CORONAVIRUS: REQUESTS FOR ADEQUATE ASSURANCE UNDER NEW YORK LAW

In the current coronavirus (COVID-19) crisis, many businesses are evaluating options for terminating or suspending performance under their contracts. The right to terminate or suspend may be available under the contract (*e.g.*, a force majeure clause), but there are also extra-contractual options under New York law for terminating or suspending performance when a contractual counterparty fails to provide reasonable assurance that the contract will be performed. Businesses may be able to protect themselves from the risk of repudiation or breach by invoking this legal doctrine in appropriate circumstances.

The doctrine of requests for adequate assurance is well-established in Section 2-609 of the Uniform Commercial Code ("UCC"), which applies to contracts for the sale of goods. The doctrine has also been applied to other long-term contracts, and there is room to argue in New York that the doctrine should be expanded to other types of contracts as well. Any business thinking of terminating or suspending performance due to the COVID-19 crisis should consider whether this legal doctrine may apply.

Contracts for the Sale of Goods: Section 2-609

In the context of contracts for the sale of goods, Section 2-609 of the UCC embodies a well-established right to have adequate assurance concerning future contract performance. Courts have noted that the "commercial purpose" of UCC § 2-609 is to "permit a party likely to be injured by the other party's nonperformance to take steps to protect itself without the worry that its own nonperformance will be construed as a repudiation by it in future litigation."[1]

The definition of "goods" under the UCC is expansive, but excludes investment securities and things in action.[2] Contracts primarily associated with the sale of

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1 *Nat'l Fuel Gas Distribution Corp. v. TGX Corp.*, No. 84-CV-1372E, 1992 WL 170819, at *6 (W.D.N.Y. July 10, 1992) (applying New York law) (citing *U.S. v. Great Plains Gasification Associates*, 819 F.2d 831 (8th Cir. 1987)).

2 UCC § 2-105 (definition of "goods").

goods fall within the ambit of the UCC, even if some services are also included. In addition, courts have recognized that contracts for the sale of currency and cryptocurrency are governed by the UCC.[3]

Section 2-609 provides that a contract party may make a written request for assurance if reasonable grounds for insecurity arise as to whether the other party will perform under the contract. The availability of a Section 2-609 request may be impacted by any contractual terms intended to mitigate such risks of nonperformance (such as any collateral or other performance related provisions such as guarantees). If a Section 2-609 request is available, and the party from whom assurance is sought fails to respond or fails to provide adequate assurance in a timely manner, then the contract will be considered repudiated. A written response to a demand for assurance is required within 30 days. While awaiting a response, the requesting party may temporarily suspend its own performance.

If the contract is deemed to be repudiated, then the non-repudiated party has a broad range of remedies under the UCC. The party has the right to cancel with respect to the goods at issue and, if the repudiation substantially impairs the value of the entire contract, with respect to the whole contract. The non-repudiating party may also seek damages for breach based on the various formulas provided by the UCC.

There is no fixed standard for what constitutes "reasonable grounds for insecurity" or "adequate assurance of due performance." They are evaluated by courts according to commercial standards taking all relevant circumstances into account.[4] Accordingly, these factual issues are almost always subject to reasonable argument on both sides in the event of litigation. If a court later decides that these standards were not met, then the requesting party may be deemed to have breached the contract by pursuing remedies under Section 2-609.

The current COVID-19 crisis arguably provides reasonable grounds for insecurity with respect to virtually any contract for the sale of goods. Thus, we believe that any buyer or seller of goods could reasonably request adequate assurance from its counterparty pursuant to Section 2-609.

Other Contracts: *Norcon Power*

The UCC approach to requests for adequate assurance has been applied outside of New York to other contracts. Section 251 of the Restatement (Second) of Contracts expressly adopts the principles of Section 2-609 for all contracts. Under Restatement § 251, an insecure party may request that the other party give assurance that it will perform its contractual obligations; if the party receiving the request fails to provide adequate assurance, the insecure party may treat such failure as a repudiation of the contract.[5]

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3 *See In re Koreag, Controle et Revision S.A.*, 961 F.2d 341, 355 (2d Cir. 1992) (currency that is the object of exchange constitutes "goods" within the meaning of UCC) (citing *Intershoe, Inc. v. Bankers Trust Co.*, 77 N.Y.2d 517, 521 (1991)).

4 *See Enron Power Mktg., Inc. v. Nevada Power Co.*, No. 01-16034 (AJG), 2004 WL 2290486, at *5 (S.D.N.Y. Oct. 12, 2004), *supplemented*, No. 01-16034AJG, 2004 WL 3015256 (S.D.N.Y. Dec. 28, 2004).

5 Restatement (Second) of Contracts § 251 (1981).

The Restatement approach has not been adopted generally in New York. Instead, the Court of Appeals has favored an incremental approach to expansion of the doctrine outside the context of contracts for the sale of goods.

In *Norcon Power Partners, L.P. v. Niagara Mohawk Power Corp.*,[6] the Court of Appeals applied the doctrine to a long-term contract for the sale of electricity. Electricity is not a "good" under the UCC, and so a contract for the sale of electricity is deemed to be a services contract under New York law.

The *Norcon Power* court held that the doctrine "should apply to the type of long-term commercial contract between corporate entities entered into by" the parties, noting that Norcon's required performance (to reimburse Niagara Mohawk for credits) was "still years away"—while, in the meantime, Niagara Mohawk's "potential quantifiable damages were accumulating," thereby putting Niagara Mohawk in a position to have to "weigh the hard choices and serious consequences that the doctrine of demand for adequate assurance is designed to mitigate."

The *Norcon Power* decision opens up the *possibility* of extending the doctrine of adequate assurance beyond UCC contracts, especially in the context of long-term services contracts like the one at issue in that case. We caution, however, that New York courts have interpreted *Norcon Power* to extend the doctrine only to situations that are "closely analogous" to contract for the sale of goods.[7] That said, *Norcon Power* at least provides a basis to argue that a request for adequate assurance may be made in other contractual contexts, and does not expressly foreclose application of the doctrine in any context. Thus, there remains room to argue that the principles of *Norcon Power* should be applied more broadly to contracts governed by New York law.

Conclusion

Businesses re-evaluating their contractual obligations in light of the COVID-19 crisis should consider whether a request for adequate assurance may provide useful legal protection. The doctrine is relatively easy to invoke, and may provide substantial protections to the requesting party. Although the doctrine does not necessarily apply to contracts other than contracts for the sale of goods, there is room to argue in New York that other contracts may be covered by this approach.

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6 92 N.Y.2d 458 (1998).

7 *Merrill Lynch Int'l v. XL Capital Assur. Inc.*, 564 F. Supp. 2d 298, 306 (S.D.N.Y. 2008) ("The Court finds a credit default swap to have very little in common with a sale of goods, and hence concludes that New York would not extend the doctrine of adequate assurance to the instant situation."); *see also Bank of New York v. River Terrace Assocs., LLC*, 23 A.D.3d 308, 309 (1st Dep't 2005) (interpreting *Norcon* as a case where "[t]he Court of Appeals has enjoined the courts to proceed warily in extending this UCC doctrine to the common law of 308, this State").

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