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Uncertainty Risks

UNCERTAINTY HAZARDS

Uncertain Expectations

Uncertainty is defined as "[t]he quality, state, or condition of being in some degree of serious doubt" and "anything that is indefinite, indeterminate, or dubious."[1] First, one or more conditions and contingencies that affect task completion and benefit realization may be in serious doubt or indeterminate at contract formation. The lack of information about such conditions and contingencies creates uncertainty about what actually exists in the case of a condition and what will occur in the case of a contingency. Second, independent of whether conditions and contingencies are known, a task or benefit may be indefinitely or vaguely conceived at contract formation; no one can definitely say which actions will complete such a task or the value that must be realized. It will be difficult or impossible to say if the task has been completed or the benefit realized.

The intentions or expectations stated in a contract can be clear or vague, they can be concordant or discordant, and they can be inadvertently or intentionally so: clear or vague and concordant or discordant. Certainty is at its best when, at contract formation:

- A party's expectations about the benefits it should realize, the tasks to be completed by all parties, the commitments to complete those tasks, and responsibility for unknown conditions and contingencies are sufficiently specific that there is no reason for doubting what is required.
- The other party understands and accepts those expectations.

The expectations are clear and concordant and known to be so. Uncertainty is at its worst when

- Whatever expectations a party has about such benefits, tasks, commitments, and responsibility are vague.
- The other party does not understand or accept those expectations.

The uncertainty described in the first bullet is the party's expectation at contract formation: the party does not know what it will expect when after contract formation its ideas about the transaction have evolved into more specific expectations. The hazard is proceeding with only vague expectations, whether or not the party knows how vague its expectations are. The uncertainty in the second bullet is whether the party's expectations will prevail in the event they are disputed by the other party. The hazard is proceeding with discordant expectations, whether or not the party is aware of them.

The following cases illustrate such uncertainties.

- *Cummings v. Dusenberry*[2]: House buyers told their sellers they wanted to buy a "year-round house." This was not a term of art in the real estate trade. The sellers sold the buyers a house in which the windows leaked and let in flies, the roof leaked badly during rains, and the walls dripped with condensation in the winter. At contract formation, the buyers had a vague notion of the house they expected to buy, but after living in it for some time came to expect a house without such shortcomings. The sellers viewed the buyers' expectation of a year-round house to be meaningless, like a "good house," "nice location," or house the buyer will be "happy with."[3] The sellers did not accept the buyers' revised expectations of a habitable house. The case illustrates uncertainty as described in both bullets.
- *Harlequin Enterprises, Ltd. v. Warner Books, Inc.*[4]: A writer who created a fictional character who decimated mafia gangsters agreed that his publisher could publish books in the series written by other authors. At contract formation, his publisher recognized it would be best protected by, and asked the writer for, a commitment not to write any work that competed directly or indirectly with sales of the series.[5] The author accepted the proposal but reserved "the right to create and/or write works for others, other than works which would compete with the sale of the action-adventure series contemplated in [the contract]." The writer later agreed to write a new series for another publisher centered on a "psychic detective" and based on "mystical and supernatural themes, mixing parapsychology and the occult with detective suspense and sex."[6] The first publisher had hoped the writer would not write a new fiction series that would erode sales of its action series and, if he did, its view of the limitation would be accepted by a court.[7] In effect, the parties decided not to decide, at contract formation, what the contract should require of the author. The author had more than a vague but less than a certain notion of the works he might write, while the publisher had a clear idea of what it hoped he would not write. The case also illustrates uncertainty as described in both bullets, though to a lesser extent than that described in the first than in the second bullet.

Vague expectations may be attributable to the following:

- Lack of sufficient experience and expertise to shape a party's ideas into a clear expectation. *Cummings* illustrates such inexperience.
- Insufficient time or effort devoted to planning the details of the transaction. Contract formation may come too early to the transaction, with the result that the parties have still to crystallize their expectations. The parties may be unwilling to invest the time and effort to reach a detailed agreement on all issues. *Harlequin Enterprises, Ltd*. illustrates such an unwillingness: they chose to leave open what the author would be allowed to write rather than resolve the issue at contract formation. Transaction planning, negotiation, and documentation, like diligence, takes time and money, both of which are limited resources that must be rationed, no matter how important the transaction is to the party. In addition, negotiating terms ancillary to the principal benefits of the transaction risks upsetting agreement on the principal matters. Vagueness of expectation may be a price a party is willing to pay for time and cost savings during transaction planning, negotiation, and documentation.
- Uncertainties about the conditions and contingencies that significantly affect any effort to describe the benefits that might be realized or the tasks that have to be completed. How such uncertainties affect that effort is explained in the following section.

Whatever the cause of uncertainty, the hazards remain the same: a party proceeds with a transaction with a vague idea of the benefits, tasks, commitments, or responsibility for conditions and contingencies, or an idea of the foregoing that differs from that of the other party.

The following cases are additional illustrations of the uncertainties described in the first two bullets.

- *Coto-Matic, Inc. v. Home Indemnity Co*.[8]: Coto-Matic's founder and general manager (H) saw a machine in Los Angeles that created a semiautomatic process that painted small pieces of sheet metal. He decided to develop a machine in Kansas that would uniquely operate an automated process: coiled metal would be unwound, treated in a series of tanks, dried in a tower, painted by a paint applicator, baked in an oven, and rewound or coiled, all operating through a connecting and timed system. He asked a contractor to quote a price for fabricating such a machine based on a loose description of how it would perform. The contractor quoted a price and later agreed to fabricate the machine, incorporating that description into the contract and a list of components. When tested, by feeding the metal coils into the machine, it had to be stopped, adjusted, and restarted. The contractor made adjustments but H was still dissatisfied with the result.[9] The case illustrates a vague idea that stemmed from lack of expertise: H had done no more than describe the dimensions and his concept of the operation of the machine, which had not previously been fabricated. Either he or the contractor had to assume responsibility for the risk the machine, the technical details of which were so vaguely described, would not meet his expectations.[10]
- *GLS Development, Inc. v. Wal-Mart Stores, Inc*.[11]: Wal-Mart, a retail chain store, after agreeing with a developer that the latter would develop a site for one of its stores, asked the developer to transfer its development rights to another developer, offering as consideration $500,000 and "a few" additional projects to work on. The developer transferred its rights but never received the payment or a new project.[12] The case illustrates uncertainty about what Wal-Mart and the developer expected by the term "few projects." At best, each had only a vague idea about what it hoped for. The vagueness of the words "few projects" created another risk, discussed in chapter 6, that the legal formalities for creating a binding commitment had not been satisfied. As a result, Wal-Mart had no commitment to give any projects to the developer. In this case, the uncertainty could have been eliminated by devoting time to specify the few projects before contract formation. Complex projects are often vague ideas in their inception and evolve with careful planning. Contract formation arrived too early for the developer, who accepted uncertainty about what tasks Wal-Mart would perform.

Condition and Contingency Uncertainty

Condition Uncertainty. A condition, the existence or nonexistence of which affects task completion or benefit realization, is uncertain when a party lacks sufficient information at contract formation to determine whether such condition exists. Such information may or may not be available; or the condition may or may not be knowable at contract formation. Either way, the existence of the condition is unknown to the party having to decide whether and how to proceed with a transaction. This predicament was described as scenario (3)(a) or (b) in the last chapter: in scenario (3)(a), a party has insufficient information about a condition affecting the completion of a task it must complete; in scenario 3(b), a party has insufficient information about a condition affecting the completion of a task the other party must complete. In each case, it makes an assumption about the condition. That assumption may be favorable, that the condition exists, or unfavorable, that it does not. Because that assumption may prove to be incorrect, proceeding on the basis of such an assumption may be also a hazard. In short, the solution—making an assumption about a condition to resolve uncertainty about that condition—swaps one risk, uncertainty, for another, an incorrect assumption.

Following are cases that illustrate condition uncertainty risk.

- *Laidlaw v. Organ*[13]: A tobacco buyer received news that a treaty had been signed ending the 1812 war between Britain and the United States. He bought tobacco from a merchant ignorant of this news in New Orleans, where tobacco prices were depressed because the port had been blockaded. The seller asked the buyer "if there was any news which was calculated to enhance the price or value of the article about to be purchased." The buyer did not respond; the seller nonetheless agreed to sell. The price of tobacco increased 30 percent to 50 percent the following day. The uncertainty, whether the war and resulting blockade continued, did not affect the task the seller was to perform, sale of the tobacco. It affected the value the seller would realize and the corresponding task the buyer had to complete, payment of the price. The transaction was scenario (3)(a)(ii) if the seller assumed the war continued and the port remained blocked. Whether or not he did, he accepted the risk the tobacco was worth more than the price he received.[14]
- *Kennedy v. Reece*[15]: A contractor agreed to drill a hole for a water well to a depth of 400 feet for a fixed price. It encountered hard rock at a depth of 130 feet. It started over at another location, where it drilled to a depth of 270 feet and encountered further hard rock. It abandoned the work. Two other contractors were willing to drill at a third location to the depth of 400 feet. The uncertainty, the hardness of the subsurface, affected the contractor's task and cost, as more time and effort was required to drill a third hole.[16] The case was also scenario

(3)(a)(ii) if the contractor assumed it would not have to drill more than one hole. The contractor had assumed responsibility for the risk its costs would exceed its fixed price unless its performance was excused.[17]

The uncertainties about whether hostilities continued and the extent of rock in the subsurface became hazards at contract formation. In the first case, the seller had to agree upon a price while unable to determine if a condition depressing the price of his tobacco continued. Had he been able to index the price to a market that reflected relevant conditions, he would have been able to avoid uncertainty risk. In the absence of such an index, he would have to assume the risk the tobacco was worth more than the agreed price, whatever that price might be, but the higher that price the less the chance of selling too low. Put another way, any increase in compensation paid to the seller would have diminished the seller's potential losses from uncertainty risk. In the second example, the contractor assumed uncertainty risk by fixing his price without knowing how many holes he would have to drill. The uncertainty risks in these cases could have been traded for incorrect assumption risks, that is, assumptions about the existence or nonexistence of the condition. If not, the uncertainty risks remained and responsibility for them was assumed by the seller in *Laidlaw* and the contractor in *Kennedy*.

Contingency Uncertainty. As observed, a contingency is always uncertain because the occurrence of a future event is to some degree unpredictable. The best information about a contingency forecasts the probability of its occurrence but cannot predict its occurrence with certainty. As such, whether a contingency will occur will be unknown to the party having to decide whether and how to proceed with a transaction. This is also the predicament described as scenarios (3)(a) and (b) in chapter 4: because it cannot confirm that a contingency will occur, a party might make an assumption about the contingency. However, because that assumption may prove to be incorrect, proceeding with a transaction on the basis of such an assumption is also a hazard.

The more possible outcomes of a contingency, the occurrence of which will affect benefit realization and task completion, the more difficult the description at contract formation of the specific benefits that may be realized and tasks that must be completed. Planning for a contingency that has two results entails just that: determining what task, if any, should be completed for each outcome. For example, two outcomes of a lottery ticket purchase are possible: the winning numbers drawn correspond to those on the ticket or they do not. The ticket buyer might plan for both outcomes or make an assumption about the outcome and plan accordingly. As the variations of an outcome multiply, planning for each becomes impractical at some point and the resulting uncertainty is a tolerable necessity. A transaction that contemplates more than one action over a period of time further complicates planning because a number of contingencies, each with multiple outcomes, may be relevant. Identifying all the potential outcomes of each contingency or combination of contingencies may be difficult, let alone specifying how a party must act in response to each outcome. Assumptions might be made, but they may be unrealistic in view of the uncertainties. Uncertainty about the outcome of the contingencies results in uncertainty about what tasks must be completed and the benefits that will be realized. Expectation uncertainty, itself a hazard, may be the result of condition and contingency uncertainty. The hazard is uncertainty about contingencies that result in uncertainties about the potential benefits and tasks.

Following are cases that illustrate such contingency uncertainty.

- *Western Geophysical Co. of America, Inc. v. Bolt Associates, Inc.*[18]: A licensee of a patent for an air gun device designed to provide a source of sound for use in underwater seismic exploration agreed to use its best efforts to promote the licensing and sublicensing of the product. After the first one and one-half years, during which time the licensee redesigned the device to eliminate technical shortcomings affecting its performance for shallow reconnaissance surveys or oceanographic mapping, one of its two uses, the licensee concluded superior devices were available in the market for such purpose and did not attempt to market it for that use. The licensee also attempted to develop a "system" for the other use for the device, deep penetration seismic exploration, as it judged that the users of such devices for such exploration were not interested in the device without a system. The licensee never completed this effort. When no one had been licensed after three and one-quarter years, the licensor terminated the license. The licensor claimed the licensee had not done enough to promote the product.[19] The case illustrates how the nature and extent of the tasks to be performed were uncertain due to contingencies: one contingency was the full development of the technical capabilities the air gun and another was the availability of similar devices in the market. Both contingencies had several potential outcomes.
- *DaimlerChrysler Motors Co., LLC v. Manuel*[20]: An automobile dealer agreed with the manufacturer to build a new dealership facility at an agreed-upon location. The manufacturer agreed it would use its best efforts to litigate or settle any protest against such new location that was lodged before a state commission by another dealer. In fact, another dealer did protest the new location before a state commission, even though it had previously waived its right to protest the location of new dealerships. The manufacturer sued the protesting dealer in federal court, which remitted the dispute to the state commission. Eventually, the manufacturer settled with the protesting dealer. The dealer claimed the manufacturer waited too long to reach such settlement.[21] The case illustrates how a contingency creates uncertainty about when and how a task should be completed. At contract formation, the manufacturer could not have stated how aggressively it would litigate before settling the protest, as that could have tipped its hand to the protesting dealer.[22] It also had to wait until a dealer protested, as only then could it assess the potential reaction to litigation by the protesting dealer, the courts, and state commission.[23]
- *Middleton v. California Co.*[24]: Land in the amount of 4,600 acres was leased for oil and gas exploration and production for a one-eighth royalty. Only 30 wells on 400 acres were drilled during the first 18 years of the lease, but they produced more than 17,000,000 barrels of oil and yielded payments of more than $4,000,000 in royalties to the lessors. Very little was done on the remainder of the leased land. When the lessors were offered a one-sixth royalty by another oil company for a lease of a portion of the leased area not developed by the first oil company, they invoked a clause in the lease allowing termination if the operations were not conducted in accordance with the lease. The alleged breach was the failure to use reasonable diligence to drill on every part of the leased premises.[25] It seems likely that because the mineral lessors did not contemplate exploration and production proceeding according to a specific drilling plan, none having been agreed at any time, they had vague expectations about the rate at which the mineral lessee would explore and develop producing wells. That changed when a better deal was offered for the undeveloped portion of the premises.[26] The case illustrates a combination of condition and

contingency uncertainty: at contract formation, the extent of the crude oil reserves was unknown (a condition) and the cost of exploration and production and the price at which such oil could be sold (contingencies) were unknown.

In none of the three cases was it practical at contract formation to state in reasonable detail all the tasks that were to be completed by the licensee, manufacturer, and mineral lessee. The various outcomes of all the contingencies made that effort unrealistic. In all three cases, the contingencies—the development of the technology and the market for such air guns in *Western Geophysical Co. of America, Inc.*, the reactions of the other dealer to litigation in *DaimlerChrysler Motors Co., LLC*[27] and the extent of the resource, the cost of production, and the price of crude oil in *Middleton*—were potential hazards before contract formation. They became hazards at contract formation when the parties decided to proceed with the transactions notwithstanding the uncertainties. They became hazards at contract formation to both of the parties in all three transactions because the tasks to be completed either had not been specified, as in *Middleton*, or vaguely specified as in the other two cases. In *Western Geophysical Co. of America, Inc.*, the best efforts obligation allocated to the licensee responsibility for the risk that it would have to do more to develop and market the air gun than it anticipated and to the licensor responsibility for the risk that the licensee would have to do less than anticipated. In *DaimlerChrysler Motors Co., LLC*,[28] the best efforts obligation allocated to the manufacturer responsibility for the risk it would have to settle earlier and for more money than anticipated and to the dealer responsibility for the risk it would have to wait longer while the litigation dragged on longer than anticipated. None of the parties could be certain what would be required of the licensee, manufacturer, or mineral lessee.

UNCERTAINTY RISK MANAGEMENT

Diligence

Examination of the potential benefits and tasks during the planning phase should drive a party to clarify its expectations about the benefits it hopes to realize and the tasks the parties must complete to realize them. In a case where a party has insufficient experience or expertise, as did the general manager in *Coto-Matic, Inc.*, it might recognize the uncertainties in its plans. It might abandon the effort or enlist help to guide the detailed planning of the tasks and benefit. Identifying and forecasting contingencies that determine what tasks will have to be completed will also help crystallize expectations about benefits and tasks, although because contingencies do not occur until after contract formation, no definitive statement of such expectations is realistic when a task is largely undertaken in reaction to a contingency.

In a transaction in which there are critical conditions and contingencies that are unknown and unknowable at contract formation, diligence will help to identify these unknowable uncertainties and their impact on a party's expectations about the potential benefits and corresponding tasks. *Middleton*[29] is an example: in view of the large area covered by the mineral lease and the absence of accurate information about the crude oil reserves, the cost of exploring, developing, producing, and marketing crude oil, the extent and pace at which the mineral lessee would proceed was bound to be uncertain at contract formation. Diligence can mitigate, if not eliminate, expectation uncertainty where the conditions and contingencies that shape expectations about benefits and tasks are knowable or, if unknowable, are few or insignificant. It mitigates uncertainty to a lesser extent when unknowable conditions and contingencies make crystallization of benefits and tasks unrealistic at contract formation. As noted in previous chapters, this text, while repeatedly emphasizing the importance of diligence to transaction planning, does not explain the diligence appropriate for any transaction.

Define Benefits and Tasks or Process

Contract interpretation principles, especially those applicable to clear terms that can be given their plain meaning, vague and ambiguous terms that require additional evidence and speculation to give them meaning in specific cases, and the implied duty of good faith and fair dealing allocate the uncertainty risks previously described. For example, in *Coto-Matic, Inc.*,[30] a case of expectation uncertainty previously summarized,[31] contract interpretation principles called for the contract to be classified as one that limited the contractor's contractual obligation to fabricate a mechanically suitable machine capable of meeting the parties' concept of a five-stage operation properly coordinated in time and function and in accord with the contractually agreed upon plans and specifications or as one to accomplish an unqualified end result for a continuous finishing system mentioned in the contract. Those principles implied that responsibility for the uncertainty risk—what was required to achieve that end and whether doing so was feasible—was assumed by the company in the former and by the contractor in the latter.

In *Middleton*, also previously summarized,[32] where the extent of the resource and the costs and returns of developing them were uncertain, contract interpretation principles would, in the absence of exceptional circumstances, have implied a term that the lessee had to develop with reasonable diligence every part of the leased premises, having due regard for the interests of all contracting parties, or surrender the lease. In exceptional circumstances, the term implied was that the lessee had to develop the lease with reasonable diligence. The former principle implied the uncertainty risks had been assumed by the lessee, and the latter implied the risk had been assumed by the lessor so long as the lessee reasonably developed the acreage. Such principles create the framework for managing the uncertainty risks previously described.

A party that recognizes benefit and task uncertainty in a transaction has two alternatives or strategies for managing that risk:

- State some or all of the tasks either vaguely or clearly in the contract.
- State clearly a process for defining some or all of the tasks in the contract as and when it becomes necessary to decide on benefits and tasks.

Although it is seemingly inconsistent for a party having only vague expectations to clearly define the tasks to be performed, whether by it or the other party, both strategies are available for both uncertainty hazards previously described.

Define Benefits and Tasks. A statement of the tasks to be completed may be clear or vague.

- A clear statement defines each of the tasks with sufficient specificity that each party can understand what is required of it and the other party. The risk to a party that has vague expectations at contract formation is that when its expectations crystallize as the transaction evolves, they will vary from what the contract requires. It will be, and such party assumes the risk it will be, required to give more or accept less than eventually expected.

- A statement of tasks will be sufficiently vague as to encompass nearly all the possible actions that might have to be completed by one or both parties during the course of implementing a transaction. The risk to a party that has vague expectations at contract formation is the same as the previous bullet: as expectations crystallize, they may vary from what the other party expects, which may be what the contract requires. *Middleton*[33] is one example: the mineral lessors came to expect a faster pace of development of the leased acreage. *DaimlerChrysler Motors Co., Ltd.* is another example: the dealer came to expect a quicker settlement by the manufacturer than the manufacturer did. The risk to a party that has clear expectations at contract formation is that they may vary from what the other party expects, which may be what the contract requires. In either event, in the worst case, it will be required to give more or accept less than eventually expected. An additional risk, as illustrated by *GLS Development, Inc.*,[34] is that the vague wording may fail to satisfy the legal formalities of contract formation, and thus not create a binding commitment.

A difference between the two strategies is that there is certainty about what the contract requires in the first but not the second.

Define with Certainty. A party that is uncertain about the benefit it expects to realize or the task it expects to be completed can, notwithstanding such uncertainty, state in the contract that a specific task will be completed in the hope that it will prove to be the correct one. If there is uncertainty about a condition or contingency that affects the description of a benefit or task, a specific task can still be described, again, on the hope that the condition or contingency will be as supposed. If the party stating or accepting such statement is the obligor, it runs the risk of having to give more than it ultimately expects. If the party stating or accepting such statement is the obligee, it runs the risk of receiving less than it ultimately expects to receive. *Laidlaw* is an example: the price of the tobacco could be fixed, notwithstanding the uncertainty about the hostilities, but stating a fixed price allocated responsibility for the uncertainties about the conditions to the seller.

The contracts in the following cases also used clear statements of tasks when one or both parties had uncertain expectations about what such tasks included.

- *State ex rel. Santa Fe Sand & Gravel Co. v. Pecos Construction Co., Inc.*[35]: A subcontractor agreed to "furnish all plant, labor and equipment required to perform" a mass excavation and backfilling for a project for a fixed price. The subcontractor underestimated the volume of mass excavation. The subcontractor claimed the contract was vague on the scope of the mass excavation, and it should be compensated for the additional work. The case illustrates how a clear statement of a task to be completed managed uncertainty about a condition that determined the scope of work. By agreeing to do all excavation for a fixed price, the subcontractor assumed responsibility for the risk the work would exceed its estimate.[36] It may also illustrate scenario (2)(a)(ii) described in chapter 4 (party incorrectly processes correct information about a task it must complete for the other party's benefit).
- *Austin v. Cotten*[37]: Austin hired Cotten, an engineer, to consult on a street improvement project for which it would pay him 8.1 percent of the total project cost, not to exceed $28,800, calculated as a percentage of an estimated project cost of $358,000. The limitation on his fees was increased twice, as the total costs exceeded the estimates. The consultant asked, but the city refused, to delete the limitation.[38] When the total project cost exceeded $980,000, the consultant claimed additional compensation, contending that the limitation was based on a mistake of fact, that the estimated total project cost was reliable.[39] The case illustrates how a contingency, in this case development of the scope of the project, generated uncertainty over the extent of tasks to be completed, the effort required of the consultant. It further illustrates how that risk was managed by a clear statement of the task the consultant was to complete—all the consulting work on the project: the consultant assumed responsibility for the risk that the effort required would exceed the initial estimate.[40] Finally, the case may illustrate scenario (1)(b)(ii) described in chapter 4 (Cotten relied upon incorrect information received from the city about the scope of the work he had complete for the city's benefit).
- *TPS Technologies, Inc. v. Rodin Enterprises, Inc.*[41]: A property owner estimated 1,000 tons of contaminated soil would have to be removed to remediate a site and hired a contractor to remove all contaminated soil for a fixed amount per ton of soil removed. The contractor removed 902.12 tons during the first phase and 916.19 tons during the second phase. The owner objected to the invoice for the second phase, claiming that the environmental permit limited the scope of work to 1,000 tons. The case illustrates how uncertainty over a condition creates uncertainty over the scope of the tasks to be completed. It is also an example of how a unit price contract can be used to manage that uncertainty risk: Had the scope been limited to phase one as the owner contended, the owner would have been responsible for the risk that a second phase had to be undertaken, but it would not have been committed to paying the contractor for that work. Because the scope had not been limited, the owner assumed responsibility for the risk that a second phase had to be executed.[42] The case may illustrate scenario (3)(b)(ii) described in chapter 4 (the property owner relied upon an incorrect assumption about a task the contractor had to complete for the property owner's benefit).

The previous cases further illustrate how the method of compensation, when combined with a specific description of the task to be completed, allocates responsibility for the uncertainty concerning the scope of the task. If the value it receives for completing a task is fixed, the scope of which task is uncertain, the obligor risks having to give more time and effort than anticipated for the fixed amount; it bears responsibility for uncertainty risk. The discrepancy between what it anticipated giving and what it must give to complete the task is its loss. If the value varies with the actual scope but is fixed for each hour, item, or other unit of measure, the obligor assumes responsibility for the risk that its unit cost will be higher than anticipated, perhaps because each unit is more difficult to complete than anticipated. Because such value is also calculated based on the actual scope, it does not assume responsibility for the risk that the scope will be greater than anticipated. If the value is based on the obligor's costs of completing the task, the obligor has passed back to the obligee responsibility for the risk that the scope and the effort of completion may be greater than anticipated.

Define with Uncertainty. A party that is uncertain about the benefit it expects to realize or the task it expects to be completed can state such tasks in the contract with such ambiguity that whatever it later decides should be the benefits and tasks will be included in the contract. The contract "reflects" the party's own vague expectations. *Cummings*,[43] *Coto-Matic, Inc.*[44] and *GLS Development, Inc.*[45] are examples. A party that is certain about the benefit it expects to realize or the task it expects to be completed could also adopt such strategy, though it would make sense as a hedge against the risk that it may later find it was wrong and the description of the tasks should have been different. Vague contractual language does not specifically allocate responsibility for the uncertainty risk to either party. *Middleton*[46] is an example: the mineral lessors assumed responsibility for the risk that exploration and production could proceed at a pace slower than they wished, and the mineral lessee assumed responsibility for the risk that exploration and production might have to proceed at a pace faster than it wished. Words such as "material," "materially adverse," and "reasonable" do not indicate what must specifically occur or be done for an event or act to be material, materially adverse, or reasonable. Their meaning is decided on a case-by-case basis. *DaimlerChrysler Motors Co., LLC*[47] is also an example. Their exact meaning—what they will mean in the circumstances in which a dispute over their meaning arises—cannot be predicted at contract formation. Their initial effect is to defer to a later date (when the event must occur or the party must complete the task described by the vague language) the determination of what specifically it means. Each party bears responsibility for the risk that the meaning ultimately given to the language varies from its ultimate expectations.

Bloor v. Falstaff Brewing Corp.[48] further illustrates the risk to an obligor whose obligation to use best efforts is defined as and when the obligor must act. A purchaser of a brewery production and distribution business agreed to pay, as part of the purchase price, a royalty per barrel of the brands sold. It also agreed to use its best efforts to promote and maintain a high level of sales of the brands. Four years later, during which the operations of the brands lost $22 million, even though advertising and sales were increased, a new buyer assumed control of the brands' operations and, following a strategy used for marketing its own brands, cut costs by reducing advertising and the number of distribution centers. Where in the year prior to the new buyer's assuming control sales increased 2.4 percent, sales declined during the new buyer's first two years by 29.72 percent and 45.81 percent, respectively, but had a net income of $8.6 million. The seller successfully claimed the new buyer's emphasis on profit over sales of the brands breached the best efforts obligation. The parties could not have detailed at contract formation how much the buyer should spend each year on marketing the products, as the potential effectiveness of such efforts would depend upon a range of factors, all contingencies, which yielded uncertainty about the extent to which marketing efforts would promote sales. The best efforts commitment left for later resolution what specifically the buyer was required to do. Both parties assumed responsibility for uncertainty risk, although the seller ultimately prevailed.

Define Process. Instead of defining the benefits and tasks and stating how responsibility for unknown conditions and contingencies should be allocated, a contract can prescribe a process by which one or more parties define benefits and tasks as expectations are clarified. Such process is similar and economically equivalent to the amendment procedure described in chapter 3. A technical difference is that an amendment changes an existing contractual term, where a process for defining tasks clarifies, eliminates ambiguity in, and supplements existing terms. A process can specify when decisions about benefits, tasks, condition, and contingencies may or must be made, who may make and participate in making them, and limitations on decision-making authority.

Single Party, Sole Discretion. The best and worst cases are the same procedure: one party has sole discretion to decide the benefits that will be realized, the tasks to be completed and when and how they will be completed, and responsibility for conditions and contingencies. The procedure is best for the decision maker and worst for the other party. The obligee, as decision maker, decides what task the obligor must complete and when and how they will be completed. The obligor, as decision maker, decides what tasks it will complete and when and how it will complete them. Uncertainty risk is mitigated, if not eliminated, for the decision maker because it can decide how such uncertainty is to be resolved. For the other party, however, the uncertainty risk is traded for another: the risk that the decision maker may properly decide in a way that was unexpected by the other party. This risk is explained and illustrated with cases in chapter 7.[49]

Single Party, Limited Discretion. The risk to a party of an adverse decision by the other party when the latter is the sole decision maker can be mitigated by requiring that the decision conform to a minimum standard. One of the most common is that the decision be reasonable. This standard allows a party to question the reasons for a decision. Because the decision maker has discretion to resolve uncertainties falling with that discretion, the discretion still mitigates uncertainty risk; however, because the exercise of that discretion must conform to a standard the meaning of which is itself uncertain at contract formation, uncertainty has not been entirely eliminated. Such limitations on discretion are discussed in chapter 7 and are mentioned here to indicate their effect on uncertainty risk.[50]

Multiple Parties. A procedure can give both parties a voice in decisions that resolve uncertainties. One common requirement is that the decision maker consult the other party before making its decision. Such consultation may be simple or elaborate. A second procedure, typified by joint venture decision-making, requires collaboration by the parties and extends participation in decision-making: the venture parties periodically exchange information, meet, and decide certain matters. In joint ventures, such decision-making may be formal and regulated: some decisions may be required to be by majority, others by a supermajority, and still others by unanimity of the parties or interests. In other contexts, depending upon the nature of the transaction and the relationships of the parties, collaboration may be more or less formal than in joint ventures. An agreement to agree on a future matter is the simplest and most extreme form of joint decision-making, giving each party total discretion to accept or reject the other party's proposals. A refusal to agree is a decision that is adverse to the party seeking agreement.

Collaborative decision-making trades one uncertainty risk for another. Uncertainty about the tasks to be completed is a risk because, at contract formation, a party may commit to complete or to accept completion of a task while being uncertain about whether that is the task that it will ultimately expect to be completed and whether the task is what is needed when its expectations crystallize. Decision-making eliminates that risk for a party when the procedure itself is certain because the parties know how uncertainties will be resolved. This is true for both the decision maker and the other party. The latter, however, assumes the risk of decisions adverse to its interest. Decision-making does not eliminate the risk if the outcome is unpredictable because a decision maker must collaborate or decision makers must agree on their decisions but have no commitment to do so. The irony of agreements to agree that are found to be too vague to be enforceable is that the outcome of such unenforceability is that the party's refusal to agree is effective. Uncertainty about benefits, tasks, commitments, conditions, or contingencies is traded for uncertainty about the decisions that should resolve such uncertainty.

Termination

Uncertainty risks can be mitigated by termination, cancellation, or rescission of a contract just as such devices manage benefit and task oversight and rejection and commitment gap risks. A termination or equivalent right enables a party to make a choice after contract formation it would not otherwise have made. An obligor whose expectations at contract formation were uncertain and who later finds its task is more onerous than it expects, having deepened and clarified its expectations, can choose to terminate, abandoning the transaction. The obligee who has expectations at contract formation that were uncertain and who, having deepened and clarified its expectations, finds the benefits less than expected or its task greater than expected may choose to terminate, abandoning the transaction. Such termination right can be broadly formulated to allow a party to terminate for any reason or be narrowly focused on a condition or contingency, permitting termination only if the condition that must exist does not exist or the contingency that must not occur occurs. Unless the contract imposes a termination fee or similar charge on the terminating party, each party bears uncertainty risk to the extent it loses all costs incurred in preparing for and proceeding with the transaction through the date of termination as well as the anticipated benefits. If the contract also imposes a termination or similar fee, the terminating party incurs that as an additional loss. The termination or equivalent right enables the terminating party to allocate such sharing of responsibility for task uncertainty risk between the parties.

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1 BLACK'S LAW DICTIONARY 1756 (10th ed. 2014).

2 129 Ill. App.3d 338, 472 N.E.2d 575 (Ill. App. 1984).

3 The house buyers sued for rescission, claiming breach of warranty (because a year-round house implied a warranty of habitability) and unilateral mistake. The court, while rejecting the implied warranty, allowed rescission on the grounds of unilateral mistake, holding, "Although the question of what constitutes a 'year-round' home is somewhat a question of personal taste, there was evidence in the record that this home was built as a vacation house, and was not suitable for winter use by a young family." *Id*. at 344.

4 639 F. Supp. 1081 (S.D.N.Y. 1986).

5 Don Pendleton, who authored a highly successful "Executioner" series of 38 action novels based on a character who hunted down and killed mafia gangsters, agreed that Harlequin could continue publishing new novels in the series, which, because the mafia had been decimated in the earlier novels, was expanded to include terrorists and other crazies and was labeled as the "Gold Eagle" series, the ideas for which would come from Pendleton but the writing would be by authors hired by Harlequin; in return, Pendleton would be paid a royalty on each book sold. Unusually, the contract prohibited Pendleton from competing directly or indirectly with the Executioner series, but, at Pendleton's request, reserved to him "the right to create and/or write works for others, other than works which would compete with the sale of the action-adventure series contemplated in this Agreement, which Pendleton may publish or cause to be published in any language throughout the world." *Id*. at 1084.

6 *Id*. at 1084.

7 "Harlequin's people claim that they knew that paragraph 8 would allow Pendleton to write in the future, but understood that his interest was limited to publishing inspirational, nonfiction works." *Id*. at 1087.

8 354 F.2d 720 (10th Cir. 1965).

9 Coto-Matic sued for damages, claiming the contractor had failed to produce the continuous finishing system called for in the contract. The appeals court upheld the trial court's verdict in favor of the contractor. "We conclude, therefore, that the obligation of [the contractor] Industrial was not to accomplish an unqualified end result for a continuous finishing system in that phrase's broad sense but was limited to a contractual obligation to fabricate a mechanically suitable machine capable of meeting the parties' concept of a five-stage operation properly coordinated in time and function and in accord with the contractually agreed upon plans and specifications." *Id*. at 725.

10 "It is difficult to comprehend that either the contractors or the owners contemplated building such a unique piece of machinery with only its size and dimensions in mind— disregarding for contract purposes whether it would actually and ultimately process and paint metal as originally conceived." *Id*. at 724–25.

11 944 F. Supp. 1384 (N.D. Ill. 1996).

12 The choice of "a few" reflected the store's preliminary thinking about what it might do for the developer, which was so highly conceptual it was too vague to be enforceable.

13 15 U.S. (2 Wheat.) 178, 4 L.Ed. 214 (1817).

14 The seller sued for rescission. Chief Justice Marshall held for the buyer, saying, "The court is of opinion that he was not bound to communicate it. It would be difficult to circumscribe the contrary doctrine within proper limits, where the means of intelligence are equally accessible to both parties." 15. U.S. at 194.

15 225 Cal.App.2d 717, 37 Cal. Rptr. 708 (Cal. App. 1964).

16 The contractor sued for breach of contract, and the owners counterclaimed for breach by the contractor. The trial court found the contractor had breached the contract. The appeal court held the finding was supported by the evidence.

17 The court held the defenses of impossibility and impracticability were unavailable because two other contractors were willing to drill the hole at another location. 225 Cal.App.2d 717, 724-7.

18 584 F.2d 1164 (2nd Cir. 1978).

19 The licensor sued for breach of contract, claiming the licensee had not used best efforts. In particular, waiting until a system had been developed to seek licensees fell short of what best efforts required. The federal district court, recognizing different promotional plans might be adopted, awarded a judgment in favor of the licensee; and the appeals court upheld the judgment, holding, "The phrase 'best efforts to promote licensing' indicates a degree of discretion in the selection of the promotional plan." *Id*. at 1171.

20 362 S.W.3d 160, 172 (Tex. App. 2012).

21 The relocating dealer successfully claimed it was entitled to compensation for profits lost during the resulting delay because the manufacturer could have settled sooner. "[T]he goal or objective of the best efforts provision in the AESSA [the contract], in light of the agreement as a whole, was for Chrysler to use its best efforts to litigate or settle the Meador protest in such a period of time that Manuel could establish the South Arlington dealership by January 1." *Id*. at 172.

22 "The question is not whether Chrysler should have litigated, as we agree that was its right. Rather, the question is when did Chrysler's choice to litigate to the exclusion of making any efforts toward settlement become unreasonable." *Id*. at 177.

23 "Chrysler argues that the AESSA [the contract] did not obligate it to pay any money to [the protesting dealer] Meador, that it had no contractual obligation to use the $50 million it had allocated to its budget to settle protests by dealers, and that it could simply have 'ignored' settling with Meador until it had fully litigated its pending federal court and administrative proceedings. Chrysler reasons that [the relocating dealer] Manuel's position (and the trial court's finding of failure to use best efforts) imposed 'an additional burden' on Chrysler of settlement." *Id*. at 176.

24 237 La. 1039; 112 So.2d 704 (La. 1959).

25 It was well-settled law in Louisiana, where the land was located, that "a mineral lessee must develop with reasonable diligence every part of the leased premises, having due regard for the interests of all contracting parties, or surrender the lease." *Id*. at 710.

26 A divided court held for the mineral lessee. Justice E. Howard McCaleb observed, "In this connection it is apt to point out that, considering the large acreage of land covered by the lease, it is apparent that neither the lesser (sic) nor the lessee contemplated that an immediate development of the land was feasible or practicable. And we think it evident that the parties assumed that the securing of production from all parts of the tract would require considerable time after the initial production was obtained." *Id*. at 708.

27 *See* text accompanying notes 20–23.

28 *See* text accompanying notes 20–23.

29 *See* text accompanying notes 24–26.

30 354 F.2d 720 (10th Cir. 1965).

31 *See* text accompanying notes 8–10.

32 *See* text accompanying notes to 24–26.

33 *See* text accompanying notes to 24–26.

34 *See* text accompanying notes 11 and 12.

35 86 N.M. 58, 519 P.2d 294 (N.M. 1974).

36 "Since the uncertainty of the volume of the excavation and backfill was the responsibility of appellant, this uncertainty was a risk which appellant assumed as part of the bargain." *Id*. at 297.

37 509 S.W.2d 554 (Tex. 1974).

38 *Id*. at 556.

39 The jury awarded the consultant additional compensation, but the Texas Supreme Court set aside the verdict, holding the mistake of fact doctrine does not apply when the parties, at contract formation, recognized the uncertainty concerning the scope of the services and limited the compensation, as they had in this case. The contract described the consultant's scope in sufficiently broad terms that it included all design services required for the street improvement project. *Id*. at 559.

40 "No reason is perceived why the City would have insisted that plaintiff's proposal be qualified by a stated maximum fee except that the City foresaw that construction costs might exceed the estimate and was unwilling to assume the risk of higher engineer's fees." *Id*. at 558.

41 816 F. Supp. 345 (E.D. Pa. 1993).

42 The court found the contract clearly obligated the contractor to remediate all of the contaminated soil on the property. "Under Florida law, which provides that 'a unit price contract provides for payment of the actual amount work done . . . where the precise amounts needed are not known at the inception of the project,' . . . there is no question that [the contractor] TPS is entitled to be compensated for performing its contractual obligation to remediate all of the soil that [the owner's representative] Dunn determined was contaminated." *Id*. at 350.

43 *See* text accompanying notes 2 and 3.

44 *See* text accompanying notes 8–10.

45 *See* text accompanying notes 11 and 12.

46 *See* text accompanying notes to 24–26.

47 *See* text accompanying notes 20–23.

48 601 F.2d 609, 26 UCC Rep. Serv. 281 (2nd Cir. 1979).

49 *See* text accompanying ch. 7, notes 18–30.

50 *See* text accompanying ch. 7, notes 46–57.