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ARE CONTRACTS ENFORCEABLE DESPITE COVID-19? PART 7: CONTRACT LAW MEETS INSOLVENCY LAW - SOME STRATEGIC CONSIDERATIONS

The previous articles in this series have explained the law regarding *force majeure* provisions which operates to temporarily suspend performance under a contract - including the circumstances in which they might be invoked, notice requirements for their invocation, the duty to mitigate *force majeure* events, and other potentially applicable principles like the doctrine of frustration.

In this article, we discuss some strategic considerations that should be contemplated before deciding to invoke *force majeure* or frustration rights; the approaches available if your company has received a *force majeure* or frustration notice or claim from another party; and the ways that insolvency law rights and remedies may potentially be used to end ongoing contractual obligations all together.

If your company is contemplating invoking a contractual *force majeure* clause or frustration claim, consider, first, whether the contract has become uneconomic in the current global COVID-19 climate. Is the contract still "in the money", or valuable, from your perspective? Or, is it now uneconomic, or "out of the money", to you? The answer may have implications for the strategy that both your company and your counterparty may independently choose to follow, especially in these uncertain times.

If You are Considering Invoking a *Force Majeure* Clause - Pro-active Options

If your company is endeavouring to obtain relief from its contractual obligations, consider these particular questions:

1. Do you have a contractual *force majeure* right? If so, what are your obligations (including notice requirements and mitigation), and can you comply with them?

2. What are your alternatives?

    a. If you do not have a contractual *force majeure* right, might the doctrine of frustration apply to your contract such that you could argue that the contract can no longer be performed?

b. If you have a contractual *force majeure* right or a contractual frustration claim, but the company is experiencing serious financial strain and the contract is uneconomic, would an insolvency filing be available and preferable with a view to restructuring and attempting to permanently end ongoing contractual obligations?[1]

If your company was to pursue a restructuring filing under the Companies' Creditors Arrangement Act ("*CCAA*")[2] or a Notice of Intention to Make a Proposal ("NOI") under the Bankruptcy and Insolvency Act ("*BIA*"),[3] it may be permitted to resiliate or "disclaim" an uneconomic contract - which has the effect of entirely doing away with ongoing obligations.

3. If you do choose to invoke a contractual *force majeure* or a frustration claim, beware that you could face, in response, an insolvency filing by or in respect of the counterparty to your contract. This risk is real if your counterparty is experiencing financial difficulties resulting in insolvency and if the contract at issue is uneconomic for your counterpart. In an insolvency proceeding respecting your counterparty, it may be that the contract can be disclaimed so that the ongoing obligations owed to you under it can be avoided.

If Your Contractual Counterparty has invoked a *Force Majeure* Clause - Reactive Options

If you receive notice that a counterparty to your company's contract has invoked a *force majeure* clause or a frustration claim to suspend its contractual obligations, you should think carefully about the options and how to respond. For example:

1. You could accept that a *force majeure* or frustration event has occurred and respond accordingly;

2. If appropriate, you could dispute the invocation and argue that a *force majeure* or frustration event has not occurred, or that your counterparty has not given proper notice or taken steps to mitigate its inability to perform under the contract; or

3. Alternatively, or concurrently, you could negotiate with your counterparty to seek solutions outside of those spelled out in the contract.

In any of the above scenarios, depending upon the type of contract at issue, you ought to know that you could face an insolvency filing by, or in respect of, the counterparty. This could result in the contract coming to an end if it is uneconomic for your counterparty and able to be disclaimed.

On the other hand, receipt of a *force majeure* notice or frustration claim, and the commercial consequences flowing from that, may cause your company's financial outlook to materially change, which may in turn engage a contractual obligation to advise your lender(s). It could even cause your company to become insolvent and to consider whether to seek insolvency protection in order to restructure the business. Doing so may allow it to end, entirely, the ongoing contractual obligations through disclaimer.

1 *COVID-19: Potential Solutions for Insolvency Situations* discusses, in detail, different insolvency filing options which may be available to companies.
2 *Companies' Creditors Arrangement Act*, RSC 1985 C c-36 [*CCAA*]
3 *Bankruptcy and Insolvency Act*, RSC 1985 c B-3 [*BIA*]

Implications of Disclaimer

Our article, *Vanquisher or Vanquished? Insolvency Law's Power to End Contracts*, describes in more detail the context in which contracts may be disclaimed (and the types of contracts that can and can't). It also explains the process by which disclaimer may occur and the rights of insolvent parties and their contractual counterparties in the face of notice of a disclaimer of contract.

Disclaiming a contract brings the ongoing obligations to an end, meaning that neither party to the contract is obliged to continue performance under it. An insolvent company that has validly disclaimed a contract remains liable for damages resulting from the contract being "broken," but the solvent contractual counterparty will often be left merely with an unsecured claim for damages. This would mean that its claim will be paid out at the same rate as all unsecured creditors of the insolvent - after its secured creditors have been fully paid. Often there is little or nothing left for unsecured creditors.

What to do?

If your company has received a *force majeure* notice or frustration claim, or is considering invoking a force majeure clause or a frustration claim itself, it would be wise to consider not only the law of contract, but also principles of insolvency law which may also come into play. The financial pressures created by the COVID-19 pandemic, coupled with the added burden related to low oil prices, make the consideration of potential insolvency law risks and remedies even more important in this place and time.

Of course, insolvency filings and potential filings are complex, and every contract and contractual relationship is unique. The lawyers at JSS Barristers have significant experience advising parties both in respect of their contractual rights, and in insolvency and restructuring matters. In these unprecedented times it is more important than ever to consider the impact that a potential insolvency could have on your business and your contractual rights, and we would be pleased to provide assistance.

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