

COVID-19 IMPACT ON CONTRACTUAL OBLIGATIONS

As the impacts of the spread of COVID-19 continue to influence dramatic changes in federal, state, and local efforts, businesses face increasing uncertainty and difficulty in managing their contractual responsibilities and expectations. In general, the virus's impact on contractual obligations will be fact-driven and a reading of the specific terms of individual contracts will be necessary. Keep in mind that the terms of each contract will typically dictate the applicable law, and contract law varies from state to state.

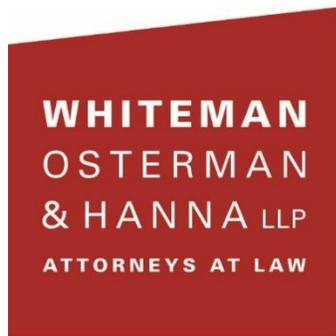
Terms

To determine the potential impact of the COVID-19 pandemic on a contract, the first step should always be to review the language of the contract itself. The contract may allow for termination without cause. There may, however, be subsequent conditions or obligations in the event of such termination, and many contracts require notice within a certain timeframe in order to terminate without cause. These provisions may make such termination unhelpful or unfeasible. It is also important to look for provisions that indicate the scope of damages that may be imposed in the event of breach and/or nonperformance. A breach may be economically effective and any clauses limiting damages will be helpful in that analysis.

Force Majeure

Force majeure clauses can relieve a party of penalties for breach where circumstances outside of the party's control made performance impossible. Typically, these clauses list specific events, such as war, natural disasters, terrorism, riots, etc. If your contract contains a force majeure clause, the scope of that clause depends on its specific language.

Principles will vary from state to state, but generally any such provision will be analyzed narrowly under its specific terms. In New York, for example, force majeure clauses are a narrow defense to nonperformance, and courts will generally only excuse performance if the clause specifically lists the event that prevents performance. It is unlikely that COVID-19 is explicitly included in any currently in-place force majeure clauses, but it may still be covered by the events listed. For example, if your contract lists "disease" or "epidemic," COVID-19 could fall in. If your contract lists "government action" or something similar, it may also cover COVID-19 related government orders and/or regulations.



Some force majeure clauses contain catchall phrases such as “or other similar causes.” However, courts in New York limit the scope of those provisions to include only events of the same kind or nature as the events specifically listed. It is possible that COVID-19 could fit into a clause that lists other worldwide disasters, but courts generally will not give these catchall provisions expansive scope. If your contract does not contain a force majeure clause, common law principles such as impossibility or frustration of purpose may still apply.

Impossibility

Standards vary from state to state but performance of obligations under a contract may be excused if intervening events make performance impossible. Generally, however, this is a difficult doctrine to invoke. In New York, the doctrine excuses performance where an unexpected event destroys the subject matter of the contract, making performance objectively impossible, and the event could not have been guarded against or foreseen in the contract. Although the standard will vary from state to state, the circumstances must be extreme, and general economic hardship will not be enough. It is possible that circumstances due to COVID-19 could excuse performance under the impossibility doctrine. For example, unforeseeable intervening government activities may excuse performance. This doctrine is narrowly construed and difficult to invoke, however, and just because performance has been made challenging or more expensive due to an event such as a new law or other governmental action does not mean that performance is excused.

Frustration of Purpose

Performance of obligations under a contract may also be excused under the doctrine of frustration of purpose. Again, standards for the doctrine will vary from state to state, but the concept here is that performance is excused if an unforeseen event has caused the principal purpose of the contract to be so frustrated that performance of one party becomes useless to the other. The purpose must be the basis of the contract — so much so that as it was originally understood by both parties, the transaction would have made little to no sense without it. Frustration of purpose is also very difficult to invoke and is narrowly applied.

Whiteman Osterman & Hanna can assist with these issues and more, as you and your business work to navigate the novel and difficult decisions arising from the COVID-19 pandemic. For additional assistance with contract issues, please contact:

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