HYPERINFLATION IN THE CONSTRUCTION INDUSTRY: EUROPEAN "HARDSHIP" PRINCIPLES VERSUS THE AMERICAN DOCTRINE OF IMPRACTICABILITY OF PERFORMANCE

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I. INTRODUCTION

Rapid escalation in the price of construction materials, highlighted by the well-documented spike in steel prices beginning in 2003, has had a substantial impact on the construction industry in the United States and across the globe. Aside from precipitating lawsuits, bankruptcies, and project cancellations, the hyperinflationary market conditions of recent years spotlight a somewhat stark divergence in legal principles and contracting approaches between those accepted in the United States and those developing in Europe. This divergence has assumed increasing importance due to the growing European economic influence on projects located in the United States, the expanding presence of American firms on European soil, and the multinational nature of participants on large construction projects throughout the

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world. American construction lawyers no longer can think of European principles as a matter only of intellectual curiosity. American lawyers are increasingly being asked to provide guidance concerning contract principles that are very much at odds with traditional American approaches.

One glaring difference between contract principles and practices in the United States and those developing in Europe concerns financial hardship resulting from the market risk of hyperinflation. In the United States, the main contract provision used to address market risk is the narrowly tailored price adjustment or escalation clause, which usually applies to specified materials. In the absence of such a clause, a contractor seeking to avoid performance might invoke the doctrines of impracticability of performance or frustration of purpose as excuses for nonperformance—doctrines that seldom (if ever) provide relief for mere increases in price. Developing European principles and contracting practices are much broader. They often authorize termination for hardship or, in the alternative, compelled renegotiation or rewriting of contracts by courts or arbitrators. These approaches to hardship might apply in the case of hyperinflation and deviate dramatically from approaches familiar to most American construction lawyers.

By way of example, the International Institute for the Unification of Private Law (Unidroit) has developed the *Unidroit Principles of International Commercial Contracts* (UPICC). These principles, first adopted in 1994, and revised in 2004, included a so-called principle of "hardship." In essence, this principle provides that a party who establishes "hardship" is entitled to request "renegotiation" and, if that fails, a court finding that hardship exists may: (i) terminate the contract; or (ii) "adapt the contract with a view toward restoring its equilibrium." The *UPICC* defines "hardship" as "the occurrence of events" that "fundamentally alter[ ] the equilibrium of the contract . . . because the cost of a party's performance has increased," provided that four other factors are satisfied, factors similar to those underlying the doctrines of impracticability and frustration in the United States. More significantly, the *UPICC* hardship principle: (i) applies to any event that causes the cost of a party's performance to increase (not just price escalation); and (ii) authorizes a court to terminate the contract or essentially rewrite the contract to restore the "equilibrium of the contract." This is a significant departure from the traditional approach to construction contracts in the United States and one with significant potential implications.

No longer can construction lawyers ignore the *UPICC* hardship

principle and similar international principles just because their practice is limited to domestic U.S. contracting. The world is small and becoming smaller all the time. This is true of the construction industry and is happening in ways that make it far more likely that a lawyer in the United States may be asked to address *UPICC* hardship principles or other European approaches to hardship.

At the same time, as the recent hyperinflation was taking place, enormous consolidation was occurring among construction and engineering firms. European companies were acquiring construction firms based in the United States, and European-based construction firms have been and continue to take a more active role in large construction projects in the United States. Similarly, large multinational corporations based in the United States, whether in the energy sector or the pharmaceutical sector, are contracting outside the United States more frequently with European owned contractors. As a result, European contracting principles are being pressed in a variety of contracting contexts, and it is not unusual for a European participant on a project to request application of, or incorporation of, the *UPICC* hardship principle as a response to escalation concerns. American lawyers, therefore, need to be able to respond to client inquiries about approaches like those reflected in the *UPICC* hardship principle.

This article addresses legal issues associated with hyperinflation and contrasts the traditional American approach with the approaches reflected in the *UPICC* hardship principles and certain other European rules. The article begins with a look back at the impact of hyperinflation that has characterized the construction industry in recent years. That retrospective is important in evaluating how to deal with economic pressures in the future and provides the background for contrasting approaches to dealing with such matters and the legal doctrines that might apply. The article next discusses the legal doctrines frequently used when a contractor seeks to avoid contractual obligations in the face of hyperinflation, including impossibility and impracticability of performance, frustration of purpose, the legal doctrine of mistake, and contractual force majeure clauses. Also discussed are three cases, decided recently, addressing attempts by contractors to avoid the contractual obligations in the context of the escalation in steel prices—cases that will be instructive to lawyers confronting similar circumstances. Next, is a brief discussion of contractual and other approaches to allocating the risk of escalation, including force majeure clauses, the various types of price escalation clauses, and other strategies to managing the risk of escalation. Lastly, this article discusses the

UPICC hardship principle and compares it to the doctrines of impracticability and frustration. As the world becomes flatter, familiarity with developing and competing approaches to allocating risk becomes more important for construction lawyers based in the United States.[1]

II. HYPERINFLATION AND GLOBALIZATION IN THE CONSTRUCTION INDUSTRY

A. Recent Escalation in the Price of Construction Materials for Domestic Projects

The price of many important building materials in the United States has increased substantially in the past five years. The material price increase that has made the headlines is steel. The rise in steel prices served as the lightning rod for the construction industry's reawakening to the perils of fluctuations in prices of commodities and materials essential to construction. In 2004, members of the Associated General Contractors of America reported steel price increases in a particular two-month span that increased from 20% to 196%.[2] The producer price index (PPI) of the United States Bureau of Labor Statistics reflects that the number of steel products has more than doubled in the past four years. For instance, since the summer of 2003, cut plate steel has risen 120%.[3] During the same period, the price of steel mill

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[1]The rapid advancements in technology and communications link the world as never before and have accelerated the ongoing process of globalization. Thomas L. Friedman, THE WORLD IS FLAT: A BRIEF HISTORY OF THE TWENTY-FIRST CENTURY (1st rev. and expanded ed. 2006). This can be seen in the construction industry as architectural design and drawings literally half a world away from the site of the project to low-cost centers like China and India. Peter S. Goodman, White-Collar Work A Booming U.S. Export; Specialized Jobs Farmed Out to China, Other Nations, WASHINGTON POST, Apr. 2, 2003, at E01; Bill Atkinson, Area Business Keeps Its Local Work Force, BALTIMORE SUN, Apr. 13, 2004, at 1D.

[2]Eric Johansen, Steel Prices Climb 200%, DENVER BUS. J., March 12, 2004. The focus of this article is on material escalation. However, the same concepts apply to other resources used on construction projects such as labor, manufactured products, and consumables.

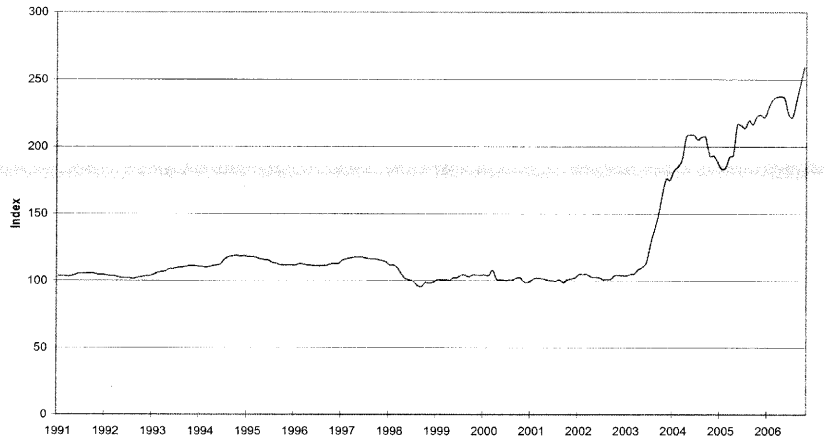
[3]U.S. Dep't of Labor, Bureau of Labor Statistics Data, Producer Price Index—Commodities (PPI-C): Cut plate and structural steel scrap, Series Id: WPU10121194. Note: PPI data available at http://www.bls.gov. The PPI is an index that shows relative changes in price over time as compared to a base value set at 100 and does not show actual prices. The PPI is frequently used as a reference index for contract escalation clauses. *See, e.g.*, Glopak Corp. v. U.S., 851 F.2d 334, 34 Cont. Cas. Fed. (CCH) P 75509, 6 U.C.C. Rep. Serv. 2d 1402 (Fed. Cir. 1988).

products jumped 136%.[4] Interestingly, scrap steel nearly tripled (195% increase)—in only 17 months.[5]

The following chart shows graphically the producer price index numbers for steel mill products from July 1991 to April 2007:

CHART 1

Producer Price Index Commodities: Semifinished Steel Mill Products
July 1991 – April 2007
Source: U.S. Department of Labor, Bureau of Labor Statistics



[4]U.S. Dep't of Labor, Bureau of Labor Statistics Data, PPI-C: Semifinished steel mill products, Series Id: WPU101702.

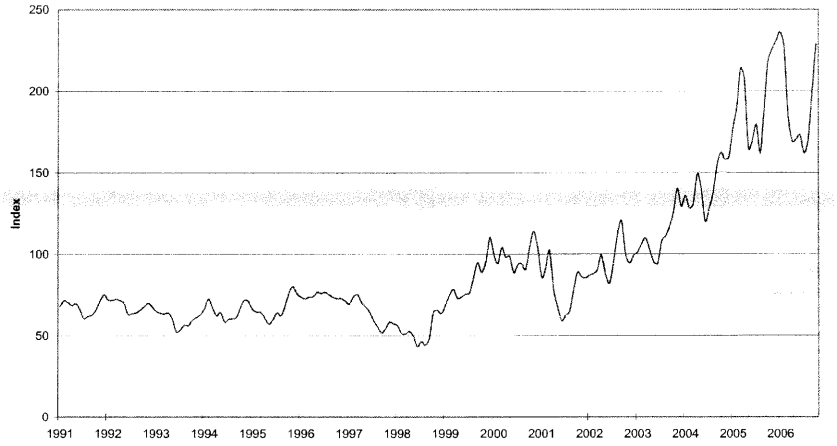
[5]U.S. Dep't of Labor, Bureau of Labor Statistics Data, PPI-C: Carbon steel scrap bundles, Series Id: WPU10121192. The jump in the price of scrap steel allowed some demolition contractors to bid below their cost yet still earn a profit. Richard Korman, Demolition Contractors May Trim Bids If Job Contains Valuable Scrap, ENR, Dec. 20, 2004, at 28. Some owners now ask contractors to consider salvage value in preparing bids, and some owners may consider specifying in contracts whether the owner or contractor is entitled to proceeds from the salvage of high-value scrap located on the owner's property. *See, e.g.*, Daniel D. McMillan & Eric R. Luschei, Price Escalation and Financial Hardship Clauses: Contractual Approaches To Dealing With Hyperinflationary Market Conditions, CONSTRUCTION LAW UPDATE, Ch. 1, at 12 (Neil J. Sweeney ed., 2006).

One point worth noting is the relative flatness of the price of steel mill products until the past four years. Before 2003, the price of steel mill products hovered in a 20% range for more than 12 years.

Like steel, fuel prices have experienced significant volatility recently. The PPI for gasoline tripled in less than five years.[6] Chart 2 illustrates the PPI for gasoline during the past 16 years:

CHART 2

Producer Price Index Commodities: Gasoline
July 1991 – April 2007
Source: U.S. Department of Labor, Bureau of Labor Statistics



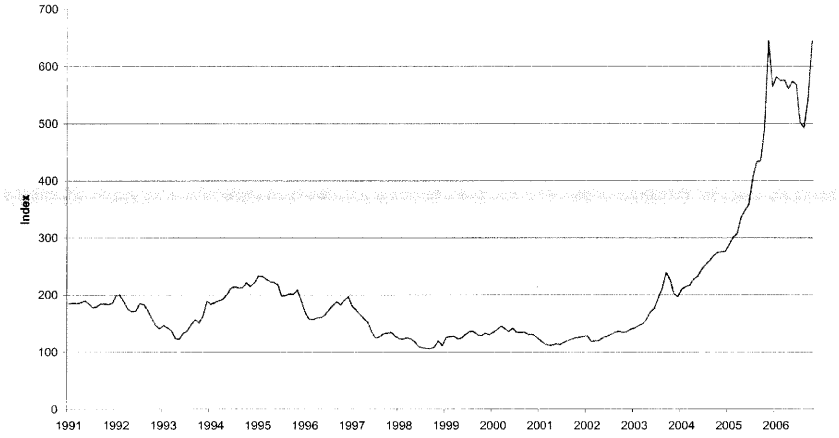
[6]U.S. Dep't of Labor, Bureau of Labor Statistics Data, PPI-C: Gasoline, Series Id: WPU0571.

Of course, fuel prices impact construction costs in several ways. Besides being a cost in operating construction equipment, higher energy prices affect many construction materials directly, such as asphalt, piping, steel, and concrete.[7] Some of these materials have experienced rocketing prices of their own. For instance, the PPI for asphalt shot up 88% in nine months.[8]

Another raw material that is manufactured into products used throughout the construction industry is copper. Copper is used in, among other things, water tubing, electrical wire, and motors.[9] The price of copper escalated even more rapidly than the prices of either steel or gasoline. Specifically, from October 2002 to May 2006, the PPI for copper scrap skyrocketed 438%.[10] Chart 3 demonstrates this price increase:

CHART 3

Producer Price Index Commodities: No. 2 Copper Scrap, Including Wire
July 1991 – April 2007
Source: U.S. Department of Labor, Bureau of Labor Statistics



[7]Tim Grogan, Higher Energy Costs and Strong Demand Keep Construction Inflation Going, Mar. 20, 2006, http://enr.ecnext.com; Ina Paiva Cordle, MIA Costs Go Sky-high; $1 Billion More Sought, MIAMI HERALD, Mar. 16, 2007.

[8]U.S. Dep't of Labor, Bureau of Labor Statistics Data, PPI-C: Asphalt, Series Id: WPU05810112.

[9]Grogan, *supra* note 7.

[10]U.S. Dep't of Labor, Bureau of Labor Statistics Data, PPI-C: No. 2 Copper scrap, Series Id: WPU10230102.

One way to appreciate the speed with which prices of many materials have risen lately is to calculate how quickly their prices have doubled during the past four years. Table 1 shows how many months several common construction materials required to double:

TABLE 1[11]
Time for Prices To Double by Commodity

PPI Commodity	Months To Double
Steel Mill Products	**16**
Asphalt	**15**
Gypsum	**15**
No. 2 Diesel	**15**
Cut Plate Steel	**13**
Scrap Steel	**9**
No. 2 Copper Scrap	**8**

Finally, what goes up must come down (sometimes). Some of these same materials that doubled in price had subsequent drops of at least one-third of their value in less time than it took for them to double. Table 2 shows how far and how fast these commodities dropped:

TABLE 2[12]
Time for Prices To Drop by Commodity

PPI Commodity	Percent Price Drop	Months To Drop
Gypsum	**44**	**18**
Cut Plate Steel	**43**	**8**

[11]U.S. Dep't of Labor, Bureau of Labor Statistics Data, *supra* note 4; U.S. Dep't of Labor, Bureau of Labor Statistics Data, *supra* note 8; U.S. Dep't of Labor, Bureau of Labor Statistics Data, PPI-C: Gypsum building plasters, boards and laths, Series Id: WPU13710102; U.S. Dep't of Labor, Bureau of Labor Statistics Data, PPI-C: No. 2 diesel fuel, Series Id: WPU05730302; U.S. Dep't of Labor, Bureau of Labor Statistics Data, *supra* note 3; U.S. Dep't of Labor, Bureau of Labor Statistics Data, *supra* note 10; U.S. Dep't of Labor, Bureau of Labor Statistics Data, *supra* note 5.

[12]U.S. Dep't of Labor, Bureau of Labor Statistics Data, *supra* note 11; U.S. Dep't of Labor, Bureau of Labor Statistics Data, *supra* note 3; U.S. Dep't of Labor, Bureau of Labor Statistics Data, *supra* note 5; U.S. Dep't of Labor, Bureau of Labor Statistics Data, *supra* note 8.

PPI Commodity	Percent Price Drop	Months To Drop
Scrap Steel	**62**	**7**
Asphalt	**34**	**4**

For two of these materials (cut plate steel and gypsum), the price drops were temporary, as they had already surpassed their earlier price peaks. While Table 1 shows that prices have increased rapidly, Table 2 demonstrates that several prices have fallen just as fast. Thus, this is a period not just of rising prices, but of price volatility.

The changes in the PPI for such material are echoed by other construction cost indices. One measure of the recent rise in overall construction costs comes from the Washington State Department of Transportation (WSDOT). WSDOT maintains a construction cost index consisting of an array of different materials, including asphalt, concrete, and steel. From 1990 to 2001, the index's average annual rate of increase was 1.5% per year. For the period 2002 to 2005, the average annual rate of increase jumped fivefold to 8% per year.[13] Still, increases of 8% per year or 6.5% above the prior average rate of increase might not signal that the sky is falling. As noted above, however, the rates of increase were far more dramatic for certain materials, and the impacts therefore magnified for projects utilizing large amounts of such materials and for suppliers dealing primarily or exclusively with those materials. A more tangible example of the impact of escalation in pricing of construction material comes from New York City, where construction costs for the expansion of the Javits Center reportedly rose at the rate of $17 million per month.[14]

B. Causes of Hyperinflation in the Pricing of Construction Materials

The causes of these price increases are numerous, but most commentators identify two main culprits: increasing demand in China and the 2005 hurricanes. China is a hotbed of construction activity. Two-thirds of the world's construction projects are

[13]2007-09 Capital Improvement and Preservation Program, Overview, WSDOT (undated), at I-3.

[14]Charles V. Bagli, Feeling Push for a Bigger Javits Expansion, N.Y. TIMES, Mar. 14, 2007, at B3. There can be many explanations for increases in construction costs in addition to escalation in the cost of materials (e.g., owner directed design changes).

estimated to be underway in China.[15] Another measure of China's impact is that it consumes 45% of the world's production of cement. This consumption directly affects prices in the United States, which imports 25% of the cement it uses.[16] China's consumption of steel is equally striking. In 2004, China's demand for steel increased by 38 million tons, which by itself equaled the annual steel usage in Mexico and Canada combined.[17] Furthermore, estimates forecast that the annual value of the output of construction in China by 2015 will increase from $151 billion to $700 billion and exceed that of the United States.[18] At least one case has suggested that the steel shortage due to China's demand for steel is not the type of event that can excuse a party under the doctrine of impracticability of performance.[19]

China, however, is not the only market experiencing rapid growth. For instance, 30% of the world's construction tower cranes are presently estimated to be at work in Dubai on projects worth $100 billion.[20] India is another focal point of construction activity. Between 2007 and 2010, it is projected that the amount spent on construction projects within India will be $450 billion.[21]

Another cause of the hyperinflation in construction material costs has been the rebuilding necessitated by Hurricanes Katrina and Rita. Rebuilding due to hurricane damage has placed and will continue to place heavy demands on a wide range of building materials including lumber, steel, plywood, electrical components, glass, roofing materials, asphalt, carpeting, drywall, and PVC

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[15]Scott A. Bannett, How to Manage Rising Construction Costs, July 5, 2006, http://www.aia.org.

[16]Christine Margiotta, Cement Shortage, Higher Prices Jitter Local Concrete Companies, THE BUSINESS REVIEW (Albany, June 4, 2004).

[17]Barbara Hagenbaugh, Steel Prices Soar 66% in a World Market "Gone Mad," USA TODAY, Feb. 20, 2004.

[18]Jennifer Lee, A Look Inside Both China and North America's Construction Industries, Feb. 2006, http://www.homebuilderstocks.com.

[19]Ecology Servs., Inc. v. GranTurk Equip., Inc., 443 F. Supp. 2d 756, 769 n.13 (D. Md. 2006).

[20]Construction Cost Bulletin—UAE (Dubai and Abu Dhabi), Dec. 2006, http://www.echarris.com/research.

[21]Three Major Exhibitions in a Major World Economy, http://www.iiexhibition.com.

piping.[22] Rebuilding caused by the hurricanes could last 10 to 15 years and cost between $80 and $100 billion.[23]

Of course, other causes that are harder to predict may force construction costs higher. A coal mine fire in West Virginia, for instance, reduced the output of coke, which is used in making steel, thus contributing to the rise in steel prices.[24] Fuel prices are susceptible to political disruptions in the Mideast or other petroleum-producing areas. Similarly, another hurricane in the Gulf of Mexico might disrupt crude oil production and transportation.[25]

C. The Practical Impact of Hyperinflationary Market Conditions on Projects in the United States

The consequences of rising material prices have included price uncertainty in the bidding process, higher construction costs, and the postponement, or in some instances outright cancellation of, construction projects. Construction projects often require bidders to guarantee their prices for one month or longer. Public projects, for example, typically require price guarantees of 60 days.[26] Because of the volatility of materials prices, however, contractors have found that they need to restrict the period for which they can guarantee their prices. In Nevada, contractors began quoting prices on a week-to-week basis.[27] During the escalation in steel prices in 2004, one Denver contractor would guarantee bids for only the period of time for which its steel supplier would guarantee prices—one day.[28]

Another result of these rising prices is an increase in the costs of construction projects. Even the briefest search uncovers numerous jobs of all sizes and from all industries that have experienced profound cost increases attributable in whole or in part to rising material prices. A sampling of these follows:

- The cost of the new Meadowlands Stadium, home of the

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[22]Construction Cost Fluctuations Make Tilt-up Construction a Better Choice, http://www.jiancai365.cn.

[23]Brian Johnson, Expert Warns of Rising Construction Costs, Fin. & Com., Mar. 13, 2006; Lee, *supra* note 18.

[24]Hagenbaugh, *supra* note 17.

[25]Steve Raaba, Gas Crests $3 in Vail: Colo Price Climb, DENVER POST, Apr. 16, 2007.

[26]Johansen, *supra* note 2.

[27]Tony Illia, Rising Construction Costs: Creative Solutions Needed, NEVADA BUS. J., Mar. 2006.

[28]Johansen, *supra* note 2.

New York Giants and Jets, nearly doubled from $750 million to $1.4 billion.[29]

- The costs for the mixed-use residential, retail, and entertainment Grand Avenue project in Los Angeles have risen 40% in three years.[30]
- Estimates for the expansion of the St. Joseph's Medical Center in Stockton, California have increased by 46%.[31]

These are but a few of the many examples of market pressure driving up the cost of construction.

Because of the rise in construction costs, many projects—both private and public—face postponement, reductions in scope, or cancellation. The examples below illustrate the range of projects impacted by existing market conditions:

- New York City had begun a five-year, $21 billion renovation of its subway system, but increasing construction costs may force it to postpone or eliminate the project less than halfway through completion.[32]
- The completion of the new UCLA Medical Center has been postponed for a third time beyond its original target of 2004 due to design changes and to the rising costs of construction materials such as steel and drywall.[33]
- The costs of the World Trade Center memorial rose to $1 billion, making it the most expensive memorial ever. The costs of other recent memorials pale in comparison (World War II memorial - $182 million; Oklahoma City memorial - $29 million; Vietnam memorial - $7 million). The latest price for the project takes into account rising steel and construction costs. After the revised price was announced, officials considered demands to cut costs, scale back, or to start over.[34]
- A nonprofit group is halting negotiations on plans to build an art gallery and museum—intended to be the cornerstone

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[29]Work to Start on $1.4 Billion Meadowlands Stadium, N.Y. CONSTR. NEWS, Mar. 1, 2007. There can be many explanations for the increase in the cost of construction on any particular project (e.g., design changes, escalation, etc.).

[30]Jennifer Steinhauer, Rising Building Costs Send Gehry Project in Downtown Los Angeles Over Budget, N.Y. TIMES, Sept. 19, 2006, at E8.

[31]Joe Goldeen, St. Joseph's Expansion Costs Increase; Construction Could Begin Soon, THE RECORD (Stockton, Ca., Mar. 14, 2007).

[32]William Neuman, Rising Costs Put M.T.A. Projects At Risk of Delay, N.Y. TIMES, Jan. 31, 2007.

[33]Charles Ornstein, Hospital's Party to Be Premature, L.A. TIMES, Mar. 10, 2007.

[34]Charles V. Bagli & David W. Dunlap, Memorial's Cost At Ground Zero Nears $1 Billion, N.Y. TIMES, May 5, 2006, at A1.

of a new civic center in Rancho Palos Verdes, California—because of steadily rising construction costs.[35]

- Seven marquee Las Vegas condo projects have been placed on hold or canceled in part because of escalating construction costs.[36]

Thus, the impact of price escalation on the construction industry within the United States has been profound, and the impact has been influenced not just by domestic factors, but also by pressure from events outside the United States.

D. Hyperinflation and the Globalization of the Construction Industry

Globalization of the construction industry has been occurring for a number of years and has a number of significant implications. Two of the most distinguished construction lawyers in the country, Philip L. Bruner and Patrick J. O'Connor, Jr., both members of the American College of Construction Lawyers, have written quite elegantly and thoughtfully about the globalization of the construction industry.[37] The process of globalization of the construction industry has changed the complexion of industry from a fundamentally "local" endeavor to one that is considered more often "global" in nature with local considerations.[38] The traditional construction lawyer considered his or her first job to be a mastery of local law and local construction requirements. Now, construction lawyers must be mindful not only of national developments and trends impacting the industry and the law, but also international influences on the construction industry and contracting practices. This can be rather challenging. Yet, it is the world in which we live and practice, and it is an interesting world. Practicing in a time of globalization broadens one's horizons and can be quite enriching and exciting.

The following discussion is meant to reinforce that the process of globalization observed by others some years ago has not stalled but is moving forward faster than ever. This process of globalization is what gives rise to the collision, or at least intersection, between the approach in the United States and growing European

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[35]Nick Green, New Arts Facility Is Being Put On Hold, Daily Breeze (Torrance, Ca.), Mar. 12, 2007, at A3.

[36]Diane Wedner, Highrollers Are Folding in Sin City, L.A. TIMES, Apr. 30, 2006, at RE 1.

[37]Philip L. Bruner & Patrick J. O'Connor, BRUNER & O'CONNOR ON CONSTRUCTION LAW § 21:1, at 899 to 902 (West 2005).

[38]Philip L. Bruner & Patrick J. O'Connor, BRUNER & O'CONNOR ON CONSTRUCTION LAW § 21:1, at 901 (West 2005).

approach reflected by the Unidroit hardship principle when it comes to the extreme inflation associated with materials used on construction projects.

The globalization of the construction industry has manifested itself in many ways. As discussed above, one powerful illustration of its impact is the manner in which demand for materials transcends national borders and impacts prices on a worldwide basis. The globalization of the construction industry means that the demand for construction materials and resulting prices are influenced by the global marketplace and not just the local marketplace that is home to a planned construction site. Similarly, global demand for construction materials impacts the cost of projects located outside the United States. For example, construction costs for the London Olympics are reported to have increased by as much as a billion dollars, and rising material costs, especially steel and concrete, may force the Las Vegas Sands Corporation to spend 40% more for its development in Macau.[39]

Another profound illustration of the globalization of the construction industry is the strategic positioning of businesses within the construction industry within this now worldwide market. The number of industry participants operating across borders has proliferated through the acquisition, consolidation, and merger of U.S. and foreign construction and design firms.[40] Companies incorporated in the United States are doing substan-

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[39]*See* Adrian Warner, Tell Us Why the Olympic Costs Have Quadrupled, EVENING STANDARD (London, UK), Feb. 28, 2007, at 6; Neil Gough, Rising Costs Lift Sands' Spending on Cotai, S. CHINA MORNING POST, Mar. 2, 2007, at 4.

[40]A perfect illustration of this phenomenon is the recently announced plan of URS Corp. to acquire Washington Group, Inc. ("WGI"), an acquisition involving two of the largest engineering and construction firms in the United States. *See* Evelyn Iritani, URS in Deal to Acquire Washington Group; The $2.6 Billion Union of the Engineering and Construction Firms Would Give It More Heft, L.A. TIMES, May 29, 2007, at C2. The deal is reported to have been "designed to give the companies additional heft in the global arena." Id. The history of these companies individually provides interesting case studies in consolidation with WGI, formerly Morrison Knudsen, having acquired Raytheon Engineers & Contractors to enhance its profile in the international construction market, and URS, having previously acquired Woodward-Clyde Group, Inc., and Dames & Moore Group. URS Eyes More Nuclear Deals, MONTEREY COUNTY HERALD (California), May 30, 2007; Michael Brick, A Leading Construction Company Files for Chapter 11, N.Y. TIMES, May 25, 2001 (late edition), at C4; *see also* Charlene Prost, Fru-Con Founder First Built Diamond In The Rough Here; Company Celebrating 125 Years In Construction Here, ST. LOUIS POST-DISPATCH (Missouri), Five Star Lift Edition, Oct. 20, 1997, at Business Plus 1 (Fru-Con Construction Co., founded in St. Louis, "has been fully owned by Germany's Bilfinger & Berger Bauaktiengesellschaft," itself one of the largest construction

tial business outside the United States, and more companies located outside the United States are building projects within the United States.[41] On any large construction project located in the United States or elsewhere, one or more project participants—owners, designers, contractors, subcontractors, suppliers, etc.—almost invariably hail from a country other than the country that is home to the project. A consequence of this globalization is the increased frequency with which different contracting philosophies and legal approaches surface with owners, contractors, or designers on projects located in the United States or abroad. For lawyers in the United States, this means that the construction bar needs to become more knowledgeable about these contracting approaches and legal traditions.

One evident reason for the globalization of the construction industry is that the construction market worldwide is rapidly expanding. In 1998, the international construction market was worth $3.2 trillion, and $2.5 trillion was outside the United States and Canada.[42] Firms performing or providing construction-related services and products that work internationally receive a significant amount of their revenue from outside of the United States. For instance, international contracting companies generated an average of 58% of their revenue from international construction operations.[43] Moreover, in recent years, American firms have accounted for half of the construction design firms operating in Europe, Latin America, and the Middle East.[44]

International construction services' receipts for United States firms have risen substantially during the past two decades. As il-

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firms in the world, since 1984); *cf.* Richard Verrier, Halliburton headquarters leaving U.S.; The defense contractor's main office will be in Dubai, L.A. TIMES, May 12, 2007, at C1 (Halliburton Co.'s headquarters moving from Houston to Dubai).

[41]Kimberly Piña, Corridor Project Faces 2-Year Halt in Light of Opposition, Questions; Waller Group Opposes Toll Road, But Others Say Project Needed, HOUSTON CHRONICLE (2 Star Ed.), May 24, 2007, This Week, at 7 ("Spanish-owner construction giant Cintra and San Antonio road-builder Zachary, joined forces" to develop, finance, and build the Trans-Texas Corridor toll road from Oklahoma to Laredo); Jon D. Markman, Subway Tunnel Costs Soaring 44% Over Budget, L.A. TIMES, April 13, 1996, at B1 (Japan-based Obayashi building portion of Los Angeles Subway).

[42]Faiza A. El-Higzi, Examining International Trade Flows for Australian Construction Companies, 29 INT'L J. OF SOC. ECON. 491, 493 (2002).

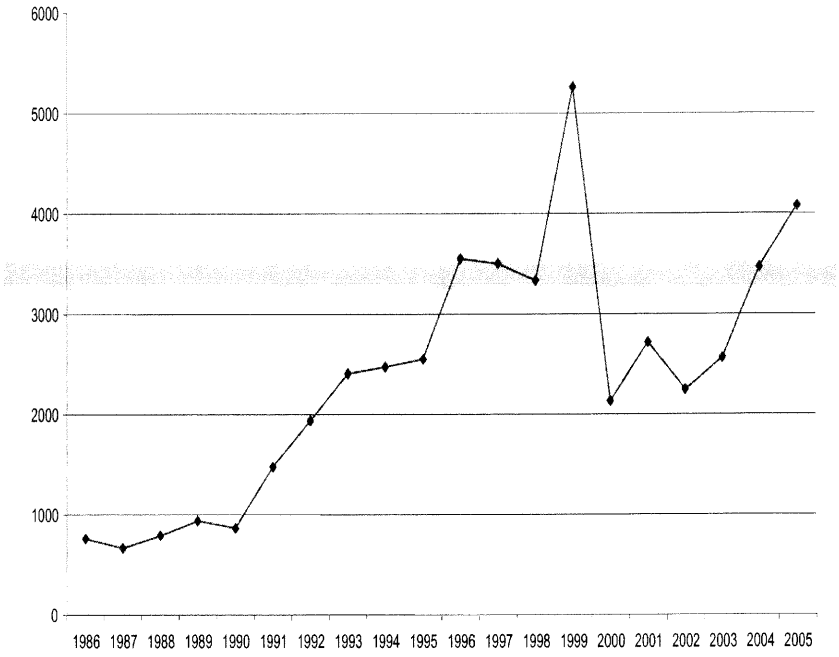
[43]Faiza A. El-Higzi, Examining International Trade Flows for Australian Construction Companies, 29 INT'L J. OF SOC. ECON. 491, 495–96 (2002).

[44]Faiza A. El-Higzi, Examining International Trade Flows for Australian Construction Companies, 29 INT'L J. OF SOC. ECON. 491, 495 (2002). Specifically, United States firms constituted 51.7% of the construction design firms operat-

lustrated in Chart 4, total receipts remained under $1 billion through 1990. They have risen since then to $4.08 billion in 2005.[45]

CHART 4

United States Construction, Architectural, and Engineering Services International Receipts (in millions of dollars), All Countries 1986 – 2005
Source: U.S. Department of Commerce, Bureau of Economic Analysis



ing in Europe, 52.1%t of the firms in Latin America, 48.7% of the firms in the Middle East, and 26.4% of the firms in Africa.

[45]U.S. Dep't of Commerce, Bureau of Economic Analysis (BEA), data on cross-border trade, Table 7: Business, professional, and technical services, 1986–2005.

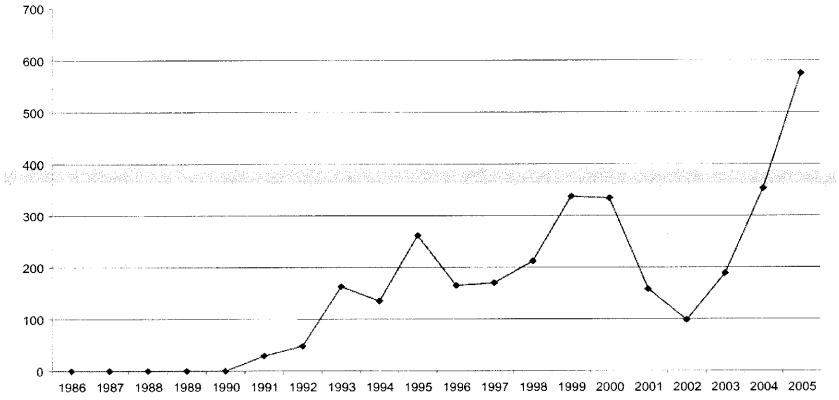
Because statistics regarding cross-border transactions exclude most construction performed by foreign affiliates of American companies, these numbers may actually reflect as little as one-tenth of the actual value of contracts won by American-owned companies.[46] During this period, payments from U.S. owners to international construction companies have averaged $300 million.[47]

As discussed above, the increase in construction in China has been one of the primary causes of hyperinflation in the price of construction materials. Many American construction firms are participating in the rapidly growing China construction market. As Chart 5 demonstrates, U.S. construction receipts from China have increased 20-fold since 1991 from $29 million to $575 million.[48]

CHART 5

United States Construction, Architectural, and Engineering Services International Receipts (in millions of dollars), China 1986 – 2005

Source: U.S. Department of Commerce, Bureau of Economic Analysis



[46]Trends in U.S. Construction, 1997 to 2001, http://www.findarticles.com.

[47]U.S. Dep't of Commerce, BEA, *supra* note 45.

[48]U.S. Dep't of Commerce, BEA, *supra* note 45.

In short, the dollar value of work performed by U.S. construction and design firms on projects outside the United States is growing. Consequently, contractors, design professionals, and owners participating on international projects located outside the United States and their in-house and outside counsel should be aware of provisions that other project participants may seek to incorporate into contracts. The process of globalization and the recent surge in prices for construction materials itself highlight differences in approaches when it comes to dealing with the risks of hyperinflation and projects encountered on construction projects.

II. COMMERCIAL IMPRACTICABILITY AS APPLIED IN THE UNITED STATES AND RELATED DOCTRINES THAT EXCUSE PERFORMANCE

This section provides an overview of the doctrine of impracticability of performance as applied in the United States, including related concepts of frustration of purpose, mutual mistake, and contractual *force majeure* clauses. Together, these are the bases for most arguments that have been asserted by contractors seeking relief from the recent escalation in the prices of construction materials on U.S. projects.[49] The discussion focuses, however, on the doctrine of impracticability. Detailed analysis is provided of four recent cases where litigants unsuccessfully asserted impracticability based on escalation in steel prices and steel shortages occurring in late 2003 through 2004. As these cases illustrate, with limited exceptions, courts in the United States are reluctant to adapt, revise, or rewrite the contacts of parties to account for changes in market conditions. An understanding of the typical approach in the United States is necessary to understand and appreciate the ways in which the Unidroit hardship principle and contract clauses embodying the Unidroit principle diverge from practices in the United States.[50]

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[49]A party seeking to excuse performance frequently raises all or some combination of the doctrines of impossibility, impracticability, frustration of purpose, and mutual mistake along with any *force majeure* clause that may have been included in the contract. *See, e.g.,* Northern Indiana Pub. Serv. Co. (NIPSCO) v. Carbon County Coal Co., 799 F. 2d 265, 268 (7th Cir. 1986) (*force majeure* clause, frustration, and impracticability); Aluminum Co. of Am. (ALCOA) v. Essex Group, Inc., 499 F. Supp. 53, 60, 70 (W.D. Pa. 1980) (mutual mistake, impracticability, and frustration).

[50]There are three particularly useful references to the problem of hyperinflation in the construction industry. *See* Price Escalation & Financial Hardship Clauses, supra note 5, at 1-69; John Gallagher & Frank Riggs, Material Price Escalation: Allocating The Risks, CONSTRUCTION BRIEFINGS, Dec.

A. *Pacta Sunt Servanda* and Fixed-Price Contracts

The legal maxim *pacta sunt servanda* is a foundational principle of U.S. contract law. While this phrase translates into "agreements must be kept,"[51] courts recognize its colloquial equivalent "a deal's a deal."[52] Regardless of its translation, the maxim binds parties to perform their bargains according to their terms. The *Restatement (Second) of Contracts (Restatement)* summarizes its effect: "Contract liability is strict liability."[53] A contracting party is "liable in damages for breach of contract even if he is without fault and even if circumstances have made the contract more burdensome or less desirable than he had anticipated."[54]

When parties enter into fixed-price contracts in inflationary times, this unyielding approach to contractual duties favors owners. A fixed-price contract, which is typical of many (if not most) large construction contracts in the United States, requires the contractor to perform at the price set in the contract. Should prices rise, the contractor must still perform for the price stated in the contract unless there is a price adjustment clause or some other contractual clause or legal doctrine that affords relief. Accordingly, in the usual case, the contractor assumes the risk that the price of materials will rise during the course of his performance. This contractual allocation of risk places the cost burden of inflationary increases in price on the contractor. The recent escalation in the cost of construction materials has triggered disputes over whether a contractor who accepts the risk of normal ranges of inflation also assumes the risk of hyperinflation, where material prices may double before the completion of performance.[55]

Law libraries are replete with decisions rendered during previ-

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2006, No. 2006-12, at 1; Renata Guidry, The Steel Price Explosion: What Is an Owner or a Contractor to Do?, 24 THE CONSTR. LAW. 5 (Summer 2004).

[51]BLACK'S LAW DICTIONARY (8th ed. 2004); *see also* Joseph M. Perillo, Force Majeure and Hardship Under the UNIDROIT Principles of International Commercial Contracts, 5 TUL. J. INT'L & COMP. L. 5, 7 (1997) ("agreements must be kept though the heavens fall"). More than a legal maxim, pacta sunt servanda is an ancient Roman doctrine mitigated by the doctrine of *rebus sic stantibus*, which can be translated as "provided the circumstances remain unchanged." Bruner & O'Connor, *supra* note 37, § 21:6 at 915.

[52]Franconia Assoc. v. United States, 61 Fed.Cl. 718, 737 (2004).

[53]RESTATEMENT (SECOND) OF CONTRACTS, Ch. 11 introductory note (1981).

[54]RESTATEMENT (SECOND) OF CONTRACTS, Ch. 11 introductory note (1981).

[55]*Compare* RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 53, § 261 cmt. d ("A mere change in the degree of difficulty or expense due to . . . costs of construction, unless well beyond the normal range, does not amount to impracticability since it is this sort of risk that a fixed price contract is intended

ous inflationary (and deflationary) times when parties adversely affected by market changes sought to escape contractual obligations. In most instances, courts have not relieved such parties from contractual duties. Indeed, many courts have held that the risk of price volatility was exactly the risk that the parties sought to allocate by entering into a fixed-price contract. As Judge Posner of the Seventh Circuit Court of Appeals explained in a frequently cited decision:

> The normal risk of a fixed price contract is that the market price will change. If it rises, the buyer gains at the expense of the seller . . . . [I]f it falls, as here, the seller gains at the expense of the buyer. The whole purpose of a fixed price contract is to allocate the risks in this way.
>
> . . . .
>
> If, as is also the case here, the buyer forecasts the market incorrectly and therefore finds himself locked into a disadvantageous contract, he has only himself to blame and so cannot shift the risk to seller by invoking impossibility or related doctrines.[56]

Thus, contractors seeking to avoid the burdens of a fixed-price contract when material prices skyrocket must overcome the notion that "a deal is a deal" and the argument that a fixed-price contract by definition allocates the risk (and the benefit) of changes in market conditions to the contractor.

B. Impracticability of Performance

Although a court's first allegiance when determining contractual rights is to *pacta sunt servanda*, American jurisprudence has recognized that the doctrines of impossibility and impracticability of performance excuse or discharge performance. Although those doctrines are well established in American law, that does not mean that they are asserted with frequent success. Courts approach claims of impossibility and impracticability with skepti-

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to cover.") *with* Spindler Constr. Corp., ASBCA No. 55007, 2006 ASBCA LEXIS 66, at *9 (Armed Servs. B.C.A. July 31, 2006) ("While [subcontractor] assumed that the steel market would remain within a 'generally predictable range,' this was not a basic, or normal, assumption about the general risk of possible cost increases for a fixed-price contract.").

[56]*NIPSCO*, 799 F. 2d at 275, 278. In the typical fixed-price contract, no construction contractor would reduce the amount it charges the owner for any net decrease in material prices occurring between the time of being awarded the contract and the time of ordering materials.

cism that must be overcome to prevail on either of these doctrines.[57]

The doctrine of impossibility excuses performance only where no contractor could perform the work (i.e., performance is truly impossible).[58] A classic example of strict impossibility is the case of *Taylor v. Caldwell,* which involved a contract to lease a music hall for live performances.[59] The music hall burned to the ground prior to the scheduled performances.[60] Since the building no longer existed, the owner's performance was rendered impossible and its performance excused.[61]

When the intervening occurrence is less stark, as in the case of price inflation, courts almost invariably find the doctrine of strict impossibility unavailing. To assert impossibility successfully in the context of price escalation, a party must establish that "no similarly-situated contractor could have performed the contract."[62] Absent such proof, the court will find that the price escalation did not render performance objectively impossible but only unprofitable.[63] The doctrine of strict impossibility provides little hope for relief in the context of price escalation. For this reason, contractors more frequently turn to the related doctrine of commercial impracticability.

The doctrine of impracticability of performance excuses performance where a supervening event occurs that renders performance commercially impracticable as opposed to strictly impossible.[64] The doctrine of impracticability developed at common law and the Restatement summarizes this doctrine as applied in the United States.[65] Additionally, the Uniform Commercial Code (UCC), which pertains to the sale of goods, contains a section on impracticability.[66]

For practitioners in the United States, it is important when

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[57]*See, e.g.*, Jennie-O Foods, Inc. v. United States, 580 F. 2d 408, 409 (1978) ("The commercial impracticability standard can be easily abused; thus this court has not applied it with frequency or enthusiasm").

[58]Seaboard Lumber Co. v. United States, 308 F.3d 1283, 1294 (Fed. Cir. 2002).

[59]Taylor v. Caldwell, 3 B & S 826, 122 Eng. Rep. 309 (K.B. 1863).

[60]Taylor v. Caldwell, 3 B & S 826, 122 Eng. Rep. 309 (K.B. 1863).

[61]Seaboard Lumber Co. 308 F.3d at 1294.

[62]Seaboard Lumber Co. 308 F.3d at 1294.

[63]Seaboard Lumber Co. 308 F.3d at 1294.

[64]Seaboard Lumber Co. 308 F.3d at 1294.

[65]RESTATEMENT, *supra* note 53, ch. 11.

[66]Uniform Commercial Code § 2-615.

analyzing the applicability of the doctrine of impracticability to consider the common law as well as statutory sources of impracticability.[67] As demonstrated by the discussion below, the *Restatement*, the *UCC*, and the case law create a very high bar when a party to a fixed-price contract asserts that inflationary market conditions have made performance impracticable.

The doctrine of impracticability, as formulated by the *Restatement*, provides as follows:

> Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or circumstances indicate the contrary.[68]

The approach articulated by the *Restatement* is widely followed across the country, and both federal and state courts rely on the *Restatement*.[69]

By way of comparison, Section 2-615 of the UCC states the doctrine of impracticability as follows:

> Delay in delivery or non-delivery in whole or in part by a seller . . . is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made . . . .[70]

The *UCC* "deliberately refrains from any effort at an exhaus-

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[67]In addition to the UCC, the doctrine of impossibility or impracticability may be codified as part of a state's general contract law, and similar types of excuses also might be codified. *See, e.g.,* Cal. Civ. Code § 1511(2) ("The performance of an obligation, or an offer of performance, in whole or in part, or any delay therein, is excused . . . [w]hen it is prevented or delayed by an irresistible, superhuman cause . . . unless the parties have expressly agreed to the contrary."); *see also* Cal. Civ. Code § 1598 (contracts with an object that is "wholly impossible of performance" are void); Cal. Civ. Code § 1441 (contract void where "fulfillment" of "condition in contract" is "impossible").

[68]RESTATEMENT, *supra* note 53, § 261. In addition to discharge by supervening impracticability, the RESTATEMENT contains several sections addressing special cases of impracticability. *See, e.g.*, *id.* § 262 ("Death or Incapacity of Person Necessary for Performance"); § 263 ("Destruction, Deterioration or Failure to Come into Existence of Thing Necessary for Performance"); § 264 ("Prevention by Governmental Regulation or Order"); § 266 ("Existing Impracticability or Frustration").

[69]*See, e.g.*, United States v. Winstar Corp., 518 U.S. 839, 904 (1996) (quoting Restatement (Second) of Contracts § 261 (1981)).

[70]Uniform Commercial Code § 2-615 (a). The seller must give "reasonabl[e]" notice of a delay in delivery or non-delivery and must allocate production and deliveries among customers when the seller's performance is only partially

tive expression of contingencies and is to be interpreted in all cases sought to be brought within its scope in terms of its underlying reason and purpose."[71]

The *UCC* is ubiquitous with virtually every state in the Union having adopted some version. The comments to *Restatement* refer to the *UCC's* concept of commercial impracticability, and there is substantial overlap between the *Restatement* and the *UCC* doctrine of impracticability.[72] Moreover, cases do not always distinguish between the doctrine as articulated under the *UCC* versus the *Restatement*, and common law and courts tend to use precedents interchangeably. Of course, the *UCC* itself applies to the sale of goods while construction contracts typically are characterized as contracts for services to which the *UCC* does not apply.[73]

The test for impracticability has been articulated in a number of different ways. For example, in *Seaboard Lumber Company v.*

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affected. Uniform Commercial Code § 2-615 (b) to (c). As worded, Section 2-615 of the U.C.C. excuses performance of a seller; however, comment 9 states that "the reason of the present section may well apply and entitle the buyer to the exemption," and a number of courts have applied this section to claims of impracticability made by buyers. *See* U.C.C. § 2-615 cmt. 9; *NIPSCO*, 799 F. 2d at 277.

[71]Uniform Commercial Code § 2-615 cmt. 2.

[72]RESTATEMENT, *supra* note 53, § 261 cmt. d; U.C.C. § 2-615 cmt. 3 ("commercial impracticability"); *NIPSCO*, 799 F. 2d at 277–278.

[73]A construction contract between an owner and a contract ordinarily is a contract for services and not subject to the *UCC*. However, many contracts on construction projects entail a combination of services (i.e., labor) and goods (e.g., material and equipment). The test for determining whether such hybrid contracts are subject to the UCC is whether the "essence" of the contract is for goods or services or, stated differently, whether the contract is "predominantly" for goods or services. *Compare* Bartec Indus., Inc. v. United Pac. Co., 976 F. 2d 1274, 1277 (9th Cir. 1992) (contract to fabricate, paint and supply steel beams was a transaction of goods under the UCC as codified in California); Bonebrake v. Cox, 499 F. 2d 951, 960 (8th Cir. 1974) (contract for sale and installation of bowling equipment predominantly a contract for the sale of goods under UCC as adopted by Iowa); Belmont Indus., Inc. v. Bechtel Corp., 425 F. Supp. 524, 527–528 (E.D. Pa. 1976) (second tier subcontract to furnish structural steel for construction of container-handling facility was a contract for sale of goods under UCC as codified by Pennsylvania despite incidental design services); *with* Freeman v. Shannon Constr. Co., 560 S.W. 2d 732, 738–39 (Tex. Civ. App. 1977) (subcontracts to supply "all labor, material and equipment" for concrete-related work for construction of apartment tower and tennis courts were "in essence" contracts for services *not* covered by UCC as enacted by Texas); Schenectady Steel Co. v. Bruno Trimpoli Gen. Constr. Co., 43 A.D. 2d 234, 237 (contract for supply and erection of steel constituted a services contract). Accordingly, it is quite possible that some contracts between participants on a construction project may be covered by the UCC while others will not.

United States, the court identified four factors based on the *Restatement*:

> This defense [of impracticability] requires [a contractor] to show that (i) a supervening event made performance impracticable; (ii) the non-occurrence of the event was a basic assumption upon which the contract was based; (iii) the occurrence of the event was not [the contractor's] fault; and (iv) [the contractor] did not assume the risk of occurrence.[74]

In *Transatlantic Financing Corporation v. United States,* a well-known case predating the *Restatement*, Judge Skelly Wright identified three steps in the analysis of impracticability: (1) occurrence of an unexpected contingency; (2) "the risk of the unexpected occurrence must not have been allocated either by agreement or by custom;" and (3) "occurrence of the contingency must have rendered performance commercially impracticable."[75]

The commentary accompanying the *Restatement* and the *UCC* elaborates on the requirements of impracticability as they relate to fixed-price contracts. The *Restatement* observes that fixed-price contracts allocate the risk of increases in costs though there may be circumstances that warrant application of the doctrine of impracticability:

> In contracting for the manufacture and delivery of goods at a price fixed in the contract, for example, the seller assumes the risk of increased costs within the normal range. If, however, a disaster results in an abrupt tenfold increase in cost to the seller, a court might determine that the seller did not assume this risk by concluding that the non-occurrence of the disaster was a "basic assumption" on which the contract was made. In making such determination, a court will look at all circumstances, including the terms of the contract.[76]

These concepts are echoed elsewhere in the *Restatement*. For example, in the context of describing the requirement that the nonoccurrence of an event must be a "basic assumption" of the contract, the *Restatement* notes:

> [A]pplication [of this requirement] is also simple enough in the cases of market shifts or the financial inability of one of the parties. The continuation of existing market conditions and of the financial

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[74]Seaboard Lumber Co. v. United States, 308 F. 3d 1283, 1294–1295 (Fed. Cir. 2002) (citing United States v. Winstar Corp., 518 U.S. 839, 904–910 (1996)).

[75]Transatlantic Fin. Corp v. United States, 363 F. 2d 312, 315 (D.C. Cir. 1966). This case is the basis for one of the illustrations in the Restatement. *See* RESTATEMENT, *supra* note 53, § 261 i1lus. 9 & Reporter's Note.

[76]RESTATEMENT, *supra* note 53, ch. 11, Introductory Note.

> situation of the parties is ordinarily *not* such assumptions, so that mere market shifts or financial inability do not usually affect discharge . . . . In borderline cases this criteria is sufficiently flexible to take account of failures that bear on a just allocation of risk.[77]

As is clear from the above quote, these concepts are "flexible" rather than rigid, which may explain in part why reported cases often seem difficult to harmonize.

The comments to the *Restatement* discuss the meaning of the word "impracticability." Impracticability does not require "absolute impossibility."[78]

> Performance may be impracticable because extreme and unreasonable difficulty, expense, injury, or loss to one of the parties will be involved. A severe shortage of raw materials or of supplies due to war, embargo, local crop failure, unforeseen shutdown of major sources of supply, or the like, which either causes a marked increase in cost or prevents performance altogether may bring the case within the rule . . . . However, "impracticability" means more than "impracticality." A mere change in the degree of difficulty or expense due to such causes as increased wages, prices of raw materials, or costs of construction, unless well beyond the normal range, does not amount to impracticability since it is this sort of risk that a fixed price contract is intended to cover.[79]

The comments to the *UCC* similarly indicate that "[i]ncreased cost alone does not excuse performance unless the rise in the cost is due to some unforeseen contingency which alters the essential nature of the performance."[80]

A few other concepts relevant to the doctrine of impracticabil-

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[77]RESTATEMENT, *supra* n. 53, § 261 cmt. b (emphasis added).

[78]RESTATEMENT, *supra* n. 53, § 261 cmt. d; *Jennie-O Foods, Inc.*, 580 F. 2d at 409 (impracticability "is not invoked merely because costs have become more expensive than originally contemplated"); Raytheon Co. v. White, 305 F. 3d 1354, 1367 (Fed. Cir. 2002) (performance is impractical where unforeseen events make it possible "only at an excessive or unreasonable cost" or "all means of performance are commercially senseless"); *see also* Natus Corp. v. United States, 371 F. 2d 450, 456 (Ct. Cl. 1967).

[79]RESTATEMENT, *supra* note 53, § 261 cmt. d.

[80]Comment 4 to Section 2-615 of the Uniform Commercial Code states:

> Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover. But a severe shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance is within the contemplation of this section.

U.C.C. § 2-615, cmt. 4 (citation omitted).

ity should be highlighted. First, "a party is expected to use reasonable efforts to surmount obstacles to performance . . ., and a performance is impracticable only if it is so in spite of such efforts."[81] Second, a party may assume by contract an obligation to bind itself to perform even though the doctrine of impracticability would otherwise excuse performance.[82] The acceptance of a greater obligation may be expressly stated in the contract or implicitly assumed from all of the circumstances.[83] Finally, the concept of foreseeability is frequently applied when assessing the applicability of the doctrine of impracticability. The *Restatement* indicates that "[t]he fact that the event was unforeseeable is significant as suggesting that its non-occurrence was a basic assumption" of the contract.[84] "However, the fact that it was foreseeable, or even foreseen, does not, of itself, argue for a contrary conclusion, since the parties may not have thought it sufficiently important a risk to have made it a subject of their bargaining."[85]

Courts demonstrate caution when considering claims that price inflation has made performance impracticable under fixed-price contracts. This is because, as highlighted in the above passages from the *Restatement*, the normal risk of a fixed-price contract is

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[81]RESTATEMENT, *supra* note 53, § 261 cmt. d; *see also* L.W. Matteson, Inc. v. United States, 61 Fed. Cl. 296, 320 (2004) ("The party asserting the impracticability defense . . . bears the burden of showing that it explored and exhausted alternatives before concluding 'that the contract was . . . commercially impracticable to perform.' ") (citations omitted).

[82]RESTATEMENT, *supra* note 53, § 261 cmt. c; *see also* Uniform Commercial Code § 2-615 (the excuse of impracticality does not apply where seller has "assumed a greater obligation"). Other legal doctrines may excuse performance even when a party has accepted the risk of supervening events as where the contract is unconscionable. *See, e.g.,* Uniform Commercial Code § 2-615 cmt. 8 ("Generally, express agreements as to exemptions designed to enlarge upon or supplant the provisions of this section are to be read in light of mercantile sense and reason, for this section itself sets up the commercial standard for normal and reasonable interpretation and provides a minimum beyond which agreement may not go."); *cf.* Glopak Corp. v. United States, 851 F. 2d 334, 337–338 (Fed. Cir. 1988) (rejecting contractor's claim that price adjustment clause was unconscionable).

[83]RESTATEMENT, *supra* note 53, § 261 cmt. c; U.C.C. § 2-615 cmt 8.

[84]RESTATEMENT, *supra* note 53, ch. 11, Introductory Note.

[85]RESTATEMENT, *supra* note 53, ch. 11, Introductory Note.; *see also* RESTATEMENT § 261 cmts. b–c. The comments to the UCC refer to "unforeseen supervening circumstances" and whether a contingency was "sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the dickered terms . . . ." Uniform Commercial Code § 2-615 cmt. 8.

that the market price will change.[86] The nonoccurrence of price increases ordinarily is not a basic assumption of a fixed-price contract, since such contracts assign that risk to the contractor.[87] Even in the face of severe price inflation, courts have demonstrated an unwillingness to find commercial impracticability in all but the most extreme circumstances. They have consistently rejected assertions of impracticability where the cost increase was 70% or less.[88] In the few cases in which courts have found impracticability, costs more than doubled.[89]

Two particularly notable cases where courts found impracticability contrast sharply with the general reluctance of courts to apply the doctrine of impracticability. First, in *Mineral Park Land Co. v. Howard*, the California Supreme Court relieved a contractor from its contractual obligation to take and pay for all gravel necessary for the construction of a bridge from property owned by the plaintiff.[90] The contractor took approximately one-half of the originally estimated quantity of gravel, which was located above the ground water level and refused to take any more

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[86]*Seaboard Lumber Co.*, 308 F.3d at 1295; *NIPSCO*, 799 F.2d at 278; Spindler Constr. Corp., ASBCA No. 55007, 2006 ASBCA LEXIS 66, at *9.

[87]*Seaboard Lumber Co.*, 308 F.3d at 1295; *NIPSCO*, 799 F.2d at 278; Spindler Constr. Corp., ASBCA No. 55007, 2006 ASBCA LEXIS 66, at *9.

[88]Gulf & W. Indus., Inc., ASBCA No. 21090, 87-2 BCA AP 19,881 at 100,575 (cost 74% higher than the contract price for a particular component); *Raytheon Co.*, 305 F.3d at 1368 (cost overrun of 57% did not establish commercial impracticability); Iowa Elec. Light & Power v. Atlas Corp., 467 F. Supp. 129, 140 (N.D. Iowa 1979), *rev'd on other* grounds, 603 F. 2d 1301 (8th Cir. 1979) (cost increase less than 50%); Short Bros., PLC v. United States, 65 Fed. Cl. 695, 785 (2005) (40% increase over the contract was not commercial senselessness); Am. Trading & Prod. Corp. v. Shell Int'l Marine, Ltd., 453 F. 2d 939 (2d Cir. 1972) (cost increase less than one-third); Conner Bros. Constr. Co., Inc. v. United States, 65 Fed. Cl. 657, 687 (2005) ($245,000 overrun constituted only a 3% increase and did not constitute commercial impracticability); Spindler Constr. Corp., 2006 ASBCA LEXIS 66 at *9 (twenty-three percent increase in the price of steel created a 5% cost overrun of the subcontract price); *see also* Publicker Indus., Inc. v. Union Carbide Corp., 17 U.C.C. Rep. Serv. 989 (E.D. Pa. 1975) ("We are not aware of any cases where something less than a 100% cost increase has been held to make a seller's performance 'impracticable.' ").

[89]Soletanche Rodio Nicholson (JV), 94-1 BCA (CCH) ¶ 26,472, at 131,774 (1993) (costs under the contract would have increased from $16.9 million to $400 million, an increase exceeding 2,200%); Whittaker Corp., 79-1 BCA (CCH) ¶ 13,805, at 67,688–89 (1979) (relief granted where costs would surpass contract amount by 148%); *cf.* Mineral Park Land Co. v. Howard, 172 Cal. 289, 291 (1916) (relief granted where cost to remove gravel below the ground water levels was "ten or twelve times as much as the usual cost per yard").

[90]Howard, 172 Cal. 289, 290 (1916). The RESTATEMENT used *Howard* as the basis for an illustration. *See* RESTATEMENT, *supra* note 53, § 266 cmt. a, illus. 5 & Reporter's Note to cmt. a.

gravel because the available gravel was below the water level. The gravel below the water level could only be taken by special means "at a prohibitive cost . . . of ten or twelve times as much as the usual cost per yard."[91] Even though performance remained possible (there was gravel on the land), the court found that performance was impracticable and therefore excused.[92] "[W]here the difference in cost is so great as here, and has the effect, as found, of making performance impracticable, the situation is not different from that of a total absence of earth and gravel."[93]

The second case is *Aluminum Co. of America (ALCOA) v. Essex Group, Inc.*,[94] a case that has spawned extensive commentary.[95] The case involved a long-term contract under which ALCOA agreed to process alumina into aluminum for a manufacturer of aluminum wire. An escalation clause was included in this contract to provide a stable net return to ALCOA. During the course of the contract, ALCOA's energy costs escalated at a rate far greater than the rate of increase in the index, and ALCOA found itself losing substantial amounts of money because the contract price did not keep pace with the increase in ALCOA's costs.[96] The court granted ALCOA relief, among other reasons, because of impracticability.[97] In the court's view, the parties had not intended simply to select an index to account for inflation. They had specifically contemplated that the index selected would adequately mirror ALCOA's own nonlabor production costs.

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[91]*Howard*, 172 Cal. at 291.

[92]*Howard*, 172 Cal. at 293.

[93]*Howard*, 172 Cal. at 293. The *Howard* court cautioned that a party to a contract may not escape its obligation to perform simply "by showing the existence of conditions which would make the performance of their obligations more expensive than they had anticipated or which would entail a loss upon them." *Id*.

[94]Aluminum Co. of America (ALCOA) v. Essex Group, Inc., 499 F. Supp. 53 (W.D. Pa. 1980).

[95]*See, e.g.,* James J. White & David Peters, Essay: A Footnote For Jack Dawson, 100 Mich. L. Rev. 1954, 1973–77 (2002); John P. Dawson, Judicial Revision of Frustrated Contracts: United States, 64 B.U. L. Rev. 1, 26–29 (1984); Richard E. Spiedel, Court Imposed Price Adjustments Under Long-Term Supply Contracts, 76 Nw. U. L. Rev. 369, 370–81 (1981). In his last book, Professor Farnsworth characterizes the *ALCOA* court's mistake analysis as "[a] notorious exception" to the way most courts approach the issue of mistake. E. Allan Farnsworth, Alleviating Mistakes: Reversal & Forgiveness for Flawed Perceptions 58 (2004); *see also* John P. Dawson, *supra* at 25 (referring to *ALCOA's* modification of contract as "grotesque").

[96]499 F. Supp. at 59.

[97]499 F. Supp. at 74. The *ALCOA* court also granted relief on the grounds of mutual mistake and frustration of purpose. 499 F. Supp. at 70, 78.

Other courts have refused to follow *ALCOA*'s lead and have rejected arguments directed at the mismatch between a party's actual costs and indices used to adjust contract prices for inflation.[98] As one court explained, "under the logical consequences of [*ALCOA*] there would be no predictability or certainty for contracting parties who selected a future variable to measure their contract liability. Whichever way the variable fluctuated, the disappointed party would be free to assert frustrated expectations and seek relief via reformation."[99]

The doctrine of impracticability injects a degree of uncertainty into contractual relations. "In spite of attempts by all of the contract scholars and even in the face of eloquent and persuasive general statements, it remains impossible to predict with accuracy how the law will apply to a variety of relatively common cases."[100]

From a practitioner's perspective, the doctrine of impracticability provides opportunities to develop arguments in cases where good lawyering—distinguishing existing cases, careful development of evidence, and responsible advocacy—can make a difference to a client on either side of the issue. The discussion below concerning four recent steel escalation or shortage cases, however, reinforces the challenges confronting a party who asserts impracticability.

C. Recent Cases Addressing Impracticability and Escalation in Steel Prices

The rapid escalation of steel prices that began in late 2003 triggered numerous disputes over the contractual and legal consequences of these market conditions. Numerous claims and lawsuits were asserted on construction projects across the country. One large public owner with projects throughout the State of California stated that it is the single largest type of claim on construction projects in 2004 related to escalation in

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[98] *See, e.g.,* Beaver Creek Coal Co. v. Nevada Power Co., 1992 WL 113747, at *4 (10th Cir. 1992) (not citable in 10th Circuit); United States v. Southwestern Elec. Co-op., Inc., 869 F. 2d 310, 315 n.7 (7th Cir. 1989); Printing Indus. Ass'n of N. Ohio v. Inter'l Printing & Graphic Comm. Union, 584 F. Supp. 990, 997 (E.D. Ohio 1984); In re Westinghouse Elec. Corp. Uranium Contracts Litig., 517 F. Supp. 440, 457–58 (E.D. Va. 1981); Wabash, Inc. v. Avnet, Inc., 516 F. Supp. 995 (N.D. Ill. 1981); *cf.* Eastern Air Lines v. Gulf Oil Corp., 415 F. Supp. 429, 439 (S.D. Fla. 1975) (failure of price index to track market prices did not relieve duty of performance).

[99] *Wabash*, 516 F. Supp. at 999 n.6.

[100] 1 James J. White & Robert S. Summers, UNIFORM COMMERCIAL CODE § 3-10, at 245 (5th ed. 2006).

steel prices. Disputes over steel escalation were not confined to the construction industry. Whether the steel escalation claims and lawsuits involved construction projects or the manufacturing of goods made of steel, these disputes almost invariably involved a contractor or supplier asserting, among other things, impracticability of performance to excuse performance or delayed performance. Of course, such disputes almost always also involved an owner or purchaser seeking to enforce the pricing terms of a fixed-price contract, often accompanied by a claim for damages for nonperformance or delayed performance.

The number of actual lawsuits filed involving steel escalation disputes on construction projects could have been much greater, but a number of owners provided concessions that reduced the need to pursue judicial relief. By way of example, the Florida Department of Transportation made available to contractors a no-cost change that essentially incorporated a steel escalation clause into contracts awarded prior to February 1, 2004.[101] This concession was made "[d]ue to recent dramatic increases in the price of steel beyond what the [c]ontractor could have anticipated at the time of bid."[102]

The accommodations made by public and private owners may explain the relative dearth of published decisions addressing the run-up in steel prices that began in 2003. The few published cases address efforts by contractors and suppliers to excuse performance in whole or in part. Notably, in each of the cases discussed below, the court rejected attempts to excuse performance based on impracticability attributed to steel escalation. These cases therefore highlight some of the challenges that contractors face when relying upon the doctrine of impracticability and suggest ways that arguments might be crafted to increase the likelihood of success.

1. *Spindler Construction Corp.*

The first two cases discussed in detail are opinions of the Armed Services Board of Contract Appeals, the first of which is the only one involving a construction contract.

In *Spindler Construction Corp.*, a contractor sought an equitable adjustment on behalf of its subcontractor for an increase in the cost of structural steel materials.[103] On September 27, 2002, the contractor entered into a fixed-priced contract with the United

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[101]Price Escalation & Financial Hardship Clauses, *supra* note 5, at 61–64.

[102]Price Escalation & Financial Hardship Clauses, *supra* note 5, at 61.

[103]*Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *3.

States Army in the amount of $14,728,745 for the design and construction of an aircraft maintenance hangar.[104] The contract did not contain a price escalation clause addressing increases in material costs.[105]

On February 5, 2004, the contractor entered into a fixed-priced subcontract for structural steel fabrication and erection which, like the prime contract, contained no escalation clause.[106] The subcontract price for steel fabrication was $3,106,250; the subcontractor's estimated cost of the prefabricated steel was $868,375, and its actual cost increased to $1,067,384. "This is an increase of $199,008.86 or 23 percent in the cost of steel."[107] In foreshadowing its decision, the Board notes that this "represents an increase of less than five percent of the total subcontract and less than two percent to the rest of the prime contract."[108]

The subcontractor made a claim for the $199,008 increase in the cost of steel, and the contractor sponsored and passed the claim on to the contracting officer, who rejected the claim.[109] This decision was appealed, and the complaint asserted "that the 'dramatic increase in steel prices' between February 2004 and December 2004 'was a supervening event that made [the subcontractor's] performance of the contract at the contract price commercially impracticable.' "[110]

On cross-motions for summary judgment, the contractor submitted evidence intended to support the applicability of the doctrine of impracticability. A declaration of the subcontractor's president explained "that the steel mill prices to the fabrication industry had fluctuated within a 'generally predictable range' for many years, allowing the fabrication industry relative predictability in the cost of structural steel scraps and plate used in construction of buildings and bridges."[111] According to the subcontractor's president, "[t]his permitted the fabrication industry to provide lump sum pricing and take the 'risk of normal fluctuations in the cost of structural steel shapes and plate from

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[104]*Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *2.

[105]*Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *2.

[106]*Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *2.

[107]*Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *2–*3 (Armed Servs. B. C. A. July 31, 2006).

[108]*Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *3.

[109]*Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *5–*6.

[110]*Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *6.

[111]*Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *3–*4.

the mills.' "[112] He asserted that "[s]uch market stability was a basic assumption upon which [subcontractor] subcontracted with [contractor] to provide steel for the project."[113] However, the board observed that "[t]here is no evidence that either [contractor] or the government made such an assumption."[114] Finally, the president of the subcontractor averred that, "between November 2003, when [subcontractor] obtained steel prices for its bid, and December 2004, when it completed performance of the subcontract, the price of steel became volatile and unpredictable due to a 'global steel crisis,' increasing the cost of steel by over 50 percent."[115]

The board applied the four-factor test for commercial impracticability as articulated in *Seaboard Lumber Co.* and found that three of the four requirements had not been satisfied.[116] First, the board found that "the supervening market fluctuation in the price of steel here did not make contract performance impracticable."[117] The board cited cases where "cost overruns of 57 percent and 70 percent . . . did not make performance commercially impracticable."[118] In contrast, "the 23 percent increase in the cost of steel" at issue in this case "represents less than a five percent cost overrun of the subcontract price."[119]

The board found that the second and fourth factors were not satisfied largely because of the nature of fixed-priced contracts:

> [T]he non-occurrence of increased costs was not a basic contract assumption because a fixed-price contract normally assigns the risk of

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[112] *Spindler Constr. Corp.*, ASBCA No. 55007, 2006 ASBCA LEXIS 66, at *4. The comments to the Restatement contemplates that an increase in the "prices of raw materials" or "costs of construction" that is "well beyond the normal range" might constitute impracticability. RESTATEMENT, *supra* note 53, § 261 cmt. d. The effort to posture the facts in *Spindler* to come within this opening failed.

[113] *Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *4.

[114] *Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *4.

[115] *Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *4.

[116] *Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at **7–*8. (citing Seaboard Lumber Co. v. United States, 308 F.3d 1283, 1294–95 (Fed. Cir. 2002). For the factors as articulated in *Seaboard Lumber Co.*, see *supra* note 75 and accompanying text.

[117] *Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *7–*8. (citations omitted).

[118] *Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *7–*8 (citations omitted).

[119] *Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *7–*8 (citations omitted).

> price increases to the contractor. [The contractor's] contract with the government to design and build a new aircraft depot maintenance hangar was a fixed-price contract that insulated the government from the risk of cost increases. [Contractor's] contract with [subcontractor] was also fixed-price. While [subcontractor] assumed that the steel market would remain within a 'generally predictable range,' this was not a basic, or normal, assumption about the general risk of possible cost increases for a fixed-price contract.[120]

The board cited two other board decisions that it characterized as establishing that the "contractor bears the general risk of performance and material price increases in a firm fixed-price contract without an economic price adjustment clause."[121] The board reiterated that "there is no evidence that either [the contractor] or the government shared [subcontractor's] assumption" and, "[e]ven if both did, . . . market shifts do not usually change basic contract assumptions."[122]

As to the third factor, the board did not blame the "global steel crisis" on either the contractor or subcontractor;[123] but because the undisputed facts did not support the other three necessary requirements, the board denied the contractor's summary judgment motion and granted the government's cross-motion.[124]

2. Demusz Manufacturing Company

The case of *Demusz Manufacturing Company* involved a "firm-fixed price contract" awarded on February 13, 2003, by the Air Force requiring that the contractor manufacture and deliver steel mating rings for airplane engines.[125] The contractor failed to deliver the products on time despite four modifications extending the delivery date.[126] In addition, the "first article" that was tested for hardness did not meet requirements of the contract.[127] The supplier of the steel refused to replace the "soft" steel except at

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[120]*Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *9.

[121]*Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *9. (citing Chevron, U.S.A., Inc., ASBCA No. 32323, 90-1 BCA AP 22,602 at 113,426; AGH Indus. Inc., ASBCA Nos. 25848, 26535, 85-1 BCA AP 17,784 at 88,845).

[122]*Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *10.

[123]*Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *10.

[124]*Spindler Constr. Corp.*, 2006 ASBCA LEXIS 66, at *12.

[125]*Demusz Mfg. Co.*, ASBCA No. 55311, 2006 ASBCA LEXIS 108, at *1–*2 (Dec. 18, 2006).

[126]*Demusz Mfg. Co.*, 2006 ASBCA LEXIS 108, at *4–*5.

[127]*Demusz Mfg. Co.*, 2006 ASBCA LEXIS 108, at *4.

an increased cost to the contractor.[128] The contractor ultimately advised the Air Force that it had "material from another contract that it could use," but failed to deliver 16 mating rings due on the modified due date for delivery.[129] As a result, the Air Force terminated the contract.

The contractor appealed to the Armed Services Board of Contract Appeals, and the Air Force moved for summary judgment. In response, the contractor disputed the propriety of the termination asserting, among other things, that the "volatility of the metals market" excused any delays by making "it impossible to perform . . . under the terms of the . . . contract."[130]

In support for its position, the contractor submitted an affidavit from its president stating "[t]hat, from late 2004 through 2005, there was a tremendous amount of volatility in the metals market which caused shortages in supply and delays in delivery."[131] The board noted that the affidavit did not "provide any specific linkage between the alleged steel shortages and its subcontractor's failure to deliver."[132] The board applied the three factors for establishing impossibility or impracticability as set out in *Transatlantic Financing Corp.*[133] The board observed that the contractor "provided no specific evidence other than its conclusory allegations that there was a steel shortage and that it was impossible to machine the material in time prior to . . . the

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[128]*Demusz Mfg. Co.*, 2006 ASBCA LEXIS 108, at *5.

[129]*Demusz Mfg. Co.*, 2006 ASBCA LEXIS 108, at *6.

[130]*Demusz Mfg. Co.*, 2006 ASBCA LEXIS 108, at *1,*8. The default clause in the contract provided that circumstances excused a default "[i]f the failure to perform is caused by the default of a subcontractor at any tier, and if the cause of the default is beyond the control of both the contractor and the subcontractor, and without fault or negligence of either . . . ." *Demusz Mfg. Co.*, 2006 ASBCA LEXIS 108, at *2. The board rejected the contractor's argument that default was excused under this clause: "Noticeably absent from [contractor's] opposition is any support that [its subcontractor's] failure to deliver was in any way caused by, or the result of the alleged steel shortages." *Demusz Mfg. Co.*, 2006 ASBCA LEXIS 108, at *17–*18. Thus, the contractor failed to raise genuine issues of fact as to whether "its failure to deliver on time was beyond the control and without the fault or negligence of its subcontractor." *Demusz Mfg. Co.*, 2006 ASBCA LEXIS 108, at *18.

[131]*Demusz Mfg. Co.*, 2006 ASBCA LEXIS 108, at *15.

[132]*Demusz Mfg. Co.*, 2006 ASBCA LEXIS 108, at *15.

[133]*Demusz Mfg. Co.*, 2006 ASBCA LEXIS 108, at *16. (citing Transatlantic Fin. Corp. v. United States, 363 F. 2d 312, 315 (D.C. Cir. 1966)). For the factors identified in *Transatlantic Financing Corp.*, see *supra* note 75 and accompanying text.

delivery date . . . ."[134] Another significant factor in the board's decision was "that the contract entered into with the government was of a firm-fixed price variety under which the risk of price increases would have been assigned to the [contractor]."[135] The board also cited *Spindler Construction Corp.* in support of its conclusion that the contractor failed to provide "a scintilla of evidence in support of a case for commercial impracticability."[136] Accordingly, the board granted the government's motion for summary judgment and denied the contractor's appeal.[137]

3. *Chainworks, Inc. v. Webco Industries, Inc.*

In *Chainworks, Inc. v. Webco Industries, Inc.*,[138] Webco agreed to supply Chainworks with its requirements for steel tubing for 2004 at a fixed rate. As steel prices increased, Webco's supplier "imposed a raw material surcharge on all steel products."[139] Webco attempted to pass on the surcharge to Chainworks and subsequently also attempted to increase the stated price under the contract.[140] Chainworks paid those increases under protest and deducted all surcharges and price increases from its final contract payment.[141]

Chainworks filed a declaratory relief action asserting that Webco breached the contract by increasing the price of the steel tubing.[142] Webco responded that "unforeseen market conditions rendered its performance impracticable" under Section 2-615 of the Uniform Commercial Code as codified in Michigan.[143] The court granted Chainworks' motion for summary judgment and flatly rejected Webco's efforts to create a genuine issue of material fact as to the applicability of the doctrine of impracticability.[144]

The analysis of the court in *Chainworks* illustrates the difficult

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[134] *Demusz Mfg. Co.*, 2006 ASBCA LEXIS 108, at *16.

[135] Demusz Mfg. Co., 2006 ASBCA LEXIS 108, at *16.

[136] *Demusz Mfg. Co.*, 2006 ASBCA LEXIS 108, at *17.

[137] *Demusz Mfg. Co.*, 2006 ASBCA LEXIS 108, at *19. The board reached the same result in a companion case involving a separate contract with the same parties and the same product. *Demusz Mfg. Co.*, ASBCA No. 55310, 2007 ASBCA LEXIS 13, at *22–*23 (Feb. 26, 2007).

[138] Chainworks, Inc. v. Webco Industries, Inc., 2006 WL 461251 (W.D. Mich. 2006).

[139] *Chainworks, Inc.*, 2006 WL 461251 at *1.

[140] *Chainworks, Inc.*, 2006 WL 461251 at *2.

[141] *Chainworks, Inc.*, 2006 WL 461251 at *2.

[142] *Chainworks, Inc.*, 2006 WL 461251 at *2.

[143] *Chainworks, Inc.*, 2006 WL 461251 at *8.

[144] *Chainworks, Inc.*, 2006 WL 461251 at *9 to *18.

hurdles that must be overcome when asserting the doctrine of impracticability. The court noted that the impracticability defense required proof of three elements: (1) "that an unforeseeable event occurred;" (2) "the nonoccurrence of the event was a basic assumption underlying the agreement;" and (3) "the event rendered performance impracticable."[145]

Webco argued "that the dramatic rise in the market price for steel in early 2004 was not foreseeable and rendered its performance . . . impracticable."[146] Importantly, Webco "did not argue that it was unable to deliver product, that it was not unable to obtain quality materials, or that there was a severe shortage of materials."[147] Instead, Webco argued "only that, due to the industry-wide surcharge, the cost to procure raw materials rose dramatically."[148] This made the court's decision rather easy given the many cases holding that mere price increases do not render a contract impracticable. As stated by the court: "It is abundantly clear to the Court, however, that increased cost, without more, does not support a claim of impracticability . . . . Moreover, Webco has failed to demonstrate that the shift in market price was the result of an unforeseen contingency."[149]

The *Chainworks* court concluded that two key pieces of evidence demonstrated "that the parties knew that the steel market was volatile and that an increase in raw material costs was foreseeable."[150] First, a large number of press releases from steel companies issued in 2003, prior to the execution of the contract between Webco and Chainworks, described in stark terms the rapid increase in steel prices and the "perfect storm in the market."[151] "[A]s a sophisticated business entity and member of the steel industry, Webco was certainly aware of these volatile market conditions and the steps that steel companies were taking in response."[152] This later point was punctuated by an e-mail in early December 2003 authored by Webco's vice president indicating: "[T]he worldwide market has shifted into high gear.

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[145]*Chainworks, Inc.*, 2006 WL 461251 at *9.

[146]*Chainworks, Inc.*, 2006 WL 461251 at *9.

[147]Chainworks, Inc., 2006 WL 461251 at *9. The court noted that, "[a]t best, Webco asserts that there was a shortage of material in the sense that it could not obtain material that was not subject to a surcharge." Chainworks, Inc., 2006 WL 461251 at *9 n.6.

[148]Chainworks, Inc., 2006 WL 461251 at *9.

[149]Chainworks, Inc., 2006 WL 461251 at *9 (citations omitted).

[150]Chainworks, Inc., 2006 WL 461251 at *9.

[151]Chainworks, Inc., 2006 WL 461251 at *9.

[152]Chainworks, Inc., 2006 WL 461251 at *9.

Supplies are tightening and pricing is rising—mills now have all customers on allocation."[153]

Second, in 2002, the parties had discussed whether to include a price adjustment clause in a potential long-term contract. The court concluded that "the discussion of a pricing adjustment clause indicates that the parties were well aware that raw materials pricing could fluctuate during the course of their dealings with each other."[154] The court acknowledged that the articles submitted by Webco indicated that steel prices increased in January and February 2004; however, "they also describe the historical volatility of the steel market as far back as 1995" and therefore "further evidence that a market shift was foreseeable prior to the parties' agreement."[155]

> The court's conclusion warrants extended quotation:
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> The evidence demonstrates that, prior to the parties' contract, both Webco and Chainworks understood that the steel market was volatile and that steel manufacturers were imposing surcharges due to raw material price increases. Based on this evidence, it is clear that the increased costs incurred by Webco were not unforeseeable and do not support the assertion of the impracticability defense. At best, the evidence shows that while increased costs were foreseeable, Webco either misjudged or did not anticipate the *degree* of the increase. In the midst of this volatile market climate, the parties agreed to a contract that provided for the payment of a fixed, certain price. Webco cannot, after the fact, alter the contract based on impracticability simply because it may have misread the market and entered into a contract which became a greater financial burden than originally expected.[156]

Thus, *Chainworks* underscores the challenges confronted by parties seeking to assert increases in commodity prices as the

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[153]Chainworks, Inc., 2006 WL 461251 at *10.

[154]Chainworks, Inc., 2006 WL 461251 at *10. The court also observed that the parties' previous dealing precluded satisfaction of the second element of the impracticability doctrine: "[B]y resisting the adjustment clause in favor of fixed pricing, the parties assumed the risk that the price could rise or fall during the contract's duration." Chainworks, Inc., 2006 WL 461251 at *10 n.9.

[155]Chainworks, Inc., 2006 WL 461251 at *10.

[156]Chainworks, Inc., 2006 WL 461251 at *10 (emphasis in original). The court gave little weight to evidence from Webco indicating it would have become insolvent in 2004 had it been required to absorb the incurred costs: "Given the fact that it was foreseeable that raw material pricing was on the rise during late 2003, and that the parties, as indicated by their prior dealings, understood that raw material pricing was volatile, it is of limited relevance that Webco may have entered into a contract which eventually became an unprofitable venture." Chainworks, Inc., 2006 WL 461251 at *10 n.10 (court cites several cases pertinent to this issue).

justification for applying the doctrine of impracticability to excuse performance on a fixed-price contract.

4. *Ecology Services, Inc. v. GranTurk Equipment, Inc.*

In *Ecology Services, Inc. v. GranTurk Equipment, Inc.*, a federal district court addressed the impracticability doctrine in the context of a sole source contract.[157] Plaintiff Ecology Services, Inc. (ESI), a waste hauling company, had contracted to purchase 12 rear loaders from defendant GranTurk, who also was to install the bodies onto a truck chassis provided by ESI.[158] GranTurk, in turn, contracted with codefendant G&H Manufacturing (G&H) to manufacture the bodies.[159] The parties executed the contract in late 2003, the same time frame as the requirements contract at issue in *Chainworks*.[160] When the garbage trucks were delivered late, ESI filed a complaint against GranTurk and G&H, including a cause of action for breach of contract against GranTurk seeking delay damages.[161] GranTurk filed a motion for summary judgment asserting, among other things, that any late deliveries were excused because it "was due to impracticability of performance caused by steel shortages experienced by G&H, the contract's sole source of supply for the truck bodies."[162]

The court applied the law of Maryland, including its codification of the Uniform Commercial Code.[163] The court rejected GranTurk's motion for summary judgment concerning the impracticability doctrine because GranTurk did not provide any evidence "to support its contention that the steel shortage that allegedly made GranTurk's performance impracticable was unforeseeable."[164]

The court's discussion in *Ecology Services, Inc.,* is notable in several respects. The court applied a three-prong test for impracticability in a sole source situation:

> [T]he source of supply must not only fail, [1] it must have [ ] been mutually contemplated by the parties as the sole source of supply, (2) the failure must not have been foreseeable at the time of contracting, and (3) the party seeking to be excused must have

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[157]Ecology Servs., Inc., 443 F. Supp. at 756 (Md. Aug. 9, 2006).

[158]Ecology Servs., Inc., 443 F. Supp. at 761 (Md. Aug. 9, 2006).

[159]Ecology Servs., Inc., 443 F. Supp. at 761 (Md. Aug. 9, 2006).

[160]Ecology Servs., Inc., 443 F. Supp. at 762 (Md. Aug. 9, 2006).

[161]Ecology Servs., Inc., 443 F. Supp. at 767 (Md. Aug. 9, 2006).

[162]Ecology Servs., Inc., 443 F. Supp. at 768 (Md. Aug. 9, 2006).

[163]Ecology Servs., Inc., 443 F. Supp. at 768 (Md. Aug. 9, 2006).

[164]Ecology Servs., Inc., 443 F. Supp. at 769 (Md. Aug. 9, 2006).

> employed 'all due measures' to insure that the sole source did not fail.[165]

The court noted that the circumstances relevant to these issues are those existing at the time the parties enter the contract.[166] As to the first prong, the parties agreed that G&H was understood to be the sole source of the truck bodies.[167]

The court, however, found that a genuine issue of material fact existed as to the issue of foreseeability of a steel shortage and whether any such steel shortage caused "G&H's failure to timely supply the truck bodies."[168] GranTurk pointed to testimony from ESI's CEO indicating that "he did not foresee the national steel shortage."[169] The court had two responses. First, the testimony of ESI's CEO only shows that this individual did not personally "foresee the steel shortage;" it "does not demonstrate that the steel shortage was not *foreseeable* (by *either* party) at the time of contracting."[170] Second, the court noted that *Chainworks* had held that the "shortage of steel in 2003–2004 . . . was foreseeable."[171] Additionally, the court reiterated the maxim that "rising costs alone is insufficient to invoke the defense" of impracticability of performance.[172]

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[165]Ecology Servs., Inc., 443 F. Supp. at 768 (Md. Aug. 9, 2006). (quoting Rockland Indus., Inc. v. E+E (US) Inc., 991 F. Supp. 468, 471 (D. Md. 1998)). The quote from *Rockland* is itself a quote of the sole source rule as formulated in a leading treatise on the Uniform Commercial Code. 1 James J. White & Robert S. Summers, Uniform Commercial Code § 3-10(c), at 257 (5th ed. 2006).

[166]Ecology Servs., Inc.443 F. Supp. at 768 (Md. Aug. 9, 2006). Where there is an agreed sole source and the failure of the sole source is foreseeable, the risk of nonperformance by the sole source is on the seller absent exculpatory language expressly transferring such risk to the purchaser. Ecology Servs., Inc. v. GranTurk Equip., Inc., 443 F. Supp. at 768 (Md. Aug. 9, 2006). In *Ecology Services, Inc.*, the court held that an expulsory clause, "[d]elivery promised subject to delay beyond our control," was too general to warrant summary judgment in GrandTurk's favor especially given that GranTurk failed to provide any "documentation of the steel shortage or its effect on G&H beyond deposition testimony," which was insufficient on this issue. Ecology Servs., Inc. v. GranTurk Equip., Inc., 443 F. Supp. at 770 (Md. Aug. 9, 2006).

[167]Ecology Servs., Inc., 443 F. Supp. at 769 (Md. Aug. 9, 2006).

[168]Ecology Servs., Inc., 443 F. Supp. at 769 (Md. Aug. 9, 2006).

[169]Ecology Servs., Inc., 443 F. Supp. at 769 (Md. Aug. 9, 2006).

[170]Ecology Servs., Inc., 443 F. Supp. at 769 (Md. Aug. 9, 2006).

[171]Ecology Servs., Inc., 443 F. Supp. at n. 12 (Md. Aug. 9, 2006).

[172]Ecology Servs., Inc., 443 F. Supp. at 769 (Md. Aug. 9, 2006).

GranTurk also asserted in its briefing that the alleged steel shortage was "precipitated by Chinese demand for steel."[173] The court quoted from Comment 4 of the UCC:

> [A] shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of main sources of supply or the like, which either causes a marked increase in costs or altogether prevents a seller from securing supplies necessary to his performance is within the interpretation of this section.[174]

The court found that increased demand for steel in China could not "be deemed one of the scenarios listed in comment 4."[175] In short, the court held that GranTurk failed to show an absence of "genuine disputes of material fact" on the foreseeability prong.[176]

In regards to the third prong, ESI did not directly address the issue. Nevertheless, because ESI challenged the argument "that timely delivery of the trucks was made impracticable," the court concluded that ESI "has not conceded that there was any contingency that required GranTurk's 'due measures' to prevent."[177] Since the court concluded that GranTurk had not proven "that a steel shortage precluded it from timely delivering the trucks to ESI," the court concluded that an issue of fact existed on this prong as well.[178]

5. Lessons from Recent Steel Escalation Cases

The four recent steel escalation cases discussed above provide several useful lessons. First, these cases reconfirm the judicial skepticism that must be overcome whenever a party to a fixed-price contract asserts that the doctrine of impracticability excuses performance because of changed market conditions. A party opposing applicability of the doctrine will invariably try to develop evidence showing that price increases were foreseeable, and that the material in question has a history of price volatility. The doctrine may find a more receptive audience where the "unforeseen" circumstance can be characterized as an event other than mere unforeseen price increases. Parties asserting the doctrine of impracticability are in a better position if they can point to an

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[173]Ecology Servs., Inc., 443 F. Supp. at 769, n. 13 (Md. Aug. 9, 2006).

[174]Ecology Servs., Inc., 443 F. Supp. at 769 (Md. Aug. 9, 2006). (quoting Md. Code, Com. Law. § 2-615 cmt. 4).

[175]Ecology Servs., Inc., 443 F. Supp. at 769 (Md. Aug. 9, 2006).

[176]Ecology Servs., Inc., 443 F. Supp. at 770 (Md. Aug. 9, 2006).

[177]Ecology Servs., Inc., 443 F. Supp. at 770 (Md. Aug. 9, 2006).

[178]Ecology Servs., Inc., 443 F. Supp. at 770 (Md. Aug. 9, 2006).

unexpected event that caused the price increase rather than simply asserting that a price increase was unexpected. For example, asserting that prices increased is not as strong a position as asserting that an unforeseen natural disaster or embargo drove up prices. At the very least, pointing to an external, fortuitous cause outside the control of the party seeking to have performance excused evokes more sympathy than a bare assertion that the parties expected price stability. Of course, this sort of enhanced advocacy may not be sufficient in any individual case.

Second, these recent cases underscore the importance of carefully developing evidence to support each of the elements of the doctrine of impracticability. Even if a party can establish that there has been an unforeseen increase in prices (or an unforeseen event leading to an increase in prices), that party should try to develop and submit evidence demonstrating how those events caused performance to be impracticable. If a contractor is relying on a sole source supplier who failed to deliver the goods or materials, the contractor is in a much better position if it can show that the alleged unforeseen event (e.g., a steel shortage) caused the supplier not to deliver or not to deliver on time. Simply demonstrating that an unforeseen contingency occurred may not be enough; efforts should be made to link nonperformance to the occurrence of the contingency. Similarly, if the party seeking to be discharged *only* presents evidence of its own uncommunicated subjective belief, a court is not likely to be persuaded that the nonoccurrence of an event was a basic assumption of the contract. Developing evidence from the other party to the contract and presenting an objective reading of the contract supportive of the contractor's position enhance the likelihood of prevailing on an impracticability argument.

D. Other Excuses: Frustration of Purpose; Mutual Mistake; and *Force Majeure* Clauses

In addition to the doctrine of impracticability, contractors seeking to have performance excused due to increases in material prices frequently assert frustration of purpose, mutual mistake, and *force majeure* clauses. A short summary of these theories is set out below.

1. Frustration of Purpose

Frustration of purpose, like impracticability, is based upon the failure of a basic assumption underlying the agreement. The *Restatement (Second) of Contracts* describes frustration of purpose as follows:

> Where, after a contract is made, a party's principal purpose is

> substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or circumstances indicate the contrary.[179]

As with impracticability, the element of foreseeability plays a key role in the analysis.[180]

Once again, however, the courts make it clear that proof of frustration of purpose will be a high bar to hurdle.[181] Under New York law, for instance, at least one court has held that frustration of purpose will not excuse performance for either a change in market conditions or an increase in the cost of performance.[182] As stated by that court, "Quite a bit more is required than demonstrating a desire to avoid the consequences of a deal gone sour."[183] Courts have limited the doctrine of frustration of purpose "to instances where a virtually cataclysmic, wholly unforeseeable event renders the contract valueless to one party."[184] Ordinarily, increases in the price of construction materials are unlikely to constitute such a cataclysm. Even so, parties asserting the doctrine can always find solace in *ALCOA*, which held that the large disparity between ALCOA's nonlabor production costs and the index selected to track those costs as a failure of a basic assumption sufficient to establish frustration of purpose.[185]

2. Mutual Mistake

Under the doctrine of mutual mistake, a party to a contract

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[179]RESTATEMENT, *supra* note 53, § 265; *see also* Chase Manhattan Bank v. Iridium Africa Corp., 474 F. Supp. 2d 613, 620 (D. Del., 2007).

[180]Bierer v. Glaze, Inc., 2006 WL 2882569 at *6 (E.D. N.Y., 2006) ("Frustration of purpose 'focuses on events which materially affect the consideration received by one party for his performance. Both parties can perform, but as a result of unforeseeable events, performance by party X would no longer give party Y what induced him to make the bargain in the first place.' ").

[181]*See, e.g.*, Wooldridge v. Exxon Corp., 39 Conn. Supp. 190 (1984) (rejecting lessee's attempt to rescind gas station leases where "circumstances unforeseen by the parties were drastic diminution of the supply of gasoline caused by an oil embargo, increase in prices and decrease in demand"); *see also* Lloyd v. Murphy, 25 Cal. 2d 48, 52–57 (1944) (federal governments system of priorities for sale of new automobiles did not render frustration of purpose lease where tenant intended to use lot to sell cars).

[182]Health-Chem Corp. v. Baker, 737 F. Supp. 770, 776 (S.D. N.Y. 1990).

[183]Health-Chem Corp., 737 F. Supp. at 776 (S.D. N.Y. 1990).

[184]Bierer v. Glaze, Inc., 2006 WL 2882569, at *6 (citing United States v. General Douglas MacArthur Senior Village, Inc., 508 F. 2d 377, 381 (2d Cir. 1974)).

[185]499 F. Supp. at 60.

may seek to rescind or reform the contract. The *Restatement* sets forth the doctrine of mutual mistake as follows:

> Where a mistake of both parties at the time the contract was made as to a basic assumption on which the contract was made has a material effect on the agreed exchange of performances, the contract is voidable by the adversely affected party unless he bears the risk of the mistake . . . .[186]

A "mistake" is defined as a "belief not in accord with existing facts."[187]

Once again, *ALCOA* provides hope for parties who assert mutual mistake. The court found that both parties were operating on the mistaken assumption that the index selected to track ALCOA's nonlabor production costs would accomplish the parties' objectives.[188] A number of courts and commentators have criticized this aspect of the *ALCOA* court's decision and, in particular, its decision to reform the contract.[189]

Indeed, the courts consider reformation to cure a mutual mistake to be an extraordinary remedy. It is available only upon establishing: "(1) the parties to the contract were mistaken in their belief regarding a *fact*; (2) that mistaken belief constituted a basic assumption underlying the contract; (3) the mistake had a material effect on the bargain; and (4) the contract did not put the risk of the mistake on the party seeking reformation."[190]

Especially relevant in a price escalation case is the requirement that the mistake "must relate to an existing fact."[191] Courts distinguish between mistakes of fact and erroneous predictions. "A prediction or judgment regarding an event to occur in the future, if erroneous, does not constitute a 'mistake' as the term is contemplated within the doctrine of mutual mistake of fact."[192] Courts frequently reject the excuse of mistake where the asserted "mistake" is really a prediction, judgment, or expectation about

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[186]RESTATEMENT, *supra* note 53, § 152.

[187]RESTATEMENT, *supra* note 53, § 151. *See generally* Farnsworth, *supra* note 95, at 9-60.

[188]499 F. Supp. at 60–70.

[189]*See supra* note 95.

[190]Nat'l Australia Bank. v. United States, 452 F.3d 1321, 1329 (Fed. Cir. 2006) (emphasis added).

[191]ECC Int'l Corp. v. United States, 43 Fed.Cl. 359, 371 (1999).

[192]La Gloria Oil & Gas Co. v. United States, 72 Fed. Cl. 544, 575 (2006).

the future.[193] The battle, however, involves the characterization of the asserted mistake as being a mistake of fact or something else not justifying the requested relief.

Courts rarely find increases in the cost of performance to constitute a mutual mistake of fact, a proposition highlighted by *Fowler v. City of Anchorage*.[194] In that case, a contractor bid on and was awarded a construction contract with a city.[195] After the bid and before the contract was awarded, the state's department of labor raised the minimum wage rates thereby increasing the labor costs of the contractor.[196] The court rejected the contractor's mutual mistake argument stating:

> The doctrine of mutual mistake does not permit rescission when the contract has expressly allocated the risk of a particular occurrence to one party and such an event has occurred . . . . The instant situation reflects such an allocation of risk; the invitation to bid contained a notice [indicating] that the bidder must inform himself of wage conditions, and we believe this provision amounts to an express requirement that the bidder bear the particular risk of mistake.[197]

Accordingly, assertion of mutual mistake to excuse performance or reform a contract due to increases in the cost of material prices itself faces a number of significant hurdles.

3. *Force Majeure* Clauses

Many construction contracts contain what is referred to as a "*force majeure* clause."[198] These clauses typically permit a party to the contract to delay or cease performance without incurring damages as a result of the occurrence of certain specified events or types of events. Most *force majeure* clauses excuse performance for events whose occurrence is beyond the control of the parties. Often, *force majeure* clauses impose an obligation on a party to take reasonable steps to overcome a *force majeure* event or to minimize its impact. A *force majeure* clause may set forth an exhaustive or partial list of events and may expressly exclude

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[193]Dairyland Power Co-op. v. United States, 16 F.3d 1197, 1203 (Fed. Cir. 1994) (see cases cited therein).

[194]Fowler v. City of Anchorage, 583 P.2d 817 (Alaska 1978).

[195]*Fowler*, 583 P.2d at 818.

[196]*Fowler*, 583 P.2d at 818.

[197]*Fowler*, 583 P.2d at 824.

[198]*See, e.g.*, Note, Force Majeure Clauses: Drafting Advice for the CISG Practitioner, 17 J.L. & COM. 301, 412 (1998) As used in this article, *force majeure* is used in the context of contractual clauses rather than as a doctrine independent of a contract clause.

certain events from qualifying as *force majeure* events. Events that might be listed as *force majeure* include natural disasters, strikes, wars, and similar types of occurrences.[199] These clauses are often heavily negotiated on large projects involving sophisticated parties. As can be seen, *force majeure* clauses share many of the characteristics of the doctrine of impracticability and can be thought of as a type of contractually specified impracticability doctrine.

Fluctuation in market prices usually is not listed in *force majeure* clauses as an event that excuses performance. "Ordinarily, only if the *force majeure* clause specifically includes the event that actually prevents a party's performance will that party be excused."[200] Courts routinely resist efforts to shoehorn changed market fluctuations into *force majeure* clauses where the parties have not expressly included changed market conditions among the list of events excusing performance.[201]

In *Langham-Hill Petroleum, Inc. v. Southern Fuels Co.*,[202] an oil supply contract contained a broadly worded *force majeure* clause excusing "any act or omission beyond the control of the party having the difficulty."[203] Nonetheless, the court rejected the purchaser's position that the clause applied to "action of Saudi Arabia, which led to a dramatic drop in world oil prices."[204] The court reasoned that "[i]f fixed-price contracts can be avoided due to fluctuations in price, then the entire purpose of fixed-price contracts, which is to protect both the buyer and seller from the risks of the market, is defeated."[205] As with the doctrine of impracticability, the likelihood of a successful *force majeure* argu-

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[199]In drafting *force majeure* clauses, it is important to understand the meaning of the words used to describe the events of force majeure as they may have specialized meanings.

[200]Kel Kim Corp. v. Central Markets, Inc., 70 N.Y. 2d 900, 903 (1987).

[201]United States v. Panhandle Eastern Corp., 693 F. Supp. 88, 96 (D. De. 1988); *see also* Gerald I. Katz & Stephen W. Smith, Stormy Weather: Material Price Increases and Force Majeure, CONSTR. ACCT. & TAX'N, Nov./Dec. 2005, at 43 (most courts hold that "*force majeure* relief is not available for profound market fluctuations even if the market fluctuations are caused by *force majeure* events.").

[202]Langham-Hill Petroleum, Inc. v. Southern Fuels Co., 813 F.3d 1327 (4th Cir. 1986).

[203]*Langham-Hill Petroleum, Inc.*, 813 F.3d at 1329, n. 1.

[204]*Langham-Hill Petroleum, Inc.*, 813 F.3d at 1328.

[205]*Langham-Hill Petroleum, Inc.*, 813 F.3d at 1330; *see also Carbon County Coal Co.*, 799 F.2d at 275 (*force majeure* clause did not provide relief in context of fixed pricing because "normal risk of a fixed price contract is that the market price will change"); *Panhandle Eastern Corp.*, 693 F. Supp. at 98 (treating

ment increases where a party can show that the event causing the price increase falls within the contract's definition of *force majeure*.[206]

E. Judicial Reluctance to Rewrite Contracts

American courts are quite reluctant to adapt, revise, or rewrite contracts. This is true whether the justification is proffered as a matter of contract construction, hardship, or mutual mistake. Although courts have revised contracts, and courts are expressly authorized in certain circumstances to reform contracts or "fill gaps" in contracts, courts are reluctant to assume this role. The reluctance of courts to rewrite contracts is deeply embedded in American jurisprudence.[207] As will be seen, this tradition may cause American firms and their lawyers to resist accepting the Unidroit hardship principle, which expressly authorizes courts to "adapt" the contract with a view to restoring its "equilibrium."[208]

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economic and market forces as *force majeure* events would insulate defendants from "the very risks they expressly assumed [and] would nullify a central term of the" agreement), *aff'd*, 868 F. 2d 1363 (3d Cir. 1989); Stand Energy Corp. v. Cinergy Servs., Inc., 760 N.E.2d 453, 456 (Ohio Ct. App. 2001) ("The inability to purchase a commodity at an advantageous price is not a contingency beyond a party's control. If it were, fixed-price contracts, where the parties allocate the risk of price rises in a fluctuating market, would serve no purpose."); Publicker Indus., Inc., 17 U.C.C. Rep. Serv. 989 (doubting that the 1970's Arab oil price rises would be covered by the *force majeure* clause in question), *cf*. OWBR L.L.C. v. Clear Channel Communications, Inc., 266 F. Supp. 2d. 1214, 1224 (D. Haw. 2003) (event organizer who reserved resort in Hawaii for January 2002 could not invoke 9/11 as *force majeure* event because it was too remote in time and location); Seaboard Lumber Co. v. United States, 41 Fed. Cl. 401, 415 (1998) (changes in federal monetary policy making timber contract unprofitable were too indirect to invoke *force majeure* clause).

[206]While of little utility in the context of hyperinflation, *force majeure* may be helpful in another context. As one court noted, "when in this case I am confronted with the near-daily avalanche of voluminous papers that the lawyers love to file, I am tempted to invoke the doctrine of *force majeure*, to evade the responsibility of reading and resolving them." Garamendi v. Altus Finance S.A., 2005 WL 399505 at *2 (C.D. Cal 2005).

[207]As stated by one leading treatise on contract law:

> A court will not rewrite the contract of the parties . . . .
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> . . . A court is not at liberty to revise, modify, or distort an agreement while professing to construe it, and has no right to make a different contract from that actually made by the parties . . . even if the resulting contract would be economically more efficient or advantageous to one or both parties, or more fair or equitable than the agreement the parties were satisfied to make.

Richard A. Lord, Williston on Contracts 293-205 (4th ed. 1999).

[208]International Institute for the Unification of Private Law (UNIDROIT), Principles of International Commercial Contracts art. 6.2.3(4) (2004) [hereinafter "UPICC"].

Long ago, the Supreme Court of the United States made clear that courts are not in the business of rewriting contracts: "Courts have no power to make new contracts or to impose new terms upon parties to contracts without their consent."[209] Both state and federal courts reiterate this hornbook proposition: "A court will not rewrite the contract for the parties or relieve a sophisticated contracting party from the terms that it later deems disadvantageous."[210] Where a contract is clear and unambiguous, a court may not rewrite a contract to comport with "its instinct for the dispensation of equity upon the facts of a given case."[211] "Courts cannot make for the parties better agreements than they themselves made or rewrite contracts because they operate harshly or inequitably as to one of the parties."[212] As recently stated by the Federal Circuit Court of Appeals: "We cannot rewrite a contract or insert words to which a party has never agreed."[213]

That being said, it is beyond peradventure that American courts will, in certain circumstances, reform or adapt a contract. First, courts are authorized to reform contracts in the case of mutual mistake.[214] The circumstances under which courts will revise contracts based on mutual mistake are limited and certainly do not completely overlap with the circumstances

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[209]City of New Orleans v. New Orleans Water-Works Co., 142 U.S. 79, 91 (1891).

[210]Constellation Power Source, Inc. v. Select Energy, Inc., 467 F. Supp. 2d 187, 203 (D. Conn. 2006); *see also* John Doris, Inc. v. Solomon R. Guggenheim Found., 209 A.D. 2d 380, 618 N.Y.S. 2d 99, 100 (App. Div. 1994).

[211]Terwilliger v. Terwilliger, 206 F.3d 240, 245 (2d Cir. 2000); *see also* Netherby Ltd. v. Jones Apparel Group, Inc., 2007 U.S. Dist. LEXIS 25720 (S.D. N.Y. 2007); De Vanzo v. Newark Ins. Co., 44 A.D. 2d 39, 43 (N.Y. App. Div. 1974); Trio Asbestos Removal Corp. v. Marinelli, 37 A.D. 3d 475, 2007 NY Slip. Op. 1127, 829 N.Y.S. 2d 596, 595 (2nd Dep. 2007).

[212]Hinckley v. Bechtel Corp., 41 Cal. App. 3d 206, 212, 116 Cal. Rptr. 33 (1974); *see also* Addiego v. Hill, 238 Cal. App. 2d 842, 846–847 (1965) ("The court cannot rewrite a contract to avoid difficulty or hardship."); Pacific Architects Collaborative v. State of California, 100 Cal. App. 3d 110, 123 (1979) (same); Wyandotte Orchards, Inc. v. Oroville-Wyandotte Irrigation Dist., 49 Cal. App. 3d 981, 986–987 (1975) (same).

[213]Am. Capital Corp. v. FDIC, 472 F.3d 859, 865 (Fed. Cir. 2006); *see also* Jaeger v. Canadian Bank of Commerce, 327 F.2d 743, 745 (9th Cir. 1964).

[214]*See, e.g.*, RESTATEMENT, *supra* note 53, § 155 ("Where a writing that evidences or embodies an agreement in whole or in part fails to express the agreement because of a mistake of both parties as to the contents or effect of the writing, the court may at the request of a party reform the writing to express the agreement . . . ."); Cal. Civ. Code § 3399 ("When through . . . mutual mistake of one party, or a mistake of one party which the other at the time knew or suspected, a written contract does not truly express the intention of the

justifying application of the duration of impracticability. The *ALCOA* case stands as a "notorious" example of reformation of a contract based on mutual mistake.[215]

Second, in certain circumstances, where a contract omits an essential term, the court will supply "a term which is reasonable in the circumstances."[216] For example, where a contract has otherwise been formed, but the time for performance has not been expressly indicated, a court may supply a term indicating that the performance is to occur within a reasonable time.[217] This is known as a gap-filling function.[218]

Third, the *Restatement* specifically contemplates that a court may be required in the case of impracticality to supply a term to "avoid injustice."[219] This essentially is a gap-filling function since impracticability applies where the nonoccurrence of an event was a basic assumption of the contract: "[I]n a case of impracticality or frustration, . . . the court's function can be viewed generally as that set out in [the section on] supplying a term to deal with that omitted case."[220] Again, in *ALCOA*, the court supplied the missing term or, as some have observed, essentially rewrote the escalation provisions in the contract.[221] As stated by one treatise:

> In that case the judge ordered neither an allocation nor a cancellation, rather he devised and imposed his own alternative price schedule. At page 80 of the *ALCOA* opinion, one comes upon a detailed set of price terms that look as though they belong in an elaborate contract, not in a court's opinion.[222]

Although one can find scholarly commentary in support of the

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parties, it may be revised on the application of a party aggrieved, so as to express that intention . . . .").

[215]499 F. Supp. at 79; *see also supra* note 95.

[216]RESTATEMENT, *supra* note 53, § 204; U.C.C. § 2-204(3).

[217]RESTATEMENT, *supra* note 53, § 204 cmt. d.

[218]Courts also will imply into an agreement terms necessary to effectuate the parties' intent where the evidence indicates that implication of such terms is fair and reasonable and is consistent with the parties' intention in entering into a contract. Ersa Grae Corp. v. Fluor Corp., 1 Cal. App. 4th 613, 623 (1991) (a "contract will be enforced if it is possible to reach a fair and just result even if, in the process, the court is required to fill in some gaps."); Frankel v. Board of Dental Examiners, 46 Cal. App. 4th 534, 544–545 (1996) (contracts include all "implied provisions [that] are indispensable to effectuate the intention of the parties").

[219]RESTATEMENT, *supra* note 53, § 272 & cmt. c.

[220]RESTATEMENT, *supra* note 53, § 272 & cmt. c.

[221]499 F. Supp. at 79.

[222]White & Summers, *supra* note 100 § 3-10, at 263.

approach in *ALCOA*,[223] most courts ordinarily eschew pleas to substantially rewrite contracts whether on a showing of mistake, impracticality, or frustration of purpose.

IV. U.S. CONTRACTING PRACTICES: AN INCREMENTAL RESPONSE TO HYPERINFLATION

The response of the U.S. construction industry to the surge in steel prices that began in 2003 can be characterized as an incremental adjustment to contracting practices. The primary change to contracting practices has been the use of narrowly tailored price escalation clauses coupled with certain other strategies for managing the risk of price escalation. Those approaches are summarized in Table 3.[224]

TABLE 3
United States Construction Industry Common Responses to Hyperinflation

Escalation Clauses Applicable to Specified Materials	Value Engineering
Price Adjustment Clauses (a Type of Escalation Clause)	Delayed Completion Dates
Banded Cost-Sharing Provisions (a Type of Escalation Clause)	Waiver of Liquidated Damages
Bid Contingency	Forward Contracting
Contractual Contingency Allowances	Bulk Purchasing
Broader *Force Majeure* Clauses	Early Invoicing for Materials
Bid Surcharges	Early Purchasing of Material

These responses are certainly incremental in that they do not embrace elements of the *UPICC* hardship principle that provide for renegotiation and judicial reformation of contracts.

A. Escalation Clauses

Escalation clauses represent a narrow and confined response to a specific circumstance: the impact of inflation on construction

[223]Spiedel, *supra* note 95.

[224]A number of publications discuss various approaches to managing the risk of material price escalation on construction projects, including those listed in Table 3. *See, e.g.*, Price Escalation & Financial Hardship Clauses, *supra* note 5, at 23–27; CONSTRUCTION BRIEFINGS, *supra* note 50, at 9–12.

materials. During the almost two decades of price stability that ended in late 2003, escalation clauses were seldom incorporated into construction contracts. Indeed, over this time period, the most common standardized industry forms of construction contracts in the United States, including forms published by the American Institute of Architects, did not provide a model escalation clause as an option to include in contracts.[225] As a result, when hyperinflation struck the construction industry in late 2003, the industry faced an abrupt awakening to the need for contractual provisions expressly addressing this risk. The most common contractual provision used to mitigate the impact of hyperinflation in fixed-price contracts was and is the escalation clause. A recent survey found that 63% and 56%, respectively, of responding contractors and subcontractors now include escalation clauses in their contracts.[226]

In addition, the escalation clauses that emerged were further focused on a small subset of construction resources. They adjusted the contractor's compensation in an amount reflecting the increase in the cost of a specifically identified construction material as determined by a contractually specified formula or index.[227] Escalation clauses tended to be specific to the cost of items such as steel, concrete, and fuel. These types of escalation clauses do not apply an inflation factor to the overall contract price and do not provide relief for the broader impact of inflation. Contractors facing abnormally high prices for materials other than those specified in the escalation clause were required to absorb those costs unless an owner agreed to escalate other items as well. Owners already reluctant to include escalation clauses did not

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[225]Construction Briefings, *supra* note 50 at 13 (model agreements published by the American Institute of Architects, Design Build Institute of America, Engineer's Joint Contract Documents Committee, and the Associated General Contractors of America did not have model escalation clauses). In 2004, the Associated General Contractors of America developed a form amendment providing for an adjustment to the contractor's compensation where the price of specifically listed materials increases over an agreed baseline price. AGC Document No. 200.1, Amendment No. 1 (Potentially Time And Price-Impacted Materials) (2004). Any such increase in the contractor's compensation "shall not include any amount for overhead and profit." *Id.* 3.

[226]Construction Briefings, *supra* note 50 at 11 (discussing results of 2006 Construction Industry Annual Financial Survey sponsored by Construction Financial Manager's Association).

[227]*See, e.g.*, Price Escalation & Financial Hardship Clauses, *supra* note 5, at 51–64 (sample escalation clauses); Construction Briefings, *supra* note 50, at 12–16 (discussing approaches to escalation clauses of the Associated General Contractors of America, the federal government, the Virginia Department of Transportation, and the Florida Department of Transportation).

want to convert their fixed-price arrangements to cost-plus contracts by expanding the range of construction resources that were subject to escalation.[228]

B. Other Approaches to Managing the Risk of Price Escalation

While the revival of narrow escalation clauses may be the best exemplar of the response within the U.S. construction market to hyperinflation, it was not the only strategy employed. The construction industry in the United States employed a variety of approaches to the impact of hyperinflation on the cost of construction projects. These approaches usually shared one common characteristic: They sought to mitigate the impact of hyperinflation *within* the framework of fixed-price contracting without disturbing the perceived utility of fixed-price contracting.

Table 3 above summarizes the other contractual and materials management approaches used to mitigate the impact of hyperinflation in addition to narrow escalation clauses. The responses to hyperinflation listed in Table 3 are not exhaustive. Some of these responses are helpful in some circumstances but not others, and some are merely variants of the others tailored to address project-specific circumstances.

Absent escalation clauses or other acceptable ways to manage market risks, contractors, subcontractors, and suppliers may decline to bid on projects or may increase the contingency in their bids. When contractors decline to bid, there is less competition, and conventional wisdom holds that this results in higher prices. In the public sector, there have been numerous instances where owners received as few as one bid.[229] Unless owners are willing to incorporate escalation clauses addressing the escalation concern *du jour*, those contractors willing to bid on a project may protect themselves by adding large amounts of contingency to their bids, and this may cause bids to substantially exceed an owner's estimate and imperil the financial viability of a job.[230] Many public owners allow for the use of escalation clauses because of the perception that it encourages contractor participation in the bid process and results in lower bids because contractors do not need to have as large a contingency.

As with escalation clauses, which address hyperinflation by

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[228]For a discussion of limitations on the circumstances in which public owners may include escalation clauses, see Price Escalations: Financing Hardship Clauses, *supra* note 5, at 38–41.

[229]Price Escalation & Financial Hardship Clauses, *supra* note 5, at 39 n.111.

[230]Price Escalation & Financial Hardship Clauses, *supra* note 5, at 10, 39.

adjusting the contract price, price adjustment clauses, contractual contingency allowances, bid surcharges, and banded cost-sharing arrangements provide a direct mechanism for sharing the risk of escalation. A price adjustment clause is a form of escalation clause in that it provides for upward adjustment in the prices of particular materials. However, a price adjustment clause also adjusts a contractor's compensation downwards when the market price for materials declines.[231] Contractual contingency allowances establish a pool of money that may be drawn down under defined circumstances, usually when a contractor is able to substantiate impacts from hyperinflation. The contract price is not adjusted unless and until the condition occurs and even then only to the extent of its impact.[232] Bid surcharges, like escalation clauses, impose a charge for a particular material when the material cost exceeds a predetermined threshold amount. In effect, such surcharges are escalators that are based on actual cost increases rather than price indices. Finally, in the case of banded cost-sharing arrangements, the contractor absorbs initial inflationary increases in the cost of materials. However, if and when such increases reach the band, the cost risk of further inflationary increases shifts to the owner, ordinarily up to a cap.[233]

In contrast to escalation and other clauses that directly adjust the contract price, other contract provisions attempt to provide relief by adjusting the contractor's time for performance. The use of a broader form of *force majeure* clause, for example, may provide a contractor with additional time for performance and potentially greater flexibility to avoid paying excessively high prices. Similarly, an owner can always elect to waive liquidated damages to provide a contractor additional flexibility to procure materials or adjust to delayed deliveries during periods of hyperinflation.[234] Another approach to the same problem is to delay project milestones and the overall date of completion. Time adjustments are a more indirect means to address hyperinflation than provisions that directly adjust the contract price and hinge

[231]Price Escalation & Financial Hardship Clauses, *supra* note 5, at 25.

[232]Price Escalation & Financial Hardship Clauses, *supra* note 5, at 26. This is different than bid contingency as described above. A bid contingency increases the bid of the contractor. Assuming a fix-priced contract is awarded at the bid price, the contractor ordinarily is paid the full contract price even if the concern that caused it to increase its bid with contingency dollars never materializes. A contract allowance is a specified sum that is paid in the event a contingency triggering the allowance occurs. Price Escalation & Financial Hardship Clauses, *supra* note 5, at 26.

[233]Price Escalation & Financial Hardship Clauses, *supra* note 5, at 26.

[234]Price Escalation & Financial Hardship Clauses, *supra* note 5, at 8–9.

upon discretionary acts of the owner. There is no certainty that providing the contractor with more time will result in significantly lower prices to the contract or ensure performance. In a market characterized by hyperinflation, time is money. Moreover, an owner may have little flexibility in terms of providing schedule relief.

The other approaches listed in Table 3 above largely involve managing the project as a means of mitigating the impact of hyperinflation. For example, value engineering, which often is undertaken when the estimated cost of construction exceeds the owner's budget, may be used to identify substitutes for materials whose prices are escalating rapidly.[235] As a practical matter, though, value engineering may be of limited assistance and is unlikely to help where steel, concrete, or oil is required.

The early procurement of materials similarly may enable a project to bypass inflationary increases in material prices that otherwise would impact the project if materials were ordered in the ordinary course. However, the cost of storage and insurance may be substantial, and design changes may result in wastage of materials procured earlier than normal.[236] Bulk purchases may provide an offset to hyperinflation by reducing the unit cost of materials.[237] Yet, there is a carrying cost of excessive inventory, and a danger exists of both wastage and the possibility of obsolescence. In short, these and other approaches to managing the impact of hyperinflation may help reduce the cost of construction, but any given approach only will serve that purpose if it matches up well with the nature of the project involved.

The types of responses to hyperinflation discussed above reflect an incremental mode of responding to price risk by the U.S. construction industry. Other industries that have endured prior periods of hyperinflation have responded in more dramatic ways. Many utilities require price reopeners or renegotiation in events of hardship—approaches much closer to the Unidroit hardship principle.[238]

Despite the impact of hyperinflation, price reopener clauses

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[235]Price Escalation & Financial Hardship Clauses, *supra* note 5, at 10.

[236]*See, e.g.*, Maya Payne Smart, How to: Plan for the Rising Cost of Construction Materials, CRAIN'S CLEVELAND BUSINESS, July 12, 2006; *see also* Hubble Smith, Rising Costs Hurt High Rises, LAS VEGAS REV. J., July 11, 2006 (discussing Las Vegas condo project where steel and concrete requirements were locked in two years prior to construction).

[237]Price Escalation & Financial Hardship Clauses, *supra* note 5, at 9.

[238]John R. Rhorer, Jr. & Penny R. Warren, Force Majeure Implications of Acid Rain Legislation: The Litigation Battle of the 1990s, 8 J. OF NAT.

have not taken hold in the construction industry in the United States. To owners at least, the concept of renegotiating is antithetical to the purpose of using fixed-price contracts. Owners select fixed-price contracts to secure the benefit of certainty for budgeting and planning. Escalation clauses alone represent a major concession from their perspective. Reopening the contract price as a whole seems to be a nonstarter within the U.S. construction market.

V. INTERNATIONAL CONSTRUCTION AND HARDSHIP APPROACHES

A. *UNIDROIT* Hardship Provision

In 1994, a working group of the International Institute for the Unification of Private Law (UNIDROIT) published its *Principles for International Commercial Contracts* (UPICC).[239] A new edition of the *UPICC* was published in 2004.[240] The *UPICC* is a restatement of law applicable to commercial contracts for goods and services, including construction contracts.[241] The working group responsible for developing the *UPICC* was comprised of eminent jurists and legal scholars from around the world, whose object was to develop "an international restatement of general principles of contract law."[242] The *UPICC* seeks to provide well-reasoned principles of international law to address unforeseen contingencies without unnecessarily adhering to the doctrines of any country's laws.[243] Parties to a contract may specify that the contract is to be governed by the *UPICC,* or they may draft

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RESOURCES & ENVTL. L. 23 (1992). In fact, many contracts became subject to cancellation on an annual basis if the price was not acceptable. Jerry Stroud, Coal Price Slide Affecting Contracts Utilities Trying to Renegotiate Long-term Pacts, ST. LOUIS POST-DISPATCH, May 15, 1988, at 1e.

[239]International Institute for the Unification of Private Law (UNIDROIT), Principles of International Commercial Contracts (1994) [hereinafter "1994 UPICC"].

[240]Although the new edition was "not intended as a revision of the 1994 edition," Comment 2 to Article 2.2.2 pertaining to the UPICC hardship principle was "substantially revised." UPICC, *supra* note 208, at vii.

[241]The illustrations in the UPICC make clear that the principles apply to construction contracts and contracts for architectural services. *See, e.g.*, *id*. art. 6.2.3 illus. 1 & 4, art. 7.4.2 illus. 3 & 6; *see also* Joseph M. Perillo, *supra* note 51, at 6–7.

[242]Barton S. Selden, Lex Mercatoria in European and U.S. Trade Practice: Time to Take a Closer Look, 2 ANN. SURV. INT'L & COMP. L. 111, 121–122 (1995).

[243]Sarah Howard Jenkins, Exemptions for Nonperformance: U.C.C., CISG, UNIDROIT Principles—A Comparative Assessment, 72 TUL. L. REV. 2015, 2027 (1998).

contractual provisions that mirror certain provisions of the *UPICC* like its hardship principle.[244] The *UPICC* is reportedly gaining increasing acceptance among contracting parties, has been referred to by arbitrators in the resolution of disputes, and has been used as the model for the reform of the domestic contract law of several countries.[245]

The *UPICC* hardship principle recognizes that a party's performance may be excused in cases of "hardship," a principle that overlaps with the doctrine of impracticability and frustration of purpose as applied in the United States.[246] The *UPICC* hardship principle also includes a right to renegotiate and authorizes a court to terminate or adapt the contract.[247] One commentator has observed that the *UPICC* hardship principle "appears to introduce radical deviations from the common law."[248] With the increasing globalization of the construction industry and the increasing acceptance of the *UPICC*, closer examination of the *UPICC* hardship principle is warranted.

The *UPICC* hardship principle is set forth in three articles, which are quoted in their entirety:

ARTICLE 6.2.1
(Contract to be observed)

> Where the performance of a contract becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligations subject to the following provisions on hardship.

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[244]*See* UPICC, *supra* note 208, Preamble (UPICC principles apply where a contract specifies it is to be governed by the UPICC, may apply when the contract is to be governed by "general principles of law," or "the *lex mercatoria*," and can be used to supplement or interpret international uniform law instruments or domestic law); *cf. id*. art. 6.2.2 cmt. 7.

[245]Michael Joachin Bonnell, UNIDROIT Principles 2004—The New Edition of the Principles of International Commercial Contract adopted by the International Institute for the Unification of Private Law, in UNIF. L. REV. DR. UNIF., 2004-1 at 6–17; Force Majeure and Hardship, Conference Report (8 March 2001 conference organized by the International Chamber of Commerce), available in Uniform Law Review, Issue 2001-1 [hereinafter "Force Majeure and Hardship"]. The UPICC hardship doctrine has been applied in at least six international arbitration awards, three granting and three rejecting hardship pleas. Civil code reforms that have been influenced by the UPICC include reforms in Russia, China, and Germany. *Bonnell*, supra at 6–17.

[246]UPICC, *supra* note 208, art. 6.2.1–6.2.3; 6.2.1 cmt. 2.

[247]UPICC, *supra* note 208, art. 6.2.3.

[248]Joseph M. Perillo, UNIDROIT Principles of International Commercial Contracts: The Black Letter Text and a Review, 63 FORDHAM L. REV. 281, 297 (1994).

ARTICLE 6.2.2
(Definition of hardship)

There is hardship where the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of a party's performance has increased or because the value of the performance a party receives has diminished, and

(a) the events occur or become known to the disadvantaged party after the conclusion of the contract;

(b) the events could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract;

(c) the events are beyond the control of the disadvantaged party; and

(d) the risk of the events was not assumed by the disadvantaged party.

ARTICLE 6.2.3
(Effects of hardship)

(1) In case of hardship the disadvantaged party is entitled to request renegotiations. The request shall be made without undue delay and shall indicate the grounds on which it is based.

(2) The request for renegotiation does not in itself entitle the disadvantaged party to withhold performance.

(3) Upon failure to reach agreement within a reasonable time either party may resort to the court.

(4) If the court finds hardship it may, if reasonable, (a) terminate the contract at a date and on terms to be fixed, or (b) adapt the contract with a view to restoring its equilibrium.[249]

There are similarities and differences between American common-law doctrines and the *UPICC* generally and its concept of hardship specifically. For instance, the *UPICC* reaffirms the

[249]UPICC, *supra* note 208, art. 6.2.1–6.2.3. The UPICC also has an article entitled "*Force Majeure*." UPICC, *supra* note 208, art. 7.1.7. This *force majeure* provision requires something more closely approaching impossibility of performance. UPICC, *supra* note 208, art. 7.1.7 cmt. 1; *see also* Joseph M. Perillo, *supra* note 51, at 15. The 1980 United Nations Convention on Contracts for the International Sale of Goods (CISG) contains no equivalent to a hardship clause. Catherine Kessedjian, Competing Approaches to Force Majeure and Hardship, 25 INT'L REV. L. & ECON. 415, 419 (2005). The CISG limited its application to circumstances that result in impossibility of performance but not impracticability or frustration. It thus reflects the traditional rule of *pacta sunt servanda* if increased costs of performance are experienced. Sarah Howard Jenkins, *supra* note 243, at 2025. One issue concerns the extent to which the UPICC principle on hardship will be used to supplement or fill gaps in the CISG. *See* Alejandro M. Garo, The Gap-Filling Role of the UNIDROIT Principles in International Sales Law: Some Comments on the Interplay Between the Principles and the CISG, 69 TUL. L. REV. 1149 (1995).

binding nature of contracts and pays homage to the doctrine of *pacta sunt servanda*.[250] According to the *UPICC*, even if a party will incur heavy losses where it expected to earn profits, the terms of the contract must be respected.[251] The *UPICC* comments recognize that the obligation to perform a contract is not "absolute" because "supervening circumstances" may create a hardship that may warrant relief from performance obligations.[252] Furthermore, the *UPICC* recognizes that the concept of hardship is similar to concepts from other legal systems such as frustration of purpose and impracticability,[253] but there are some notable differences between the *UPICC* hardship principles and the U.S. doctrine of impracticability. In addition to differences in terminology, the comments and illustrations suggest that hardship might be found in at least some circumstances where the U.S. doctrine of impracticability might not apply.

1. Hardship as Defined Under the *UPICC*

The *UPICC* hardship principle requires that a party establish hardship in fact and then satisfy four additional requirements. Hardship in fact, according to the *UPICC*, arises "where the occurrence of events alters the equilibrium of the contract" in either of two ways: (1) "the cost of a party's performance has increased;" or (2) "the value of the performance a party receives has diminished."[254]

The comments to the *UPICC* hardship principle explain that, in the case of an increase in cost of performance, the fundamental alteration "is characterized by a substantial increase in the cost for one party of performing its obligations."[255] "This party normally will be the one who is to perform the non-monetary obligation."[256] The comments to the *UPICC* identify "a dramatic rise in the price of raw materials" as an example of such an

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[250]UPICC, *supra* note 208, art. 6.2.1.

[251]UPICC, *supra* note 208, art. 6.2.1, cmt. 1.

[252]UPICC, *supra* note 208, art. 6.2.1, cmt. 1.

[253]UPICC, *supra* note 208, art. 6.2.1, cmt. 1. Although the Comments to the UPICC acknowledge the similarity between frustration of purpose and hardship, hardship is distinguishable from frustration as the latter is explained by the Restatement. Hardship arises where performance is more onerous or burdensome but still possible; the Restatement requires frustration of a party's principal purpose. The mere fact that a transaction has become less profitable is insufficient to establish frustration of purpose. Jenkins, *supra* note 243, at 208; Restatement, *supra* note 53, § 265.

[254]UPICC, *supra* note 208, art. 6.2.3.

[255]UPICC, *supra* note 208, art. 6.2.2, cmt. 2.

[256]UPICC, *supra* note 208, art. 6.2.2 cmt. 2.

alteration in the fundamental equilibrium of the contract.[257] The 1994 *UPICC* had a comment stating that "[a]n alteration amounting to 50% or more of the cost or the value of the performance" would likely involve a fundamental alteration.[258] Notably, in response to critical commentary, this statement was deleted from the 2004 edition of the *UPICC*.[259]

The comments to the *UPICC* indicate that, where a price increase begins before the parties finalize the contract, hardship will not arise unless the pace of change increases dramatically during the life of the contract.[260] The key requirement of hardship in fact is that the circumstances giving rise to the claim of hardship must "fundamentally alter[] the equilibrium of the contract."[261]

2. Legal Hardship: Four Additional Requirements

In addition to hardship in fact, a party must satisfy four additional requirements to establish hardship under the *UPICC*.

First, the events that fundamentally alter the equilibrium of the contract must "occur or become known to the disadvantaged party after the conclusion of the contract."[262] If those events were known at the time of contracting, a party should "take them into account at that time and may not subsequently rely on hardship."[263] This concept is consistent with the general law of impracticability as applied in the United States.[264]

Second, "the events could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion

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[257]UPICC, *supra* note 208, art. 6.2.2 cmt. 2.

[258]1994 UPICC, *supra* note 239 art. 6.2.2 cmt. 2. According to one commentator who participated as a member of the Working Group of UNIDROIT, the fundamental character of the change "is that it must be decisive . . . . In my view as a rule an alteration of at least 50% (increase of costs, decrease of value) should be required." Dietrich Maskow, Hardship and Force Majeure, 40 AM. J. COMP. L. 657, 662 (1992).

[259]UPICC, *supra* note 208, art. 6.2.2 cmt. 2; Bonnell, *supra* note 245 at 18 ("Comment 2 to Article 6.2.2 [was redrafted] to delete the statement that an alteration amounting to 50% or more of the cost or value of the performance is likely to constitute hardship").

[260]UPICC, *supra* note 208, art. 6.2.2 cmt. 3b.

[261]UPICC, *supra* note 208, art. 6.2.2.

[262]UPICC, *supra* note 208, art. 6.2.2(a).

[263]UPICC, *supra* note 208, cmt. 3(a).

[264]*See supra* notes 84–85 and accompanying text.

of the contract."[265] Although the *UPICC* hardship principle does not use the term "foreseeable," the comment explaining this requirement includes an illustration indicating that a party may not "invoke hardship" where a "rise in the price of crude oil was foreseeable."[266] The concept of forseeability as applied to the U.S. doctrine of impracticality usually pertains to whether the nonoccurrence of the supervening event was a basic assumption of the contract or whether the risk of such event would be expected to have been allocated by the parties' agreement either expressly or impliedly.[267] The comments to the *UPICC* also recognize that a known risk may not preclude recovery when the magnitude or nature of the risk actually experienced changes. "If the change began before the contract was concluded, hardship will not arise unless the rate of the change increases dramatically during the life of the contract."[268] This is similar to concepts articulated in the *Restatement* of American contract law.[269]

Third, the *UPICC* hardship principle requires that the events giving rise to the hardship be "beyond the control of the disadvantaged party."[270] There is nothing controversial with this requirement, and the concept is consistent with the American doctrine of impracticability.[271]

Fourth, "the risk of the events" must not have been "assumed by the disadvantaged party."[272] The comments to the *UPICC* indicate that "the risks need not have been taken over expressly, but that this may follow from the very nature of the contract."[273] Under the U.S. doctrines of impossibility, impracticability, and frustration of purpose, courts frequently find that fixed-priced contracts by their "very nature" allocate the risk of market changes.[274] It is not clear that the *UPICC* hardship principle requires as strict an approach. As stated by one prominent commentator: "[I]t is clear from the nature of the hardship doc-

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[265]UPICC, *supra* note 208, art. 6.2.2(b).

[266]UPICC, *supra* note 208, art. 6.2.2 illus. 2.

[267]*See supra* notes 84–85 and accompanying text.

[268]UPICC, *supra* note 208, art. 6.2.2 cmt. 3(b).

[269]*See supra* notes 79–80 and accompanying text.

[270]UPICC, *supra* note 208, art. 6.2.2(c).

[271]*See supra* notes 68 and 74 and accompanying text.

[272]UPICC, *supra* note 208, art. 6.2.2(d). The parties to a contract are free (within limits) to contractually accept greater risk, including the risk of that which would otherwise constitute hardship. *Id.* cmt. 7.

[273]UPICC, *supra* note 208, art. 6.2.2 cmt. 3d.

[274]*See supra* notes 86–89 and accompanying text.

trine, that, unlike American law, the mere fact that the contract contains a fixed price does not allocate the risk."[275] This potential interpretation of the *UPICC* hardship principle clearly is something that should be appreciated by American parties before agreeing to have a contract governed by the *UPICC* hardship principle or a contractual provision of equivalent import.

3. Right to Renegotiate and the Remedy of Adaptation

The *UPICC* contract provides for renegotiation and adaptation of the contract in the case of hardship. This, of course, is a substantial departure from U.S. law.

"In the case of hardship the disadvantaged party is entitled to request renegotiations."[276] A number of procedural requirements and limitations are imposed on the right to renegotiate. The request for renegotiation must be made "without undue delay and shall indicate the grounds on which it is based."[277] Delay in making a request for renegotiation does not result in automatic waiver of the right though any delay may affect the finding of whether hardship exists and the consequences of any such hardship.[278] Renegotiations must be conducted in good faith, and a party should not seek to exercise the right for strategic purposes.[279] The failure to honor a proper request for renegotiation is a violation of the *UPICC* hardship provision. The disadvantaged party ordinarily may not withhold performance pending renegotiation except in extraordinary circumstances.[280]

The comments to the *UPICC* discuss whether a party is entitled to request renegotiation where a contract has a price escalation clause. The *UPICC* provides an example with several variations. In the first scenario, a construction company situated in country X enters into a lump-sum contract to build a plant in country Y.

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[275]Joseph M. Perillo, *supra* note 51, at 24.

[276]UPICC, *supra* note 208, art. 6.2.3(1).

[277]UPICC, *supra* note 208, art. 6.2.3(1).

[278]UPICC, *supra* note 2089, art. 6.2.3(1), cmt. 2.

[279]UPICC, *supra* note 208, art. 6.2.3(1), cmt. 5.

[280]UPICC, *supra* note 2089, art. 6.2.3(1), cmt. 4. The comments include an illustration of extraordinary circumstances justifying the withholding of performance pending renegotiation. *Id.* art. 6.2.3 cmt. 4, illus. 4. A contractor who contracts to build a plant may withhold performance pending renegotiation when a country enacts a safety regulation that requires "additional apparatus," making the contractor's "performance substantially more onerous." *Id.* One commentator suggests that the circumstances described by the illustration are not extraordinary but rather ordinary. *See* Joseph M. Perillo, *supra* note 51, at 25–26.

Most of the machinery for the project has to be imported from abroad. An unexpected devaluation of the currency in country Y occurs which the illustration indicates constitutes hardship entitling the contractor to request renegotiation.[281] A request for renegotiation is not appropriate under the same scenario where the contract contains a currency index clause that automatically adjusts for variation in the costs of materials and labor.[282] Presumably, this is because the inclusion of an index clause indicates that the parties contractually allocated this risk. However, the *UPICC* comments state that renegotiation would be appropriate "if the adaptation clause incorporated in the contract did not contemplate the events giving rise to hardship."[283] Thus, if the increase in the cost of performance was due to country Y's enactment of a new safety regulation (presumably requiring additional or different equipment), the contract's escalation clause for variations in labor and material prices would not preclude a finding of hardship, and the contractor would be entitled to request negotiation.[284]

In the event that renegotiation does not resolve the matter within a reasonable time, "either party may resort to the court" and seek to have the contract adapted or revised to restore the "equilibrium."[285] As a practical matter, on many international projects outside the United States, the parties will contractually substitute an arbitral forum for a judicial forum. If the court or arbitrator finds hardship, it may "terminate the contract" or "*adapt the contract with a view to restoring its equilibrium*."[286] The remedy will depend upon the circumstances and what is reasonable.[287] If the court adapts the contract, it "will seek to make a fair distribution of the losses between the parties."[288]

The remedy of adapting the contract may take many different forms:

> This may or may not, depending on the nature of the hardship, involve a price adaptation. However, if it does, the adaptation will not necessarily reflect in full the loss entailed or the change in circumstances, since the court will, for instance, have to consider the

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[281]UPICC, *supra* note 208, art. 6.2.3 cmt. 1, illus. 1.

[282]UPICC, *supra* note 208, art. 6.2.3 cmt. 1 & illus. 2.

[283]UPICC, *supra* note 208, art. 6.2.3 cmt. 1.

[284]UPICC, *supra* note 208, art. 6.2,3, illus. 3.

[285]UPICC, *supra* note 208, art. 6.2.3(3).

[286]UPICC, *supra* note 208, art. 6.2.3(4) (emphasis added).

[287]UPICC, *supra* note 208, art. 6.2.3 cmt. 7.

[288]UPICC, *supra* note 208, art. 6.2.3 cmt. 7.

> extent to which one of the parties has taken a risk and the extent to which the party entitled to receive a performance may still benefit from that performance.[289]

Additionally, even where hardship exists, the circumstances may not warrant termination or adaptation, and the court may "direct the parties to resume negotiation" or "confirm the terms of the contract as they stand."[290]

The renegotiation and adaptation features of the *UPICC* hardship principle are a substantial departure from American law and something that has not been voluntarily embraced within the U.S. construction industry. The American doctrine of impracticability does not give the disadvantaged party the right to request renegotiation and typically does not authorize a court to adapt the contract.[291] Instead, the American doctrine ordinarily operates to excuse or discharge a party's duty to perform.[292] In a number of contexts, U.S. businesses have been reluctant to incorporate into contracts compelled renegotiation and adaptation clauses.[293] Reasons for not including such clauses include potential reduction in contract stability, increased costs of the transaction, and uncertainty about whether and how a court or arbitrator might modify or adapt the agreement.[294] These same types of concerns make U.S. parties to a construction contract, particularly owners, generally unreceptive to renegotiation and

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[289]UPICC, *supra* note 208, art. 6.2.3 cmt. 7.

[290]UPICC, *supra* note 208, art. 6.2.3 cmt. 7.

[291]Joseph M. Perillo, *supra* note 51, at 27 ("Compelled renegotiation and judicial reformation are not in the mainstream of the Common Law.").

[292]*See supra* note 69 and accompanying text. An argument has been made by some commentators that an implied renegotiation clause could be added by a court to fill a gap in a contract under certain circumstances. *See, e.g.*, Joseph M. Perillo, *supra* note 248 at 301–02; Note, Continuity for Transatlantic Commercial Contracts after the Introduction of the Euro, 66 FORDHAM L. REV. 1985, 2029–2030 (1996).

[293]*See, e.g.*, John Y. Gotanda, Renegotiation and Adaptation Clauses in Investment Contracts, Revisited, 36 VAND. J. TRANSNAT'L L. 1461, 1464 (2003) ("U.S. businesses in particular may be reluctant to include compelled renegotiation and adaptation clauses [in investment contracts] both because of the legal system's reliance on the principle of *pacta sunt servanda* and because such clauses are not regularly used in common-law countries"); 36 VAND. J. TRANSNAT'L L. at 1461 ("Although commentators have often championed [renegotiation and adaptation clauses], private parties in international transactions have included them infrequently.").

[294]36 VAND. J. TRANSNAT'L L. at 1463.

adaptation clauses.[295] As a practical matter, American businesses will often resist application of the *UPICC* hardship principle. This is especially so given the long-standing jurisprudence holding that courts should rarely (if ever) rewrite contracts.[296] Certainly, most American lawyers would be reluctant to encourage a client to contractually authorize a court to adapt contracts especially when conventional wisdom holds that judges are neither equipped nor experienced at performing this function.[297]

4. Observations About American Openness to *UPICC* Hardship Principle

The UPICC hardship principle and contract provisions modeled after that principle are unlikely to gain widespread endorsement among American construction lawyers and their clients in the short run for several reasons. The notion of equating hardship with events that "fundamentally alter[ ] the equilibrium of the contract" may be viewed as too ill defined a standard. Even though the U.S. doctrine of impracticality itself suffers from unpredictability, it is a doctrine that American lawyers believe they understand. Similarly, American lawyers understand that fixed-price contracts are generally presumed to allocate the risk of changes in the price of materials and may not be comfortable with how the *UPICC* principles might alter this general presump-

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[295] Renegotiation and adaptation clauses have been used in certain long-term supply contracts. *See, e.g.*, Beaver Creek Coal Co. v. Nevada Power Co., 1992 WL 113747, at *3 (10th Cir. 1992) (not citable in the Tenth Circuit). Renegotiation and adaptation clauses are far more common with international trade agreements and in other international settings. *See, e.g.*, Joseph M. Perillo, supra note 248 at 302; Hernany Veytia, The Requirement of Justice and Equity in Contracts, 69 TUL. L. REV. 1191, 1205 (discussing various international organizations' approaches to long-term contracts, including renegotiation and adaptation).

[296] *See supra* IIIE.

[297] John P. Dawson, *supra* note 95, at 37 ("The first reason . . . for judges to abstain from rewriting contracts of other people is that they are not qualified for such tasks."). One commentator suggested that U.S. courts might resist assuming the role of adapting contracts, notwithstanding contractual authorization to do so in the case of hardship. Scott D. Slater, Overcome By Hardship: The Inapplicability of the UNIDROIT Principles' Hardship Provisions to CISG, 12 FLA. J. INT'L L. 231, 243 (1998) ("One may wonder whether common law courts will simply spurn attempts to effectuate the Principles' civilian-style hardship provisions, which authorize courts to adapt contracts by adjusting existing terms and constructing new ones."). In contrast, "a number of arbitral tribunals have determined that they would have the power under hardship provisions to equitably modify an agreement." Gotanda, *supra* note 293, at 1471. This may be of little comfort to those who worry that expressly empowering arbitrators to revise contracts is unwise.

tion, but the single biggest impediment to American acceptance of the *UPICC* hardship principle is the aspect of compelled renegotiation and judicial adaptation of the contract. Most American business people are more comfortable living with imperfect risk allocation in a contract that they drafted than authorizing courts to revise contracts in the case of hardship. The average American owner is not yet willing to surrender and transfer control over this aspect of contractual relationships to courts or arbitrators.

The globalization of the marketplace may change this American mindset, and it may be that market conditions and bargaining positions may cause acceptance of renegotiation and adaptation clauses in construction contracts in the same way that hyperinflationary conditions compelled owners to reexamine their unwillingness to entertain narrow price escalation clauses. Anecdotal evidence suggests that such conditions do not yet exist. The author has been involved in international construction projects where contractors concerned about hyperinflationary conditions have requested that the contract be governed by the *UPICC* hardship principle. In each instance, the owner rejected the proposal and proposed a narrowly tailored escalation clause limited to the specific construction materials of concern to the contractor. This compromise proved agreeable in each situation, and the *UPICC* hardship principle was returned to the library. Regardless of one's view of the advisability of agreeing to the *UPICC* hardship principle, it is a principle that American construction lawyers can expect to encounter with greater frequency both in negotiating contracts and in the dispute resolution arena.[298]

B. Other Approaches to Hardship

The *UPICC* hardship principle is not the only hardship principle that parties involved in international transactions may encounter. In addition to two other examples discussed below, the domestic law of a growing number of countries parallels the *UPICC* hardship principle in whole or in part.[299] For example, some aspects of the *UPICC* hardship principle are recognized by

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[298]*See supra* note 245 and accompanying text; *see also* Hengxing Co. v. Guandong Petrochemical Subsidiary Co., (case number unavailable) (April 28, 2005) (Chinese court applies the UNIDROIT Principles to terminate a contract for reasons of hardship) (abstract of case available at www.unilex.info/case.cfm?pid=2&id=1120&do=case).

[299]Force Majeure and Hardship, *supra* note 245.

the law of, among others, Germany, The Netherlands, Italy, Greece, Portugal, and Denmark.[300]

1. European Principles

Three years after the release of the *UPICC* in 1994, the Commission on European Contract Law (CECL) published its *Principles of European Contract Law* (European Principles). While the *UPICC* is intended to be used throughout the world and on international contracts, the *European Principles* are intended to be applied as general rules of contract law for the European communities, though they have not been adopted as such.[301] Initially begun as the project of Professor Ole Lando of the Copenhagen Business School (and thus occasionally referred to as the "Lando Principles"), the European Commission in Brussels partly funded the effort.[302] The *European Principles*, however, have not received the same level of acceptance as the *UPICC*.

The *European Principles* include a hardship provision, quoted in full below, under the label "Change of Circumstances."

> Article 6:111 (ex art. 2.117): Change of Circumstances
>
> (1) A party is bound to fulfill its obligations even if performance has become more onerous, whether because the cost of performance has increased or because the value of the performance it receives has diminished.
>
> (2) If, however, performance of the contract becomes excessively onerous because of a change of circumstances, the parties are bound to enter into negotiations with a view to adapting the contract or terminating it, provided that:
>
> (a) the change of circumstances occurred after the time of conclusion of the contract,
>
> (b) the possibility of a change of circumstances was not one which could reasonably have been taken into account at the time of conclusion of the contract, and
>
> (c) the risk of the change of circumstances is not one which, according to the contract, the party affected should be required to bear.
>
> (3) If the parties fail to reach agreement within a reasonable period, the court may:
>
> (a) terminate the contract at a date and on terms to be determined by the court; or

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[300]Force Majeure and Hardship, *supra* note 245.

[301]Principles of European Contract Law art. 1:101(1) (1998) [hereinafter "European Principles"].

[302]Kessedjian, *supra* note 249, at 422.

> (b) adapt the contract in order to distribute between the parties in a just and equitable manner the losses and gains resulting from the change of circumstances.
>
> In either case, the court may award damages for the loss suffered through a party refusing to negotiate or breaking off negotiations contrary to good faith and fair dealing.[303]

While the *European Principles'* concept of changed circumstances parallels that of hardship in the *UPICC*, significant differences exist both in their definition and application. Hardship under the *UPICC* arises when an event "fundamentally alters the equilibrium of the contract;"[304] a change of circumstances under the *European Principles*, on the other hand, requires that the contract become "excessively onerous."[305] Unlike the 1994 *UPICC*, which suggested that a change of 50% can trigger the hardship provision, the *European Principles* identify no similar benchmark either in its text or accompanying comments.[306]

A more important distinction involves the obligation which the two guidelines impose upon the parties when a triggering event occurs. The *UPICC* entitles the disadvantaged party to request renegotiations.[307] The *European Principles*, however, *obligate* the parties to enter into negotiations concerning adaptation or termination of the contract.[308] Finally, the *European Principles* authorize a remedy not mentioned in the *UPICC*. Both principles authorize a court to adapt the contract or to terminate it,[309] but the *European Principles* expressly provide that the court may award damages if a party refuses to negotiate or breaks off negotiations in a manner contrary to good faith and fair dealing.[310]

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[303]European Principles, *supra* note 301, art. 6:111.

[304]UPICC, *supra* note 208, art. 6.2.2.

[305]European Principles, *supra* note 301, art. 6:111(2).

[306]Martijn W. Hesselink, The Principles of European Contract Law: Some Choices Made by the Lando Commission, 1 GLOBAL JURIST FRONTIERS 1, 40 (2001).

[307]UPICC, *supra* note 2089, art. 6.2.3(1).

[308]European Principles, *supra* note 301, art. 6:111(2).

[309]*Compare* UPICC, *supra* note 208, art. 6.2.3(4), *with* European Principles, *supra* note 301, art. 6:111(3)(a)–(b).

[310]European Principles, *supra* note 3012, art. 6:111(3). Of course, the comments to the UPICC indicate that the parties must negotiate in good faith and that they have a duty to cooperate, which suggest that failure to act in accordance with these duties carries consequences. UPICC, *supra* note 208, at art. 6.2.3, cmt. 5.

This provision is bilateral and may operate to penalize either party.[311]

2. International Chamber of Commerce Hardship Clause

The International Chamber of Commerce (ICC) issued a model hardship clause in 2003. The ICC designed the clause to be used by parties who may prefer to use it rather than negotiate unique clauses of their own. The model hardship clause follows:

> 1. A party is bound to perform its contractual duties even if events have rendered performance more onerous than could reasonably have been anticipated at the time of the conclusion of the contract.
>
> 2. Notwithstanding paragraph 1 of the Clause, where a party to a contract proves that:
>
> a. the continued performance of its contractual duties has become excessively onerous due to an event beyond its reasonable control which it could not reasonably have been expected to have taken into account at the time of the conclusion of the contract; and that
>
> b. it could not have avoided or overcome the event or its consequences, the parties are bound, within a reasonable time of the invocation of this Clause, to negotiate alternative contractual terms which reasonably allow for the consequences of the event.
>
> 3. Where paragraph 2 of this Clause applies, but where alternative contractual terms which reasonably allow for the consequences of the event are not agreed by the other party to the contract as provided in that paragraph, the party invoking this Clause is entitled to termination of the contract.[312]

As seen with other hardship provisions, the ICC clause begins in paragraph 1 by effectively reaffirming *pacta sunt servanda*. The hardship provision adopts the seemingly more rigorous "excessively onerous" requirement of the *European Principles* as opposed to the altered equilibrium standard of the *UPICC*. Where this standard is met, the clause binds the parties to negotiate alternative terms, thus again following the *European Principles*.[313] The ICC clause diverges significantly from the *UPICC* and *European Principles* in the situation where negotiations reach an impasse. If the parties do not agree to an adaptation, then the ICC provides that the disadvantaged party is entitled to terminate the contract. This contrasts markedly with the *UPICC*

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[311]Kessedjian, *supra* note 249, at 424.

[312]ICC Force Majeure Clause 2003/ICC Hardship Clause 2003, ICC Publication No. 650, at 15 (2003).

[313]Kessedjian, *supra* note 249, at 424–425.

(where the disadvantaged party ordinarily is not entitled to withhold performance but may resort to court)[314] and from the *European Principles* (authorizing the court to terminate the contract).[315] One commentator described this provision as "unfortunate" because it fails to provide a real incentive to the disadvantaged party to renegotiate the contract.[316]

VI. CONCLUSION

The recent spike in steel prices and other construction materials has brought into focus a rather significant difference in legal doctrines and contracting approaches between the U.S. and Europe. In the United States, the doctrine of impracticability provides relief from changed circumstances. Contracting parties have used narrowly tailored price escalation issues to allocate the risk of hyperinflation. In contrast, the trend emerging from Europe, as exemplified by the *UPICC* hardship principle, entitles a party to a contract to request renegotiation in the event of hardship and expressly authorizes courts and arbitrators to adapt the contract to restore the "equilibrium" of the contract. This is a dramatic departure from American jurisprudence and contracting practices within the United States where renegotiation and judicial adaptation clauses rarely find their way into construction contracts. The globalization of the construction industry, however, means that there will be collisions between these competing approaches, especially as the *UPICC* hardship principle continues to find commercial acceptance. American construction lawyers need to be familiar with the *UPICC* hardship principle so they can advise clients who encounter this principle. The *UPICC* is coming to a town near each of us. It is time to read the reviews.

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[314]UPICC, *supra* note 2089, art. 6.2.3(2)–(3).

[315]European Principles, *supra* note 301, art. 6.111(3).

[316]Kessedjian, *supra* note 249, at 425.