Coronavirus: Contract Enforceability

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As companies continue to grapple with the economic implications of COVID-19, many of them are re-evaluating their contractual obligations. Specifically, companies are trying to determine which contracts need to be modified or terminated, because they are either impossible to perform or subject contracting parties to unreasonable and unforeseeable costs. The purpose of this article is to provide guidance to companies and their counsel concerning the enforceability of commercial contracts, based upon the legal doctrines of force majeure, frustration of purpose, and impracticability, resulting from significantly altered economic contractual assumptions 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. Force majeure 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 performing their contractual obligations. This includes terms such as "pandemic", "Act of God", or "government act". Parties 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 contractual obligations. By contrast, if the unforeseeable event simply decreases the profitability of a contract, then it is less likely a court will excuse that contract.

Thus, if a force majeure clause mentions a pandemic, epidemic, disease, Act of God, or government act, and as a result you are unable to perform your contractual obligations, then you may be able to terminate or modify the contract.

Frustration of purpose

In the absence of an express force majeure provision, a contract can still be avoided if the purpose of the contract has been frustrated. To prevail on this contract defence, 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.

Impracticability

If it is still theoretically possible to perform a contract, but 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 under impracticability 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 for an impracticability defence 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

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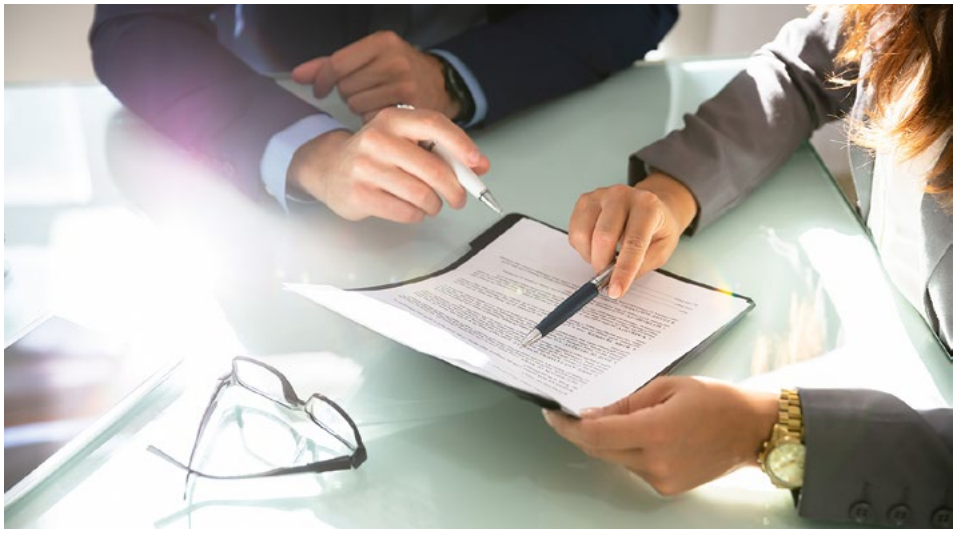
uneconomical likely to excuse performance. Instead, the party seeking to avoid a contractual obligation because it is no longer practicable to adhere to the contract must show that their performance is beyond the realm of possibility due to assumptions made by the contracting parties at the time the contract was executed.

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 defences, such as frustration and impracticability. While courts generally do not invalidate contracts based upon these legal bases, they may change their aversion to these defences given the magnitude of the economic impact of the current coronavirus crisis. In addition, this may be an opportunity to negotiate a favourable 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.



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