CLIENT ALERT:
LEGAL DEFENSES TO CONTRACTUAL NONPERFORMANCE UNDER NEW YORK LAW

This Alert reviews potential legal defenses under New York law to nonperformance of contractual obligations that might occur due to the coronavirus pandemic. The doctrines of *force majeure*, impossibility, impracticability, and frustration of purpose might afford a defense to the nonperforming party. Historically, courts have narrowly construed those doctrines, and defendants have seldomly invoked them successfully. Whether the pandemic's severity and pervasiveness will result in more liberal judicial interpretations of those doctrines remains to be seen. Companies should carefully evaluate their contracts to determine whether they include *force majeure* provisions and the scope of those provisions, as well as options to mitigate the impact of nonperformance.

WHEN THE CONTRACT HAS A *FORCE MAJEURE* PROVISION

Force majeure, Latin for "superior force," is a legal doctrine that excuses nonperformance due to extraordinary circumstances beyond the control and contemplation of the parties.[1] Many contracts contain express *force majeure* provisions. Circumstances commonly enumerated in those provisions include (i) acts of God (weather disasters, fires); (ii) war, (iii) terrorism and civil disorder; (iv) acts of governmental authorities such as expropriation, condemnation, and changes in laws and regulations; (v) strikes and labor disputes; and (iv) curtailment of transportation facilities.[2] Some *force majeure* provisions include epidemics and pandemics.[3] Some include a "catch-all" provision excusing performance due to "any other emergency beyond the parties' control, making it inadvisable, illegal, or impossible to perform their obligations under this Agreement" or similar language.[4]

Force majeure is a restrictive doctrine intended "to limit damages in a case where the reasonable expectation of the parties and the performance of the contract have been frustrated by circumstances beyond the control of the parties."[5] Because the doctrine's application may deprive the promisee of the benefit of its bargain, courts typically require that the contract's *force majeure* provision expressly enumerate the extraordinary circumstances relied upon to invoke the doctrine.[6] Contractual "catch-all" language is not read expansively in *force majeure* provisions.[7]

Consistent with the narrow construction typically given to *force majeure* provisions, the party asserting *force majeure* must demonstrate not only that one of the listed events has occurred, but also that

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[1] *Kel Kim Corp. v. Cent. Markets, Inc.*, 519 N.E.2d 295, 296 (N.Y. 1987).

[2] 30 Williston on Contracts § 77:31 (4th ed.) ("Williston").

[3] As concerns about the coronavirus began to increase earlier this year, lawyers began inserting into merger and acquisition agreements express language excepting pandemics from *force majeure* provisions. *See* James B. Stewart, "The Victoria's Secret Contract that Anticipated a Pandemic," *N.Y. Times* (Apr. 29, 2020) (noting that the language is at issue in *L Brands v. SP VS Buyer*, No. 2020-0304 (Del. Ch.)).

[4] Williston § 77:31.

[5] *Constellation Energy Servs. v. New Water St. Corp.*, 46 N.Y.S.3d 25, 27 (App. Div., 1st Dep't, 2017) (*quoting United Equities Co. v. First Nat'l City Bank*, 383 N.Y.S.2d 6, 9 (App. Div., 1st Dep't, 1976), *aff'd on op. below*, 363 N.E.2d 1385 (N.Y. 1977)).

[6] *Kel Kim Corp.*, 519 N.E.2d at 296; *In re Cablevision Consumer Litig.*, 864 F. Supp. 2d 258, 264 (E.D.N.Y. 2012). *But see Duane Reade v. Stoneybrook Realty, LLC*, 882 N.Y.S.2d 8 (App. Div., 1st Dep't, 2009) (landlord's failure to deliver the premises timely due to temporary restraining order prohibiting construction on the premises for 40 days excused under *force majeure*; the *force majeure* provision did not include express language about court orders but did include "governmental prohibitions" language applied to excuse).

[7] *Team Mktg. USA Corp. v. Power Pact, LLC*, 839 N.Y.S.2d 242, 246 (App. Div., 3rd Dep't, 2007).

(i) the risk of nonperformance was unforeseeable by the parties[8] and could not have been mitigated against,[9] and (ii) the circumstance relied upon to assert the doctrine has rendered that party's performance under the contract objectively impossible.[10] A party seeking to invoke *force majeure* must satisfy each of these requirements. Failure to satisfy any one precludes the doctrine's application.[11]

Exploring these requirements against the current backdrop, the first step is to determine whether a contractual *force majeure* provision covers a pandemic. The provision might directly reference epidemics or pandemics. Or it might do so indirectly by referencing acts of governmental authorities in response to a pandemic, including changes in laws and regulations. Whether the coronavirus-related governmental orders closing non-essential businesses and mandating social distancing are "acts of governmental authorities" sufficient to support *force majeure* remains to be decided. The *force majeure* provision's catch-all language, as noted, typically is insufficient to support the doctrine's application. But given the pandemic's pervasiveness, a court conceivably could view the crisis as an "emergency beyond the parties' control," notwithstanding the narrow construction courts typically give these provisions.

Assuming the *force majeure* provision addresses the current circumstances, the next step is to determine whether, at the time of contracting, the parties could have foreseen the risk that a virus would impair one party's ability to fulfill its contractual obligations. If the risk was not foreseeable at that time, then the party seeking to invoke the doctrine must demonstrate that it took steps to mitigate that risk. That is largely a fact-intensive inquiry. Depending on the nature of the business, relevant questions could include whether the business had and made use of alternative supply lines or created and/or implemented a plan to continue operations in the event of an emergency.

As a practical matter, parties to contracts with an applicable *force majeure* provision should be mindful of the duty to mitigate, and proactively consider and take reasonable steps to assure continued operations and their continued ability to fulfill their contractual obligations. To assist in proving that they met the mitigation requirement, those parties also should maintain a record of the steps they considered, which steps they took, which steps they rejected, and why they did not take those steps.

The final element of *force majeure*, impossibility, overlaps with other common law defenses to nonperformance, and is addressed in the next section.

WHEN THE CONTRACT HAS NO *FORCE MAJEURE*, OR APPLICABLE *FORCE MAJEURE*, PROVISION

Parties seeking to excuse nonperformance under a contract that does **not** contain a *force majeure* provision (or an applicable *force majeure* provision) might try to assert the common law doctrines of impossibility, impracticability, and frustration of purpose. Those doctrines are subject to stringent requirements similar to those applicable to the *force majeure* doctrine.

Impossibility/Impracticability

A party seeking to excuse contractual nonperformance on the basis of "impossibility" must show that the impossibility was produced by an unanticipated event that could not have been foreseen or

[8] *See, e.g.*, *In re Cablevision Consumer Litig.*, 864 F. Supp. 2d at 264; *Route 6 Outparcels, LLC v. Ruby Tuesday, Inc.*, 931 N.Y.S.2d 436, 438 (App. Div., 3rd Dep't, 2011).

[9] Williston § 77:31.

[10] *Kel Kim Corp.*, 519 N.E.2d at 296.

[11] *See, e.g.*, *Macalloy Corp. v. Metallurg, Inc.*, 728 N.Y.S.2d 14, 14 (App. Div., 1st Dep't, 2001).

guarded against in the contract, in other words, that the event was unforeseeable.[12] Additionally, "[i]mpossibility excuses a party's performance only when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible."[13] An example of objective impossibility is a contract for the sale of a car and the car's destruction before delivery. It remains to be seen whether courts will hold that the inability to deliver services, occupy leased space, or deliver goods due to the pandemic or related governmental orders renders performance objectively impossible. The financial hardship of performing under the circumstances generally is insufficient to establish objective impossibility, even if the financial hardship is substantial.[14]

Under the Restatement (Second) of Contracts, a party's duty to perform may be deemed "impracticable," and thus excused, when "performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made."[15] "Impracticable" is a slightly lower standard than "impossible," as the Restatement explains:

> Although the rule stated in this Section is sometimes phrased in terms of 'impossibility,' it has long been recognized that it may operate to discharge a party's duty even though the event has not made performance absolutely impossible. This Section, therefore, uses "impracticable," the term employed by Uniform Commercial Code § 2-615(a), to describe the required extent of the impediment to performance.[16]

The Restatement describes circumstances that might be "impracticable," such as circumstances in which "extreme and unreasonable difficulty, expense, injury, or loss to one of the parties will be involved" in performance. However, "'impracticability' means more than 'impracticality,'" and "[a] mere change in the degree of difficulty or expense due to such causes as increased wages, prices of raw materials, or costs of construction, unless well beyond the normal range, does not amount to impracticability since it is this sort of risk that a fixed-price contract is intended to cover."[17]

Although impracticability appears to provide a somewhat more promising basis to excuse a party's nonperformance, the differences between the doctrines are irrelevant under New York law because New York law treats impracticability as part of the impossibility defense, not as a stand-alone defense.[18]

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[12] *Kel Kim Corp.*, 519 N.E.2d at 296.

[13] *Id.*

[14] *See Urban Archaeology Ltd. v. 207 E. 57th St. LLC*, 891 N.Y.S.2d 63, 64 (App. Div., 1st Dep't, 2009); *Gen. Elec. Co. v. Metal Resources Group, Ltd.*, 741 N.Y.S.2d 218 (App. Div., 1st Dep't, 2002); Williston § 77:31.

[15] Restatement (Second) of Contracts § 261 (2019). The section has been cited by numerous courts in decisions applying New York law. Under the Uniform Commercial Code, the defense of commercial impracticability may apply where performance "has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made." N.Y.U.C.C. § 2-615(a).

[16] Restatement (Second) of Contracts § 261, cmt. d. We found a single case in Westlaw's Second Circuit and New York decision databases in which a court, applying New York law, cited comment d. *See Edge Group WAICCS LLC v. Sapir Group LLC*, 705 F. Supp. 2d 304, 319 (S.D.N.Y. 2010) (citing the comment for the proposition that the "impracticability defense does not apply if event preventing performance is caused by obligee").

[17] *Id*.

[18] *Axginc Corp. v. Plaza Automall, Ltd.*, 759 F. App'x 26, 29 (2d Cir. 2018).

Frustration of Purpose

This doctrine applies when "a change in circumstances makes one party's performance virtually worthless to the other."[19] Under such circumstances, the principal of the contract is deemed to be "frustrated" and contractual performance is excused. "The frustrated purpose must be so completely the basis of the contract that, as both parties understood, without it, the transaction would have made little sense."[20] As with the other doctrines discussed here, the event rendering the contract valueless must be unforeseeable,[21] and a contract's purpose is not frustrated merely "because it becomes more economically difficult to perform."[22] The doctrine has traditionally been applied in three types of cases: supervening death or incapacity of a person necessary for performance; supervening destruction of a specific thing necessary for performance; and supervening prohibition or prevention by law.[23]

LESSONS FROM OTHER CATASTROPHIC EVENTS

We earlier raised the possibility that the pandemic's pervasiveness could lead to more liberal applications of *force majeure* and related doctrines. But history suggests otherwise.

Spanish Flu Pandemic

Courts generally declined to excuse a party's nonperformance in cases arising from the 1918 Spanish Flu pandemic.[24] For example, in *Phelps v. School District No. 109*, the Illinois Supreme Court held that an epidemic was not an act of God that would allow the school district to avoid paying teachers who could not teach due to school closures. The court determined that "[b]oth parties are presumed to have known when the contract was made that the state board of health had authority to order the school to be closed, if an epidemic occurred which rendered such action necessary for the protection of the lives and health of the people of the community."[25] The court further held that if the school district had wanted to avoid liability, it should have "insert[ed] in the contract of employment a provision exempting them from liability in the event of the school being closed on account of a contagious epidemic."[26]

In *Poston v. Western Union Telegraph Co.*, the South Carolina Supreme Court held Western Union liable in negligence for the delay in conveying a telegram that resulted in the plaintiff's loss of a sale. At trial, a jury had rejected the defense that "there was no negligence in the transmission and delivery of the messages, but that the delay, if there was any, was due solely to the prevalence of an epidemic of influenza, which was an act of God."[27]

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[19] *PPF Safeguard, LLC v. BCR Safeguard Holding, LLC*, 924 N.Y.S.2d 391, 394 (App. Div., 1st Dep't, 2011).

[20] *Crown IT Servs., Inc. v. Koval-Olsen*, 782 N.Y.S.2d 708, 711 (App. Div., 1st Dep't, 2004).

[21] *See, e.g.*, *Gander Mountain Co. v. Islip U-Slip LLC*, 923 F. Supp.2d 351, 360 (N.D.N.Y. 2013), *aff'd*, 561 Fed. Appx. 48 (2d Cir. 2014); *Warner v. Kaplan*, 71 A.D.3d 1, 6 (App. Div., 1st Dep't, 2009).

[22] *A + E Television Networks, LLC v. Wish Factory Inc.*, No. 15-cv-1189, 2016 WL 8136110, at *13 (S.D.N.Y. Mar. 11, 2016).

[23] Restatement (Second) of Contracts § 261 (2019).

[24] The cases discussed here were discussed in "Contract Performance During Pandemic: Lessons from 1918," *Law360* (Apr. 17, 2020).

[25] 134 N.E. 312, 313 (Ill. 1922).

[26] *Id.* at 314. *See also Crane v. School District No. 14*, 188 P. 712 (Or. 1920).

[27] 107 S.E. 516, 517-18 (S.C. 1920). The U.S. Supreme Court reversed the decision, not on the basis of the flu pandemic, but on the ground that a joint resolution authorizing the president to take possession of the defendant's telegraph line precluded the telegraph company from being liable for damages for negligent delay while its system was under government control. *W. Union Telegraph Co. v. Poston*, 256 U.S. 662 (1921).

Finally, in *Napier v. Trace Fork Mining Co.*, the Kentucky Court of Appeals rejected the plaintiff's claim that he was entitled to the higher payment provided for in the contract for timely completion of the work, notwithstanding his failure to make the deadline, because his inability to meet the deadline was due to the flu pandemic, which made it difficult to find workers. The court acknowledged that the epidemic reduced the labor supply, but held that the shortage simply rendered the task more difficult and expensive.[28]

The 2008 Financial Crisis

New York courts were not particularly sympathetic to parties who sought relief from their contractual nonperformance due to financial conditions allegedly resulting from the 2008 Great Recession. For example, in *Route 6 Outparcels, LLC v. Ruby Tuesday, Inc.*, the court rejected the defendant's argument that the economic hardship of the financial crisis prevented it from constructing a restaurant as required under a lease. The defendant's argument relied on catch-all language in the lease's *force majeure* provision that excused performance for "any other cause, *whether similar or dissimilar* to the foregoing, not within the control of the [plaintiff] and/or [defendant]."[29] The court held that the world economy was beyond the defendant's control, but "the decisions [defendant] made with respect to how to cope with the financial downturn—notwithstanding that its options may have been limited—remained within defendant's power and control. Defendant made a calculated choice to allocate funds to the payment of its debts rather than to perform under the subject lease."[30]

CONCLUSION

Courts historically have construed *force majeure* and similar doctrines narrowly, and the application of the doctrines to excuse performance has been more the exception than the rule. Yet the coronavirus's severity and pervasiveness, and resulting economic upheaval, is unlike anything most Americans, including American judges, have ever seen. As courts begin to address breach of contract cases arising from the coronavirus pandemic, some judges might consider the doctrines' restrictive precedents more skeptically, particularly in jurisdictions heavily impacted by the virus, such as New York.

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[28] 235 S.W. 766, 766-67 (Ky. 1921).

[29] 931 N.Y.S.2d 436, 438 (App. Div., 3rd Dep't, 2011).

[30] *Id*. *See also Urban Archaeology*, at n.14, above.