

# CLIENT ALERT

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## **CAN A FORCE MAJEURE CLAUSE BE RELIED UPON IN LIGHT OF THE COVID-19 PANDEMIC?**

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### **FORCE MAJEURE CLAUSES AND THE COVID-19 PANDEMIC**

Although usually set out at the end of a contract in the general or miscellaneous articles of an agreement (and often not paid much attention by the parties), force majeure clauses are now getting a lot of attention and are being scrutinized by parties and their legal counsel in light of the COVID-19 pandemic, with the main question being "Can I (or can the other side) get out of this contract?"

### **WHAT IS THE NATURE OF A FORCE MAJEURE CLAUSE?**

Force majeure clauses authorize contracting parties to extend or suspend the time of performance, or to be excused from performance, in whole or in part, as a result of specifically negotiated and enumerated conditions or events.

Obligations under the contract may resume once the condition or event has been remedied – a determination of the exact circumstances will depend on the clause, and its place contextually within the contract as a whole.

### **WHAT IS A FORCE MAJEURE EVENT OR CONDITION?**

If a party wants to rely on a force majeure clause, they must first establish that the event or condition falls within the definition of force majeure; this is evaluated in the context of each specific contract.

The Supreme Court of Canada, in the leading decision, *Atlantic Paper Stock Ltd. v. St. Anne-Nackawic Pulp and Paper Company Limited*, defined a force majeure clause as "generally [operating] to discharge a contracting party when a supervening, sometimes supernatural event, beyond control of either party, makes performance impossible. The common thread is that of the unexpected, something beyond reasonable human foresight and skill."

It is not sufficient that the event makes performance more expensive or time-consuming than expected. The event must make performance substantially more difficult, substantially more expensive, or imprudent.

### **WHAT WILL THE FORCE MAJEURE CLAUSE CONTAIN?**

Force majeure clauses typically contain the following four parts:

- A contracting party is excused from performance: The clause typically starts with language excusing one or both of the contracting parties from performing the contract if one of the specified force majeure events occur.
- A list of force majeure events or conditions: The contracting parties can negotiate the list of force majeure events or conditions.
- Impacted party's obligations: The parties can negotiate the impacted party's obligation to:
  - o notify the contracting party of inability to perform; and
  - o mitigate the damages of the force majeure event.
- Remedies: The contracting parties can negotiate appropriate

remedies, for example, the contracting party's right to terminate the contract without penalty if the force majeure event remains in effect after the specified number of days or consecutive days.

### **DOES COVID-19 CONSTITUTE A FORCE MAJEURE EVENT?**

Force majeure provisions may alleviate the risk of non-performance or delayed performance. In light of the COVID-19 outbreak, force majeure may or may not be an excuse for non-performance; however, the applicability of the force majeure clause for any particular contract will depend on how it was negotiated and drafted. There is no "one size fits all" answer on this and the specific list of force majeure events needs to be reviewed to determine if the COVID 19 pandemic qualifies as a force majeure with respect to the particular agreement.

Traditional and older force majeure clauses may not adequately capture the risks presented by outbreaks and pandemics. Importantly, however, an emerging trend in contracts is to explicitly include "public health emergencies," "communicable disease outbreaks," or "pandemic" in force majeure clauses.

In the event that there is not specific language to capture COVID-19, it may be the case that the outbreak is covered by more generic language. For example, the government declaring a state of emergency or closing its borders to neighbours and trade partners might fall under the definition of a force majeure that includes "government or administrative action." A clause that includes "shortages" may apply when an obligor cannot fulfil its obligation to deliver goods to its customer if the distributor cannot secure adequate transportation services.

Again, a determination of the applicability of the force majeure clause to the COVID-19 pandemic will vary on a case-by-case basis and, as such, requires a careful review of the contract and the force majeure clause.

### **CAUSATION AND MITIGATION**

If the COVID-19 outbreak is considered to be a force majeure event or condition pursuant to the explicit provision of a contract, the elements of causation and mitigation must be considered when determining use of the clause.

The triggering event or condition must be connected to the non-performance of a contractual obligation. The strength of the connection required will depend on context and the contractual language. If the clause requires a causal tie between the event or condition and non-performance, there must be a substantial relationship between the two. This will vary depending on the contract, but usually requires that the impacted party's performance be either prevented or hindered or delayed. The forced closure of all nonessential businesses in Ontario would make it likely that businesses have met this criteria.

A party who is relying on a force majeure event to justify non-performance is expected to make reasonable efforts to mitigate the effect of the event. It is important to note that, in this context, mitigation refers to mitigating the effects of the force majeure event or condition and does not refer to mitigating contractual

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damages. For example, a gas supplier who is faced with a force majeure shortage is expected to make reasonable efforts to acquire replacement gas for its customers. The duty to mitigate is limited to a standard of commercial reasonableness. As long as Ontario businesses are following the Government of Ontario's rules and have also made reasonable attempts to meet their obligations, it is likely that they can meet this criteria.

## WHAT IF THE CONTRACT DOES NOT CONTAIN A FORCE MAJEURE CLAUSE?

If a contract is silent on force majeure, a court will render their decision whether to excuse an impacted party's performance during the force majeure event based on the foreseeability of the event which may be either:

- **Foreseeable:** The court deems that the parties can allocate the risk of foreseeable events by adjusting the monetary terms of the contract. Therefore, the court generally does not excuse the impacted party's performance. In this case, the obligor bears the risk of the specified event.
- **Unforeseeable:** The court generally excuses the impacted party's performance. In this case, the contracting party bears the risk of the specified event.
- **Where a force majeure provision is absent or inapplicable,** the courts may apply the more general principles of frustration or impossibility to excuse performance, although they are limited in their application.

## SELF-EVALUATION

While various companies have already declared force majeure over the COVID-19 pandemic, this relief does not apply to all parties to contracts with force majeure clauses. A careful review of force majeure clauses is essential prior to the declaration that force majeure applies.

The evaluation for contracting parties is twofold: i) How has the COVID-19 pandemic affected my business? ii) Is this impact sufficient to trigger the force majeure clause? A careful consideration of the steps required to mitigate any related damages should immediately follow.

## COMPARISON: FRUSTRATION

In the absence of an applicable force majeure clause and in limited circumstances, a party may be relieved from its obligations by claiming frustration of contract. When an unforeseen event renders performance of the contract radically different than what was bargained for, this may be the result. Contrary to force majeure, which offers flexibility, frustration automatically results in both parties being discharged from the contract. The doctrine of frustration is an equitable remedy for extreme events that break down the very basis for contracting.

Contracting parties are free to agree to the legal effect of a force majeure event and the contract is not necessarily at an end as a result; there are ongoing obligations although the parties may be excused from penalties or damages due to delayed performance. In contrast, if a contract is frustrated, the result is that both parties are discharged from their obligations; the contract is at an end.

Due to the likely temporary nature of the COVID-19 outbreak, the temporary effects of force majeure rather than the permanent termination of the contract under frustration may be preferable.

## HOW WE CAN HELP

Paying attention to detail and rapidly adapting to changing circumstances is what we do at Dickinson Wright, both in Canada and the United States. While this should not be construed as legal advice, should you require any assistance, please do not hesitate to contact us.

Our colleague in the Columbus office has offered insights on force majeure provisions and the coronavirus: <https://www.dickinson-wright.com/news-alerts/force-majeure-and-covid19>

Our colleagues in Las Vegas and Reno have provided insights into how COVID-19 has impacted contractual relationships under Nevada law: <https://www.dickinson-wright.com/insight/2020/04/covid19-impact-on-contractual-relationships>

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