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COVID-19 and Commercial Contracts

What Businesses Need to Know About Potential Contractual and Non-Contractual Remedies

by Marc Esterman & Pat Naples

Introduction

The COVID-19 outbreak has taken a devastating toll on global health and the global economy. Many businesses are struggling to satisfy their contractual obligations. In the weeks following government orders of increasing severity in response to the COVID-19 pandemic, reality has set in and many businesses are left wondering how the resulting business downturn might affect the enforcement of their commercial contracts.

Businesses may be able to leverage the legal doctrine of *force majeure*, or perhaps other non-contract remedies, as a means of suspending their contractual obligations and/or terminating the subject contract. However, as summarized below, these doctrines are narrowly construed and must be analyzed carefully in order to determine their effectiveness for the given facts and circumstances. Finally, in certain very limited instances, companies may be able to make claims under their business interruption insurance policies, subject to their terms of coverage.

While most of the analysis presented in this article has widespread jurisdictional application, this article focuses on Connecticut and New York law; accordingly, interested parties should check the laws of their local jurisdiction for definitive guidance.

Contracts with *Force Majeure* Clauses

A *force majeure* clause in a contract is intended to excuse performance due to an event beyond the non-performing party's control that has interfered with performance.[1] When determining the applicability of *force majeure* clauses in contracts, in general, courts look to the language of the contract to resolve the following questions: does the triggering event fall within the scope of *force majeure* events listed in the clause (*e.g.*, "national disaster," "act of terrorism," "pandemic," "governmental order," etc.)[2]; was the likelihood of non-performance foreseeable and capable of mitigation (a party cannot claim *force majeure* where the non-performance was foreseeable and could have been mitigated but was not)[3]; and is the level of interference sufficient to warrant relief (mere financial difficulty will not typically suffice)[4].

Several other conditions also govern the application of *force majeure*. First, in most jurisdictions, including New York, *force majeure* is inherently a contractual remedy and may be invoked only if it is in the contract.[5] Although Connecticut courts have not expressly addressed the issue of whether *force majeure* may be invoked as a non-contractual remedy, courts in New York have made clear that there is no common law *force majeure* doctrine.[6] Second, a *force majeure* clause is enforceable only to the extent provided by the contract, *i.e.*, courts typically construe *force majeure* clauses narrowly,[7] and thus the language of the clause is important. The scope of the *force majeure* remedy – who may invoke it (either party?)[8]; what remedy may be sought (suspension of performance or termination of contract?)[9]; whether notice is required[10]; and under what circumstances it may be invoked (does it only excuse certain types of non-performance?)[11] – will be defined by the *force majeure* clause's express language. For example, if the clause only allows temporary suspension of performance, rather than termination, then a court would only allow the temporary suspension of performance.[12] For another example, if the clause expressly includes intervening government orders, contract parties may be able to claim *force majeure* if such an order is promulgated after execution of the contract; but if the clause does not include government orders, parties may not be able to claim *force majeure* in that circumstance.[13] Third, parties are not excused from performance under *force majeure* clauses when they create their own inability to perform.[14]

Notably, both New York and Connecticut courts have found that *force majeure* clauses may excuse payment, even when the other party stands ready, willing, and able to perform under the contract, albeit under narrow, fact-dependent circumstances.[15] For example, in *Constellation Energy Services of New York, Inc.*, the plaintiff, an electricity provider, entered into a contract with the defendant, a purchaser of electricity. Under the contract, the fixed-rate price could be upwardly adjusted if the defendant failed to meet a certain quantity baseline. The Court permitted the defendant to use *force majeure* as a defense to the plaintiff's price-adjustment claim, on the grounds that Hurricane Sandy could be a *force majeure* event that operated to prevent achievement of the contractual baseline. In short, if a *force majeure* event interferes with the payor's ability to pay in a substantial and unforeseeable way, the *force majeure* clause may excuse payment.[16]

All things considered, for the purposes of *force majeure*, the language of the contract will control. Accordingly, businesses should consult with their counsel when analyzing the breadth and scope of their contracts' *force majeure* clauses.

Relief Beyond *Force Majeure* Clauses

By contrast, impossibility and impracticability are common law doctrines that may provide relief separate and apart from the contract.[17] These doctrines generally require an unanticipated, intervening event that has rendered performance impossible or impracticable.[18] These doctrines are strict, requiring that the event be truly unforeseeable[19] and the performance truly impossible or impracticable[20]. For long-standing contracts, this may not be much of a hurdle; however, for recently entered contracts, the party seeking to enforce the contract could argue that the disruptions wrought by COVID-19 were foreseeable.

In New York, there is no doctrine of impracticability—performance is only excused if performance is truly impossible, *i.e.*, the contract could not be performed at any cost.[21] Accordingly, it is exceedingly rare for performance to be excused on the grounds of impossibility; however, in 1994, the U.S. Court of Appeals for the Second Circuit affirmed the dismissal of a breach of contract action by bank account holders against their banks for failing to wire certain funds on the ground of impossibility.[22] Due to an intervening government order that seized the electronic fund transfers, the Second Circuit held, it was impossible for the banks to perform under the contract.[23]

In Connecticut, performance may be excused if performance is impracticable, *i.e.*, could only be completed at excessive costs; but even then, the cost must be truly excessive — it is not enough that the contract is no longer profitable.[24] For example, in one 2010 Connecticut Superior Court decision, a trial judge permitted a commercial real estate plaintiff to survive a motion to strike while attempting to successfully rescind its obligations under a $205 million purchase agreement, including a $22.5 million deposit, under the doctrine of impracticability.[25] In short, the Court held that the 2008 financial crisis and, specifically, the decline in the availability of credit resulting therefrom, could have made it commercially impracticable for the plaintiff to perform under the contract, justifying rescission.[26]

Frustration of purpose, like impossibility/impracticability, is a common-law doctrine that generally permits parties to avoid contract obligations when an unforeseeable event for which neither party is at fault substantially frustrates the principle purpose of the contract (as opposed to making a party's performance more difficult).[27] The hurdle here is in defining the "principal purpose" of the contract: parties will not be able to invoke the doctrine simply by claiming that the purpose of the contract was to make a profit and that COVID-19 has frustrated the purpose of making a profit.[28]

In New York, courts have almost never applied the frustration of purpose doctrine; that said, in 1987, a district court in Nassau County refused to enforce a home improvement contract because the contractor substantially frustrated the purpose of the contract by failing to adhere to the city's building code.[29]

In Connecticut, frustration of purpose is more flexible than in New York but still rare; that said, in 2014, a Connecticut trial court ruled in favor of a defendant (a homeowner) on the defense of frustration of purpose after the plaintiff (a pool company) had repeatedly failed to satisfy the underlying letter of intent despite the defendant's best efforts to contact the plaintiff, when the plaintiff attempted to then enforce the letter of intent years' later.[30]

Ultimately, impossibility, impracticability, and frustration of purpose are common law doctrines and, thus, subject to revision and application by the courts. Whether the courts will interpret these doctrines more liberally in the wake of the COVID-19 crisis remains to be seen, but it is likely that any such review will be filtered by a precedent of narrow application.

Business Interruption Insurance Coverage

Business interruption insurance typically covers losses arising from interruptions to operations caused by physical property damage (*e.g.*, fire). Post-SARS outbreak, most insurers have excluded infectious diseases from coverage.[31] And, interestingly, the New York State Department of Financial Services notes, on its website, "It is unlikely that a current business interruption policy has contemplated the coronavirus specifically...business interruption insurance requires a related property damage. Fear of COVID-19 alone is unlikely to trigger business interruption insurance coverage."[32]

It would be the rare policy to find insurance coverage that would include an epidemic; so, while insureds should certainly review their policy, they should do so with tempered enthusiasm.

Conclusion

The ways in which each of the above doctrines will apply will be fact-specific, so this article is meant only for general guidance, not an assessment of any particular circumstances. Businesses should consider ways to mitigate operating risk and closely analyze their commercial contracts – both existing ones that they are living with and template forms for future use – in light of the COVID-19 pandemic. We are happy to assist in connection with any particular contracts issues your business may be experiencing.

MARC R. ESTERMAN
mesterman@goodwin.com
(203) 324-8150
Firm bio: https://www.shipmangoodwin.com/mesterman

PASCAL F. NAPLES (PAT)
pnaples@goodwin.com
(860) 251-5223
Firm bio: https://www.shipmangoodwin.com/pnaples

Endnotes

[1] *See Kel Kim Corp. v. Cent. Mkts., Inc.,* 70 N.Y.2d 900, 902, 519 N.E.2d 295 (N.Y. 1987); *Milford Power Co., LLC v. Alstom Power, Inc.*, No. X04CV000121672S, 2001 WL 822488, at *3 (Conn. Super. Ct. June 28, 2001), *vacated on other grounds by* 263 Conn. 616, 822 A.2d 196 (Conn. 2003).

[2] *See Kel Kim Corp.,* 70 N.Y.2d at 902; *Reade v. Stoneybrook Realty, LLC,* 63 A.D.3d 433, 434, 882 N.Y.S.2d 8 (N.Y. App. Div. 2009).

[3] *See Goldstein v. Orensanz Events LLC,* 146 A.D.3d 492, 493, 44 N.Y.S.3d 437 (N.Y. App. Div. 2017).

[4] *See Constellation Energy Servs. of N.Y., Inc. v. New Water St. Corp.,* 146 A.D.3d 557, 559, 46 N.Y.S.3d 25 (N.Y. App. Div. 2017); *Butler v. Buchanan Marine, Inc.*, No. CV95-0149347 S, 1998 WL 294056, at *3 (Conn. Super. Ct. May 22, 1998).

[5] *General Elec. Co. v. Metals Res. Grp. Ltd.*, 293 A.D.2d 417, 419, 741 N.Y.S.2d 218 (N.Y. App. Div. 2002).

[6] *See id.*

[7] *See Kel Kim Corp.,* 70 N.Y.2d at 902.

[8] *See Rich Taubman Assocs. v. Sweeney Todd's Hair Design*, No. SPNO30972, 2005 WL 1155079, at *3 (Conn. Super. Ct. Feb. 9, 2005).

[9] *See Monarch Shipping Agency, LLC v. Logistic Conn., Inc.,* No. CV03401818S, 2003 WL 21185783, at *1 (Conn. Super. Ct. May 7, 2003); *Ahlstrom Mach. Inc. v. Associated Airfreight Inc.*, 251 A.D.2d 852, 853, 675 N.Y.S.2d 161 (N.Y. App. Div. 1998).

[10] *See Milford Power Co.*, 2001 WL 822488, at *3.

[11] *See Stanley Works v. Halstead New England Corp.*, No. CV010506367S, 2001 WL 651208, at *5 (Conn. Super. Ct. May 18, 2001).

[12] *See Monarch Shipping Agency, LLC,* 2003 WL 21185783, at *1; *Ahlstrom Mach. Inc.,* 251 A.D.2d at 853.

[13] *See Burnside 711, LLC v. Nassau Reg'l Off-Track Betting Corp.*, 67 A.D.3d 718, 720, 888 N.Y.S.2d 212 (N.Y. App. Div. 2009); *Int'l Auto. Showcase, Inc. v. SMG,* No. CV030477177S, 2004 WL 1833312, at *2 (Conn. Super. Ct. July 21, 2004).

[14] *See Macalloy Corp. v. Metallurg, Inc.*, 284 A.D.2d 227, 227, 728 N.Y.S.2d 14 (N.Y. App. Div. 2001); *Hershman Recycling, Inc. v. Am. Disposal Servs. of Mo., Inc.*, No. CV0104504069S, 2003 WL 283813, at *4 (Conn. Super. Ct. Jan. 28, 2003).

[15] *See Constellation Energy Servs. of N.Y., Inc.,* 146 A.D.3d at 559; *Monarch Shipping Agency, LLC,* 2003 WL 21185783, at *1.

[16] *See Constellation Energy Servs. of N.Y., Inc.,* 146 A.D.3d at 559; *Monarch Shipping Agency, LLC,* 2003 WL 21185783, at *1.

[17] *See Kel Kim Corp.*, 70 N.Y.2d at 902; *Roy v. Stephen Pontiac-Cadillac, Inc.,* 15 Conn. App. 101, 105, 543 A.2d 775 (1988).

[18] *See Kolodin v. Valenti,* 115 A.D.3d 197, 200, 979 N.Y.S.2d 587 (N.Y. App. Div. 2014); *Dills v. Town of Enfield,* 210 Conn. 705, 717, 557 A.2d 517 (1989).

[19] *See RW Holdings, LLC v. Mayer,* 131 A.D.3d 1228, 1230, 17 N.Y.S.3d 171 (N.Y. App. Div. 2015); *Dills,* 210 Conn. at 718.

[20] *See Urban Archaeology Ltd. v. 207 E. 57th St. LLC,* 68 A.D.3d 562, 563, 891 N.Y.S.2d 63 (N.Y. App. Div. 2009); *Dills,* 210 Conn. at 718.

[21] *See Stasyszyn v. Sutton E. Assocs.,* 161 A.D.2d 269, 271, 555 N.Y.S.2d 297 (N.Y. App. Div. 1990).

[22] *See Organizacion JD Ltda. v. U.S. Dep't of Justice,* 18 F.3d 91, 95 (2d Cir. 1994).

[23] *See id.*

[24] *See Dills,* 210 Conn. at 718.

[25] *See Dryland Steamboat Rd., LLC v. GRC Realty Corp.,* No. X05CV094017179S, 2010 WL 4276761, at *7 (Conn. Super. Ct. July 20, 2010).

[26] *See id.*

[27] *See O'Hara v. State,* 218 Conn. 628, 639, 590 A.2d 948 (1991); *Crown IT Servs., Inc. v. Koval-Olsen,* 11 A.D.3d 263, 265, 782 N.Y.S.2d 708 (N.Y. App. Div. 2004).

[28] *See Howard-Arnold, Inc. v. T.N.T. Realty, Inc.,* 315 Conn. 596, 605, 109 A.3d 473 (N.Y. App. Div. 2015); *Rockland Dev. Assocs. v. Richlou Auto Body, Inc.,* 173 A.D.2d 690, 691, 570 N.Y.S.2d 343 (N.Y. App. Div. 1991).

[29] *See Reale v. Linder,* 135 Misc. 2d 317, 322, 514 N.Y.S.2d 1004 (N.Y. Dist. Ct. 1987), *aff'd as modified,* 143 Misc. 2d 496, 544 N.Y.S.2d 702 (N.Y. App. Term 1988).

[30] *See Willis Pool Co., LLC v. Maurath,* No. DBDCV126015400S, 2014 WL 7671664, at *4 (Conn. Super. Ct. Dec. 2, 2014).

[31] *See "Business disruption insurance: can it help with coronavirus?,"* Financial Times (online, on April, 6, 2020, at https://www.ft.com/content/1d359ef3-9104-4441-a039-82c6b9683ad2).

[32] *See* New York State Department of State, online on April 6, 2020, at https://www.dfs.ny.gov/consumers/coronavirus/business_interruption_insurance_faqs.

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