

COVID-19 AND PERFORMANCE OF CONTRACTUAL OBLIGATIONS

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As the global community works to respond to the challenges presented by the spread of COVID-19, many Canadian businesses have been impacted by market and supply chain disruptions, as well as government mandated travel and business restrictions. This article considers the utility of force majeure clauses in commercial contracts, and whether COVID-19 may be invoked as an excuse to non-perform, or delay the performance of, contractual obligations.

Force Majeure

A force majeure clause operates to excuse a party from a delay, or non-performance of, its obligations under a contract upon the occurrence of certain serious events which are unforeseen, or beyond an affected party's control. These serious events make contractual performance impossible or impracticable.

What constitutes an "event of force majeure" varies from contract to contract and is entirely fact specific *and* dependent on the specific contractual wording contained in the contract.

Where an event of force majeure is more narrowly defined, the clause will only be triggered upon the occurrence of specific delineated events which are claimed to have prevented performance. In the context of the current global health crisis, reference in the contract to "public health emergency", "pandemic", "communicable disease outbreak" or other similar terms may mean that the clause can be successfully invoked.

On the broader end of the spectrum, it is typical to see a force majeure event defined to encompass *any* unforeseeable circumstance outside the reasonable control of the affected party. Such clauses may contain certain qualifications, such as:

- the event cannot have been foreseen, prevented, remedied or removed by the affected party;
- the event has had a material adverse effect on the ability of such party to perform its obligations under the agreement; and/or
- such party has taken all reasonable precautions to mitigate the consequences thereof.

Once a force majeure event has occurred in accordance with the specific terms of the contract, the party looking to be excused from performance or delay must also prove that such event directly impacted its ability to perform its contractual obligations. Again, this will depend upon the language of the force majeure provision, which will likely specify different degrees of causation from "cause" or "prevent" to "hinder" or "delay".



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It is important to note that, however broad the language of the force majeure clause, historically, these provisions have been narrowly interpreted by Canadian courts. For example, where a contract is silent on the requisite standard of causation between the force majeure event and a party's performance, courts have imposed a high threshold, only invoking force majeure where performance is rendered an impossibility. Courts have consistently concluded that financial hardship (versus impossibility) is not sufficient grounds to successfully invoke force majeure. Mere delay in the ability to perform or changes in circumstances that make the performance of a contract less profitable will not generally suffice to relieve a party's obligation to perform.

Where an event of force majeure has occurred, it is important to review the specific language of the force majeure clause to determine the mechanics of relying on the clause and the obligations of each party. For example, there may be notice requirements where the affected party is required to notify the other party within a certain time after the commencement of the event of force majeure. Failure to provide such notice may nullify the ability to rely on the clause.

There may also be a requirement for the affected party to mitigate damages by using diligent efforts to ensure the effects of the force majeure event are minimized to the fullest extent possible, and for the affected party to resume the performance of its obligations as soon as possible.

Additionally, any or all of the parties may be entitled to permanently terminate or temporarily suspend the operation of the agreement if the force majeure event continues for a specified period of time and obligations under the agreement have not been performed. The ability to terminate may depend on the specific wording of the agreement overall, and the force majeure clause in particular.

Frustration

It should be noted that courts will not read in (or add) force majeure clauses into contracts where they are absent – regardless of world circumstances.

In the absence of a force majeure clause, or where the language of such a clause does not extend to a pandemic like COVID-19, there may be an excuse available at common law for non-performance. This excuse is known as the doctrine of frustration. Frustration applies where, due to an unforeseen event, performance of a contract is "radically different" from what the parties originally bargained for. However, the threshold to successfully claim frustration is high, given that its effect is to extinguish the contract and completely relieve all parties of their obligations thereunder. A close factual analysis would be required to assess whether the impact of COVID-19 significantly alters the nature of the parties' contractual obligations.

Business Considerations

In addition to the legal factors noted above, there are other business realities to consider when determining whether relief from contractual obligations is available, or even appropriate:

- *The need for relief:* In the face of closures and extended periods of quarantine and self-isolation, businesses are experiencing a steep reduction in revenues, harming their cash flow and their ability to satisfy outstanding obligations. It is uncertain how long this will last. Short-term relief from current obligations may make room for businesses to fulfill long-term obligations.

- *Industry trends:* Reflect on what competitors are doing and how that impacts the parties with whom your business contracts. For example, Canada's big six banks have announced mortgage payment deferrals - other lenders may be required to enact similar measures to maintain client relationships.
- *Dispute resolution mechanisms:* Review the dispute resolution mechanisms in agreements containing force majeure clauses. It may be more productive to negotiate with parties seeking or granting relief, instead of proceeding directly to dispute resolution for breach of contract.

Bottom line - is it better to bankrupt a business and forgo performance of all obligations under the contract; or to work with the business during this crisis and ultimately increase the probability of receiving full performance?

Notwithstanding the fact that force majeure clauses have been narrowly interpreted in the past, it remains to be seen how courts will react in light of current circumstances, and in the face of what can be expected to be a flood of new force majeure cases.

Please feel free to contact the authors, or your Foglers lawyer, for advice during these difficult times. We would be pleased to review your individual agreements, force majeure clauses and to advise on any of your other legal or business needs during this unprecedented time.