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What COVID-19 Means for Your Contracts

As the world enters into uncharted territory with nation-wide lockdowns and most commercial activity delayed indefinitely, questions arise as to how existing contracts will be affected. Here is what to look for in your contracts and the options for potential relief in New York State.

1) Review the terms of your contract: Unless your agreement contains an ‘act of god’ or ‘force majeure’ clause releasing a party from performance specifically due to an epidemic or pandemic, all parties can expect the contract to remain in effect. This is because courts have generally ruled that “a force majeure clause must include the specific event that is claimed to have prevented performance.”¹

Alternatively, some ‘act of god’ clauses include *government ‘action’ or ‘intervention’* or other similar broader term as an applicable event triggering the clause. Whether New York State’s “Pause” Executive Order excuses nonperformance under a broader catch-all term will depend on the other types of events enumerated in your contract’s ‘act of god’ or ‘force majeure’ clause.² For example, a clause may include specific examples of events (floods, earthquakes, tsunamis, fires) such that ‘government action’ will likely be interpreted as actions in connection with those types of natural disasters.³

Finally, a court is more likely to excuse performance if the event forces or prohibits certain actions as opposed to making them more impractical or costly to perform.⁴ Looking at judicial decisions in the aftermath of the 2008 financial crisis, while some courts found that ‘force majeure’ was properly invoked due to financial hardship⁵ others did not.⁶ Thus, the applicability of these clauses has to be analyzed in the context of each individual agreement.

If you think your ‘act or god’ or ‘force majeure’ clause may apply to your particular situation, make sure to meet any requirements to notify your counterpart included in the terms of your agreement in order to properly trigger the clause.

2) Determine if there are other grounds to excuse nonperformance: There may still be a basis to relieve a party from its contractual duties under two legal doctrines: impossibility and frustration of purpose. Under both doctrines, the first question to ask is: was the event unforeseeable such that the parties could not have anticipated it when drafting the agreement? While a government mandated lockdown due to a global pandemic may seem like an obvious unforeseeable event, there is little legal precedent to know how the courts will address this with certainty.⁷ We assume for purposes of our present discussion that the unforeseeability threshold is met.

The doctrine of *impossibility* will apply “only when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible.”⁸ So the question to ask under this doctrine will be: is performance impossible or just impractical? To prove impossibility courts will want to see that the party seeking relief took every possible action within its power to perform its duties under the contract.⁹

For the doctrine of *frustration of purpose* to apply, the unforeseen event must essentially “destroy[] the underlying reasons for performing the contract, even though performance is possible.”¹⁰ However, and similar to the application of an ‘act of god’ clause, if performance is merely more difficult due to financial hardship, *frustration of purpose* will not excuse nonperformance.¹¹ The question to ask here will be: is there a mere loss of profits or is there no point to the contract anymore? The events must be “virtually cataclysmic” and “wholly

unforeseeable” and must “render[] the contract valueless to one party.”¹²

Finally, your counterpart may be the one unable to perform their side of the bargain. In such situations, you may have the recourse to *rescind* the contract, which would require obtaining a declaratory judgment by a court to that effect.¹³

3) Reach out to your counterpart to negotiate a non-judicial solution: With the New York State court system only entertaining emergency applications indefinitely and the federal courts operating on a limited basis, your best course of action for the moment may be to negotiate new terms to your agreement. Most businesses are willing to work out deferred payments, extended deadlines, modified requirements, etc., in order to accommodate struggling companies. Consult with your counsel to either open negotiations or review any amended agreements to make sure the new terms can be met realistically and to protect your business from additional liability in the face of these uncertain times.

¹ Beardslee v. Inflection Energy, LLC, 904 F. Supp. 2d 213, 220 (N.D.N.Y. 2012), *aff'd*, 798 F.3d 90 (2d Cir. 2015).

² Team Mktg. USA Corp. v. Power Pact, LLC, 839 N.Y.S.2d 242, 246 (N.Y. App. Div. 2007); Kel Kim Corp. v. Central Markets, 70 N.Y. 2d 900, 902-03 (N.Y. Ct. App. 1987).

³ Id.

⁴ Macalloy Corp. v. Metallurg., Inc., 728 N.Y.S.2d 14, 14-15 (N.Y. App. Div. 2001).

⁵ In re Old Carco LLC, 452 B.R. 100, 119 (S.D.N.Y.2011).

⁶ Route 6 Outparcels, LLC v. Ruby Tuesday, Inc., 27 Misc.3d 1222(A), No. 2413–09, 2010 WL 1945738, *3–4 (N.Y.Sup.Ct. May 12, 2010).

⁷ Some analogous cases dealing with regulatory changes, which could constitute ‘government action’ for example, have not been ruled as unforeseeable events. Pleasant Hill Developers, Inc. v. Foxwood Enter., LLC, 885 N.Y.S. 2d 531, 534, (N.Y. App. Div. 2009); Rooney v. Slomowitz, 784 N.Y.S.2d 189, 193 (N.Y. App. Div. 2004).

⁸ Kel Kim Corp. v. Cent. Markets, Inc., 519 N.E.2d 295, 296 (1987).

⁹ Kama Ripa Music, Inc. v. Schekeryk, 510 F.2d 837, 842 (2d. Cir. 1975).

¹⁰ Sage Realty Corp. v. Jugobanka, D.D., No. 95-0323, 1997 WL 370786, at *1–2 (S.D.N.Y. July 2, 1997).

¹¹ Bank of New York v. Tri Polyta Finance B.V., No. 01-9104, 2003 WL 1960587 at *4 (S.D.N.Y. Apr. 25, 2003).

¹² U.S. v. Gen. Douglas MacArthur Senior Vill., 508 F.2d 377, 381 (2d Cir. 1974).

¹³ Babylon Associates v. Suffolk Cty., 475 N.Y.S.2d 869, 874 (N.Y. Div. App. 1984)) (party seeking rescission “must allege fraud in the inducement of the contract; failure of consideration; an inability to perform the contract after it is made; or a breach of the contract which substantially defeats the purpose thereof”).

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