BEYOND FORCE MAJEURE: EXCUSING PERFORMANCE UNDER NEW YORK LAW DURING COVID-19

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Lenders, shipowners, operators and many others are experiencing the impact of COVID-19 and related acts of government. Today's extraordinary circumstances may excuse a party's nonperformance of its contractual obligations under the New York common law doctrines of "impossibility of performance" or "frustration of purpose."[1]

> "Market swings and economic hardship (even if resulting in insolvency) do not excuse performance under the doctrine of impossibility."

New York law generally requires a party to perform under a contract, or pay damages for nonperformance, "even when unforeseen circumstances make performance burdensome."[2] Of course, express contractual terms may excuse a party from performance for specific reasons. For example, an agreement may provide that if a "force majeure" occurs (as defined in the agreement), the affected party is excused from performance. New York courts have found that only those events expressly identified in a "force majeure" provision excuse performance.[3] However if the parties have not specifically allocated these types of risks, they may still be relieved from performance.

WHEN IS PERFORMANCE "IMPOSSIBLE"?

The closure of ports, restrictions on travel and government-imposed "lockdowns" or "stay-at-home" orders intended to stop the spread of COVID-19 may render performance under a contract "impossible" if the party asserting the defense can satisfy New York's high standard. Impossibility may be raised as a defense in an action to enforce a contract if one of the parties cannot satisfy its contractual obligations because of an unforeseen, intervening event "that could not have been… guarded against in the contract."[4] Examples might include an act of government or the destruction of the goods that were the subject of the contract by an act of God.[5]

The impossibility doctrine is applied narrowly because "the purpose of contract law is to allocate the risks that might affect performance and that performance should be excused only in extreme circumstances."[6] Market swings and economic hardship (even if resulting in insolvency) do not excuse performance under the doctrine of impossibility.[7] Rather, as one New York federal court has summarized, the impossibility defense "is available only when the inability to perform results from an act of God, *vis major* or operation of law."[8] Determining whether performance is impossible is highly fact-specific.

The defense of impossibility often arises during times of worldwide disruption. The Olympics, now postponed due to the COVID-19 crisis, were last cancelled because of World Wars I and II. The coronavirus pandemic is the type of global crisis that make impossibility a viable defense.

For example, in 1916, a steamship company was excused from carrying a passenger from a foreign country because a declaration of war, mobilization of the crew, and consequent acts of the French government restraining the passage of ships made performance impossible.[9] However, another defendant who had agreed to transport goods in 1921 was not excused from performance because "[i]nterference with the commerce of the world and the ordinary facilities of… transporting merchandise [as a result of World War I] was well known."[10] Although not deciding this issue, another New York state court observed that had an absolute embargo been in place preventing the export of the goods at issue, the defendant may have successfully asserted impossibility of performance; however, because the defendant could seek a permit to export, performance was not impossible. In another decision, the US Supreme Court concluded a vessel owner was not liable for the delay caused by a US embargo effected in 1917 which required the vessel to sail to New York rather than Bordeaux.[11]

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The outcomes of these cases indicate that the impossibility defense is challenging to establish. In most circumstances it is extremely difficult to show that performance is not only more difficult, but impossible. The unique, worldwide nature of the restrictions imposed in response to COVID-19, which restrictions have, for example, prevented many shipowners from replacing crews due to travel restrictions and mandated quarantines, may, however, be sufficient to excuse nonperformance if such risks have not been specifically addressed and allocated in the contract. Further, performance under a contract entered into prior to the World Health Organization's classification of COVID-19 as a pandemic on March 11, 2020 may be excused (because it was arguably unforeseeable) while performance of a contract entered thereafter, when scope and risks were better known, may not.

The defense of commercial impracticability also remains viable under New York law, and is codified in New York's Uniform Commercial Code.[12] Impracticability excuses contractual performance that "could only be accomplished at an excessive and unreasonable cost."[13] In one federal case in New York, a vessel owner was excused from performing under a charter for a vessel that suffered a collision because the cost of the rehabilitation necessary to continue to perform under the charter party exceeded the fair market value of the vessel.[14]

WHEN IS PERFORMANCE POSSIBLE, BUT THE PURPOSE "FRUSTRATED"?

Where COVID-19 and related acts of government have not rendered performance impossible under New York law, a party may still be excused from performing if the purpose of the agreement has been frustrated; that is, if COVID-19 has rendered the contract valueless to one of the parties. An agreement's purpose has been "frustrated" if an event has materially affected the consideration received by the party for performance or obviated the purpose of the agreement. The frustration defense is not available if the circumstances frustrating performance were expressly considered by the parties in their contract but rather require that the defendant show the event was unforeseeable. The frustration doctrine excuses performance "when a virtually cataclysmic, *wholly unforeseeable event* renders the contract valueless to one party."[15] The relevant question is whether the defendant could have foreseen and guarded against the frustrating event.[16]

The effects of the coronavirus have been felt in every aspect of global trade including work stoppages and the closure of numerous ports, mines, factories and other suppliers. These are the types of unforeseeable and extraordinary events that may give rise to a viable frustration defense. To assert frustration in the maritime context (i.e. "maritime frustration"), a party must establish (1) unexpected contingencies, (2) the risk of which was not allocated between the parties (expressly or impliedly), and (3) "commercial impracticability of performance."[17] Commercial impracticability means that "performance [could]… only be accomplished with extreme and unreasonable difficulty, expense, injury or loss."[18] US courts have found charters were frustrated where the subject ships were requisitioned by the government during war time.[19]

As more events and activities are canceled, postponed or "go virtual" because of COVID-19, the purpose of agreements related to such events may effectively disappear, and parties may have a viable claim of frustration. In one decision contemplating the doctrine of frustration, a New York state court concluded the defendant, who had contracted to advertise in a Souvenir Program for the America's Cup races (and featuring the legendary *Shamrock IV*), was frustrated when the races were cancelled after Great Britain's declaration of war on Germany in August 1914. The defendant had agreed to pay the publisher "upon publication and delivery of one copy" of the Souvenir Program. The publisher had already sold about 2,500 copies of the Souvenir Program when the races were cancelled. Nevertheless, the court found that the contract contemplated a race, and clearly the defendant had not bargained for advertising in a souvenir program of a nonexistent event.[20]

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CONCLUSION

Under New York law, parties to agreements that do not contain a force majeure clause or otherwise allocate the risk of the current government restrictions and closures may still be excused from nonperformance under New York's common law doctrines of impossibility and frustration. Businesses should review their existing contracts, particularly contracts that do not contain force majeure provisions, and consult with legal counsel on next steps. Watson Farley & Williams has formed a dedicated team to assist our clients worldwide to address challenges posed by COVID-19, and is prepared to advise on any of the current and anticipated effects of COVID-19, including contractual nonperformance.

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[1] *U.S. v. Gen. Douglas MacArthur Senior Village, Inc.*, 508 F.2d 377, 381 (2d Cir. 1974).

[2] *Kel Kim Corp. v. Cent. Markets, Inc.*, 519 N.E.2d 295, 296 (N.Y. 1987). Notably, even "catch-all" provisions are not broadly interpreted to include every type of event, but limited to events similar to those expressly identified. *Team Marketing USA Corp. v. Power Pact, LLC*, 41 A.D.3d 939 (N.Y. App. Div. 3d Dep't 2007).

[3] *See Kel Kim Corp.*, 519 N.E.2d at 296 (concluding "only if the *force majeure* clause specifically includes the event that actually prevents a party's performance will that party be excused"); *Phibro Energy, Inc. v. Empresa de Polimeros de Sines Sarl*, 720 F.Supp. 312, 318 (S.D.N.Y. 1989) ("New York law provides that ordinarily, a *force majeure* clause must include the specific event that is claimed to have prevented performance.").

[4] *Beardslee v. Inflection Energy, LLC*, 904 F.Supp.2d 213, 221 (N.D.N.Y. 2012) (internal quotation omitted).

[5] *Id.*

[6] *Kel Kim Corp.*, 519 N.E.2d at 296.

[7] *See 407 E. 61st Garage, Inc. v. Savoy Fifth Ave. Corp.*, 23 N.Y.2d 275, 281 (N.Y. 1968); *General Elec. Co. v. Metals Resources Group*, 741 N.Y.S.2d 218 (N.Y. App. Div. 1st Dep't 2002); *Bank of N.Y. v. Tri Polyta Finance, B.V.*, No. 9109104, 2003 WL 1960587, at *4-5 (S.D.N.Y. Apr. 25, 2003).

[8] *VJK Prods., Inc. v. Friedman/Meyer Productions, Inc.*, 565 F.Supp. 916, 920 (S.D.N.Y. 1983).

[9] *Foster v. Compagnie Francaise de Navigation a Vapeur*, 237 F. 858 (E.D.N.Y. 1916).

[10] *Krulewitch v. Nat'l Importing & Trading Co.*, 195 A.D. 544 (N.Y. App. Div. 1st Dep't 1921).

[11] *Republic of France v. French Overseas Corp. The Malcolm Baxter, Jr.*, 277 U.S. 323 (1928).

[12] *See* N.Y. U.C.C. §2-615.

[13] *Asphalt Int'l, Inc. v. Enter. Shipping Corp., S.A.*, 514 F.Supp. 1111, 115 (S.D.N.Y. 1981) (internal quotation omitted).

[14] *Axginc Corp. v. Plaza Automall, Ltd.*, No. 14-CV-4648, 2017 WL 11504930, at *8 (E.D.N.Y. Feb. 21, 2017).

[15] *Beardslee*, 904 F.Supp.2d at 221 (internal quotation omitted) (emphasis in original).

[16] *Gander Mountain Co. v. Islip U-Slip, LLC*, 923 F.Supp.2d 351, 360 (N.D.N.Y. 2013) (internal quotation omitted).

[17] *Reefer and Gen. Shipping Co., Inc. v. Great White Fleet, Ltd.*, No. 93 CIV. 906 (SWK), 1995 WL 575290, at *3 (S.D.N.Y. Sept. 28, 1995).

[18] *Amer. Trading & Prod. Corp. v. Shell Int'l Marine Ltd.*, 453 F.2d 939, 942 (2d Cir. 1972).

[19] *See e.g., Henjes Marine, Inc. v. White Const. Co.*, 58 N.Y.S.2d 384 (Sup. Ct. Kings County, Trial Term 1945); *The Frankmere*, 278 F. 139 (4th Cir. 1921) (concluding requisition of steamship by British government in 1915 frustrated charter).

[20] *Alfred Marks Realty Co. v. Hotel Hermitage Co.*, 170 A.D. 484, 485 (N.Y. App. Div. 2d Dep't 1915).

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