COVID-19: WHAT HAPPENS IF YOUR CONTRACT IN CANADA (EXCLUDING QUEBEC) DOES NOT HAVE A FORCE MAJEURE CLAUSE

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On March 11, 2020, the World Health Organization officially designated the outbreak of COVID-19, otherwise known as coronavirus, as a global pandemic. In recent weeks, this unforeseen global event has grown into a significant health crisis, one that is already disrupting business operations and affecting trade and profits across multiple sectors.

In this article, we look at what happens if your contract/agreement does not have a force majeure clause.

Force Majeure clauses protect you in times of extreme events

The concept of force majeure refers to when a contract can no longer be fully executed or adhered to because of extraordinary or extreme circumstances, often referred to as "acts of God". When "Force Majeure Events" occur, the force of a portion, if not all, of the liability for damages arises from the breaching party. In order to successfully rely on a force majeure clause, the relying party has the burden of establishing Force Majeure Event and proving that it has effectively prevented the party from fulfilling its obligations under the contract.
In short, when you have no force majeure clause in an agreement:

1. Canadian courts are unlikely to find an implied force majeure provision notwithstanding the occurrence of a likely force majeure event.
2. You may be able to rely on the doctrine of frustration.
3. The key criteria for establishing frustration: the occurrence of an unforeseen event that causes a radical change in performance of contract for the relying party. This radical change is generally one that makes performance under existing circumstances impossible, impractical or frustrates the original purpose of the agreement. The onus would be on the party alleging frustration of the contract to prove these elements.

Despite the occurrence of an extreme and impairing event, Canadian courts (excluding Quebec) have not implied a force majeure provision in common law. This infers the standard rules of force majeure interpretation would not apply if there is no force majeure clause expressly written in the contract. However, there have been some cases where courts have pondered the applicability of force majeure in contracts missing such express provisions.

In *Royal Bank v. Netupsky*, the court acknowledged the novel question of whether a force majeure term could be implied or operate as a matter of law. In this case, the Royal Bank of Canada had negotiated a line of credit agreement without a force majeure clause with a company that had substantial ties to Iraq. At the time of contract, the bank was aware that Canada had set trade prohibitions with Iraq; i.e. the alleged force majeure event that led to the borrowing company’s credit default. Although the court did not decide on the issue of whether a force majeure provision could be implied, analysis was conducted on the foreseeability of the alleged force majeure event. It was held that there was no basis for a force majeure argument because both parties had agreed to a contract that did not contemplate the effects of the trade prohibitions despite having full knowledge of the inhibition.

The Doctrine of Frustration

Where an express force majeure provision did not exist, the courts’ default treatment has been to apply the more general doctrine of frustration. The doctrine of frustration, also historically known as the doctrine of discharge, originated in English courts to serve as an equitable remedy for extreme events that destroyed the very basis of the contract. In Canada, this core concept has been preserved but its interpretation has evolved throughout its rich case history.

According to the Supreme Court case *Naylor Group Inc. v Ellis-Don Construction Ltd.*, the doctrine is applied where, "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.' " This statement can be broken down into three considerations:

i. **The Situation**: Similar to how force majeure clauses trigger upon force majeure events, the doctrine of frustration is activated by a supervening event that occurs through no fault of either party. Furthermore, according to *Capital Quality Homes Ltd. v Colwyn Construction Ltd.* and *Gerstel v Kelman* the event must not have been contemplated by the parties or foreseeable at the time of contracting.

ii. **The Absence of Contractual Provision**: The lack of a contractual provision, generally referring to an express force majeure clause, is a prerequisite for the general doctrine of frustration to apply. This means that courts will choose to apply either frustration or force majeure—parties are not meant to rely on both.

iii. **The Radically Different Performance of Contract**: According to the recent case of *Bang v Sebastian*, this consideration can be interpreted as a situation which "renders the performance of the contract substantively different than the parties had bargained for". As *McLean v Miramichi (City)* further elaborates with reference to legal scholarship, the basis of changing circumstances can be categorized into three types of circumstances: (1) where the frustrating event has rendered performance impossible; (2) cases in which performance remains possible, but the purpose for which one or both parties entered the agreement has been undermined; and (3) cases where temporary impossibility has grounded discharge for frustration. The concept of impossibility is discussed further under the Doctrine of Impossibility section below.

In applying these considerations, the onus is on the relying party to establish all necessary elements of frustration. It is also important to note that the applicability of frustration is meant to be broad. As phrased in *Dhillon v PM Management Systems Inc. (2014)*, "The doctrine of frustration is a flexible doctrine and is not restrictive to any formula and can be applied to all types of contracts including contracts involving the sale or leasing of land." Indeed, frustration has been applied to a variety of contractual disputes including employment, commercial, and real estate.

The standard threshold for establishing frustration is a higher threshold than establishing force majeure. Although "radical difference in performance" has been interpreted with varying levels of strictness, courts have been relatively firm in setting the minimum level of radical difference. In *Delta Food Processors Ltd. v East Pacific Enterprises Ltd.*, the court in quoting an earlier
English case, agreed that, "The fact that it has become more onerous or more expensive for one party than he thought is not sufficient to bring about a frustration. It must be more than merely more onerous or more expensive. It must be positively unjust to hold the parties bound." In this case, the defendant was sued for lost profit after it failed to supply 1200 tons of herring to the plaintiff because of a poor fishing season and difficulties in securing fish packers. The court ultimately decided against a finding of frustration as the lack of fish and difficulties with packers did not amount to a sufficiently "radical change in the nature of the obligation". These difficulties could have been overcome with more effort from the defendant.

Notwithstanding the judicial consensus on the core principles of modern frustration, some courts have mentioned additional factors that may be considered as part of the doctrine's application. For example, despite the requirement of the supervening event occurring at no fault of the parties, there may be a case where the default of one party frustrates the contract between the other parties in a tripartite agreement. Such was the case in Cortina Foods Inc. v Bari Cheese Ltd., where the unilateral termination by a cheese manufacturer caused the frustration of an agreement between the manufacturer, a cheese marketer and a milk producer. However, an important element of this case was that the defaulting cheese manufacturer was a necessary and key party in the supply chain of cheese—it was the only manufacturer in the province that would accept milk from the milk producer. Its withdrawal from the agreement consequently made the performance of the milk producer fundamentally different than what was initially contemplated. Another additional factor is the inclusion of policy considerations in the analysis. In Kreway v Kreway, the court listed policy considerations for non-enforcement vs enforcement of the contract.

The result of a successful frustration claim is that the contract is deemed frustrated and all obligations are extinguished as of the date of the supervening event. Many provinces have enacted provincial legislation to administer the outcomes of contracts found to be frustrated. For example, Ontario's Frustrated Contracts Act applies to any contract that is governed by the law of Ontario and that has become frustrated and consequently discharged. It prescribes that amounts paid or benefits conferred prior to discharge are recoverable. Additionally, it allows the severance of frustrated obligations of a contract if the remainder was substantially performed prior to discharge.
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