COVID-19 is disrupting global supply chains and economic activity. Factories are being closed, events cancelled and employees are being forced into alternative work arrangements. Businesses are experiencing increasing hardship which may make it difficult to meet contractual obligations and protect bottom lines.

Your business may be one of the many impacted and his may take the form of:

- A decrease in demand for your goods and services, but no corresponding changes to your obligations to accept deliveries from your suppliers;
- Your operational capacity decreased, or perhaps you are dependent on manufacturers located in a coronavirus hotspot, and you are unable to produce sufficient quantities of products within the timeline imposed by your customers;
- Due to port closures, airline cancelations, and travel restrictions, the delivery of your goods and services need to be rerouted, resulting in delays and increased costs;
- You are hosting a trade conference or employee retreat and have paid for the venue, the catering and the activities, but now you have to cancel the event; or
- You have received a notice from your customer or your supplier, informing you that they will stop performing their contractual obligations so long as the impact of COVID-19 on their business persists.

What do you do in these situations? From a legal perspective, depending on the contract’s wording, its governing law, the industry norm, and the specific impact of COVID-19, a contractual party may be rightfully excused from not performing its obligations due to COVID-19 through assertion of a force majeure clause.

Force majeure clauses are often included in contracts to excuse performance or absolve a party from liability due to the occurrence of certain events that are beyond the parties’ control. Courts generally interpret these clauses very narrowly so whether a party can actually rely on the clause to excuse performance and escape liability will be a question requiring a detailed and fact-specific legal analysis.

The first step of analysis is to determine whether a force majeure clause is actually included in your contract. As it is commonly drafted, the force majeure clause begins with a definition of what types of events constitute force majeure. A short form clause may have a broad catch-all of “events beyond the reasonable control of a party” while a long form clause may specifically list the events such as “epidemic”, “pandemic”, “disease outbreak”, and “government action”.

Depending on the specific language used, some force majeure clauses require the force majeure event to render contractual performance legally or physically impossible before it may be relied upon. Other clauses set a lower threshold only requiring performance to become substantially more onerous before the non-performance may be excused. A change in market conditions that only results in more expensive or less profitable performance typically does not qualify for force majeure.
Additionally, a force majeure clause may require the non-performing party to notify the other party within a certain time period and to mitigate the impact of its non-performance. In certain sectors such as information technology, it is also common to see an obligation on the suppliers to have a disaster recovery or business continuity plan in place so that the service deliveries are not interrupted by the adverse event. For the party at the receiving end of a force majeure notice, there may be a right to terminate the contract if the non-performance continues for a certain length of time.

The other provisions of your contracts, outside of the force majeure clause, may also contain rights and obligations affected by a specific adverse event such as the coronavirus. A fulsome review of these contracts may raise questions such as:

— Does the impact of COVID-19 on your business trigger an event of default under your financing arrangements?
— Does the situation meet the definition of a material adverse event under the contracts your business has entered into?
— Is there any impact on your representations or warranties given to other parties, such as those relating to litigation and loss outside of the ordinary course of business?
— Is there insurance coverage under your policy’s terms and conditions for the losses your business have incurred due to COVID-19?

The governing law of a contract also impacts any analysis. There may be common law remedies or remedies enacted by provincial statute implementing the UN Convention on Contracts for the International Sale of Goods. Civil Code jurisdictions (such as France and Germany) and the U.S. Uniform Commercial Code may also contain statutory provisions relating to force majeure events that are applicable to your contracts.

If your business is impacted by COVID-19 and you are concerned with how it may impact your contractual rights and obligations, please contact us.

Contact us
Harvey Garman
Partner, Business Law
KPMG Law LLP
416 777 3252
hgarman@kpmg.ca