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COMMERCIAL DIVISION UPDATE

Expert Analysis

The Frustration of Purpose Doctrine Is Alive and Well

In times of economic or political turmoil, the doctrine of frustration of purpose usually gets a workout. A series of recent Commercial Division decisions have signaled that this doctrine is alive and well in New York. First, this article examines the history of the frustration of purpose doctrine. Next, we review recent decisions out of the Commercial Division that apply this doctrine to a variety of fact settings.

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History of the Doctrine

The frustration of purpose doctrine traces its ancestry back to the courts of England in the line of so-called coronation cases.[1] In *Krell v. Henry*, a decision familiar to any first-year law student, the English Court of Appeals excused the defendant from his obligation to rent the plaintiff's apartment on coronation day in 1902 because the coronation procession of King Edward VII was cancelled when the king became sick.[2] The court reasoned that the occurrence of the coronation procession was the basis of the contract, the cancellation of which was not contemplated by either party at the time they made the contract.[3] Based on the extrinsic evidence presented, the court determined that both parties had knowledge that the defendant decided to rent the rooms because of the coronation, even though the contract itself was silent on the purpose of the renting.

New York state courts have adopted a somewhat narrower version of the frustration of purpose doctrine than that laid down in *Krell*.[4] The New York doctrine is limited to instances where "a virtually cataclysmic, unforeseeable event renders the contract valueless to one party."[5] Unlike its close cousin impossibility of performance, which focuses on an unforeseen event making performance impossible, frustration of purpose comes into play when the object of the intended performance has been destroyed; performance may still be possible, but the purpose of the performance has evaporated.

Recent Precedent

A number of recent Commercial Division decisions provide considerable guidance on the application of the doctrine of frustration of purpose.

In *D&A Structural Contractors Inc. v. Unger*, the plaintiff, a contracting company, alleged that it was owed monies for house renovations that it performed at the request of the defendant.[6] The parties' contract expressly contemplated that the renovations and certain other services would be paid for from the proceeds of an insurance claim that defendant allegedly was owed as a result of fire damage.[7] At the time of the making of the contract, the defendant was in the midst of divorce proceedings with her husband and the house was a marital asset subject to distribution.[8] After the plaintiff began her home renovations, the defendant's husband moved the matrimonial court for a temporary restraining order preventing the payment of any of the insurance proceeds to the defendant.[9]

The plaintiff brought suit to recover the money that was owed for the renovations that it had completed. The defense was based in the doctrine of frustration of purpose, the defendant arguing that the basis of the contract was payment for the renovations from the proceeds of the insurance policy.

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Justice Timothy Driscoll of the Nassau County Commercial Division granted the defendant's motion for summary judgment on three counts of the plaintiff's complaint on the grounds that the defendant had established frustration of purpose. The court noted that "[w]hether a party will be excused from performance on the ground of impracticability or frustration turns on the foreseeability of the event occurring, the fault of the nonperforming party in causing or not providing protection against the event occurring, the severity of the harm, and other circumstances affecting the just allocation of the risk."[10]

The court found that the basis of the renovation contract was the controverted insurance proceeds and that the restraining

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order issued in the matrimonial proceeding "was an unanticipated event that frustrated the contracts' purpose, thereby discharging [the defendant's] obligation to make payment pursuant to the various contracts." While the court excused the defendant of her contractual obligation to pay, the court allowed the plaintiff's quantum merit claims to proceed to trial.

In a subsequent case, *Noble Americas Corp. v. CIT Group/Equipment*, Justice Melvin Schweitzer of the New York County Commercial Division found the frustration of purpose doctrine unavailing. The plaintiff, Noble Americas Corp., had leased rail cars from the defendant with the intended purpose of using those rail cars to transport ethanol.[11] The plaintiff contended that it intended to transport the ethanol from two specific ethanol production facilities which thereafter went bankrupt. The plaintiff commenced a suit seeking a declaration that it was relieved from making lease payments on the leases, arguing that the bankruptcy frustrated the purpose of the leases.[12] The plaintiff argued that all parties were aware at the time they executed the leases that sourcing from these two specific ethanol producers was the contemplated purpose thereof.[13]

The defendant responded by arguing that the leases merely reflected that the plaintiff intended to "lease railcars to [plaintiff] for the transport of only ethanol," and nowhere did the leases make reference to any specific facilities.[14] Since the viability of a specific producer was not set forth in the agreement, the bankruptcy of the producers did not frustrate the purpose of the lease. The defendant pointed out that the plaintiff did not even have a contractual relationship with the two bankrupt producers and that, in any event, the leases specifically contemplated that the plaintiff could source from other suppliers, including outside the United States. The defendant further argued that "the bankruptcy of specific third-party shipping suppliers is a reasonably foreseeable risk in railroad car leases such as these, and this bankruptcy contingency could have been the subject of a risk sharing or shifting provision in the leases themselves."[15]

The court's analysis began by noting that neither party, nor the court, could find a New York case holding "that the bankruptcy of a non-party to a contract either does, or does not, frustrate the purpose of an underlying contract."[16] Relying on a 1945 case which involved the cancellation of a contract by the government,[17] Justice Schweitzer found against the plaintiff and wrote that "to hold otherwise would shift the risk of [plaintiff's] third-party contracts onto [the defendant]."

The frustration of purpose doctrine can be an incredibly powerful tool against a breach of contract claim as a party asserting this doctrine can effectively nullify its contractual obligations. Given the current economic turmoil and recent interventions on the part of governments, this doctrine may see an increased significance in litigation.

The court based this conclusion on portions of the lease agreement that expressly shifted defendant's third-party risk to plaintiff. The court concluded that "this was a reasonably foreseeable contingency against which [plaintiff] could have protected itself in the lease. In the absence of such a risk shifting provision here, it is Noble, not CIT which assumed the risk." As a result, the court dismissed plaintiff's declaratory judgment complaint.

In *528-538 W. 159th St. LLC v. Soloff Mgmt. Corp.*, Justice Carolyn Demarest of the Kings County Commercial Division applied the frustration of purpose doctrine to an agreement to arbitrate.[18] In that case, the plaintiffs, who had allegedly hired the defendants to manage a series of apartment buildings, commenced a lawsuit alleging breach of contract, unjust enrichment, conversion and fraud. Two years after the commencement of the action, the parties entered into an agreement that provided for the arbitration of the claims raised in the action before Beis Din, a panel of rabbis that makes decisions under the Din Torah "which the court underst[ood] to be Jewish law."

The agreement contemplated that discovery would continue under the auspices of Beis Din. Based on this agreement, the court stayed the lawsuit. Thereafter, the rabbinical panel informed the parties that it could not reach a decision as the defendant had failed to provide the necessary discovery. The plaintiffs then requested the court to rescind the agreement to arbitrate and to allow them to proceed with their claims in court.

The court found that the defendants had committed a "willful and material" breach of the arbitration agreement by failing to complete discovery requested by the plaintiffs.[19] The court based this conclusion on letters from the rabbinical panel stating that without the completion of discovery the panel would not be able to decide the dispute.[20] Thus, based on the defendants' willful conduct, the court concluded that the defendants "frustrated the entire purpose of the arbitration agreement…[and the agreement] cannot be enforced."[21]

Conclusion

As is evident from the discussion above, frustration of purpose is a versatile doctrine which can be used in a variety of settings. This doctrine, when available, can be an incredibly powerful tool against a breach of contract claim as a party asserting this doctrine can effectively nullify its contractual obligations. Given the current economic turmoil and recent interventions on the part of governments, this doctrine may see an increased significance in litigation. Notably, the cases discussed above relied largely on New York precedent from World Wars I and II. The reliance on case law from this era suggests that the doctrine's use is most pronounced during times of extreme political and economic upheaval, and corresponding unforeseeable bankruptcies and actions of the governments that may impact contractual relationships.

1. *Noble Americas Corp. v. CIT Group/Equipment, No. 602269/2009, slip op. at 4 (Sup. Ct. N.Y. Co. Dec. 4, 2009).*
2. *Krell v. Henry, [1903] 2 K.B. 740.*
3. *Id.*
4. *Noble Americas Corp., slip op. at 4.*
5. *Id.*
6. *D&A Structural Contractors Inc. v. Unger, No. 001112-08, 2009 WL 3206596, at *5 (Sup. Ct. Nassau Co. Aug. 20, 2009).*
7. *Id. at *1.*
8. *Id. at *1.*
9. *Id. at *3.*
10. *Id. at *5.*
11. *Noble Americas Corp., slip op. at 1.*
12. *Id.*
13. *Id. at 5.*
14. *Id.*
15. *Id. at 6.*
16. *Id.*
17. *Id. (citing State Mutual Life Assurance Co. v. H.J. Gruber, 269 A.D. 170, 54 N.Y.S.2d 729 (1st Dept. 1945) (where the lessee of certain property argued the cancellation of a contract it had with the government frustrated the purpose of its contract with plaintiff lessor)).*
18. *27 Misc.3d 1216 (A); 910 N.Y.S.2d 762 (Sup. Ct. Kings Co. May 3, 2010).*
19. *Id.*
20. *Id.*
21. *Id.*

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