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Construction Contracts in the Age of COVID-19 and Potential Defenses to Non-Performance Under New York Law by David Loglisci and Brenna Strype

May 29, 2020 - Long Island

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The novel coronavirus has completely upended the way of life for New Yorkers – including the way we work, feed our families and interact with people in our own communities. Every industry, including construction, has been impacted by the pandemic. Pursuant to a series of Executive Orders issued by Governor Cuomo, all non-essential businesses have been shut down in New York. “Essential” construction has been limited primarily to projects involving infrastructure, healthcare, schools, affordable housing and homeless shelters.

What can a contractor do if these pandemic-related restrictions make it difficult or impossible to perform its contract? Even if a project is deemed essential, equipment and materials, or perhaps skilled workers, may be in short supply due to the epidemic. Perhaps the costs to perform have skyrocketed. Can the contractor simply terminate the contract? Or, if he is sued for non-performance, does he have a valid defense?

This article discusses a number of contractual and common law defenses that should be considered by the contractor and his attorney.

Force Majeure

While COVID-19 and its impact on the business community most likely was not foreseen and therefore not specifically addressed in the contract, many contracts contain a “force majeure” clause that may excuse performance.

Force majeure clauses have a long history in contract – and are present in many contracts to excuse parties’ non-performance due to unforeseeable circumstances that are out of a party’s control. Kel Kim Corp. v. Central Markets, Inc.,70 N.Y.2d 900 (1987). New York courts narrowly enforce these types of clauses and require that they specifically include the event that is claimed to have prevented a party’s performance. Id.; Phibro Energy, Inc. v. Empresa De Polimeros De Sines Sarl, 720 F. Supp. 312, (S.D.N.Y. 1989). Therefore, unless the force majeure clause specifically lists

“pandemics,” “government shut-down” or the like, it is not likely to excuse a party’s performance based on the current situation, even if the clause contains a “catchall” phrase such as “any and all other events beyond the contractor’s control.” Kel Kim, 70 N.Y.2d at 903.

To succeed on a force majeure defense, a party also must demonstrate that the event prevented him from performance and timely comply with any applicable notice provisions in the contract. PT Kaltim Prima Coal v. AES Barbers Point, Inc., 180 F. Supp. 2d 475, (S.D. N.Y. 2001); Gulf Oil Corp. v. F.E.R.C., 706 F.2d 444, 455 (3d Cir. 1983). In addition, he must be able to show that he made reasonable efforts to perform under the contract. Phillips Puerto Rico Core, Inc. v. Tradax Petroleum Ltd., 782 F.2d 314, 319 (2d Cir. 1985).

While the COVID-19 pandemic likely would qualify as an unforeseeable event beyond a party’s control, the availability of a force majeure defense will depend on the specific language in the contract, as well as the other factors noted above. Notably, it is not sufficient merely that the pandemic has had an adverse economic impact on the contractor. Macalloy Corp. v. Metallurg, Inc., 284 A.D.2d 227, (1st Dep’t 2001).

Impossibility

Even if the contract does not contain a force majeure clause, the contractor still may have a common law defense of impossibility.

Impossibility excuses a party’s performance “when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible.” Kolodin v. Valenti, 115 A.D.3d 197, 979 N.Y.S.2d 587 (1st Dep’t 2014). The impossibility must be produced by an unanticipated event that could not have been foreseen or guarded against in the contract, and the doctrine “is generally limited to the destruction of the means of performance by an act of God, vis major, or by law.” Id.

Thus, contract performance will be excused where an unforeseeable change in the law or government action makes such performance objectively impossible. See Canrock Realty Corp. v. Vim Elec. Co., 179 Misc. 391, 393, 37 N.Y.S.2d 139, 141 (Sup. Ct. Westchester Co. 1942) (“[I]f a governmental act or decree destroys the subject matter of the contract, and makes performance impossible, that … thereby terminates the lease. The parties to the lease are presumed to have contracted with a view to the law as it existed at the time the lease was made.”); 119 Fifth Ave. v. Taiyo Trading Co., 275 A.D. 695, 87 N.Y.S.2d 430 (1st Dep’t 1949) (“If … the premises were vacated by government decision and direction, performance of the contract was prevented by law and defendant would be relieved of further liability under the lease.”).

For example, government restrictions immediately following the September 11 terrorist attacks potentially excused a travel customer’s late cancellation of a safari. Bush v. Protravel Intern, 192 Misc.2d 742, 746 N.Y.S.2d 790 (Civ. Ct. Richmond Co. 2002). In another case, a lessee of a tenement house was discharged from liability for rent where the premises were leased for a moving picture show, and the city subsequently prohibited the licensing of moving picture shows located in

tenement houses, so that the premises could not be used for the intended purpose, nor the lease performed according to its terms. Adler v. Miles, 69 Misc. 601, 126 N.Y.S. 135 (App. Term 1910).

Where the impossibility is only temporary, it suspends performance until the impossibility is removed. Scanlan v. Devon Sys., Inc., No. 89 CIV 1634 LMM, 2000 WL 218389, at *2 (S.D.N.Y. Feb. 24, 2000).

To succeed on an impossibility defense, performance must be impossible, not merely expensive or difficult. Generally, "the mere fact that a contract has become increasingly difficult and expensive to perform because of a law enacted after its execution does not excuse performance." 22A N.Y. Jur.2d Contracts § 404. "[E]conomic inability to perform contractual obligations, even to the extent of insolvency or bankruptcy, is simply not a valid basis for excusing compliance." Stasyszyn v. Sutton East Associates, 161 A.D.2d 269, 555 N.Y.S.2d 297 (1st Dep't 1990); 407 E. 61st Garage, Inc. v. Savoy Fifth Ave. Corp., 23 N.Y.2d 275, 281, 244 N.E.2d 37, 41 (1968). But see, Moyer v. City of Little Falls, 134 Misc.2d 299, 510 N.Y.S.2d 813 (Sup. Ct. Herkimer Co. 1986) (sanitation contractor relieved from contract to collect and dispose of refuse where contract was entered into on assumption that refuse could be dumped in nearby landfill, but State Department of Environmental Protection subsequently ordered such facility closed and contractor's only alternative was more distant landfill with rates more than six times greater than first facility's).

Impracticability

Notably, New York state courts generally do not recognize the related, but less stringent, defense of impracticability except in certain situations, such as the sale of goods. Impracticability excuses performance where a party can demonstrate that a supervening event has caused performance to be impracticable, though technically possible, including where performance would involve a "risk of injury to person … that is disproportionate to the ends to be attained by performance." See Restatement (Second) of Contracts § 261 (1981), and Comment d thereto. The defense of impracticability, as set forth in the Restatement, tends to be recognized only by the federal courts in New York. See, e.g., Allen v. City of Yonkers, 803 F. Supp. 679, 709 (S.D.N.Y. 1992); In re Martin Paint Stores, 199 B.R. 258, 265 (Bankr. S.D.N.Y. 1996), aff'd, 207 B.R. 57 (S.D.N.Y. 1997).

Frustration of Purpose

Another potential defense that a contractor may have is frustration of purpose. This defense applies where "the reasons for performing the contract cease to exist due to an unforeseeable event which destroys the reasons for performing the contract," even if "literal performance is still possible." 22A N.Y. Jur.2d Contracts § 367. "[T]he 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." PPF Safeguard, LLC v. BCR Safeguard Holding, LLC, 85 A.D.3d 506, 508, 924 N.Y.S.2d 391, 394 (1st Dep't 2011). Furthermore, this defense "only applies when a change in circumstances makes one party's performance virtually worthless to the other, frustrating his purpose in making the contract." Id.; see also, Restatement [Second] of Contracts § 265. The frustration must be substantial and is not sufficient merely if it is less profitable. Rockland Dev. Assocs. v. Richlou Auto

Body, Inc., 173 A.D.2d 690, 691, 570 N.Y.S.2d 343, 344 (2d Dep't 1991).

Given the unprecedented nature of the global COVID-19 pandemic and its impact on the construction industry, it is critical to discuss the specific circumstances and contract provisions in detail with an experienced attorney before making any decisions on how to proceed.

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