Toronto Law Journal

The COVID-19 Pandemic and the Doctrine of Frustration of Contract

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Introduction

This article examines whether litigants in Ontario have generally been successful in claiming that the COVID-19 pandemic and associated lockdowns have frustrated their contracts such that they are entitled to relief from their contractual obligations under the doctrine of frustration of contract. Spoiler alert: they have not.

The doctrine of frustration of contract applies where an unforeseeable, supervening event occurs that radically alters the nature of the obligations set out in a contract.

At first blush, an unprecedented global pandemic that has caused widespread disruption to businesses in Ontario may seem like precisely the type of supervening event that is contemplated by this doctrine. However, recent cases in which parties claim that the pandemic has frustrated their contracts underscore that the doctrine of frustration continues to apply in only rare circumstances and courts will generally hold parties to their bargains.

The doctrine of frustration of contract

The doctrine of frustration of contract was developed as a response to the rigid common-law rule that required performance of a contract, or liability in damages, even if performance became impossible, regardless of the reason.[1]

The modern doctrine of frustration was clarified by the Supreme Court of Canada in *Naylor Group Inc. v. Ellis-Don Construction Ltd.*, 2001 SCC 58. As the Court explained, "[f]rustration 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.'"[2]

Courts will intervene to relieve the parties of their bargain where a supervening event has occurred without the fault of either party. The supervening event must alter the nature of the contractual obligations "to such an extent that to compel performance despite the new and changed circumstances would be to order the appellant to do something radically different from what the parties agreed to under the […] contract."[3]

Frustration of contract is notoriously difficult to establish, and courts have limited its application to a very narrow set of circumstances. However, there is good reason for its limited

[1] *Capital Quality Homes Ltd. v Colwyn Construction Ltd.* (1976), 9 OR (2d) 617, 61 DLR (3d) 385.
[2] *Naylor Group Inc. v. Ellis-Don Construction Ltd.*, 2001 SCC 58, [2001] 2 SCR 943 at para 53.
[3] *Naylor Group Inc. v. Ellis-Don Construction Ltd.*, 2001 SCC 58, [2001] 2 SCR 943 at para 55.

application. The doctrine clashes with the fundamental principle of contract law that parties should be held to the bargains that they make. Frustration is a compromise of that fundamental principle, and it aims to respect the allocation of risk negotiated by the parties to the contract. Only in very limited circumstances, where "the occurrence of the unexpected event is so much outside the range of risks that the agreement allocates – so fundamental a piece of the framework within which the bargain was struck has dropped out – that the values favouring enforcement are outweighed."[4]

Recent cases invoking the pandemic as a frustrating event

A review of several cases in which litigants have claimed that the COVID-19 pandemic frustrated their contracts demonstrates that this doctrine remains one of limited application.

In *Fsc (Annex) Limited Partnership v Adi 64 Prince Arthur L.P,*[5] Forgestone and Adi were partners in a joint venture in a luxury condominium development project. Adi agreed to purchase Forgestone's interest in the development on January 9, 2020, with a closing date of April 8, 2020.

On March 25, 2020, Adi advised that it would not be able to close on April 8, 2020 due to the "unforeseeable" circumstances caused by the COVID-19 pandemic. In response, Forgestone brought an application for specific performance. Adi argued that the agreement to purchase Forgestone's interest had been frustrated by the unforeseeable economic downturn caused by the pandemic that made obtaining financing for the purchase impossible.

Koehnen J. disagreed for two reasons. First, the obligation to purchase was not conditional on the ability to obtain financing. Adi had not made any considerable efforts to obtain financing in the three months between agreeing to purchase Forgestone's interest and the government of Ontario's declaration of a state of emergency on March 17, 2020. Second, "[w]hile it may be that we have not experienced a pandemic of this proportion in our lifetimes, restrictions on the availability of credit are not uncommon."[6] It would have been "entirely unfair to let Adi exercise the purchase option and then let it claim frustration when it could not obtain financing as a result of an economic downturn," which is "an inherent risk in any purchase agreement".[7]

In *RBC v. 974585 Canada Corp. et al.*[8] and *Bank of Montreal v. 2643612 Ontario Ltd.*,[9] two debt recovery actions, the pandemic and accompanying lockdowns were held not to have frustrated the lending agreements at issue. McCarthy J. held in *RBC* that there was nothing about the pandemic and lockdowns that radically altered the fundamental nature of the lending agreement.[10] Moreover, there was no evidence that the pandemic caused the debtor's default.

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[4] S.M. Waddams, *The Law of* Contracts, 4th ed. (Toronto: Canada Law Book Inc.) at para 365.
[5] 2020 ONSC 5055.
[6] *FSC (Annex) Limited Partnership v ADI 64 Prince Arthur L.P.*, 2020 ONSC 5055 at para 25.
[7] *FSC (Annex) Limited Partnership v ADI 64 Prince Arthur L.P.*, 2020 ONSC 5055 at para 27.
[8] 2021 ONSC 2908.
[9] 2021 ONSC 4401.
[10] *RBC v 974585 Canada Corp. et al.*, 2021 ONSC 2908 at para 19.

The business was in dire financial straights before the pandemic began. Likewise, Vermette J. held in *Bank of Montreal* that the pandemic and lockdowns did not render the obligations in the loan agreement at issue, which were simply to make specific payments on specified dates, something "radically different" from what the parties agreed to.[11]

The decision in *Sub-Prime Mortgage Corporation v. Kaweesa*[12] demonstrates that the COVID-19 pandemic cannot be used as a "trump card" without evidence regarding the specific impact on the obligations in the contract that are said to be impossible to perform. In *Kaweesa*, the plaintiffs brought a motion to enforce a settlement agreement in respect of a mortgage enforcement action. The defendants argued that the settlement agreement, which provided for a payment by the defendants to the plaintiffs in exchange for an assignment or discharge of their mortgages, had been frustrated by the pandemic and lockdowns. Stinson J. disagreed. The ongoing pandemic and lockdown did not radically alter the obligations in the settlement agreement, which was merely an agreement to pay a specified sum on a specified date, in exchange for specific actions by the plaintiffs. Moreover, the "supposed supervening event – the pandemic – was contemplated by the parties at the time of contracting, since it was ongoing then…but the parties deliberately chose not to provide for it in their contract."[13] Frustration therefore could not apply.

Mew J. arrived at the same conclusion in the commercial leasing context. In *Braebury Development Corporation v. Gap (Canada) Inc.*,[14] a landlord brought a summary judgment motion against a tenant, Gap Canada, seeking to recover arrears of rent for April to September 2020. Gap Canada claimed the purpose of the lease was frustrated by the pandemic and public health restrictions that caused Gap Canada to shut down its store at the premises. Mew J. granted the landlord's summary judgment motion. A force majeure clause in the lease excused performance of certain obligations where the party was hindered by "restrictive governmental laws or regulations" beyond the party's control, but it did not excuse the tenant from prompt payment of rent. As such, the clause did not apply.

Frustration did not apply to excuse the non-payment of rent either. Gap Canada was not required to operate its store under the lease's terms, so its inability to do so did not "radically alter" the obligations in the lease. Finally, the events covered by the force majeure clause were contemplated by the parties at the time the contract was made and therefore could not be said to be unforeseeable.

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[11] *Bank of Montreal v. 2643612 Ontario Ltd.*, 2021 ONSC 4401 at para 17.
[12] 2021 ONSC 739.
[13] *Sub-Prime Mortgage Corporation v. Kaweesa*, 2021 ONSC 739 at para 29, affirmed *Sub-Prime Mortgage Corporation v. Kaweesa*, 2021 ONCA 215 at para 26.
[14] 2021 ONSC 6210.

Conclusion

It is impossible to say that the COVID-19 pandemic would never be considered a frustrating event. Each case necessarily involves the fact-specific task of contractual interpretation and the fact-specific determination of the impact of the event on the obligations in the contract at issue.

However, the recent cases confirm that not even an unprecedented global health crisis will cause the courts to deviate from the fundamental principle that parties should be held to their bargains. Where parties have voluntarily allocated risk between themselves in a contract, the court will be reticent to intervene, particularly where the pandemic merely makes the contract more difficult or expensive, as opposed to impossible, to perform.