

## COVID-19 and Contracts: Remedies for Non-Performance of Contractual Obligations

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April 2020

In light of current social distancing measures, the shut down of non-essential businesses, and other government-imposed measures in response to the COVID-19 outbreak, many business and commercial activities have been disrupted and, in some cases, entirely halted.

Due to the various constraints on normal business operations, will parties to commercial contracts be able to rely on the doctrine of frustration, or *force majeure* clauses, to absolve them of their contractual obligations?

### **Common Law Frustration**

At common law, frustration of contract occurs when “a situation has arisen for which the parties made no provision in the contract and the performance of the contract becomes ‘a thing radically different from that which was undertaken by the contract.’”<sup>1</sup>

In *ACT Greenwood Ltd. v. Desjardins-McLeod*, the Ontario Court of Appeal held that: “the law of frustration requires that there be a radical change in the nature of the parties’ contractual obligations, arising from a situation which the parties had not contemplated in the formation of the contract.”<sup>2</sup>

In G.H.L. Fridman’s *The Law of Contract in Canada*, the author writes:

From the decided cases to which reference has been made it is deducible that the basis of **frustration** is impossibility. By this is meant physical impossibility and impossibility resulting from a legal development that has rendered the contract no longer a lawful one. However, **frustration** goes further, and comprehends situations where the contract may be both physically and legally capable of being

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<sup>1</sup> *Naylor Group Inc. v. Ellis-Don Construction Ltd.*, 2001 SCC 58 (S.C.C.) at para 53.

<sup>2</sup> *ACT Greenwood Ltd. v. Desjardins-McLeod*, 2019 ONCA 158 at para. 17.

performed but would be totally different from what the parties intended were it performed after the change that has occurred.[...]<sup>3</sup>

In some circumstances, it will be clear that the performance of a contract has been frustrated, as the operation of a business has been rendered illegal, due to the government ordered closure of various non-essential businesses.

However, in other circumstances, when a business remains open but, due to the current state of affairs, is unable to operate normally, maintain their normal staff, and maintain normal business operations generally, it is less clear whether the doctrine of frustration will apply.

The key consideration is whether the contracting party seeking to rely on frustration can demonstrate that the events surrounding COVID-19 rendered performance of the contract impossible, or “totally different from what the parties contemplated.” This will depend on the particular circumstance of each case.

Generally speaking, however, the events surrounding COVID-19 will likely satisfy the common law doctrine of frustration in many situations. Although there is limited case law on this topic, it would be difficult to argue that the COVID-19 pandemic was foreseeable, at least until a specific point in time.

### ***Force Majeure***

Most modern commercial contracts contain *force majeure* clauses, which generally absolve the parties of their contractual obligations when an “act of god” or “*force majeure*” occurs. In these circumstances, the parties will be able to look to the contract rather than the common law, to determine whether there is a remedy for non-performance under the contract.

The Supreme Court of Canada has stated 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. The common thread is that of the unexpected, something beyond reasonable human foresight and skill.”<sup>4</sup>

Some contracts will enumerate the list of events, or types of events, which constitute a *force majeure*. Otherwise, the circumstances where these provisions will operate are

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<sup>3</sup> G.H.L. Fridman, *The Law of Contract in Canada*, 6th ed. (Toronto: Carswell, 2011), at p. 619.

<sup>4</sup> *Atlantic Paper Stock Ltd. v. St. Anne-Nackawic Pulp & Paper Co.*, [1976] 1 S.C.R. 580 at para 4.

subject to interpretation, which will be depend on the language of the provision and the specific contract in question.

Generally, however, courts will interpret *force majeure* to only include events which are not foreseeable and not caused by the party seeking to rely on the provision, even if the provision in question purports to deem an event as a *force majeure* but that event is foreseeable or the result of the conduct of a party.<sup>5</sup>

Although there is limited analogous case law on this topic, COVID-19 will likely constitute a *force majeure* under contract law, subject to any contrary indication in the language of the contract in question.

It would be difficult to argue that the COVID-19 pandemic was foreseeable at the time of contract formation or that it was caused by any individual contracting party. Thereafter, the contracting party seeking to absolve itself of performance under the contract need only demonstrate that the events surrounding COVID-19 rendered performance of the contract impossible.

### **Conclusion**

The applicability of the doctrine of frustration of contract or *force majeure* clauses will depend on the facts of each particular case and whether the party contemplated or attempted other methods of complying with their contractual obligations.

That being said, it is anticipated that the doctrine of frustration and *force majeure* clauses will apply to many contracts due to COVID-19.

Practically, a party that anticipates that it will be unable to comply with its contractual obligations as a result of COVID-19 should take steps to mitigate the negative impact of their non-compliance.

Parties seeking to enter into contracts, or who suspect that their existing contractual obligations may be affected by COVID-19 related measures, should take all known or foreseeable possibilities into account when drafting and negotiating contracts.

In this regard, parties should keep a close eye on the evolving situation, such as market fluctuations and government action, as it relates to their relevant industries to ensure that

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<sup>5</sup> *Ibid.*

they are taking all reasonable steps to mitigate the effect of their (potential or actual) non-performance of contractual obligations.