

# Can You Rely on the Force Majeure Clause in Your Insurance Based on COVID-19?

Here is some information for you from an Insurance Partner of FEO:

There are four key factors that determine whether a party can rely on an FM clause based on COVID-19:

1. Whether COVID-19 falls within the scope of the FM clause;
2. Whether COVID-19 has sufficiently impacted an obligation of the relying party;
3. Whether the relying party has taken sufficient steps to avoid and mitigate COVID-19's impact; and
4. Whether additional contractual conditions, such as notice, are met.

These factors are discussed in detail below.

Where there is no FM clause at all in the agreement, a party may still have recourse to the doctrine of frustration of contract. Frustration may provide relief from the obligations under a contract where an event renders the performance of the contract impossible or radically different from what was originally agreed to. The event must go to the core purpose of the contract. Note that frustration has a different (typically higher) standard before it is triggered, and different implications for an agreement than an FM clause—most notably the fact that a finding of frustration of contract brings the entire contract to an end.

## 1. COVID-19 as a force majeure

Whether COVID-19 is an FM under a contract depends on the clause's specific wording within that contract, bearing in mind that FM clauses are typically interpreted narrowly. It may therefore be difficult for a party to rely on an FM clause where there is some level of ambiguity over whether it applies to COVID-19.

COVID-19 is more likely to qualify as an FM event when wording such as "pandemic," "epidemic," "quarantine," "illness," "outbreak" or "disease" is included in the FM clause. Depending on the context, COVID-19 could arguably be included within the scope of broader phrases, such as "Act of God," or "plague" or "circumstances beyond a party's reasonable control."

## 2. Sufficient impact on contractual obligation

**Requisite level of impact.** FM clauses typically set out the threshold of interference in an obligation that must exist before the clause is triggered. Typical phrases include "prevents," "renders impossible," and "substantially hinders." Whether COVID-19 meets the requisite threshold of impact depends on the factual circumstances at issue, the wording of the FM clause and the obligation a party seeks excuse from. Courts are reluctant to give effect to FM clauses where the only impact has been to render an obligation more expensive to perform.

**Causal link.** COVID-19 must have an actual and direct impact on the relying party's ability to perform their contractual obligation. Indirect impacts of COVID-19, such as pricing fluctuations, are less likely to be found to have prevented contractual performance.

### 3. Avoidance and mitigation

Companies seeking to rely on COVID-19 as an FM need to keep in mind their obligations to avoid and mitigate foreseeable impacts. Some contracts will specify the requisite level of mitigation efforts to be taken by the relying party but, even where the contract is silent, courts will be more reluctant to recognize COVID-19 as an FM where the impacts to the relying party were reasonably avoidable. Once impacted, the relying party is still obligated to take steps to mitigate those impacts.

### 4. Notice and evidence requirements

FM clauses often require the giving of notice as a condition precedent to trigger the operation of an FM clause. A party seeking to rely on an FM clause should consider whether notice and any supporting documentation is required under its contract, and if so, any timing or other formal requirements applicable to its delivery.

Even where there is no formal requirement to provide evidence or documentation as part of the FM clause, relying parties will be well served if they document the impacts of COVID-19 on their ability to meet contractual obligations as well as efforts to avoid and mitigate such impacts. This documentation will be useful in the event of a dispute, and may also help avoid disputes if shared voluntarily with counterparties in some circumstances.

### Operational considerations and practice tips

Reliance on an FM clause should always be considered in light of other contractual and operational realities. To this end, we offer some further factors for consideration:

#### Be proactive and get organized

- Identify and prioritize key agreements (e.g., largest suppliers or customers) for a review of FM clauses and potential vulnerabilities to your organization's ability or the counterparties' ability to perform contractual obligations.
- Consider the following avoidance and mitigation steps:
  - Monitor the spread of COVID-19, and formulate a general COVID-19 prevention, mitigation and response plan
  - Coordinate communication with suppliers, affiliates and employees on COVID-19 prevention and response
  - Evaluate levels of inventory
  - Assess alternative means or locations of work or production

- Document the steps taken to avoid, mitigate and respond to COVID-19, as well as the impacts COVID-19 has had on your business.
- If you receive an FM notice, consider seeking any documentation supporting the assertion of FM and inquire about mitigation efforts.

### Consider other aspects of the contract

A party's reliance on an FM clause is likely to affect, or be affected by, several other contractual clauses:

- **Negotiation and dispute resolution.** FM clauses may require parties to negotiate an outcome. Likewise, dispute resolution clauses may be triggered if parties cannot reach an agreeable outcome.
- **Limitation of liability, indemnity and liquidated damages.** Parties should consider the interplay of an FM with any limitation of liability clause or a clause providing for liquidated damages. While FM clauses typically absolve the relying party of liability for non-performance, these clauses are particularly important where there is some ambiguity as to whether the FM clause can be relied upon.
- **Governing law.** As with most contractual issues, attention should be paid to what law applies to the agreement and the jurisdiction in which disputes are to be determined.
- **Termination rights.** Reliance on an FM clause may allow or motivate a party to terminate the agreement. Termination may also be a preferable alternative to a party that seeks to rely on an FM clause but cannot meet the clause's conditions.

### Be prepared for litigation and dispute resolution

Reliance on an FM clause may ultimately result in litigation or trigger other dispute resolution mechanisms. Consideration should be given to what means of dispute resolution are available in the circumstances and how to be best prepared if a dispute resolution mechanism is triggered. This includes being mindful of communications to counterparties regarding the FM clause and any honest performance or good faith obligations that may apply, the retention of documents, and whether and when litigation privilege may apply.

### Consider the entire relationship

Parties weighing how to react to COVID-19 should consider the possible long-term impacts of relying on an FM clause on the overall relationship between the contracting parties and potential reputational risks. An attempt to rely on an FM clause is a high-risk maneuver—the likelihood of disputes and anticipatory breaches by counterparties are greatly increased when a party admits it is or was unable to perform. Your business may be better served by coming to the table prepared to negotiate a mutually-agreeable outcome, particularly where the FM clause is not clearly in your favour or where you are not otherwise in a position to rely on it as a result of other terms of the contract.