**Legal update**

**Contract performance in a coronavirus world: Force majeure clauses and the doctrine of frustration**

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Businesses worldwide have been forced to navigate the challenges brought on by the rapid spread of COVID-19 (coronavirus), including interruptions to supply chains and challenges in meeting contractual obligations. With no end to the outbreak in sight, businesses are considering whether they can (or should) rely on force majeure clauses, the common law doctrine of frustration or material adverse change constructs as legal options to mitigate the impact of the crisis on their business.

**Force majeure**

The purpose of force majeure clauses is to protect the parties from events that are agreed to be outside normal business risk. Force majeure clauses excuse the performance of contractual obligations if specified events outside the parties’ control have prevented such performance. If successfully invoked, the clause would excuse a party’s performance of its obligations under the contract, thereby avoiding a breach.

**Applicability of Force Majeure Clauses**

Not all contracts contain a force majeure clause. To the extent included in contracts, there is no standardized form of the provision, and therefore analysing the applicability of force majeure clauses is contract specific. Canadian courts typically apply a high threshold when determining the applicability of a force majeure clause – they look to several elements:

- whether the scope of the contract’s force majeure clause (since force majeure clauses are not standardized) captures the event being invoked;
- whether non-performance was foreseeable and whether the risk of non-performance could be mitigated; and
- whether the contractual performance in question has truly been prevented or rendered impossible, rather than merely more expensive.
Scope of Force Majeure Clause

Force majeure clauses typically specify those events that constitute force majeure. Some of the typical circumstances identified in a force majeure clause include acts of God, war, riots, natural or other disasters. In some cases, “epidemic,” “pandemic,” “quarantine,” and/or “disease” are expressly enumerated. Other specified events — although less directly related to the COVID-19 outbreak — may also be relevant, such as the inability to procure necessary supplies or labour, market conditions, or government action (e.g., a state-imposed shut-down). Many force majeure clauses also contain a basket clause that covers all other events “beyond the reasonable control of the parties,” which may be applicable to events relating to COVID-19.

Force majeure clauses are interpreted narrowly, and the party invoking a force majeure clause to excuse performance must prove the event in question falls within the scope of the clause. It seems reasonably clear that the World Health Organization’s recent classification of COVID-19 as a “pandemic” would result in this outbreak as being within the scope of at least those force majeure clauses that include “pandemic” and even “epidemic.” However, certain other aspects of this crisis, such as the increasing breadth of government-decreed shut-downs aimed at slowing the pandemic’s spread, may also fall within the scope of certain force majeure provisions.

Obligation to Mitigate

Even in the face of an “in-scope” force majeure event, the party seeking to invoke force majeure for non-performance is under an obligation to have taken reasonable steps to mitigate the foreseeable risk of its non-performance. A party would not be successful in invoking force majeure if its non-performance could reasonably have been mitigated.

The extremely rapid and fluid developments surrounding COVID-19, including the related governmental directives and restrictions regarding the outbreak and reasonable measures taken to safeguard the wellbeing of your employees and clients, make it likely that strong arguments could be made that many tangible impacts of the pandemic (including shut-downs or supply-chain ruptures) could neither be foreseen nor mitigated in any meaningful manner or timetable.

For instance, sophisticated manufacturing operations in a certain jurisdiction typically cannot be migrated to another facility on the timeline of this expanding crisis (which evolves by the hour and day), the more so since there are very few, if any, unaffected jurisdictions.

The impacts of COVID-19 (including shut-downs and related governmental directives and restrictions) on your business should be centrally documented, as should steps taken to mitigate those impacts. In addition to forming a record for a force majeure claim, such records are likely to serve other beneficial purposes, such as a general record in support of claims under any eventual business recovery programmes that may be made available from various governments or under business interruption insurance.

Possibility of Contractual Performance

A party claiming force majeure for its non-performance would need to show that performance has been truly prevented, rather merely rendered more expensive, and the causal link between the event and its inability to perform. A court is unlikely to excuse contractual performance simply because the event has rendered performance relatively more financially burdensome or more expensive.

By way of example, if the contract requires supplies to be obtained from a high-risk area that is currently subject to shut-down or travel restrictions, and no alternatives are available, the requisite level of impact and causation are more likely to be met. Similarly, a manufacturer with a sophisticated line in a jurisdiction that has mandated the shut-down of commercial plants may be able to show that performance has been prevented during this period, since the manufacturer’s plant is required to be closed.

In this regard, it should be noted many force majeure clauses state the “remedy” in the circumstances is that performance times under the contract are extended for a period equivalent to the time lost because of any delay that is excusable as force majeure.
Practical Implications

Before suspending performance in reliance upon a force majeure clause, or to otherwise understand one’s exposure under a force majeure clause, parties should carefully review their key agreements and consider:

- the definition and scope of the applicable force majeure provision and whether the event in question falls within such scope (bearing in mind that such clauses are not standardized and need to be read and analysed individually)
- the contract’s notice requirements and whether they have been or may be triggered
- the governing law provisions and impact that such law will have on interpreting the contract
- whether mitigation steps or alternative means of performance can reasonably be taken in respect of the contract
- the potential consequences of a breach and/or default of the contract
- how the force majeure provisions interact with the contract’s indemnity and termination provisions

Frustration

Without a contractual force majeure clause, a party may consider relying on the common law doctrine of frustration (or “force majeure” under the civilian legal tradition) to excuse its non-performance. Pursuant to this doctrine, a court may fully excuse both parties from their obligations where performance of a contract becomes legally or physically impossible or the contract is “frustrated” without fault of either party.

The Supreme Court of Canada has described frustration as occurring “when a situation has arisen for which the parties made no provision in the contract and performance of the contract becomes ‘a thing radically different from that which was undertaken by the contract’.”\(^1\) This is a high threshold to meet.

Risk management measures

As a general note, in addition to measures taken to slow the spread of COVID-19 and safeguard the wellbeing of your workforce, consideration may be given to the following risk management measures to avoid, mitigate or respond to COVID-19 in this uncertain period:

- Engage with safety managers and ensure there is continual and ongoing communication with workers, providing updates on the outbreak and training refreshers and drills as and when required.
- Check insurance arrangements – including whether the business is covered by business interruption insurance.
- Conduct risk assessments, considering factors specific to suppliers and working conditions.
- Keep up to date with details of the affected areas through WHO’s Disease Outbreak News.
- Ensure proper training and provide information and education on the virus for the workforce, including how the virus spreads, how to prevent contracting the virus and how to dispel myths, fears and misconceptions.
Audit suppliers and review their respective work health and safety systems and policies, especially relating to virus and disease control, ensuring they are up to date and appropriate or require compliance with applicable company policies on the subject.

Insert express infectious disease/epidemic wording into new contracts (and amending existing contracts if possible).

Civil law
Different considerations apply to contracts governed by civil law jurisdictions such as Quebec. An update specific to civil law will be published shortly.

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Footnote

¹ Naylor Group Inc. v Ellis-Don Construction Ltd., 2001 SCC 58 at para 53.