

EXCUSE 2.0

Yehonatan Givati, Yotam Kaplan & Yair Listokin†

Excuse doctrine presents one of the great enigmas of contract law. Excuse allows courts to release parties from their contractual obligations. It thus stands in sharp contrast to the basic principles of contract law and adds significant uncertainty to contract adjudication. This Article offers a crucial missing perspective on the doctrine of excuse: the view from a macroeconomic lens. Macroeconomics offers a new justification for the law of excuse and new ways of understanding the doctrine's mysteries, creating Excuse 2.0.

We offer a simple macroeconomic model of excuse doctrine, highlighting the role the doctrine plays under conditions of economic crisis and potential recession. Our analysis illustrates a counterintuitive advantage of excuse doctrine, suggesting that the legal uncertainty surrounding the doctrine can induce loss-sharing between contractual parties, thus minimizing the costs of long-term economic instability. In the COVID crisis, for example, excuse doctrine facilitated an extraordinary wave of contractual renegotiation and loss sharing—without triggering excessive litigation. We discuss the interpretive and normative implications of our analysis and highlight its significance for contemporary policy debates in the wake of the COVID-19 pandemic.

INTRODUCTION.....	630
I. BACKGROUND: LAW & THEORY.....	636
A. Excuse Doctrine	636
B. Excuse & Legal Uncertainty.....	642
C. Economic Theory of Excuse	645

† Yehonatan Givati is the Sylvan M. Cohen Professor at Hebrew University Law School. Yotam Kaplan is a professor at Hebrew University Law School. Yair Listokin is Deputy Dean and the Shibley Family Fund Professor of Law at Yale Law School. We wish to thank Jonathan Arbel, Hanoch Dagan, Yoan Hermstrüwer, Luke Herrine, Kobi Kastiel, Alexander Mechanick, Moran Ofir, Bruno Pellegrino, Roy Shapira, Eyal Zamir, and seminar participants at Yale Law School, Tel-Aviv University Law School, Hebrew University Law School, the University of Texas-Austin Law School, the University of Bonn, the Law and Macroeconomics Association Annual Meeting, and the American Law and Economics Association Annual Meeting. Karissa Kang provided excellent research assistance.

II. MACROECONOMIC THEORY OF EXCUSE	649
A. Systematic Macroeconomic Risk	649
B. Excuse Doctrine and Systematic Macroeconomic Risks	655
III. UNCERTAINTY, MACROECONOMICS, & EXCUSE.....	658
A. A Simple Model of Excuse and Macroeconomic Uncertainty	658
B. Excuse as Tailored Risk-Sharing	663
IV. INTERPRETATIVE AND NORMATIVE IMPLICATIONS	665
A. A New View on Legal Uncertainty	665
B. Excuse & Systematic Risk	668
C. Excuse & Idiosyncratic Risk	670
CONCLUSION.....	673
APPENDIX	674
A. Basic Model.....	674
B. Extensions	676

INTRODUCTION

The COVID-19 pandemic rendered many contracts obsolete.¹ Government-imposed lockdowns, for example, meant that previously mutually beneficial transactions to lease commercial retail space or hire wedding caterers suddenly became one-sided albatrosses.²

We would expect the overturning of the presumptions of so many contracts to trigger a tidal wave of contract litigation. Not so. New state court contract dispute litigation *declined* by approximately 39% in 2020,³ while contract litigation in federal

¹ See, e.g., *NetOne, Inc. v. Panache Destination Mgm't, Inc.*, No. 20-cv-00150-DKW-WRP, 2020 WL 6325704 (D. Haw. June 5, 2020); *JN Contemp. Art LLC v. Phillips Auctioneers LLC*, 507 F. Supp. 3d 490 (S.D.N.Y. Dec. 16, 2020); *Sanders v. Edison Ballroom LLC*, No. 654992/2020, 2021 WL 1089938 (N.Y. Sup. Ct. Mar. 22, 2021).

² Meg Heesaker, *COVID-19 and Commercial Leases: Rethinking Frustration and Contractual Discharge in the Canadian Common Law* (Aug. 21, 2020) (1L Rsch. Paper, McGill Univ.), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3801951 [<https://perma.cc/N5H7-CJAP>]. As David Hoffman and Cathy Hwang recently pointed out, during a pandemic some contracts may become not simply senseless, but also socially harmful. This is the case, for instance, when performance of the contract entails large gatherings such as in a wedding or concert. See David A. Hoffman & Cathy Hwang, *The Social Cost of Contract*, 121 COLUM. L. REV. 979 (2021). For a response to Hoffman and Hwang, see Anthony J. Casey & Anthony Niblett, *The Limits of Public Contract Law*, 85 L. & CONTEMP. PROBS. 51 (2022).

³ Data is from twenty-four states via the Court Statistics Project. See *Trial Court Caseload Overview*, CT. STAT. PROJECT (July 8, 2022), <https://www.>

courts remained constant.⁴ Rather than litigation, COVID-19 triggered a perhaps unprecedented wave of voluntary contractual renegotiation. One survey of retailers, for example, indicated that almost 50% received rent abatements during the early pandemic.⁵ The Great Contract Renegotiation of 2020 happened without much litigation or legislative contractual reformation, even as hundreds of billions of dollars in obligations were forgiven or rewritten.

This wave of renegotiation, like all contractual renegotiations, took place in the “shadow of the law.”⁶ This makes the Great Renegotiation still more puzzling. The pandemic implicated the contractual doctrines of excuse,⁷ in which promisors argue that their performance is excused by a change in a basic presumption underlying the original agreement. This doctrine is considered by scholars to be “the most intractable problem in contract law.”⁸ Yet bargaining under the shadow of this legal morass produced a remarkable wave of contractual renegotiation rather than litigation.

In a final puzzle, it is not clear we have made any real progress in understanding or managing excuse doctrine—even after it has played a pivotal role in an almost unprecedented wave of contractual renegotiation. Excuse remains as vague and ambiguous as ever. For example, lawyers surveying COVID-19-related excuse and impossibility cases struggle to summarize the state of the law, with conclusions ranging from

courtstatistics.org/csp-stat-nav-cards-first-row/csp-stat-civil [https://perma.cc/EZ6M-DLR7]. While all types of civil litigation fell in 2020, the decline in contractual disputes exceeded the overall reduction.

⁴ See “Contract Actions, Total” in Table C-2, U.S. District Courts—Civil Statistical Tables for The Federal Judiciary (calendar years 2015–2021), available at <https://www.uscourts.gov/statistics-reports/analysis-reports/statistical-tables-federal-judiciary> [https://perma.cc/F52W-H578].

⁵ *Landlords and Retail Tenants Compromise to Emerge Stronger Post-COVID-19*, Says NRF and PJ SOLOMON, NAT’L RETAIL FED’N (Sept. 24, 2020), <https://nrf.com/media-center/press-releases/landlords-and-retail-tenants-compromise-emerge-stronger-post-covid-19> [https://perma.cc/V5ZD-DDWK]; see also Itai Ater, Yael Elster, David Genesove & Eran B. Hoffmann, *Must Agreements Be Kept? Residential Leases During COVID-19*, 133 *ECON. J.* 477 (2023).

⁶ Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 *YALE L.J.* 950, 997 (1979) (studying contract law as a starting point for private ordering, stating that “individuals in a wide variety of context bargain in the shadow of the law”).

⁷ Excuse, as a general category, includes the doctrines of impossibility, impracticability, and frustration of purpose. See Melvin A. Eisenberg, *Impossibility, Impracticability, and Frustration*, 1 *J. LEGAL ANALYSIS* 207, 211 (2009) (providing a terminology for the different categories of excuse).

⁸ *Id.* at 208.

“most [courts] have concluded that the COVID-19 burden most appropriately falls on the tenant and it should not be absolved of its obligation to pay rent,”⁹ to “there is a growing trend among state court judges that suggests commercial tenants may be able to successfully argue that government shutdowns should excuse their obligation to pay rent.”¹⁰ In a surprising twist, it seems excuse doctrine remains mysterious even after the COVID-19 crisis made it ubiquitous.

In this paper, we rethink excuse doctrine, offering for the first time a macroeconomic theory of the doctrine.¹¹ This modality of legal theory seeks to explain and evaluate the excuse doctrine in terms of its possible implications for macroeconomic policy and large-scale economic processes and trends.¹² This contribution is especially timely in the wake of the COVID-19 pandemic.

Existing excuse and impossibility scholarship, which we describe below,¹³ examines local interactions between two parties and does not study the broader economic implications of the doctrine. This scholarship seeks to resolve the doctrine’s ambiguity by arguing that the risk of a significant unforeseen contingency should be assigned to the party best able to

⁹ Mark Stadler, *Lessons Learned; Hopefully, No Bridges Burned: The COVID-19 Pandemic and Its Impact On Commercial Leasing*, MONDAQ (Sept. 24, 2021), <https://www.mondaq.com/unitedstates/landlord-tenant-leases/1114392/lessons-learned-hopefully-no-bridges-burned-the-covid-19-pandemic-and-its-impact-on-commercial-leasing> [<https://perma.cc/8243-EDNA>].

¹⁰ See Perrie Weiner, Aaron Goodman, Erin Shields & Desirée Hunter-Reay, *Common Law Defenses May Favor Commercial Tenants in COVID-19 Disputes*, BLOOMBERG LAW (Mar. 2021), <https://www.bakermckenzie.com/-/media/files/people/weiner-perrie/bloomberg-common-law-defenses-may-favor-commercial-tenants-april-2021.pdf?la=en> [<https://perma.cc/YE9A-NNZ9>].

¹¹ On the macroeconomic approach to legal analysis, see YAIR LISTOKIN, *LAW AND MACROECONOMICS: LEGAL REMEDIES TO RECESSIONS* 14–21 (2019); Yair Listokin, *A Theoretical Framework for Law and Macroeconomics*, 21 AM. L. & ECON. REV. 46, 49 (2019); Yair Listokin, *Law and Macroeconomics: The Law and Economics of Recessions*, 34 YALE J. ON REGUL. 791 (2017). For a new microeconomic understanding of excuse, see Yehonatan Givati & Yotam Kaplan, *A New Theory of Impossibility, Impracticability, and Frustration*, 52 J. LEGAL STUD. 377 (2023). For an information-production theory of excuse, see Assaf Jacob, Yotam Kaplan & Roy Shapira, *An Information-Production Theory of Contract Law*, 109 IOWA L. REV. 603, 633 (2024).

¹² The growing literature on the macroeconomic analysis of law studies the implications of legal institutions to broad macroeconomic issues such as unemployment (Jonathan S. Masur & Eric A. Posner, *Regulation, Unemployment, and Cost-Benefit Analysis*, 98 VA. L. REV. 579 (2012)), business cycle (Yair Listokin, *Stabilizing the Economy Through the Income Tax Code*, 123 TAX NOTES 1 (2009)), and recession (Yair Listokin, *Law and Macroeconomics: The Law and Economics of Recessions*, 34 YALE J. ON REGUL. 791 (2017)).

¹³ See *infra* Sections II.A and II.C.

avoid, mitigate, or insure against the risk.¹⁴ Crucially, none of these considerations apply to macroeconomic risk, which recent scholarship has emphasized is an important concern of the law.¹⁵ COVID-19 caused acute economic pain throughout the economy.¹⁶ This type of systematic economic risk is unavoidable—there is little that an individual party to a contract can do to prevent COVID-19. Systematic macroeconomic risk is also uninsurable because harm is both economically significant and highly correlated across individuals.¹⁷ Private insurers who attempt to bear the risk of global pandemics would rapidly become insolvent when the risk materializes.¹⁸ Hence, they generally exclude such risks. The factors conventionally applied to rationalize excuse doctrine simply do not apply to systematic macroeconomic risk.¹⁹

In this Article, we offer a theory of excuse doctrine as a response to systematic risks. We contend that in the aftermath of macroeconomic shocks, the pervasive legal uncertainty associated with contract excuse is a virtue and not a vice. Legal uncertainty facilitates efficient risk sharing between private parties to contracts in the face of systematic macroeconomic risk. Uncertainty about the outcome of an excuse defense related to COVID-19 or other systematic risks encourages the parties to a contract to settle the dispute by sharing the costs of the unexpectedly bad outcome. In the extreme case of complete legal uncertainty, if the judge is going to flip a fair coin to decide the outcome of an excuse or impossibility case in the wake of COVID-19, then the parties to the contract should settle such potential claims with agreements that share the cost of the macroeconomic event evenly. The loss-sharing facilitated by uncertain excuse doctrine helps avoid bankruptcies, thus

¹⁴ Richard A. Posner & Andrew M. Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83, 90 (1977).

¹⁵ See YAIR LISTOKIN, LAW AND MACROECONOMICS: LEGAL REMEDIES TO RECESSIONS 3–21 (2019) (describing how law allocates macroeconomic risk and advocating for a greater role for “expansionary legal policy” in recessions); Yair Listokin, *A Theoretical Framework for Law and Macroeconomics*, 21 AM. L. & ECON. REV. 46 (2019) (embedding legal considerations into macroeconomic models).

¹⁶ See, e.g., Center for Budget and Policy Priorities, *Tracking the COVID-19 Economy’s Effects on Food, Housing, and Employment Hardships*, available at <https://www.cbpp.org/research/poverty-and-inequality/tracking-the-covid-19-economys-effects-on-food-housing-and> [<https://perma.cc/3C77-N2Q3>].

¹⁷ See Dwight M. Jaffee & Thomas Russell, *Catastrophe Insurance, Capital Markets, and Uninsurable Risks*, 64 J. RISK & INS. 205 (1997) (describing uninsurable systematic risks).

¹⁸ *Id.*

¹⁹ *Id.*

contributing to economic stability. While many contracts would have been renegotiated post-COVID even in the absence of excuse claims, the uncertainty associated with excuse enabled these renegotiations to allocate risk more efficiently.

Moreover, the cost-sharing settlements facilitated by legal uncertainty enable tailoring in risk sharing that would be infeasible via fiscal or monetary policy. In an ideal macroeconomic world, we not only want systematic risks to be shared widely, but we also want extra risk assumed by those with the liquidity to bear losses without being forced to drastically cut consumption. Achieving this via fiscal or monetary policy requires the fiscal authority and/or central bank to know how each person is exposed to the risk. Private renegotiation of contracts, however, requires no third-party knowledge to achieve this allocation of the contracts' exposure to the macro risk. If one party to the contract is likely to be bankrupted by COVID-19, then, in the face of uncertainty, they will be more willing to "roll the dice" with an impossibility claim or defense. A win means a lower probability of bankruptcy, leaving some return for the party at risk. A loss costs this judgment-proof party relatively little. Knowing (or at least guessing) this, the counterparty to the contract will offer more generous settlement terms so that they will at least recover something. Thus, legal uncertainty in excuse doctrine produces contract renegotiations that share COVID-19 costs, with more of the costs borne by the party best able to bear them. This is the efficient risk-sharing outcome without requiring the government to know anything about the party's risk-bearing capacity. Inefficient bankruptcies are avoided, and aggregate demand recovers faster than might be expected as those most at risk are cushioned from the risk's harshest macroeconomic effects. Uncertain excuse doctrine helped ensure that the Great Renegotiation distributed pandemic risk efficiently without noticeably increasing the amount of litigation.²⁰

In offering this argument, the Article makes several novel contributions. The first contribution is conceptual, as we offer a new theory of excuse doctrine—Excuse 2.0. The Article offers, for the first time, a macroeconomic theory of excuse doctrine, highlighting the role of the doctrine in relation to systematic economic shocks. This perspective immediately proves fruitful,

²⁰ We *do not* claim that uncertain excuse doctrine reduced litigation in the face of COVID-19, but rather that the doctrine increased loss-sharing while having an ambiguous effect on litigation.

challenging received wisdom. Existing literature does not distinguish excuse claims that rise against the background of systematic economic shocks (such as a pandemic or war) from excuse claims that follow a more local disaster (such as a fire). We show that, from a macroeconomic perspective, such cases are crucially different and justify different legal responses. The second contribution is jurisprudential, offering a new understanding of the effect of legal uncertainty, a central concept to legal theory and legal philosophy. We show that legal uncertainty, usually viewed as a vice, can sometimes be beneficial because it facilitates risk sharing, and describe the conditions under which this may be the case.²¹ In the context of excuse doctrine, our analysis helps explain how and why the excuse doctrine was ambiguous before the COVID-19 crisis and why it remains so today. The third contribution is normative; we offer guidelines for courts to decide cases of contract excuse, as well as guidelines for legislatures and policymakers looking to reform contractual excuse doctrine and related legal mechanisms. Finally, the excuse doctrine's role in the response to COVID-19 demonstrates the unsung role played by private ordering shaped by law in allocating macroeconomic risk—the “Great Renegotiation” was an important component of the social response to COVID-19's economic dislocation, even if it did not draw as much attention as heroic fiscal and monetary interventions.

The paper proceeds as follows. Part I offers a review of excuse doctrines in contract law. It highlights the inherent ambiguity of excuse and reviews the main points of the existing (micro)economic theory of excuse, which explains the doctrine as a loss-shifting (and not loss-spreading) tool. Part I then surveys existing legal accounts of the role of legal uncertainty, which are by and large negative. Part II describes systematic macroeconomic risk and policy responses to such risk. Part II explains how existing theories of excuse do not address the problems posed by macroeconomic risks, even though the occurrence of such risk greatly increases the salience of excuse doctrine. Part III offers a theory of ambiguous excuse doctrine as an efficient response to systematic macroeconomic shocks, arguing that the success of the Great Renegotiation may be

²¹ For a defense of legal uncertainty from a philosophical perspective arguing that uncertainty induces useful deliberation, see Seana Valentine Shffrin, *Inducing Moral Deliberation: On the Occasional Virtues of Fog*, 123 HARV. L. REV. 1214 (2010). This paper, by contrast, emphasizes the risk-sharing benefits of uncertainty.

attributed in part to the excuse doctrine's ambiguity. Part IV discusses the interpretive and normative implications of our argument. This Part highlights the comparative institutional advantages of excuse doctrine as a loss-sharing mechanism. This Part also suggests that recent attempts to remove ambiguity from excuse doctrine may be misguided. A short conclusion follows. The Appendix presents the formal model that supports the analysis in Part III.

I

BACKGROUND: LAW & THEORY

This Part provides an overview of excuse doctrine and existing accounts of the law of excuse. The analysis in this Part highlights a key theme, namely the high degree of legal uncertainty in the application of the excuse doctrine.

A. Excuse Doctrine

Contract law recognizes three distinct excuse doctrines: the doctrines of impossibility,²² commercial impracticability,²³ and frustration of purpose.²⁴ Under these doctrines, a court can release a party from their contractual obligations in the face of extreme, unexpected, and unavoidable circumstances that drastically change the nature of the parties' bargain.²⁵ This form of release means that a party that would have otherwise been considered in breach of contract is exempt from the legal duty to perform and is also freed from the duty to pay expectation damages.²⁶

The three excuse doctrines differ in some important details. First, under the doctrine of impossibility, a promisor (the party under duty to perform) may be excused from performance if the court finds there is no way for them to perform their

²² John D. Wladis, *Common Law and Uncommon Events: The Development of the Doctrine of Impossibility of Performance in English Contract Law*, 75 GEO. L.J. 1575 (1987).

²³ George Wallach, *Excuse Defense in the Law of Contracts: Judicial Frustration of the U.C.C. Attempt to Liberalize the Law of Commercial Impracticability*, 55 NOTRE DAME L. REV. 203 (1979).

²⁴ T.W. Chapman, *Contracts: Frustration of Purpose*, 59 MICH. L. REV. 98 (1960).

²⁵ Hanoch Dagan & Ohad Somech, *When Contract's Basic Assumptions Fail*, 34 CAN. J. L. & JURIS. 297 (2021); GIVATI & KAPLAN, *supra* note 11.

²⁶ Dagan & Somech, *supra* note 25.

contractual obligation.²⁷ For instance, if a house burned to the ground, the seller, the promisor, may be excused from the duty to sell it to the promisee.²⁸ The promisee is entitled, of course, to restitution of any payments already made²⁹ but not to expectation damages for any profits they hoped to secure through the execution of bargain.

Second, under the doctrine of impracticability, a promisor may be excused from performance if the court finds it extremely difficult—but not strictly impossible—for them to perform.³⁰ For instance, if a promisor is obligated to deliver goods, but weather conditions make delivery ten times costlier, a court might (or might not) decide performance is commercially impracticable and release the promisor from their duties.³¹ Both impossibility and impracticability focus on the promisor and differ in the terminology used to describe the promisor's difficulty in performing the contract.³²

Third and finally, the doctrine of frustration of purpose offers release to the promisee (the party receiving contractual

²⁷ For a classic impossibility case, see *Taylor v. Caldwell*, 3 B. & S. 826, 122 Eng. Rep. 309 (1863) (voiding a contract for musical performance in a specified auditorium after the music hall was burned down); *Dermott v. Jones*, 69 U.S. (2 Wall.) 1, 7 (1864) (“[I]f a party by his contract charge himself with an obligation possible to be performed, he must make it good, unless its performance is rendered impossible by the act of God.”).

²⁸ For such cases, see *Siegel v. Eaton & Prince Co.*, 46 N.E. 449 (1896) (discussing impossibility following a fire); *Texas Co. v. Hogarth Shipping Co.*, 256 U.S. 619 (1921); *Emerich Co. v. Siegal, Cooper & Co.*, 86 N.E. 1104 (1908).

²⁹ RESTATEMENT (SECOND) OF CONTS. § 377 (AM. L. INST. 1981) (“A party whose duty of performance . . . is discharged as a result of impracticability of performance . . . is entitled to restitution for any benefit that he has conferred on the other party by way of part performance.”); *Id.* cmt. a (“Furthermore, in cases of impracticability . . . the other party . . . is also entitled to restitution.”); Victor P. Goldberg, *After Frustration: Three Cheers for Chandler v. Webster*, 68 WASH. & LEE L. REV. 1133, 1161 (2011) (“[T]he majority position is that restitution should be made for work performed and money paid before the intervening event.”).

³⁰ See Wallach, *supra* note 23, at 206 (stating that impracticability cases arise when a change renders the contract “economically unattractive” but not objectively impossible); see also Andrew A. Schwartz, *Contracts and COVID-19*, 73 STAN. L. REV. ONLINE 48, 49 (2020) (explaining the difference in terminology between the categories of impossibility and impracticability).

³¹ See *Mineral Park Land Co. v. Howard*, 156 P. 458, 459 (Cal. 1916) (deciding that “an expense of ten or twelve times as much as the usual cost” merits excuse); see also RESTATEMENT (SECOND) OF CONTS. ch. 11, intro. note (AM. L. INST. 1981) (stating that when “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” and void the contract).

³² See Posner & Rosenfield, *supra* note 14, at 85.

performance) rather than the promisor.³³ Under frustration, the promisee may be excused of the contractual obligation to pay for the other party's performance.³⁴ For instance, if the promisee rented an apartment to throw a party, but changes in circumstances meant the event could no longer take place, the court might declare that the purpose of the contract was frustrated, and the promisee is released from it.³⁵ The distinction between the three doctrines is not always clear-cut, and several other subcategories are sometimes mentioned in court decisions, but these three basic categories are generally recognized as the standard forms of excuse doctrine.

Under all three doctrines, release from the contract is considered justified only in exceptional cases, when the "essence" of the parties' contract has "collapse[d]."³⁶ Thus, the mere fact the contract is losing for one party is never sufficient to justify excuse.³⁷ Instead, it is required that performance is impossible, worthless, or drastically different from what the parties had contemplated at the time of performance.³⁸ These requirements closely relate to the requirement of foreseeability, according to which excuse can only be granted following a contingency that was unanticipated by the parties' contract and that renders performance completely different from what the parties intended originally.³⁹

³³ See *id.*; see also Eisenberg, *supra* note 7, at 211 (explaining that "the term frustration will be used primarily to refer to cases in which a buyer is adversely affected by the occurrence of an unexpected circumstance because the occurrence significantly diminishes the value of the seller's performance to the buyer").

³⁴ See Chapman, *supra* note 24, at 117–18.

³⁵ See cases cited *infra* note 49; see also Posner & Rosenfield, *supra* note 14, at 85.

³⁶ Dagan & Somech, *supra* note 25, at 13, 23, 26.

³⁷ See *Mineral Park Land Co. v. Howard*, 156 P. 458, 460 (Cal. 1916) ("We do not mean to intimate that the defendants could excuse themselves by showing the existence of conditions which would make the performance of their obligation more expensive than they had anticipated, or which would entail a loss upon them."); see also RESTATEMENT (SECOND) OF CONTS. § 261 cmt. d (AM. L. INST. 1981) ("[M]ere 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."); see also Eisenberg, *supra* note 7, at 241–242; see also Dagan & Somech, *supra* note 25, at 28; see also Heesaker, *supra* note 3, at 18–19 (describing backlash against an impracticability decision that appealed to fairness).

³⁸ See, e.g., Wallach, *supra* note 23, at 204; see also GUENTER H. TREITEL, FRUSTRATION AND FORCE MAJEURE 202 (3d ed. 2014); see also Dagan & Somech, *supra* note 25, at 31–32.

³⁹ See Eisenberg, *supra* note 7, at 216.

These threshold requirements for excuse are notoriously vague, with courts and scholars struggling to provide consistently applicable explanation as to when parties should be excused from their contracts.⁴⁰ Thus, it is often difficult to explain which changes constitute “mere hardship” and which changes are considered drastic enough to allow contract discharge. The question of foreseeability is similarly complex, as it involves a deep interpretive dive into the intentions and expectations of the parties at the time of contracting.

These difficulties in the application of excuse doctrine can be illustrated in cases involving commercial leases adjudicated following the COVID-19 pandemic. In this context, courts typically release tenants from the duty to pay rent only when the tenants’ business activities are entirely or almost entirely forbidden by government mandates. Conversely, when tenants’ business activities have only been partially shut down by government mandates, or when tenants simply lost business due to the pandemic, courts are far more reluctant to grant excuse. The application of this distinction to specific cases can generate significant legal uncertainty.

For instance, in *267 Development, LLC v. Brooklyn Babies & Toddlers, LLC*,⁴¹ a daycare center was required to close its business following a New York State government mandate. In this case, the court discharged the contract, accepting the defenses of impossibility and frustration of purpose. The court’s reasoning, in this case, was that excuse is justified following complete frustration or impossibility since the lessee’s business was unable to operate under government ban. Conversely, a similar claim was rejected under similar circumstances in *A/R Retail LLC v. Hugo Boss Retail, Inc.*⁴² In this case, Hugo Boss stopped paying its rent following a New York executive order. Yet here, the court denied the tenant’s frustration claim since the ban was only temporary and thereby did not *completely*

⁴⁰ See *id.* at 208 (discussing the intractability of impossibility, impracticability, and frustration defenses); see also John Henry Schlegel, *Of Nuts, and Ships, and Sealing Wax, Suez, And Frustrating Things—The Doctrine of Impossibility of Performance*, 23 RUTGERS L. REV. 419 (1969); Sheldon W. Halpern, *Application of the Doctrine of Commercial Impracticability: Searching for “The Wisdom of Solomon”*, 135 UNIV. PA. L. REV. 1123, 1155–56 (1987) (discussing that “[t]here is much to be said for a coherent doctrine that is not dependent on the search for intent”).

⁴¹ *267 Dev., LLC v. Brooklyn Babies & Toddlers, LLC*, No. 510160/2020, 2021 BL 97086 (N.Y. Sup. Ct. Mar. 15, 2021).

⁴² *A/R Retail LLC v. Hugo Boss Retail, Inc.*, 149 N.Y.S. 3d 808 (N.Y. Sup. Ct. 2021).

prevent the tenant from operating its business. This decision is not easy to reconcile with *Brooklyn Babies & Toddlers*; after all, any COVID-19-related government ban was temporary by nature. This comparison illustrates a more general point: it is not always easy to say if changes in circumstances merely resulted in added “hardship” or rather rendered performance “impossible,” or “impracticable,” as those terms are never precisely defined.

Similar problems pertain to the requirement of foreseeability. In the context of commercial leases under COVID-19, this requirement is often related to the language of the force majeure clause the parties included in their original contract. Thus, if the force majeure clause explicitly rejects the possibility of excuse following a government ban, the court will not grant an excuse claim; although this distinction makes perfect sense in theory, its application in practice again indicates significant legal uncertainty.

For instance, in *UMNV 205-207 Newbury, LLC v. Caffé Nero Americas Inc.*,⁴³ the court granted the tenant’s excuse claim, finding that the force majeure clause included in the lease prevented excuse in case of impossibility (when a government ban made it impossible for the tenant to pay rent), but not in case of frustration (when a government ban made it impossible for the tenant to operate its business). The court, therefore, discharged the tenant’s obligation to pay rent during any period when the government forbade the consumption of food or beverage on the premises of the tenant’s business. Conversely, in *Gap Inc. v. Ponte Gadea New York LLC*,⁴⁴ under similar circumstances and under a similar force majeure clause, the court denied the tenant’s excuse claim. In this case, the court did not make a distinction between impossibility and frustration, and it found that the force majeure clause prevented any type of excuse claim following a government ban. This difference in outcomes seems difficult to predict based on a comparison of the language of the force majeure clauses in both leases. The scenario in *Newbury v. Caffé Nero* is by no means unique; in fact, Professors Albert Choi and George Triantis have shown that, as a general matter, commercial parties tend to include highly vague force majeure clauses in their contracts.⁴⁵

⁴³ No. 2084CV01493-BLS2, 2021 WL 714016 (Mass. Super. Ct. Feb. 8, 2021).

⁴⁴ 524 F. Supp. 3d 224 (S.D.N.Y. 2021).

⁴⁵ Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848, 848 (2010).

Uncertainty in the application of excuse doctrine is by no means a new phenomenon and is not unique to COVID-19. The uncertainty of excuse doctrine is clearly illustrated in classic impracticability cases. For instance, in *Eastern Air Lines, Inc. v. McDonnell Douglas Corp.*,⁴⁶ the promisor, a manufacturer of aircraft, failed to provide aircraft when its subcontractors were engaged by the United States government as part of its war efforts in Vietnam. In this case, the court decided that performance under the changed circumstances was sufficiently different from what the parties had agreed upon as to be considered “impracticable.” Conversely, in *Transatlantic Financing Corp. v. United States*,⁴⁷ the famous Suez Canal case, war was considered insufficient to justify excuse. In this case, the promisor, a carrier, had to reroute a cargo shipment when passage through the Suez Canal was prevented due to war. Despite the fact that the change in circumstances was difficult to anticipate and that it caused an immense increase in costs to the promisor, the court decided not to discharge the contract as performance was merely costly but not “impracticable.” The comparison between *Eastern Air Lines* and *Transatlantic Financing Corp.* illustrates the ambiguous nature of the threshold of impracticability.

While COVID-19 and the instability of the 1970s yielded ambiguity in the applicability of excuse doctrine to macroeconomic risks, the period between these two events evinced a general judicial hostility to claims that unusual macroeconomic events triggered the application of the excuse doctrine. As one review article written in the wake of the Great Recession concluded, “[t]he basic theme that emerges from the case law is that major market changes are rarely, if ever, the basis of avoidance of a contractual obligation.”⁴⁸

The general theme of uncertainty in excuse cases, and more specifically in the doctrine of frustration, is also easy to demonstrate through the classic “coronation cases.”⁴⁹

⁴⁶ 532 F.2d 957, 991 (5th Cir. 1976).

⁴⁷ 363 F.2d 312, 319 (D.C. Cir. 1966).

⁴⁸ Nathan M. Crystal & Francesca Giannoni-Crystal, *Contract Enforceability During Economic Crisis: Legal Principles and Drafting Solutions*, 10 GLOB. JURIST 1, 1 (2010). The 1980s, 90s, and early aughts were known as the “Great Moderation”, a period in which macroeconomic risks were subdued. See Yair Listokin & Daniel Murphy, *Macroeconomics and the Law*, 15 ANN. REV. L. & SOC. SCI. 377 (2019). As a result, there may simply have been few risks significant enough to trigger widespread applications of the excuse doctrine.

⁴⁹ *Krell v. Henry*, [1903] 2 KB 740 (granting frustration claim); *Chandler v. Webster*, [1904] 1 KB 493; *Herne Bay Steamboat Co. v. Hutton*, [1903] 2 KB 683

These cases all pertain to short-term rental contracts made to allow spectators to view the coronation procession of King Edward VII.⁵⁰ The procession was eventually canceled due to King Edward's illness.⁵¹ In response, most contracts were voided by the courts,⁵² but some were not.⁵³

B. Excuse & Legal Uncertainty

The notorious reputation of excuse doctrines as an unprincipled element of contract law contributes to a general sense of unease and to a perceived inability to anticipate court decisions. Melvin Eisenberg describes these difficulties, addressing excuse doctrine as “the most intractable problem[] in contract law.”⁵⁴ James White and Robert Summers explain that “[t]he doctrines of impossibility [and] commercial impracticability . . . comprise unclimbed peaks of contract doctrine. Clearly, all of the famous early and mid-twentieth century mountaineers, Corbin, Williston, Farnsworth, and many lesser persons, have made assaults on this topic, but none has succeeded in conquering the very summit.”⁵⁵ Arthur Corbin, one of the founding fathers of modern contract law, explains the difficulty in applying the tests for excuse: “[T]he court must exercise its equity powers and pray for the wisdom of Solomon.”⁵⁶

Part of the reason for the persistent ambiguity in excuse doctrine pertains to its problematic standing within contract law⁵⁷ and to the tension between the notion of excuse and the

(denying frustration claim); *Hobson v. Pattenden & Co.* (1903) 19 TLR 186; *Clark v. Lindsay* (1903) 19 TLR 202; *Griffith v. Brymer* (1903) 19 TLR 434.

⁵⁰ R. G. McElroy & Glanville Williams, *The Coronation Cases*, 4 MODERN L. REV. 241, 245 (1941) (describing the circumstances and background facts leading to the court decisions in the coronation cases).

⁵¹ *Id.*

⁵² The most famous of these cases is *Krell v. Henry*, [1903] 2 K.B. 740.

⁵³ For instance, in *Herne Bay Steamboat Co. v. Hutton*, [1903] 2 K.B. 683, under circumstances similar to those of *Krell v. Henry*, [1903] 2 K.B. 740, the contract was upheld; see McElroy & Glanville, *supra* note 50, at 241 (“The Coronation Cases are a landmark in the history of impossibility of performance of contract, and are still the most disputed group of cases in this difficult topic.”).

⁵⁴ Eisenberg, *supra* note 7, at 208.

⁵⁵ JAMES J. WHITE, ROBERT S. SUMMERS, DANIEL D. BARNHIZER, WAYNE BARNES & FRANKLIN G. SNYDER, UNIFORM COMMERCIAL CODE 138 (7th ed. 2022).

⁵⁶ ARTHUR L. CORBIN ET. AL, CORBIN ON CONTRACTS: A COMPREHENSIVE TREATISE ON THE RULES OF CONTRACT LAW § 1352 (1962), as cited by Posner & Rosenfield, *supra* note 14, at 88.

⁵⁷ Schwartz, *supra* note 30, at 49 (explaining that excuse doctrine “undermines the very nature of a contract as a legally enforceable promise”).

basic principles of contract doctrine. A first central principle relevant here is that of *pacta sunt servanda*—agreements must be kept.⁵⁸ A fundamental rationale of contract law is to provide parties with a credible commitment mechanism so that they can generate relationships of commercial trust.⁵⁹ Such commitment mechanisms are crucial in allowing investments in reliance on promises and agreements.⁶⁰ The idea of excuse from the duty to perform and to pay damages stands in clear tension with these fundamental principles. For instance, if weather conditions make performance extremely costly, even near impossible, why should this ever serve to free a party from their duty to perform, given the *pacta sunt servanda* principle? After all, that party took it upon themselves to perform and assumed responsibility to compensate the other party in case they cannot.

A second fundamental principle is that of the freedom of contract.⁶¹ Freedom of contract dictates that parties are free to form their own legal rights, obligations, and relationships, and the court should limit its role to enforcing the parties' will.⁶² Freedom of contract follows from the requirements both of personal autonomy⁶³ and economic efficiency.⁶⁴ Excuse doctrines are a clear exception to the freedom of contract principle, as the court interferes in the parties' agreement, providing an exit point where the parties did not.⁶⁵ Of course, this should not be taken to mean that excuse doctrine is unjustified or should be abolished, but simply to point out the exceptional nature

⁵⁸ Malcolm P. Sharp, *Pacta Sunt Servanda*, 41 COLUM. L. REV. 783, 783–84 (1941) (surveying the development of the principle in Roman, Continental, and Anglo-American law).

⁵⁹ *Id.* at 785–86 (describing the practical advantages of the *pacta sunt servanda* principle).

⁶⁰ Lon L. Fuller & William R. Perdue, *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52 (1936) (introducing famously the “reliance interest” as a central justificatory element in contract law); Victor P. Goldberg, *Protecting Reliance*, 114 COLUM. L. REV. 1033, 1033 (2014) (“Reliance plays a central role in contract law and scholarship.”).

⁶¹ STEPHEN A. SMITH, CONTRACT THEORY 59, 139 (2004) (explaining the centrality of the freedom of contract principle to contract law and theory).

⁶² *Id.*; Samuel Williston, *Freedom of Contract*, 6 CORNELL L.Q. 365, 368–69, 373 (1921).

⁶³ HANOCH DAGAN & MICHAEL HELLER, THE CHOICE THEORY OF CONTRACTS 2 (2017) (describing and developing the connection between autonomy and the freedom of contract).

⁶⁴ Richard Craswell, *Freedom of Contract*, in CHICAGO LECTURES IN LAW AND ECONOMICS 81–82 (Eric A. Posner ed., 2000).

⁶⁵ Posner & Rosenfield, *supra* note 14, at 90.

of these doctrines and explain some of the problems in their application.

As demonstrated above, the contractual excuse doctrine introduces significant legal uncertainty into the legal system. First, it provides an exception to the general rules of contract law by allowing the court to void the contract where the parties did not explicitly provide for this option in their contract. Since the occurrence of something unexpected can always be asserted as an excuse, legal uncertainty increases. Second, the lines drawn by the excuse exception are blurry; it is not clear which specific cases will fall into this category and which will not.

In legal scholarship, legal uncertainty is widely considered a vice, a deep flaw of the legal system, something to be avoided or fixed.⁶⁶ Broadly defined, legal uncertainty means that individuals and firms cannot know the content, validity, and scope of their rights and duties.⁶⁷ Under high legal uncertainty, individuals and firms will find it difficult to predict the outcome of legal procedure, even when legal counsel is available.⁶⁸ Note that legal uncertainty does not mean that potential litigants literally *cannot* predict trial outcomes; rather, it means that their prediction is that their chances of winning and losing their cases are more-or-less equal.⁶⁹ For instance, under high legal uncertainty, a party to a contract will not know if their contract is valid or void, what their duties are under the contract, or what remedies will follow in case of breach.

Legal uncertainty is considered a vice for obvious reasons: If individuals and firms do not know what the law requires of them, they cannot know how to act, and the law fails in its role of guiding behavior.⁷⁰ In a sense, beyond a certain point of ambiguity, a legal norm stops being law, as guiding behavior is part of the definition of what makes something "law."⁷¹

⁶⁶ Richard R. W. Brooks & Warren F. Schwartz, *Legal Uncertainty, Economic Efficiency, and the Preliminary Injunction Doctrine*, 58 STAN. L. REV. 381, 382 (2005) ("[I]ndividual incentives to behave efficiently are distorted by uncertain legal entitlements.").

⁶⁷ Anthony D'Amato, *Legal Uncertainty*, 71 CAL. L. REV. 1, 2 (1983); *but see* Shiffrin, *supra* note 21 (explaining the positive role of uncertainty in fostering deliberation).

⁶⁸ D'Amato, *supra* note 67.

⁶⁹ *Id.* ("[B]y 'legal uncertainty' I mean the situation that obtains when the rule that is relevant to a given act or transaction is said by informed attorneys to have an expected official outcome at or near the 0.5 level of predictability.").

⁷⁰ Brooks & Schwartz, *supra* note 66, at 382.

⁷¹ Edwin W. Tucker, *The Morality of Law*, by Lon L. Fuller, 40 IND. L.J. 270, 274 (1965) (summarizing Fuller's famous assertion according to which the "internal

Scholars have long pointed out the disadvantages of uncertainty in that it pushes parties to costly trials and discourages cheap and effective settlements.⁷² Thus, if the law is known to the parties and uncertainty is not a concern, the parties will know in advance the outcome of their case if it goes to court.⁷³ Or, if they cannot know this outcome themselves, their professional lawyers will be able to advise them on it. Therefore, if the parties know how the legal dispute will end, they have no reason to invest money and time in seeing the process through;⁷⁴ they will simply settle the dispute, making whichever payments they anticipate the court to order, and save the costs of litigation.⁷⁵ This is considered a significant advantage of legal certainty in saving the enormous costs of litigation and trial.

Conversely, if the law is uncertain, this may push the parties to go to court and spend resources on costly litigation.⁷⁶ Uncertainty means that parties cannot know the outcome of their case. Under legal uncertainty, each party might estimate they have a good chance of winning in court.⁷⁷ If this is the case, and both parties are over-optimistic, the parties will go to trial and not settle, each of them believing they stand to win by doing so.⁷⁸ In this sense, uncertainty is detrimental, generating the potential for costly litigation.⁷⁹ Without uncertainty, there seems to be no reason for parties to engage in costly litigation.

C. Economic Theory of Excuse

Some support for excuse doctrine comes from the economic literature, in a classic article by Richard Posner and Andrew

morality of law" requires that "[s]tandards of action and inaction should be clearly stated").

⁷² Steven Shavell, *Suit, Settlement, and Trial: A Theoretical Analysis Under Alternative Methods for the Allocation of Legal Costs*, 11 J. LEGAL STUD. 55, 63 n.36 (1982) ("[W]hat leads to litigation is uncertainty as to the law or as to the facts. Without such uncertainty, the plaintiff's beliefs about his chances or possible judgment could not differ from the defendant's.").

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *Id.* at 63 ("[T]he only factor that could lead to a trial is that the plaintiff's expectations as to the likelihood of success or the judgment that could be obtained are more optimistic than the defendant's.").

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

Rosenfield.⁸⁰ Posner and Rosenfield maintain that excuse doctrine can serve a beneficial purpose if it is used to shift risks, harms, and losses between the promisor and the promisee in a way that will improve their overall ability to bear, prevent,⁸¹ or insure against losses.⁸² Thus, contractual excuse doctrine operates when one of the parties stands to suffer a great loss; if the other party is a more capable loss-bearer, it would be efficient to use excuse doctrine to shift the loss to this party.⁸³ For instance, assume that a small farmer suffers a bad season and finds it near impossible to send a shipment of vegetables promised to be delivered to a wholesaler.⁸⁴ Assuming the farmer could have done nothing to prepare for the bad season and that the wholesaler is a financially stable national chain, it might be more efficient for the court to simply excuse performance, prevent any loss to the farmer, and shift the loss to the promisee.⁸⁵ Posner and Rosenfield's argument is that excuse doctrines are efficient if they shift losses to whichever party is the superior risk-bearer—the party better able to prevent the undesirable eventuality or to insure or self-insure against it, or the party that is less risk averse.⁸⁶

Posner and Rosenfield detail several factors that might make one of the parties a superior risk bearer.⁸⁷ First, a party can be a superior risk bearer if they are better positioned to prevent the risk from materializing.⁸⁸ For instance, assume a contractor was hired to manufacture and install an elevator in an apartment building, but the building then burned down after the contractor started manufacturing the elevator and before they installed it in the building.⁸⁹ Following the fire, the

⁸⁰ Posner & Rosenfield, *supra* note 14; see also George G. Triantis, *Contractual Allocations of Unknown Risks: A Critique of the Doctrine of Commercial Impracticability*, 42 U. TORONTO L.J. 450 (1992) (critiquing arguments that commercial impracticability doctrine constitutes efficient contractual gap filling by courts).

⁸¹ Posner & Rosenfield, *supra* note 14, at 90.

⁸² *Id.* at 91.

⁸³ *Id.*

⁸⁴ For a similar example, see *id.* at 106.

⁸⁵ *Id.*

⁸⁶ *Id.* at 90. Note that one party can be a superior risk bearer even if it is more risk averse than the other party if the first party is better able to avoid the risk. By making that party "bear" the risk, we prevent the risk from occurring.

⁸⁷ *Id.* at 90–113.

⁸⁸ *Id.* at 90.

⁸⁹ Siegel, *Cooper & Co. v. Eaton & Prince Co.*, 46 N.E. 449 (Ill. 1896); *Huyett & Smith v. Chicago Edison Co.*, 47 N.E. 384 (Ill. 1897). For similar cases dealing

owner of the building no longer requires the contractor's work and would like the contract to be discharged.⁹⁰ The contractor, on the other hand, has suffered a loss: they already started manufacturing the elevator, which was built according to the owner's specifications and has little value outside the parties' contract.⁹¹ In such a case, in terms of the ability to prevent harm, the building owner seems like the superior risk bearer.⁹² In particular, even if it was difficult for the owner to prevent the fire, they were still in a better position to do so as compared with the contractor.⁹³ This factor will therefore point against discharging the contract in such a case.⁹⁴

Alternatively, a party can be a superior risk bearer if they are the superior insurer.⁹⁵ Posner and Rosenfield explain that many contractual risks are impossible to prevent;⁹⁶ in such cases, the superior risk bearer is the party able to more cheaply insure against the risk.⁹⁷ The identity of the superior insurer is typically determined based on two factors: each party's ability to price the risk and their ability to purchase insurance.⁹⁸ Thus, the superior insurer will have better information regarding the probability that the risk will materialize and regarding the magnitude of the loss in such an eventuality;⁹⁹ the superior insurer will also have better access to the insurance market.¹⁰⁰ In the elevator example described above, this consideration seems to make the contractor, rather than the building owner, the superior risk bearer.¹⁰¹ Note that the harm in question is not the loss of the building (which is unrelated to the contract) but only the loss suffered by the contractor due to non-performance.¹⁰² As the contractor is better able to estimate

with house repairs, see *Young v. City of Chicopee*, 72 N.E. 63 (Mass. 1904), and *Carroll v. Bowersock*, 164 P. 143 (Kan. 1917).

⁹⁰ Posner & Rosenfield, *supra* note 14, at 93.

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.* at 91.

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² *Id.*

their own costs of performance, and the alternative use of their work in case of breach, they are the superior insurer.¹⁰³

Similarly, a party can be a superior risk bearer through self-insurance if they are able to diversify their activities in a way that will spread the risk.¹⁰⁴ For instance, in the elevator example described above, the contractor might be a better self-insurer if they have many similar contracts for installing elevators. If this is the case, the contractor can slightly raise prices to reflect the risk of an occasional fire, thereby spreading this risk over multiple parties.¹⁰⁵ Of course, to act as a superior self-insurer, a party must also be able to price the risk (as is the case with regular insurance).¹⁰⁶

Posner and Rosenfield similarly argue that parties can self-insure simply by diversifying their holdings.¹⁰⁷ Thus, a publicly held firm will often be a superior risk bearer when compared to a private individual or a closely held firm, simply as any losses it suffers are spread over multiple parties, and as its owners can spread the risk by diversifying their investments.¹⁰⁸ Finally, it seems Posner and Rosenfield believe that a party may be a superior risk bearer simply because they are generally less risk-averse when compared to the other party,¹⁰⁹ but they do not state this explicitly.

Posner and Rosenfield also briefly discuss the possibility of loss sharing following contract discharge.¹¹⁰ Three related points are noteworthy in this context. First, Posner and Rosenfield clarify that existing law does not allow for loss sharing under discharge doctrine, and this option is only discussed as a possible path for reform.¹¹¹ Second, Posner and Rosenfield argue that a loss sharing rule will not be efficient, as it distorts the parties' incentives, shifts risks away from the superior risk bearer, and is costly to administer.¹¹² Thus, under the framework advocated by Posner and Rosenfield, once a superior risk bearer has been identified, that party should be made to bear all costs, and any sharing of losses will simply represent divergence from the

¹⁰³ *Id.*

¹⁰⁴ *Id.* at 93.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.* at 91.

¹⁰⁷ *Id.* at 93–94.

¹⁰⁸ *Id.* at 94.

¹⁰⁹ *See id.* at 113.

¹¹⁰ *Id.*

¹¹¹ *Id.*

¹¹² *Id.* at 114.

most efficient solution.¹¹³ Third, Posner and Rosenfield only discuss loss sharing in the context of reliance investments, and not in losses related to the expectation interest.¹¹⁴ Namely, Posner and Rosenfield consider the possibility that the parties will share losses in expenses already incurred, but they do not consider the possibility of partial expectation damages or any mechanism designed to share the loss of future profits.¹¹⁵ Our analysis challenges Posner and Rosenfield on all three fronts.

II

MACROECONOMIC THEORY OF EXCUSE

This Part offers a macroeconomic theory of excuse doctrine. This Part opens by explaining the basic tenets of macroeconomic theory and then moves on to apply these principles and offer a novel theory of contractual excuse doctrine.

A. Systematic Macroeconomic Risk

Individuals and organizations tend to be risk averse, preferring a certain event to a risky one with the same average value.¹¹⁶ Of many possible reasons for risk aversion, we emphasize two here. First, economists assume that people generally experience diminishing marginal utility of wealth, meaning that the first \$10,000, which will be used for basic necessities, is worth more than the hundredth increment of \$10,000, which will be used to buy luxuries or saved.¹¹⁷ Diminishing marginal utility of wealth makes people risk averse.¹¹⁸ They prefer a guaranteed amount of income to a risky bet that yields them nothing 50% of the time and twice the guaranteed amount 50% of the time, even though both amounts have the same average. Because of diminishing marginal utility, the extra money when the gamble pays off is

¹¹³ *Id.*

¹¹⁴ *Id.* at 113.

¹¹⁵ *Id.*

¹¹⁶ For a rigorous definition and discussion of risk aversion, see Miles S. Kimball, *Standard Risk Aversion*, 61 *ECONOMETRICA* 589 (1993).

¹¹⁷ For a discussion of the diminishing marginal utility of wealth assumption in economic history, see Kepa M. Ormazabal, *The Law of Diminishing Marginal Utility in Alfred Marshall's Principles of Economics*, 2 *EUR. J. HIST. ECON. THOUGHT* 1 (1995).

¹¹⁸ See Ted O'Donoghue & Jason Somerville, *Modeling Risk Aversion in Economics*, 32 *J. ECON. PERSP.* 91, 91–92 (2018) (stating that “risk aversion derives from diminishing marginal utility for wealth”).

worth less to a person than the harm done by having no money when the gamble loses.¹¹⁹

A second source of risk aversion is the cost of financial distress.¹²⁰ An inability to pay debts often results in a costly debt restructuring and/or bankruptcy. The costs of financial distress are both direct (e.g., lawyer's fees) and indirect (e.g., distraction and difficulty financing new opportunities that arise during bankruptcy).¹²¹ To avoid these costs, businesses may avoid gambles with big downsides, even if they are profitable on average. Such businesses are risk averse even if they do not experience diminishing marginal utility of wealth.¹²²

Risk aversion means that most people are willing to pay a premium for insurance.¹²³ For what is known as "idiosyncratic risk," insurance is indeed ubiquitous for both individuals and businesses. A risk is idiosyncratic if the outcome of one event is independent of the outcome of another similar event.¹²⁴ Many disease risks are idiosyncratic. If person A develops cancer, that often has little bearing on whether person B also develops the disease.¹²⁵

Insurance, which spreads the costs of idiosyncratic risks across many people, is an efficient response to such risks.¹²⁶ People and organizations will pay an insurance company a premium for an insurance contract that will pay upon the occurrence of a bad event, such as a fire that destroys a home or critical building.¹²⁷ If the bad event does not happen, then the insured collects nothing. The insurance company can offer such insurance without charging a very high premium.¹²⁸ In the

¹¹⁹ *Id.*

¹²⁰ J. Eric Bickel, *Some Determinants of Corporate Risk Aversion*, 3 DECISION ANALYSIS 233, 233 (2006).

¹²¹ *Id.* at 234.

¹²² See *id.* at 236–39; Bruce Greenwald & Joseph Stiglitz, *New and Old Keynesians*, 7 J. ECON. PERSP. 23, 27 (1993).

¹²³ O'Donoghue & Somerville, *supra* note 119, at 91 (asserting that "[r]isk aversion creates a demand for insurance").

¹²⁴ See CFI Team, *Idiosyncratic Risk: The Inherent Risk Involved in Investing in a Specific Asset*, CORP. FIN. INST. (Sept. 13, 2020), <https://corporatefinanceinstitute.com/resources/knowledge/other/idiosyncratic-risk/> [<https://perma.cc/7R65-C3ZC>].

¹²⁵ If A's risk of cancer is correlated with B's risk of cancer, then some of the cancer risk is systematic.

¹²⁶ O'Donoghue & Somerville, *supra* note 118, at 93.

¹²⁷ For a stylized numerical example, see *id.* at 94.

¹²⁸ For a formal model illustrating the calculation of insurance premiums, see KARL H. BROCH, *ECONOMICS OF INSURANCE* 3 (2014).

aggregate, the insurance company is not bearing a great deal of risk. While the chance of any one building burning is highly variable, the insurance company can predict with a high degree of certainty roughly how many buildings will burn in total and charge and invest accordingly, without worrying about whether writing insurance threatens the insurance company's solvency.

Even in the case of idiosyncratic risks, insurance markets face obstacles. Moral hazard, for example, sometimes causes insurance markets to fail.¹²⁹ If someone is fully insured against fire damage, then they will have less incentive to avoid fires. To maintain incentives, insurance may be less than complete (e.g., require high deductibles). If moral hazard is severe enough, then insurance markets may fail completely.¹³⁰

Private insurance markets fare even worse when faced with "systematic" risks. Many important macroeconomic risks, such as pandemic risk, war risk, or the risk of a painful recession, are best modeled as systematic rather than idiosyncratic.¹³¹ A risk is systematic if the risk is both economically significant and highly correlated across individuals.¹³² If one person catches a contagious disease, for example, then there is a (much) higher probability of others catching the same disease. As a result, pandemics are a paradigmatic example of a systematic risk. Most risks fall on a spectrum between purely idiosyncratic and purely systematic, but we focus on the polar cases for clarity.

Private insurance is generally unavailable for systematic macroeconomic risk.¹³³ A company that writes pandemic insurance, for example, will face no claims most years. Every now and then, however, the insurance company bearing pandemic risk will face an onslaught of claims that is likely to bankrupt the company. Determining the appropriate premium to charge and capital buffer to maintain is therefore a fool's game. As a result, insurance companies (and their regulators) usually limit their exposure to systematic risks by explicitly excluding such risks from coverage.¹³⁴

¹²⁹ See, e.g., James A. Kahn, *Moral Hazard, Imperfect Risk-Sharing, and the Behavior of Asset Returns*, 26 J. MONETARY ECON. 27 (1990).

¹³⁰ See Mark V. Pauly, *The Economics of Moral Hazard: Comment*, 58 AM. ECON. REV. 531, 531 (1968).

¹³¹ CFI Team, *supra* note 124.

¹³² *Id.* Quantitatively small risks, even if they are highly correlated across individuals, do not qualify as systematic since they are easy to self-insure or to insure against.

¹³³ See Jaffee & Russell, *supra* note 17, at 206–08.

¹³⁴ *Id.*

Systematic risks are also more ambiguous than idiosyncratic risks. Idiosyncratic risks can be measured with lots of data from individuals. If an insurance company wants to estimate the probability of fire damage in a building, for example, then the insurance company can mine troves of individual data on buildings. Systematic risks, which by their nature happen to populations rather than individuals, are much harder to model and estimate. Global pandemics such as COVID-19, for example, are extremely rare and hard-to-predict events. This makes the private insurance pricing problem still harder, further explaining the absence of such insurance.¹³⁵

Even if private insurance is non-existent, someone must bear systematic risk. Stock equity holders, for example, benefit when the economy roars and suffer when it shrinks. Because bearing systematic risk is undesirable, equity investments earn a return premium. Stocks that are more exposed to systematic risk (known as “high beta” stocks) earn higher average returns than stocks that are less correlated with the economy and the overall market.¹³⁶ Equity investors, who tend to be wealthy and relatively risk-tolerant, offer an effective locus of systematic risk bearing. But only up to a point. If too much systematic risk is directed towards equity, then firms go bankrupt, triggering the costs of financial distress. And if we imposed unlimited liability for systematic risk, forcing equity investors to bear still more systematic risk, then equity investors would demand prohibitively high returns to make investments that might cost them their fortunes. As a result, equity investors do not bear all systematic risk. They benefit from limited liability, keeping their exposure to systematic risk to tolerable levels.¹³⁷

When pandemics or financial crises strike, workers, contractors, customers, and undiversified small businesses suffer in addition to corporate equity. These individuals may or may not be effective risk bearers. They may lack access to the liquidity needed to keep their spending at reasonable levels until the economy recovers. And if they all reduce their

¹³⁵ *But see* Alan O. Sykes & Anne Gron, *Terrorism and Insurance Markets: A Role for the Government as Insurer?*, 36 *IND. L. REV.* 447 (2003) (arguing that government should not step in as insurer when private markets fail).

¹³⁶ *See* John Y. Campbell & Tuomo Vuolteenaho, *Bad Beta, Good Beta*, 94 *AM. ECON. REV.* 1249 (2004) (finding a strong correlation between a measure of systematic risk termed “bad beta” and stock returns).

¹³⁷ Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 *U. CHI. L. REV.* 89, 89–90 (1985) (explaining the concept of limited liability and its economic rationale).

spending in response to the negative shock, then the economy will suffer from a shortage of spending, which can exacerbate the harms caused by the occurrence of systematic risk via the multiplier effect.¹³⁸

To protect people from systematic risk and protect the economy from collapsing from a lack of spending, governments often act as risk spreaders in the face of a negative systematic shock via fiscal policy.¹³⁹ When negative systematic events occur, the state often compensates those harmed, financing this compensation with higher taxes on everyone else. When COVID-19 raised unemployment to a postwar record high in the United States,¹⁴⁰ the U.S. Congress passed stimulus packages worth more than 26% of the GDP in response,¹⁴¹ with measures ranging from the Paycheck Protection Program to enhanced unemployment benefits to three rounds of stimulus checks for all U.S. taxpayers earning below a threshold. Monetary policy also played a role.¹⁴² The U.S. Federal Reserve offered emergency loans to businesses, states, and municipalities in addition to financial institutions and corporations. The Fed also effectively financed Congress's fiscal expansion by expanding the money supply through the purchase of vast new quantities of government debt.¹⁴³

The stimulus measures were effective in preventing the economic fallout from COVID-19 from being even worse—a

¹³⁸ For a discussion of the multiplier effect, see Yair Listokin, *Law and Macroeconomics as Aggregate Demand Externalities: An Application to Optimal Tort Law*, 5 CRITICAL ANALYSIS L. 60, 61–62 (2018).

¹³⁹ See Christina D. Romer & David H. Romer, *A Social Insurance Perspective on Pandemic Fiscal Policy: Implications for Unemployment Insurance and Hazard Pay*, 36 J. ECON PERSP. 3, 4 (2022).

¹⁴⁰ See Lucy Bayly, *Unemployment Rate Soars to 14.7 Percent, Highest Level Since the Great Depression*, NBC NEWS (May 8, 2020), <https://www.nbcnews.com/business/economy/u-s-economy-shed-record-20-5-million-jobs-last-n1202696> [<https://perma.cc/SZZ5-5APS>].

¹⁴¹ See Einar H. Dyvik, *Value of COVID-19 Stimulus Packages in the G20 as Share of GDP 2021*, STATISTA (Nov. 2021), <https://www.statista.com/statistics/1107572/covid-19-value-g20-stimulus-packages-share-gdp/> [<https://perma.cc/7WZP-8UR5>].

¹⁴² See COVID-19 FAQs, FED. RSRV. (2021), <https://www.federalreserve.gov/covid-19-faqs.htm> [<https://perma.cc/BW4K-8LS8>] (describing the most important lending, regulatory, and supervisory responses by the Fed to COVID-19 economic crisis).

¹⁴³ See U.S. Dep't of the Treasury, *Federal Debt Held by Federal Reserve Banks*, retrieved from FED. RSRV. BANK OF ST. LOUIS (July 20, 2022), <https://fred.stlouisfed.org/series/FDHBFRBN> [<https://perma.cc/A62W-SMTM>].

heroic achievement.¹⁴⁴ But they suffered from many deficiencies. Checks for all Americans, for example, benefitted workers unaffected by the pandemic as much as those who lost their jobs. Similarly, the Paycheck Protection Program showered money on many businesses unaffected by the pandemic, costing almost \$200k per job saved, with the money distributed in a regressive manner.¹⁴⁵ And in addition to avoiding depression, mammoth fiscal and monetary stimulus caused high inflation and record public debt levels.¹⁴⁶

Stimulus better tailored to those harmed by the pandemic would likely have reduced the harms associated with the pandemic without some of the excesses that caused inflation and increased inequality. Congress tried. Expanded unemployment benefits, for example, directed funds to those most harmed by the pandemic.¹⁴⁷ Similarly, Congress directed rental assistance to those unable to afford it, benefiting tenants while preventing landlords of poor tenants from going under.¹⁴⁸

These programs, however, suffered from administrative gridlock.¹⁴⁹ In the early pandemic, many unemployed workers were unable to access newly generous benefits because the unemployment systems were overwhelmed by the number of applicants. Likewise, the rental assistance payments took months or even years to find their way to landlords, if the money was dispersed at all.¹⁵⁰

¹⁴⁴ See, e.g., REcession Remedies: Lessons Learned From The U.S. Economic Policy Response To COVID-19 (Wendy Edelberg, Louise Sheiner, & David Wessel eds., 2022).

¹⁴⁵ See David Autor et al., *The \$800 Billion Paycheck Protection Program: Where Did the Money Go and Why Did it Go There?* (Nat'l Bureau of Econ. Rsch., Working Paper No. 29669, 2022), <https://www.nber.org/papers/w29669> [<https://perma.cc/6V9B-RJ5Y>].

¹⁴⁶ See, e.g., Santul Nerkar & Amelia Thomson-DeVeaux, *Were the Stimulus Checks a Mistake?*, FIVE THIRTY EIGHT (Apr. 26, 2022), <https://fivethirtyeight.com/features/were-the-stimulus-checks-a-mistake/> [<https://perma.cc/4C88-7H2S>].

¹⁴⁷ Jean Folger, *Federal Pandemic Unemployment Programs: How They Worked*, INVESTOPEDIA (Jan. 3, 2023), <https://www.investopedia.com/federal-pandemic-unemployment-programs-how-they-worked-4801925> [<https://perma.cc/UK68-TP4Q>].

¹⁴⁸ *Id.*

¹⁴⁹ See Yair Listokin & Peter Bassine, *Better Rules for Worse Economies: Efficient Legal Rules Over the Business Cycle*, 12 HARV. BUS. L. REV. 55, 59 (2022) (discussing difficulty of administering expanded unemployment benefits).

¹⁵⁰ Glenn Thrush & Alan Rappeport, *About 89% of Rental Assistance Funds Have Not Been Distributed, Figures Show*, N.Y. TIMES (Aug. 25, 2021), <https://www.nytimes.com/2021/08/25/us/politics/eviction-rental-assistance.html> [<https://perma.cc/Y35G-EUCY>].

The problems encountered by these tailored programs are evidence of a more general dilemma. Systematic risk is best dealt with by tailoring extraordinary stimulus to those most affected by the risk and otherwise spreading the risk as widely as possible. To be more specific, if COVID-19 shrinks the size of economy by 7%, then the government should make sure that no one suffers by significantly more than 7% unless they have extraordinary risk bearing capacity that they have been compensated for. In particular, policy should prevent waves of bankruptcies that paralyze individuals and organizations and lead to fire sales of assets.

Such tailoring requires detailed information. Much of a person's or organization's risk profile is determined by contracts (including labor, property, and debt contracts) and it is hard for the government to obtain information about these risks as quickly as needed in the face of a severe systematic shock, as the failure of the U.S. rent assistance programs suggests. This leaves stimulus reliant on untailored programs such as stimulus checks and support for the financial sector. These programs get money out the door quickly but indiscriminately, benefiting those untouched by the systematic risk as much (or more) as those who were devastated by it.

A better risk sharing regime tailors support to the amount needed and otherwise spreads risk as widely as possible. Below, we argue that the vagueness of the excuse and impossibility doctrine offers a superior risk spreading system in the face of systematic risk and uncertainty.

B. Excuse Doctrine and Systematic Macroeconomic Risks

The distinction between idiosyncratic and systematic risk not only provides a coherent framework for evaluating monetary and fiscal policy but also offers a new lens for examining excuse doctrine. Posner and Rosenfield, for example, argue that excuse cases should impose risk on the "superior risk bearer"¹⁵¹ and emphasize the role of risk aversion in determining the identity of the "superior risk bearer."¹⁵² As we just demonstrated, however, idiosyncratic and systematic risks differ along many dimensions. Indeed, the superior risk bearer for an idiosyncratic risk may be the opposite party from the superior risk bearer of a systematic risk. Alternatively, the identity of the superior

¹⁵¹ Posner & Rosenfield, *supra* note 14, at 90.

¹⁵² *Id.* at 91, 113.

risk bearer may be indeterminate in the face of systematic risk. As a result, making sense of excuse doctrine requires us to distinguish between idiosyncratic risks and those of a more macroeconomic nature.

Posner and Rosenfield begin their analysis by emphasizing that, as in torts, the superior risk bearer will often be the superior risk avoider.¹⁵³ For idiosyncratic risks, like a fire, this criterion is coherent and efficiency maximizing. For systematic risks, however, the superior risk avoider is usually ill-defined. Neither party to a commercial real estate contract, for example, was better placed to prevent a pandemic-induced lockdown, nor would either party be better placed to prevent a pandemic or a war.

When the superior risk bearer question does not resolve the excuse claim (such as when a fire is determined to be unpreventable), Posner and Rosenfield argue that the excuse doctrine should shift the risk to the low-cost insurer.¹⁵⁴ Here too, the criterion is ill-defined for systematic risks. By definition, insurers usually exclude systematic risks (such as a pandemic) from coverage, lest the occurrence of such a risk sink the insurance company. If neither party can buy insurance against a pandemic, then it is silly to decide a case on these grounds.

Systematic risks also complicate Posner and Rosenfield's claim that excuse doctrine should assign risks to the party "in a better position to determine the probability that [the risk] would occur."¹⁵⁵ While this question is at least coherent with respect to systematic risks, what is the point? In the vast majority of cases, neither party to a contract was well placed to estimate the probability of a global pandemic or recession. Because systematic risks are highly correlated events, they do not generate the quantities of data necessary to develop reliable predictive models—they are uncertain rather than risky. If they were able to judge such risks, then they would be more likely to be advising governments or running "macro" hedge funds than a party to a contract subject to an excuse claim.

Posner and Rosenfield also emphasize the role of self-insurance in determining the superior risk-bearer.¹⁵⁶ Indeed, they assert that larger entities such as "dealers" will be superior risk bearers without insurance when they can "diversify" a given

¹⁵³ *Id.* at 92–93.

¹⁵⁴ *Id.* at 93.

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

risk over many similar transactions, unlike smaller entities.¹⁵⁷ Yet again, this factor is less relevant for systematic risk than for idiosyncratic risk. With idiosyncratic risk, multiple independent transactions imply that losses associated with the occurrence of risk in one setting will be offset, on average, by different outcomes elsewhere.¹⁵⁸ Systematic risk, however, means that the two events do not offset, even on average.¹⁵⁹ If the risk occurs in one setting, then it also occurs in the other.¹⁶⁰

In the face of systematic risk, larger entities conducting multiple transactions of a similar type may in fact be the worst risk-bearers, rather than the best as suggested by Posner and Rosenfield. If we assigned pandemic risk entirely to large commercial landlords, for example, then many of them would have been in distress during COVID-19 as their revenues shriveled to a fraction of their previous amounts. Even the most well-capitalized landlords would have experienced costly financial distress. And the distress of large landlords might have threatened their bank lenders, risking a broader financial panic.

The microeconomic excuse theory developed by Posner and Rosenfield would have caused significant distress in the commercial real estate sector (and others) if it had been applied during the pandemic. While commercial landlords could easily have managed risk from one tenant and (in some cases) one city, making them superior risk bearers in the conditions examined by Posner and Rosenfield and discharging all rent due to COVID-19 would have devastated commercial real estate. The doctrine, however, was not applied in the uniform fashion advocated by Posner and Rosenfield. In some cases, as described in Part I, small tenants successfully argued excuse in court and had their rent obligations reduced or discharged. Somewhat more often, the court upheld the rent obligation, even if the tenant was unable to fully access the property. Most often, of course, the parties reworked the rental agreement in the shadow of these excuse arguments.

Beyond the case of COVID-19, the analysis in this Part illustrates a more general point. Since Posner and Rosenfield do not acknowledge the difference between idiosyncratic and systematic risks, their theory of excuse seems largely

¹⁵⁷ *Id.* at 106–07.

¹⁵⁸ CFI Team, *supra* note 124.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

irrelevant for the understanding of excuse as a response to macroeconomic shocks. The purpose of our inquiry is therefore clear: to explain how excuse claims should be decided in cases of systematic risks, when considerations highlighted in the existing microeconomic model seem irrelevant.

III

UNCERTAINTY, MACROECONOMICS, & EXCUSE

When systematic risks materialize, what principles or policies should guide decision making in excuse cases? When the familiar search for the “superior risk bearer” is futile or meaningless, what other logic underlies excuse decisions and what criteria should be used to evaluate the efficiency of the doctrine, or the lack thereof? To answer these questions, this Part offers a simple model of excuse doctrine and systematic risk. We show that in times of macroeconomic crisis, excuse doctrine serves a unique role: by introducing uncertainty into contract adjudication, it can contribute to loss sharing and to economic stability.

Since almost every breaching promisor can offer an excuse defense, the doctrine introduces pervasive uncertainty to contract law. This explains the widespread discomfort among legal scholars with excuse and impossibility.¹⁶¹ In ordinary times, the doctrine introduces uncertainty when contract law pursues predictable private ordering. When there is a systematic macroeconomic shock, however, the uncertainty associated with the excuse doctrine becomes a virtue. Excuse promotes efficient risk sharing between contracting parties, increasing economic resilience. The Appendix presents the formal model supporting the analysis in this Part.

A. A Simple Model of Excuse and Macroeconomic Uncertainty

Signing a contract allocates risk.¹⁶² Consider, for example, a contract signed between a commercial landlord and tenant for fixed monthly rent (the analysis would be much the same for almost any type of risk allocated by other contracts). The rental contract allocates risks associated with the tenant’s business to the tenant. If the tenant’s business deteriorates

¹⁶¹ Eisenberg, *supra* note 7, at 208; WHITE & SUMMERS, *supra* note 55, at §§ 3–10.

¹⁶² Posner & Rosenfield, *supra* note 14, at 88.

and paying the monthly rent becomes difficult, then that is the tenant's problem, not the landlord's.

This allocation of risk is generally efficient. Tenants who reap the profit when their business thrives and suffer when their business falters run better businesses than tenants who are insulated from business success and failure.

This risk allocation, however, exposes the tenant to costly financial distress.¹⁶³ If the business falters and the tenant cannot pay the rent and other expenses, then the tenant needs to restructure its obligations, a complex multiparty process that involves considerable costs and effort.¹⁶⁴ During this process, the tenant may miss out on opportunities that could have been seized by a financially healthy business.¹⁶⁵ Moreover, these costs cannot be easily monetized because businesses have a hard time selling inchoate assets such as executive attention or future investment opportunities to be determined.¹⁶⁶

When the business is a bad one, this restructuring, however costly, is necessary. But if the business has faltered for reasons outside its control, then financial distress introduces unnecessary costs.¹⁶⁷ To minimize these costs, tenants typically buy insurance for risks outside their control, such as fires or idiosyncratic business interruption. The availability of insurance for these risks means that the allocation of risk between the tenant and landlord is efficient, even if it introduces the possibility of costly financial distress. The costly distress only arises when the tenant's business struggles, or in the face of uninsurable risk. As a result, excuse doctrine, which shifts some of the risk of the business failing to the landlord, undermines the tenant's incentives to run a good business.

The efficiency of this risk allocation between landlord and tenant changes in the face of systematic risks such as the advent of the global COVID-19 pandemic. The pandemic crushed many tenants' businesses through no fault of their own. Financial distress induced by these business struggles was wasteful—some businesses would experience distress even

¹⁶³ See David M. Cutler & Lawrence H. Summers, *The Costs of Conflict Resolution and Financial Distress: Evidence from the Texaco-Pennzoil Litigation*, 19 RAND J. ECON. 157, 158 (1988).

¹⁶⁴ *Id.*

¹⁶⁵ *Id.* at 158, 167–68.

¹⁶⁶ In the formal model in the Appendix, the economic cost of bankruptcy is captured by the parameter B.

¹⁶⁷ Cutler & Summers, *supra* note 163, at 167.

though they did not need to be reorganized.¹⁶⁸ Moreover, the systematic nature of pandemic risk, like other macroeconomic risks, meant that private insurance was not available.¹⁶⁹

Without the excuse doctrine, contract law would have imposed unnecessary financial distress on tenants during COVID-19. Lockdown caused tenants' businesses to falter, making them unable to pay, but contract law would not excuse their rent obligations. Costly financial distress would have followed, with restructuring only occurring in a complex and lengthy multi-lateral reorganization.¹⁷⁰

Introducing excuse doctrine appears to reduce these costs. If the tenant is excused from paying rent when a pandemic prevents its business from operating as normal, then the tenant avoids costly financial distress.

Certain application of the excuse doctrine, by contrast, allocates pandemic risk to the landlord. The landlord, however, is also subject to costly financial distress. If the landlord acts as pandemic risk insurer to all of its tenants, then the landlord will be in financial distress (remember that no private party can provide insurance for systematic macroeconomic risks).¹⁷¹ The landlord must now restructure its obligations with its many contractual co-parties (financiers, employees, tenants, etc.), a process potentially just as costly as it would be for the tenant. Thus, pandemic-induced financial distress for the landlord is just as costly (and just as uninsurable) as pandemic induced financial distress for the tenant.¹⁷² As a result, excuse doctrine that is automatically triggered by a systematic macroeconomic shock merely reshuffles the costs of financial distress to the landlord.

¹⁶⁸ *Id.*

¹⁶⁹ See *supra* notes 132–135 and accompanying text (discussing systematic risk).

¹⁷⁰ The tenant might have wished to offer a slightly higher renegotiated rent to prevent a suit by the landlord and avoid the resulting costs of financial distress, but the benefits of avoiding such distress cannot be turned into an asset that can be shared with the landlord. This would be the case if the costs represent effort and distraction costs or foregone economic opportunities as a result of financial distress. In the formal model in the Appendix, this is captured by the assumption that there is no way for the buyer to somehow offer to share the cost of bankruptcy (B) with the seller, to avoid the lawsuit.

¹⁷¹ In the formal model in the Appendix, this idea is captured by the assumption that the seller needs the payment from the buyer to pay back the seller's own debt.

¹⁷² In the formal model in the Appendix, the economic cost of bankruptcy is captured by the parameter B, and it does not depend on whether it is the buyer or the seller who is going bankrupt.

Enter the uncertain application of the excuse doctrine. For simplicity, we can model uncertainty as the resolution of excuse cases associated with the occurrence of systematic risk via coin flip. Namely, assume that when the promisor is unable to perform due to systematic macroeconomic risk, there is a 50% chance the court will void the contract. This form of uncertain application of the excuse doctrine encourages parties to renegotiate their contracts and share losses so that neither party faces unnecessary costs of financial distress. This resolution distributes uninsurable systematic macroeconomic risk more efficiently.

We also assume that neither party can bear the risk of systematic risk unilaterally. If the tenant is forced to pay full rent, then the tenant will go bankrupt. If the landlord is forced to accept no rent, then the landlord goes bankrupt.

Consider now the tenant's settlement incentives regarding rent during the pandemic. If the tenant chooses to go to court with the landlord and argue for excuse, then it faces a 50% chance of a trial victory, which would forestall financial distress, and a 50% chance of a loss, which would trigger the costs of financial distress and require the tenant to pay all of its assets to the landlord (recall that the tenant cannot pay the full rent amount). The tenant is therefore willing to renegotiate the rental contract for any amount that is less than its expected value from going to court, which is the value of half of its assets (in expectation) *plus* half the costs of financial distress.¹⁷³

Now consider the landlord. Court yields the landlord a 50% chance of overcoming the excuse defense. In that case, the tenant owes the full rent but can only pay its remaining assets due to insolvency. If the excuse defense succeeds (with 50% probability), the landlord receives no rent. Financial distress follows for the landlord, with its attendant costs (while one tenant's failure to pay rent is unlikely to induce financial distress, a string of successful excuse defenses would undermine most

¹⁷³ In the formal model in the Appendix, the buyer is willing to settle for any amount smaller than $0.5*(A_b+B)$, where A_b is the buyer's assets, and B is the cost of bankruptcy. The tenant is willing to pay more than half the expected rent payment it would pay upon losing because it gains from avoiding the costs of financial distress.

landlords,¹⁷⁴ who tend to be heavily leveraged).¹⁷⁵ The landlord is therefore willing to renegotiate the rent for any amount greater than half the tenant's assets *minus* half the expected costs of financial distress.¹⁷⁶

Any renegotiated rent between half the tenant's assets *minus* half the costs of financial distress to the landlord (the least the landlord is willing to accept) and half the tenant's assets *plus* half the costs of financial distress to the tenant (the most the tenant is willing to pay) benefits both the landlord and the tenant. Moreover, this range is larger (implying that renegotiation is more likely) when the costs of financial distress are higher. The frantic efforts of the Fed and Congress to avoid widespread business defaults indicate that these costs are indeed very high,¹⁷⁷ as do empirical estimates that the financial distress costs for firms in financial straits are 15-30% of firm value.¹⁷⁸ The benefits of avoiding financial distress, especially when both parties to a contract are at risk of such distress, create a high likelihood of rent renegotiation.

To state these conclusions in more general terms, note that the parties' willingness to share losses in their renegotiation rises with the level of legal uncertainty. Thus, when legal outcomes are certain, parties will not share losses at all, as their settlement will reflect the allocation of losses at the end of trial. For instance, if the probability of excuse is zero, the landlord

¹⁷⁴ In the formal model in the Appendix, the seller is willing to settle for any amount greater than $0.5*(A_b - B)$.

If each excuse defense were statistically independent, then the landlord would be highly likely to win approximately 50% of cases, which would cause financial distress to some but not all landlords with much less aggregate uncertainty. Each excuse case, however, is not statistically independent. Once precedent develops in a given jurisdiction, landlords are likely to win or lose almost all similar cases.

¹⁷⁵ The average debt to equity ratio in the U.S. real estate sector is 3.5 to 1. See Andriy Blokhin, *Typical Debt-to-Equity (D/E) Ratios for the Real Estate Sector*, INVESTOPEDIA (Oct. 16, 2019), <https://www.investopedia.com/ask/answers/060215/what-average-debtequity-ratio-real-estate-companies.asp> [<https://perma.cc/56EZ-2HB7>].

¹⁷⁶ The landlord is willing to accept less than half the expected rent payment it would receive upon victory because the landlord gains from avoiding the costs of financial distress.

¹⁷⁷ In 2020, these included the \$800 billion Paycheck Protection Program and the Fed's unprecedented commercial bond and even direct lending programs. Susan C. Morse, *Emergency Money: Lessons from the Paycheck Protection Program*, 55 U. MICH. J.L. REFORM 175, 220 (2021).

¹⁷⁸ Sergei A. Davydenko, Ilya A. Strebulaev & Xiaofei Zhao, *A Market-Based Study of the Cost of Default*, 25 REV. FIN. STUD. 2959, 2959 (2012); Arthur Korteweg, *The Net Benefits to Leverage*, 65 J. FIN. 2137, 2138 (2010).

will not accept anything less than the maximum amount that can be collected from the tenant. As uncertainty rises, and the probability of excuse increases, the landlord will be willing to forgo some of the debt owed by the tenant and share the losses borne by the tenant.¹⁷⁹ Finally, when uncertainty reaches the maximal level (equal chances of winning and losing at trial) the parties will share losses more-or-less equally.

The likelihood of renegotiation rises further when we consider two additional factors—litigation costs and diminishing marginal utility of wealth. By renegotiating rents rather than going to court, the parties economize on the costs of trying the case. Saving these costs provides another incentive towards renegotiation. In addition, some parties to a contract, particularly individuals and small businesses, may experience diminishing marginal utility of wealth, meaning that they prefer average outcomes to extremes. Since renegotiation to avoid court provides a certain outcome, risk averse individuals prefer renegotiation, even if there are no costs of financial distress.

B. Excuse as Tailored Risk-Sharing

Not only does the uncertain excuse doctrine reduce the financial-distress costs of systematic risk, but it also tailors risk sharing to the assets of the tenant. Recall that the rent renegotiation range centers on half the assets of the tenant.¹⁸⁰ Strapped tenants are relatively judgment proof. If their excuse defense fails and the court upholds the contract, these tenants have few assets to lose. As a result, strapped tenants are more tolerant of court than tenants closer to solvency. To induce tenants to withdraw their excuse defenses, the landlord must accept a lower renegotiated rent. The uncertain excuse doctrine thus provides risk sharing tailored to the assets of one of the parties.

Other popular forms of risk sharing struggle to tailor risk effectively in the face of systematic risk. Tailored government financial assistance programs, such as unemployment insurance, rent assistance for the insolvent, and mortgage restructuring after the Great Recession,¹⁸¹ require government

¹⁷⁹ In the formal model in the Appendix, this can be seen in Figure 2, where the range of possible settlement amounts increases as q increases from $q=0$, where q is the probability that the court will recognize frustration of purpose.

¹⁸⁰ In the formal model in the Appendix, the parties can settle on any amount between $0.5*(A_b - B)$ to $0.5*(A_b + B)$, where A_b is the buyer's assets.

¹⁸¹ See *supra* Part II.

bureaucracies to sort between eligible and ineligible citizens. In the face of systematic risk creating widespread need, creating or scaling up such bureaucracies often proves impossible. The virtue of the uncertain excuse doctrine is that it facilitates private, tailored risk sharing when systematic risks lead to the risk of widespread insolvencies. The uncertain excuse doctrine helped enable the Great Renegotiation to redistribute risk effectively.

If risk sharing is the purpose of the uncertain excuse doctrine under systematic risk, why not implement the risk sharing directly via remedies? For example, the excuse doctrine could provide that, when systematic risk occurs, tenants must always pay half the contractual rent.¹⁸² This excuse rule eliminates legal uncertainty, but still gives both tenants and landlords some relief when unpreventable risk occurs.

While seemingly attractive, this alternative excuse doctrine suffers from two flaws. First, “splitting the baby” conflicts with the excuse and impossibility doctrines as currently understood.¹⁸³ Excuse and impossibility are performance defenses that either do or do not discharge a promisor’s obligation to perform. The doctrines rarely lead to substantially reformed or partial performance obligations.¹⁸⁴ While remedial innovations that complement excuse defenses could be promulgated accordingly, these innovations would require analysis from a remedial perspective, which is outside the scope of this paper.

More fundamentally, a 50%/50% sharing rule weakens the private tailoring of risk sharing that is such an attractive quality of the uncertain excuse doctrine. If both landlord and tenant avoid financial distress with the sharing rule, then the proposed excuse rule always splits the rent obligation evenly. A strapped tenant who can barely afford half rent pays the same rent as a more financially robust tenant. As a result, private risk tailoring is undermined. If the tenant, but not the landlord, faces financial distress upon triggering a rent/sharing rule via the excuse doctrine, then the tenant will want to settle for less than 50% of the rent to avoid the costs of financial distress. The landlord, however, faces little reason to accept anything less than the plaintiff’s entire net worth. Because the landlord does not risk financial distress from court, court becomes a

¹⁸² Posner and Rosenfield consider such a rule. See *supra* note 14, at 113; see also CHARLES FRIED, *CONTRACT AS PROMISE* 69–73 (1981) (advocating the principle of sharing in some contract law loss scenarios).

¹⁸³ Posner & Rosenfield, *supra* note 14, at 113.

¹⁸⁴ *Id.*

more attractive “outside option.” The landlord therefore drives a harder bargain, demanding, at a minimum, whatever the tenant would be able to pay during financial distress. In total, a defined 50%/50% risk sharing doctrine specifies risk sharing less tailored to the financial realities of the tenant and landlord than the uncertain application of excuse doctrine described above.

IV

INTERPRETATIVE AND NORMATIVE IMPLICATIONS

A. A New View on Legal Uncertainty

Our analysis shows that uncertainty may be beneficial when it is socially desirable to have parties share their losses. When faced with uncertainty regarding the outcomes of court proceedings, plaintiffs will settle for sums that represent only part of their full claims; symmetrically, defendants will agree to make settlement payments, but those payments will not equal the full amount originally sought by plaintiffs. This view can reconceptualize our understanding of uncertainty, typically viewed by legal scholars exclusively as a vice and never as a virtue.¹⁸⁵

Existing scholarship studies the relationship between legal uncertainty and the probability of settlement.¹⁸⁶ We seek to add another dimension to this familiar picture. We go beyond the question of the probability of settlement and ask how uncertainty will affect the *content* of settlements or the measure of settlement payments. In this context, the basic intuition is that if the law is certain and clear, settlements will clearly favor one party—whichever party is expected to win at trial. On the other hand, if the law is unclear and the result of litigation is uncertain, then settlement payments will reflect this, and the parties will tend to share the costs of their dispute.

For example, assume that the plaintiff sues the defendant for a sum of \$1M and that the law is clear enough for the parties to know the plaintiff's claim is very strong and highly likely to win in court. Under this assumption, the parties are likely to settle, simply to avoid the costs of litigation, and agree that the defendant pay the plaintiff a sum of close to \$1M.

¹⁸⁵ See, e.g., John E. Calfee & Richard Craswell, *Some Effect of Uncertainty on Compliance with Legal Standards*, 70 VA. L. REV. 965, 974–89 (1984) (arguing that errors can create adverse consequences); but see Shiffrin, *supra* note 21, at 1214 (arguing that uncertainty may be useful to induce deliberation)

¹⁸⁶ See Shavell, *supra* note 72, at 63.

Alternatively, assume an identical case, only that this time the law is extremely vague and the parties find it near impossible to guess the outcome of the case. In such a situation, the parties will still probably settle, to avoid the uncertainty associated with trial, and the costly process of litigation. Yet the payment they will agree on in their settlement will be far from \$1M and will reflect the uncertainty of the legal outcome. In particular, if the parties both estimate that success of the claim is about as likely as its failure, they will settle for a payment of about half of \$1M.

This is a general claim regarding the effects of legal uncertainty, highlighting its effect on loss sharing. Three comments are in order here. First, this feature of uncertainty relates to basic structural features of the civil litigation system. Private law claims usually feature a binary structure. Either there was breach, or there was not.¹⁸⁷ Either the contract is excused, or it is not.¹⁸⁸ In this sense, when a dispute ends with a court decision, losses and gains are not usually shared by the parties—it's a winner-takes-all system, by which one party is declared to have been in the right all along, and that party's entitlements are restored. This is, of course, not always the case, but, in the basic and common form of civil litigation, one party wins the dispute, and losses are then borne by the other party and are not shared. This means that uncertainty is a mechanism for inducing parties to share their losses, as trial outcomes will not typically achieve this goal independent of settlement.

Second, legal scholars are not usually interested in the question of how the parties' losses are shared. Thus, everyone agrees that the question of the probability of settlement or trial is an important one, since trials are so costly.¹⁸⁹ Yet scholars rarely discuss the question of the amount of settlement sums. To existing theories of settlement, as long as the parties settled and the costs of litigation have been saved, why should it matter if one party paid the other \$5M or \$1M? Apparently, they paid whatever they saw fit "in the shadow of the law," based on their estimation of the outcome of trial.¹⁹⁰ We argue that in some important cases, the way losses are shared in settlement

¹⁸⁷ For such a standard interpretation of contract breach, see Steven Shavell, *Damage Measures for Breach of Contract*, 11 *BELL J. ECON.* 466, 472–73 (1980).

¹⁸⁸ Posner & Rosenfield, *supra* note 14, at 113.

¹⁸⁹ See George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 *J. LEGAL STUD.* 1 (1984) (offering the seminal model of probability of settlement vs. probability of success in litigation).

¹⁹⁰ Mnookin & Kornhauser, *supra* note 6, at 997.

is, in fact, highly important. In particular, when faced with a systemic crisis, making sure that losses are shared might be more important than lowering the costs of trials or assuring owners' rights are fully vindicated. Loss sharing can reduce the risk of bankruptcies and defaults; in times of economic crisis, mass bankruptcies are a key concern as they can lead to a downward economic spiral.

Third, we do not argue that uncertainty in the law is created because judges wish to incentivize parties to share their losses. This might be true, or might be true sometimes, but we make no strong claim on this matter. Uncertainty is created in such cases because these are difficult cases and judges struggle to decide them. On the one hand, the contract is clearly failing and there seems to be no sense in keeping it alive just for the sake of punishing an economically disabled defendant. On the other hand, this is a contract, and contracts are to be respected.¹⁹¹ If parties are excused from performing their contracts whenever performance is difficult, then contract law, with all its benefits, loses much of its meaning.¹⁹² Uncertainty therefore is not created because it is in some sense efficient—it is simply there. Yet, the fact that uncertainty is sometimes efficient helps it persist. Legal uncertainty and legal certainty in excuse doctrine both exist out there in the legal world. Some courts issue decisions that will lead to more certainty, and other courts produce decisions that will lead to more confusion. If legal confusion was highly inefficient, it would eventually, with time, become less prevalent—so long as common law has any tendency towards efficiency.¹⁹³ If it has some efficiency, it might persist. In this sense, we argue that the efficiency of excuse doctrine, through its ambiguity, is an emergent feature of the legal system.¹⁹⁴ It is not a designed one, nor a manifestation of spontaneous, rather than planned, order.¹⁹⁵

¹⁹¹ Sharp, *supra* note 58, at 783–84.

¹⁹² Schwartz, *supra* note 31, at 49 (“[I]f courts regularly excused parties from their contracts when performance turned out to be tougher than expected, then parties would lose faith that contracts really are legally enforceable.”).

¹⁹³ Unlike some scholars, we do not claim that common law is efficient. But we do suspect that efficiency is one (of many) factors determining the path of common law. For a review of the efficient common law hypothesis, see Francesco Parisi, *The Efficiency of the Common Law Hypothesis*, in *THE ENCYCLOPEDIA OF PUBLIC CHOICE* 519, 519 (Charles K. Rowley & Friedrich Schneider eds., 2004).

¹⁹⁴ On the concept of emergent properties, see Timothy O'Connor, *Emergent Properties*, 31 *AM. PHIL. Q.* 91, 91–92 (1994).

¹⁹⁵ *Planned order* refers to social institutions that are “the product of deliberate design.” FRIEDRICH A. HAYEK, *LAW, LEGISLATION AND LIBERTY: RULES AND ORDER* 5 (1973).

B. Excuse & Systematic Risk

Our analysis offers a new normative framework for deciding excuse cases following a broad economic crisis. In the aftermath of a macroeconomic crisis, the standard considerations for deciding excuse cases, as described in the literature,¹⁹⁶ become largely irrelevant. Thus, when a party cannot perform its contract due to war or a global pandemic, questions regarding the relative abilities of the parties to prevent the harm,¹⁹⁷ insure¹⁹⁸ or self-insure against it,¹⁹⁹ lose their normative appeal. This means that a whole new set of normative arguments is required for generating correct decisions in such cases. We suggest that this new normative language can be found in considerations pertaining to the economic stability of the parties and the possible effect of this stability on overall market conditions and on the possibility of mass bankruptcies and a downward economic spiral.

Within this framework, our analysis shows that ambiguity may be a beneficial feature of excuse doctrine during a broad economic crisis. During a crisis, the financial stability of businesses and individuals is paramount. Massive waves of bankruptcies and defaults can destabilize an already faltering economy and lead to catastrophic recessions. A good way to prevent bankruptcies is to make sure losses are shared rather than fall fully on specific actors. Mechanisms allowing for loss sharing can save many individuals the costs of financial distress, thus offering a significant overall social advantage. Loss sharing prevents and reduces bankruptcies, which could otherwise send the economy in a downward spiral in times of economic strife. Uncertainty, in a kind of paradoxical twist, readily achieves the goal of loss sharing. This is a normative point, highlighting a potential efficiency advantage of uncertainty from a macroeconomic perspective.

Note that this potential efficiency of excuse doctrine does not depend on the ability of judges to accurately conduct some complicated macroeconomic assessment. Thus, we do not imagine a judicial-regulatory function by which judges must directly decide cases in ways that will prevent bankruptcies,

Spontaneous order refers such institutions that are “the outcome of a process of evolution whose results nobody foresaw or designed.” *Id.* at 37.

¹⁹⁶ Posner & Rosenfield, *supra* note 14, at 90.

¹⁹⁷ *Id.* at 91.

¹⁹⁸ *Id.*

¹⁹⁹ *Id.* at 93.

induce loss-sharing, or stabilize the economy. Instead, these effects are achieved indirectly, as parties share losses in the shadow of legal uncertainty. To achieve these goals, all judges need to do is to continue to struggle in the difficult task of deciding excuse cases and applying excuse doctrine. Indeed, the judicial trend of the 1980s-2000s to reduce legal uncertainty by rejecting all excuse claims brought in response to recessions²⁰⁰ likely impeded rather than assisted the process of macroeconomic adjustment.²⁰¹

This analysis also offers guidelines for policymakers and legislators looking to shape the future of excuse doctrine. In particular, most law-reform efforts in this area of law are designed to reduce ambiguity, increase stability, and offer a more detailed and systematic judicial application of excuse rules. We expose a fundamental flaw in these reform efforts, as they seek to remove the very core of the efficiency of excuse doctrine, namely its ambiguity.

Faced with the COVID-19 crisis, some jurisdictions attempted to clarify the law of excuse. Calls for reform included recommendations for courts to articulate clear threshold requirements for excuse, to detail types of contracts that might merit excuse under the conditions of the COVID-19 pandemic, and recommendations for legislators and regulators to offer new guidelines for adjudication or bypass the doctrine completely through emergency legislation.²⁰²

²⁰⁰ See Crystal & Giannoni-Crystal, *supra* note 48, at 1 and accompanying text.

²⁰¹ In the Great Depression, some courts even rejected renegotiated lease contracts under the pre-existing duty rule, holding that “general economic adversity, however disastrous it may be in its individual consequences, is never a warrant for judicial abrogation of this primary principle of contract law.” *Levine v. Blumenthal*, 186 A. 457, 459 (N.J. 1936), *aff’d*, 189 A. 54 (N.J. 1937). Wide application of this precedent would have precluded the Great Renegotiation. If, as we advocate, the excuse doctrine is sometimes applied to systematic macroeconomic risks like deep recessions, then the pre-existing duty rule no longer bars renegotiations; the tenant’s agreement to continue paying rent rather than advancing an excuse or impracticability claim would constitute consideration for the reduction in rent offered by the landlord.

²⁰² See, e.g., *COVID-19 and Frustration of International Contracts*, INSTITUTO HISPANO LUSO AMERICANO DERECHO INTERNACIONAL (July 16, 2020), <http://www.oas.org/en/sla/dil/docs/COVID-19-and-frustration-of-international-contracts.pdf> [<https://perma.cc/7LMU-ZSRF>] (detailing the IHLADI Recommendations on COVID-19 and Frustration of International Contracts, published relatively early during the pandemic, calling upon states to “partially revise the general rules on contracts included in their normative bodies in civil and commercial matters, establishing specific regulation of the effects of the supervening circumstances that produce impossibility, hardship or frustration of the contract’s purpose”).

These early efforts made intuitive sense: it was clear that multiple excuse claims were about to enter the court system, and it was also known that excuse doctrine is notoriously vague. The natural legal response is to see it as a necessary measure to finally settle excuse law. Our analysis sheds new light on such efforts and offers a new metric for their evaluation. As a general policy recommendation, we offer the counterintuitive advice that excuse doctrine, flawed as it may be, should remain unchanged.

Of course, pointing to any “optimal” level of uncertainty in this context seems impossible to do with any meaningful degree of accuracy. But a bird’s-eye view of the doctrine and the caselaw shows that it is plausible that contract law maintains a sufficient degree of uncertainty through the doctrines of excuse to facilitate considerable amounts of loss sharing in times of crisis.

C. Excuse & Idiosyncratic Risk

Our analysis raises a key question regarding the role of excuse doctrine outside of times of crisis. That is, if uncertain excuse doctrine performed so well during the COVID-19 economic crisis, why not allow tailored risk sharing in ordinary economic conditions as well? Tenants who suffer from idiosyncratically bad luck would also benefit from the risk sharing renegotiations just described. In fact, some claims of this nature succeed, as described above. The unexpected death of the promisor, for example, usually excuses performance. For most idiosyncratic risks, however, the excuse defense for breach of contract fails. Why?

One answer is that enabling the excuse doctrine in the face of idiosyncratic risk undermines incentives to acquire private insurance. When private insurance is feasible, as it is with idiosyncratic risks, then this preemption of the private sector is inefficient.²⁰³ In addition, overly broad excuse undermines the integrity of contract—almost every failure to perform can be characterized as caused by unforeseen idiosyncratic risk, meaning that the defense would be available frequently. Systematic risks (e.g., pandemics, wars, economic crises), by contrast, are observable and verifiable—meaning that enabling the excuse defense on the occurrence of systematic risk entails less risk to the integrity of contracts more generally.

²⁰³ CFI Team, *supra* note 124.

Perhaps as importantly, the tailored risk sharing enabled by the uncertain excuse doctrine is less important in the face of idiosyncratic risk. As described above,²⁰⁴ efficient renegotiation is more likely under systematic risk because both the tenant and the landlord face financial distress if they lose in an excuse case. As a result, they both have an incentive to settle, even if they leave some money “on the table.” In idiosyncratic risk, by contrast, typically only one of the parties faces financial distress (by the definition of idiosyncratic risk). This asymmetric distribution of financial distress undermines the risk sharing properties of the uncertain excuse doctrine. If only the tenant faces financial distress caused by idiosyncratic risk, then the tenant holds a weak bargaining position before trial. The tenant wants to avoid trial to preclude distress, while the solvent landlord cares only about expected value. The landlord will therefore be reluctant to settle for less than the expected value of the rent. In these circumstances, the uncertain excuse doctrine is less likely to facilitate successful rent renegotiation and less likely to facilitate risk sharing tailored to the financial circumstances of both the tenant and landlord. Uncertain excuse doctrine performs better in the face of systematic risk than idiosyncratic risk.

Finally, facilitating loss sharing is simply less important under idiosyncratic risks as opposed to systematic risks. Of course, helping parties avoid financial distress is also beneficial in cases of idiosyncratic risk; yet, the benefits of doing so are mostly limited to preventing the hardship experienced by the specific parties. In the face of acute systematic risk, by contrast, preventing financial hardship is of broader social importance as part of the efforts to prevent waves of destabilizing bankruptcies. In this sense, preventing financial distress in times of economic crisis is a public interest, and its benefits are not limited to the parties to the specific contract.

For all these reasons, excuse doctrine can be said to offer a tradeoff. During economic crisis, excuse provides significant benefits in the form of loss sharing and increased economic stability; outside of times of crisis, excuse doctrine mainly produces costs in the form of undesirable legal uncertainty.

This suggests an overall desirable valence of excuse doctrine. When excuse entails high costs and low benefits outside of economic crisis, it is not highly active, so costs remain relatively low. Excuse doctrine is more active, and becomes more prevalent, in times of economic crisis, when its effects are positive.

²⁰⁴ See *supra* section III.A.

Ordinarily, excuse claims are argued in a relatively small number of cases, when failure to perform follows some bizarre and unexpected contingency. As such claims are not common, the overall level of uncertainty those claims generate is small, and the costs associated with the existence of excuse doctrine are not great. Conversely, during times of economic crisis, for instance when a pandemic or a war is looming, excuse claims suddenly become relevant to a great number of contracts (perhaps even all contracts). Thus, during systematic economic crisis, the overall level of uncertainty produced by excuse doctrine spikes, nudging parties to share losses more widely. This means excuse doctrine, to some extent, regulates its own level of activity: ordinarily (when it mainly produces undesirable costs) it remains largely inactive, but it can spring into action at times of crisis when its effects can be beneficial. Figure 1 below offers evidence for this claim, demonstrating the spike in google searches for the term *Frustration of Purpose* during the early months of the COVID-19 pandemic.²⁰⁵

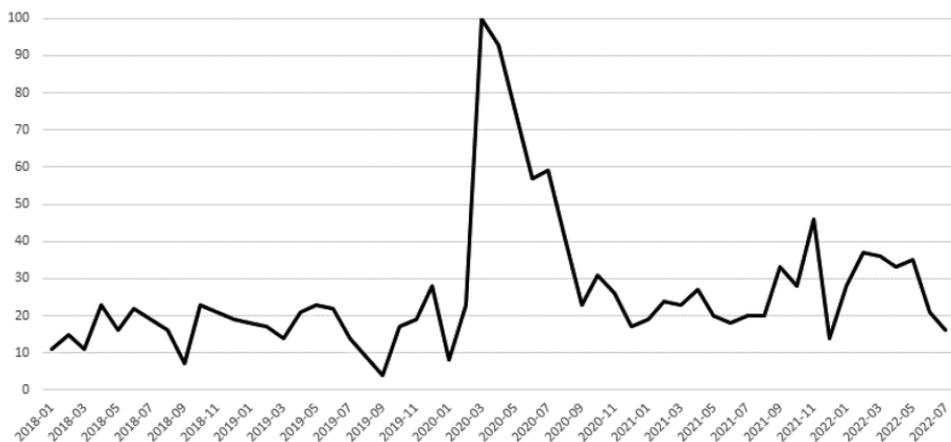


FIGURE 1: Google searches for “Frustration of Purpose” in the U.S. over time

Similar trends can be observed in the explosion of law firm guidance memos issued during the pandemic. These were so

²⁰⁵ As explained on the Google trends website, in the figure, “numbers on the graph don’t represent absolute search volume numbers, because the data is normalized and presented on a scale from 0–100, where each point on the graph is divided by the highest point, or 100.” *Google Trends: Understanding the Data*, GOOGLE NEWS INITIATIVE, <https://newsinitiative.withgoogle.com/resources/trainings/fundamentals/google-trends-understanding-the-data/> [<https://perma.cc/W4CY-QPYX>] (last visited July 22, 2023).

voluminous that they are now collected in a Stanford University searchable database.²⁰⁶ The database includes more than 200 memos on different issues relating to contract doctrine, the great majority of which discuss topics of excuse, force majeure, impracticability, and frustration.

CONCLUSION

Excuse doctrine presents one of the more persistent riddles of contract law. The core concepts of the doctrine seem to directly contradict the principal teachings of the law of contract, and it adds an alarming degree of uncertainty to contract adjudication.

Macroeconomic theory sheds new light on the key patterns of excuse doctrine and on its underlying justification. In particular, we show that the risk of contract discharge induces contractual parties to share losses and partially forgive obligations instead of insisting on complete performance and on full payment. We further argue that the structural characteristics of this legal mechanism as a common law exception allows it to spring into action when it is most needed, in times of great economic turmoil and financial instability.

Excuse doctrine is structured in such a manner that the level of uncertainty it entails rises in times of grave economic hardship. Ordinarily, excuse doctrine largely lies dormant, and the uncertainty it produces is therefore limited. In times of economic crisis, excuse becomes more relevant, causing a spike in legal uncertainty. Such a rise in legal uncertainty induces contractual parties to share losses precisely when doing so is most important from a broad macroeconomic perspective, namely when the dangers of mass bankruptcies and a downward economic spiral are imminent.

²⁰⁶ COVID-19 Memo Database, STAN. L. SCH., <https://covidmemo.law.stanford.edu> [<https://perma.cc/LE35-3LSB>] (last visited Mar. 5, 2023).

APPENDIX

A. Basic Model

Two parties meet at date 0. They write an incomplete contract for the delivery of a product from the seller to the buyer at date 2 for the price of p . The cost of production to the seller is c , and the value of the product to the buyer is v . The contract is incomplete because it does not depend on these values. Assume also that the seller has an outstanding debt to a third party, D .

Under standard expectation damages, if the buyer breaches the contract he pays the seller $p - c$ in damages. Assume that the total assets of the buyer are A_b , and the total assets of the seller are A_s . If the damages are greater than one's assets, one goes bankrupt. The fixed cost of going bankrupt are B , where B is large.

Suppose that, if a macroeconomic crisis hits at date 1, the value of performance to the buyer (v) goes down to zero. Also, the value of the buyer's assets goes down, so that $p - c > A_b$, which means that the buyer cannot pay expectation damages. Moreover, the value of the seller's assets goes down as well, so that the seller needs the payment from the buyer to pay back his debt. That is $A_s + A_b > D > A_s$.

No frustration of purpose doctrine:

With no frustration doctrine, the seller enforces expectation damages, collecting A_b in damages (since the buyer does not have enough assets to pay the full expectation damages, $p - c$), and the buyer goes bankrupt. Total social cost is B (the cost of the buyer going bankrupt).

Expected benefit to seller from bringing a lawsuit is A_b , which is the assets of the buyer that are transferred to the seller. Expected cost to buyer from the lawsuit is $A_b + B$, which is all the buyer's assets, plus the cost of going bankrupt.

Note that under any possible settlement the seller will request at least A_b and the buyer goes bankrupt, which means that there is no amount they can settle on. In other words, even though the gain to the seller from the lawsuit is smaller than the loss to the buyer from the lawsuit, there is no way for the buyer to somehow offer to share the cost of bankruptcy (B) with the seller, to avoid the lawsuit.

Frustration of purpose doctrine applied in all cases:

With frustration doctrine, the seller cannot collect anything from the buyer, so the seller goes bankrupt because he is

unable to pay his debt to the third party. Total social cost is B (the cost of the seller going bankrupt).

Uncertain application of frustration of purpose doctrine:

The seller can take the buyer to court, hoping to get A_b in damages. But there is some chance that the frustration of purpose doctrine will be applied, in which case the buyer will be exempt from any payment. Suppose there is a 50% chance the court will apply expectation damages, and a 50% the court will recognize frustration of purpose in this case.

If the seller sues the buyer for breach of contract, there's a 50% probability that he will be able to collect A_b . There's also a 50% probability that the frustration of purpose doctrine will be applied, in which case the seller collects nothing, and goes bankrupt, because he cannot pay his debt. Thus, the expected benefit *to the seller* from litigation is $0.5 * A_b - 0.5 * B = 0.5 * (A_b - B)$.

On the buyer's side, if the seller sues the buyer for breach of contract, there's a 50% probability that buyer will pay A_b and go bankrupt. There's also a 50% probability that the frustration of purpose doctrine will be applied, in which case the buyer will pay nothing. Thus, the expected cost *to the buyer* from litigation is $0.5 * (A_b + B)$.

We can now calculate total social cost under litigation, which is $0.5 * B + 0.5 * B = B$.

Settlement will be possible if the expected benefit of the lawsuit to the seller is smaller than the expected cost of the lawsuit to the buyer. In our case this condition holds, and the parties can settle on any amount between $0.5 * (A_b - B)$ to $0.5 * (A_b + B)$

Suppose the parties settle on an amount S , so that ($A_b > S > D - A_s$). With this amount the seller is able to pay his debt to the third party (because $A_s + S > D$), and the buyer does not go bankrupt (because $S < A_b$). Thus, there is no social cost to settlement, as both parties avoid bankruptcy.

The settlement amount S is within the range of settlement as long as B , the fixed cost of going bankrupt, is sufficiently larger (specifically, $B > A_b + 2(A_s - D)$), and recall that $D > A_s$). For example, if $B = A_b$, the range of settlement amounts is 0 to A_b .

This shows that the uncertain application of frustration of purpose doctrine allows for settlement and is superior to not employing the frustration of purpose doctrine, or employing the frustration of purpose doctrine in all cases.

B. Extensions

Only some buyers and some sellers go bankrupt:

Our analysis assumed that the buyer goes bankrupt if he has to pay expectation damages, and the seller goes bankrupt if he does not get paid. The analysis does not change if only some of the buyers go bankrupt if they have to pay expectation damages, and only some of the sellers go bankrupt if they do not get paid.

Specifically, suppose that only a share g_b of buyers have low assets ($p - c > A_b$) and thus go bankrupt if they have to pay expectation damages. Suppose also that only a share g_s of sellers have low assets ($D > A_s$) and thus go bankrupt if they do not get paid.

Under these assumptions, with no frustration of purpose doctrine, the seller enforces expectation damages and a share g_b of buyers go bankrupt. Social cost is $g_b B$ in such a case. If frustration of purpose doctrine is applied in all cases, sellers cannot collect anything from the buyers, so a share g_s of sellers go bankrupt because they are unable to pay their debt to third parties. Total social cost is $g_s B$ in such a case.

If, however, the frustration of purpose doctrine is applied in 50% of the cases, there's a 50% probability that the seller will be able to collect from the buyer and a 50% probability he will not. Table 1 notes in each cell the expected gain to the seller from bringing a lawsuit against the buyer and the expected loss to the buyer from such a lawsuit. This is calculated in different cases: The case where the buyer has low assets and will go bankrupt from the lawsuit (that is $A_b < p - c$), and the case where the buyer has high assets, and can pay expectation damages ($A_b > p - c$). We also look at the case where the seller has low assets and will go bankrupt if he is not paid because of his debt obligation ($D > A_s$) and the case where the seller has high assets and can pay his debt even if he is not paid by the buyer ($D < A_s$).

Table 1: Settlement Range in Different Case

		Cost to Buyer	
		Low Assets	High Assets
Gain to Seller	Low assets	$0.5*(A_b - B), 0.5*(A_b + B)$	$0.5*(p - c - B), 0.5*(p - c)$
	High Assets	$0.5*A_b, 0.5*(A_b + B)$	$0.5*(p - c), 0.5*(p - c)$

As one can see in Table 1, when the risk of bankruptcy arises—that is, as long as either the buyer or the seller has low

assets—the expected gain to the seller from bringing a lawsuit is lower than the expected loss to the buyer. This means that bankruptcy can be avoided, as there is room for a settlement that will improve both parties' position.

The analysis thus shows that, with no frustration of purpose doctrine, social cost is $g_b B$, and if frustration of purpose doctrine is applied in all cases, social cost is $g_s B$. By contrast, if frustration of purpose doctrine is applied in 50% of the cases, the parties are able to settle and avoid the costs of bankruptcy.

Different levels of uncertainty regarding the application of the doctrine:

In our main analysis we assumed that the uncertainty regarding the application of the frustration of purpose doctrine means that there is a 50% chance the court will apply expectation damages and a 50% chance the court will recognize frustration of purpose. Assume now that the probability that the court will recognize frustration of purpose is simply the parameter q .

With this assumption, the expected benefit *to the seller* from a lawsuit is $(1 - q)A_b - qB$. This is because if the seller sues the buyer for breach of contract, there's a $1 - q$ probability that the buyer will pay A_b (all of his assets) and there is a probability q that the frustration of purpose doctrine will be applied, in which case the buyer will pay nothing and the seller will go bankrupt. The expected loss *to the buyer* from the lawsuit is $(1 - q)(A_b + B)$. This is because there is a $1 - q$ probability that the buyer will pay A_b and go bankrupt, and there is a probability q that the frustration of purpose doctrine will be applied, in which case the buyer will pay nothing.

Settlement will be possible if the seller's expected gain from the lawsuit is smaller than the buyer's expected loss from the lawsuit. In our case this condition holds, and settlement will be possible for any amount between $(1 - q)A_b - qB$ and $(1 - q)A_b + (1 - q)B$.

Note, however, that the settlement amount must be smaller than the assets of the buyer (A_b), since the buyer cannot pay more than his assets. Similarly, the settlement amount cannot be negative. This means that that if the probability that court will recognize frustration of purpose, q , is very small or very large, the range of possible settlement amounts shrinks. This is captured in Figure 2.

Figure 2 shows the upper and the lower boundary of the settlement amount for different levels of q , q being the probability that the court will recognize frustration of purpose. When q is between q_L and q_H , the lower boundary is simply the

seller's expected gain from bringing a lawsuit against the buyer, and the upper boundary is buyer's expected loss from such a lawsuit. When $q > q_H$ (where q_H is defined as the q for which $(1 - q_H)A_b - q_H B = 0$), the lower boundary is zero. When $q < q_L$ (where q_L is defined as the q for which $(1 - q_L)A_b + (1 - q_L)B = A_b$), the upper boundary is A_b .

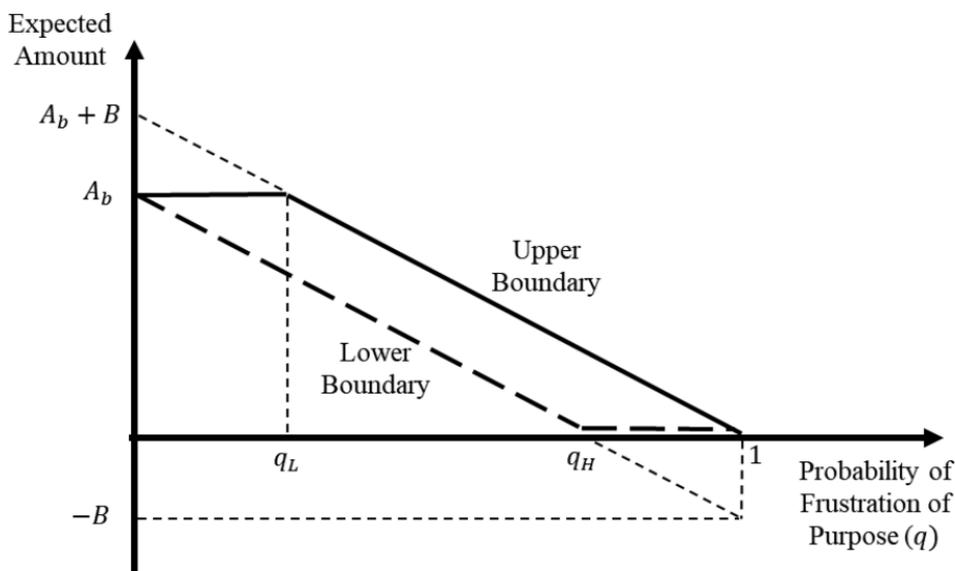


FIGURE 2: Upper and Lower Boundary for Settlement Amounts for Different Likelihoods of the Court Applying the Frustration of Purpose Doctrine

If a smaller range of settlement amounts means lower likelihood of settlement, then based on Figure 2 one can see that the likelihood of settlement is maximized when q is between q_L and q_H . In other words, to maximize the likelihood of settlement and avoid the cost of bankruptcy, the likelihood of the court applying the frustration of purpose doctrine should be neither too high nor too low, but at an intermediate level.