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"Impact of COVID-19 on Contractual Obligations: *Frustration*"


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With the impact of the COVID-19 pandemic causing retail stores, restaurants, shopping malls and other businesses to close, parties are increasingly looking to their leases and contracts for potential excuses of non-performance, including non-payment of rent.

In the case where a *force majeure* clause is drafted into a lease or contract, then the non-performing party may be able to rely on that provision for non-performance. The applicability of the *force majeure* clause is discussed in a separate article (see *Impact of COVID-19 on Contractual Obligations: Force Majeure*). While courts are likely to reject a *force majeure* claim if the parties' agreement does not contain a force majeure clause, parties seeking to excuse non-performance may still avail themselves of the common law doctrine of frustration.

In order to rely on the common law concept of frustration to argue that the spread of COVID-19 is a "supervening event" that has brought the contract to an end and released both parties from further performance of it.
As per the Supreme Court of Canada decision in *Naylor Group Inc. v Ellis-Don Construction* at para 53:

"Frustration occurs when a situation has arisen for which the parties made no provision in the contract and performance of the contract becomes a thing radically different from that which was undertaken by the contract."

A contract may be frustrated where an event occurs which renders performance impossible or which transforms the relevant obligation into a radically different obligation from that agreed to when the parties entered into the contract. This test may be satisfied if the commercial purpose of the contract is no longer achievable. Delay caused by COVID-19 could, in principle, be a frustrating event, depending on the nature of the contract in question and the length of the delay.
The focus will be on the parties' specific contractual obligations and whether they have "radically changed" as a result of the spread of COVID-19 to the extent that a party would be required to do something fundamentally different from its original obligations.
It will be important to identify the consequences of the pandemic on the parties' ability to perform the specific contract in question. It is unlikely to be sufficient that circumstances have changed in society generally such that performance of the contract has become more onerous or expensive.
The "supervening event" must not be the fault of the non-performing party. Clearly, contracting parties cannot be held responsible for the spread of COVID-19, but the court may nevertheless take the view that a failure to perform a contract is a result of the non-performing party's acts or decisions (albeit ones taken in light of COVID-19). As the law stands, where a catastrophic event means that a party can comply with its obligations to some of its contractual counterparties, but not all of them, and it has to choose between them, it will not be able to argue that contracts which it has chosen not to perform have been frustrated.

The court is likely to take the view that the failure to perform the relevant contract was “self-induced” by the non-performing party’s decision not to comply with that particular contract. Given the rapid spread of COVID-19, it is unlikely to have been foreseen by the parties other than in very recently concluded agreements.

There is very little case law on whether a pandemic can frustrate a contract. In the Hong Kong District Court decision *Li Ching Wing v Xuan Yi Xiong,* [2003] HKDC 54, the Court found that the outbreak of severe acute respiratory syndrome ("SARS") did not frustrate a contract in the landlord and tenant context. In that case, there was an outbreak of SARS in the tenant’s building. The tenant argued that the agreement was frustrated because of a 10-day isolation order against the premises. The Court found that 10 days was an insignificant amount time in light of the tenant’s two-year term and that the supervening event did not significantly change the contractual obligations of the parties. The Court stated that the outbreak of SARS may constitute an unforeseeable event, but did not analyze this issue further due to its conclusion that SARS did not significantly change the contractual obligations of the parties.

Most of the provinces in Canada have enacted a *Frustrated Contracts Act* (the "Acts"). The Acts attempt to resolve uncertainty by establishing the rights of the parties where a contract is deemed frustrated. The Acts may be useful where contracts do not expressly deal with the rights of parties on frustration of the contract.

Generally, the Acts in each province provide the following:

- The frustrated parts of the contract can be severed.
- A party who has done something in fulfillment of the contract may be entitled to restitution.
- A claim for restitution can include only reasonable expenditures; it cannot take into account any loss of profits or insurance money received because of the frustrating events.

Whether the law of frustration applies will need to be reviewed on a case by case basis and the impact that COVID-19 has on your business.

The lawyers at DD West LLP have extensive experience relating to contractual disputes.