

## TRANSPORTATION

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### IN THIS ISSUE

*If you have contracts that are frustrated or impossible to perform due to COVID-19 restrictions, or government sanctions, it may be possible to collect (or avoid) damages if your contract has the appropriate Force Majeure Clause. We examine how to apply and interpret relevant Force Majeure Clauses in current agreements, and propose tips for drafting new agreements in today's uncertain business environment.*

## Frustrated by COVID-19: Recovering and Preventing Business Losses

### ABOUT THE AUTHORS



**Heather Devine** is one of Canada's leading transportation lawyers. From 2014-2020, she has been recognized as one of the *Best Lawyers*® in Canada for Transportation Law, and is the current President of the Canadian Transport Lawyers Association. Heather was admitted to the Ontario bar in 1999 and the Nova Scotia Bar in 1998, and has a J.D. law degree from Queens University. Heather worked as a commercial litigator until learning to fly single engine planes in 2009, which led her to focus in transportation law. Since then, her focus has included combining technology, transportation, and intellectual property to advise clients such as brokers, freight forwarders, carriers, and other clients who move goods locally and internationally. In her spare time, Heather flies airplanes and works as an instructor to perform simple aerobatics in the Pitts Special S-2A. She also rides motorcycles, including her Kawasaki Ninja. She can be reached at [hdevine@ahbl.ca](mailto:hdevine@ahbl.ca).



**Siarra Sanderson** graduated with a business degree in 2015 and a Juris Doctor degree in 2019 from the University of Western Ontario. She is currently an articling student with Alexander Holburn Beaudin + Lang LLP in Vancouver, British Columbia. She can be reached at [ssanderson@ahbl.ca](mailto:ssanderson@ahbl.ca).

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**Alan Polivnick**  
**Vice Chair of Publications**  
Watson Farley & Williams  
[apolivnick@wfw.com](mailto:apolivnick@wfw.com)

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Last week, the Country of Italy was closed for business: 60 million people are under lockdown.<sup>1</sup> Only thirty seven days earlier, Samsung announced it closed a phone manufacturing plant in Gumi, South Korea after confirming that a factory worker was infected with COVID-19.<sup>2</sup>

In the New Year, one factory closure appeared calamitous: today, the Country lockdown of the world's 8th biggest economy appears prudent.

While the repercussions from countries in lockdown, closed factories, and travel bans escalate internationally, local businesses realize that non-performance due to COVID-19 related issues will cause business losses.

The economic impact is far-reaching.

### **Can a business recover its losses caused by COVID-19?**

Normally, when a party fails to perform its contractual obligations, the failure is considered a breach of contract: the affected party claims damages arising from the breach and seeks to be paid damages so that the affected party is put in the position it would have been in 'but for' the breach of contract.

However, COVID-19 restrictions or sanctions prevent a party from performing its obligations. The COVID-19 restrictions are beyond the 'breaching' party's control and make it impossible for a party to perform.

### **What is an act or event of Force Majeure?**

It depends: when a party cannot perform due to COVID-19, a party may argue it has no liability for damages arising from a breach of its contractual obligation such as failure to deliver, or failure to comply with other contractual obligations on the grounds that the impossibility caused by COVID-19 restrictions is an act of 'force majeure' or frustration of contract.

A force majeure clause is often included in contracts to protect parties from damages caused by extraordinary events. The force majeure clause is included to set out what will happen in the event of an epidemic, labour strike, or hurricane, and practically will set out relief from delivery obligations, liability for damages arising from delay or non-performance, and may provide for suspension or termination of the contract.

This is why defining COVID-19 as an event of force majeure could provide a defence against a claim for damages for breach of contract -- because if COVID-19 is defined to be an event triggering a force majeure clause, it could, for example, trigger suspension of a contract and non-performance, would not be a breach of the contract.

### **Does Your Contract Have a Force Majeure Clause?**

First, check your contract for a force majeure clause - prevailing law requires the triggering act or event of force majeure to be defined in

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<sup>1</sup> "Coronavirus Italy: PM extends lockdown to entire country" Lorenzo Tondo in Palermo, The Guardian, March 10, 2020, theguardian.com.

<sup>2</sup> "Samsung temporarily shuts down phone manufacturing following coronavirus case" by Jon Fingus 02/02/2020.

the contract.<sup>3</sup> Regrettably, some contracts include 'boilerplate' force majeure clauses which are poorly written, or so inclusive that they appear archaic.

On the other hand, the outbreaks of SARS (2003), H1N1 (2009) and Ebola (2014), required lawyers to consider whether health emergencies would trigger force majeure clauses. Since then, some drafters have generally modified their standard list of defined force majeure events to include "public health emergencies", "epidemics", and "communicable disease outbreak" to ensure they would be captured by the clause.

### **Is COVID-19 included in your contract's force majeure clause?**

Second, if the contract contains a force majeure clause it should extend to include COVID-19.

Force majeure clauses are interpreted by Canadian Courts 'against their purpose', which is intended to protect parties from liability for breaches of contract caused by events outside of the scope of their control. Accordingly, such clauses are interpreted narrowly and a party relying on a force majeure clause carries the burden to "bring itself squarely within it"<sup>4</sup>; the party must demonstrate that the intervening event falls within one of the pre-determined listed events within the clause.

Since COVID-19 is a new virus, the first hurdle to overcome is that COVID-19 will not be defined as an event of force majeure in any contract - at least by name. Therefore, one has to read the contract's force majeure clause very carefully to determine whether COVID-19 will fall within the clauses' defined events of force majeure.

It will be important to assess whether your contract's force majeure clause contains defined events such as "public health emergencies", "epidemics", and "communicable disease outbreak". However, if the force majeure clause does not reference these events, then it may be possible to argue that COVID-19 falls within such defined events as "government action" or "non-availability of markets" since government action would extend to include mandatory quarantines and possible port closures..

Notably, the China Council for the Promotion of International Trade (officially accredited with Beijing's Commerce Ministry) "CCPIT" is issuing force majeure certificates to Chinese companies, stating that they are accepted by governments, customs, trade associations and enterprises in more than 200 countries.

As of March 3, per CCPIT and state media reporting, 4,811 force majeure certificates have been issued by China to cover contracts totaling a value of almost 54 billion USD.<sup>5</sup>

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<sup>3</sup> The Supreme Court of Canada affirmed in *Atlantic Paper Stock Ltd. v. St. Anne Nackawic Pulp & Paper Co. (1975) S.C.J. No. 46* that a *force majeure* clause generally operates to discharge a contracting party when a supervening, sometimes supernatural, event, beyond control of either party, makes performance impossible. Justice Dickenson held that "the common

thread is that of the unexpected, something beyond reasonable human foresight and skill...." (Para 4).

<sup>4</sup> *M.A. Hanna Co. v. Sydney Steel Corp.* 1995 CarswellNS 45, 136 N.S.R. (2d) 241, 18 B.L.R. (2d) 264, 388 A.P.R. 241, 52 A.C.W.S. (3d) 771

<sup>5</sup><https://www.cnn.com/2020/03/06/coronavirus-impact-china-invokes-force-majeure-to-protect->

There is no Canadian case law which has considered the implication of these certificates on contracts but if such a certificate is provided by the non-performing party, it could argue the event of force majeure was due to government action.

### **What if my Force Majeure Clause is Very Broad?**

Canadian courts may accept an event of force majeure that falls within very broad language such as "... or any other causes... beyond the control of..." the parties when considering the clause in its entirety. This is often referred to as a 'basket clause' and it may apply if the event is beyond one's control.<sup>6</sup>

Such a clause would likely apply in a contract executed pre-COVID-19; however, contracts executed now may not offer the same respite since the impact of COVID-19 on certain obligations is known -- and a court may find it is within a company's control to obtain the goods from another source. The key to the applicability of the basket clause is whether the event or non-performance is within the company's control.

### **What impact must COVID-19 have on the party invoking the clause?**

Finally, it must be demonstrated that the alleged force majeure event actually caused non-performance or delay. Some of the questions to consider: Is the Samsung cell phone manufacturing facility the only source

for the product? Or can one find competing or replacement products from another source? The contract may set out duties or obligations to remedy or cure the non-performance, or it may provide for suspension of the contract, or even termination.

The contract will likely contain relief provisions built into the force majeure clause and they may set out the failure or delay that is permissible in the event of force majeure. Is there a permitted period of delay before an obligation to pay for business losses arises? Perhaps there is an agreement that no business losses will be paid.

### **What to Include in your Contracts Going Forward**

While we cannot give legal advice in this column, we can make recommendations to consider when drafting your next contract in a world affected by COVID-19:

- Be specific: do not rely upon boilerplate clauses for future protection.
- Consider which type of events will be defined to constitute a force majeure but be careful not to make the inclusion too broad.
- When defining an event of force majeure make sure to either expressly include or exclude certain events such as COVID-19.

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[businesses.html](#);;  
[http://www.xinhuanet.com/politics/2020-03/03/c\\_1125658518.htm](http://www.xinhuanet.com/politics/2020-03/03/c_1125658518.htm)

<sup>6</sup>*World Land Ltd. v. Daon Development Corp.* 1981 CarswellAlta 131, [1982] 4 W.W.R. 577, [1982]

*A.W.L.D. 220, 20 Alta. L.R. (2d) 33; Domtar Inc. v. Univar Canada Ltd.*, 2011 BCSC 1776

- Define the threshold of non-performance: is it “impossibility of contractual performance” or is the threshold to be set lower?
- Consider the impact that the event or act of force majeure will have on either party’s performance; i.e. suspension of the contract (if so, set out the duration of the suspension) or excusing the non-performing party’s obligation.
- If the parties select suspension of the contract during the event of force majeure, consider whether the possibility of terminating the contract will arise after the duration of suspension has expired.
- It can be helpful to include notice provisions requiring the party relying on a force majeure clause to provide notice to the other party once the event has occurred.
- Consider drafting liquidated damages clauses, provided they are a genuine pre-estimate of damages.

The most common advice to protect yourself from COVID-19 is to wash your hands thoroughly, with soap, for at least 20 seconds. Our advice to protect your business from losses arising from non-performance due to COVID-19 is to review your contract thoroughly, assess its force majeure clause, and draft your new contracts with precision and intent.

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