

# ALERT

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## CORONAVIRUS – CONTRACT ENFORCEABILITY

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With the recent coronavirus crisis, and the devastating economic implications resulting from the “shelter in place” polices imposed by various states, many companies are re-evaluating their contractual obligations. Specifically, companies are trying to determine which contracts need to be terminated or modified, because they are either impossible to perform or subject the contracting parties to unreasonable and unforeseeable costs. Accordingly, *force majeure* (a phrase not generally used in the ordinary course) has emerged in the daily corporate lexicon to address contract enforceability because of the coronavirus, health risks, and the government forced shut down of businesses. The purpose of this article is to provide information concerning the enforceability of commercial contracts, based upon the legal doctrines of *force majeure*, frustration of purpose, and impracticability, resulting from restrictions imposed as a result of the coronavirus.

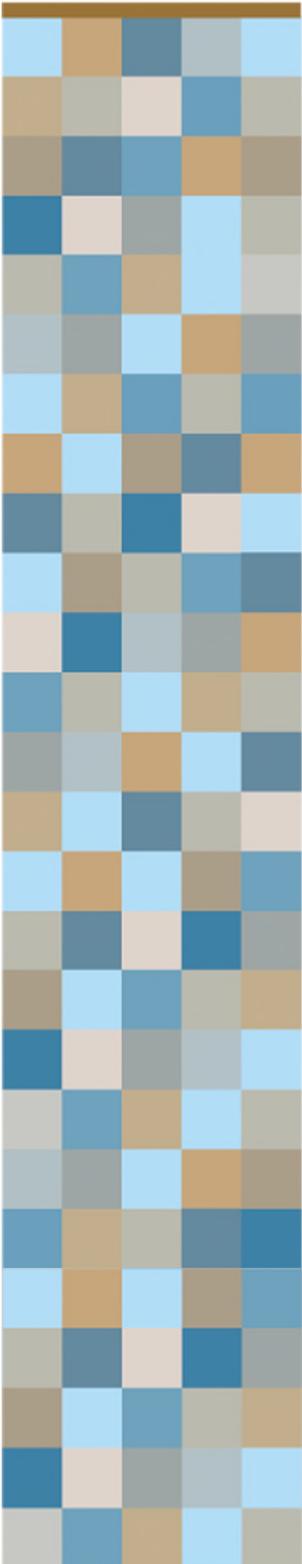
### Force Majeure

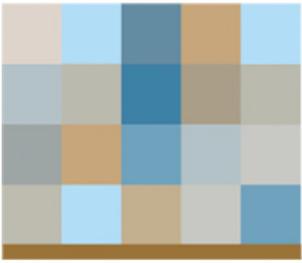
The first thing a party should do to determine whether a contract remains enforceable during the coronavirus is to review the subject contract to see if there is a *force majeure* provision. This type of provision allows a party to suspend or terminate performance of their obligations when certain circumstances beyond their control arise, making performance inadvisable, commercially impracticable, illegal, or impossible. Courts generally interpret *force majeure* clauses narrowly and only if the provision specifically includes the event that actually prevents a party from complying with their contractual obligations, such as “pandemic,” “Act of God,” or “government act.”

A party seeking to invoke this provision must demonstrate not only that the unforeseeable event was specifically enumerated in the contract and in fact occurred, but as a result it is no longer possible for that party to perform their obligations under the contract. By contrast, if the unforeseeable event simply decreases the profitability of a contract, then it is less likely that a court will excuse that contract.

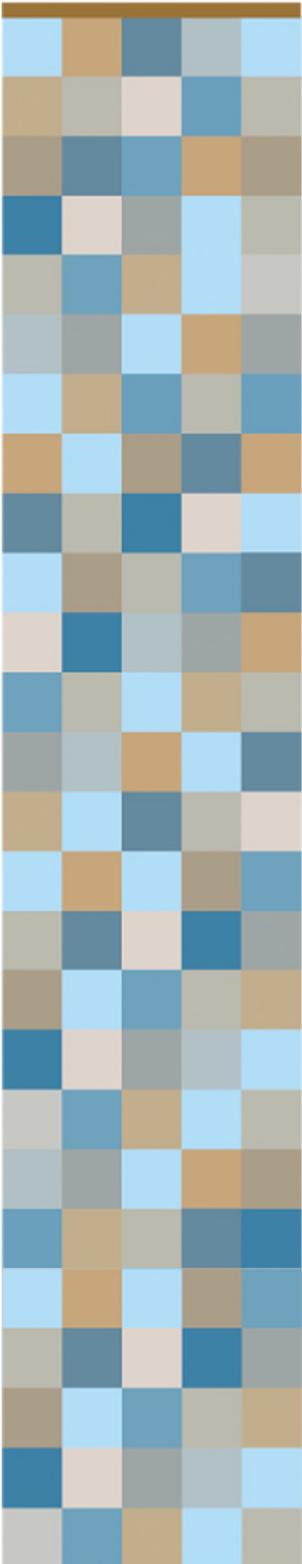
### Key Takeaway

If your contract contains a *force majeure* provision (which includes a pandemic, epidemic, disease, Act of God, or government act, as an event) and, as a result, you are unable to perform your obligations under the contract, then you may be able to terminate or modify it.





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## **Frustration of Purpose**

In the absence of an express *force majeure* provision, a contract can still be avoided because the purpose of the contract has been frustrated. To prevail on this contract defense, the party seeking to avoid their contractual obligations will need to show that both parties to the contract understood at the time they entered into it, that without the purpose of the contract, the transaction would have made little sense. The doctrine applies when a change in circumstances makes one party's performance virtually worthless to the other, frustrating the purpose of entering into the contract.

The frustration of purpose doctrine is narrowly construed and will not apply unless the frustration is substantial and unforeseeable. Moreover, New York courts will not excuse performance if economic hardship is the sole basis for asserting the frustration of purpose defense.

## **Impracticability**

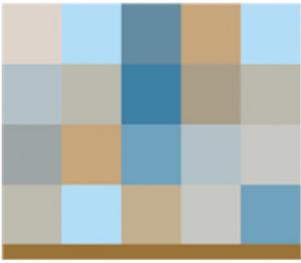
If it is still theoretically possible to perform a contract, but nevertheless the costs necessary to complete it render the contract woefully uneconomical, the doctrine of impracticability may be available to a party to avoid their contract. Contract cancellation has been upheld or approved by courts because they are impracticable due to the 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. The elements necessary to sustain an impracticability defense are: (1) the non-occurrence of the supervening event must have been a basic assumption on which both parties made the contract; (2) it must render performance impracticable; and (3) the party must make reasonable efforts to overcome the obstacle preventing performance.

Change in economic conditions and market instability, by themselves, will not permit a party to avoid their contractual obligations. Nor is the issuance of governmental regulations which render a transaction uneconomical likely to excuse performance. Instead, the party seeking to avoid a contractual obligation because it is no longer practicable to adhere to the contract must show that their performance is beyond the realm of possibility due to assumptions made by the contracting parties at the time the contract was executed.

## **Key Takeaway**

If your contract does not contain a *force majeure* provision, you may still be able to terminate or modify your contract if:

- the purpose of the contract is frustrated (*i.e.*, the transaction would not have made any sense to both parties at the time it was entered into); or
- it is impracticable to perform because after the contract was entered into a person necessary to perform the contract passed away or became incapacitated, a specific thing necessary for performance of the contract was destroyed, or a law was imposed preventing the contract from being completed.



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## Conclusion

Generally speaking, courts in New York infrequently permit a party to avoid their contractual obligations because of unforeseen events, such as the coronavirus, unless the parties bargain for a *force majeure* clause specifically enumerating the event that would give rise to non-performance. If, in the event, the subject contract does not contain a *force majeure* provision, parties seeking to avoid their contract because of the recent coronavirus crises are going to have to rely on other legal defenses, such as frustration and impracticability. While courts generally do not invalidate contracts based upon these legal bases, they may change their aversion to these defenses given the magnitude of the economic impact of the current coronavirus crisis. In addition, this may be an opportunity to negotiate a favorable resolution while the law remains uncertain and the costs of litigation outweigh the benefit of a quick negotiated settlement. Any negotiation should be preceded by a thorough legal analysis of the contract.

Moritt Hock & Hamroff remains available during this unprecedented time to assist you and your business with your legal needs.



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