

Impracticability

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Abstract

The principle of *pacta sunt servanda* requires that agreements must be kept. However such rule is not absolute. When performance of a contractual obligation becomes impracticable, i.e., considerably more burdensome (expensive) than originally contemplated –albeit physically possible- due to an unexpected event, this would lead to adaptation of the contract to the changed circumstances or to avoidance of the contract. In the law and economics literature, impracticability has been substantially studied to figure out who should bear the risk of impracticability; and what would be the efficient remedy for such breach of contract.

Synonyms

[Change of circumstances](#); [Economic impossibility](#); [Hardship](#); [Lapse of the contract basis](#); [Wegfall der Geschäftsgrundlage](#); [Imprévision](#)

Definition

An unforeseeable change in the circumstances, arising after the formation of the contract due to an external event, which renders the performance considerably more burdensome albeit physically possible.

Introduction

In the mid-1970s, Westinghouse Electric Corporation sold nuclear reactors to electric companies and also agreed to supply uranium at a fixed price of \$8–10 per pound. However, while the company was still obliged to deliver around 70 million pounds of uranium to 27 different buyers, the market price of uranium increased to over \$30 per pound. On September 8, 1975, Westinghouse Corporation claimed that performance of its contractual obligation would result in a loss of \$2 billion and announced that it would not honor fixed price contracts to deliver uranium. Could the Westinghouse Corporation rely on such change in the circumstances and refrain from performing its contractual obligations?

The principle of *pacta sunt servanda* requires that agreements must be kept. Accordingly, non-performance of any contractual obligation constitutes breach and may cause liability of the debtor. However such rule is not absolute. For instance, in almost all legal systems, it is a well-established principle that when performance is rendered impossible by an event of *force majeure* (e.g., war,

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earthquake, hurricane, etc.), the debtor will not only be released from his obligation to perform, but this will also eliminate his/her liability to compensate the damages of the creditor. However, the issue is more controversial when performance of a contractual obligation becomes impracticable, i.e., considerably more burdensome (expensive) than originally contemplated – albeit physically possible – due to an unexpected event.

On a theoretical basis, the result of impracticability might be one of the following:

- (i) The debtor can be expected to perform despite the increase in costs of performance. Correspondingly, if the debtor fails to perform, he/she has to compensate the damages of the creditor. In such cases, the scope of the recoverable damages (reliance damages or expectation damages) of the creditor must also be determined.
- (ii) Impracticability can be regarded as an event, which excuses the debtor. In such cases, the creditor can neither ask for performance nor compensation. In return, the creditor does not perform either. However it must still be decided if impracticability excuses the debtor *ipso facto* or it grants the debtor a right to avoid the contract.
- (iii) It can be argued that impracticability does not lead to an absolute excuse or the avoidance of the contract but only to the adaptation of the terms of the contract to the changed circumstances. In other words, either the parties themselves or the court adapts the contract to the changed circumstances and reestablishes the balance between the debtor's obligation and the creditor's counter-obligation.

Impracticability in Modern Legal Doctrine

The modern legal doctrine regards impracticability as an exception to the principle of *pacta sunt servanda* provided that the performance becomes excessively difficult for the debtor due to an external event, which could not be foreseen at the time of the conclusion of the contract, and under the new circumstances the debtor cannot reasonably be expected to perform as stipulated in the contract.

It must be emphasized that the border between impossibility and impracticability is hard to draw. Despite their similarities, these two concepts have important differences as well. Since impossibility is regarded as an objective and permanent obstacle to performance, it causes expiration of the primary obligation of the debtor. This follows from the fact that the debtor cannot be expected to perform what is impossible. On the other hand, in case of impracticability the obligation is – at least theoretically – still possible, however at enormous and unexpectedly high cost. Therefore, in such cases, the primary tendency is to preserve the contract, and it is generally ruled that the contractual balance must be restored through adaptation of the obligations of the parties to the changed circumstances. However, if such adaptation is not possible, the second option is the avoidance of the contract. This would result in elimination of the obligations of both parties, including compensation liability.

When performance becomes more burdensome – albeit possible – some legal orders, for instance, the German Civil Code, distinguish between two case groups, which lead to different legal consequences. According to §275 II BGB, if there is gross disproportionality between the creditor's interest in performance and the debtor's interest in non-performance (i.e., required efforts and expenses to perform), the debtor may refuse to perform. The classical example of this case is the ring which falls into the sea. In this case, the legal consequence of impracticability is the same as that of impossibility: the debtor's obligation to perform the primary obligation extinguishes. A second

group captures those cases, in which the cost of performance rises enormously, just as in the first group, after the conclusion of the contract, but the value of the contract (performance) rises too. In such cases, which fall under §313 BGB, there is no disproportionality, but the circumstances which became the basis of the contract significantly change. For example, an art dealer buys a painting of a famous painter from a gallery which the gallery must still buy on the market. But before the purchase by the gallery, a fire in a museum destroys many paintings of the particular painter, which increases the price of the bought painting by the factor 10. Here the event which makes the performance so expensive increases proportionately the interest of the creditor in performance. In this case, the debtor's obligation to perform the primary obligation would not extinguish but the legal consequence would be adaptation of the contract by raising the price. Revocation would be the secondary option, if adaptation is not possible or one party cannot reasonably be expected to accept adaptation.

The practical difference between the scopes of these provisions is the following: when the value of the performance increases, the creditor's interest in receiving performance increases proportionally as well; hence the performance which has become burdensome for the debtor is not disproportionate to the interest of the creditor. Therefore, an objective increase in the market price of the good is separated from the cases, where the procurement of the good has become particularly costly for the specific debtor.

Economic Analysis of Impracticability

Impracticability has been substantially studied in the law and economics literature. In fact, economic considerations might play an important role in drawing the line between a bearable difficulty and "excessive difficulty" (impracticability). Moreover, economic reasoning might be useful in determining when the parties can resort to avoidance of the contract instead of adaptation to the changed circumstances.

Risk-Bearing Perspective

In the earlier stages, authors approached the issue from the economic theory of efficient risk bearing and imposed the entire results of impracticability on either of the parties (Posner and Rosenfield 1977; Joskow 1977). Within this stance, in their pioneering study, Posner and Rosenfield argue that a discharge question arises only if the contract has not assigned the risk in question (to either of the parties) and the event, giving rise to the discharge claim was not avoidable by any cost-justified precautions (of the debtor). Provided that these two conditions are met, the authors argue that the loss should be placed on the party who is the superior (the lower-cost) risk bearer. Accordingly, the superior risk bearer can be figured out by three factors: knowledge of the magnitude of the loss, knowledge of the probability that it will occur, and costs of self-insurance or market insurance. For instance, the party, who is in the position to prevent the materialization of the risk or to insure the risk at a lower cost, would be the superior risk bearer. In the end, if the debtor is found to be the superior risk bearer, he/she must perform despite the increase in the costs of performance. However should the creditor be in the position to bear the risk, the debtor would be discharged.

Efficient Remedy Perspective

Posner and Rosenfield's all-or-nothing approach, which shifted the entire risk to either of the parties, was later on questioned by some authors, who focused their studies on designing efficient remedies for breach of contract. Instead of deciding who should bear the entire risk, these authors associated

impracticability with efficiency and focused on dividing the risk between the contracting parties. Within this context, considering the efficiency of the remedy in a given case, the result of impracticability could vary between expectation damages and no remedy.

With efficiency considerations, it is generally argued that except for some very rare cases, discharge of the debtor would not yield to efficient results (White 1988; Sykes 1990). As a matter of fact, associating impracticability with discharge of a contract will negatively affect the risk bearing of the parties. Moreover the availability of discharge as a remedy will create high breach incentives on the debtor.

Even if it is accepted that impracticability should not lead to discharge of the debtor except for exceptional cases, it is argued that neither expectation damages nor reliance damages must be covered in all cases of impracticability. In fact such decision must be rendered on a case-by-case analysis. Within this stance, some authors propose to focus on the risk aversion of the parties while making a choice between the imposition of expectation damages and reliance damages (Shavell 1980; Polinsky 1983) or even between expectation damages and no damages (Sykes 1990). Others argue that the parties' expectancies at the time of the conclusion of the contract regarding the change of circumstances will be decisive on the choice between expectation and reliance damages (Eisenberg 2009).

Another group of authors argue that in cases of impracticability, the appropriate remedy would be adjustment of the contractually contemplated price (Speidel 1981; Trakman 1985; Trimarchi 1991). The main arguments of these authors is that in cases of absolute uncertainty (in systematic risks such as inflation or international crises, which affect the economy as a whole), the "superior risk bearer" criterion is inappropriate and insurance is not an adequate option (Trimarchi 1991). Moreover, it is asserted that the price adjustment of the court redresses the advantaged party's opportunistic conduct as the advantaged party has the duty to cooperate and bargain in good faith ex-post (Speidel 1981).

Another proposal is that the total surplus of the contract must be taken into consideration, when deciding on the result of impracticability (Aksoy and Schäfer 2012). Within this stance, following the increase in costs of performance, if the contract still generates positive surplus, there is no reason to avoid the contract. In this case, if the risk was very remote and both parties failed to consider the risk, the obligations of the parties can be adapted to the changed circumstances. However if the total surplus is obviously highly negative and if this is observable by a third party like the judge, the contract would be avoided. In this case, in addition to the excessive and low probability cost increase, the increase in relation to the interest of the buyer (consumer surplus) triggers avoidance of the contract.

Finally, it must be emphasized that the necessity of the excuse doctrines is disputed itself. For instance, there are some authors who question the well-recognized assumption that parties cannot allocate risks under uncertainty. According to Triantis (1992), the question is not whether a particular risk is allocated or not, but at what level it is allocated. The author argues that even if all risks are not "explicitly" allocated, they can be allocated under broader risk groups. For instance, an increase in the transportation costs due to increase in oil prices following a nuclear accident in the Middle East cannot be "explicitly" anticipated, but the parties may allocate the broader risk of a large increase in oil prices for any reason. Therefore, allocation of risks must be left to the parties and the role of the contract law should be restricted to interpretation and enforcement of the risk allocations of the parties.

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