The Impact of COVID-19 on Contractual Relationships: Force Majeure and Business Interruption Insurance Claims

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As the novel coronavirus (COVID-19) continues, contracting parties will find it difficult to fulfill their existing obligations. The legal concept of *force majeure* has been brought into the limelight as disruptions to supply chains, international travel, and business operations have continued to occur. This is leading many businesses trying to determine if the *force majeure* clauses in their contracts will apply.

In addition to *force majeure* clauses, another COVID-related issue is how insurers should address claims regarding business interruption insurance. Historically, business interruption insurance has typically dealt with physical damage to an insured's business or property. However, recent case law may affect how these claims are addressed. While this may influence future outcomes, it is far from certain.

Test for *Force Majeure*

A *force majeure* clause generally operates to discharge a contracting party when an event beyond the control of either party makes performance impossible.[1] These clauses are interpreted in light of their general purpose of excusing non-performance upon the occurrence of a supervening event.

In *Atlantic Paper Stock Ltd. v St. Anne-Nackwaic Pulp & Paper Co.* Dickson J in the Supreme Court characterized the general nature of *force majeure* clauses as:

> "[A]n act of God clause or *force majeure* clause…generally operates to discharge a contracting party when a supervening, sometimes supernatural, event, beyond control of either party, makes performance impossible. The common thread is that of the unexpected, something beyond reasonable human foresight and skill."[2]

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[1] *Domtar Inc v Univar Canada Ltd.*, 2011 CarswellBC 3501, 2011 BCSC 1776.
[2] *Atlantic Paper Stock Ltd. V St. Anne-Nackwaic Pulp & Paper Co.*, [1976] 1 SCR 580 at 583. In *Atlantic*, the Supreme Court of Canada found that the respondent pulp and paper company was unable to rely on a *force majeure* provision for the non-availability of markets because the cause of non-availability did not arise as something independent of the company's control, but rather was brought on by itself.

Force majeure clauses generally operate in circumstances falling short of frustration.[3] The applicability of a *force majeure* clause requires that the claiming party demonstrate (1) the event and its consequences were **beyond reasonable foresight** and **beyond their control**, and that (2) such an event renders the performance of the parties' obligations **impossible**.[4] Notwithstanding the occurrence of the triggering event, if a contracting party can otherwise continue to satisfy its contractual obligations in a commercially reasonable manner, the *force majeure* clause will not operate to absolve that party from its contractual responsibilities.[5]

There may also be other requirements built into a specific *force majeure* clause, such as an obligation to take reasonable steps to prevent the event, mitigate the disruption caused by the event, and strict notice requirements.

Force majeure clauses are generally interpreted narrowly[6], requiring a party to bring itself squarely within the exemption sought.[7] Where a *force majeure* clause contains broad wording, there is a danger that courts may interpret any ambiguity against the drafter, concluding that the event does (or does not, depending on which party is arguing what) fall within the *force majeure* clause.[8] While obligations of performance will be excused frequently in this way, obligations of payment will not.[9]

Courts have upheld the applicability of *force majeure* clauses in the following cases:

I. An "act of god event",

II. An "act of the Queen's or public enemies", and

III. In the event of a strike.[10]

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[3] *M.A. Hanna Co v Sydney Steel Corp* (1995), 18 BLR (2d) 264, 136 NSR (2d) 241 (NSSC) at para 74.
[4] Joni R Paulus and Dirk J Meeuwig, "Force Majeure – Beyond Boilerplate", *Alberta Law Review Society* (Alberta Law Review Society, 1999) at 306, online.
[5] *Atcor Ltd. v Continental Energy Marketing Ltd.* (1994), 38 Alta LR (3d) 229), 19 BLR (2d) 48 at 55, rev'd (1996), 25 BLR (2d) 1 (Alta CA) at 243-44 (*Atcor*) In *Atcor* the Alberta Court of Appeal did not provide specific guidelines as to what may or may not be commercially reasonable.
[6] GR Hall, *Canadian Contractual Interpretation Law*, 3d ed (Markham, ON: LexisNexis Canada, 2016) at 341-2.
[7] *Supra* note 3.
[8] *Ibid.*
[9] See, *e.g.*, *VNB Financial Services Inc. v Marques*, [2000] OJ No 795 (Ont SCJ). An obligation to pay a car loan was not discharged because the car, having being sold by its true owner, was seized and returned to its owner.
[10] "Contracts", *Halsbury's Laws of Canada* (LexisNexis: Canada, 2017) at 419.

On the other hand, *force majeure* clauses have been inapplicable when:

I. An event has caused a serious problem but has not necessarily prevented performance[11],

II. There has been an increase in price in fulfilling the contractual obligations, but has not rendered performance impossible[12], and

III. There has been a dramatic drop in real estate values.[13]

In *Wal-Mart Canada Corp./Cie Wal-Mart du Canada v Gerard Developments Ltd.*,[14] McDonald JA stated that "a *force majeure* clause applies where circumstances occur which were unforeseen or beyond a party's control and does not apply to normal business risks to reallocate bargained for contractual risks."[15]

Force majeure clauses were considered more closely following the 2002/2003 SARS (Severe Acute Respiratory Syndrome) outbreak and H1N1 virus in 2009. Lawyers began to examine whether public health emergencies could constitute *force majeure* events. Contracts following both SARS and H1N1 saw an amendment to the standard list of *force majeure* events to add "public health emergency" and "communicable disease outbreak" or "epidemic" to ensure such events were captured in *force majeure* clauses.[16]

Obligation to Mitigate

One of the requirements that may be built into a *force majeure* clause is the obligation to mitigate. The duty to mitigate will fall on the party failing to perform the contractual obligation as a result of the intervening event.[17]

In *Atcor Ltd. v Continental Energy Marketing Ltd.,*[18] Atcor Ltd., a natural gas supplier, claimed to be entitled to cut off supplies to the buyer, Continental Energy Market Ltd., due to needed

[11] *Supra* note 5 para 17.
[12] *Domtar Inc v Univar Canada Ltd.*, 2011 BCSC 1776, 2011 Carswell BC 3501 (*Domtar*).
[13] *Holst v Singh*, 2018 ONSC 4220, 2018 CarswellOnt 10922 at para 6.
[14] *Ibid.*
[15] *Ibid,* at para 15.
[16] Cynthia L. Elderkin & Julia S. Shin Doi, Behind and Beyond Boilerplate: Drafting Commercial Agreement, 4th Ed (Toronto: Carswell)
[17] *Ibid*, at 310.
[18] *Supra* note 5.

pipeline repairs. Atcor argued the need for repairs constituted a force majeure event and they were therefore no longer obligated to perform their part of the contract. The Alberta Court of Appeal found, in addition to ordering a new trial, a supplier had to show that an event caused it a serious problem, not necessarily a prevention of performance, when seeking to invoke a *force majeure* clause. The concept of mitigation when relying on a *force majeure* clause was also considered. The Court found the supplier had to show that it was unable, by acting reasonably, to mitigate the consequences of the interruption in supply.[19]

In the context of a broad list of triggering events in a force majeure clause, the Alberta Court of Appeal in Atcor found that:

> *When the list [of triggering events] is broad, one reasonably expects to see in the contract that the event is tied to meaningful consequences. A good contract would expressly deal with several possible results, and different levels of obligation to mitigate.*[20]

Economic Events

Canadian courts appear to be hesitant to interpret economic events as a situation in which a party may rely on a *force majeure* clause to excuse their non-performance of contractual obligations.

In *Domtar*, the British Columbia Supreme Court established that there exists a high threshold for enforcing a *force majeure* clause for economic reasons. At paragraph 86, Fisher J stated "the fact that that a contract has become expensive to perform, even dramatically more expensive, is not a ground to relieve a party on the grounds of force majeure". Therefore, *Domtar* suggests that a claimant will face challenges before Canadian courts when invoking a *force majeure* clause for purely economic reasons.

Similarly in *Tandrin Aviation Holdings Ltd. v Aero Toy Store LLC*, the Queen's Bench Division (Commercial Court) found that "it is well establish under English law that a change in economic/market circumstances, affecting the profitability of a contract or the ease with which the parties' obligations can be performed, is not regarded as a *force majeure* event". [21]

[19] *Supra note 5*
[20] *Ibid* at 36.
[21] 2010 EWHC 40 (Common); [2010] 2 Lloyd's Rep 668.

Absence of Clauses and Doctrine of Frustration

Courts will be unlikely to find an implied *force majeure* clause when one does not appear within the contract, despite the occurrence of an event beyond the party's control.[22] If the contract is silent on *force majeure*, a court will determine whether to excuse an impacted party's performance based on the foreseeability of the event. When an event is reasonably foreseeable, the court will likely find that the parties can allocate risk by adjusting the monetary terms of the contract, and will generally not be excused from performance. Conversely, in unforeseeable events, courts will generally excuse the impacted parties' performance.

Such a situation is differentiated from one in which "some irresistible event occurs which frustrates the fundamental purpose of the contract"[23] as a contract in such a case is excused from performance due to being discharged by frustration.[24]

When a contract does not include a *force majeure* clause, a party may still be able to rely upon the common law doctrine of frustration to excuse their non-performance. To rely on this doctrine, a party must show: 1) there has been an event, occurring through no fault of either party, which was neither contemplated nor reasonably foreseeable, 2) which has rendered performance of the contract impossible or substantively different than what was originally intended.[25]

MDS Inc. v. Factory Mutual Insurance Company, 2020 ONSC 1924

This case involved a claim made for business interruption insurance coverage. These policies are typically triggered when a business experiences a loss of revenue or increased operational expenses resulting from tangible "physical damage" to the business' insured property.

The Plaintiff ("MDS") was in the business of purchasing and processing radioisotopes created in the Nuclear Research Universal Reactor in Chalk River, Ontario ("the NRU"). The Defendant insurer, Factory Mutual Insurance Company ("FM"), had issued a policy of insurance to MDS ("the Policy"), which provided lost revenue coverage resulting from all risks of physical loss or damage to the NRU, except as specifically excluded under the Policy.

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[22] *Royal Bank v Netupsky*, 1998 CarswellBC 87, 39 CLR (2d) 37 at para 14.
[23] Bernard Cartoon, "Drafting an Acceptable *Force Majeure* Clause" [1978] JBL at 231.
[24] *Ibid.*
[25] *Victoria Wood Development Corporation Inc. v. Ondrey et al.,* [1978] O.J. No. 3613 (ONCA).

In May, 2009, a leak of radioactive water as a result of corrosion was discovered in the NRU, which resulted in a shutdown order by the Canadian Nuclear Safety Commission ("CNSC"). This shutdown lasted for an unexpected 15 month period, during which MDS lost over $120,000,000.00 in profits, as its only source of radioisotopes could no longer operate. MDS made a claim to the insurer for lost profits in May, 2009. The insurer denied the claim in August 2009.[26]

The central question in this case was whether or not the definition of "physical damage" should be defined broadly or narrowly. Justice Janet Wilson of the Ontario Superior Court found in favour of MDS, holding that "a broad definition of resulting physical damage is appropriate in the factual context of this case to interpret the words in the policy to include impairment of function or use of tangible property caused by the unexpected leak of heavy water."[27]

In arriving at her decision, Justice Wilson underlined that:

- Physical damage was not defined in the FM Global all-risks policy;
- There is no definitive decision in Canada defining the meaning of resulting physical damage in all-risks insurance policies;
- Neither *Black's Law Dictionary* nor *Halsbury's Laws of Canada* define "resulting damage" or "physical damage." Nor do they define "resulting physical damage" or "resultant physical damage; and
- No Canadian textbooks define "physical damage," "resultant physical damage," or "resulting physical damage."[28]

Ultimately, Justice Wilson reasoned that "[t]o interpret physical damage as suggested by the insurer would deprive the insured of a significant aspect of the coverage for which they contracted, leading to an unfair result contrary to the commercial purpose of broad all-risks coverage."[29]

Applying *MDS Inc. v. Factory Mutual Insurance Company* to COVID-19

Justice Wilson's analysis demonstrates that the ability to prove coverage will depend on the interpretation of the specific words or phrases when considered in the factual context of the

[26] *MDS Inc. v. Factory Mutual Insurance Company*, 2020 ONSC 1924, at paras. 1-5.
[27] *Supra* note 26, at para. 518.
[28] *Ibid*, at paras. 442, 443 and 446.
[29] *Ibid*, at para. 519.

particular claim. For instance, even if a term is defined, coverage will still be determined based on the meaning of particular words when considered in the context of case law and, specifically, the factual context of a particular COVID-19 claim.

If, on the other hand, if a term is not defined, or is a term that may be applicable due to the common law, such terms will need to be determined in accordance with, amongst other things, the factual context of the particular COVID-19 claim. For instance, words such as "property damage" and "physical damage," and what these words entail, may need to be examined closely. However, it must be noted that this decision may be appealed, and such, this decision will only apply if it is upheld on appeal.

On a narrow view, *MDS* involved a coverage claim for a nuclear reactor leak, made to an insurer that underwrote a policy for that specific purpose. In that sense, *MDS* is limited to its particular facts and the particular policy at issue. On the other hand, the Court in *MDS* was careful to note the general nature of an "all-risks" policy, which is purchased "to provide peace of mind in case the unforeseen occurs". As the Court in *MDS* observed, "the purpose of all-risks property insurance…is to provide broad coverage". A broad interpretation such as this may be very costly for insurers, and may require rewording their all-risk policies in order to mitigate risk going forward. However, at the time of the preparation of this article, it is not known whether this decision will be, or is already under appeal.

The American Approach

American case law on this subject is unclear as judges have taken both broad and narrow approaches regarding business interruption claims.

In *Gregory Packing, Inc. v. Travelers Property Cas. Co. of America 51*, the New Jersey Federal Court held that where the accidental release of ammonia into a facility rendered the building unsafe as this constituted physical damage to the premises. The court reasoned that "property can sustain physical damage without experiencing structural alteration." This line of reasoning could suggest that the mere presence of the virus at the insured's property could constitute direct physical loss sufficient for business interruption coverage.

However, in *Mama Jo's, Inc. v. Sparta Ins. Co.*, a judge of the Southern District of Florida considered whether there was a "direct physical loss" when construction debris and dust from road work required the insured to clean its floors, walls, tables, chairs, and countertops. The court held that "cleaning is not considered direct physical loss," stating specifically:

> A direct physical loss 'contemplates an actual change in insured property then in a satisfactory state, occasioned by accident or other fortuitous event directly upon the property causing it to become unsatisfactory for future use or requiring that repairs be made to make it so.'"

Mama Jo's, Inc. appealed the decision to the United States Court of Appeals for the Eleventh District and oral argument was heard on Jan. 17, 2020. No decision has been issued as yet by the court.

In *Source Food Technology, Inc. v. United States Fidelity & Guaranty Co. (2006)* the United States Court of Appeals, Eight Circuit, held that Source Food's inability to transport beef product across the border from Canada, on account of USDA prohibition, and sell the beef product in the United States did not constitute direct physical loss to property. It was found that suggesting otherwise would render the word "physical" meaningless. The policy's use of the word "to" in the policy language "direct physical loss to property" is significant. Source Food's argument might have been be stronger if the policy's language included the word "of" rather than "to," as in "direct physical loss of property" or even "direct loss of property." But these phrases were not found in the policy. The policy's use of the words "to property" further undermined Source Food's argument that a border closing triggered insurance coverage under its policy. Under this line of reasoning, it could be argued that the inability of a business to operate because its key supplier has closed down, by government order would not constitute direct physical loss sufficient for business interruption coverage.