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Force Majeure and Frustration in Light of COVID-19

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The global COVID-19 pandemic has resulted in unprecedented and rapidly developing challenges for companies attempting to fulfill their contractual obligations in the face of supply chain interruptions, labour shortages, government-ordered closures and unexpected declines in demand. In these circumstances, contractual force majeure clauses or the contract law doctrine of frustration may offer relief if a negotiated resolution is not possible.

Force Majeure

A force majeure clause generally operates to discharge a contracting party when a supervening event, beyond the control of either party, makes performance in accordance with the contract impossible. In common law jurisdictions such as Ontario, a contract must contain an explicit force majeure clause in order for a party to rely on force majeure. A force majeure clause cannot simply be read into a contract. A force majeure clause typically lists the types of events that may constitute force majeure and sets out a procedure for the party affected by the force majeure event to give notice to the other party and an obligation for it to mitigate the effect of the event to the extent possible. The clause may provide an option to terminate the contract if the force majeure is not resolved within a specified time period.

While courts will typically respect contracting parties' apportioning of risk by giving effect to the terms of a force majeure clause, courts also apply the principles of contractual interpretation to narrowly construe force majeure clauses. The limited case law on force majeure clauses indicates that a party claiming force majeure must demonstrate the following factors:

- First, the event alleged to have triggered the force majeure clause must be sufficiently dramatic and unusual to constitute a force majeure – normal or even slightly abnormal circumstances such as bad weather, brief supply chain delays or other obstacles that commonly interrupt the flow of work in a particular workplace will not suffice.
- Second, the event must render performance of the contract impossible, extremely onerous or otherwise impeded to the degree specified in the clause. In making this assessment, courts will consider whether alternative avenues were available to fulfill the party's obligations; the fact that the contract has become uneconomical to perform will not suffice.
- Third, the supervening event must not result from the "act, or negligence, or omission, or default" of the party relying on the clause.

Triggering Events

Whether or not the impact of the COVID-19 pandemic triggers a force majeure clause will likely depend on the specific wording of the clause, particularly the list of enumerated force majeure events. Although many clauses explicitly provide for a pandemic or epidemic, other formulations such as "act of god" or "natural disaster" may encompass a pandemic. Depending on a party's line of business, clauses that refer to changes to governing laws and regulations will likely be increasingly relevant, as local, provincial and municipal governments formalize and enforce their recommendations for business closures and social distancing by executive orders or legislative action.

Other Considerations

- Force majeure clauses are highly context-specific and must be interpreted in light of the relevant facts.
- When reviewing contracts to assess the availability of relief under a force majeure clause, parties should look for any stipulated notice periods.

- Where possible, parties should attempt to negotiate solutions with the contract counterparty rather than turning to litigation, particularly given the current limited functioning of the courts, which may result in lengthy delays.
- All avenues to mitigate damages arising from an inability to perform the contract should be pursued.
- Parties should review any business interruption insurance policies for potential application to COVID-19-related losses (see our bulletin COVID-19: Insurance Claims Considerations).
- Parties should strongly consider including force majeure clauses and specific language to address pandemic events in future contracts.

Frustration

If a contract does not contain a force majeure clause, or the language of the force majeure clause is inapplicable to the problem faced by a party that is unable to fulfill its contractual obligations due to the COVID-19 pandemic, the contract law doctrine of "frustration" may provide relief.

Under the doctrine of frustration, a contract is "frustrated" when (i) an unforeseen supervening event takes place (ii) without the fault of either contracting party (iii) and that event radically alters the contractual obligations so that the contract as contemplated can no longer be carried out. Performance need not be literally impossible, however. Frustration may be present when the circumstances in which performance is called for would render the performance radically different from that which was undertaken by the contract. The result of a contract being frustrated is that the parties' contractual obligations are terminated. As is the case with force majeure clauses, the applicability of frustration to any specific COVID-19 dispute will require a thorough and contextual analysis of the contract at issue and the effect of the pandemic on the contract and the parties' obligations.

Other Considerations

- Although force majeure clauses can allocate known risks, frustration will only protect parties against risks that were unforeseen at the time of contracting. Parties may therefore encounter difficulty in relying on frustration to assist in terminating contracts entered into after the threats posed by COVID-19 became widely known.
- Although frustration results in the termination of a contract, this does not necessarily mean that there will be no further money owing between the parties. Ontario's *Frustrated Contracts Act* may require payments to compensate for costs incurred or benefits accrued under the contract to date.
- It may be more difficult to rely upon frustration in long-term contracts because the duration of the COVID-19 pandemic is currently unknown. Where a contract is lengthy in duration, a court may be less inclined to find that a temporary upheaval due to COVID-19 constitutes the necessary radical change to the contractual obligations.

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