MANAGING SUPPLY CHAIN DISRUPTIONS: THE IMPORTANCE OF *FORCE MAJEURE* AND DISPUTE RESOLUTION CLAUSES

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The devastating impact of the coronavirus has exposed the fragility of globalized supply chains. Canadian businesses have already experienced delays in receiving goods from their foreign suppliers and interruptions in service from critical non-resident service providers. As the impact of these disruptions becomes more severe, companies will need to pay close attention to "boilerplate" provisions in their contracts dealing with issues such as *force majeure* and dispute resolution.

***Force Majeure*: Scope and Notice Issues**

The common thread amongst *force majeure* clauses "is that of the unexpected, something beyond the reasonable human foresight and skill."[1] Despite this commonality, *force majeure* clauses vary widely and it is important to check the wording of these clauses promptly after a dispute arises to consider the following issues:

a) *Scope of the triggering events*: The wording of f*orce majeure* clauses will be a critical factor in determining whether impacts from the coronavirus can excuse delays in contractual performance. Courts will seek to determine the intention of the parties by reading the contract as a whole, giving the words used in a *force majeure* clause their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of the formation of the contract.[2]

b) *Impact on the triggering events:* A supplier need not necessarily show that the triggering events make contract performance impossible, but it will usually need to show that the events created, in commercial terms, a real and substantial problem. A supplier may also have a duty to mitigate the effect of the triggering events, if doing so is reasonable in the circumstances.[3]

c) *Notice and Duration*: Many *force majeure* clauses require prompt notice of a triggering event. If the event lasts beyond a defined time period, the counterparty may have the right to give notice of termination of the contract.

The Common Law Doctrine of Frustration

In Canadian common law jurisdictions, absent a *force majeure* clause in a contract, a supplier may need to invoke the doctrine of frustration or commercial impossibility. This doctrine allows a party to set aside the contract in its entirety rather than to suspend performance of an obligation temporarily. However, the threshold for a claim of frustration is high. The test is whether an event has occurred after the formation of the contract that makes performance of the contract radically different from what the parties contemplated at the time the contract was formed. If this strict test is met, the contract will come to an end.[4]

Default Rules in Québec and Other Civil Law Jurisdictions

In civil law jurisdictions such as Québec, suppliers lacking a *force majeure* clause may rely on the provisions found in the *Civil Code of Québec*[5] ("CCQ") or its counterparts. The CCQ contains default provisions pertaining to *force majeure* that apply when the parties have failed to include such a clause in their contracts. These provisions are not of public order and, therefore, any contractual clauses on the subject will take precedence.[6] The two criteria required for an event to be considered a *force majeure* event are that the event is:[7]

- unforeseeable for a reasonably prudent and diligent debtor at the time of formation of the contract;[8] and
- irresistible such that any resistance by the debtor to the event, or the effects resulting from it, would be futile. There is no expectation of perfection on the part of the debtor, but it must still exercise reasonable means of diligence. Debtors cannot avoid liability for an obligation that merely becomes more difficult, dangerous or costly. The performance of the obligation must be prevented by the event in an absolute and permanent manner, except if time is of the essence.[9]

If a debtor can demonstrate a *force majeure* event, it may be relieved from its obligations. A debtor can rely on the *force majeure* provisions in the *CCQ* before it is in default of its obligations. Once in default of its obligations, the debtor may only rely on the force majeure provisions where its creditor could not have benefitted from the performance of the obligations due to that same *force majeure* event. Therefore, the applicability of these provisions will be heavily reliant on the individual facts at hand and should be assessed on a case-by-case basis. In all cases, the burden of proof lies on the debtor.[10]

If the debtor has assumed liability for the events at issue in contractual clauses, or is at fault based on its actions, it will not be able to avail itself of the *force majeure* provisions of the CCQ.[11] The debtor invoking *force majeure* should keep in mind that, in doing so, it releases the creditor from performing its correlative obligation. If the obligation was already fully performed, the creditor will be required to provide restitution to the debtor. In cases where partial performance of the obligation is occurred, the creditor remains liable to the extent of its enrichment from the debtor's performance.[12]

Choice of Law and Dispute Resolution Clauses

As illustrated above, the possibility of resorting to *force majeure* and the interpretation of *force majeure* clauses will depend on the parties' choice of law. Moreover, the choice of contract law should not be confused with the choice of forum to resolve disputes arising out of the contract.

Parties to international supply agreements often choose international arbitration rules to resolve their disputes. The flexibility of these rules is a key advantage in a business climate where witnesses and counsel may be unable to travel or hold in person meetings. Many international arbitration rules have more informal requirements for service of process or the presentation of evidence than the rules of most domestic courts. Routine filings are made by email, examinations for discovery are not usually allowed and witness evidence is often presented through unsworn written statements. While witnesses may be required to testify under oath, international arbitration tribunals will often allow testimony by video-conference or be willing to hold oral hearings in venues that are more convenient for the parties than the legal seat of arbitration provided in the contract.

In light of the current crisis, courts in many Canadian jurisdictions are only now issuing directives to dispense with legal formalities that may create unnecessary health risks. These directives are rapidly evolving and permit electronic filing, extend procedural deadlines and waive strict adherence to certain rules of civil procedure. Litigants and courts should be guided by the success of arbitration practitioners in dispensing with formalities and take steps to protect public health in the current crisis.

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[1] *Atlantic Paper Stock Ltd v St Anne-Nackawic Pulp & Paper Co*, [1976] 1 SCR 580, 56 DLR (3d) 409, at para 4.
[2] *Sattva Capital Corp. v. Creston Moly Corp*., [2014] 2 S.C.R. 633 at para.47
[3] *Atcor Ltd v Continental Energy Marketing Ltd*, [1996] 6 WWR 274, 1996 CarswellAlta 642 (Alta CA) at paras 29-30.
[4] *Naylor Group Inc. v Ellis-Don Construction Ltd*., 2001 SCC 58
[5] CQLR c CCQ-1991 [*CCQ*].
[6] Pierre-Gabriel Jobin & Nathalie Vézina, Motifs légaux d'exonération, *Les obligations*, 7th Edition, EYB2013OBL128, 1051-1072 at para 844 [*Jobin & Vézina*].
[7] *CCQ*, *supra* note 5 at art 1470.
[8] J*obin & Vézina, supra* note 6 at para 845.
[9] *Jobin & Vézina*, *supra* note 6 at para 846.
[10] *CCQ, supra* note 5 at art 1693.
[11] *Zurich, compagnie d'assurances du Canada c. Centre du camion Beaudoin inc*., 2013 QCCS 1985 at paras

90-101.

[12] *CCQ*, *supra* note 5 at art 1694.

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.