

COMMERCIAL CONTRACTS IN THE TIME OF CORONAVIRUS

Hodgson Russ Corporate Alert
March 23, 2020

The federal, state, and local efforts to control the spread of the Coronavirus and associated disease have created significant uncertainty for businesses of all sizes and across industries. While the ultimate fallout of these efforts is far from clear, a number of companies are grappling with situations where performance under a current agreement has been rendered difficult or not economically reasonable. How should these companies assess their options and risk?

What do the terms of the contract say?

It may be self-evident, but the first step is the actual terms of the contract, many of which may be implicated by the current situation.

Termination Can the contract be terminated without cause? If yes, how much advance notice is required, and what are the parties' obligations after the termination takes effect? In some cases, termination will not serve to cancel orders accepted prior to termination, which may not provide necessary relief.

Order Cancellation If the framework contract cannot be cancelled without cause, does it permit the suspension, cancellation, or modification of previously placed orders under the agreement?

Force Majeure Force majeure clauses excuse a party from fulfilling its contractual obligations where prevented by an unforeseeable event. However, there are a number of specific considerations in invoking such a clause:

- Does the definition of "force majeure" include the term "epidemic," "pandemic," or "government regulation"? [1] If yes, the party seeking to invoke the clause may have a good argument. However, if the term is not expressly included, and instead generally refers to "events outside a party's control", the interpretation of the clause will rely on judicially-created common law principles, discussed further below.
- What obligations are actually excused by the clause? Sometimes, each party's obligations generally are excused. Other times, specific obligations (like the obligation to make payment under the contract) cannot be excluded by force majeure.

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COMMERCIAL CONTRACTS IN THE TIME OF CORONAVIRUS

Damage Exclusions and Limitations of Liability If a party walks away from the agreement, is the party's exposure to consequential damages excluded? Is there an aggregate cap on the party's exposure? These types of clauses are frequently enforced under New York law even in the case of an intentional breach. When assessing whether an efficient breach of the agreement makes sense, the analysis may be simplified based on a comparison of the potential capped exposure against the cost of continued performance. [2]

What does the law say?

Common Law Doctrine If your contract does not include any provision that, on its face, could excuse performance, there are certain common law doctrines that may apply. These differ from state to state, so it is important to consult a professional in assessing options in this situation.

The doctrine of "impossibility" or "impracticability" may be used to excuse a party's failure to perform if that party can generally establish: (1) an unexpected event occurred, (2) the contract assumed the event would not occur, and (3) the event has made the subject matter of the contract or the means of performance objectively impossible [3] or impracticable. The facts necessary to meet this standard must be extreme – general financial inability to perform will not ordinarily satisfy the requirements. [4] Again, the standards for these doctrines vary from state to state.

Some states also recognize "frustration of purpose" as a common law defense to a breach of contract claim. In New York, "to invoke this defense, the frustrated purpose must be so completely the basis of the contract that, as both parties understood, without it, the transaction would have made little sense." [5] The doctrine applies "when a change in circumstances makes one party's performance virtually worthless to the other, frustrating his purpose in making the contract." [6] This doctrine is narrowly applied and largely rests on the foreseeability of the change in circumstances.

Force Majeure If the contract includes a force majeure clause, but that clause does not expressly reference "epidemic" or "pandemic" or "government regulation," in New York a party will not be excused from performance, [7] even if the force majeure clause contains a "catchall" provision. [8] In other words, an imprecisely drafted force majeure clause virtually returns the parties to the high common law standards for impossibility. Laws of states other than New York may take a different approach to imprecisely drafted force majeure clauses, so it is important to assess this issue with your counsel based on the law governing the applicable agreement.

Isn't there insurance for this?

Most businesses have some form of insurance that may provide some coverage for losses attributable to the Coronavirus pandemic. Such coverage is generically referred to as business interruption insurance and is typically buried in your commercial property policy. Such policies include coverage for lost profits resulting from property damage.

The coverage for lost income often covers loss resulting from:

- Damage to the policyholder's own property (business interruption)
- Damage to the property of a customer or supplier or a supplier's supplier (contingent business interruption)
- Government action such as evacuation orders (order of civil authority)

COMMERCIAL CONTRACTS IN THE TIME OF CORONAVIRUS

- Damage to properties that attract customers to the policyholder's business (lead property)

Business Interruption If your business is shut down due to the presence of Coronavirus in your facility, you may have coverage for the lost profits during the time that the business is closed.

Contingent Business Loss Coverage Many companies have a rider to their commercial property policies that provides coverage for contingent business losses. These are losses caused by damage to a supplier or customer. Many businesses have already reported that their overseas suppliers and customers have shut down due to the presence of the virus at their facilities.

The "supplier" whose property damage triggers contingent business interruption coverage may not be limited to the manufacturers or distributors of goods. It could be the transportation that brings customers or goods to your business. To qualify as a "supplier" it is not necessary that the policyholder even have a supply contract with the third party.

Order of Civil or Military Authority Closures of public gathering places and all nonessential business activity in major cities worldwide may trigger coverage for losses caused by an "order of civil or military authority" — that is, for loss due to the prohibition of access to a business's premises if caused by property damage within a specified distance of the insured property, such as one or five miles. When Super Storm Sandy hit New York City in 2012, some businesses were reimbursed for their business losses because they were prohibited from entering their buildings due to police orders because transformers in the area had been damaged.

Lead Property Finally, for businesses that are dependent upon visitors to nearby attractions, your broker may have negotiated a lead property rider on your policy. Those riders provide business interruption coverage in the event the nearby attraction suffers damage and cannot remain open.

Be aware that insurers have a range of defenses that may allow them to avoid, or limit, payment for losses stemming from the Coronavirus. Perhaps most significantly, after the 2003 SARS outbreak, most insurers added broad exclusions for damage caused by biological agents or communicable diseases. There are also complicated sub-limits and deductible calculations that may enable insurers, in the first instance, to limit what they pay.

It is important that our business colleagues review their insurance policies immediately to determine if they have insurance for some of their losses. If you are unsure, reach out to your insurance broker or your attorneys to determine if you have such coverage and, if you do, the potentially applicable limits. Be sure to track your losses and notify your insurer of potentially covered claims.

For a more detailed discussion of the insurance issues relating to the Coronavirus, please see a companion alert [here](#).

Hodgson Russ's business litigation and commercial contract attorneys will be available throughout this developing situation to assist you in working through these and any other challenges facing your business in these uncertain times. Please contact Ryan K. Cummings or Valerie E. Stevens for any questions you may have.

Hodgson Russ remains on top of these circumstances as they develop. Our attorneys are working remotely, and ready, willing, and able to address the needs of our clients, so do not hesitate to contact us (attorney directory). **Please check our Coronavirus Resource Center to view many other alerts our attorneys in various practice areas have published on**

COMMERCIAL CONTRACTS IN THE TIME OF CORONAVIRUS

topics related to the pandemic.

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[1] The World Health Organization (WHO) classified the novel Coronavirus as a “pandemic” on March 11. Parties may also consider whether “Act of God,” customarily included in force majeure definitions, could be invoked here.

[2] *Metro. Life Ins. Co. v. Noble Lowndes Int’l Inc.*, 84 N.Y.2d 430, 439 (1983); *DynCorp v. GTE Corp.*, 215 F. Supp.2d 308, 318 (S.D.N.Y. 2002) (citing *Metro. Life Ins. Co.*, 84 N.Y.2d 430 (1983)).

[3] *Kel Kim Corp. v. Central Markets, Inc.*, 70 N.Y.2d 900, 902 (1987).

[4] The doctrine of impracticability generally holds that a “thing is impossible in legal contemplation when it is not practicable; and a thing is impracticable when it can only be done at an excessive and unreasonable cost.” *City of Vernon v. City of Los Angeles*, 290 P.2d 841 (Cal. 1955).

[5] *Crown IT Services, Inc. v Koval-Olsen*, 11 A.D.3d 263, 265 (1st Dep’t. 2004) (citing Restatement (Second) of Contracts, § 265 (1981)).

[6] *PPF Safeguard, LLC v BCR Safeguard Holding, LLC*, 85 A.D.3d 506, 508 (1st Dep’t 2011) (quoting (Restatement (Second) of Contracts § 265, Comment a)).

[7] *Kel Kim Corp.*, 70 N.Y.2 at 902 (“Ordinarily, only if the force majeure clause specifically includes the event that actually prevents a party’s performance will that party be excused.”). As mentioned above, if the definition includes “Act of God,” that may be another basis for argument, but one likely to be argued by the parties.

[8] See *Rochester Gas and Elec. Corp. v. Delta Star, Inc.*, No. 06-CV-6155-CJS-MWP, 2009 WL 368508, at *8 (W.D.N.Y. Feb. 13, 2009) (declining to hold that a worldwide shortage of steel and subsequent rise in price was “beyond the reasonable anticipation and control of the Party affected thereby”); *Team Marketing USA Corp. v. Power Pact, LLC*, 41 A.D.3d 939, 942-43 (3d Dep’t 2007) (expansive catchall phrases only apply to the same general kind or class of excuses as those specifically mentioned).