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The COVID-19 Effect: The Future of Contracts, Disputes and Commercial Litigation

The outbreak of the coronavirus (also known as COVID-19) is expected to result in thousands of deaths throughout the U.S. and is responsible for a shutdown of businesses, establishments, and offices throughout the country resulting in a national economic breakdown. In March 2020, Governor Andrew Cuomo ordered a shutdown of all non-essential businesses in New York and has mandated that non-essential employees work from home. The order was intended to quarantine workers, support social distancing and slow the spread of the virus as much as possible. The foreseeable consequence of this order is a slew of lawsuits, litigation, and contract disputes.

By reason of the government mandate, many establishments, offices, and companies have been unable to conduct business as usual, with many being forced to cease operations completely. The consequences likely will be that many such businesses will be unable to pay rent to their landlords, or will have to materially delay or renege on their obligations pursuant to commercial contracts. There are several potential defenses that parties to a contract whose obligations were made difficult or impossible by COVID-19 and the resulting government actions may claim to as a defense to such non-performance.

1) Force Majeure

A party to an agreement may assert a defense based upon a *force majeure* provision in commercial contracts, typically when an event that is deemed out of the control of either party, such as the occurrence of an act of God, or natural disaster. Historically, commonly referenced *force majeure* events include war, acts of terrorism, strikes, earthquakes, hurricanes, and, most relevant in recent times, quarantine or an epidemic.[1] First, it is important for parties to examine

[1] https://www.natlawreview.com/article/covid-19-force-majeure-event.

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the specific terms in these provisions, because for force majeure to apply to current instances of COVID-19 cases, courts will consider whether the "language in the *force majeure* clause specifically references the event as beyond the parties' control"[2], as well as whether the event in question was foreseeable and whether the event was the actual reason for the party's nonperformance.

Historically, state courts throughout New York have ruled that a pandemic, illness, or epidemic are typically and "…generally accepted by international practice as *force majeure*."[3] Further, in most cases, even on the federal level, *force majeure* acts are usually defined as epidemics, quarantine, strikes, severe weather, delays of common carriers, acts of God or "acts of the Government in either its sovereign or contractual capacity."[4] Articulating a defense based on a *force majeure* clause would allow a party to argue that their non-performance of its obligations pursuant to the agreement is excused based on an event or circumstances that were beyond their control. Given the recent events surrounding COVID-19, it may be expected that many contract parties will assert this defense for non-performance of their contractual obligations for periods affected by the government mandates related to the COVID-19 pandemic.

2) Impossibility; Frustration of Purpose

The doctrine of impossibility is a defense that a contract party may raise by reason of its inability to perform its contractual obligations by reason of COVID-19 and the related government mandates in effect during this time, asserting that the performance of such contractual obligations would be impossible because of the current circumstances. On a federal level, courts have ruled that when an epidemic occurs and affects society as a whole that may constitute an impossibility defense that renders the contract party unable to perform their contractual obligations. In *Jennie-O Foods, Inc. v. U.S.*, the court ruled that plaintiff's issue constituted only a case of economic hardship rather than legal impossibility of performance, because the "costs would be excessive and unreasonable, thus rendering performance so costly as to be impracticable."[5] In those instances, if courts find that performing would be costly, inconvenient, or difficult for a party, the doctrine of impossibility would not apply; whereas when an epidemic directly prevents a party from performing its obligations, then the defense of impossibility would likely apply.

3) Condemnation Claims

Many tenants are finding that they are unable to pay rent due under their leases as a result of loss of revenues. Meanwhile, other real estate related businesses, such as new developments, have been required to cease construction and related operations entirely as "non-essential" businesses due to the government mandate, thereby incurring tens of thousands of dollars of unanticipated expenses for carrying costs, demobilization and, when work is allowed to resume, re-mobilization. In such instances, there may be a claim that the cessation of business by reason of the government mandates resulted in a "taking" of the property, for which an owner or tenant may be compensated by the government authority issuing the order that made the subject property unusable.

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[2] https://www.natlawreview.com/article/covid-19-force-majeure-clauses-and-contractual-nonperformance.
[3] *Touche Ross & Co. v. Manufacturers Hanover Trust Co*., 107 Misc. 2d 438, 441 (1980).
[4] *General Injectables & Vaccines, Inc. v. Gates*, 527 F. 3d 1375, 1376 (2008).
[5] *Jennie-O Foods, Inc. v. U.S*., 580 F. 2d 400, 328 (1978).

Most condemnation claims are made in the context of physical takings of a property and in such instances, a tenant or an owner is paid the fair market value of its interest by the government authority that exercised such rights to eminent domain. However, it is possible that inverse condemnation claims may be made, which would not be limited to the physical taking of property.[6] There may also be a temporary taking or occupation of private property by reason of the action of a government authority, such as a flooding, or a "government regulation which burdens your property in such a way that you cannot derive any economical use out of it."[7] *In re Willis Avenue Bridge Replacement*, the court stated that in order "…to succeed on an inverse condemnation claim, a property owner must show that the government has intruded onto the [owner's] property and interfered with the owner's property rights to such a degree that the conduct amounts to a constitutional taking requiring the government to purchase the property from the owner." *In re Willis Avenue Bridge Replacement*, 177 A.D. 3d 453, 455 (2019). In that case, the claimant's claim for a *de facto* taking or inverse condemnation failed. However, in *Knapp v. County of Livingston*, the court ruled that the county of Livingston acquired use of an easement by inverse condemnation and could use it for limited purposes, but not to interfere with the enjoyment of the owner or tenant's property. *Knapp v. County of Livingston*, 175 Misc. 2d 112, 120-121 (1997). Although there is not much existing case law in New York that upholds inverse condemnation claims, this is a possible avenue for tenants and owners to seek compensation for claims related to the mandated cessation of business by reason of COVID-19.

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[6] https://www.ownerscounsel.com/eminent-domain-vs-inverse-condemnation-whats-the-difference/.
[7] *Id*.