CARTERS
BARRISTERS
SOLICITORS
TRADEMARK AGENTS

LITIGATION BULLETIN NO. 7

APRIL 30, 2020

EDITOR: TERRANCE S. CARTER
ASSISTANT EDITORS: NANCY E. CLARIDGE,
RYAN M. PRENDERGAST AND ADRIEL N. CLAYTON

PRACTICAL STRATEGIES FOR DEALING WITH TERMINATION OF CONTRACTS IN A PANDEMIC

By Sean S. Carter and Heidi LeBlanc[*]

A. INTRODUCTION

The ongoing COVID-19 pandemic in Canada has caused an unprecedented situation with a unique set of challenges for organizations, including charities and not-for-profits ("NFPs"). Due to the governmental restrictions and the continually evolving advisories and guidelines, organizations have been forced to face difficult decisions regarding operations, not just in the immediate future, but also to make decisions regarding future operations that are weeks and months down the road. As a result, many charities and NFPs are having to consider cancellation or postponement of events and programs through either cancelling those events outright or rescheduling a wide variety of contractual obligations in the face of the COVID-19 pandemic. The results are far-reaching, including the loss of donations and/or program-related income, which could mean potentially significant monetary losses. As such, it is critical to consider what practical strategies may be available to help minimize or possibly eliminate contractual losses or damages. This Bulletin outlines some practical strategies for charities and NFPs to consider in this regard.

B. *FORCE MAJEURE* CLAUSES

1. What Are *Force Majeure* Clauses?

Force majeure clauses are often included in contractual agreements to permit parties to avoid or limit liability for non-performance of contractual obligations as a result of circumstances beyond their control. *Force majeure* cannot be implied by the parties, and only exists as a contractual

[*] Sean S. Carter, B.A., LL.B., practices general civil, commercial and charity related litigation from the Toronto office of Carters Professional Corporation. Heidi LeBlanc, J.D., practices general civil, commercial and not-for-profit related litigation from the Toronto office of Carters Professional Corporation.

remedy. In looking to the enforceability of these clauses, the courts will look closely to the facts of the case, conduct of the parties, and the terms of the *force majeure* clause itself. No one *force majeure* clause is usually the same, and the particular language, manner in which it was negotiated, and facts become very important in determining enforceability.

In considering the use and reliance upon *force majeure* clauses during and after the COVID-19 pandemic, it is important that parties carefully consider the specific language of the clause, any particular notice requirements, and strategies in negotiating solutions to potential long-term barriers to contractual performance. Charities and NFPs need to be aware that the mere existence of a *force majeure* clause does not necessarily relieve the parities from their obligations, nor ensure rescheduling or other adjustment. The manner in which the clause is invoked, the circumstances, and the timing are all part of what may make a *force majeure* clause effective in assisting negotiations or formal reliance.

2. The Language of the Clause

Although *force majeure* clauses can be found in different types of contracts, each clause is unique and must be carefully reviewed, as the specific language therein and the present facts may drastically affect a court's interpretation of the clause.

In particular, many of these clauses include specific language with respect to the types of events which can trigger the effect of the clause, often referencing events such as riots, strikes, floods, war, and other events beyond human foresight. Depending on the specific language and the types of events listed, the courts will then have to decide whether the individual clause being examined was meant to cover an event like the COVID-19 pandemic. Due to similar health-related incidents in the recent past, such as SARS and H1N1, many contracts have contemplated the disruption caused by other health-related concerns, and make specific reference to "epidemics" or "pandemics" in general. In the event that there is no specific language including "pandemics" or "epidemics" in general, which would clearly encompass the ongoing situation with COVID-19, most standard *force majeure* clauses include "acts of God" in the list of triggering events. Subject to other limiting language included in the clause, it is likely that the COVID-19 pandemic could fall within the scope of a standard *force majeure* clause as an "act of God", though its application will ultimately depend on the court's interpretation of the provision. In order to determine whether the COVID-19 pandemic

falls within the scope of the triggering events under the clause, parties will have to undertake a careful review of the specific language of the clause and the types of events that were contemplated to trigger the operation of the clause at the time the contract was agreed to.

In addition to determining whether the COVID-19 pandemic triggers the operation of a *force majeure* clause, parties should also carefully review the language of the clause with respect to the type of relief provided if the clause is triggered. In some instances, the clause may operate to eliminate all liability for a party who is unable to meet its contractual obligations as a result of the *force majeure* event. This is not always the case, however, and it is important to look to the specific wording of the clause to determine whether it provides for complete relief from contractual responsibilities, or only provides some partial relief. As such, when considering whether to invoke a *force majeure* clause, a party should carefully review the type of relief provided before moving forward in providing notice of reliance upon the clause. For example, if the clause only provides partial relief to an invoking party, the party may choose to engage in “without prejudice” negotiations (to be discussed below) to reach an alternate resolution with the opposing party with respect to a future breach of contractual responsibilities, rather than relying upon the partial relief provided under the *force majeure* clause.

3. Minimum Notice Requirements

Force majeure clauses typically include a minimum notice period to notify the other parties that the notifying party intends to rely upon the clause. Parties should take note of any deadlines set out in the clause and ensure that all notice requirements are strictly adhered to, in order to be able to successfully rely upon the clause. In the event that these minimum notice requirements are not met, it will likely cause significant difficulty for an invoking party to overcome these arguments from the opposing party before the court.

Due to the evolving government restrictions and current social climate due to the COVID-19 pandemic, contracting parties may already foresee potential difficulties in performing some or all of their obligations. In the event that a party is unable to perform obligations in the short term, it will need to consider whether the minimum notice requirements can still be met. In some cases, the party’s ability to satisfy the notice requirements will depend upon when the afflicting government restrictions came into effect and when the party first became aware that it would be unable to fulfill

its contractual responsibilities. As a result, parties should carefully consider the language of a notice provision in the clause, with particular attention to whether there is any guidance as to when the minimum notice period begins to run.

4. Considerations for Negotiations

The constantly evolving nature of the restrictions and public safety guidelines caused by the COVID-19 pandemic have created significant uncertainty for the months to come. As such, many parties are being forced to consider how to approach their potential inability to meet contractual obligations, not just in the short term, but also on a long-term basis into the future. As a result, charities and NFPs may wish to consider engaging in negotiations with their contractual partners in order to reach a resolution in an effort to reduce potential damages, losses, and liability on a go-forward basis.

It is important, however, to remember that well-meaning attempts to rely upon a *force majeure* clause, even as a part of early stage negotiations, may inadvertently lead to arguments from contractual partners regarding anticipatory or peremptory breach of contract. These difficulties should be avoided, if possible, by framing these discussions as “without prejudice” negotiations, wherein the *force majeure* clause is utilized as a tool to assist in negotiations, and is only openly invoked as a matter of last resort. This is particularly important when parties begin to engage in these negotiations long before the expiry of any notice requirements under the applicable clause.

Due to the COVID-19 pandemic, the courts have suspended their regular operations and are not currently allowing any in-person appearances due to current social distancing guidelines. Although the courts continue to expand the scope of the matters that they will begin to hear by video and teleconference, the COVID-19 pandemic will inevitably continue to cause a delay with respect to the courts’ ability to hear non-urgent civil matters. Although *force majeure* clauses are helpful tools for contracting parties, significant delays will inevitably result to parties who intend to enforce clauses before the civil courts over the next year or two. This provides a further incentive for parties to consider pursuing an early negotiated settlement, or even private arbitration, in managing issues with respect to suspected non-performance of contractual obligations due to the COVID-19 pandemic, which may otherwise typically be enforced via a *force majeure* clause.

C. FRUSTRATION OF CONTRACT

In the event that a contract does not include a *force majeure* clause, or the *force majeure* clause is unenforceable under the current circumstances, the parties may be able to resort to the common law remedy of "frustration of contract." The doctrine of frustration can be relied upon if an unforeseen event results in the contract being impossible to perform, or has become radically different than what was initially intended by the parties at the time the contract was entered into. Further, organizations such as charities and NFPs may also be able to rely upon frustration if the purpose of the contract itself has been frustrated. This can occur when the contract may be physically performed, but the purpose of doing so has been entirely subverted by an unforeseen supervening event.

Frustration may be particularly applicable under the current circumstances in defending against a breach of contract claim for a failure to perform obligations under the contract due to the COVID-19 pandemic. In determining whether frustration applies, the court will consider the purpose of the contract and, particularly, whether it has been undermined by the COVID-19 pandemic, as well as the timing of the COVID-19 pandemic's effect upon the parties' ability to perform their obligations under the contract. Similar to the analysis regarding the applicability of *force majeure* clauses, the specific facts of the case will need to be assessed in determining whether the doctrine of frustration applies to a given circumstance.

D. LIQUIDATED DAMAGES CLAUSES

Liquidated damages clauses exist in many contracts in order to discourage last minute contract cancellation and operate to impose pre-specified monetary damages upon a party if it wants to terminate the contract. It is important to note that an anticipatory or peremptory breach may trigger the operation of these clauses, resulting in monetary penalties to the offending party. These clauses will be of particular concern to parties who may be unable to meet contractual obligations in the coming months due to the COVID-19 pandemic, as they will want to avoid or limit any potential penalties under the contract for early termination thereof.

Even if a termination of the contract is likely to occur due to the COVID-19 pandemic, and the applicable contract includes a liquidated damages clause, it is not a foregone conclusion that the clause would be upheld by a court. If the clause is akin to a penalty, and the monetary damages set out therein does not represent a genuine attempt to pre-estimate the loss to the other party resulting from the termination, the

clause will not be enforceable against the terminating party and they will not be subject to pay the monetary damages set out in the clause.

In addition, it could be argued that a liquidated damages clause should not be enforceable in circumstances where parties need to terminate a contract due to the challenges posed by the COVID-19 pandemic on the basis of public policy. While there is little case law at this time on this point, the COVID-19 pandemic may well constitute a sufficient public policy concern causing the courts to either strike down a clause or dramatically lessen the damages imposed under the clause in question.

It is important to note, however, that these considerations regarding enforceability of liquidated damages clauses do not relate to deposits. Deposits and clauses relating to them are to be assessed separately and, by their very nature, are intended to be forfeited. As such, the recovery, or even partial recovery, of a deposit following a subsequent termination of the contract, is highly unlikely regardless of any public policy concerns.

E. CONCLUSION

Given the relatively unprecedented nature of the COVID-19 pandemic, charities and NFPs are encouraged to carefully review active contracts, assess any ongoing contractual obligations (with legal advice if possible) and consider how they may be affected in the coming months. The strategies discussed above may assist both those organizations which are seeking relief from some contractual responsibility, as well as those that wish to ensure that the maximum funds or damages are retained in light of a terminated or unperformed contract. It will be important to consider these strategies throughout any negotiations pertaining to potential contract cancellations, but to also do so on a proactive basis in order to set the best possible narrative in the event that litigation becomes necessary.

CARTERS

Carters Professional Corporation / Société professionnelle Carters
Barristers · Solicitors · Trademark Agents / Avocats et agents de marques de commerce
Toronto · Ottawa · Orangeville
www.carters.ca **www.charitylaw.ca** **www.antiterrorismlaw.ca**
Toll Free: 1-877-942-0001

DISCLAIMER: This is a summary of current legal issues provided as an information service by Carters Professional Corporation. It is current only as of the date of the summary and does not reflect subsequent changes in the law. The summary is distributed with the understanding that it does not constitute legal advice or establish a solicitor/client relationship by way of any information contained herein. The contents are intended for general information purposes only and under no circumstances can be relied upon for legal decision-making. Readers are advised to consult with a qualified lawyer and obtain a written opinion concerning the specifics of their particular situation. © 2020 Carters Professional Corporation

00466941.DOCX