



**THE POTENTIAL IMPACT OF COVID-19 ON CONSTRUCTION  
AND SUPPLY AGREEMENTS**

**FORCE MAJEURE PROVISIONS AND THE DOCTRINE OF FRUSTRATION**

**I. INTRODUCTION**

The COVID-19 pandemic has interfered with the performance of many construction and supply agreements. As a result, many contractors are asking whether contract law provides any relief from contractual obligations when performance is prevented or hindered by unforeseen events beyond the control of either party.

In general, parties are free to determine the terms of their contract and the role of the courts is limited to enforcing those terms. There are, however, two circumstances in which a party may be relieved of its obligations under a contract as a result of events beyond its control.

The first relies upon a provision that appears in many standard form construction contracts, called a “force majeure” (French for “superior force”) clause. It relieves one or both parties from performance of their contractual obligations when an extraordinary event beyond the control of the parties prevents or inhibits performance.

In the circumstances expressly identified in the clause, force majeure provisions allow the parties to:

1. Delay the obligation to provide or accept goods and services without terminating the agreement; or
2. Terminate the agreement.

The second does not depend upon a specific provision of the contract. Instead, the law empowers courts to grant relief from contractual obligations in circumstances in which the performance of the contract is legally “frustrated”.

The doctrine of frustration is a common law principle that allows parties to contracts (written or oral) to terminate the agreement in certain circumstances. Usually, where an agreement contains a force majeure provision, the doctrine of frustration will not apply. However, it may apply when the written agreement has a force majeure provision that is narrowly drafted or otherwise provides for the parties to rely on frustration of contract.

Unfortunately, the interpretation of force majeure provisions and the application of the doctrine of frustration depend critically upon the particular circumstances of the contract. In addition, both

force majeure and frustration can be subtle and complex making it difficult to determine whether they apply in the circumstances. Specifically, it is not possible to offer a general opinion on whether COVID-19 related events will allow a party to (a) rely on a force majeure provision to suspend its obligations under a contract, or (b) terminate the agreement relying on the force majeure provision or the doctrine of frustration.

## **II. FORCE MAJEURE PROVISIONS**

### **A. Are all force majeure provisions the same?**

There is no standard force majeure provision. While they may appear to be similar, courts will carefully examine the wording of the particular provision on a case by case basis.

Contracts with force majeure provisions often include the following:

1. A definition of force majeure events.

It is common for contracts to state that a force majeure event arises when a party is unable to comply with its obligations under the contract because of:

- (a) a law or governmental order, rule, regulation or direction;
  - (b) an action by a government or public authority to impose an embargo, export restriction or other restriction or prohibition;
  - (c) war, insurrections, terrorism, riots or crime;
  - (d) hurricane, flood, earthquake, lightning or other natural event or disaster;
  - (e) plague or epidemics; and
  - (f) strikes or other work stoppages;
2. A requirement, for the party seeking relief, to demonstrate an inability to comply with obligations under the contract as a result of the event and that non-compliance could not have been avoided by taking commercially reasonable action; and
  3. The contractual consequences, if there is a force majeure event, which may include the following:
    - (a) A time period in which the parties do not have to comply with the obligations that are being impacted by the force majeure event;
    - (b) A right to terminate the contract if a force majeure event continues for a specified time period; and

- (c) If the agreement is terminated, all obligations come to an end except for those that had crystallized prior to the start of the force majeure event (e.g. the obligation to pay for services provided up to that date).

Sometimes force majeure clauses have catch-all language such as “any other event or series of events beyond the reasonable control of the party”. Depending on where this type of phrase is found, it may significantly expand the scope of the force majeure clause or, alternatively, may only expand the scope of a limited part of it.

#### **B. Do you have a force majeure provision in your agreement?**

A force majeure provision is only available if (a) it is included in your written agreement, or (b) the parties verbally (and very specifically) agreed to this type of provision in their oral contract. In the absence of express agreement, a force majeure clause will not be implied into a contract.

Given that there is no standard force majeure provision, it is very unlikely that such a clause would be a term of a verbal contract unless the parties specifically agreed on the scope (which would be unusual).

#### **C. Courts narrowly interpret force majeure provisions**

Courts will generally narrowly interpret force majeure provisions. This means that courts will usually not allow a party to rely upon a force majeure provision unless the party seeking to do so can bring itself within the specific language of the clause. Absent very exceptional circumstances, courts will not “read in” words into a force majeure provision that are not there.

#### **D. Scope of force majeure provisions**

Some of the key issues courts consider when analyzing whether a party is entitled to rely on a force majeure provision are the following:

1. Do the circumstances raised by the party constitute a force majeure event as defined in the provision;
2. Has the party taken sufficient steps to avoid and mitigate the force majeure event; and
3. Have any other additional contractual conditions, such as notice, been complied with.

Generally, force majeure may only be invoked when the relevant event has prevented performance of the contract, not simply that the event exists, has caused economic hardship, or that performance has become difficult or commercially undesirable.

**E. How does a party invoke a force majeure clause?**

Force majeure clauses typically set out a procedure which must be followed to claim relief under the clause. Contractors must ensure that they have properly complied with that procedure. If the clause is not properly invoked, the contractor may be precluded from relying on the provision.

**III. THE DOCTRINE OF FRUSTRATION**

**A. Introduction - the Doctrine of Frustration**

Frustration occurs when there is an event or circumstances for which the parties have made no provision in the contract and performance of the contract becomes radically different from what was undertaken by the contract.

More specifically:

1. The question is whether the contract is broad enough to apply to the changed circumstances or whether the change is such that performance of the contractual obligations in the new circumstances would be something radically different from what the parties had agreed upon; and
2. There is no need to consider what the parties thought or how they or reasonable persons in their shoes would have dealt with the new situation if they had foreseen it. The question is whether the contract which they did make is wide enough to apply to the new situation. If not, it is at an end.

**B. Circumstances that will amount to frustration**

Courts have described the circumstances amounting to frustration as follows:

1. The event in question occurred after the formation of the contract and cannot be self-induced;
2. The contract must, as a result, be totally different from what the parties intended. This difference must not amount to mere inconvenience;
3. The disruption must be permanent, not temporary or transient;
4. The change must totally affect the nature, meaning, purpose, effect and consequences of the contract for either or both parties;
5. Finally, the act or event that brought about such radical change must not have been foreseeable.

### **C. Consequences of a contract being found to be frustrated**

Subject to the provisions of the British Columbia *Frustrated Contracts Act* (see below), the doctrine of frustration has the effect of automatically terminating the contract. The parties remain entitled to enforce rights and obligations under the contract that arose prior to the events which caused the frustration.

British Columbia has specific legislation related to frustrated contracts: the *Frustrated Contract Act*. The Act does not define what amounts to a frustrated contract but does set out the remedies in cases of a frustrated contract. In very broad strokes, the *Act* seeks to:

1. Separate out parts of the contract that have not been frustrated and continue to apply those as a separate contract; and
2. Fairly adjust the “benefits” from performing or partially performing the frustrated aspects of a contract.

The *Act* also provides for various exceptions, methods of calculation, and limitations.

### **D. Consequences to the defaulting party if a contract is not found to be frustrated (and there is no force majeure provision)**

Where the non-performance is only temporary and not such as to constitute a frustration of the contract, generally the contract remains in effect even if one party is in breach of its obligations for a period of time (whether as a result of an unforeseen event beyond their control or any other reason). In such situations, the issue is often the amount of damages a defaulting party will be liable to pay as a result of the breach.

## **IV. GENERAL CONSIDERATIONS RELATED TO COVID-19 CIRCUMSTANCES**

### **A. Is it likely that COVID-19 constitutes a force majeure event?**

It is unlikely that your clause specifically envisages COVID-19. However, standard force majeure clauses often include pandemics, epidemics, and government orders.

### **B. Should you rely on your force majeure provision?**

Simply because a force majeure clause exists does not necessarily mean that a party should invoke it. A careful consideration of the circumstances is required. For example:

1. Force majeure clauses typically permit the unaffected party to terminate when the event has continued for a specific period of time;
2. The contract may require parties to negotiate an outcome, or it may be more desirable to do so. Likewise, dispute resolution clauses may be triggered if parties cannot agree on an outcome.

3. Parties also need to consider the significance of any limitation of liability clause or a clause providing for liquidated damages;
4. Parties do not want to inadvertently waive rights, vary the contract terms, or admit liability; and
5. There may be other remedies available in addition to or instead of a force majeure provision.

**C. Do not make assumptions on what rights you have just because the contract contains a force majeure provision**

Do not assume the meaning or applicability of a force majeure clause. Force majeure clauses are rarely the same. Therefore, a one-size-fits-all approach will not work. Each contract must be reviewed to determine if there has been a force majeure event and the consequences, if any.

It is also important to review the entire contract, as there are likely to be several terms, which modify or interact with each other.

**D. Determining when to take the position that a contract is frustrated involves a complicated analysis**

The effects of COVID-19 would not necessarily result in a contract being frustrated. Incorrectly taking the position that an agreement has been frustrated could result in the other party being entitled to terminate the contract and sue for substantial damages. A careful assessment of the risks is essential.

**E. Negotiating force majeure provisions in future agreements**

All agreements involve the allocation of risks. In the future, parties may wish to devote more attention to force majeure clauses, and draft a more appropriate list of triggering events.

This memorandum is intended to provide general information only. For advice or questions about particular situations, or for additional clarification of any points in this memorandum, please contact John Legge, Rob Grant, David Penner or any of our lawyers. The contact information for all of our lawyers can be found at [www.glgzlaw.com](http://www.glgzlaw.com)

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