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Force Majeure and Covid-19

The ongoing pandemic caused by the novel coronavirus (COVID-19) has created uncertain economic conditions for the world. With respect to outsourcing arrangements, COVID-19 may result in site closures, a failure to meet service levels, delays due to a failure to perform customer obligations required for performance by the provider, or labour and product shortages. As such, businesses are (and if they are not, they should be) scrutinizing their commercial agreements in order to understand their obligations and rights where there is an actual or prospective failure in performance as a result of COVID-19.

From a legal perspective, much of this analysis will center around two major factors: (i) the contractual force majeure clause; and (ii) a consideration of whether the common law doctrine of frustration may apply to the particular facts of each contract. In common law countries “frustration of contract” may also be known as the doctrine of impossibility, impracticability or frustration of purpose. Even without a force majeure clause, a party seeking to excuse its failure/inability to perform a contract may have the ability to do so under frustration of contract or its common law equivalent in the applicable jurisdiction.

Force majeure clauses are intended to allocate risk for events that are not within the reasonable control of a party and will generally excuse performance when it is delayed or prevented by such uncontrollable events. Circumstances arising from COVID-19 may or may not entitle a party to invoke a force majeure clause or claim frustration of contract, however, this will depend on the facts and the language of the contract. If a contract does not contain a force majeure clause, depending on the jurisdiction, there may be a common law or statute-based right to claim a remedy that is similar to force majeure. In Canada, as is common in common law jurisdictions, the doctrine of frustration is a common law right that allows a party to be excused of contractual obligations that it cannot fulfil as a result of an event or circumstances beyond the control of the party. Under common law, the doctrine relieves contracting parties of their obligations if there is a supervening event, arising through no fault of either party, which alters the nature of their contractual obligations to such an extent that compelling performance despite the new and changed circumstances would be akin to ordering them to do something “radically different” from what they agreed to do in the first place. This doctrine has also been codified in a number of civil law jurisdictions but may be applied differently. Generally, in civil law jurisdictions, if the contract does not contain a force majeure clause, then the applicable civil code provisions shall apply - under which the parties have a legal right to claim that their contractual obligations have been extinguished or suspended, provided the applicable civil test is satisfied.

Absent such a doctrine, the parties must contract for that right in an express force majeure clause - in any event it is almost always more prudent to include a force majeure clause that describes exactly what the parties want to/understand will happen on the occurrence of an event beyond their reasonable control.

If an agreement includes a force majeure clause, the following questions provide a framework for a meaningful review:



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Does the force majeure clause apply to the relevant party?

Force majeure clauses are sometimes highly negotiated provisions because they are a risk management tool more often relied upon by providers. As such, they tend to be drafted in favor of the provider, such that only the provider can rely on the provision. However it is also common for the clause to be mutual, applying to both provider and customer. However, a failure by a customer to pay fees when due is often not excused on the theory that the customer should not be off the hook to pay for services received, even if the payment is late or issued in a different format to the one contemplated in the contract. The foregoing circumstances may be reflected in a contract as follows: *“Provider [or both parties] will not be liable for failure to perform its obligations under this Agreement to the extent that it is unable to do so for reasons that are beyond its reasonable control...”*.

Does COVID-19 fall within the scope of the force majeure clause?

This analysis should be guided by general contract interpretation principles in the context of the agreement as a whole. Force majeure clauses are generally construed narrowly because it is presumed that parties do not intend to exempt performance of the very contractual obligations that they contracted for. Therefore, specific language that excuses performance under the current circumstances or wording closely resembling the example of the COVID-19 pandemic is the most useful e.g. does the force majeure clause reference as examples of force majeure: “disease”, “illness”, “pandemic”, “epidemic”, “contagion”, “outbreak”, “health emergency”, or the relevant effects of such emergencies, such as “work stoppages”, “supply chain disruption”, “transportation shortages”, “unavailability of labor”, “unavailability of materials”, “government action”, “government inaction”, “national emergency”, “local emergency” or “quarantine”.

If the wording of the contract does not consider any specific events that may cover the impact of COVID-19 on a particular agreement, look at the language and breadth of any catch-all or basket clause, such as “any other cause beyond the party’s control” or “an act of God”. COVID-19 would likely be covered by such catch-all language however, you also need to consider the reasonable expectations of each party and the realities of the current circumstances. For example, if the agreement was signed after the declaration by the World Health Organization (WHO) that COVID-19 is a pandemic, a party could argue that this particular COVID-19 pandemic was a foreseeable event and therefore failure of obligations arising from COVID-19 should not be excused. However even in this circumstance, other factors caused by COVID-19 such as government mandated orders and/or economic implications arising after the declaration of pandemic would still apply.

Has COVID-19 caused the non-performance or inability to perform, and are there any exceptions?

Enforcement of a force majeure clause requires that: (a) there be a causal link between the event and the impairment of contractual performance; and (b) there be a certain level of impairment to trigger the clause. For example, a party’s failure to pay for amounts owed under a contract due to the economic conditions caused by COVID-19 may not be excused if the lack of funds is due to a reduction in revenue generated, but it may be excused if the amount could not be paid because of a government order that froze the export of currency outside of a national economy for example. In the event of



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decreased revenue the party could borrow against a line of credit and still make the payment but if its money could not leave the country to pay a foreign provider then the client's ability to pay could be frustrated. Additionally, a party should consider what the standard of inability to perform obligations will be. Here the case law is mixed. Certain decisions suggest the standard is one of impossibility to perform while others have set a lower threshold such as "real and substantial problems" rendering performance commercially unfeasible. Generally, the fact that performance is simply more difficult or more expensive will not be sufficient to trigger a force majeure. Finally, businesses should consider whether any circumstances are specifically carved out from the application of the force majeure clause.

Invocation Procedure

Upon the application of a force majeure, the party invoking the clause should also consider procedural requirements such as notice and certain timing obligations which will may result in the other party being granted the right to terminate if service does not resume in a given period of time.

Mitigation

If it is determined that the force majeure can be invoked, both parties must proceed on a reasonable efforts basis unless otherwise agreed. The party invoking the clause must show that it has taken all reasonable steps to avoid the event and its consequences and that it has pursued all reasonable alternative methods of performing its obligations under the contract. Correspondingly, the other party must take all reasonable steps to mitigate its damages. For COVID-19, what is reasonable in the circumstances will evolve as the COVID-19 pandemic unfolds. For example, requiring a party to violate a government order would not be reasonable. However, requesting a party to perform certain obligations while following social distancing guidance would be reasonable.

Consider the interrelationship between a force majeure and business continuity obligations. For example, if a primary outsourced site is ordered to close due to social distancing in one jurisdiction but a backup site in another jurisdiction is still legally permitted to operate, could the provider be excused under a force majeure clause if it shut down its other site on its own initiative out of prudence despite the failure of the local government to order such an action?

Other Considerations

Prior to invoking a force majeure clause, parties may wish to first consider alternatives. For example, certain contracts may provide for suspension of payments or services, or the parties may agree to negotiate a manageable outcome. In addition, the jurisdiction under which the contract is governed will also impact the application of force majeure clauses. Certain jurisdictions have specific statutes that are invoked in times of crisis. As noted above, the governing jurisdiction will be crucial if a contract has no force majeure clause, or if COVID-19 is not captured by a force majeure clause and the doctrine of frustration is to be considered.

Regardless of the results of the analysis described herein, businesses should endeavour to remain flexible and practical as the global economy navigates these difficult times.



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One Fasken

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