

COVID-19's Impact on Commercial Transactions and Disputes

Introduction

The ongoing Coronavirus (COVID-19) pandemic is among the most devastating and disruptive forces in recent history, with, as of the writing of this article, tens of thousands of cases confirmed worldwide. In an effort to curb the outbreak, governments have introduced various emergency measures, including travel restrictions, curfews, bans on public gatherings, and mandatory quarantines. In addition, many businesses have cancelled events, are requiring employees to work from home, and are taking other steps to limit the spread of the virus.

It is unclear how long the pandemic will last or how long the measures currently being undertaken will remain in effect. It is certain, however, that the global response to COVID-19 will have substantial effects on pending litigation. It is also likely that the pandemic will lead to numerous civil disputes, particularly in the context of commercial contracts.

The Pandemic's Impact on Pending Litigation

The pandemic will likely affect ongoing court proceedings in at least three ways.

First, as concerns about COVID-19 have escalated, courts have implemented various restrictions, ranging from visitor screenings to complete court closings. These measures will surely slow the pace of litigation. New York state courts, for instance, have implemented particularly drastic restrictions. Effective March 16, 2020, trials already pending in New York Supreme Court, which includes the Commercial Division, will continue to conclusion, but no other trials shall commence until further notice.¹ In addition, all non-essential court functions have been postponed indefinitely.² Essential functions in the Supreme Court outside the Commercial Division include civil commitments, guardianships, and any other essential applications as the court may allow.³ In the Commercial Division, they would likely include matters such as temporary restraining orders and other emergency forms of relief. Some Commercial Division judges have also issued individual practice rules to address the fallout from the pandemic. Justice Andrea Masley, for instance, has ordered that there will be no in-person appearances until further notice and that all oral arguments (currently scheduled between March 17, 2020 and April 17, 2020) and court conferences (currently scheduled between March 20, 2020 and April 17, 2020) will either be cancelled or conducted via teleconference.⁴

The Appellate Divisions for the First and Second Departments, meanwhile, have suspended certain filing and perfection deadlines indefinitely and until further notice.⁵ These appellate courts also will not be entertaining any motions aside from emergency applications, and will be re-calendaring arguments scheduled beyond a certain date (the second week of April in the First Department and April 2, 2020 in the Second Department).⁶

¹ <http://www.nycourts.gov/whatsnew/pdf/MEMO-3.13.20.pdf> (last visited March 18, 2020).

² <http://www.nycourts.gov/whatsnew/pdf/Updated-Protocol-AttachmentA3.pdf> (last visited March 18, 2020).

³ *Id.*

⁴ <https://www.nycourts.gov/LegacyPDFS/courts/comdiv/NY/PDFs/Part48-Temporary-Rules.pdf> (last visited March 18, 2020).

⁵ <http://www.courts.state.ny.us/courts/ad1/PDFs/Temporary%20Suspension%20Order.pdf> (last visited March 18, 2020); <http://www.courts.state.ny.us/courts/ad2/pdf/ADM%202020-0317.2%20-%20Emergency%20extensions.pdf> (last visited March 18, 2020).

⁶ <http://www.courts.state.ny.us/courts/ad1/PDFs/COVID-19%20EmergencyProcedures%20Mar2020.pdf> (last visited March 18, 2020); http://www.courts.state.ny.us/courts/ad2/NOTICE_REGARDING_LIMITATION_OF_COURT_OPERATIONS.pdf (last visited March 18, 2020).

Similarly, the U.S. District Courts for the Southern and Eastern Districts of New York have postponed trials scheduled to begin before April 27, 2020, while trials already pending will continue to conclusion.⁷ The Eastern District, however, is conducting case-related business as usual, subject to various visitor restrictions, and it will allow individual judges to decide whether to hold hearings, conferences, and bench trials.⁸ Similarly, civil case operations in the Southern District will proceed at the discretion of individual judges, with in-court appearances limited strictly to emergency matters.⁹

The U.S. Court of Appeals for the Second Circuit, by contrast, is currently hearing its appeals and motions calendars as scheduled.¹⁰ The Second Circuit has, however, extended certain deadlines by twenty-one days to minimize the disruption caused by the pandemic.¹¹ Whether these extensions will produce additional litigation logjams down the line remains to be seen.

Going forward, litigants should be cognizant that these restrictions have been – and likely will remain – subject to rapid changes as responses to this pandemic evolve. Even in the U.S. Supreme Court, where proceedings do not require appearances from any jurors or witnesses, extraordinary measures have resulted from concerns about the pandemic. Not only has the Court banned public visitors, it postponed its next round of oral arguments – the first time it has done so since 1918, when the Spanish flu epidemic hit Washington, D.C.¹²

Second, even if a proceeding has not been postponed, that proceeding might be conducted differently, such as via remote means, to limit the spread of the virus. Again, using New York state courts as an example, trial court judges have been directed to conduct any essential functions in a manner designed to minimize court appearances, meaning that most motions will be heard on submission.¹³ Similarly, judges in the Eastern District have been encouraged to conduct court proceedings by telephone or video conferencing where practicable, while judges in the Southern District, where in-court appearances are limited to emergency matters, have been directed to conduct proceedings remotely even in emergency matters if possible.¹⁴ At least one judge in the Southern District allowed – over objections from the government – a juror to participate in deliberations in a criminal case via videoconference.¹⁵

At the appellate level, the Appellate Divisions for the First and Second Departments will be processing the remainder of calendared arguments without in-person oral argument, and they will not be conducting any in-person oral argument until further notice.¹⁶ The Second Circuit has likewise suspended in-person oral argument and will be hearing all oral arguments using a teleconference platform.¹⁷

Outside of the courtroom, practitioners may find themselves turning to videoconferencing for discovery procedures

⁷ [https://nysd.uscourts.gov/sites/default/files/2020-03/20%20MISC%20154a%20\(002\)%20-%20In%20Re%20Coronavirus-COVID-19%20Pandemic.pdf](https://nysd.uscourts.gov/sites/default/files/2020-03/20%20MISC%20154a%20(002)%20-%20In%20Re%20Coronavirus-COVID-19%20Pandemic.pdf) (last visited March 18, 2020); https://img.nyed.uscourts.gov/files/general-ordes/2020-06_In_Re_CoronavirusCovid19Pandemic.pdf (last visited March 18, 2020).

⁸ https://img.nyed.uscourts.gov/files/general-ordes/2020-06_In_Re_CoronavirusCovid19Pandemic.pdf (last visited March 20, 2020).

⁹ <https://www.nysd.uscourts.gov/sites/default/files/2020-03/COVID%20Memorandum%20-%20FINAL.pdf> (last visited March 20, 2020).

¹⁰ <http://www.ca2.uscourts.gov/> (last visited March 18, 2020).

¹¹ *Id.*

¹² https://www.washingtonpost.com/politics/courts_law/supreme-court-coronavirus/2020/03/16/4dcbe6a8-679f-11ea-9923-57073adce27c_story.html (last visited March 18, 2020).

¹³ <http://www.nycourts.gov/whatsnew/pdf/Updated-Protocol-AttachmentA3.pdf> (last visited March 18, 2020).

¹⁴ <https://www.nysd.uscourts.gov/sites/default/files/2020-03/COVID%20Memorandum%20-%20FINAL.pdf> (last visited March 20, 2020); to https://img.nyed.uscourts.gov/files/general-ordes/2020-06_In_Re_CoronavirusCovid19Pandemic.pdf (last visited March 20, 2020)

¹⁵ Stewart Bishop, SDNY Judge Lets Sick Juror Deliberate Via Videoconference, Law360, Mar. 16, 2020.

¹⁶ <http://www.courts.state.ny.us/courts/ad1/PDFs/COVID-19%20EmergencyProcedures%20Mar2020.pdf> (last visited March 18, 2020); <http://www.courts.state.ny.us/courts/ad2/covid-19.shtml> (last visited March 18, 2020).

¹⁷ <http://www.ca2.uscourts.gov/> (last visited March 19, 2020).

such as depositions, as well as for notarizations where permitted under state law.¹⁸ Many client meetings and witness interviews may also occur remotely, whether out of a need to comply with governmental orders, or out of a commitment to social distancing – *i.e.*, the practice of creating physical space between individuals to reduce the spread of the virus, which has been strongly encouraged by health organizations.

Third, the unavailability of witnesses, inaccessibility of documents, and indisposition of attorneys due to COVID-19 will likely result in adjournments of trial dates, discovery periods, and briefing schedules, among other deadlines. Many documents are only accessible abroad and thus may lie outside the reach of attorneys subject to travel restrictions. Witnesses likewise may be unable to travel. And courts have regularly found good cause to extend deadlines due to the unexpected illnesses of witnesses and attorneys.¹⁹

Many courts may even take prophylactic measures to excuse likely delays. For example, the New York State Unified Court System Chief Administrative Judge Lawrence K. Marks issued an administrative order on March 19, 2020, providing that (1) civil litigants “shall use best efforts to postpone proceedings by agreement and stipulation for a period not to exceed 90 days” whenever a party, attorney, or other person is unable to meet discovery or other litigation deadlines “for reasons related to the coronavirus health emergency”; (2) “[a]bsent such agreement, the proceedings shall be deferred until such later date when the court can review the matter and issue appropriate directives”; and (3) “[i]n no event will participants in civil litigation be penalized if discovery compliance is delayed for reasons relating to the coronavirus public health emergency.”²⁰ In addition, the Governor of New York, Andrew Cuomo, issued an executive order that tolled numerous statutes of limitations, among other statutory deadlines.²¹

Any adjournments, in turn, will likely delay the adjudication and resolution of many commercial cases. Similarly, efforts to settle cases — whether by court involvement or by non-binding mediation or other consensual means — are likely to see a slowdown.

The Pandemic’s Implications for Commercial Disputes

Many commercial disputes are likely to arise out of the pandemic, particularly in the context of commercial contracts. As a result of the emergency measures imposed by various governments, it has or will become impracticable or impossible for many parties to perform their contractual obligations – or at least some will claim as such.²² A common question in the wake of the pandemic will thus be whether a party should be excused for its non-performance.

The answer to that question will vary by the terms of the contract at issue, the particular facts surrounding the non-performance, and the law of the jurisdiction involved. However, a party whose operations were compromised by the pandemic should seek to assess the applicability of three potential defenses: *force majeure*, frustration of purpose, and impossibility. In addition, parties to a contract of sale disrupted by the COVID-19 pandemic may be able to invoke Section 2-615(a) of the Uniform Commercial Code, which governs commercial impracticability for U.C.C. transactions.²³

¹⁸ The Governor of New York, Andrew Cuomo, issued an executive order authorizing notary services to be provided remotely. <https://www.governor.ny.gov/news/no-2027-continuing-temporary-suspension-and-modification-laws-relating-disaster-emergency> (last visited March 20, 2020).

¹⁹ See, e.g., *Martinez v. City of Avondale*, 2013 WL 673507, at *4 (D. Ariz. Feb. 25, 2013).

²⁰ <https://bit.ly/2WxY1Yv> (last visited March 20, 2020).

²¹ <https://www.governor.ny.gov/executiveorders> (last visited March 21, 2020).

²² For example, in New York City, Mayor Bill DeBlasio has issued an Executive Order requiring all bars and restaurants to close effective on the evening of March 16, 2020. See <https://www1.nyc.gov/assets/home/downloads/pdf/executive-orders/2020/eo-100.pdf> (last visited March 17, 2020). This, in turn, will force the cancellation of any events that were to be held at these establishments. In addition, the President has restricted travel from Europe which will render unfeasible various business conferences and meetings.

²³ Where contracts are governed by the United Nations Convention on Contracts for the International Sale of Goods (“CISG”), non-performance may also be excused under Article 79 of the CISG. Article 79 provides that “[a] party is not liable for failure to perform any of his obligations if he proves that failure was due to an impediment beyond his control and that he could not reasonably

1. Force Majeure

The *force majeure* defense is available only if the contract contains a *force majeure* clause,²⁴ which is a provision that excuses non-performance due to certain circumstances beyond the parties' control. What constitutes a *force majeure* event varies by contract but typically includes events such as war, strikes, riots, governmental orders, and "Acts of God."²⁵

In deciding whether to rely on a *force majeure* clause, parties should be cognizant of a few potential obstacles. First, courts construe these clauses narrowly. In New York, for example, the general rule is that a party's performance will be excused only if the clause specifically contemplates the particular event which prevents performance.²⁶ In addition, the New York Court of Appeals held in a seminal case involving interpretation of a *force majeure* clause that, where such a clause contains an expansive catch-all provision in addition to specifically listed events, the catch-all provision should not be given expansive meaning.²⁷ Instead, according to the Court, it should be read to include only those events that fall within the same general kind or class as the listed events. In that case, the recited events pertained to a party's ability to conduct day-to-day operations on its premises. The Court found that the claimed *force majeure* event (*i.e.*, the inability to procure and maintain certain insurance) did not relate to day-to-day operations and therefore could not excuse non-performance.

Second, under certain circumstances, a party may be unable to rely on a *force majeure* clause if it failed to comply with conditions attached to the exercise of that clause.²⁸ Such conditions may include, among other things, obligations to notify affected parties within a specific time period following a *force majeure* event and to take steps to minimize the impact of the *force majeure*.²⁹ Relatedly, some *force majeure* clauses may not totally relieve a party of the obligation to the perform, instead suspending or delaying the time for performance.

Third, again depending on the language of the clause, a party seeking to invoke this defense may be required to show that non-performance was unavoidable.³⁰ Mere commercial impracticality of, or unanticipated difficulty in, performance is typically insufficient to excuse non-performance.³¹ Consistent with these principles, some courts applying New York law have rejected a *force majeure* defense where the purported basis for non-performance was financial hardship,³² but this defense is valid where the contract specifically contemplated such an excuse.³³ The need to comply with a government order, by contrast, has been held to be a sufficient excuse because the government has the power to compel compliance.³⁴

be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome its consequences." CISG Art. 79(1). It also imposes notice obligations. CISG Art. 79(4). Article 79 applies even if a contract does not contain an express *force majeure* provision. *Raw Materials, Inc. v. Manfred Forberich GmbH & Co.*, KG, No. 03 C 1154, 2004 WL 1535839, at *3 (N.D. Ill. July 7, 2004). In applying the Article, courts have looked to caselaw interpreting analogous U.C.C. provisions for guidance. *Id.*; see also *Macromex SRL v. Globex Int'l, Inc.*, No. 08 CIV. 114 (SAS), 2008 WL 1752530, at *1 (S.D.N.Y. Apr. 16, 2008).

²⁴ *Gen. Elec. Co. v. Metals Res. Grp. Ltd.*, 293 A.D.2d 417, 418 (1st Dep't 2002).

²⁵ See, e.g., *Team Mktg. USA Corp. v. Power Pact, LLC*, 41 A.D.3d 939, 942 (3d Dep't 2007).

²⁶ *Kel Kim Corp. v. Cent. Markets, Inc.*, 70 N.Y.2d 900, 902-03 (1987).

²⁷ *Id.* at 903.

²⁸ *PT Kaltim Prima Coal v. AES Barbers Point, Inc.*, 180 F. Supp. 2d 475, 482 (S.D.N.Y. 2001).

²⁹ See *id.*

³⁰ *Constellation Energy Servs. of New York, Inc. v. New Water St. Corp.*, 146 A.D.3d 557, 559 (1st Dep't 2017) (denying motion to dismiss on the basis of *force majeure* clause because the defendant had not established as a matter of law that its failure to perform was an unavoidable result of the claimed *force majeure*); see also *Rembrandt Enterprises, Inc. v. Dahmes Stainless, Inc.*, 2017 WL 3929308, at *13 (N.D. Iowa Sept. 7, 2017) (in commercial dispute arising out of the avian flu epidemic, poultry farmer was unable to invoke *force majeure* to cancel an order for no-longer-needed machinery because the *force majeure* clause applied to the supplier's performance, and supplier remained capable of performing).

³¹ *Id.*; see also *Phibro Energy, Inc. v. Empresa De Polimeros De Sines Sarl*, 720 F. Supp. 312, 318 (S.D.N.Y. 1989).

³² See, e.g., *Macalloy Corp. v. Metallurg, Inc.*, 284 A.D.2d 227, 227 (1st Dep't 2001).

³³ *In re Old Carco LLC*, 452 B.R. 100, 119 (Bankr. S.D.N.Y. 2011)

³⁴ *Harriscom Svenska, AB v. Harris Corp.*, 3 F.3d 576, 580 (2d Cir. 1993).

Fourth, a *force majeure* defense is only available if the non-performance resulted from the claimed *force majeure*.³⁵ Therefore, if a party was incapable of performing regardless of the COVID-19 outbreak, that party likely could not successfully argue that the outbreak should excuse its non-performance.

The foregoing are only some of the issues associated with likely litigation surrounding *force majeure* defenses, and the outcome of any of these disputes will turn on the particular facts involved.

2. Frustration of Purpose

A non-performing party may also be able to avail itself of the frustration of purpose defense. Unlike *force majeure*, this defense is potentially available regardless of whether the contract specifically mentions the doctrine.

The specific requirements for this defense vary by jurisdiction but are generally quite stringent. Under New York law, the frustration doctrine excuses non-performance only when a change in circumstances makes one party's performance virtually worthless to the other, frustrating its purpose in making the contract.³⁶ The defense does not apply where performing under the contract would merely occasion financial difficulty or hardship.³⁷ In addition, the defense is not available where the event that prevented performance was foreseeable and reasonable provision could have been made for its occurrence.³⁸

3. Impossibility and U.C.C. Section 2-615(a)

If neither of the foregoing defenses is available, a non-performing party may still seek to invoke the impossibility defense. Under New York law, the impossibility doctrine excuses a party's performance when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible.³⁹ Generally, the impossibility must be the result of an unanticipated event that could not have been reasonably foreseen or guarded against in the contract.⁴⁰

The court's decision in *U.S. Bancorp Equip. Fin., Inc. v. Ameriquest Holdings LLC* is instructive. In that case, participants in the airline industry who had defaulted on their loan agreements argued that their performance was rendered impossible by the events of 9/11.⁴¹ The court rejected that argument because, although 9/11 had radically depressed the market for airplanes, the subject matter of the contract – *i.e.*, airplanes – had not been destroyed.

Some jurisdictions have abandoned the requirement of strict impossibility and, following Section 2-615(a) of the Uniform Commercial Code, require only commercial impracticability.⁴² The commercial impracticability doctrine typically requires a party to show impracticability because of extreme and unreasonable difficulty, expense, injury or loss involved.⁴³

Other Legal Issues Arising out of the Pandemic

In addition to these contractual issues, the pandemic is poised to create numerous other legal challenges for businesses. Businesses experiencing operational disruptions, for example, may find themselves embroiled in insurance disputes. These disputes will turn on the language of the policy at issue. For example, in some property

³⁵ *In re Old Carco*, 452 B.R. at 120.

³⁶ *PPF Safeguard, LLC v. BCR Safeguard Holding, LLC*, 85 A.D.3d 506, 508 (1st Dep't 2011).

³⁷ *Bierer v. Glaze, Inc.*, 2006 WL 2882569, at *7 (E.D.N.Y. Oct. 6, 2006).

³⁸ *Warner v. Kaplan*, 71 A.D.3d 1, 6 (1st Dep't 2009).

³⁹ *Kel Kim*, 70 N.Y.2d at 902.

⁴⁰ *Id.*

⁴¹ *U.S. Bancorp Equip. Fin., Inc. v. Ameriquest Holdings LLC*, 2004 WL 2801601, at *4 (D. Minn. Dec. 7, 2004) (applying New York law).

⁴² See *Opera Co. of Bos. v. Wolf Trap Found. for Performing Arts*, 817 F.2d 1094, 1099 (4th Cir. 1987)

⁴³ *Hemlock Semiconductor Operations, LLC v. SolarWorld Indus. Sachsen GmbH*, 867 F.3d 692, 702 (6th Cir. 2017) (applying Michigan law); accord *Int'l Minerals & Chem. Corp. v. Llano, Inc.*, 770 F.2d 879, 886 (10th Cir. 1985) (applying New Mexico law).

insurance policies, coverage for business interruptions requires “direct physical loss” to insured property.⁴⁴ Thus, if a business files a claim for a COVID-19-related interruption, insurers may dispute whether a “physical loss” has occurred. Other policies may contain exclusions such as for viruses.

Businesses may also face tort claims from patrons alleging that they contracted COVID-19 on their premises, as well as employees claiming that they contracted the virus on the job.

Another issue that may arise is whether the pandemic constitutes a “Material Adverse Change” or “Material Adverse Effect” (collectively, “MAC”) under an existing transaction. Many acquisition and financing agreements contain MAC provisions, under which the non-existence of a MAC is a condition to closing. Whether the pandemic constitutes a MAC will depend on the terms of the provision at issue, as well as the magnitude of the impact on the relevant party’s business. However, a few general principles bear mentioning. First, courts typically read MAC provisions narrowly. Second, while there is no bright-line rule for assessing materiality, courts generally apply a strict standard. For example, in a seminal decision from the Delaware Court of Chancery, the court held that the event at issue must substantially threaten the overall earnings potential of the relevant party in a durationally-significant manner (*i.e.*, for years, not months).⁴⁵ Third, an adverse change must usually be company-specific. If every business in the relevant market is similarly affected, then the buyer or financier must usually bear the risk.

In sum, a host of legal issues are likely to arise in the wake of the Coronavirus pandemic.

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⁴⁴ See Generally; “Physical” loss or damage, 10A Couch on Ins. § 148:46.

⁴⁵ *In re IBP, Inc. Shareholders Litig.*, 789 A.2d 14, 68 (Del. Ch. 2001).