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THE DISRUPTIVE IMPACT OF COVID-19 ON BUSINESSES AND PERFORMANCE OF CONTRACTUAL OBLIGATIONS

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On March 11, 2020, the World Health Organization (WHO) declared COVID-19 as a pandemic. On March 18, 2020, the Canadian government implemented a ban on foreign nationals from all countries except the United States, from entering Canada. COVID-19 has deeply impacted every sector of our economy, forcing reduced operations, temporary or permanent closures and mass layoffs.

There has been a growing number of inquiries from business owners as to whether they would be able to rely on *force majeure* provisions under their existing contracts. The purpose of a *force majeure* clause is to provide relief to a party affected by an event or circumstance beyond its control which prevents that party from performing its contractual obligations.

While parties to a contract are free to negotiate the types of events which will trigger the *force majeure* clause depending on the nature and needs of the commercial relationship, *force majeure* clauses commonly provide a laundry list of triggering events such as the following: acts of God, war, acts of terrorism, strikes and governmental action (changes in law). On the other hand, other *force majeure* clauses may be more broadly drafted to provide that an affected party will not be liable to the other party for failure to perform its contractual obligations as a result of a *force majeure* event, without listing specific events or circumstances, leaving open to the parties' interpretation the question as to what qualifies as a *force majeure* event. Generally speaking, higher operating costs and lack of funds due to an inability to borrow do not constitute events of *force majeure* since these are typically seen as risks normally associated with operating a business.

In the decision of *Atlantic Paper Stock Ltd. v. St. Anne-Nackawic Pulp and Paper Company Limited*, [1976] 1 SCR 580, the Supreme Court of Canada stated that an act of God or *force majeure* clause generally operates to discharge a contracting party when "a supervening, sometimes supernatural, event, beyond control of either party, makes performance impossible" and that such event is "beyond reasonable human foresight and skill". The Court further held that such event must "strike at the root of the contract".

If the *force majeure* clause in question contains a list of triggering events including pandemics or communicable disease, it will likely be easier for the party seeking relief from its contractual obligations due

to COVID-19 to show that the outbreak of COVID-19 is a triggering event. If the *force majeure* clause does not specifically include pandemics or communicable disease but contains more general language, then the affected party will first need to show that COVID-19 is a *force majeure* event within the scope of the clause.

It is not sufficient for the party invoking *force majeure* to establish that COVID-19 falls within the contractual definition of *force majeure*. The invoking party will also need to demonstrate that:

- the *force majeure* event impacted its ability to perform its contractual obligations. The language of the *force majeure* clause is the starting point for determining the impact required in order for the invoking party to obtain relief (e.g. whether the event must render performance impossible or some lesser impact is sufficient). In the absence of clear language specifying the required degree of impact, Canadian courts have applied varying thresholds; and
- the impact of the *force majeure* event was the cause of the invoking party's failure to perform its contractual obligations. A party should not be excused for failure to perform its contractual obligations when such failure is caused by an event within its control. The issue of causation often involves consideration of whether there were other options unaffected by the *force majeure* event available to the invoking party for performing its obligations and if so, whether such alternate options for performance were pursued by the invoking party.

Given the myriad of challenges COVID-19 has created for business owners, including supply chain disruptions, workplace health and safety issues, government shutdowns and consumer concerns, it is difficult to anticipate how the courts will approach the application of *force majeure* clauses where a party seeks to invoke COVID-19 as a *force majeure* event. In each case the analysis will be heavily dependent on the particular circumstances before the court.

If a party invokes the *force majeure* clause, that party should closely follow all notice requirements under the agreement (i.e. providing the other party with details regarding the nature and extent of the *force majeure* event) and make commercially reasonable efforts to mitigate the effect of the *force majeure* event on the performance of its contractual obligations. Relief from performance is usually intended to be temporary for the duration of the actual delay resulting from the *force majeure* event.

In the absence of a *force majeure* clause, parties may consider whether the doctrine of frustration may apply in circumstances where performance becomes impossible due to an unforeseen event, without the fault of either party, similar to a *force majeure* event. The parties need to establish that the effect of the unforeseen event is such that contractual obligations have become radically different from those which the parties had originally contemplated. However, it can be difficult to establish frustration and once

established, both parties will be discharged from further performance of their contractual obligations.

To reduce the disruptive impact of COVID-19 on business, business owners are encouraged to review the terms of their existing contracts for potential issues and availability of protection (such as a *force majeure* clause) and to assess their ability to perform their contractual obligations. If you require assistance in this regard, please do not hesitate to contact any member of our firm's Business Law Group.