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COVID-19 litigation brings few surprises so far

New York Law Journal

December 17, 2020 | By **Thomas J. Hall** and **Judith A. Archer**

In their Commercial Division Update, Thomas J. Hall and Judith A. Archer write that where COVID-based arguments have been raised, the results are not particularly surprising in light of well-developed New York law, including for the criteria to establish impossibility of performance, frustration of purpose or other contractual excuse.

Earlier this year, there were many predictions of a litigation explosion due to the COVID19 pandemic. While the worst may be yet to come, an avalanche of COVID-19 arguments has not yet cascaded into the Commercial Division. Where COVID-based arguments have been raised, the results are not particularly surprising in light of well-developed New York law, including for the criteria to establish impossibility of performance, frustration of purpose or other contractual excuse. In this column, we examine how the Commercial Division has dealt with these issues to date, which might provide some insight into how COVID-19 arguments will be resolved in the future.

Contractual issues

Predictably, the pandemic—and resulting business and travel restrictions—has led to arguments that a party's contractual performance should be excused, most notably due to impossibility of performance or frustration of purpose. Those arguments, however, have run up against the high hurdle under New York Law for establishing such.

Under New York law, the doctrine of impossibility excuses one party's performance of its contractual obligations "only when destruction of the subject matter of the contract or the means of performance makes performance objectively impossible." *Kel Kim v. Cent. Mkts.*, 524 N.Y.S.2d 384, 385 (1987). Financial difficulty or economic hardship alone does not excuse performance for impossibility. *Valenti v. Going Grain*, 159 A.D.3d 645, 645 (1st Dept. 2018) (citing *407 E. 61st Garage v. Savoy Fifth Ave., 23* N.Y.2d 275, 281 (1968)). Relatedly, the doctrine of frustration of purpose requires that the 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." *Crown IT Servs. v. Koval-Olsen*, 11 A.D.3d 263, 265 (1st Dept. 2004) (citing Restatement (Second) of Contracts, §265 (1981)).

The Commercial Division applied these principles in *Vector Media v. Go New York Tours*, 2020 WL 5992328 (N.Y. Co. Oct. 7, 2020). Go New York, the operator of double-decker tour buses in Manhattan, contracted to provide a media advertiser the exclusive rights to place advertising on and in its buses, and agreed to provide access to its fleet so advertisements could be placed. Prior to the pandemic, the court issued a preliminary injunction ordering Go New York to comply with its contractual obligation to provide such access. Following the COVID-19 outbreak, Go New York moved to vacate that preliminary injunction on the grounds of impossibility and frustration of purpose. Go New York asserted that, following the outbreak, it shut down all operations and that, when it resumed limited operations several months later, it generated only 2 to 3% of its ordinary revenues. As a result of these reduced operations, the media plaintiff allegedly ceased making payments and ceased placing new advertising. Go New York argued that the purpose of the parties' agreement had been thwarted and the parties should be relieved from any further obligations thereunder.

Justice Andrew Borrok of the New York County Commercial Division rejected these arguments in denying the motion, keeping the earlier preliminary injunction in place. The court observed that Go New York could still operate its business "notwithstanding with certain restrictions, and as such, cannot claim that performance is objectively impossible." Additionally, the court concluded that a reduction in revenue as a result of COVID-19 was insufficient to establish frustration of purpose which applies only where the frustrated purpose is "so completely the basis of the contract that, as both parties understood, without it the transaction would have made little sense." The court found significant that the parties' agreement expressly contemplates periods of reduced operation and provides for resulting reduced payments.

Similarly, in *Maesa v. TPR Holdings*, Justice Jennifer Schecter of the New York County Commercial Division concluded that the doctrines of impossibility and frustration of purpose based on the COVID-19 pandemic did not excuse defendant's obligations under a settlement agreement. Under that settlement agreement entered on March 6, 2020, just before the pandemic exploded, the defendant agreed to pay almost $2.5 million for goods the plaintiff had provided, and further agreed to deliver certain other goods to plaintiff. In seeking to avoid those obligations, the defendant argued it was unable to perform due to the COVID-19 pandemic. Unpersuaded, the court reasoned that the defendant submitted "no evidence or explanation of how performance was impossible by the … cure date, rather than being difficult due to the pandemic." The court recognized that the legal excuse of impossibility is not triggered where performance is possible, albeit unprofitable. 2020 WL 5499231, at *1 (N.Y. Co. Sept. 9, 2020) (citing *Lantino v. Clay*, 2020 WL 2239957, at *3 (S.D.N.Y. May 8, 2020) (stating that "financial difficulties arising out of the COVID-19 pandemic" do not excuse performance under a pre-COVID settlement agreement)).

Commercial reasonableness

Aside from arguments to excuse contractual performance, the impact of COVID-19 has also caused the Commercial Division to grapple with what is commercially reasonable in the context of the pandemic. In *D2 Mark v. Orei VI Investments*, 2020 N.Y. Slip Op. 32057(U), 2020 WL 3432950 (N.Y. Co. June 23, 2020), the plaintiff's COVID-based arguments were successful in achieving preliminary injunctive relief.

Following plaintiff's default on a loan, the defendant lender gave notice of a UCC sale of plaintiff's membership interest in a limited liability company that owned the Mark Hotel in New York, which had been pledged as security for that loan. The plaintiff complained that the defendant gave only 36 days' notice of that sale, which the plaintiff asserted did not satisfy the UCC requirement of commercial reasonableness. The plaintiff argued, among other things, that such a sale at that time was commercially unreasonable as, due to the pandemic, prospective buyers would be inhibited from inspecting the hotel to assess its value. Plaintiff moved for a preliminary injunction enjoining defendant from proceeding with that proposed sale. Defendant countered that it was simply exercising its rights under the loan agreement and that delaying the sale risked the hotel deteriorating in value from COVID-19 "or its resurge, civil unrest, and disagreements between the Governor and Mayor of New York City on how to proceeding re-opening the economy."

In evaluating each element for a preliminary injunction, Justice Andrea Masley of the New York County Commercial Division first concluded that plaintiff had "established likelihood of success on its claim that defendants' notice of 36 days may be unreasonable during a global pandemic as the Mark Hotel was closed until June 15, 2020 making inspection impossible for 27 of the 36 days of notice, which deprives interested bidders of the chance to do due diligence." Additionally, because the parties' loan agreement limited plaintiff's remedies to injunctive relief, the court determined that money damages would be unavailable and, therefore, plaintiff would have no adequate remedy at law if the provisional relief was denied. Finally, in balancing the equities, the court determined that plaintiff's potential losses if injunctive relief were denied greatly outweighed those of the defendant, whose alleged injuries were purely conjectural: "The court cannot accept defendant's invitation to predict the future: whether COVID-19 will resurge; whether protests will continue to be peaceful; whether the mayor and governor will together address transportation problems in New York City."

As such, the court granted limited injunctive relief and stayed the sale for 30 days. The court further directed that the defendant re-notice the sale, that the defendant must clearly state in that notice that bidders may participate virtually, and that the notice must "comport with current CDC, state and local regulations."

Use and occupancy

Not surprisingly, the pandemic has also given rise to a dispute over whether the amount ordered to be paid by a tenant for use and occupancy of real property should be modified.

In *538 Morgan Ave. Properties v. 538 Morgan Realty*, 2020 N.Y. Slip Op. 32780(U), 2020 WL 5026659 (Kings Co. Aug. 20, 2020), the parties had executed an agreement by which plaintiffs

purchased defendants' business, and a separate agreement by which plaintiffs agreed to purchase the building out of which the business operated. A dispute over the real estate sale arose. Plaintiffs made two initial rounds of payments for the property, but defendants canceled the contract alleging plaintiffs materially breached the agreement by failing to make further payments, which plaintiffs disputed. After the plaintiffs brought suit to enforce the real estate sale contract, plaintiffs were granted a preliminary injunction enjoining defendants from interfering with their tenancy pending a determination of that action, on the condition that plaintiffs paid use and occupancy in a monthly amount set by the court.

Following the outbreak of the pandemic, plaintiffs moved for an order reducing or eliminating the use and occupancy payments. Plaintiffs argued that, due to various state executive orders, it was unable to operate its business and was forced to close, and asked that the obligation to pay use and occupancy be suspended until such time as they were legally permitted to resume business operations. Defendants cross-moved for an order increasing the use and occupancy amount, arguing that the previous rate was now below market value.

Justice Lawrence Knipel of the Kings County Commercial Division initially observed that the court is "empowered to modify use and occupancy upon a proper showing." However, the court found "plaintiffs have failed to satisfy their burden that their use and occupancy should be modified in the form of forgiveness." The court stated that, while plaintiffs had submitted evidence that their business was temporarily closed, they failed to submit any evidence that they were unable to pay the monthly use and occupancy amounts previously set by the court.

The court also denied defendants' cross-motion for an increase in the monthly use and occupancy payment. While the defendants had submitted expert market analyses to support the requested increase, the court found that the defendants' expert failed to account for the effects of COVID-19 on commercial rent prices, and thus the evidence was "insufficient to support an upward modification of use and occupancy."

Conclusion

The COVID-19 pandemic has had an enormous impact on businesses and people across the country. To date, that impact does not seem to be as pronounced in the decisions coming from the Commercial Division. Without more, the pandemic has been insufficient for parties in Commercial Division cases to be excused from performance under contracts or previous court orders, but it has supported relief in the context of commercial reasonableness. Stronger cases, including where COVID-19 has left obligations objectively impossible to perform, are likely yet to come.

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