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Covid-19 and Contracts: Force Majeure?

Authors: Lisa Stiver, K.C. Jessica Barley

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COVID-19 & Contracts: Can I get out of a Contract due to the Pandemic?

The short answer is: it depends.

Most commercial agreements provide for parties to be excused from their contractual obligations in the event of serious unforeseen circumstances. Often referred to as *"force majeure"* clauses, they generally discharge a contracting party when a supervening event, beyond the control of either party, makes performance impossible. While force majeure clauses differ in their terms, the common thread between them is the occurrence of something unexpected and beyond reasonable human foresight and skill.

When can a Business rely on COVID-19 as a FM?

It depends on the wording of the clause, the nature of the party's contractual obligation, and COVID-19's actual impact on that obligation. There are four key factors that determine whether a party can rely on a FM clause based on COVID-19:

Does COVID-19 fall within the scope of the FM clause?

This depends on the clause's specific wording within the contract.

COVID-19 is more likely to qualify as a FM event when wording such as "pandemic," "epidemic," "quarantine," "illness," "plague", "outbreak" or "disease" is included in the FM clause. Depending on the context, COVID-19 could arguably be included within the scope of broader catch-all phrases, such as "Act of God," or "circumstances beyond a party's reasonable control."

Has COVID-19 sufficiently impacted an obligation of the relying party?

Level of Impact – FM clauses typically set out the threshold of interference in an obligation that must exist before the clause is triggered. Typical phrases include “prevents,” “renders impossible,” and “substantially hinders.” Whether COVID-19 meets the requisite threshold of impact depends on the factual circumstances at issue, the wording of the FM clause and the obligation from which a party seeks to be excused.

Causal Link – COVID-19 must have an *actual and direct impact* on the relying party’s ability to perform its contractual obligation. Indirect impacts of COVID-19, such as pricing fluctuations, or increased costs to revise workflow methods to perform obligations, are less likely to be found to have prevented contractual performance.

Has the relying party taken sufficient steps to avoid and mitigate COVID-19’s impact?

Some contracts will specify the requisite level of mitigation efforts to be taken by the relying party but, even where the contract is silent, courts will be more reluctant to recognize COVID-19 as a FM where the impacts to the relying party were reasonably avoidable.

Are there other additional contractual conditions, such as notice, that must be met?

Some contracts require notice to be given by the party wishing to exercise its rights pursuant to a FM clause. Notice obligations typically require that notice that a force majeure event has occurred be given in writing within a specified number of days of the event. Particular attention must be paid to these timelines as an individual’s ability to rely on the FM clause may be barred if the timelines are missed.

Even where there is no requirement to provide evidence or documentation as part of the FM clause, relying parties would be well served to document the impacts of COVID-19 on their ability to meet contractual obligations as well as efforts to avoid and mitigate such impacts. This documentation will be useful in the event of a dispute, and may also help avoid disputes if shared voluntarily with counterparties in some circumstances.

A party seeking to rely on a FM clause should consider whether any supporting documentation is required under its contract, and if so, any timing or other formal requirements applicable to its delivery.

Have I done enough to Mitigate my losses?

A party seeking to rely on a FM clause should be taking steps to mitigate the foreseeable or actual impacts of the FM, and demonstrating to the other party that it has taken those steps.

Businesses will likely want to receive evidence from a contracting party relying on a FM clause of the steps taken to avoid and mitigate the impacts of COVID-19 on the performance of its contractual obligations. In the context of COVID-19, reasonable preventative steps can include: quarantine protocols, increased sanitation, policies with respect to travelling, remote work capabilities, seeking guidance from public health officials, etc.

Businesses should be proactive. Organizations should formulate and implement a COVID-19 prevention, mitigation and response plan which, among other things, contemplates a review of key contracts for FM and related clauses, the potential for litigation, and the broader relationship with both upstream and downstream contracting parties.

If you receive a FM notice, consider seeking any documentation supporting the assertion of FM and inquire about mitigation efforts.

What other provisions in the Contract affect this?

A party's reliance on a FM clause is likely to affect, or be affected by, several other contractual clauses:

Negotiation and dispute resolution. FM clauses may require parties to negotiate an outcome. Likewise, dispute resolution clauses may be triggered if parties cannot reach an agreeable outcome. Reliance on a FM clause may ultimately result in litigation or trigger other dispute resolution mechanisms. Consideration should be given to what means of dispute resolution are available in the circumstances and how to be best prepared if a dispute resolution mechanism is triggered.

Limitation of liability, indemnity and liquidated damages. Parties should consider the interplay of a FM clause with any limitation of liability clause or a clause providing for liquidated damages. While FM clauses typically absolve the relying party of liability for non-performance, these other clauses are particularly important where there is some ambiguity as to whether the FM clause can be relied upon.

Governing law. As with most contractual issues, attention should be paid to what law applies to the agreement and the jurisdiction in which disputes are to be determined.

Termination rights. Reliance on a FM clause may allow or motivate a party to terminate the agreement. Termination may also be a preferable alternative to a party seeking to rely on a FM clause but cannot meet the clause's conditions.

How will this affect my relationship with the other party?

Parties weighing how to react to COVID-19 should consider the possible long-term impacts of relying on a FM clause on the overall relationship between the contracting parties and potential reputational risks. An attempt to rely on a FM clause is a high-risk maneuver — the likelihood of disputes and anticipatory breaches by counterparties are greatly increased when a party admits it is or was unable to perform its obligations. Your business may be better served by coming to the table prepared to negotiate a mutually-agreeable outcome, particularly where the FM clause is not clearly in your favour or where you are not otherwise in a position to rely on it as a result of other terms of the contract.

Strategically, businesses should consider all potential knock-on effects of relying on a FM clause before deciding to rely on it: will it be detrimental to my ongoing business relationship with the other party, if I attempt to get out of my obligations?

What if my Contract does NOT Contain a FM Clause? – Frustration

Courts are typically unwilling to imply a *force majeure* provision into a contract where no express language exists. In such circumstances, parties may instead rely on the common law doctrine of frustration.

Frustration occurs where 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.” Much like in the force majeure context, performance of the contract must become impossible; it is not enough that the contract becomes more onerous, or even significantly more difficult, but still possible to perform. Rather, a party must show that the original purpose of the contract has been frustrated, and it would be unjust for that party to be bound to the contract under the existing circumstances.

As with force majeure, the situation or event that has allegedly frustrated the contract must (1) be unforeseeable at the time the contract was entered into; and (2) not be the fault of either party.

The doctrine of frustration generally has a higher standard than force majeure, and the consequences of its application may be different. A force majeure clause may provide for temporary suspension or deferral whereas the consequence of frustration is generally the end of the contract. However, depending on the specific facts, frustration may potentially be an option if a force majeure clause is unavailable.

Last Words: Can I get out of a Contract due to COVID-19?

The short answer remains: it depends. It depends on the specific wording of the FM clause, any related notice or mitigation requirements in the contract, and the effect of other provisions in the contract related to default and termination.

We are here to assist you, as always, in navigating your way through this, and can review the specific contracts for which you are seeking advice.
