The Coronavirus Pandemic: Impossibility, Frustration & *Force Majeure*

Many businesses are dealing with contracts under pressure. You may be struggling to obtain the benefit of a bargain struck before the pandemic, or having difficulty performing in a timely fashion yourself. Borrowers and buyers are slow to pay, suppliers are slow to deliver, labor availability is disrupted.

Now is the time to consider your options. Amid the pandemic, there has been a lot written in general terms on enforcement of contracts and defenses thereto by many law firms. We have prepared this analysis to highlight some important differences in the law between New York and other U.S. and international jurisdictions, and note that even under New York law the result may depend on the subject matter of the contract.

This article surveys the three main defenses that are likely to arise: impossibility, frustration and *force majeure*. We look at how they function in New York and how they may be applied differently in other jurisdictions. We also consider how the subject matter of a contract may affect their application.

If the technical doctrines do not interest you, feel free to skip to the end for a survey of practical considerations as you look over your agreements in this challenging time.

Summary

The doctrines known as "impossibility," "frustration," "impracticability" and "*force majeure*" may provide defenses to contract claims where non-performance has been caused by extrinsic events.

There are, however, important differences between them, and in how New York, other U.S. states and non-U.S. jurisdictions apply them.

This analysis is intended to provide a basic grounding in some of the key factors to think about as businesses consider their strategy going forward.

The Doctrines

Two English cases that have become U.S. casebook classics help define impossibility and frustration. The first is *Taylor v. Caldwell*.[1] Caldwell agreed to rent the Surrey Gardens & Music Hall to Taylor for a series of concerts and events. The hall burned to the ground a week before the first concert. The Court concluded that the failure of an implicit precondition in the agreement—that the concert hall actually *exist*—meant that both parties were excused from performance, and they were returned to the *status quo ante*. This is *impossibility*—the parties *could not* have performed irrespective of cost or difficulty because the subject matter of the agreement had been destroyed.

In *Krell v Henry*,[2] Henry rented a flat at Pall Mall from Krell so he could watch the coronation procession of Edward VII. The King got appendicitis and the procession did not take place as planned. Krell sued for the balance of the rent and Henry sued to get his deposit back. Although there was nothing actually preventing Henry from occupying the flat, and the agreement did not specifically mention the procession, the Court concluded that its nonoccurrence frustrated an implicit shared assumption of the parties and excused payment of the balance. (The claim to recover the deposit was dropped.) This is *frustration*: there would be no point to performing given the shared assumptions of the parties.

The view taken by the Restatement of Contracts (Second) and adopted by the Uniform Commercial Code ("U.C.C.") for sales of goods groups both impossibility and frustration under the heading of *impractability*.

Many states have adopted the Restatement view, which has similarities to the approach under Civil law and certain international agreements.

New York, however, has not adopted the Restatement view when it comes to its general contract law. But because New York *has* adopted the U.C.C., those doctrines will apply to

the sale of goods in New York. This means that the subject matter of a contract may affect the legal analysis.

Force majeure is not an overarching rule of contract law like impossibility or frustration, but takes its meaning and scope from the contract itself.

Impossibility

"Freedom of contract" plays a large role in New York's judicial thinking. As the Court of Appeals modestly put it:

> **In keeping with New York's status as the preeminent commercial center in the United States, if not the world, our courts have long deemed the enforcement of commercial contracts according to the terms adopted by the parties to be a pillar of the common law. Thus, [f]reedom of contract prevails in an arm's length transaction between sophisticated parties..., and in the absence of countervailing public policy concerns there is no reason to relieve them of the consequences of their bargain.[3]**

The rationale is that

> **when a court invalidates a contractual provision, one party is deprived of the benefit of the bargain. By disfavoring judicial upending of the balance struck at the conclusion of the parties' negotiations, our public policy in favor of freedom of contract both promotes certainty and predictability and respects the autonomy of commercial parties in ordering their own business arrangements.[4]**

The focus on parties' autonomy to allocate risks between themselves as they choose is reflected in New York's rigorous application of the doctrines of impossibility and frustration. New York courts are reluctant to disturb the allocation of risk chosen by the parties. The doctrines of impossibility and frustration are therefore viewed as extraordinary remedies, to be invoked sparingly and carefully. It is far easier to find cases rejecting these defenses than applying them. The two key ideas to keep in mind are *actual impossibility* and *foreseeability*. It is a necessary, often unstated, precondition that the factors making performance impossible be beyond the parties' control.

The language of the New York courts often emphasizes that "impossible" means *impossible*. It should not matter how onerous or expensive performance is, only that the thing cannot be done. As the Court of Appeals has explained,

> **where impossibility or difficulty of performance is occasioned only by financial difficulty or economic hardship, even to the extent of insolvency or bankruptcy, performance of a contract is not excused.[5]**

This is a point to keep in mind when we look at impracticability and the Restatement approach.

The most cited case on impossibility is *Kel Kim Corp. v Cent. Markets, Inc.*[6] Kel Kim was lessee of a commercial property, and was obliged by the lease to maintain liability coverage. When its policy expired, Kel Kim sought to obtain replacement coverage but was unable to do so. The owner sent a notice of default and the plaintiff sought declaratory judgment that performance was either impossible or fell within the lease's *force majeure* clause. The Court unanimously concluded that performance was not "impossible":

> **Impossibility excuses a party's performance only when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible. Moreover, the impossibility must be produced by an unanticipated event that could not have been foreseen or guarded against in the contract.[7]**

The language about performance being "objectively impossible"—not just really, really hard—is often cited by the New York courts.

Interestingly, the *Kel Kim* case arose during an unprecedented moment in the liability insurance industry; policies were extraordinarily expensive if they could be obtained at all. The Court did not conclude that insurance was in fact available—it may well have been unobtainable on any terms. Instead, it focused on the element of *foreseeability*:

> **[P]laintiff's predicament is not within the embrace of the doctrine of impossibility. Kel Kim's inability to procure and maintain requisite coverage could have been foreseen and guarded against when it specifically undertook that obligation in the lease, and therefore the obligation cannot be excused on this basis.[8]**

Foreseeability is therefore often the crucial issue. If the agreement assigns a particular risk to a party, that's the end of the analysis. Because the risk was foreseen and assigned to a particular party, performance will not be excused and equitable considerations will be of no avail. In *Kel Kim*, the parties assigned to the lessee the obligation to obtain appropriate insurance. Therefore the risk that it could *not* be obtained was foreseen and, having been allocated to Kel Kim, would not be judicially reallocated.

So, in New York, to invoke impossibility as a contract defense, you must show that performance was *objectively impossible*, and that the impossibility was *unforeseeable*. And the Court of Appeals has held that the fact that performance would impose hardship even to the point of insolvency does not make it

"objectively impossible." This is New York's approach to promoting predictability in commercial agreements.

When is Performance "Impossible"?

What counts as "objective impossibility"? Destruction of the subject matter of the contract (like the burning of the concert hall) will count (but not if the possibility was foreseen and the risk assigned to one of the parties). Another consideration—and a more significant one in the current environment—is *legal* impossibility: what if one party is *prohibited* from performing because of an intervening legal act?[9] Given widespread government restrictions on transportation and on the movement of persons in light of the pandemic, this is a very likely scenario.

The law will not compel a party to perform an illegal act. For example, during Prohibition, the New York Appellate Division considered a case involving the sale of whiskey; a change in regulations meant the seller could not obtain the required permits. The Court observed that

> **the contract was made by parties who believed themselves to be legally qualified to carry it through. Whether the failure to obtain the … permits is logically to be ascribed to a change in the regulations, or to a change in the interpretation which the federal authorities placed on the law, the result here would be the same. Substantially the situation was that, because of such a change, of either kind, both being entirely beyond the control of the parties, the performance of the contract became impossible.[10]**

The deposit was returned and the parties placed in their initial positions.

In *Kolodin v. Valenti*[11] the plaintiff jazz singer had a romantic relationship with her producer, which deteriorated to the point that it resulted in a stipulated order of protection prohibiting contact between them. The problem was the ongoing recording contracts between them. The First Department concluded that

> **performance of the contracts at issue has been rendered objectively impossible by law, since the stipulation destroyed the means of performance by precluding all contact between plaintiff and Valenti except by counsel.[12]**

While the parties might have worked through their differences earlier, "when the Family Court so-ordered the stipulation to which Valenti and plaintiff assented, performance of the contracts … became legally and objectively impossible."[13] The recording contracts were voided.

However, even issues of legal impossibility are narrowly construed. In a Second World War case involving the Trading with the Enemy Act, a New York court required a party to show that it had sought a license from the government before claiming impossibility, and "[i]n the absence of such a showing, the Trading with the Enemy Act alone may not be availed of as a defense."[14] As the Second Circuit put it:

> **The party pleading impossibility as a defense must demonstrate that it took virtually every action within its powers to perform its duties under the contract.[15]**

A pary would be well advised to avail iself of any regulatory mechanism by which an exemption could be obtained, even if it seems unlikely to succeed.

The requirement of unforeseeability applies with just as much force to legal as to factual impossibility: "the law of impossibility provides that performance of a contract will be excused if such performance is rendered impossible by intervening governmental activities, but only if those activities are unforeseeable."[16] The burden is on the party claiming impossibility to show that the governmental action or legislation was not foreseeable. One might reasonably respond: if the behavior of a virus is difficult to predict, try guessing what a legislature will do.

Frustration

The same requirements that the unexpected event be unforeseen and beyond the control of the parties apply with equal rigor to frustration. But the element of impossibility is replaced by a different criterion:

> **In order 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.[17]**

The fact that "the transaction has become less profitable for the affected party" is not enough.[18] "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.'"[19]

In practice, frustration is even more difficult to invoke than impossibility. A party seeking to invoke the defense is usually frustrated that they are not going to make any money on the deal, and as we have seen that is not enough. Rather, the intervening event must be so dire, and so intertwined with the *purpose* of the contract, that the parties simply would not have made the contract if they could have foreseen the intervening event.

Force Majeure

Kel Kim also illustrates the relative narrowness of the doctrine of *force majeure* in New York law. *Force majeure* is not a rule of contract law, but a term given to a relatively common contract provision that defines the circumstances under

which one or both parties may be excused from performance. "Acts of god," weather, wars, public disorder, strikes and the like are typical provisions excusing performance. *Force majeure* clauses often include language like "and other similar events."

In *Kel Kim*, the Court explained that such clauses would be narrowly construed: "[o]rdinarily, only if the *force majeure* clause specifically includes the event that actually prevents a party's performance will that party be excused."[20] The court declined to give "other similar causes" language an expansive interpretation and strictly limited it to "to things of the same kind or nature as the particular matters mentioned."[21] Fortunately, many boilerplate *force majeure* clauses contain language about epidemics and about government action.

The Restatement / U.C.C. View

Many U.S. states have mitigated the rigor of the common law approach applied in New York, and this is reflected both in the language of the Restatement (Second) of Contracts and in the U.C.C. as it applies to the sale of goods. Many states have adopted the Restatement rule.

Under the U.C.C.[22] and the Restatement[23] the key term is not impossibility but "impracticability." How does impracticability differ from impossibility?

Unlike the New York view, which would require a party to perform (or answer in damages even if it proved ruinous), impracticability is expressly intended to take into account the commercial difficulties of the transaction. Official Note 3 to the U.C.C. observes that

> **commercial impracticability (as contrasted with "impossibility," "frustration of performance" or "frustration of the venture") has been adopted in order to call attention to the commercial character of the criterion chosen by this Article.**

The Restatement notes that:

> **Performance may be impracticable because extreme and unreasonable difficulty, expense, injury, or loss to one of the parties will be involved.**[24]

Similarly, some states (like California) have codified a defense applicable to all contracts that sounds a lot like impractiability. In California, performance is excused "[w]hen it is prevented or delayed by an irresistible, superhuman cause, or by the act of public enemies of this state or of the United States, unless the parties have expressly agreed to the contrary."[25] Interpreting this, the California Supreme Court (in a case involving Gene Autry's World War Two military service) has echoed the Restatement language as to "extreme and unreasonable difficulty, expense, injury, or loss involved."[26]

If you are in a jurisdiction that applies the Restatement approach, or are dealing with the sale of goods under the U.C.C. in New York, the law may be more flexible. However, the increased flexibility comes with decreased certainty. If performance would render a party insolvent, however, impracticability (as opposed to impossibility) may be a viable defense.

International Considerations

It is difficult to generalize across the many legal regimes that may apply to international transactions. We look here at a few instructive examples.

The Civil Law approach is illustrated by the French Civil Code. Article 1218 of the French Civil Code provides that for an event to excuse performance, it must actually prevent the obligor from performing and satisfy three factors: (i) it must have been beyond the control of the obligor ("external"), (ii) it must not have been reasonably foreseeable at the time of contracting ("unforeseeable"), and (iii) its effects cannot be prevented by appropriate measures ("irresistible"). If the impediment is temporary, performance is merely suspended; if it is permanent, the contract is automatically canceled.

French law reads this provision into contracts that contain no separate *force majeure* provisions. When there is no *force majeure* clause, Article 1218 applies, and the courts determine as a matter of law whether a particular event will be considered *force majeure*. However, the parties to a contract are free to specifically exclude *force majeure* from their contract or to determine its scope.

The same basic factors—an unforeseeable, external event that actually prevent performance—are woven into international agreements as well. For example, under Article 79 of the United Nations Convention on Contracts for the International Sale of Goods ("CISG") a party is not liable where non-performance "was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it, or its consequences." Like the Restatement and the U.C.C., the CISG relies on the concept of commercial and practical reasonableness, as opposed to absolute impossibility.

Similarly, organizations dealing with international trade often have language intended to address these issues. The International Chamber of Commerce ("ICC") has recently updated

its *Force Majeure* and Hardship Clauses in an effort to "balance business people's legitimate expectations of performance with the harsh reality that circumstances do change to make performance so hard that the contracts simply must change."[27] This language is in some respects similar to that of the U.C.C. in mitigating the "impossibility" factor in light of commercial reality.

Practical Observations

What Law Applies?

We have described above the common law approach taken by New York when it comes to contract law in genera. But, even in New York, if the contract is one for the sale of goods the U.C.C. approach will likely apply. Many states have expressly adopted the Restatement test, and for international transactions the CISG or another treaty may apply.

The first step to take is therefore to figure out what law applies. This will help you gauge your risk if you are in the position of not being able to perform, or evaluate your remedies if you are the non-breaching party.

How Does the Contract Assign Risk?

Under New York law, if the agreement itself expressly assigns a risk to one party, that party must bear that risk. If it assigns a specific duty to one party, it is almost certain that the risks associated with that duty will be considered "foreseeable." In *Kel Kim*, it was irrelevant whether liability insurance was actually impossible to obtain because Kel Kim had agreed to maintain such insurance and could have foreseen the possibility that it would be unavailable; it had therefore agreed to bear that risk. Even under the more flexible Restatement/U.C.C. formulation, if a party expressly undertakes a specific risk, it is unlikely to be relieved of its obligation.

Take a look at your agreements and see if there is language that can be read to assign the risk that has eventuated to one party or the other. This is not necessarily the specific risk of a pandemic—it could be simply that the risk of late delivery, or the inability to obtain goods from suppliers, or the possibility of a labor shortfall has been allocated to one party.

What Was Foreseeable?

Next, there is the question of foreseeability. Plagues have been interrupting trade and commerce since the beginning of recorded history. In a global historical context, plague, like war and death, is almost certainly foreseeable on a general level. And in fact many contracts *do* foresee these risks, and write them into *force majeure* clauses—a circumstance which would greatly simplify any litigation.

However, the cases on impossibility and frustration generally do not take a world-historical view. They look at the specific context of the agreement and the parties to it. "Sophisticated" parties are held to a higher standard and are expected to foresee the risks that inhere in their sphere of operations even if they would not be apparent to others. Therefore, "sophisticated" parties will benefit from "sophisticated" contracts if they want to preserve these defenses.

In the context of COVID, timing may matter a lot. When COVID first emerged is a matter of both epidemiological interest and partisan bickering. It seems clear that Chinese authorities were aware of a novel coronavirus as early as November of 2019. It seems equally clear that China downplayed its significance internationally for some time before embarking on a massive quarantine in late January 2020. During this period, was the possibility of a pandemic foreseeable? And where? And to whom?

For commercial contracts entered into after December 2019, there may well be significant issues of foreseeability depending on industry and geography. Different countries and U.S. states have also taken radically different approaches, whether driven by politics or epidemiology. Given mixed (and occasionally manifestly false)[28] messages from officials as to the status and likely trajectory of the pandemic, questions of foreseeability may persist for some time. It is worth looking at those agreements and considering options now.

How are Different Types of Contracts Affected?

Purely financial transactions, such as loans, securities transactions and the like are unlikely to be avoided under any of the legal regimes discussed here. Financial hardship by itself is just not enough, and these kinds of transactions rarely involve performance that would be made difficult by quarantine. A possible exception would be if settlement were delayed (for example, by bank closures or delays) or prohibited (for example, by new and unforeseen capital controls). But a debtor who cannot pay just because the business is in trouble will not likely be able to plead impossibility, frustration or impracticability.

Secured transactions present a different issue. If a transaction is secured by physical assets it may simply not be possible to take possession, even if your transaction and jurisdiction permit self-help. If court assistance is required, court closures may mean significant delays in foreclosing. If you

have a secured transaction at issue it would be wise to take a close look at your possible remedies now.

Sales of goods are likely to be profoundly affected. Many areas have been subject to mandatory quarantine, which means that factories in those areas are not fulfilling orders. Where the workforce has been sent home or the factory closed because of a government order, the case for impossibility seems strong, at least for those having direct contractual relationships with that business. But with many goods being assembled from complex networks of suppliers all over the world, it is quite possible that (for example) an end-product seller can get some, but not all, of their parts because some factories are open and some closed, or that they can get substitute parts only at exorbitant cost, or that they have taken title to the parts or goods but are unable to ship them. The issues here are potentially very complex. Now is a good time to begin considering possible remedies or defenses.

Finally, large capital projects could be at substantial risk as milestones come and go. If these are tied to lending covenants the drafting of the loan agreements with respect to *force majeure* could be crucial.

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1 EWHC QB J1 (1863), 3 B & S 826, 122 ER 309.

2 (1903) 2 KB 740.

3 159 MP Corp. v. Redbridge Bedford, LLC, 33 N.Y.3d 353, 359 (2019), rearg. denied, 33 N.Y.3d 1136 (2019).

4 *Id.* at 359 – 360..

5 407 E. 61st Garage, Inc. v. Savoy Fifth Ave. Corp., 23 NY2d 275, 281 (1968).

6 70 N.Y.2d 900, 902 (1987).

7 *Id.*

8 70 NY2d 900, 902 (1987).

9 If performance was illegal at the time of contracting there are different legal issues to consider, beyond the scope of this article.

10 Panto v Kentucky Distilleries & Warehouse Co., 215 A.D. 511, 515-16 (1st Dep't 1926).

11 115 AD3d 197, 200 (1st Dep't 2014).

12 *Id.*

13 *Id.* at 202.

14 Meijer v. Gen. Cigar Co., 81 NYS2d 488, 490 (Sup. Ct. New York Cnty. 1948).

15 Kama Rippa Music, Inc. v. Schekeryk, 510 F2d 837, 842 (2d Cir. 1975) (collecting cases).

16 Matter of A & S Transp. Co. v. County of Nassau, 154 AD2d 456, 459 (2d Dept 1989).

17 Crown IT Services, Inc. v Koval-Olsen, 11 A.D.3d 263, 265 (1st Dep't 2004).

18 Rockland Dev. Assoc. v. Richlou Auto Body, Inc., 173 A.D.2d 690, 691 (2d Dep't 1991).

19 PPF Safeguard, LLC v. BCR Safeguard Holding, LLC, 85 AD3d 506, 508 (1st Dep't 2011).

20 *Id.* at 902 – 903.

21 *Id.* at 903.

22 Section 2-615—"Excuse by Failure of Presupposed Conditions."

23 Restatement (Second) of Contracts § 261 *et seq*. Similarly, the Restatement refers to "substantial" frustration.

24 *Id.* § 261, comment (d).

25 Cal. Civ. Code § 1511(2).

26 Autry v. Republic Productions, 30 Cal 2d 144, 148-49, 180 P2d 888, 891 [1947]

27 https://iccwbo.org/publication/icc-force-majeure-and-hardship-clauses/

28 This is not intended as a gratuitous political statement. There may be a very real question of fact as to whether a party reasonably relied on various government pronouncements given their fact-challenged content and face-saving and overtly political objectives. It is not at all clear how reliance on government "data" and pronouncements affects "foreseeability."

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