Contracts and Performance: Impossibility/Impracticability

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The coronavirus and resulting increase in government regulation will continue to cause detrimental economic impact to businesses and individuals. This adverse impact on revenues and expenses will create challenges in meeting obligations under contracts. A properly drafted force majeure clause can help, but what happens if the force majeure clause is too narrow or the contract simply does not include one? Companies should know they may still have a legal basis under Oklahoma law to avoid or limit contractual obligations that have become impossible or impracticable to perform.

Impossibility and impracticability are closely related, but technically distinguishable, doctrines. Impossibility is a common law defense while impracticability is a Uniform Commercial Code defense. Oklahoma courts generally do not distinguish between impossibility and impracticability because the terms are of equal legal effect. In either case, a party's performance is excused if it has become "impossible" or "totally unreasonable or impracticable" due to an event outside of the party's control and that the party could not reasonably foresee when executing the contract.

Impossibility and Impracticability

A duty is impossible to perform if it cannot be accomplished by any means. Impracticability requires extreme and unreasonable difficulty, expense, injury, or loss. As a result, changes in market forces do not render performance impracticable unless far outside the normal range, because they are the sort of risk that commercial contracts are intended to cover. Whereas severe shortages due to exigencies such as war, embargo, local crop failure, or unforeseen shutdown of major sources of supply that cause a marked increase in cost or prevent performance may render performance impracticable. Even when performance is impossible or impracticable, parties must use reasonable efforts to surmount any obstacles to performance and must continue to perform those portions of obligations that are possible or practicable.

For example, courts in Oklahoma have held that it was impossible or impracticable: for an employer to comply with the terms of a settlement agreement requiring it to use the plaintiff as a back-up machine operator, where the company stopped using the machine and there was no need for an operator or back-up operator; for a lessor to restore a tornado-demolished hotel, where the hotel could not be reasonably reconstructed or the defendant could not obtain the necessary materials due to a state of war; and for a railroad to continue shipping grain, where the railroad ceased operations following the construction of a dam that flooded 19 miles of tracks and which would have cost $25 million in today's dollars to relocate.

In contrast, an Oklahoma court has held that it was not impossible or impracticable for a defendant to purchase natural gas at the "take-or-pay" contract price despite an extreme deviation between that price and the market value of the gas caused by governmental regulation and financial hardship, because "a more than twofold increase in the cost of performing [did] not alter the essential nature of performance."[i]

Not Reasonably Foreseeable

The event that makes performance impossible or impracticable cannot be reasonably foreseeable when the parties made the contract. An event is deemed foreseeable if the parties allocated the risk of its occurrence in the contract.

Oklahoma courts have applied these principles to hold: the parties to a settlement agreement requiring the defendant to use the plaintiff as a back-up machine operator reasonably assumed there would be a continued need for operators and back-up operators; a basic assumption of the parties' shipping agreement was that if the railroad ceased to exist, the contract would be dissolved and the railroad's non-performance would be excused; and the parties to a lease never contemplated their agreement to repair included rebuilding a leased hotel after a tornado destroyed it.

On the other hand, courts in Oklahoma have held: the parties to a swine purchasing agreement reasonably foresaw the market price could fall to one-third or one-sixth of the agreed floor price; a consultant and casino developer "had every reason to anticipate" that the developer's subsidiary could fail to obtain required financing, where the contract acknowledged the risk that pre-development opportunities may not lead to permanent opportunities; a gas-purchaser assumed the risk of an extreme disparity between the contract price and the market value of gas when it agreed to purchase gas at a fixed price subject to redetermination based on the highest price paid in a four-county area; and "[a] world-wide glut of oil, a severe national economic recession, foreign commodity competition, abnormally warm weather during 1982–1983, price-induced consumer[] energy conservation and 'a sudden, wholly unexpected, unanticipated and unforeseeable change in the natural gas market because of the world-wide glut of oil'" were exactly the type of risks that business contracts made at fixed prices are intended to cover.[ii]

Considerations

The coronavirus and related government action are clearly outside of companies' control and not something they could have reasonably foreseen. The absence of a force majeure clause may actually strengthen the argument that the risk of a pandemic was not allocated in a contract. As a result, we expect companies' ability to successfully assert these defenses will primarily turn on the extent to which performing would actually cause extreme and unreasonable difficulty, expense, injury, or loss. This is a fact-intensive inquiry and must be assessed on a case-by-case basis. Companies must use reasonable efforts to overcome any obstacles to performance and must continue to perform those portions of their obligations that are not impossible or impracticable.

Companies should also be aware of the related common law defense of frustration of purpose. Even if performance likely remains possible or practicable, companies may avoid or limit their contractual obligations if coronavirus or related government action has substantially frustrated the principal purpose of the contract. It is not enough for the contract to become less profitable or for the affected party to sustain a loss; the frustration must be so severe that it cannot fairly be regarded as within the risks assumed under the contract. For example, one court held the principal purpose of a car rental franchise agreement was not impaired by a hurricane because rental cars remained intact and the franchise conducted some business immediately following the hurricane.[iii]

Even in the absence of a force majeure clause or strong common law defense, companies can still take steps to protect themselves, such as reviewing their contract's termination clause or negotiating with the other party to amend or suspend performance.

What Should Companies Do?

As the coronavirus and governmental response continue to unfold, companies and their counterparties should expect to face increased challenges to performing their contractual obligations. Companies should be proactive and begin the process now of carefully reviewing their contracts to determine their rights and obligations as to force majeure (and termination). Even in the absence of a force majeure clause, companies should be aware they may have a legal basis under Oklahoma law to avoid or limit contractual obligations that have become impossible or impracticable to perform. Companies that intend to rely on these defenses must take all reasonable steps to meet their contractual obligations and continue to perform those portions of their obligations that are not impossible or impracticable.

For help evaluating how force majeure may apply to your contracts in light of the spread of coronavirus, please contact your GableGotwals attorney or a member of our Commercial Law team.

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[i] *Gulley v. Shinseki*, 2010 WL 3824173, at *4 (W.D. Okla. Sept. 28, 2010); *Garrett v. Mayor*, 216 P.2d 965, 967–68 (Okla. 1950); *Kan., Okla. & Gulf Ry. Co. v. Grand Lake Grain Co.*, 434 P.2d 153, 158 (Okla. 1967); *Sabine Corp. v. ONG W., Inc.*, 725 F. Supp. 1157, 1174–78 (W.D. Okla. 1989).

[ii] *Gulley*, 2010 WL 3824173, at *4; *Grand Lake Grain*, 434 P.2d at 259; *Garrett*, 216 P.2d at 967–68; *Brewer v. J-Six Farms, L.P.*, 350 P.3d 420, 425–26 (Okla. Civ. App. 2015); *Sabine*, 725 F. Supp. at 1174–78; *Kennedy & Mitchell, Inc. v. Internorth, Inc.*, 1989 WL 433016, at *15–16 (N.D. Okla. Apr. 10, 1989).

[iii] *Thrifty Rent-A-Car Sys., Inc. v. S. Fla. Trans., Inc.*, 2005 WL 8175935, at *6 (N.D. Okla. Oct. 26, 2005).