

Coronavirus (COVID-19): Implications on performance under commercial contracts

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The consequences of the novel coronavirus disease (COVID-19), which was [declared a worldwide pandemic](#) last week by the World Health Organization, can already be seen on the global economic stage. Canadian organizations will need to be responsive to new circumstances as the full impact of COVID-19 and government responses to COVID-19 continue to evolve. We can safely anticipate continued and, in some cases, prolonged disruptions to workforce availability and supply chain operations.

In order to appropriately respond to these disruptions, organizations need to understand their contractual obligations to their customers, suppliers, partners and any other parties with which they do business.

An organizations' contractual obligations to a party typically depends primarily on the terms of its written and oral contracts with that party. Certain contracts may contain often overlooked provisions that are applicable to the current situation. There are also rarely applicable legal doctrines that will gain significance and have a considerable impact on current organization operations in light of COVID-19.

In this Article, we will provide a high-level overview of the force majeure contractual provision and the doctrines of force majeure, impossibility and frustration at law to help guide your preliminary analysis of your commercial obligations.

Force Majeure Clause

Many contracts have a Force Majeure clause which sets out a list of events and the parties' agreed upon response should any of the listed events occur. These clauses may:

- excuse one or more parties from the performance of their obligations (and resulting liability for non-performance);
- state that one or another party will still be required to perform their obligations (or pay for non-performance) despite the occurrence of a listed event; or
- delay performance obligations for a certain period of time following the occurrence of a listed event.

An example Force Majeure clause is included below:

Neither party shall be held accountable or penalized under the terms of this agreement for failure to perform which is occasioned by war, strike, **pandemic**, act of God, natural disaster, or other casualty beyond the reasonable control of a Party ("Force Majeure"). If the Force Majeure results in delay or non-performance of a party hereto for a period of three (3) months or longer, then either party shall have the right to terminate this agreement with immediate effect without liability towards the other party.

The above example may excuse both parties from performance and liability if, as a result of COVID-19, they are actually prevented from performing their respective obligations and, depending on the duration of COVID-19, could allow either party to terminate the contract after three months.

There are a number of other terms beyond the express use of the word "pandemic" that could be included and, depending on contract interpretation, may cover the circumstances surrounding COVID-19, including: "epidemic"; "public health emergency"; "communicable disease outbreak"; "quarantine"; or "national or regional emergency". Some clauses may be open-ended and have language that includes events "similar to" those listed in the provision.

Organizations should proactively review any such clauses in their contracts to see whether they are applicable in the current circumstances. If they are applicable, organizations must determine the consequences of the specific clause on their obligations or rights.

The consequences of the occurrence of a Force Majeure event can vary and the clause may only delay the obligations instead of terminating the contract in its entirety. Organizations should be careful to note any notice or termination requirements, and any duty to mitigate included in the Force Majeure provision. In the circumstances of COVID-19, mitigation efforts should include early communication of concerns resulting from COVID-19 and any plan designed to address the effects.

Other Applicable Legal Doctrines in Canada

Force Majeure as a Legal Principle

In order to determine whether to excuse performance under a Force Majeure clause, courts will consider whether the event was foreseeable. Subject to the application of the legal doctrines set out below, if a court determines that the COVID-19 outbreak was foreseeable, the court may uphold the terms of the agreement and require that the obligations be performed, or that the non-performing party pay for non-performance.

For reference, we have included a [flow chart of considerations](#).

Impossibility

If a Court determines that the event was unforeseeable, it may grant an organization relief from its contractual obligations if it further determines that performance would be absolutely 'impossible'. In making this assessment, a court will consider whether performance of the contract is objectively impossible in the circumstances, not just more expensive or time-consuming.

For example, the performance of obligations will be considered absolutely impossible if they are prevented or prohibited by operation of law. This has particular application in the context of COVID-19 as some governments have imposed lockdowns and regional quarantines. Other pertinent examples may eventually be argued to include the cancellation of seasons by major sports leagues, and the cancellation of concerts and industry conferences. Governmental restrictions or the voluntary cancellation of the foregoing events may be argued to make contractual performance impossible depending on the circumstances of each case.

Frustration

Frustration is another legal doctrine which may operate to excuse an organizations' performance under a contract. For the purposes of this analysis, a court will consider whether the principal purpose for one party's entering into an agreement is destroyed or removed. Similarly to impossibility, this doctrine does not apply to situations where parties are simply inconvenienced or experience a material loss – the threshold for establishing frustration is high. The principal purpose of the contract must have been known by or have been clear to all parties when the agreement was entered into and the parties cannot have contemplated the consequences of a COVID-19 outbreak during its negotiation. The consequence of a court's acceptance that COVID-19 has "frustrated" an agreement is full termination of the agreement and discharge of all parties' obligations. Frustration will not operate to 'suspend' contracts.

As an example, an exclusive supply agreement between a distributor and an end-user that is reliant on the distributor's known relationship with the sole manufacturer of the product and time-dependent may be frustrated in the event that the manufacturer is unable to provide the product as a result of the circumstances of the COVID-19 outbreak.

To the extent that a contractual remedy discussed above relies on a court to decide a party's rights, there will necessarily be a delay between breach of the contract and determination of whether the breach is excused. This period could be extended if COVID-19 disrupts the court system in any way. Organizations will have to take this period of uncertainty into account when making the assessment of whether to attempt performance under a contract or approach renegotiations with their contractual counter-parties.

Of course, if COVID-19 makes performance absolutely impossible, organizations will have to be responsive and find a way to work with their commercial partners to minimize the negative consequences. While care should be taken to mitigate effects of non-performance, we wanted to share this update so that organizations could proceed with some confidence knowing that the law takes account of business and factual realities in assessing non-performance under commercial contracts.

If you have any questions about the availability of any of the above principles in connection with your organization, reach out to one of our lawyers, as follows:

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