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Will COVID-19 Excuse Contractual Performance?

In recent days, companies across a wide range of industries have begun to alter their business practices and contractual arrangements in response to the outbreak of COVID-19. Among the questions that have arisen is whether, and under what conditions, the COVID-19 outbreak will excuse the nonperformance of a contract. We review certain key considerations below:

Preliminarily, businesses should review their relevant contracts to determine if they contain a *force majeure* clause. In the absence of a *force majeure* clause, two common law doctrines are potentially applicable: the doctrine of impossibility and the doctrine of frustration of purpose. Under New York law, the doctrine of impossibility provides only a limited path to relief and has been narrowly applied by the courts "due in part to judicial recognition that the purpose of contract law is to allocate the risks that might affect performance and that performance should be excused only in extreme circumstances." *Kel Kim Corp. v Central Mkts.*, 70 N.Y.2d 900, 902 (1987). Under the doctrine of impossibility, a party's performance will be excused "only when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible." *Id.* "Moreover, the impossibility of performance must be produced by an unanticipated event that could not have been foreseen or guarded against in the contract." *Id.* "Thus, where impossibility or difficulty of performance is occasioned only by financial difficulty or economic hardship, even to the extent of insolvency or bankruptcy, performance of a contract is not excused." *407 East 61st Garage, Inc. v. Savoy Fifth Ave. Corp.*, 23 N.Y.2d 275, 281-282 (1968).

The frustration of purpose doctrine excuses non-performance when a change in circumstances is such that one party's performance would no longer give the other party what induced him to make the bargain in the first place. *Bierer v. Glaze, Inc.*, 2006 U.S. Dist. LEXIS 73042, *21-22 (E.D.N.Y. Oct. 6, 2006); *U.S. v. General Douglas MacArthur Senior Village, Inc.*, 508 F.2d 377, 381 (2d Cir. 1974). Like the doctrine of impossibility, the doctrine of frustration of purpose is a narrow one. Its application is "limited to instances where a virtually cataclysmic, wholly unforeseeable event renders the contract valueless to one party." *Id.* In order to successfully invoke the doctrine of frustration of purpose, a party must show that the purpose that is frustrated is the principal purpose of that party in making the contract. "The object must be so completely the basis of the contract that, as both parties understand, without it the transaction would make little sense." Restatement (Second) of Contracts § 265 (comment).

With respect to contracts that include *force majeure* provisions, the general rule under New York law is that "only if the *force majeure* clause specifically includes the event that actually prevents a party's performance will that party be excused." *Id*. As one New York court recently explained, *force majeure* clauses are designed to limit damages "where the reasonable expectation of the parties and the performance of the contract have been frustrated by circumstances beyond the control of the parties." *Constellation Energy Servs. of N.Y. v. New Water St.*, 146 A.D.3d 557, 558 (1st Dept. 2017). The court further explained that when the parties have themselves defined the contours of *force majeure* in their agreement, those contours dictate the application, effect, and scope of *force majeure*." *Id*.

Accordingly, businesses will need to look to the specific language of the contract to assess whether nonperformance is excused. Some contracts may include "epidemic" as a specific example of a *force majeure* event. See, *e.g., Touche Ross & Co. Manufacturers Hanover Trust Co.*, 107 Misc. 2d 438, 441 (Sup. Ct. N.Y. County 1980) (quoting contract that defines *force majeure* as including "flood, epidemics, earthquake, [and] war"). Other contracts may not specifically list epidemic

as a *force majeure* event, but may include a catch-all provision. If the coronavirus pandemic is sufficiently similar to the events listed in the *force majeure* clause, then—under the rule of contract construction known as *ejusdem generis*—the coronavirus pandemic may be considered a *force majeure* event. See *Kel Kim Corp.*, 70 N.Y.2d at 903.

If the contract does not contain a *force majeure* provision, then nonperformance may be excused only under the limited circumstances permitted by the doctrines of impossibility or frustration of purpose. If the contract does contain a *force majeure* provision, then the language of the contract will govern. Businesses should review their relevant contracts to determine if they contain a *force majeure* provision, and, if they do, further review the scope of the language used in the provision.

If you have any questions about this Information Memo, please contact John D. Clopper, Brian J. Butler, any of the attorneys in our Litigation Practice, or the attorney in the firm with whom you are regularly in contact.

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