[Florida Law Review](https://scholarship.law.ufl.edu/flr)

Volume 28 | Issue 4 Article 1

June 1976

Drafting Contracts in an Inflationary Era

Thomas R. Hurst

Follow this and additional works at: https://scholarship.law.ufl.edu/flr

Part of the Law Commons

Recommended Citation

Thomas R. Hurst, *Drafting Contracts in an Inflationary Era*, 28 Fla. L. Rev. 879 (1976).
Available at: https://scholarship.law.ufl.edu/flr/vol28/iss4/1

This Article is brought to you for free and open access by UF Law Scholarship Repository. It has been accepted for inclusion in Florida Law Review by an authorized editor of UF Law Scholarship Repository. For more information, please contact jessicaejoseph@law.ufl.edu.

University of Florida Law Review

VOLUME XXVIII SUMMER 1976 NUMBER 4

DRAFTING CONTRACTS IN AN INFLATIONARY ERA

THOMAS R. HURST*

INTRODUCTION

The present uncertain state of the economy hardly needs to be documented. In 1974 the Consumer Price Index increased by 11 percent,[1] the largest yearly increase since 1951,[2] and during the same period the Wholesale Price Index posted an even greater increase of 18.9 percent.[3] Accompanying this inflationary surge were shortages of oil, natural gas, various petrochemical products, and other crucial commodities.[4] To combat this inflation, Congress instituted general wage-price controls, which were in effect from August 1971 until May 1974[5] and remained in effect for domestically produced oil until June 30, 1976.[6]

This inflationary pressure has also been partially responsible for the increasing instability of the international monetary system. The dollar has been devalued against gold twice since 1972,[7] and since the abandonment of the gold standard, the free market price of gold has increased from its former fixed rate of $35 per ounce to a peak of $195 per ounce in December 1974.[8] Moreover, there have been increasingly erratic fluctuations in the value of various important foreign currencies vis-à-vis the dollar.[9]

---

*B.A. 1966, University of Wisconsin; J.D. 1969, Harvard University; Member of the Wisconsin Bar; Assistant Professor of Law, University of Florida. The author wishes to acknowledge the research assistance of Carolyn Wilson.

1. MONTHLY LAB. REV., Jan. 1976, at 105.
2. *Id. See also* 62 FED. RES. BULL. 558 (1976).
3. MONTHLY LAB. REV., Jan. 1976, at 105.
4. *See, e.g.*, Wall St. J., Mar. 5, 1973, at 22, col. 2; *id.* July 6, 1973, at 6, col. 1; *id.* Sept. 7, 1973, at 1, col. 5; *id.* Oct. 18, 1973, at 3, col. 1; *id.* Nov. 19, 1973, at 22, col. 2.
5. Economic Stabilization Act of 1970, Pub. L. No. 92-8, 84 Stat. 13, *as amended*, Act of May 18, 1971, Pub. L. No. 92-210, 85 Stat. 743; Act of Apr. 30, 1973, Pub. L. No. 93-28, 81 Stat. 27.
6. Emergency Petroleum Allocation Act of 1975, Pub. L. No. 94-99, Stat. , *amending* Act of Dec. 5, 1974, Pub. L. No. 93-511, Stat. .
7. The price of gold was increased from $35 to $38 per troy ounce by the Par Value Modification Act, Pub. L. No. 92-268, 86 Stat. 116 (1972). This Act was subsequently amended to further increase the price of gold to $42.22 per troy ounce. 31 U.S.C.A. §449 (Supp. 1976).
8. Wall St. J., Dec. 30, 1974, at 6, col. 4.
9. As of October 15, 1976, the Swiss franc, which prior to the abolition of fixed exchange rates in 1971 was maintained at a value of 4.37 per dollar, had appreciated to 2.56 per dollar; the West German mark, formerly pegged at 3.66 per dollar, had also appreciated to 2.56 per dollar; the Japanese yen, formerly maintained at 366 per dollar had appreciated to 303 per dollar; while the British pound sterling, formerly fixed

Published by UF Law Scholarship Repository, 1976

Unfortunately, many of these problems seem likely to persist in the foreseeable future. Although 1975 witnessed the most severe recession since the Great Depression of the 1930's,[10] the Consumer Price Index nonetheless increased by 7 percent and the Wholesale Price Index increased by 4.2 percent, rates that only a few years ago would have seemed excessive in years of economic expansion.[11] While the rate of increase of the Consumer Price Index in the first half of 1976 has declined to slightly under 5 percent,[12] many economists are predicting a resurgence of inflation to the levels of 1973-1974 as the economy recovers further.[13]

In addition, the OPEC oil cartel shows no signs of disintegrating in the immediate future, and the threat of another oil embargo is always present.[14] Since the major countries of the world have thus far been unable to agree on the establishment of a new foreign exchange system,[15] the unstable foreign currency exchange rates that have existed since the abolition of the fixed rates established at the Bretton Woods conference of 1947 appear likely to continue.

This climate of economic uncertainty poses significant risks for the businessman who has contracted to supply goods or services without allowing for the effects of such instability. A large rise in the cost of labor or materials required to fulfill a contractual commitment could easily turn a contract that was apparently profitable at the time of execution into a losing proposition.[16] Similarly, these adverse effects could also result from a change in

---

at $2.40 per pound, had depreciated to $1.61 per pound. BARRON'S NAT'L BUS. & FINANCIAL WEEKLY, Oct. 18, 1976, at 90.

10. The Revised Federal Reserve Board Index of Industrial Production declined from 131.9 in June 1974 to 111.7 in March 1975, a decline of slightly more than 15%. 62 FED. RES. BULL. 479 (June 1976). The real Gross National Product for the entire year 1975 declined by 2%. *Id.* at A-54. The unemployment rate rose from under 6% in the summer of 1974 to 9.2% in May 1975. MONTHLY LAB. REV., June 1975, at 78.

11. FED. RES. BULL. A-53 (Aug. 1976). *See also* Wall St. J., May 11, 1976, at 2, col. 3.

12. The Consumer Price Index increased at an annual rate of 4.6% in the first half of 1976. 62 FED. RES. BULL. A-53 (Aug. 1976).

13. *See, e.g.*, Wall St. J., Jan. 27, 1976, at 3, col. 1; *id.* May 3, 1976, at 10, col. 3; *id.* May 12, 1976, at 1, col. 6.

14. Indeed, in September 1975, the OPEC cartel voted to increase crude oil prices by an additional 10% effective October 1, 1975. Wall St. J., Sept. 29, 1975, at 3, col. 1. At its most recent meeting in May 1976, however, the cartel failed to reach an agreement as to further oil price increases. but they did agree to continue the present price schedule until the next OPEC meeting in the fall of 1976. *Id.* June 1, 1976, at 6, col. 2.

15. *See, e.g.*, Wall St. J., Aug. 25, 1975, at 8, col. 4.

16. An excellent example of this is the current litigation brought against Westinghouse Electric Corporation by several electric utilities as a result of Westinghouse's refusal to supply them with the agreed amount of uranium under long term supply contracts. Many of these contracts called for Westinghouse to supply uranium at $8 to $9 a pound, while the current market price of uranium was approximately three times this amount. Since Westinghouse had on hand only enough uranium to supply approximately 19% of its total commitments under these contracts, Westinghouse would suffer a substantial loss if forced to purchase additional uranium in the open market in order to satisfy its contractual commitments. Westinghouse is seeking to be excused from its commitments under these contracts on the ground of impossibility of performance. Westinghouse Elec. Corp. v. Alabama Power Co., Civ. No. 75-1393 (W.D. Pa., filed Oct. 30, 1975). *See*

currency values.[17]

Even more serious problems may result if the materials necessary to fulfill the contractual commitment are unavailable at any price because of an embargo or shortages resulting from price controls.[18] In such a situation, the seller's liability may include the difference between the contract price and the market price on the date of delivery as well as substantial consequential damages.[19]

In some of these situations, the law provides relief to the seller either through the doctrine of frustration of purpose or through the doctrine of impossibility of performance.[20] The doctrines of impossibility and frustration, as codified in section 2-615 of the Uniform Commercial Code, discharge the seller from his obligation if performance becomes "commercially im-

---

Wall St. J., Nov. 3, 1975, at 10, col 3; BARRON'S NAT'L BUS. & FINANCIAL WEEKLY, Sept. 15, 1975, at 7, col. 1. Other situations in which sellers have been faced with substantial losses as a result of steeply rising prices for the goods they must supply have included contracts involving such commodities as oil. Eastern Air Lines v. Gulf Oil Corp., 415 F. Supp. 429 (S.D. Fla. 1975). *See also* Publicker Indus., Inc. v. Union Carbide Corp., 17 UCC REP. SERV. 989 (E.D. Pa. 1975) (chemicals); J.L. McEntire & Sons v. Hart Cotton Co., 256 Ark. 937, 511 S.W.2d 179 (1974) (cotton).

17. For example, a German businessman who had entered into a sales contract with a United States dealer in 1971, with the price payable in dollars, would find that the value of those dollars in terms of German marks was 40% less in 1974 — the time of payment — than it had been in 1971. See note 9 *supra.*

18. This problem developed in situations involving a variety of petroleum products in the period following the Arab oil embargo of late 1973. Wall St. J., Mar. 5, 1973, at 22, col. 2; *id.* July 6, 1973, at 6, col. 1; *id.* Sept. 7, 1973, at 1, col. 5; *id.* Oct. 18, 1973, at 3 col. 1; *id.* Nov. 19, 1973, at 22, col. 1.

19. Under the classic test of Hadley v. Baxendale, 156 Eng. Rep. 145 (Ex. 1854), damages recoverable for breach of contract are "such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the comtemplation of both parties at the time they made the contract, as the probable result of the breach." *Id.* at 151. In most cases damages resulting from failure of the seller to deliver the goods under contract will be controlled by the so-called "contract and market rule." This rule limits the recoverable damages to the difference between the contract price and the market price at the place and time of delivery since the buyer can avoid other damages by covering — purchasing substitute goods in the open market. If the buyer is unable to purchase substitute goods, however, he may suffer additional damages, such as lost profits and liabilities incurred as a result of his inability to perform other contracts. To recover for these consequential damages, the buyer faces the task of satisfying the test of *Hadley*; therefore, he must prove that these consequences were reasonably within the contemplation of the parties at the time the contract was made. The buyer's remedies and right to recover damages are substantially the same under the Uniform Commercial Code. *See* UNIFORM COMMERCIAL CODE §§2-711(1), 2-712, 2-713, 2-715.

20. Generally, the doctrine of impossibility of performance will excuse the promisor from liability for nonperformance of a contractual obligation if such nonperformance has been rendered impossible or extremely impracticable due to factors beyond the control of the promisor, and the promisor has not assumed the risk of the occurrence of such contingency. RESTATEMENT OF CONTRACTS §454 (1932). Thus, the defense of impossibility would apply in a case in which the seller had contracted to supply grapes from a specific crop to be grown on his land, and the crop failed because of a drought. Squillante v. California Lands, Inc., 5 Cal. App. 2d 89, 42 P.2d 81 (Dist. Ct. App. 1935).

practicable" as the result of the "occurrence of a contingency, the non-occurrence of which was a basic assumption . . ." on which the contract was made.[21] Nonetheless, exclusive reliance on the impossibility doctrine as a tool to cope with inflationary disruptions is undesirable for two reasons. First, the impossibility defense will not operate to release the promisor from his contractual obligation in every situation in which changed circumstances might conceivably warrant a discharge.[22] Second, the doctrine operates to release the seller or buyer from his obligation of performance entirely.[23] In many situations the parties would prefer to modify the contract so that performance would become feasible despite changed circumstances. Thus, drafting sufficient flexibility into the contract to allow for prevailing economic realities is preferable to exclusive reliance on the impossibility doctrine.[24]

The doctrine of frustration of purpose will excuse the promisor in cases in which performance of the promisor's contractual obligations is literally possible, but the motive or purpose for which the promisor entered into the contract will not be accomplished by complete performance of the contract. This doctrine is applicable only if such frustration is not the fault of the promisor and the promisor did not assume the risk of such frustration. RESTATEMENT OF CONTRACTS §288 (1932). The doctrine of frustration of purpose, for example, was applied in a case in which a person had purchased a ticket giving him the right to occupy plaintiff's apartment for the express purpose of viewing a coronation parade, and the parade was cancelled because of illness of the king. Krell v. Henry, [1903] 2 K.B. 740 (C.A.). Since the doctrines of impossibility and frustration are substantially similar for analytical purposes, they will be discussed together throughout the remainder of this article. For convenience the term "impossibility" will be used to refer to both the doctrines of impossibility and frustration, unless expressly indicated otherwise.

21. See note 106 *infra.*

22. See text accompanying notes 107-129 *infra.*

23. This statement is subject to two qualifications. First, under UNIFORM COMMERCIAL CODE §2-615(b), the seller who is unable to totally fulfill his contractual obligation is nevertheless required to partially perform his duties to the extent possible if the buyer so requests and to allocate his output in a fair and equitable manner to all buyers. Second, in some situations in which the court has found that time of performance is not of the essence of the contract, the courts have held that the seller who is unable to timely perform his obligations must still perform them at the earliest time possible. RESTATEMENT OF CONTRACTS §462 (1932). *See generally* Patterson, *Temporary Impossibility of Performance of Contract*, 47 VA. L. REV. 798 (1961).

24. In many situations, of course, whether the contract contains provisions that either excuse or modify the promisor's duty in a situation in which performance as originally called for would be burdensome is of little consequence. In the context of an ongoing business relationship in which the parties to the contract anticipate doing business with one another over a period of years, the buyer's long term interests will not be best served by insisting on strict enforcement of his contractual rights in situations in which the contract has become unduly burdensome on the seller. Thus, regardless of whether the contract contains any provisions exculpating or modifying the seller's obligations, it is likely that the parties will voluntarily agree on a modification of the seller's duty of performance in such situations. *See generally* L. FRIEDMAN, CONTRACT LAW IN AMERICA (1965). Nevertheless, for a variety of reasons, there will be situations in which voluntary renegotiation may not occur. First, the contract in question may be an isolated transaction in which there is no incentive for the buyer to behave leniently toward the seller. Second, the possible windfall resulting to the buyer from insisting on full performance of the contract may be so great that the buyer is willing to risk alienating the seller by insisting on full performance of the contract as written. Third, even if a

The balance of this article examines the techniques that may be utilized within the confines of existing contract law to protect the parties to a contract from various changes resulting from economic instability. The article briefly describes the history of the development of each technique, the situations in which each technique is most appropriately used, and the dangers or problems involved in its use.

Protecting Against Changes in Price or Cost of Performance

The Open-Price Contract

Perhaps the most obvious means by which the parties to an executory contract can protect themselves against changes in the cost of performance between the time the agreement is made and the time performance is called for is to postpone the determination of the contract price until the time of performance. This technique, which is known as the open-price contract, is advantageous to the seller when inflation is anticipated and to the buyer when deflation is feared.[25]

In the past, courts have been hostile to the open-price contract and seldom, if ever, have enforced an executory contract that did not contain a specified price. The courts have generally justified this hostility on the grounds that a mere "agreement to agree" is unenforceable[26] or that the Statute of Frauds

---

voluntary renegotiation of the contract is likely, the contract may contain some exculpatory language that places the party seeking modification or termination in a stronger bargaining position. Finally, even if voluntary renegotiation of a contract seems likely in the event of unexpected occurrences, there inevitably will be some cases in which the parties simply will fail to reach a satisfactory renegotiation of the agreement; thus, litigation will result. Since the defenses of impossibility of performance and frustration of purpose have been raised frequently in recent litigation, the parties to the contract should, for the above reasons, provide at the outset for discharge or modification of an agreement in the event that performance becomes impossible or unduly burdensome. See cases cited in note 16 *supra*.

25. There are various categories of open-price contracts. Among the more commonly used are the following: (1) Nothing whatsoever is said about price. (2) A provision stipulates that the price is "to be agreed upon" by the buyer and seller at the time of performance. (3) The price shall be the market price at the time of performance. (4) The price shall be the seller's cost plus a specified percentage or absolute dollar markup. (5) The price shall be no more than that charged by the seller's competitors at the time of performance. (6) The price shall be that charged by the seller to other buyers on the date of performance. (7) The price shall be determined by one of the previous methods but with specified maximum and minimum limitations. (8) The price shall be the buyer's resale price less a specified absolute or percentage discount. (9) The price shall be determined by an impartial third party or by reference to a specified trade journal or formula.

26. *See, e.g.*, Livingston Waterworks v. City of Livingston, 53 Mont. 1, 162 P. 381 (1916). In this case the court, in refusing to enforce an executory open-price renewal clause in a contract for the sale of water, stated: "An agreement to renew on terms to be agreed upon is simply not enforceable because the court cannot compel the parties to agree nor make an agreement for them; but the uncertain term can be made certain by agreement of the parties, and, if they choose to agree, the difficulty is surmounted and the agreement is complete. In such a case no need exists for thrusting into the contract a condition not expressed by the parties, nor — in our judgment — implied

bars enforcement of an open-price contract.[27]

This judicial reluctance to enforce open-price contracts is curious, especially when it is contrasted with the willingness of the courts to imply an obligation of reasonableness into contracts in other contexts. For example, in one well-known case in which defendant gave plaintiff the exclusive right to market dresses and millinery under her trademark, the court upheld the agreement over defendant's claim that it lacked mutuality of obligation by reading into the contract an implied obligation of reasonable effort on the part of the plaintiff to promote and market dresses under plaintiff's trademark.[28] Similarly, in situations in which contracts have appeared to give the defendant the absolute right to personal satisfaction, courts have upheld such contracts against the defense of lack of consideration on the grounds that the "personal satisfaction called for is that of a reasonable man and that such approval cannot be unreasonably withheld."[29]

In a similar vein, a strong argument can be made that an open-price contract should be sustained by reading into the agreement an implied obligation of the parties to agree to a reasonable price. Few courts, however, have found this argument persuasive.[30] Instead, the majority of jurisdictions appears to regard the contract price as an extremely critical provision and thus feels that judicial reconstruction of the parties' presumed intent should not extend to the determination of the price. Also, the courts frequently find

by them, since they reserve to themselves the right to bargain; and the right to bargain means the right to negotiate for and settle upon terms which a court might or might not consider entirely 'fair and equitable.' Any other conclusion vests with courts the power to make contracts for parties in every instance." *Id.* at 15-16, 162 P. at 385. *See also* Ansorage v. Kane, 244 N.Y. 295, 155 N.E. 683 (1927); Varney v. Ditmars, 217 N.Y. 223, 111 N.E. 822 (1916); Acebal v. Levy, 10 Bing. 376, 3 L.J.C.P. 98 (N.Y. 1834); Lambert v. Hays, 136 App. Div. 574, 121 N.Y.S. 80 (1910). Of course, if the contract was executed, the courts would generally hold that the buyer was under an obligation to pay a reasonable price, but this obligation was typically held to be of a quasi-contractual nature rather than a recovery on the contract. *See, e.g.*, Comstock v. Sanger, 51 Mich. 497, 16 N.W. 872 (1883); Stout v. Caruthersville Hardware Co., 131 Mo. App. 520, 110 S.W. 619 (1908); Standard Coal Co. v. Stewart, 72 Utah 272, 269 P. 1014 (1928).

27. Hanson v. Marsh, 40 Minn. 1, 40 N.W. 841 (1888); Elmore v. Kingscote, 5 B & C 583 (1826).

28. Wood v. Lucy, Lady Duff Gordon, 222 N.Y. 88, 118 N.E. 214 (1917).

29. *See, e.g.*, Hawkins v. Grahm, 194 Mass. 284, 21 N.E. 312 (1889) (agreement to construct heating system "proving satisfactory" to the owner held sufficiently definite to be enforceable); Duplex Safety Boiler Co. v. Garden, 101 N.Y. 387, 4 N.E. 749 (1886) (agreement to do work that will be "satisfactory" to the adverse party is sufficiently definite). *Contra*, Brown v. Foster, 113 Mass. 136 (1873) (agreement to make suit of clothes "to the satisfaction" of the customer gives customer absolute right of approval); Gibson v. Cranage, 39 Mich. 49 (1878) (contract for portrait to be "perfectly satisfactory . . . [to the buyer] in every particular" gives buyer an absolute right of approval).

30. *See generally* Prosser, *Open Price in Contracts for the Sale of Goods*, 16 MINN. L. REV. 733, 745-46 (1932). For one of the few early cases in which the court held an executory open-price contract enforceable, *see* United States v. Swift & Co., 270 U.S. 124 (1926). In that case, the Supreme Court enforced an executory contract that was silent as to the price for the sale of meat. "In such a case, a reasonable price is presumed to have been intended." *Id.* at 141. *See also* Abrams v. George E. Keith Co., 30 F.2d 90 (3d Cir. 1929).

difficulty in determining exactly how the parties intended to establish the price; therefore, any judicial interference would run the risk of contravening the intent of the parties.[31]

Notwithstanding such reluctance, the courts have been willing generally to enforce executory open-price contracts that contained a formula by which the price could be determined at the time of performance. Typically, such formula would be the price established in the market place,[32] or the price published in some specified trade journal,[33] or the price charged by some competitor,[34] or a price based on the seller's cost.[35] By presently agreeing on the formula to be applied in determining the contract price, any future agreement of the parties is not required.

Section 2-305 of the Uniform Commercial Code has further encouraged the use of the open-price contract by providing that "if they so intend," the parties can conclude a contract even if nothing is said about the price and no means is provided by which the price can be determined.[36] The comments accompanying section 2-305 provide that the intent of the section is to overrule prior case law to the effect that an agreement to agree is unenforceable and that a contract with an open-price term is void for

---

31. For example, how would the court determine whether the parties intended the price to be a reasonable price at the date the contract was signed or at the date delivery was called for? In what market should a reasonable price be determined? How can it be determined for certain that the parties intended the agreement to be binding at all? Was the signed document only intended to be binding if the parties later agreed to a mutually acceptable price? These and other considerations may have led to the traditional judicial hostility toward open-price contracts. See cases cited in note 26 *supra*.

32. Rose & Dasher v. Taylor, Lowenstein & Co., 26 Ga. App. 700, 106 S.E. 922 (1921); Jensen v. Turner Bros., 16 S.W.2d 742 (Mo. App. 1929); McConnell v. Hughes, 29 Wis. 537 (1872).

33. American Car & Foundry Co. v. East Jordan Furnace Co., 275 F. 786 (7th Cir. 1921) (price *quoted in* IRON AGE); Boret v. L. Vogelstein & Co., 188 App. Div. 605, 177 N.Y.S. 402 (1919), *aff'd.*, 230 N.Y. 573, 130 N.E. 878 (1920) (prices published in ENGINEERING & MINING JOURNAL).

34. Matthews Glass Co. v. Burk, 162 Ind. 608, 70 N.E. 371 (1904).

35. Humphrey v. Holden, 157 Mich. 481, 122 N.W. 103 (1909); Kann v. Wausau Abrasives Co., 81 N.H. 535, 129 A. 374 (1925).

36. UNIFORM COMMERCIAL CODE §2-305 provides:

"§2-305. Open Price Term

(1) The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time for delivery if (a) nothing is said as to price; or (b) the price is left to be agreed by the parties and they fail to agree; or (c) the price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded.

(2) A price to be fixed by the seller or by the buyer means a price for him to fix in good faith.

(3) When a price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party the other may at his option treat the contract as cancelled or himself fix a reasonable price.

(4) Where, however, the parties intend not to be bound unless the price be fixed or agreed and it is not fixed or agreed there is no contract. In such a case the

indefiniteness.[37] The comments also indicate that section 2-305 is not intended to give the seller unfettered discretion to establish any price that he may wish but that the price must be reasonable.[38] Comment 3 states that the "posted price," "market price," "price in effect," or "given price" would all be considered to be a reasonable price for purposes of section 2-305.[39]

The usefulness of section 2-305, however, is extremely limited. As with all of article 2 of the Uniform Commercial Code,[40] section 2-305 is only applicable to contracts for the sale of goods. Therefore, contracts other than for the sale of goods may continue to be held unenforceable for want of mutuality or for indefiniteness if they do not contain a price or a definite formula for agreeing on a price.[41]

Despite the increasing acceptance of the open-price contract evidenced by Uniform Commercial Code section 2-305 and, to a lesser extent, by the courts at common law, its usefulness is mitigated by the following considerations. First, the open-price contract may be unsatisfactory to the buyer if his main purpose in entering into the contract is to protect himself against future increases in price or to the seller if he wishes to lock into a sale at the prevailing market price to protect himself against future price declines.[42] Thus, to the extent that a contract provides for *future* determination of the price, it fails to accomplish these objectives.[43] If, however, the major purpose for entering into a contract for future delivery is to assure the buyer a supply of an essential product or the seller a market for his output and the

---

buyer must return any goods already received or if unable so to do must pay their reasonable value at the time of delivery and the seller must return any portion of the price paid on account."

37. *Id.* Comment 1. In states that have adopted the Uniform Commercial Code, the courts have followed the comment. *See, e.g.*, Southern Fire & Cas. Co. v. Teal, 287 F. Supp. 617 (D.S.C. 1968), *aff'd per curiam*, 406 F.2d 1330 (4th Cir. 1969); Sargent v. Highlite Broadcasting Co., 466 S.W.2d 866 (Tex. Civ. App. 1971).

38. UNIFORM COMMERCIAL CODE §2-305, Comment 2. *See also* Illinois Commerce Comm'n v. Central Ill. Pub. Ser. Co., 25 Ill. App. 3d 79, 322 N.E.2d 520 (1975); Columbus Milk Producers Co-op v. Department of Agriculture, 48 Wis. 2d 451, 180 N.W.2d 617 (1970).

39. UNIFORM COMMERCIAL CODE §2-305, Comment 3. *See also* Umlas v. Acey Oldsmobile Inc., 62 Misc. 819, 310 N.Y.S.2d 147 (Civ. Ct. 1970); Boca Chica Hardware Co. v. AG-Spray Supply Co., 479 S.W.2d 107 (Tex. Civ. App. 1972).

40. UNIFORM COMMERCIAL CODE §2-102, 2-105(1).

41. There is, however, some indication that the courts have been more lenient in upholding open-price contracts during the past few decades. *See, e.g.*, Abrams v. George E. Keith Co., 30 F.2d 90 (3d Cir. 1929); Memphis Furniture Co. v. Wemyss Furniture Co., 2 F.2d 428 (6th Cir. 1924); Laveson v. Warner Mfg. Corp., 117 F. Supp. 124 (D.N.J. 1953); Schneider v. Walts, 186 Kan. 140, 348 P.2d 593 (1960); Mantell v. International Plastic Harmonica Corp., 141 N.J. Eq. 379, 55 A.2d 250 (Ct. Err. & App. 1947); Bendalin v. Delgado, 406 S.W.2d 897 (Tex. 1966).

42. *Cf.* UNIFORM COMMERCIAL CODE §2-615, Comment 4.

43. This will be true in situations in which the price is left totally open — the price is to be the market price or a reasonable price. The open-price contract, however, cannot by criticized on these grounds when the contract contains a predetermined formula for determining the price so that there is little or no room for negotiation between the parties.

parties are content that the contract price be determined at the time of delivery, then the open-price contract should be satisfactory.[44]

Second, the open-price contract is of limited utility when it is difficult to find a formula by which the price will be determined. For this reason, open-price contracts are most commonly used in agreements for the sale of homogeneous commodities or for services that are regularly bought and sold in an active market. Conversely, a contract for a manufactured product involving a variety of materials and substantial labor costs in its production will not normally be suitable for an open-price contract.[45]

Third, in using an open-price contract, considerable care should be exercised in specifying the manner in which the price is to be determined. For example, if the contract specifies that the price is to be the "market price," there is often considerable room for argument as to just what is the market price. Disputes that may arise include what price is meant when trading is inactive,[46] whether customary discounts from listed market prices should be taken into account,[47] and whether the prices of one or two sellers who habitually undercut the majority of sellers in a given market should be taken into account.[48]

Finally, in some situations a contract calling for payment of the current "market price" or a "reasonable price" at the time of delivery might be subject to challenge if the market is severely distorted by shortages, strikes, or price-wars.[49] Hence, if the parties decide that the use of the open-price contract is desirable, they should specify as precisely as possible the manner in which the price is to be determined and the circumstances, if any, that would render the formula inapplicable.

Cost-Plus Contracts

Another method by which the seller may protect himself against inflationary increases in his cost of materials or labor is through the use of the cost-plus contract. In this type of contract, the contract price is computed by determining the seller's cost of production and adding to that the seller's profit, which may be either a fixed sum agreed on in advance or a percentage of the total cost of production.[50]

---

44. *Cf.* Prosser, *supra* note 30, at 733-34.

45. For example, while a contract for the sale of coffee or lumber would be suitable subject matter for an open-price contract, a contract for the sale of an airplane would not. The problems of the use of the open-price contract in such a case are similar to the difficulties associated with the cost-plus contract. See text accompanying notes 50-60 *infra*.

46. South Gardiner Lumber Co. v. Bradstreet, 97 Me. 165, 53 A. 1110 (1902); New York Overseas Co. v. China, Japan & S.A. Trading Co., 206 App. Div. 242, 200 N.Y.S. 449 (1923).

47. Abshire v. Smith, 86 Ind. App. 354, 156 N.E. 408 (1927); McGarry v. Superior Portland Cement Co., 95 Wash. 412, 163 P. 928 (1917).

48. Ford v. Norton, 32 N.M. 518, 260 P. 411 (1927); Taylor Oil & Gas Co. v. Pierce-Fordyce Oil Ass'n, 226 S.W. 467 (Tex. Civ. App. 1920).

49. *Cf.* Ford v. Norton, 32 N.M. 518, 260 P. 411 (1927).

50. The basic cost-plus pricing provision for government procurement contracts, 32 C.F.R. §7.203-04 (1972), which defines "allowable cost," provides: "(a)(1) For the performance

The cost-plus contract has been used most commonly in the defense industry.[51] Rather than protecting against inflation, this contract has been used in the defense industry because of the inability of contractors to estimate accurately the cost of developing new weaponry. Since most contractors would refuse to enter into a fixed price contract in this situation, the cost-plus contract has become virtually a necessity. Although cost-plus contracts, as such, have not met with the hostility that has been accorded open-price contracts, they have on occasion been held unenforceable because of uncertainty in situations in which the court was not able to determine what the parties meant by "cost."[52]

While use of the cost-plus contract may be a necessity in research and development contracts, it is not the most desirable contractual device when the parties' main concern is protecting against inflation or deflation. First, the cost-plus clause is not likely to be viewed with favor by the buyer because it removes the incentive for the seller to minimize his costs of production; indeed, if the seller's profit is to be determined by taking a specified percentage of the total cost, the seller actually has an incentive to *maximize* his costs of production.[53] Theoretically, the buyer could guard against this possibility by providing in the contract that only those costs that are "reasonable and necessary" to perform the contract shall be allowed in computing the contract price.[54] In practice, however, the buyer inevitably encounters difficulty in establishing that a particular item claimed by the contractor was not reasonable and necessary.

In addition, it is extremely difficult to draft a cost-plus contract that contains a definition of "cost" that will be sufficiently clear to avoid controversy in its application. A glance at the extensive provisions of the Armed Services Procurement Regulations dealing with the determination of cost illustrates the magnitude of this problem.[55] If the contract involves the sale of goods in their present state – for example, a contract between a wholesaler and a retailer – the problem may be relatively simple since the seller's cost will consist of the cost of goods purchased plus associated incidental

of this contract, the Government shall pay to the Contractor – (i) the cost thereof (hereinafter referred to as 'allowable cost') determined by the Contracting Officer to be allowable in accordance with – (A) Part 2 of Section XV of the Armed Services Procurement Regulations as in effect on the date of this contract; and (B) the terms of this contract; and (ii) a fee determined as provided in this contract."

51. *See generally* Moore, *Efficiency and Public Policy in Defense Procurement*, 29 LAW & CONTEMP. PROB. 3 (1964).

52. Dwight Bros. Paper Co. v. Ginzburg, 238 Ill. App. 21 (1925); Buckmaster v. The Consumers Ice Co., 5 Daly 313 (N.Y. 1874). *Cf.* Hazleton Tripod-Boiler Co. v. Citizens St. R.R., 72 F. 317 (C.C.W.D. Tenn. 1896).

53. *See generally* Hansen, *Price Protection in Contracts*, 17 STUDIES IN BUS. POL. 11 (1946). For this reason the federal government has attempted to limit the use of cost-plus contracts. *See generally* Cuneo & Crowell, *Impossibility of Performance – Assumption of Risk or Act of Submission?*, 29 LAW & CONTEMP. PROB. 531 (1964).

54. *See, e.g.*, 32 C.F.R. §7.203-04(b) (1972).

55. 32 C.F.R. §7.203-04 (1972). The basic provision defining "cost" in the Armed Services Procurement Regulations continues for more than 4 pages in the Code of Federal Regulations.

costs of transportation, storage, and insurance.[56] By contrast, however, the determination of "costs" for a manufacturing contract will require the parties to resolve many complex problems of cost accounting.[57] Overheard expenses must be allocated to the contract.[58] The hiring of additional labor to perform the contract may be a source of controversy as may be the employment of workers at overtime wages. The hiring of additional managerial and front office personnel may be even more difficult to allocate to a particular contract, and the decision on the valuation of inventory on a LIFO or FIFO basis is open to question.

In summary, the cost-plus contract should be used only as a last resort when other methods of protecting against economic fluctuations are unavailable. In situations in which the parties' primary concern is providing protection against price changes in critical costs of production, a much simpler solution than the cost-plus contract is to include a price-adjustment clause providing for the contract price to be increased in proportion to any increases in the costs of materials and labor above the current market price for such materials and labor.[59] This technique avoids the complex cost determination problems that are involved in the cost-plus contract; furthermore, it provides some protection for the seller's profit margin in times of economic uncertainty. In any event, the attorney who decides to draft a cost-plus contract would be wise to consult the Armed Services Procurement Regulations for guidance in drafting the agreement.[60]

Price Indexing and Price Escalator Clauses

One of the most commonly employed methods of protecting against inflation and deflation in contracts is the use of price indexing or price escalator clauses.[61] Generally, these clauses provide for periodic adjustments in the contract price based on the change in a price index or the change in the price of materials or labor that constitutes a significant portion of the seller's cost of performance. Both indexing clauses and escalator clauses are commonly found in such diverse types of contracts as collective bargaining agreements,[62] Social Security and other pension benefits,[63] various govern-

56. J.W. Finn & Co. v. Culverhouse, 105 Ark. 197, 150 S.W. 698 (1912); Swisher v. Dunn, 89 Kan. 412, 131 P. 571 (1913).

57. *See, e.g.*, Red Wing Shoe Co. v. Shepard Safety Shoe Corp., 164 F.2d 415 (7th Cir. 1947); Beech Aircraft Corp. v. Ross, 155 F.2d 615 (10th Cir. 1946).

58. Pacific Portland Cement Co. v. Westvaco Chlorine Products Corp., 77 F. Supp. 406 (N.D. Cal. 1948) ("cost of production" includes indirect as well as direct costs); Fillmore v. Johnson, 221 Mass. 406, 109 N.E. 153 (1915).

59. See text accompanying notes 61-87 *infra*.

60. *See generally* 32 C.F.R. Part 1-30 (1972).

61. The term "price indexing" is usually applied to a contract that provides for the price to be adjusted according to the change in some recognized price index, such as the Department of Labor's Consumer Price Index. The term "escalator clause" is generally applied to contracts that provide for price increases based on actual cost increases to the seller in specified commodities or services. For analytical purposes, however, the two terms are substantially identical, and they will be used interchangeably here.

62. The first major collective bargaining agreement that was indexed to the Consumer Price Index was that of the United Auto Workers in the late 1940's. The Department

ment welfare programs,[64] long term bank loans,[65] residential mortgage loans by savings and loan associations,[66] commercial office leases and shopping center leases,[67] insurance policies,[68] and long term commercial purchase contracts.[69] Several foreign countries have even indexed personal income tax rates and government bond interest rates.[70]

In contrast to the judicial reluctance to enforce open-price contracts, the courts generally have had no difficulty in upholding contracts containing indexing provisions. In *Ames v. Quimby*,[71] the Supreme Court upheld a contract for the sale of shovel handles that provided for the price to be regulated according to variations in the price of gold. Similarly, in *Solter v. Leedom & Worrell Co.*,[72] a contract for the sale of tomatoes containing a clause that guaranteed the sale price of tomatoes against price declines in comparison to the prices charged by established packers was held enforceable against claims that it was too indefinite and uncertain. Another decision, *Calcasieu Paper Co. v. Memphis Paper Co.*,[73] approved the use of a contract that provided that the price charged should be increased or decreased in accordance with ceiling prices allowed by the Office of Price Administration. As long as the indexing formula is drafted so that the method of price

of Labor estimates that approximately eight million employees or about 10% of the nonagricultural work force are now covered by contracts containing wage escalator clauses. Wall St. J., March 10, 1976, at 13, col. 1.

63. Pensions of 31.2 million Social Security recipients and 2.5 million military and civilian federal retirees are indexed. *Id.*

64. The allotments of 18.7 million food stamp recipients and 25 million school children, among others, are now indexed. *Id.*

65. Virtually all major "money center" commercial banks now make most long term commercial loans at a variable interest rate that is tied to the price or minimum interest rate. *Id.* at 13, col. 2.

66. About 20 states allow state-chartered savings and loan associations to make residential mortgage loans at variable interest rates. *Id.* In addition, some federally chartered savings and loan associations have made variable rate mortgage loans, although the regulations of the Federal Home Loan Bank Board do not explicitly allow this practice. On February 14, 1975, the Board issued a set of proposed regulations governing the issuance of variable rate mortgage loans. 42 Fed. Reg. 6870 (1975). The effective date of these regulations has been postponed pending further study. *See generally* Note, *Adjustable Interest Rates in Home Mortgages: A Reconsideration*, 1975 WIS. L. REV. 742.

67. While a national total would be only speculative, a leading Chicago-based real estate concern estimates that 90% of the 400 office buildings it manages throughout the United States use leases containing escalator clauses compared with less than 50% as recently as five years ago. Wall St. J., March 10, 1976, at 13, col. 2.

68. More than 100 companies now offer homeowner policies in which both the premium and the benefits are tied to home-repair costs, and at least one auto insurance company is offering a similar policy for auto insurance. *Id.*

69. *Id.*

70. Countries such as Brazil, Israel, and Finland have experimented, with varying degrees of success, with one or more of these techniques. *Id.* at 1, col. 6. At least one government economist has suggested that the federal income tax in the United States should be indexed to prevent inflation from pushing taxpayers into higher rates. Wall St. J., Feb. 14, 1975, at 15, col. 6.

71. 96 U.S. 324 (1878).

72. 252 F. 133 (4th Cir. 1918).

73. 32 Tenn. App. 293, 222 S.W.2d 617 (1949).

calculation can be determined by the courts with reasonable certainty, the contract will likely withstand judicial scrutiny. This conclusion is strengthened by the adoption of Uniform Commercial Code section 2-305, which relaxes the common law requirements of definiteness and certainty.[74]

While the use of the price indexing clause presents no serious conceptual difficulties, a number of practical problems must be surmounted if an indexing clause is to be acceptable and fair to both parties. The first problem is the selection of an appropriate price index for use in a given contract. Most parties contemplating the use of an indexing clause automatically turn to the Department of Labor's Consumer Price Index (CPI) or Wholesale Price Index (WPI). In many contexts, however, neither of these indices will provide an accurate measure of the effect of inflation on a particular contract. The CPI is designed to measure the effects of inflation on the income of urban, blue-collar wage earners. It does so by measuring monthly the price changes of approximately 400 goods and services.[75] The WPI measures the monthly changes in the wholesale prices of a representative group of 2700 industrial and agricultural commodities.[76] While providing a reasonably accurate overall picture of inflation, both of these indices are too broad to accurately measure the effect of inflation on many types of contracts.[77] For example, use of the CPI as an indexing tool in a commercial office lease or a contract for the sale of farm machinery would be inappropriate since the Index will not accurately measure the change in the promisor's costs. Despite these limitations, many persons appear to be utilizing the CPI in precisely those situations because of the lack of knowledge of what the CPI does measure or because of the lack of a more accurate index.

Fortunately, a multitude of other, more accurate indices are readily available. In addition to the CPI and WPI, the Department of Labor's Bureau of Labor Statistics also publishes specific price indices for the output of selected Standard Industrial Classification industries.[78] The Department of Agriculture publishes an Index of Prices Paid by Farmers and an Index of Prices Received by Farmers.[79] In addition, various indices dealing with

---

74. See text accompanying notes 37-39 *supra.*

75. *See generally* THE PRICE STATISTICS OF THE FEDERAL GOVERNMENT (National Bureau of Economic Research, Inc. N.Y. 1961).

76. *Id.* The index consists of a weighted average of the price changes for such commodities with the weights calculated based on the total new selling value of the commodities produced, processed, and flowing into primary markets.

77. The Consumer Price Index can be considered a proper indexing device for use in contracts for the sale of consumer goods if the parties are concerned with the buyer's ability to pay rather than the seller's cost of production. Ordinarily, however, this is not the case. In collective bargaining agreements, the CPI is an accurate measure of the seller-worker's cost of maintaining himself and his family, but this is one of the few situations in which this will be true.

78. U.S. OFFICE OF MANAGEMENT & BUDGET, STANDARD INDUSTRIAL CLASSIFICATION MANUAL (1972). These indexes measure average price changes in commodities produced by particular industries and are published in the MONTHLY LABOR REVIEW.

79. This index is based on 55 commodities that accounted for 93% of the total cash receipts from the sale of farm products in 1953-1957. The index is published monthly in AGRICULTURAL PRICES.

prices in particular industries are published by trade associations.[80]

In short, indexing is an accurate means of compensating for inflation only if the indexing device is an accurate measure of the changes in the cost of performing a contract. To the extent that such an index is unavailable and cannot be calculated by the parties, indexing may not be a satisfactory answer to the problem at hand.

The problem of finding a suitable index that will accurately represent the true change in the contract price can be solved at least partially by including in the index only those elements of the total contract price that can be accurately measured. Although the formulation of an index that would accurately measure the change in rental value of commercial real estate over a long period of time would be difficult and impractical, a long term commercial lease can provide for an automatic adjustment of the rent on the basis of certain changes in the landlord's costs that can be easily measured, such as property taxes, utility expenses, and custodial fees. Similarly, in the case of a contract for the manufacture of goods, the price could be indexed to labor costs or to the cost of one or more crucial commodities involved in the manufacturing process.

The second problem confronting potential users of a price indexing clause is to be certain that the index is carefully and accurately compiled, preferably by an impartial source. A trade association publishing an index may have a vested interest in making prices appear as high as possible, which would render such an index unfair to the buyer. For this reason, indices compiled by impartial sources, such as the government or an independent business publication, are generally more desirable.[81]

The third problem lies in attempting to assess the reliability and continuity of the index. Litigation has occasionally resulted when the index on which a contract was based was no longer compiled.[82] Again, government indices would generally seem to be the most reliable, although even these are occasionally changed.[83] To guard against drastic modification or termination of an index, the contract should contain a provision designed to protect the parties from this contingency. An arbitration clause, for example, would be one solution to the problem. Finally, to enable appropriate adjustments in the contract price to be timely made,[84] the parties should take care to select an index that will be published with reasonable speed.

80. For example, IRON AGE publishes the monthly indexes of steel production and price indexes for various primary and scrap metals in different sections of the country. In addition, indexes of production and prices for various industries appear in periodicals such as BUSINESS WEEK, FORBES, and BARRON'S NATIONAL BUSINESS AND FINANCIAL WEEKLY.

81. See note 80 *supra.*

82. Domhoff & Joyce Co. v. Hamilton Furnace Co., 108 Ohio St. 25, 140 N.E. 485 (1923). *See generally* Dawson & Coultrap, *Contracting by Reference to Price Indices,* 33 MICH. L. REV. 685 (1935).

83. For example, the Department of Labor has announced that it is considering the publication of a separate consumer price index designed to measure changes in the cost of living for white collar workers.

84. The problem of expeditious publication is one shortcoming in the use of government price indexes. Although many government indexes are not published for some

Assuming the seller is able to find an appropriate index that satisfies the above criteria, he may encounter problems in using such an index. Although the seller's cost of production may increase in a given situation, the buyer's ability to pay will not necessarily increase commensurately. Thus, the seller may find the buyer reluctant to agree to an open-ended indexing clause. In the case of a labor contract, although the cost of living may have increased so that the wage earner feels himself entitled to a wage adjustment, the employer's revenues may not have increased sufficiently to enable him to pay the increase.[85]

Another problem with indexing in a period of constantly changing prices is that it may necessitate frequent and inconvenient revision of the contract price. This problem may be minimized by including a triggering clause providing that adjustments in the contract price shall be made only if the index increases by a certain specified minimum percentage in a given time period.[86] Furthermore, the indexing clause can provide for adjustments to be made semi-annually or yearly rather than monthly.[87]

To summarize, indexing is perhaps the most useful device that can be employed to safeguard the parties from the effects of changes in the price level. Price indexing clauses are well accepted by the judiciary, can be tailored to suit the needs of the particular parties involved, and can provide near total protection to the parties against changes in the price level. On the other hand, because it eliminates the certainty provided by a fixed-price contract, indexing may not always be acceptable to both parties. When utilized, indexing clauses must be carefully drafted to avoid problems in application and to fairly represent actual, relevant changes in costs and prices.

Gold Clauses

Another technique that has been widely used to provide protection against changes in the level of prices is the use of a gold payment clause. Generally, this clause provides for payment of the contract price in gold. This clause gained increased popularity following the 1869 decision of the

---

time after the period for which they are calculated, they are unofficially published in a reasonably short period of time by the press and various commercial periodicals. For example, the MONTHLY LABOR REVIEW, the official source of the Bureau of Labor Statistics indexes, does not appear for weeks after the indexes are calculated. Nevertheless, the more widely watched indexes compiled by the Bureau of Labor Statistics are quickly published in such readily available publications as the Wall Street Journal, BUSINESS WEEK, and FORBES.

85. The phenomenon was recently illustrated by President Ford's refusal to recommend congressional approval of the 8% pay raise for federal employees even though application of the cost-of-living escalator clause by the Federal Pay Board required such a raise. *See* Wall St. J., Sept. 16, 1975, at 1, col. 5.

86. *See, e.g.*, Ames v. Quimby, 96 U.S. 324 (1918).

87. For example, the escalator clause for Social Security benefits provides for annual adjustment of benefits based on changes in the Consumer Price Index.

Supreme Court in *Bronson v. Rhodes*,[88] which held such clauses to be enforceable. In 1933, however, Congress declared that such clauses were unenforceable as against public policy. This terminated the use of the gold clause in this country for more than a generation.[89]

In 1973, Congress passed the Par Value Modification Act,[90] which restored the right of American citizens to own gold as soon as the President permitted them to do so. With the signing of Executive Order 11825,[91] President Ford authorized the use of gold clauses in the United States effective January 1, 1975.

There are two basic types of gold clauses. One is the gold payment clause that provides for the contract price to be paid in a specified number of ounces of gold or gold coins.[92] The other is the gold value clause that indexes the contract price based on changes in the value of gold.[93] In practice, the gold value clause is probably the preferable approach. This clause provides protection similar to that accomplished through the gold payment clause but avoids the difficulty involved in the physical transferring and assaying of gold.[94]

Regardless of which type of gold clause is utilized, a few caveats should be noted. First, the clause should specify precisely how and where the price of gold is to be determined. Gold is traded on several exchanges and the price of gold may vary significantly from one exchange to another.[95] In addition, since the price of gold may vary greatly from one day to another, the party contemplating the use of a gold clause may wish to provide that the price should be determined by taking the average price of gold over a

---

88. 74 U.S. (7 Wall.) 229 (1869). *See generally* Nebolsine, *The Gold Clause in Private Contracts*, 42 YALE L.J. 1051 (1933).

89. 31 U.S.C. §§462-63 (1933). In 1935, the Supreme Court held this law to be constitutionally valid. *See* Perry v. United States, 294 U.S. 330 (1935); Nortz v. United States, 294 U.S. 317 (1935); Norman v. Baltimore & O.R.R., 294 U.S. 240 (1935). For an excellent discussion of the Gold Clause Cases, see Dawson, *The Gold Clause Decisions*, 33 MICH. L. REV. 647 (1935).

90. Act of March 31, 1972, Pub. L. No. 92-268, 86 Stat. 116. *See also* Act of Sept. 21, 1973, Pub. L. No. 93-110. 87 Stat. 352.

91. 40 Fed. Reg. 1003 (1974).

92. Norman v. Baltimore & O.R.R., 294 U.S. 240 (1935).

93. For example, if a contract was entered into when the price of gold was $100 per troy ounce and at the time performance was due the price of gold had increased to $150 per troy ounce, the dollar price would be increased by 50%, the percentage increase in the price of gold over the period in question.

94. Wormser and Kemmerer, *Restoring "Gold Clauses" in Contracts*, 60 A.B.A.J. 942, 947 (1975). Furthermore, since money damages based on the change in value of gold would adequately compensate the plaintiff, a court would probably not decree specific performance of a gold payment clause.

95. An active market in gold is maintained in the United States by the Chicago Board of Trade, the New York Mercantile Exchange, the International Monetary Market of the Chicago Mercantile Exchange, and Commodity Exchange, Inc. of New York. In addition, active markets for gold exist overseas in London, Paris, and Zurich. Quotations in each of these markets are published daily in the financial pages of leading newspapers, such as the New York Times and the Wall Street Journal.

specified time span[96] rather than using the spot price on the day the contract is to be performed.

Perhaps most importantly, the prospective user of a gold clause should consider whether some other method of indexing the contract to adjust for changes in the general price level would better serve his interests. The use of a gold clause is, after all, simply a form of indexing. As with any contract containing a price indexing clause, the question is whether changes in the basis of the index, here the value of gold, accurately reflect changes in the seller's cost of performance.[97]

The answer to this question is unclear. Since the dollar was freed from its gold backing in 1971, the price of gold has risen from its former fixed price of $35 per ounce to a peak of almost $200 per ounce in December 1974.[98] During that period the price of gold more than quadrupled, rising 471 percent, while the Consumer Price Index rose only 17 percent. The result of this comparison, however, may be somewhat misleading. Since the price of gold was artificially maintained at $35 per ounce from 1933 until 1971, perhaps a fairer comparison would be to measure the change in the price of gold vis-à-vis the change in the Consumer Price Index between 1933 and 1975. Over that period the comparison seems much more reasonable. Between 1933 and 1975 the price of gold rose 471 percent while the Consumer Price Index increased by 381 percent.[99]

Nevertheless, such a comparison overlooks the fact that the price of gold may fluctuate significantly over a short time span. For example, while the price of gold *declined* from almost $200 in December 1974 to less than $110 in July 1976,[100] the CPI *increased* by 9.2 percent during the same period.[101] Thus, a contract containing a gold clause entered into in December 1974 providing for payment in July 1976 would have resulted in a 45 percent decrease in the price payable to the seller, notwithstanding the 9.2 percent increase in the general price level during that period.[102]

For this reason, indexing the contract price by a published price index or by changes in the prices of the principal components of the contract price will generally be preferable to using a gold clause in the contract.[103] Nevertheless, there may be situations in which the parties are unable to agree on any other index, and a gold clause may be the only mutually

96. In recent years the price of gold has frequently fluctuated a dollar or more in the course of one trading day. For example, on August 24, 1976, following the announcement of an action of gold by the International Monetary Fund, the price of gold dropped $1.80 per ounce to $104.80. On January 2, 1975, the price of gold dropped a record $11.50 per ounce to $175. Wall St. J., Jan. 3, 1975, at 2, col. 2.

97. See notes 75-80 *supra* and accompanying text.

98. BARRONS NAT'L BUS. & FINANCIAL WEEKLY, July 26, 1976 at 28.

99. *See* MONTHLY LAB. REV., Dec. 1952, at 706; *id.* April 1976, at 85.

100. Wall St. J., Dec. 30, 1974, at 6, col. 4; *id.*, July 21, 1976, at 10, col. 2.

101. MONTHLY LAB. REV., Aug. 1976, at 81.

102. Since the value of the dollar is now defined in terms of Special Drawing Rights, an arbitrary unit established by the International Monetary Fund, the United States no longer attempts to maintain the price of gold in the free market at a fixed amount. 31 U.S.C.A. §449 (Supp. 1976).

103. See text accompanying notes 60-81 *supra*.

acceptable solution. This is particularly true of international trade, in which the gold clause has historically been used to protect against fluctuations in currency values.[104] In such cases, the parties must decide whether a gold clause is preferable to using no indexing clause at all.

In the present economy the gold clause has become an anachronism, having little or no utility for the serious contract draftsman. The gold clause may have had its place in an era of fixed currency exchange rates, but in today's confused international monetary situation, with the price of gold often moving several dollars a day rather than merely a few cents, use of the gold clause introduces into the contract a highly speculative element that few parties will find desirable.

PROTECTING AGAINST INABILITY TO PERFORM

The Defense of Impossibility of Performance

While the above contract provisions may protect the contracting parties from extreme fluctuations in prices and costs of production, such methods may not adequately protect the parties in all situations. For example, in times of severe inflation, the buyer may be unwilling to enter into a contract containing an escalator clause or other open-price provision. The seller would then be forced to choose between entering into a risky fixed-price contract or losing the opportunity of doing business with the prospective customer. Even if an escalator clause or open-price provision is acceptable to the buyer, such clauses will not protect the seller in situations in which supplies necessary to perform the contract are unavailable at any price because of an embargo, rationing, or other governmental regulation. Finally, the chance that the price index used in the contract will be discontinued or modified by its publisher is always present.

In some of these cases, the seller will be able to obtain relief through the doctrine of impossibility of performance or its companion doctrine, frustration of purpose. Generally, these doctrines excuse the promisor from the duty of performance under a contract if performance has been made impossible or if the purpose of the promisor in entering into such contract has been substantially frustrated by causes beyond the control of the promisor.[105] These doctrines are codified for contracts dealing with the sale of goods in section 2-615 of the Uniform Commercial Code.[106]

In most cases the seller who relies exclusively on the doctrine of impossibility of performance to protect himself from increases in cost or un-

---

104. See generally Nebolsine *supra* note 88, at 1051.

105. The defenses of impossibility of performance and frustration of purpose, however, will not protect the promisor if the court finds that the promisor assumed the risk of the occurrence of the contingencies that have rendered performance burdensome. *See* RESTATEMENT OF CONTRACTS §§228, 454-69 (1932); 6 A. CORBIN, CONTRACTS §§1353-72 (1962). *See also* Krell v. Henry, [1903] 2 K.B. 740 (C.A.); Taylor v. Caldwell, 122 Eng. Rept. 309 (Q.B. 1863). See note 20 *supra*.

106. UNIFORM COMMERCIAL CODE, §2-615 provides: "§2-615 Excuse by Failure of Presupposed Conditions. Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance: (a) Delay in delivery or non-

availability of supplies will be taking a considerable gamble. As Professor Corbin has observed, the "application of the doctrine of impossibility of performance cannot be predicted with confidence in any given case."[107] The impossibility and frustration doctrines have been applied and rejected in various situations. For example, courts have applied the doctrines to absolve the seller of a crop of grapes from liability when part of his crop was destroyed by heat damage,[108] to excuse a licensee who agreed to pay the plaintiff to rent his apartment to view a coronation that was subsequently cancelled due to illness of the king,[109] and to relieve a lessee of the duty to pay rent when the concert hall on the property was destroyed by fire.[110] On the other hand, courts have refused to apply the doctrines to discharge a lessee's duty to pay rent when his land was occupied by a foreign army,[111] to release the seller of wheat from a contract after his crop was destroyed by frost,[112] or to excuse a wholesale marketer of molasses when his anticipated source of supply unexpectedly curtailed its output.[113]

This inconsistency has been caused largely by a failure on the part of the courts to focus on the proper factors in analyzing cases in which the defense of impossibility or the defense of frustration is raised. When facing such issues, the courts should first attempt to determine the actual or presumed intent of the parties to the contract. The courts' primary inquiry should be directed toward determining which party assumed the risk of the contingency that resulted in impossibility of performance.[114] In a sales contract, the courts could reasonably assume that, in the absence of specific language to the contrary, the seller intended to bear the risk of whatever consequences might result from nondelivery.[115] Yet, rather than

---

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

107. 6 A. CORBIN, CONTRACTS §1320, at 321-24 (2d ed. 1962).

108. Squillante v. California Lands, Inc., 5 Cal. App. 2d 89, 42 P.2d 81 (Dist. Ct. App. 1935).

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

110. Taylor v. Caldwell, 122 Eng. Rep. 309 (Q.B. 1863).

111. Paradine v. Jane, 82 Eng. Rep. 897 (K.B. 1647).

112. Anderson v. May, 50 Minn. 280, 52 N.W. 530 (1892).

113. Canadian Indus. Alcohol Co. v. Dunbar Molasses Co., 258 N.Y. 194, 179 N.E. 393 (1932).

114. Transatlantic Financing Corp. v. United States, 363 F.2d 312 (D.C. Cir. 1966); Mishara Constr. Co. v. Transit Mixed Concrete Corp., 365 Mass. 122, 310 N.E.2d 363 (1974); Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co., 508 F.2d 283 (7th Cir. 1974).

115. *Cf.* Canadian Indus. Alcohol Co. v. Dunbar Molasses Co., 258 N.Y. 194, 179 N.E.

analyzing the cases in terms of assumption of risk, the courts have focused on such factors as whether the occurrence of the contingency was foreseeable,[116] whether the impossibility is peculiar to the individual promisor (subjective impossibility)[117] or would prevent anyone from performing (objective impossibility),[118] and whether an implied condition of the contract was that the seller would be discharged in the event of impossibility.[119] The terminology used by the draftsmen of Uniform Commercial Code section 2-615, which discharges the promisor on "the occurrence of a contingency, the non-occurrence of which was a basic assumption on which the contract was made," is laudatory in that it attempts to focus the court's attention on the distribution of risks by the parties to the contract.[120] Notwithstanding this language, the courts often apply the old common law tests under section 2-615 with the accompanying unpredictable results.[121]

The doctrine of impossibility of performance will not discharge the seller in many situations in which he presumably would desire to be discharged. It is a common situation for the seller to seek discharge when his costs have increased to the point that the contract will be unprofitable for him to perform; however, the courts have seldom discharged the promisor in such cases.[122] Only in extreme situations, such as during the post-World War I period of inflation in Germany[123] and the post-Civil War period of

---

393 (1932). *See generally* Berman, *Excuse for Nonperformance in the Light of Contract Practices in International Trade*, 63 COLUM. L. REV. 1413, 1420-24 (1963).

116. Lloyd v. Murphy, 25 Cal. 2d 48, 153 P.2d 47 (1944).

117. Levy Plumbing Co. v. Standard Sanitary Mfg. Co., 68 S.W.2d 273 (Tex. Civ. App. 1933).

118. Taylor v. Caldwell, 122 Eng. Rep. 309 (Q.B. 1863).

119. *See, e.g.*, Madeirense Do Brasil S/A v. Stulman-Emrick Lumber Co., 147 F.2d 399 (2d Cir. 1945); Nebaco, Inc. v. Riverview Realty Co., 87 Nev. 55, 482 P.2d 305 (1971). *See generally* Hurst, *Freedom of Contract in an Unstable Economy; Judicial Reallocation of Contractual Risks Under UCC §2-615*, 54 N.C. L. REV. 545, 574-75 (1976).

120. For the full text of UNIFORM COMMERCIAL CODE §2-615(a), see note 106 *supra*.

121. *See, e.g.*, Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co., 508 F.2d 283 (7th Cir. 1974); Transatlantic Financing Corp. v. United States, 363 F.2d 312 (D.C. Cir. 1966); United States v. Wedgematic Corp., 360 F.2d 674 (2d Cir. 1966); Natus Corp. v. United States, 371 F.2d 450 (Ct. Cl. 1967); Mishara Constr. Co. v. Transit-Mixed Concrete Corp., 365 Mass. 122, 310 N.E.2d 363 (1974).

122. *See* American Trading & Prod. Corp. v. Shell Int'l Marine, Ltd., 453 F.2d 939 (2d Cir. 1972) (cost increase of 32%); Translatlantic Financing Corp. v. United States, 363 F.2d 312 (D.C. Cir. 1966) (cost increase of 14%); Maple Farms v. City School Dist. 76 Misc. 2d 1080, 352 N.Y.S.2d 784 (Sup. Ct. 1974) (cost increase of 23%). In the absence of some indication in the contract that the parties intended otherwise, the position taken by the courts in these cases is sound since one of the main reasons why a party typically enters into a long term contract is to protect himself against the fluctuations of the market place. Therefore, to excuse the seller merely because his cost of performance has increased would be to frustrate one of the major reasons inducing buyers to make such contracts. See UNIFORM COMMERCIAL CODE §2-165, Comment 4.

123. *See generally* Dawson, *Effects of Inflation on Private Contracts: Germany, 1914-1924*, 33 MICH. L. REV. 171 (1934). In Germany, for example, the courts refused to grant relief from contracts in which the cost of performance had greatly increased during the early stages of the German inflation. In 1919, however, wholesale prices nearly quadrupled and the courts' attitudes began to change. In one decision, the court re-

inflation in the United States, have the courts granted relief to the seller.[124]

The official comments accompanying Uniform Commercial Code section 2-615 indicate that the draftsmen of the Code intended to retain the common law denial of discharge merely for increased cost.[125] Several recent cases that arose from the 1973-1974 inflation and that considered section 2-615 indicate that the courts are continuing to apply a stringent test in such instances.[126]

In addition, the impossibility and frustration doctrines will not always protect the promisor when he is totally unable to procure the goods necessary to perform the contract. Although this situation might first appear to be a strong one for application of the impossibility defense, courts often hold the defendant liable based on a finding that the contracting parties intended that the promisor assume the risk of liability in the event that he is unable to perform. A good example of this is found in the series of cases involving the sale of crops to be grown by the promisor that were destroyed prior to the time of sale. In some of these cases the court excused the seller after the crop was destroyed on the basis that the contract was for the specific crop grown by him. Since the crop was destroyed without

---

manded the case to the lower court for consideration of whether performance would be "essentially different" from that contracted for when the defendant alleged that the cost of performance would have been three times that which it had estimated at the time the contract was signed. Judgment of Dec. 2, 1919, 98 R.G.Z. 18. In 1920 the court granted relief to a lessor who had convenanted to supply the lessee with steam in a situation in which the cost of providing the steam reached 10 times the amount of rent received by the lessor. Judgment of Sept. 21, 1920, 100 R.G.Z. 129. The court ordered the trial court to determine a reasonable price for the steam in light of changed conditions. *See also* Judgment of Feb. 3, 1922, 103 R.G.Z. 328 (person obligated to sell interest in partnership for fixed sum that became grossly inadequate because of depreciation of the mark, was granted relief); Judgment of March 24, 1922, 104 R.G.Z. 218 (case remanded to lower court with instructions to fix a fair rental value when stipulated rent had become grossly inadequate). The legislature, however, finally provided a solution to the problem by setting up a series of "scaling acts" providing for different values of conversion between old and new currency depending on the date on which the contract was executed or performance was due.

124. *See generally* Dawson & Cooper, *The Effect of Inflation on Private Contracts: United States, 1861-1879*, 33 MICH. L. REV. 706 (1935), for a discussion of the contractual problems resulting from the severe inflation in the Confederate States during and following the Civil War. This inflation ultimately rendered Confederate currency worthless, and, as in the German situation, the ultimate solution resorted to by many state legislatures was a series of "scaling acts."

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

126. Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co., 508 F.2d 283 (7th Cir. 1974) (seller not discharged despite governmental imposition of a floor on prices nearly 50% greater than the contract price); Eastern Airlines v. Gulf Oil Corp., 415 F. Supp. 429, (S.D. Fla., Case No. 74-355-Civ-JLK, filed Oct. 20, 1975) (defendant not discharged from long term contract to deliver oil despite sharp rise in market price of oil and the imposition of government petroleum allocation regulations); Publicker Indus. v. Union Carbide Corp., F. Supp. , 17 UCC REP. SERV. 989 (E.D. Pa. 1975) (defendant not discharged from contract to deliver ethanol despite rise in market price from 26.5 to 37.2 cents per gallon); Maple Farms v. City School Dist., 76 Misc. 2d 1080, 352 N.Y.S.2d 784 (Sup. Ct. 1974) (defendant held to contract to deliver milk despite 23% increase in price of raw milk).

his fault, performance was totally impossible.[127] In other cases, however, the courts have refused to discharge the seller on the ground that the contract was not for the sale of the specific crop destroyed; therefore, the seller had an obligation to purchase substitute commodities in the open market.[128] Since the face of the contract does not usually indicate whether the parties contemplated the sale of a specific crop, the results in this type of case are rather unpredictable.

Finally, even if performance is totally impossible, the court may refuse to discharge the seller if the occurrence of the contingency was foreseeable at the time the contract was signed. The rationale generally given for this is that the seller is ordinarily expected to have assumed the risk of the occurrence of such contingencies unless the contract specifies otherwise. For example, in a well-known case the Second Circuit refused to discharge the seller-shipper from a contract to deliver cargo from Brazil to the United States, although the seller was unable to procure a ship because of a shortage induced by the start of World War II.[129] Reasoning that the shortage of ships was foreseeable in view of the impending hostilities, the court concluded that the seller should have taken steps to guard against the contingency.[130]

The Force Majeure *Clause*

Since reliance on the doctrine of impossibility of performance has led to unpredictable results, a seller wishing to protect himself from liability when his failure to perform results from a cause beyond his control should include a *force majeure* clause in his contracts.[131] Although many standard forms for such clauses are available,[132] this clause must be carefully drafted because automatic use of a standard "boilerplate" *force majeure* clause, designed for use in one type of contract but unthinkingly placed in another, may create more problems than it solves. The following are some of the major problem areas that should be considered in drafting this clause.

---

127. Squillante v. California Lands, Inc., 5 Cal. App. 2d 89, 42 P.2d 81 (Dist. Ct. App. 1935).

128. Anderson v. May, 55 Minn. 280, 52 N.W. 530 (1892).

129. Madeirense Do Brasil S/A v. Stulman-Emrick Lumber Co., 147 F.2d 399 (2d Cir. 1945).

130. *Id.* at 403.

131. The term *force majeure* is French, meaning "superior or irresistible force." BLACK'S LAW DICTIONARY 774 (4th ed. 1968). When used in this context, the term refers to a clause to protect the promisor from the occurrence of contingencies that are beyond his control.

132. For example, the *force majeure* clause contained in the standard form contract of the Cocoa Merchants' Association of America, Inc., reads as follows: "Should shipment be prevented or delayed owing to prohibition of exports, fire, strikes, lockouts, riots, war, revolution or other cases of 'force majeure' the time of shipment shall be extended by one month but should the delay exceed one month the buyer shall have the option of cancelling the contract for any quantity not shipped or of accepting the Cocoa for shipment as soon as the cause for prevention or delay of shipment shall have been removed provided if such shipment be not effected within five months following the expiration date of the first month's extension with the contract shall be automatically cancelled for any quantity not shipped; such option to be declared in writing as soon as Seller announces

One initial problem is whether the clause should only delay the seller's duty of performance or should terminate it entirely.[133] To illustrate, suppose that the OPEC oil embargo had made it impossible for the seller to fulfill his contract to deliver a specified quantity of crude oil, but after the embargo was lifted, delivery again became possible. Should the seller be required to make delivery at the earliest possible date or was his obligation terminated entirely by the embargo? Conversely, does the buyer have the right to terminate the contract entirely when delivery is not made on the date specified on the contract, or is he required to accept delivery at a later date? If so, for how long a period is he obliged to accept late delivery? The RESTATEMENT OF CONTRACTS takes the position that temporary impossibility merely suspends the promisor's duty of performance unless the delayed performance would impose a burden on the promisor "substantially greater" than would have been imposed on him had there been no impossibility.[134] The cases, however, are divided on this point.[135] For this reason, the contract should provide expressly for this contingency.

Another problem lies in determining what degree of impossibility or impracticability should discharge the seller under the *force majeure* clause. Suppose that severe inflation in 1974 had increased the cost of performance of a contract by 50 percent. Should the seller be discharged on the ground that performance is impracticable, or should he be held to his obligation on the ground that he should have anticipated this degree of inflation and taken

---

his inability to ship within the extended period, or, at the latest, seven days after the extended period has expired, a reasonable time being allowed for passing on such announcements. Contract void if the Buyer fails to declare such aforesaid option as hereinbefore provided. If required, Seller must produce conclusive evidence to establish his claim for extension." Standard Contract 2-A of the Cocoa Merchants' Association of America, Inc. *reprinted in* E. FARNSWORTH, W. YOUNG, & H. JONES, CASES & MATERIALS ON CONTRACTS 270 (Supp. 1972). For other examples of *force majeure* clauses, *see, e.g.*, AMERICAN INSTITUTE OF ARCHITECTS, GENERAL CONDITIONS OF THE CONTRACT FOR CONSTRUCTION Doc. A201, §8.3 (11th ed., 1967); Armed Services Procurement Regulations, 32 C.F.R. §7-103.11(c) (1975).

133. In this era of adhesion and mass form contracts, it may be practically impossible for a party to negotiate changes in a standard *force majeure* clause. There are, however, several instances in which negotiation may be possible. First, in many commercial situations the seller, who has probably drafted the standard boilerplate agreement, may have less bargaining power than the buyer. Thus, the buyer may be able to force changes in the clause. The large automobile manufacturer bargaining with a supplier of component parts is an example. Second, many form contracts are not drafted by one of the parties but by an impartial third party. The American Institute of Architects Standard Form Agreement for use by the contractor and owner is one example. In this situation, the parties may have more freedom to make changes in the contract than if a powerful seller had initially drafted the contract. *See* Sweet, *Architectural Cost Predictions: A Legal and Institutional Analysis*, 56 CAL. L. REV. 996, 1019 n.78 (1968).

134. RESTATEMENT OF CONTRACTS §462 (1932).

135. *Compare* United States Trading Corp. v. Newmark Grain Co., 56 Cal. App. 176, 205 P. 29 (Dist. Ct. App. 1922) *and* Nordman v. Royner, 33 T.L.R. 87 (K.B. 1916) (no discharge for temporary impossibility) *with* Wasserman Theatrical Enterprise v. Harris, 137 Conn. 371, 77 A.2d 329 (1950) *and* Citizens Home Ins. Co. v. Glisson, 191 Va. 582, 61 S.E.2d 859 (1950) (promisor discharged for temporary impossibility).

necessary precautions? Again, careful draftsmanship can minimize this problem.[136]

A further problem lies in determining what is to be considered a cause of the impossibility of the seller performing the contract. The issue here is similar to the question of proximate cause, which is encountered frequently in tort law.[137] For example, while the OPEC oil embargo greatly reduced the supply of oil to the United States, the embargo did not entirely cut off the production of oil. If a seller was unable to perform a contract for the delivery of crude oil, should the court conclude that the OPEC embargo caused the inability to perform, even though oil was at least theoretically available from other sources? To take another example, should the seller be discharged from his contractual obligations because of a lengthy strike caused by excessive wage demands made by the seller's employees when the seller could have settled the strike by conceding to the employees' demands? Finally, should the seller be required to purchase black market supplies in situations in which government action has rendered the supplies needed for performance legally unavailable?

The problem of cause is perhaps the most difficult of all to deal with satisfactorily by draftsmanship, but it is probably better to attempt to come to grips with the problem than to ignore it entirely.[138]

A further difficulty that should be considered by the draftsman is the situation in which the seller is able to procure enough supplies to satisfy some but not all of his contractual obligations to various customers. In such situations, section 2-615(b) of the Uniform Commercial Code imposes on the seller the duty to allocate his output among his customers in such manner as he may determine is "fair and reasonable."[139] In addition, this section gives the seller the right, at his option, to include in such allocation regular customers not under contract.[140]

In order to avoid litigation over the seller's duty to allocate, the seller should include an express provision for allocation in the contract. The language of section 2-615 notwithstanding, several courts have held that the duty of allocation may be contractually modified by the seller.[141] Thus, presumably if the seller wishes to favor one customer over another in the event of a shortage, he may reserve the right to do so in the contract. In

136. See text accompanying notes 122-124 *supra.* Although the courts are reluctant to discharge the promisor merely because his costs of performance have increased, the parties are perfectly free to provide for discharge in the event of increased cost. While some language in Comment 8 to UNIFORM COMMERCIAL CODE §2-615 seems to suggest that the promisor cannot draft a more liberal *force majeure* clause than that provided in §2-615, there is nothing in the text of §2-615 to support this position. *See* Hurst, *supra* note 119, at 557 n.138.

137. *See generally* Patterson, *Temporary Impossibility of Performance of Contract,* 47 VA. L. REV. 798 (1961).

138. See note 132 *supra.*

139. UNIFORM COMMERCIAL CODE §2-615(b). See note 106 *supra.*

140. *Id.*

141. Intermar, Inc. v. Atlantic Richfield Co., 364 F. Supp. 82 (E.D. Pa. 1973); North Penn Oil & Tire Co. v. Phillips Petroleum Co., 358 F. Supp. 908 (E.D. Pa. 1973); Manis-field Propane Gas Co. v. Folger Gas Co., 231 Ga. 868, 204 S.E.2d 625 (1974).

such event, the seller would be wise to include a priority clause not only in the contract with the customer to be favored but also in all other contracts so that less-favored customers will have notice of their status. Moreover, since section 2-615(b) is vague as to the manner of allocation, the contract should expressly state the manner in which such an allocation would be made in order to forestall litigation over this point.

In conclusion, to avoid placing total reliance on the defenses of impossibility and frustration, it is highly desirable to include a *force majeure* clause in the contract. Although it is virtually impossible to foresee and satisfactorily deal with all of the contingencies that may occur, the parties should certainly make every effort to do so. The greater the number of contingencies that are dealt with in the *force majeure* clause, the lesser is the probability that the courts will have to deal with the issue of discharge unaided by some indication of the intent of the parties to the contract.

Conclusion

Contract law today is sufficiently flexible to allow the use of many techniques that render the use of long term contracts feasible, even in an era of persistent inflation. In most situations, the open-price contract, which contains a formula for determining the contract price at the time of performance, and the price indexing or escalator clause, which adjusts the contract price according to the cost of performance or changes in the general price level, are the most effective techniques. The gold clause, on the other hand, is of limited utility today, given the de-monetization of gold and erratic fluctuations in its price. The cost-plus contract, because of its complexity and the difficulty in calculation of the true cost of performance, is generally undesirable if the only reason for its use is to provide protection against inflation. Finally, a carefully drafted *force majeure* clause should be an essential part of most long term contracts since escalator clauses and open price provisions do not offer full protection in the event of embargo or shortages of materials essential for performance.

Notwithstanding the availability of the above techniques, parties contemplating the use of a long term contract always should consider using a short term, fixed-price contract. Open-price and indexing provisions introduce an element of uncertainty into the contract that may be unacceptable to the parties, particularly if advance knowledge of costs is critical. Thus, in situations in which advance knowledge of the contract price is critical, the short term, fixed price contract may be a more satisfactory alternative than a long term contract containing clauses designed to protect the parties from the effects of inflation.

Regardless of the precise technique that is chosen, the lawyer who is aware of the effects that inflation may have on a contract and who possesses a working knowledge of the techniques described above will be in a much better position to protect the interests of his client.[142]

---

142. *See generally* White, *Drafting Contracts in a Shortage Economy*, in P.L.I., Breach of Contract in a Shortage Economy Revisited (1974).