

# MSF CLIENT ALERT

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## Considerations for Invoking the Defenses of Frustration of Purpose & Impossibility of Performance

*Frustration of purpose and impossibility of performance are often mentioned as potential excuses for failing to perform contractual obligations because of the Coronavirus pandemic. Whether, and in what circumstances, New York courts will permit these defenses in the context of the COVID-19 crisis is a matter of significant speculation. This post surveys how New York courts have applied these doctrines and discusses how they might be applied in the post-Coronavirus world.*

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### Overview of the Doctrines

*Frustration of purpose.* The doctrine of frustration of purpose applies when a change in circumstances makes one party's performance virtually worthless to the other, frustrating his purpose in making the contract. In order to invoke this defense, the frustrated purpose must be so essential to the basis of the contract that, as both parties understood, without it, the transaction would have made little sense. However, the doctrine of frustration of purpose is not available where the event which prevented performance was foreseeable and provisions could have been made for its occurrence, or where the party asserting the defense was responsible for the frustrating event.

*Impossibility of performance.* The defense of impossibility of performance is applied narrowly and performance is excused only when performance becomes objectively impossible. Moreover, the impossibility must result from an unanticipated event that could not have been addressed in the contract.

At their core, both doctrines are judicially-created defenses derived from concepts of equity: New York courts have concluded that it is unfair to require a party

to continue perform its obligations under a contract when the party has been deprived of the benefits of the contract due to unforeseeable events outside of the party's control. Under such circumstances, the doctrines of frustration of purpose and impossibility "excuse" the party from further performance.

An example can help differentiate between the doctrines. Suppose that a multistory building leases one of its floors to a pet grooming shop to provide services to residents who own pets. Imagine that the building adopts a new policy strongly discouraging residents from owning pets. Under these circumstances, the pet grooming shop might seek to be excused from its lease obligations based on the doctrine of frustration of purpose, as the building's new anti-pet policy undermines the reason the pet shop entered into the lease in the first place: namely, to provide services for pet owners in the building. Alternatively, instead of adopting an anti-pet policy, suppose that the town in which the building is located passes a new zoning ordinance forbidding multistory buildings from renting space to pet shops. Under these circumstances, the pet grooming shop might seek to be excused from the lease based on the doctrine of impossibility, as the town's new

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zoning ordinance legally prohibits the pet shop from continuing to operate its business in the building.

## ***Questions to Consider***

To determine the likelihood of success on a frustration of purpose or impossibility of performance defense, parties should consider the following questions.

### ***Are the Doctrines Being Invoked to Excuse Contractual Performance Involving the Payment or Receipt of Money?***

New York case law suggests that a party is more likely to successfully invoke the doctrines of frustration of purpose and impossibility of performance when the doctrines are used to excuse contractual obligations that go beyond the mere payment or receipt of money. Thus, any business considering relying on the doctrines of frustration of purpose or impossibility of performance should establish that the obligations sought to be excused involve more than the payment or receipt of money.

### ***Is the Excuse for Non-Performance Based on Financial Difficulty or Economic Hardship?***

New York courts have repeatedly held that financial difficulty or economic hardship — no matter how extensive or devastating — virtually never excuse performance under the doctrines of frustration of purpose or impossibility of performance. Even a party's insolvency or bankruptcy are generally insufficient to constitute a defense based on frustration of purpose or impossibility of performance. The implicit assumption behind the courts' rulings appears to be that market downturns and poor economic performance are always a possibility, and therefore foreseeable, any time parties enter into a

contract, and thus cannot justify application of the doctrines to excuse parties from performance.

### ***Is the Excuse for Non-Performance Based on Law?***

New York courts have sometimes excused parties from their contracts under the doctrines of frustration of purpose and impossibility of performance based on the impact of new laws. In the context of COVID-19, the case law suggests that businesses may have a better chance of relying on a frustration of purpose or impossibility of performance defense based on new laws, such as Governor Cuomo's executive orders requiring non-essential business to close their doors, rather than the negative economic impact of COVID-19 in general. However, when relying on a law as the basis for being excused, a party must still prove that enactment or issuance of the law in question was unforeseeable at the time the contract was made.

### ***Does the Contract Contain Any Provision Addressing the Obligations Sought to be Excused?***

New York courts hold parties to the terms of their bargained-for agreements by closely analyzing the language of the agreements. If the change of circumstance relied upon by the parties to excuse their performance is specifically addressed by the agreements, then the defenses of frustration of purpose and impossibility of performance are less likely to succeed. Thus, before invoking the frustration of purpose or impossibility of performance defenses based on a change of circumstances, businesses must carefully review and analyze the language of the contract from which they seek to be excused to determine whether

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such change of circumstances has already been addressed in some way by the contract. Particular attention should also be given to a contract's representations and warranties section, which courts may examine to assess the parties' expectations at the time they entered into the contract.

## ***Could the Change of Circumstances Have Been Foreseen at the Time the Contract was Being Negotiated?***

To be successfully applied, the doctrines of frustration of purpose and impossibility of performance both require the relevant change of circumstance to have been unforeseeable. New York case law suggests that, even if a contract is completely silent about a particular change in circumstances, courts will look beyond the language of the contract and examine what the parties *could have* theoretically foreseen at the time the contract was being negotiated.

Hence, businesses intending to assert a defense of impossibility of performance or frustration of purpose should be prepared to demonstrate not only that the change of circumstances is not addressed by the contract, but also that this change of circumstances could not have been reasonably foreseen at the time the contract was negotiated. This may prove challenging, as pandemics have occurred in the past; for instance, infectious diseases such as SARS, H1N1 influenza, and Ebola all were concerns during the twenty-first century.

## ***Conclusion***

It is unclear if the defenses of frustration of purpose and impossibility of performance will provide any relief to business. Nevertheless, businesses looking to make predictions concerning the likelihood of success with a defense of frustration of purpose or impossibility of performance should ask themselves the questions listed above.

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For more information or if you have any questions about how this new development may affect your business, please contact a member of our team.



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