

Goodmans^{LLP} Update

COVID-19 and Contractual Implications: Frustration and Impossibility

This is part of a series of Goodmans Updates on COVID-19 and its potential ramifications on contract law issues. In our March 18, 2020 Update, *COVID-19 and Contractual Implications: Force Majeure Clauses*¹, we discussed the concept of “force majeure” as one possible way in which a party could be excused for non-performance of a contract in certain circumstances. This Update discusses the common law doctrines of “frustration” and “impossibility”, which may offer other potential avenues of relief for parties that cannot fulfill their existing contractual obligations.

In response to the rapid spread of COVID-19 (commonly known as Coronavirus), businesses across various industries have been forced to suspend or reduce their operations. As the global impact of the COVID-19 pandemic worsens, parties may increasingly look to delay or avoid performance of existing contractual obligations.

Absent a force majeure clause, parties seeking relief from a contract may have recourse under the common law doctrines of frustration and impossibility, subject to the circumstances.

What is Frustration?

Frustration occurs when there is a radical change in the circumstances governing performance of a contract without the fault of either party and for which the parties made no provision in their contract. The party claiming frustration must establish that the principal purpose of entering the contract has been obviated from the supervening event. In these situations, frustration, when established, operates to release both parties from their contractual obligations.

Notably, the Supreme Court of Canada held that parties cannot rely on frustration where a contract already contains a force majeure clause.² Since the inclusion of a force majeure clause in an agreement indicates the parties turned their minds to potential supervening events, frustration will not apply in these cases.

Although frustration is a flexible doctrine applicable to any type of contract, there is a high standard to meet. Parties cannot invoke frustration where performance simply becomes more expensive or onerous. Also, frustration will not be found to have occurred where the event in question was foreseeable at the time of the contract. A finding of frustration automatically terminates a contract and discharges both parties from their contractual obligations.

¹ Since the publication of this Update, we came across a decision from the Quebec Court that discusses a force majeure clause in connection with a pandemic. In *Lebrun c. Voyages à rabais (9129-2367 Québec inc.)*, 2010 QCCQ 1877, the Court held that the outbreak of the H1N1 virus was a force majeure as defined in the Civil Code since it was unforeseeable and prevented the defendant airline and travel agent from fulfilling its contractual obligations. Accordingly, the plaintiffs were not entitled to damages or a refund of their flight expense but were entitled to restitution of the sums paid for the days they did not spend at the resort.

² *Naylor Group Inc. v Ellis-Don Construction Ltd.*, 2001 SCC 58 at para 53.

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The author would like to thank Clara Ryu, Student-at-Law, for her assistance in writing this Update

Many provinces in Canada have enacted legislation regarding contracts that have become impossible to perform or are otherwise frustrated. Ontario's *Frustrated Contracts Act*, for instance, applies to any contract that is governed by Ontario law. Among others, it stipulates that amounts otherwise payable under a contract cease to be payable upon frustration and that amounts already paid are recoverable.

What is Impossibility?

The doctrine of impossibility requires a party to establish that performance of a contract is rendered objectively impossible due to a supervening event beyond its control. This commonly occurs due to the destruction of the subject matter of the contract or the means of performance.

As with frustration, there is a high bar to successfully satisfy the test for impossibility. In general, parties always bear the risk of their inability to perform their duties according to the contract. A party's non-performance is not excused where the supervening event was foreseeable or where there was an inherent risk in the type of contract in question. For instance, market shifts or a drop in real estate value – no matter how drastic – would not constitute an event of impossibility sufficient to justify a party's contractual non-performance.

Although the doctrines of impossibility and frustration share many similarities, the two are distinct in that frustration does not require strict impossibility to perform a contract; rather, it may be that a party's primary purpose for entering into a contract is radically altered due to an unforeseen event. Despite this difference, the dividing line between the two doctrines have become blurred, and Ontario courts have largely treated them as the same concept.³

Do Frustration or Impossibility Apply to COVID-19?

Whether frustration or impossibility apply to COVID-19 will largely depend on the circumstances. To assert frustration, the party seeking relief from a contract must establish that the outbreak of COVID-19 has radically altered the central purpose of the contract or that it has become drastically different from what was contemplated at the time of contract formation. The impact of COVID-19 on the party's affairs must be such that the very foundation of the contract is destroyed.⁴ In the case of impossibility, it must be shown that the contract has become objectively impossible to perform given the changed circumstances.

This may be the case where performance under a contract has become physically or commercially impractical to fulfill in accordance with its terms, or where the object of the agreement is no longer obtainable such that performance has become impossible. For instance, subject to the circumstances, a contract for personal services may be frustrated and/or rendered impossible if the individual specified in the agreement is unable to perform his or her services due to illness from COVID-19. Other examples could potentially include:

- a subsequent change in the law rendering performance of the contract illegal;
- the goods to be delivered under the contract have been destroyed;
- the only method of delivering the goods pursuant to the contract is unavailable; or
- the particular source of supply contemplated in the contract is unavailable.

Depending on the circumstances, it is possible that a global pandemic and a government directive to shut down may qualify as a valid excuse for non-performance under a contract. In all cases, it is important to consider the nature of the parties' performance under the contract and the degree to which its underlying purpose or objective is affected by the outbreak of COVID-19.

³ 224981 Ontario Inc. v Intact Insurance Co., 2016 ONSC 642; *Shell Canada Products Ltd. v Northmore*, [1997] OJ No. 523; *Capital Quality Homes Ltd. v Colwyn Construction Ltd.*, [1975] OJ No. 2435.

⁴ In 2003, the Hong Kong District Court held that a 10-day period in which the premises was uninhabited due to the SARS epidemic did not frustrate the 2-year tenancy agreement. See *Li Ching Wing v Xuan Yi Xiong*, [2004] 1 HKLRD 754.

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Conclusion

The determination of whether one should assert frustration or impossibility as an excuse for non-performance is a fact-intensive analysis. This assessment must take into account the unique circumstances of the parties, their businesses, and the contract at issue. Parties looking to raise these arguments should be aware that, depending on the circumstances, an invalid claim of frustration or impossibility may constitute a breach of contract that could entitle the other party to damages or termination. Therefore, it is important for businesses to review their contracts with counsel to determine their rights and potential liability.

The team at Goodmans LLP is available to review any operative contracts or arrangements that your organization may be operating under and can assist in any issue that has arisen or that you anticipate will arise.

For further information on this Update, please contact any member of our [Litigation Group](#).

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