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2 NY Contract Cases Highlight Limits Of Impossibility Defense

By **Muhammad Faridi and Timothy Smith** (September 24, 2020, 12:35 PM EDT)

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A common question in the wake of the COVID-19 outbreak has been whether the pandemic or governmental responses to the pandemic provide, depending on the jurisdiction, an impossibility or impracticability defense for nonperformance under a contract.

The answer to that question will, of course, turn on the facts underlying the nonperformance, as well as the law of the jurisdiction.[1] Two recent decisions from New York are instructive on the contours of the defense of impossibility — the relevant defense under New York law.

As an initial matter, while some jurisdictions have opted for the less stringent impracticability defense, New York has chosen to follow the common law rule that requires impossibility to excuse nonperformance.[2] This defense requires that "the destruction of the subject matter of the contract or the means of performance [made] performance objectively impossible."[3] "Moreover, the impossibility must [have been] produced by an unanticipated event that could not have been foreseen or guarded against in the contract."[4]

The impossibility defense is often asserted alongside the contract-based force majeure defense, as well as the common law defense of frustration of purpose. Contracts that involve the sale of goods are subject to the impracticability defense provided by Section 2-615 of the Uniform Commercial Code.[5]

Although there is limited case law on the impossibility defense in New York, two recent decisions — one from the U.S. District Court for the Southern District of New York and one from the Supreme Court of New York, New York County — have interpreted it narrowly.

In the first case, Lantino v. Clay LLC, the Southern District of New York held that financial difficulty, standing alone, cannot support the impossibility defense under New York law.[6]

The parties in Lantino — a group of gym operators and their employees — had entered into a settlement agreement in late 2019 to resolve the employees' wage and hour claims.[7] Under that agreement, the gym operators were required to make monthly payments in the total amount of $300,000.[8] In the event of a default, the employees would be entitled to seek a consent judgment

against the gym operators in the amount of $1 million, less any payments previously made.[9]

In April, the employees moved for entry of the consent judgment in the amount of $923,913.51 ($1 million less $76,086.49 previously paid), claiming a default.[10] In opposition, the gym operators did not dispute that they were in default, but argued that "their performance should be excused based upon the doctrine of impossibility because of their inability to pay, ostensibly as a result of the COVID-19 pandemic and Governor [Andrew] Cuomo's PAUSE Executive Order."[11]

The court granted the employees' motion for entry of the consent judgment, explaining that the impossibility defense is inapplicable "where impossibility or difficulty of performance is occasioned only by financial difficulty or economic hardship."[12]

The second case, Backal Hospitality Group LLC v. 627 West 42nd Retail LLC in the Supreme Court of New York, New York County, turned on a specific provision in the parties' contract.[13]

In Backal, the plaintiffs — a caterer, its personal guarantor and the caterer's issuer of a letter of credit — sought preliminary injunctive relief absolving the caterer's rent payment obligations under a commercial lease.[14] The plaintiffs contended that they were likely to succeed on the merits because, inter alia, Cuomo's "March 22 order prohibiting large gatherings of people rendered it impossible ... to perform under the lease."[15]

Historically, parties have sometimes succeeded in asserting the impossibility defense where a governmental regulation or order forbade or prevented performance.[16] In Backal, however, the court rejected the plaintiffs' argument, noting that the lease contained a clause providing that:

If the fixed rent or any additional rent shall be or become uncollectable by virtue of any law, governmental order or regulation, or direction of any public officer or body, Tenant shall enter into such agreement or agreements and take such other action (without additional expense to Tenant) as Landlord may request, as may be legally permissible, to permit Landlord to collect [rent].[17]

The court reasoned that this provision showed that the parties "evidently contemplated a scenario in which performance of the lease terms by plaintiffs might become prohibited by a governmental order, and agreed that, if such a situation arose, they would reach an agreement regarding the collection of rent at the conclusion of the governmental restriction."[18]

And, the court continued, the impossibility defense was not available because plaintiffs had not complied with the provision but had instead "attempted to terminate the lease in a manner violative of the terms thereof."[19]

This decision appears to embrace two bases for rejecting the impossibility defense. First, it suggests that the impossibility defense was unavailable because the parties had foreseen and contracted around the event underlying the defense.[20] Second, it appears to be premised in part on the defense's causation requirement.[21]

That is, the court suggested that it was not the executive order that caused the plaintiffs' breach of contract, but rather the plaintiffs' decision not to follow the lease's prescribed method for resolving a dispute in the event of that executive order. Thus, the court reasoned, the plaintiffs could not claim impossibility as the basis for nonperformance.

In any event, the Backal decision confirms that the availability of the impossibility defense will turn largely on the facts underlying the nonperformance.

Going forward, we expect to see numerous decisions addressing whether the circumstances engendered by COVID-19 support an impossibility defense. As these cases indicate, it may be challenging for parties to invoke the defense.

But, even with these cases as guidance, practitioners should be cognizant that the outcome of COVID-19-related contract disputes will frequently be difficult to predict. In many cases, the contract at issue will not contain a provision similar to the one that determined the outcome in Backal. And, in some cases, the issue of whether the contract was, in fact, impossible to perform due to COVID-19 may be more difficult to determine than it was in Lantino.

Also, some jurisdictions have abandoned the requirement of impossibility in favor of requiring commercial impracticability.[22] This lesser — but still rigorous — standard may be met where performance would involve extreme and unreasonable difficulty, expense, injury or loss.[23]

It also bears noting that courts have, at least in the past, addressed the impossibility defense in divergent manners. In cases arising out of what is perhaps the closest parallel to COVID-19 — the 1918 flu pandemic, which killed tens of millions of people between 1918 and 1920 — many courts rejected attempts to invoke the pandemic as an excuse for nonperformance,[24] while other courts reached a different conclusion on analogous facts.[25]

Practitioners should also be aware that a nonperforming party may be able to succeed on a force majeure or frustration of purpose defense even if the impossibility defense is unavailable. That is so because, even though the defenses are often asserted alongside each other, they are in fact different and have varying standards depending upon the jurisdiction.

In sum, although Lantino and Backal provide some guidance for practitioners, they address only a handful of the issues associated with likely litigation surrounding nonperformance in the wake of COVID-19.

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[1] See Stephen Younger, Muhammad Faridi and Timothy Smith, "COVID-19's Impact on Commercial Transactions and Disputes," New York State Bar Association (March 23, 2020).

[2] Kel Kim Corp. v. Cent. Markets Inc., 70 N.Y.2d 900, 902 (1987).

[3] Id.

[4] Id.

[5] Parties to a contract of sale who are located in different countries may also seek to invoke a similar provision under Article 79 of the United Nations Convention on Contracts for the International Sale of Goods.

[6] Lantino v. Clay LLC, No. 1:18-cv-12247, 2020 WL 2239957 (S.D.N.Y. May 8, 2020).

[7] Id. at *1.

[8] Id. at *2.

[9] Id.

[10] Id.

[11] Id. at *3.

[12] Id. (quoting 407 E. 61st Garage Inc. v. Savoy Fifth Ave. Corp., 23 N.Y.2d 275, 281 (1968)).

[13] Backal Hospitality Group LLC v. 627 West 42nd Retail LLC, No. 154141/2020, 2020 WL 4464323 (N.Y. Sup. Ct. Aug. 03, 2020).

[14] Id. at *1.

[15] Id. at *4.

[16] See, e.g., Organizacion JD Ltda. v. U.S. Dep't of Justice, 18 F.3d 91, 95 (2d Cir. 1994) (intended recipients of money transfers could not sue banks for failing to transfer funds given that act of federal official made performance impossible).

[17] Id.

[18] Id. at *5.

[19] Id.

[20] See Kel Kim, 70 N.Y.2d at 902 (holding that impossibility defense was unavailable where "the plaintiff's predicament ... could have been foreseen and guarded against ... in the lease").

[21] See id. ("[T]he impossibility must be produced by [the] unanticipated event.").

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

[23] 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).

[24] See, e.g., Phelps v. Sch. Dist. No. 109, Wayne Cty., 134 N.E. 312, 313 (Ill. 1922) (rejecting attempt to avoid paying teacher's salary because school was closed for a two-month period due to the pandemic).

[25] See Gregg Sch. Twp., Morgan Cty. v. Hinshaw, 132 N.E. 586, 587 (Ind. App. 1921) (excusing school board from paying teaching salaries on the basis of impossibility after school was closed by board of health).