HERBERT SMITH FREEHILLS

COVID-19: PRESSURE POINTS: CONTRACTUAL IMPLICATIONS AND CONSIDERATIONS UNDER NEW YORK LAW (UNITED STATES)

02 April 2020 | United States
Legal Briefings – By **Christian Leathley, Amal Bouchenaki and Ben Rubinstein**

As the COVID-19 outbreak keeps impacting contractual performance, an increasing number of counterparties are seeking ways to avoid contractual liability for non-performance.

Parties with contracts governed by New York law should consider a number of issues before attempting to excuse performance through force majeure clauses, as well as other statutory and common law defenses such as impossibility, impracticability and frustration of purpose.

At the outset, it is important to seek legal advice before taking any steps to enforce force majeure provisions and avoiding contractual performance, as several considerations should be kept in mind:

- **First**: it is necessary to assess whether the COVID-19 outbreak and its implications are encompassed by the force majeure clause contained in your contract. The language of the contract is of fundamental importance, since the construction of force majeure clauses will largely depend on the wording of the clause, and in particular whether it lists the relevant force majeure event. If the contract does not contain a force majeure

clause, or if the event is not included in the force majeure clause, advice should be sought to ascertain whether other statutory or common law defenses are available.

- **Second**: it is important to provide timely notice, if required by your contract. Contracts containing force majeure clauses typically contain provisions requiring notification of a force majeure event. Failure to provide notice in the form and pursuant to the process set out in the contract may result in waiver by the non-performing party. Complying with the form and process provided by the contract for sending a force majeure notice is also important to prevent any claim that the party notifying the force majeure event has anticipatorily breached or repudiated the contract.

- **Third**: courts assessing whether to enforce force majeure clauses usually require the party invoking force majeure to prove that it made reasonable efforts to perform under the contract. While specific contractual terms may govern the level of attempted performance required, New York courts usually require a showing that performance was prevented by the force majeure event. It is therefore important make sure that efforts at compliance are documented properly.

FORCE MAJEURE CLAUSES

A typical force majeure clause provides that a party is excused from performing under the contract due to the occurrence of an event beyond the reasonable control of the parties. Force majeure clauses often include a list of force majeure events, either by way of example or as an exhaustive list. The list of force majeure events may also include "catch-all" language intended to capture events not specifically listed in the force majeure clause.

New York courts interpret force majeure clauses narrowly, and excuse a party's performance only if the force majeure clause specifically includes the event that is actually preventing the party's performance.[1] New York courts consider that when the parties have defined in their contract the contours of force majeure, those contours should dictate the application, effect, and scope of force majeure clauses.[2]

Every contract must be interpreted according to its own terms based on the particular facts of the situation. However there are several categories of events that are typically included in force majeure clauses that could potentially apply here.

For example, many contracts define a force majeure event to include government intervention that makes performance impossible.[3] Governments are now issuing "stay at home" orders, ordering the closure of "non-essential" businesses, and banning gatherings in excess of a certain number of people, any of which could potentially make contract performance impossible depending on the business and contract at issue.

"Acts of God" are also a potentially applicable category. New York courts have insulated a party from liability pursuant to such clauses where there was no contributing human negligence.[4]

Finally, force majeure clauses that include “catch-all” language could potentially be applicable. Those clauses are construed narrowly.[5] In particular, New York courts have found that catch-all clauses with wording such as “conditions beyond control” should be applied only to unforeseeable extraordinary causes.[6] What is unforeseeable is also strictly construed.

Importantly, even where a court finds that the event is included in the force majeure clause, the non-performing party must demonstrate its efforts to perform its contractual duties despite the occurrence of the force majeure event.[7] Mere impracticability or unanticipated difficulty is not enough to excuse performance.[8] New York courts do not excuse performance based only on financial difficulty or economic hardship,[9] and have held that economic factors cannot excuse non-performance.[10] Thus, generalized effects of COVID-19 that merely make performance of a contract uneconomical – as opposed to impossible – may not be sufficient to invoke a force majeure defense. Put simply, despite the unprecedented nature of events, it does not automatically equate to a force majeure clause becoming operational.

Furthermore, parties should also take into account the fact that New York courts do not appear to have decided cases related to whether epidemics or pandemics like COVID-19 are valid force majeure events.[11] In light of this, early legal advice is especially important, as the COVID-19 outbreak and its implications are likely to present issues of first impression in New York courts.

RELATED DEFENSES: IMPOSSIBILITY, IMPRACTICABILITY, FRUSTRATION OF PURPOSE

As set out above, if a contract is silent on force majeure, whether a New York court will excuse a party’s non-performance largely depends on whether the event (the COVID-19 pandemic and its consequences) is unforeseeable under applicable statutory or common law. As with force majeure clauses, a detailed assessment of the circumstances is necessary in order to ascertain whether a party’s performance may be excused under any of these defenses as a result of not only the COVID-19 outbreak, but its implications.

IMPOSSIBILITY

Impossibility excuses the performance of a party only when the contractual performance has become objectively impossible as a result of a supervening event beyond the control of the parties that causes the destruction of either (i) the subject matter of the contract, or (ii) the means of performance.

New York courts apply impossibility narrowly and excuse performance in extreme circumstances. In particular, impossibility must be the result of an unanticipated event that a party could not have foreseen at the time of the contract.[12] For example, the Supreme Court of New York has found that although unanticipated, a snowstorm was not an unforeseeable event, also in light of the fact that the contract scheduled the shipment in the middle of winter.[13] Furthermore, New York courts exclude impossibility only based on financial difficulty or economic hardship (including when this results in bankruptcy or insolvency).[14]

IMPRACTICABILITY UNDER THE UCC

Article 2 of the New York Uniform Commercial Code ("UCC"), which applies to transactions in goods, recognizes impracticability based on commercial reasons.

Section § 2-615(a) of the UCC provides that a seller is excused from a delay in delivery or non-delivery of goods (in whole or in part) where the seller's performance has become impracticable because of either (i) unforeseen circumstances not within the contemplation of the parties at the time of contracting; or (ii) compliance in good faith with an applicable foreign or domestic governmental regulation or order (whether or not it later proves to be invalid).[15] Therefore, a party can be excused from the performance of a contract under the UCC even if the object or means have not been destroyed.

New York courts will therefore look at whether the event is foreseeable to determine how to allocate the risk of events not contemplated by the parties when they entered into the contract. In particular, courts consider that parties can independently allocate the risk of foreseeable events by adjusting the monetary terms of the contract and do not generally excuse party performance. Therefore, New York courts tend to excuse the impacted party's performance if the event was unforeseeable at the time the parties entered into the contract.[16]

FRUSTRATION OF PURPOSE

Frustration of purpose occurs where the performance of a contract is still possible, but no longer provides a party with the benefits that induced them to make the bargain as a result of intervening unforeseeable events.[17] Therefore, as a result of the intervening unforeseeable events, the purpose for entering the contract was frustrated and it makes little or no sense to continue performing the contract.

New York courts recognize frustration of purpose based on financial difficulties or economic hardship, as long as the unforeseeable event renders the contract wholly valueless to one party. In particular, New York courts have found that frustration of purpose excuses performance when a virtually cataclysmic, wholly unforeseeable event renders the contract valueless to one party.[18]

---

1. *Kel Kim Corp. v. Cent. Markets*, Inc., 70 N.Y.2d 900, 902–03, 519 N.E.2d 295 (1987).

2. *Constellation Energy Servs. of New York, Inc. v. New Water St. Corp.*, 146 A.D.3d 557, 558, 46 N.Y.S.3d 25, 27 (N.Y. App. Div. 2017).

3. *See, e.g., NFL Enterprises v. Echostar Satellite, L.L.C.*, Index. No. 600556/05, 2008 N.Y. Misc. LEXIS 8752, *11 (N.Y. Sup. May 13. 2008).

4. *British W. Indies Produce Inc. v. S/S Atl. Clipper*, 353 F. Supp. 548, 553 (S.D.N.Y. 1973).

5. *Kel Kim Corp. v. Cent. Markets,* Inc., 70 N.Y.2d 900, 903, 519 N.E.2d 295 (1987).

6. *Vernon Lumber Corp. v. Harcen Const*. Co., 60 F. Supp. 555, 558 (E.D.N.Y. 1945).

7. *Phillips Puerto Rico Core, Inc. v. Tradax Petroleum Ltd*., 782 F.2d 314, 319 (2d Cir. 1985).

8. *Phibro Energy, Inc. v. Empresa De Polimeros De Sines Sarl*, 720 F. Supp. 312, 318 (S.D.N.Y. 1989).

9. *Rochester Gas & Elec. Corp. v. Delta Star, Inc.*, No. 06-CV-6155-CJS-MWP, 2009 WL 368508, at *7 (W.D.N.Y. Feb. 13, 2009).

10. *Macalloy Corp. v. Metallurg, Inc.*, 284 A.D.2d 227, 227, 728 N.Y.S.2d 14, 14–15 (2001).

11. However, the United States District Court for the Southern District of Indiana held, in relation to an agreement to supply eggs, that the avian flu epidemic would have constituted a valid unforeseeable event causing a change in market conditions ("Unlike the avian flu example, which may plausibly constitute an unforeseeable event precipitating a dramatic change in market conditions, a change in purchaser demand—even a substantial change—is a foreseeable part of doing business.") *Rexing Quality Eggs v. Rembrandt Enterprises,* Inc., 360 F. Supp. 3d 817, 841 (S.D. Ind. 2018).

12. *Kel Kim Corp. v. Cent. Markets, Inc*., 70 N.Y.2d 900, 902, 519 N.E.2d 295 (1987).

13. *Ahlstrom Mach. Inc. v. Associated Airfreight Inc*., 251 A.D.2d 852, 854, 675 N.Y.S.2d 161, 162 (1998).

14. *Gander Mountain Co. v. Islip U-Slip LLC,* 923 F. Supp. 2d 351, 359 (N.D.N.Y. 2013), aff'd, 561 F. App'x 48 (2d Cir. 2014).

15. NY UCC § 2-615(a).

16. *Cliffstar Corp. v. Riverbend Prod.*, Inc., 750 F. Supp. 81, 84 (W.D.N.Y. 1990).

17. *Profile Publ'g & Mgmt. Corp. APS v. Musicmaker.com.,* Inc., 242 F. Supp. 2d 363, 365 (S.D.N.Y. 2003).

18. *United States v. Gen. Douglas MacArthur Senior Vill., Inc.,* 508 F.2d 377, 381 (2d Cir. 1974).

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

CHRISTIAN LEATHLEY
PARTNER, NEW YORK

+1 917 542 7812
Christian.Leathley@hsf.com

AMAL BOUCHENAKI
PARTNER, NEW YORK

+1 917 542 7830
amal.bouchenaki@hsf.com

BENJAMIN RUBINSTEIN
PARTNER, NEW YORK

+1 917 542 7818
Benjamin.Rubinstein@hsf.com

LEGAL NOTICE