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The Impossibility of Simple Models of Impossibility in Contract Law

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Uri Benoliel, *The Impossibility Doctrine in Commercial Contracts: An Empirical Analysis*, __ **Brooklyn L. Rev.** __ (forthcoming), available at SSRN.

The use of theoretical economics to analyze legal rules faces a special challenge in contract law, particularly when applied to default rules rather than mandatory ones: it has to match up with what contracting parties are actually doing. One of the foundations of the economic analysis of contract law is that business parties ordinarily know what's in their own best interests, so economic prescriptions about default, gap-filling rules are also ordinarily predictions: they are statements of what parties actually wanted but didn't express or what they would have wanted if they had thought about a particular problem in advance.

Economic pronouncements about rules of contract law, therefore, are subject to a particular type of empirical verification unavailable in at least many other areas of law: we can simply look at what sophisticated business parties are doing and see if it matches up with what economists predict they will do. This is precisely what Uri Benoliel has been doing. And the result of his recent empirical study on the impossibility doctrine in contract law, *The Impossibility Doctrine in Commercial Contracts: An Empirical Analysis*, bears out Grant Gilmore's famous observation in *The Ages of American Law* that "no historian, social scientist, or legal theorist has ever succeeded in predicting anything."

The specific prediction that Professor Benoliel analyzes and helps disprove comes from Richard Posner and Andrew Rosenfield's foundational legal-economic analysis of the doctrine of unexpected circumstances (mainly impossibility and impracticability) in contract law. Posner and Rosenfield's analysis is subtle, but its core is that the law should assign the risk of unexpected events to the party best able to avoid or bear them. As an example of avoiding a risk, the seller of goods may more easily be able to take precautions to reduce the risk of fire while the goods are still in its possession; as an example of bearing a risk, the government, or a party able to purchase insurance, may be able to absorb it at lower cost than its counterparty. Posner and Rosenfield argue that the party best able to avoid or bear a risk should be made to bear it because that is what rational contracting parties do, or would do. As Posner and Rosenfield explain, if a draft of a contract assigns the risk differently, the parties can produce a new contract that is better in the aggregate, for both of them, and they can simply adjust the price accordingly so that each party is better off than under the original draft agreement.

Though this argument remains immensely influential, there are many theoretical objections to it. As Mel Eisenberg has pointed out, the rule that Posner and Rosenfield propose would probably be impossible to administer in practice. As I have argued, there is no reason to assume rational parties are focused on particular cost-reductions associated with impossibility or impracticability, and once we recognize that parties may have other considerations, the cleanliness of Posner and Rosenfield's argument falls apart and it becomes extremely difficult to make predictions about their views on impossibility or impracticability.

Either way, however, Posner and Rosenfield's argument comes down to a relatively simple prediction: rational parties will assign risks to those best able to bear them. This is what Professor Benoliel's study tests. And he finds, after reviewing a database of almost 2000 commercial contracts disclosed to the SEC, that parties do not behave in the way that Posner and Rosenfield have predicted. Commercially sophisticated parties are free to choose, explicitly, the rule that Posner and Rosenfield have identified—or to adopt a clause that roughly mirrors it. But they do not. They seem, in other words, to be happy with the traditional legal rule, with all its potential ex post fuzziness and admission of noneconomic criteria, than with the structured variant that Posner and Rosenfield have proposed. That is, the contracts in Professor Benoliel's study came from sophisticated firms that easily could have allocated the risks of impossibility as Posner and Rosenfield suggest, but in fact a majority chose not to contract around the traditional default at all—and of the minority that did, none explicitly used the superior-risk-bearer formulation, and few seemed consistent with it. The findings, as Professor Benoliel succinctly puts it, "cast significant doubt on the validity of the existing economic analysis of the impossibility doctrine."

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