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## COVID-19 and Contract Enforcement

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There has been much discussion of the legal issues raised by the pandemic when contractual obligations can no longer be met. This memorandum notes some of those issues.

### Waiver

Contracts are voluntary arrangements. Likewise, enforcement of a contract is a voluntary act. One may decide not to insist on strict compliance. This can raise questions as to whether rights have been waived, and, if so, to what extent. Contract rights can be waived “fully or only partially,” depending on the circumstances.<sup>1</sup>

A decision to forbear from the enforcement of a contract right can be a valuable concession that serves as the basis of a new agreement, but ideally the new agreement will be drafted with care. Otherwise the decision can easily turn into a dispute. For waiver of contract rights is an issue of intent,<sup>2</sup> and questions of intent are often difficult prove. “[T]he intent to waive is usually a question of fact,”<sup>3</sup> therefore any failure to make one’s intention explicit and unambiguous can lead to the worst sort of dispute: a protracted one.

Contract provisions designed to avoid disputes over potential waivers and modifications of the contract may fail to serve their purpose. For example, many written contracts contain a provision stating that modifications of the contract are ineffective unless the modifications are made in writing. New York has a statute requiring such provisions be respected.<sup>4</sup> But New York’s highest court has held that two circumstances can make this statute’s protection against oral modifications inapplicable. The first is when “the oral agreement to modify has in fact been acted upon to completion”; the second is when “there is partial performance” that is “unequivocally referable to

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<sup>1</sup> *Fundamental Portfolio Advisors, Inc. v. Tocqueville Asset Mgmt., L.P.*, 850 N.E.2d 653, 659 (N.Y. 2006) (holding that a trial was necessary to determine whether a contracting party “fully or only partially waived its rights”).

<sup>2</sup> *Beth Israel Med. Ctr. v. Horizon Blue Cross & Blue Shield of N.J., Inc.*, 448 F.3d 573, 585 (2d Cir. 2006) (“[W]aiver of a contract right must be proved to be intentional ... and mere silence, oversight or thoughtlessness in failing to object to a breach of the contract will not support a finding of waiver.” (internal quotation marks omitted)).

<sup>3</sup> *Jeppaul Garage Corp. v. Presbyterian Hosp.*, 462 N.E.2d 1176, 1178-1179 (N.Y. 1984).

<sup>4</sup> N.Y. Gen. Oblig. Law § 15-301(1) (“A written agreement or other written instrument which contains a provision to the effect that it cannot be changed orally, cannot be changed by an executory agreement unless such executory agreement is in writing and signed by the party against whom enforcement of the change is sought or by his agent.”).

the oral modification.”<sup>5</sup> Furthermore, even if neither of those two exceptions to the statute apply, a party may still be barred from enforcing the original, written contract if a court finds that enforcing the unmodified contract would be unfair: “Once a party to a written agreement has induced another’s significant and substantial reliance upon an oral modification, the first party may be estopped from invoking the statute to bar proof of that oral modification.”<sup>6</sup>

Although events are unfolding quickly, parties to commercial contracts are urged to take the time to make their intentions in modifying their written contracts as clear as possible.

## **The Defense of Impossibility**

Under New York common law, sometimes a party is relieved from its contractual obligations because performance has become impossible. “Generally, however, the excuse of impossibility of performance is limited to the destruction of the means of performance by an act of God, Vis major, or by law.”<sup>7</sup> “[T]he impossibility must be produced by an unanticipated event that could not have been foreseen or guarded against in the contract.”<sup>8</sup> In the specific case of contracts for the sale of goods, New York’s Uniform Commercial Code codifies this rule. The statute refers to circumstances where “performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.”<sup>9</sup>

More often than not, impossibility defenses fail. For example, financial hardship, taken alone, is generally not enough.<sup>10</sup> But a government directive interfering with the contract can support an impossibility defense. The impossibility defense can succeed even if the government directive is informal. For example, in a case decided by a federal appeals court applying New York law, a U.S. business had a contract with a Swedish business relating to the supply of radio parts to Iran and other countries. The U.S. business then made an agreement with the U.S. government that it would cease supplying the parts to Iran. When the Swedish business sued it for breaching their contract,

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<sup>5</sup> *Rose v. Spa Realty Assocs.*, 366 N.E.2d 1279, 1283 (N.Y. 1977).

<sup>6</sup> *Id.*

<sup>7</sup> *407 East 61st Garage, Inc. v. Savory Fifth Ave., Corp.*, 244 N.E.2d 37, 41 (N.Y. 1968).

<sup>8</sup> *Kel Kim Corp. v. Central Markets, Inc.*, 519 N.E.2d 295, 296 (N.Y. 1987).

<sup>9</sup> N.Y. U.C.C. § 2-615.

<sup>10</sup> *Axginc Corp. v. Plaza Automall, Ltd.*, No. 14-CV-4648, 2017 WL 11504930, at \*8 (E.D.N.Y. Feb. 21, 2017) (“Financial difficult or economic hardship of the promisor does not establish impossibility sufficient to excuse performance of a contractual obligation” (citation, internal quotation marks and alteration marks omitted)).

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the court held that the U.S. business's "compli[ance] in good faith with the government's informal requirements" established an impossibility defense.<sup>11</sup>

Today, emergency orders and related government directives are issuing at a rapid pace. In New York City, restaurants, "entertainment venues," and "commercial gyms" have been directed to cease their principal operations.<sup>12</sup> Throughout New York State, most businesses have been directed to ensure that at least 50% of their workforce operates remotely.<sup>13</sup> More recently, the governor of New York State has tweeted that this figure will be increased to 75%<sup>14</sup> and that indoor portions of retail shopping malls throughout New York and other nearby states will be ordered to close.<sup>15</sup> These government directives may support an impossibility defense to certain contract claims.

New York's common law of contracts and the Uniform Commercial Code provide the applicable rules absent any agreement to the contrary. Many contracts seek to expand the law by a *force majeure* clause. These clauses must, however, be read carefully. "Ordinarily, only if the *force majeure* clause specifically includes the event that actually prevents a party's performance will that party be excused."<sup>16</sup>

## Insurance Policies

An insurance policy is a contract. Many businesses will naturally look to recover under their policies for losses caused by recent events. This can easily lead to disputes over the interpretation of the policy.

For example, some policies cover losses of income that are caused by "physical damage" to the insured's property. In such instances, the question naturally arises whether the presence of a virus on the property – or the potential for contamination – constitutes "physical damage." For example, in a 2005 case, it was held that a trial was necessary to determine whether an e-coli contamination on the insured's property constituted "physical damage" within the meaning of the policy.<sup>17</sup> The applicability of various exclusions written into particular contracts must also be closely examined. No doubt, the meaning of many insurance policies will be litigated in the time to come.

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<sup>11</sup> Harriscom Svenska, AB v. Harris Corp., 3 F.3d 576, 580 (2d Cir. 1993).

<sup>12</sup> Mayor's Emergency Executive Order No. 100 (Mar. 16, 2020), available at <https://www1.nyc.gov/assets/home/downloads/pdf/executive-orders/2020/eo-100.pdf>.

<sup>13</sup> Governor's Executive Order No. 202.6 (Mar. 18, 2020), available at <https://www.governor.ny.gov/sites/governor.ny.gov/files/atoms/files/EO202.6.pdf>.

<sup>14</sup> See <https://twitter.com/NYGovCuomo/status/1240651109108199424>.

<sup>15</sup> See <https://twitter.com/NYGovCuomo/status/1240350449041125376>.

<sup>16</sup> *Kel Kim Corp.*, 519 N.E.2d at 296.

<sup>17</sup> *Motorists Mut. Ins. Co. v. Hardinger*, 131 Fed. App'x 823, 826-827 (2d Cir. 2005).

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Businesses must review their insurance policies closely – including any notice provisions. Timely notice to the insurer, in appropriate form, should be one of the first concerns.

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