contracts were written in their light, in the way that we should assume contracts are written to be consistent with background public policy in place at the time those contracts were entered. When new legal norms act on existing agreements, they act truly from without. Unlike background legal norms, these supervening legal norms either displace contractual terms or leave them intact.

## V

### CONCLUSION

It is common to worry that courts interpret with hindsight bias. But it is also common to celebrate learning, much of which also takes place with the benefit of hindsight. The concept of hindsight bias does not properly apply to the exercise of risk allocation that an unexpected contingency like the COVID-19 pandemic presents. While judges are often in the position of second-guessing litigants—as in asking whether their actions were reasonable—that is not at issue when deciding whether a party is excused from performing under an agreement. If there is no contractual clause on point, courts apply the nebulous impracticability doctrine. Asking whether performance was commercially impracticable could be an exercise in second-guessing the business decisions of the party seeking relief, but it should not be. It is rather the assignment of risk to one party or the other. When the parties have not made any allocation, there is often no good reason to assign risk to one party over the other. The equitable solution—dividing the burdens associated with the contingency between the parties—is best achieved through a judicial response that aims to achieve risk-sharing. If they can negotiate fruitfully, the parties may adjust to a more efficient sharing arrangement if there is one.

One might hope this exercise could be avoided in those cases where parties do attempt to allocate risk through something like a force majeure clause. But those are often ambiguous too. The ambiguity could be read to reflect the limits of language or parties' inability to properly conceive of just which questions a contingency will present. But ambiguity can also be read as silence; indeed, this is often the more plausible reading. Parties do not always work out precisely how they will proceed if something goes wrong. The clause is merely a broad stroke suggestion that the harshest consequences are not intended. Beyond that, it is again the work of the adjudicator to learn from details that emerge over time and to craft a moderate response. Ambiguity, on this view, is an invitation to such moderation. A court achieves moderation in results, again, through equitable risk-sharing. If the parties shared risks by leaving each vulnerable to a range of risks, the courts realize that broadly painted mandate for equity by directing each party to carry some of the burdens associated with a contingency for which neither was responsible.

If this approach is partial to learning, it nevertheless does not indiscriminately

favor updating agreements to reflect new facts. While contracts are appropriately read against the backdrop of public policy at the time of contract formation, regulators armed with information about the pandemic bear the burden of issuing new public policy that responds in the ways they intend. Courts have a more limited role when they extrapolate from contemporaneous public policy than when they extrapolate from policy not informed by the details of the contingency contracting parties face.