

Overview

The novel COVID-19 virus has exposed all businesses to unforeseen challenges. A number of those challenges relate to the impact of the associated economic and societal upheavals on existing commercial contracts. As a general matter, commercial contracts vary greatly in their terms, structure and scope. Each party to a commercial contract has a different set of objectives, each contract has different obligations that may be affected in different ways, and each jurisdiction has different applicable laws. Businesses should seek to identify contracts that are likely to be affected by COVID-19 and review the highest-priority contracts among those to assess where the respective parties now stand.

Your principal commercial contracts may well be silent on whether they may be terminated due to the impact of COVID-19. In that circumstance, for the reasons set out below, it is unlikely that they can be terminated. While arguments could potentially be made that a contract has been “frustrated” in certain circumstances, such matters would be arguable on both sides and thus would likely need to be resolved through litigation.

In these circumstances, you may consider the extent to which you or your counterparty are able to be flexible and renegotiate key terms (e.g. the term of the contract, payments, quantities, performance milestones, etc.). Any such changes would constitute a renegotiation of the terms of the original contract and should thus be documented and agreed upon in writing either by correspondence or through a formal amendment to the original contract.

Advice

Termination of Commercial Contracts

Commercial contracts are likely to end either upon completion of any relevant services or after a defined period of time. It may be that a contract contains a “break clause” which enables a party to terminate the contract after a certain period of time and prior to its expiry, for a defined reason (“with cause”) or simply for convenience (“without cause”). In the absence of this, it is necessary to focus on other legal avenues which may potentially be available.

“Force Majeure” Clauses in Commercial Contracts

Commercial contracts may contain a “force majeure” clause, which temporarily excuses non-performance caused by events beyond the non-performing party’s control, such as war, terrorism or “Acts of God.” Courts typically interpret force majeure clauses narrowly. Therefore, whether a disruption like COVID-19 excuses performance will depend on the language of the particular force majeure clause in the contract. Under New York law, the force majeure clause will be triggered only where the clause expressly includes the event that has occurred. Where a force majeure clause explicitly uses terms such as “disease,” “epidemic,” “pandemic,” “quarantine,” “act of government” or “state of emergency,” parties may, depending on the circumstances, be able to assert force majeure as a defense to non-performance or a of contract breach in the case of the COVID-19 pandemic. In addition, although

rare, some contracts may excuse non-performance in circumstances where performance would be economically devastating because of a change in prices or costs. In addition, a court may require the party looking to rely on the force majeure clause to demonstrate the good faith steps it took in attempting to complete performance. Even if a force majeure clause can be relied upon to suspend performance, businesses should review the notice and other obligations which they may be required to comply with during the non-performance period.

Other Potential Actions

If a commercial contract does not expressly contain a helpful termination or force majeure clause, each party is required to perform its respective obligations or otherwise risk being sued for non-performance or breach of contract. In situations where non-performance is not contractually excused, businesses should consider whether the applicable contract contains price adjustment clauses (or a similar mechanism for altering the economics of the contract). Alternatively, the contract may contain a “liquidated damages” provision, which allows a party to terminate the contract in exchange for a payment penalty by the other party. In some circumstances, the liquidated damages provision may provide an “out” that is less costly than the cost of continued performance for the remainder of the term.

Remedies if a Business is Sued for Non-Performance

If a party is sued due to its non-performance, in the absence of force majeure clause, the party can argue “impracticability of performance” or “frustration of purpose” as a result of either COVID-19, or the governmental response, and may seek to excuse its lack of performance. To succeed on an impracticability defense, the party must show that its performance was made impracticable due to a supervening event. Many courts will also require the supervening event to be unforeseeable. While this principle has traditionally been applied based on the death of a party or destruction of a thing, a supervening prohibition of law (such as a shutdown of “non-essential” businesses, quarantine or travel restrictions) may be a sufficient basis to support such a defense. For a party to be discharged from its obligations under frustration of purpose, the frustration must go to the very purpose of the contract, and it must be substantial (e.g., not just that the transaction would result in a loss). Further, where the supervening event is temporary, courts will typically find that the supervening event only temporarily excuses timely performance. It may not be sufficient to discharge the contractual obligations fully.

Deposits

If under the terms of the contract you paid or collected a deposit that was expressed to be nonrefundable, or did not expressly contemplate being refundable, there is likely, depending on the stated purpose of that deposit, no legal obligation to return it.

Insurance

For more information on the potential for making claim under a business interruption insurance or other policy in light of COVID-19,

please see, the Legal Aid Society's pamphlet, Filing an Insurance Claim In the Aftermath of a Pandemic.

Government Relief

The federal and New York State governments have respectively indicated their intention to urgently assist small businesses in response to the economic hardships occasioned by the ongoing COVID-19 pandemic. The full scope of relief is unknown at the time of publication.

Goodwill

Notwithstanding your legal position, vendors may well be willing to not strictly enforce covenants in their favor, in order to maintain a relationship with their clients, enhance their reputation in the local community and generally respond to these unprecedented times. In particular, such vendors may be willing to renegotiate the terms of the contract through measures such as waiving termination rights, default or penalty events, allowing credit, agreeing to new payment plans or other creative solutions.

This is for informational purposes only and is not legal advice or counsel regarding your actual circumstances. If you have any questions or need legal assistance for your small business or not-for-profit organization please contact The Legal Aid Society's Community Development Project at (212) 426-3000 or communitydevproject@legal-aid.org