
Allan Ritchie
416.748.4754
aritchie@loonix.com


Althea Yip
416.748.5142
ayip@loonix.com


Gordon Chan
416.748.4762
gchan@loonix.com

Loopstra Nixon LLP
Woodbine Place
135 Queen's Plate Drive Suite 600, Toronto, Ontario M9W 6V7
www.loopstranixon.com

COVID-19

Force Majeure Clauses and the Doctrine of Frustration of Contract

By Allan Ritchie, Althea Yip, and Gordon Chan

Since being declared a global pandemic by the World Health Organization (the "**WHO**") on March 11, 2020, the novel coronavirus (COVID-19) has severely disrupted business activity resulting in practical and economic challenges for many parties in performing their contractual obligations. Consequently, businesses have sought to understand their contractual obligations in the context of COVID-19 and what options they have to address any unexpected and unforeseeable "Acts of God" in the future.

In short, businesses should review their existing agreements to determine if they contain an applicable force majeure clause. Depending on how the clause is drafted, it may or may not apply in the context of COVID-19. Where a contract does not contain an express force majeure clause or contains one that does not apply in the context of COVID-19, it may be worth considering whether the common law doctrine of frustration of contract applies. Further, it is recommended that businesses conduct a comprehensive review of their existing contracts to determine if any revisions are necessary (i.e. to add or revise the existing force majeure clause) to address any future extraordinary circumstances.

This article will analyze how a force majeure clause or the doctrine of frustration of contract may assist businesses in the context of COVID-19.

What is a Force Majeure Clause?

A force majeure clause is an express provision in a contract which typically relieves a party from performing its contractual obligations if performance is prevented by extraordinary circumstances beyond that party's control. However, depending on the industry and the parties involved, force majeure clauses have also recently been used to capture specific ordinary course business activities or other circumstances (which are not beyond the control of the parties) as a triggering event which relieves performance. Essentially, a force majeure clause is a risk allocation tool and the language of the clause will govern. The types of events which may be included in a force majeure clause will depend on the nature of the contract and bargaining power of the contracting parties.

Force Majeure Clauses in the Context of COVID-19

Traditionally, very little attention has been paid to negotiate extensive force majeure clauses as they were seen as standard terms to a contract. However, the COVID-19 landscape has brought such provisions under the spotlight as they could provide the flexibility and options necessary to enable a business to manage its contractual obligations while under pressure from the pandemic and other government-imposed restrictions. Accordingly, businesses are well advised to discuss with their legal counsel on how to protect their interests by negotiating customized force majeure clauses and to review their existing contracts to determine how any applicable force majeure clauses apply. There is no common law doctrine of force majeure, so a force majeure clause must be expressly stated in a contract to be available as an excuse for a contracting party's non-performance.

In general, the 'customer' (i.e. recipients of goods and/or services) of a contract will want more restrictive language in the force majeure clause to increase the likelihood that they receive what they have bargained for, while the 'merchant' (i.e. suppliers of goods and/or services) will want broader language to enable them greater flexibility to be excused for any non-performance during unexpected and unforeseen circumstances. As a starting point, two general considerations that are the focus, and often, the negotiating points, of every force majeure clause include: i) the definition of force majeure events (which often includes a list); and ii) the degree of impact required to trigger a force majeure clause. Ultimately, force majeure clauses are highly context and language specific, so businesses are advised to have discussions with their legal counsel to ensure the proper contractual intent is captured within their force majeure clauses.

What is the Doctrine of Frustration of Contract?

If a contract does not contain an express force majeure clause, a party to a contract may attempt to seek relief through the common law doctrine of frustration of contract. The doctrine provides that a contract is terminated for frustration if a situation has arisen that the contracting parties have not contemplated, and the situation has rendered further performance impossible or radically different from the contractual obligation. In other words, if a contract is frustrated, all obligations under the contracts immediately come to an end. There is a high bar to establish frustration of contract as the party relying on the doctrine must demonstrate substantial frustration of the contractual purpose and the frustrating event must be unforeseeable and extraordinary. Whether frustration of contract can be established is context specific, and businesses are advised to consult with their legal counsel to determine whether or not the doctrine may apply to them.

How Might the Doctrine of Frustration of Contract Apply in the Context of COVID-19?

The unprecedented impact of COVID-19 may be sufficient to meet the high bar required to establish frustration of contract especially if a contract was formed prior to COVID-19 being announced as a global pandemic. The timing of contract formation is critical because the doctrine only protects against unforeseen risks at the time of contracting. Therefore, it may be difficult for a party to establish frustration of contract after the risks of COVID-19 became widely known. Nevertheless, the case law surrounding the doctrine of frustration of contract for COVID-19 is still developing, so it is unclear how courts will decide on this matter.

As a further consideration, Ontario's *Frustrated Contracts Act* provides that even after a contract has been terminated for frustration, a court may order amounts payable to adjust for costs or benefits derived by parties under the contract prior to its termination for frustration. Therefore, a business seeking to terminate a contract for frustration should consider whether there is any advantage in doing so after accounting for these amounts payable, as it may be more worthwhile for a business to negotiate amendments, such as extending timelines to deliver on goods and services or adjusting payment deadlines, to facilitate continued performance of a contract.

Conclusion

COVID-19 serves as a stark reminder for businesses to carefully consider their allocation of risk. A well-crafted force majeure clause can minimize future disputes regarding options available to the parties when unexpected and unforeseen circumstances arise.

For contracts without an express force majeure clause, the doctrine of frustration of contract may be applicable to provide relief. However, the jurisprudence for the doctrine of frustration of contract due to COVID-19 is still developing, so it is unclear how courts will apply the doctrine in the context of COVID-19. For commercial certainty, discussing with legal counsel to review existing contracts for force majeure clauses and to prepare clearly drafted force majeure clauses for future agreements remains the preferable option.
