HOW FRUSTRATING: THE DOCTRINE OF FRUSTRATION IN THE AGE OF COVID-19

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Contract law has always served an important role in facilitating business and economic activity. In particular, the law has long recognized the foundational nature of commercial obligations and the largely unqualified policy basis for holding parties strictly to their bargained-for positions. A significant exception to the "absolute" nature of contractual obligations arises from the doctrine of frustration of contract. The doctrine recognizes a supervening event beyond the contemplation of parties to an agreement and results in the discharge of outstanding contractual obligations, subject to the applicability of frustrated contracts legislation. Recently, the doctrine of frustration has seen a renewed significance upon the outbreak of COVID-19 and its global impacts. This article offers an overview of the state of the doctrine of frustration, its relationship with force majeure clauses, and the legal effect of frustration under the common law as modified by frustrated contracts legislation. It also offers some observations with respect to the manner in which the doctrine may be applied to future cases arising from the circumstances of COVID-19.

THE DOCTRINE OF FRUSTRATION: AN OVERVIEW

The legal framework underlying the doctrine of frustration has been subject to considerable disagreement over the course of its development within the English and Canadian jurisprudence. Frustration has been approached in a number of ways throughout its evolution, most principally in accordance with what are commonly known as the "total failure of consideration", "implied term" and "radical change" approaches.

The total failure of consideration approach essentially requires a supervening event to interrupt an agreement to such an extent that one party does not receive any part of its bargain. In contrast, the implied term and radical change approaches require the happening of supervening events beyond the contemplation of the parties. The implied term approach views

such supervening events as triggering an implied term for the discharge of the contract on the happening of the unexpected event. In contrast, the radical change approach permits the discharge of an agreement only where a supervening event results in the performance of obligations being "radically different" from that originally bargained for by the parties.[1]

The total failure of consideration approach has largely fallen out of view beyond its adoption in the seminal English case of *Krell v. Henry*.[2] Dubbed the most consequential of the "coronation cases", *Krell* involved the hiring of a room from which to view the procession of the coronation of Edward VII. Upon the cancellation of the procession on the grounds of the king's illness, Krell brought a claim for the payment of monies under the contract. The English Court of Appeal found that the defendant had specifically hired "rooms to view the procession" and, in this way, construed the contract to fundamentally relate to the viewing of the procession, rather than treating the procession as an ancillary aspect of the agreement. The court concluded that the doctrine of frustration applied on the basis that the cancellation of the procession created a total failure of consideration.

The total failure of consideration approach seems to have originated in the earlier case of *Taylor v. Caldwell*,[3] where frustration of contract was considered to have occurred when the music hall for hire had "perished" in a fire. Nevertheless, in light of the court's construction of the contract in *Krell*, both the implied term and radical change approaches would have served as adequate bases for frustration. In contrast, the House of Lords relied upon the radical change approach in *Tsakiroglou & Co. Ltd. v. Noblee & Thorl GmbH*.[4] In that case, the House of Lords held that the closure of the delivery route through the Suez Canal and the consequent extra time and expense required for delivery of goods had not rendered performance under the contract to be so radically different from that contemplated by the agreement to amount to frustration. In this way it seemed to conceive of a very narrow scope for the doctrine, according with the ancient rule that parties to an agreement are to be held strictly to their bargains unless expressly provided for within the contract.[5]

The high water mark of judicial disagreement with respect to the proper approach to the doctrine of frustration appears to be found in the decision of the House of Lords in *National Carriers Ltd. v. Panalpina (Northern) Ltd*.[6] The case involved a lease agreement for the demise of a warehouse for commercial purposes. Upon the closure of the street serving as the only access point to the property as a consequence of a nearby planned demolition, the plaintiff brought a claim for unpaid rent. Although the House of Lords was largely in agreement that the proper approach to frustration is the radical

change approach, Lord Wilberforce appeared to regard the doctrine of frustration as entirely equitable in nature and thus incapable of constraint into a rigid legal framework. The appropriate formulation, in his opinion, is that which accords with the dictates of justice. In the case at bar, he preferred the implied term approach, noting with respect to the total set of potential approaches that it was "not necessary to attempt selection of any one of these as the true basis", that "they shade into one another" and that "a choice between them is a choice of what is most appropriate to the particular contract under consideration".[7]

In contrast, the Canadian jurisprudence is largely in agreement that the radical change approach is the proper approach to the doctrine of frustration. While the 1922 decision of the Supreme Court of Canada in *Canadian Government Merchant Marine v. Canadian Trading Co.*[8] seems to adopt the implied term approach, this was supplanted almost 80 years later by the Supreme Court's decision in *Naylor Group Inc. v. Ellis-Don Construction Ltd.*,[9] which adopted the radical change approach to frustration. The latter case involved a claim for breach of contract stemming from the award of a construction contract to a subcontractor in breach of the bidding agreement. The appellant argued that the supervening event was a decision of the Ontario Labour Relations Board ("OLRB") precluding it from considering the bids of subcontractors not affiliated with a certain union. Justice Binnie, writing for the court, held that supervening events will not result in frustration unless they were unforeseeable and beyond the control of the parties. In particular, what the doctrine requires is a supervening event that alters the nature of the party's contractual obligation to such an extent that to compel performance despite the changed circumstances would be to order the party to do something radically different from what it had agreed to under the contract. The court considered the decision of the OLRB to be a retroactive affirmation of the pre-existing collective bargaining agreement, rather than a novel statement of the obligations of the parties. Because the decision of the OLRB was not considered to create any new obligations, there was no radical change and no basis to apply the doctrine of frustration.

Similarly, the Ontario Court of Appeal in *Capital Quality Homes Ltd. v. Colwyn Construction Ltd.*[10] considered the radical change theory as the proper approach to the doctrine of frustration. In reviving the doctrine of frustration within the realm of real property transactions, the Court of Appeal rejected the implied term approach, instead characterizing the supervening event as an instance of "frustration of the common venture" encroaching upon the fundamental identity of the bargain. The radical

change approach was also applied by the B.C. Court of Appeal in both *KBK No. 138 Ventures Ltd. v. Canada Safeway Ltd.*[11] and *Rickards (Estate of) v. Diebold Election Systems Inc.*,[12] the latter case being one of the most recent statements on the law of frustration by our Court of Appeal. In that case, the Court of Appeal viewed the radical change theory as requiring something akin to the deprivation of "a substantial part of the consideration for which [a party] had bargained".[13] In this way the Court of Appeal seems to have somewhat revived the "failure of consideration" approach to frustration, albeit within the confines of the accepted radical change approach.

In general, the cases emphasize that frustration will not apply where the change in circumstances makes a party's performance more expensive or onerous but does not prevent the party from performing the agreement.[14] Nor will the fact that changed circumstances make the contract non-advantageous or uneconomic for a party, provided that the contract can still be performed in accordance with its terms.[15] In such cases, it cannot be said that compelling performance despite the changed circumstances would be to order the parties to do something radically different from what had been agreed. Parties to a contract are understood to accept that the bargains they strike may become more or less economically advantageous, and performance more or less onerous, depending on the many external local, national and global events that continually impact the interests of parties. The law is understandably reluctant to excuse parties from bargains that are no longer valuable in hindsight, and it is only upon the happening of "black swan" events that the doctrine of frustration is realistically available.

In the same vein, courts have drawn a distinction between changes which are temporary or transient as opposed to permanent.[16] Where a change is temporary, it may temporarily interrupt performance or make it less economically viable, but it will not give rise to frustration unless it renders a complete change to the nature of the obligations. For instance, the House of Lords in *Panalpina* was reluctant to recognize the street closure in that case as a true supervening event in consideration of the fact that the closure had not entirely abrogated the party's remaining rights under the lease agreement and was comparatively brief in relation to the entire term of the lease. In that case, it was decided that an interruption of one year in a contract conferring rights over a period of ten years was not sufficient to meet the radical change standard.

In addition, the doctrine of frustration will generally not apply where the party seeking to rely on it has brought about or contributed to the supervening event in the sense that the frustration is "self-induced".[17] This principle arises from the requirement that the supervening event be beyond the con-

trol of the parties and the ancient principle that a party cannot rely on its own blameworthy conduct to escape liability.[18] In some cases, frustration may be partially self-induced in that the unexpected event exacerbates some pre-existing frailty, such as undercapitalization, poor management or existing supply chain issues. In such cases, parties are much less likely to obtain the protection of the doctrine of frustration.[19]

FRUSTRATION'S RELATIONSHIP WITH FORCE MAJEURE

As discussed above, the doctrine of frustration typically applies only where a supervening event arises such that compelling performance despite the changed circumstances would be to order the parties to do something radically different from what had been agreed. Because of this, the doctrine of frustration should not apply where the parties have put their mind to the possibility of the "black swan" and made express provision for its arrival in their contract. In such cases, it cannot be said that the event was unforeseen.

It is for this reason that the doctrine of frustration generally has no applicability in cases where the contract contains a force majeure or other clause which makes provision for the contractual outcome in the event of the occurrence of the supervening event. In such cases, if the force majeure clause is triggered and thereby ends the contract, it is not because the contract is frustrated, but because the parties agreed to that outcome.[20]

The applicability and effect of any given force majeure clause depends on its language and the interpretation given to the language. Such clauses tend to be construed strictly and narrowly.[21] In some cases, the interpretation of a force majeure clause may impact the issue of whether the doctrine of frustration is available. For example, where a force majeure clause expressly makes provision for certain possibilities but excludes the one that did occur, this may provide a strong basis to conclude that the doctrine of frustration applies.

THE EFFECT OF FRUSTRATION AT COMMON LAW AND STATUTE LAW

The common law doctrine of frustration provides that upon the happening of a frustrating event, the contract comes to an immediate end. The result is that neither party has any future obligations under the contract, although the contract is treated as having been valid and effective until the time of frustration. With respect to the situation after the moment of frustration, the common law essentially treats any losses as lying where they fall. While this may achieve a just result in some cases, it will create unfair outcomes in others.

For example, a supply agreement that is frustrated by some unexpected event after the date of supply but prior to the due date for payment may result in the purchaser becoming relieved of its obligation to make payment, thereby conferring on it an unfair windfall. While some courts have found ways to avoid such unfair outcomes, such as by finding a total failure of consideration and thereby unravelling the entire bargain,[22] or considering some contractual obligations to have been severed from the contract prior to the time of frustration,[23] these were often uneasy fits.[24] For example, the total failure of consideration approach was limited in that the failure had to be "total", meaning that the escape hatch was inaccessible where at least some consideration had passed.[25]

In response, legislatures attempted to equip courts with scalpels where the common law of frustration provided only blunt instruments. In the words of one appellate court judge, frustrated contracts legislation "allows a court to step in and to alleviate against some of the common law harshness with respect to frustration".[26] In British Columbia, the applicable legislation is known as the *Frustrated Contract Act* (the "Act").[27] There is similar legislation in all other Canadian provinces and territories, except Nova Scotia.[28]

The Act invited little debate in the British Columbia legislature when it was introduced in 1974. In general, it was superficially characterized as legislation that permitted "a settlement of claims to be worked out" given that the common law permitted recovery in the event of a "total failure of consideration" but not "partial failure". It was also characterized as a "pruning Act" that "takes the unworkable parts of common law and adjusts them to the present-day practises and interpretations".[29]

To date, the Act has received very limited judicial attention; the same can be said of the comparable legislation in other Canadian jurisdictions.[30] The Act permits the severance of those parts of the contract that were wholly performed or wholly performed except for payment at the time of the frustrating event. The Act requires that those severed aspects be treated as separate contracts that have not been frustrated. The Act also provides parties with the ability to claim restitution for any benefits they conferred on their counterparties prior to the time of frustration. The Act sets out a formula for calculating the value of such benefits, though it is limited to reasonable expenditures and excludes profit. In addition, where the frustrating event has created a loss in the value of a benefit conferred, the Act requires that the parties equally bear that loss.

The Act does not purport to modify the common law as it pertains to determining whether a contract has been frustrated. In particular, s. 1 of the Act provides that it applies to contracts "from which the parties to it are dis-

charged by reason of the application of the doctrine of frustration". Further, s. 2 of the Act expressly provides that it applies only to contracts that "contain no provision for the consequences of frustration".

The language of s. 2 is uncertain. In particular, it is not clear what the Act refers to when it speaks of a "provision for the consequences of frustration". Viewed through a common law lens, the reference should not include a force majeure clause because, in the presence of such a clause, there can be no frustration. However, the alternative is that the section refers to a clause that specifies the outcome in cases where the contract has been frustrated. Such clauses are rare, and it would be an unusual contract that contains no force majeure clause but does contain a provision that dictates the consequences of frustration. Nevertheless, in a recent decision, the B.C. Supreme Court stated in *obiter* that the Act applies "[i]f frustration is established and the contract provides no guidance on what to do in the event of frustration", which suggests that s. 2 of the Act contemplates the existence of a clause that specifically provides for the consequences of frustration.[31]

In addition, s. 6 of the Act provides that a party that has partly performed a contractual obligation is not entitled to restitution if there is "(a) a course of dealing between the parties to the contract", "(b) a custom or a common understanding in the trade, business or profession of the party so performing", or "(c) an implied term of the contract" to the "effect that the party performing should bear the risk of the loss in value". The first two of these factors might be considered in determining whether a term should be implied into a contract;[32] this makes them an odd fit with the third factor, which is arguably more in the nature of a legal conclusion to be reached based on the first two factors.

Moreover, there appears to be a fundamental inconsistency between s. 6 and the other aspects of the Act. In particular, s. 6(c) provides that restitution is not available where there is an "implied term" that one party is to bear the loss caused by the supervening event. However, in cases where there is such an implied term, that term could arguably be characterized either as a force majeure clause or as a "provision for the consequences of frustration", which is the language used in s. 2. However, contracts that contain force majeure clauses cannot be frustrated and, if the implied term constitutes a "provision for the consequences of frustration" within the meaning of s. 2, then the Act does not apply by virtue of s. 2. Accordingly, if a contract has an implied term, then the Act may well not be engaged in the first place.

It is also not clear why parties are precluded from claiming restitution under the Act where an exception in s. 6 applies. Given that the Act appears

intended to provide courts with the flexibility to do justice in all cases, it would arguably better support the object of the Act to permit courts the latitude to determine, unrestricted by s. 6 of the Act, whether restitution is appropriate. It is also not clear whether restitution in unjust enrichment is available where restitution under the Act is not.[33] The Act does not appear to preclude such a claim, so this avenue may remain open.

There is also uncertainty with respect to when performance of a contract will constitute a "benefit" sufficient to trigger restitution. Section 5(1) of the Act provides that "every party to a contract to which this Act applies is entitled to restitution from the other party or parties to the contract for benefits created by his performance or part performance of the contract". The term "benefit" is broadly defined in s. 5(4) of the Act to mean "something done in the fulfilment of contractual obligations, whether or not the person for whose benefit it was done received the benefit". In one case, the B.C. Supreme Court found that a plaintiff who had agreed to write some chapters of a proposed school textbook had provided a "benefit" to the defendant within the meaning of the Act notwithstanding that the contract had been frustrated by a change in the curriculum that rendered the plaintiff's work superfluous to the defendant.[34] Yet, in a subsequent case, the B.C. Supreme Court found that no "benefit" within the meaning of the Act was created by a purchaser who had expended time, effort and funds to obtain subdivision approval in respect of a property that was the subject of a frustrated contract of purchase and sale because that work had not benefitted the seller.[35] These different approaches to the concept of "benefit" under the Act indicate a tension between the plain language of the Act and the idea that no restitution should be available unless the benefit is a tangible one that survives the frustrating event and actually enriches the other party. This is a sensible approach, given that the underlying rationale of the Act appears to be to prevent the unjust enrichment of one party at the expense of the other.

COVID-19 AS A SUPERVENING EVENT

COVID-19 will undoubtedly generate litigation that prominently features the law of frustration. In this section, we offer some observations on the manner in which the legal framework may apply in COVID-19-related frustration cases.

Notwithstanding the magnitude and unprecedented nature of COVID-19, it is unlikely to provide parties with an automatic "free pass" in respect of their failure to meet their contractual obligations. The pandemic is not an automatic frustrating event, but it may have consequences that impact cer-

tain contractual relations in a way that results in frustration.[36] For example, a supply contract does not become frustrated merely by the happening of COVID-19; it becomes frustrated, for example, by the decision of a jurisdiction to close its borders in a way that makes it impossible for the supplying party to deliver its goods. Accordingly, the analysis should be focused on the specific impacts of the pandemic on the parties and exactly how those impacts have brought a radical change to their contractual relations. Hardship and inconvenience will be insufficient and, given the pandemic's wide impact, one might expect courts to be cautious in applying the doctrine, reserving it for only the most compelling cases.

In conducting this analysis, courts may face challenges distinguishing between the uncontrollable impacts of COVID-19 and the impacts of related or intermingled matters that were arguably within a party's control. Where a government decision clearly has the effect of suspending certain non-essential business activity (and thereby making performance illegal), the result on application of the doctrine of frustration should not be hard to predict.[37] However, where a party has voluntarily adopted policies or measures in accordance with public health directives intended to limit the spread of COVID-19, and it is those voluntary actions that impose a radical change on the contractual relationship, will the doctrine of frustration be unavailable because the true supervening event was not beyond the party's control? Or, where a party had pre-existing frailties that were exacerbated by the circumstances of COVID-19, but without which there would not have been any supervening event, will the doctrine be unavailable because the frustration was partially self-inflicted? In the former, more sympathetic scenario, one might argue that the doctrine of frustration ought to evolve to protect parties that have taken prudent steps to protect the well-being of others. The solution in such cases may be to incorporate a rule excusing a party where it acted in good faith and in a commercially reasonable manner. By causing the common law to evolve in such a manner, courts can also make available the restitutionary features of the Act, thereby helping to achieve a more just allocation of losses.

It may be that many COVID-19 frustration cases will involve extensive discovery processes in an effort to distinguish the uncontrollable impacts of COVID-19 from the impacts of related or intermingled matters that were within the party's control. For example, while a party may plead frustration on the basis that COVID-19 made it impossible for the party to source sufficient labour to meet its contractual obligations, discovery processes may uncover that the party's management chose to allocate the party's remaining available labour to the performance of other contracts, with the result

that frustration was arguably self-inflicted. In more complex cases, expert evidence may be required for courts to make findings as to the manner in which the consequences of COVID-19 impacted the parties and their economic relations.

For contracts entered into after COVID-19 was declared a pandemic, parties are unlikely to obtain the benefit of the doctrine of frustration given that the circumstances were or should have been known to them such that they are not unforeseeable. On a related point, given that COVID-19 represents only one of a number of pandemics that have arisen over past decades, it may become more difficult for parties to rely on the doctrine of frustration in the event of future pandemics. Rather, courts may for some time into the future treat pandemics as events that should have been foreseen by parties. As a result, parties should consider including well-drafted force majeure clauses in their contracts that specify the outcome in the event that a future pandemic impacts the contractual relationship. By doing so, parties may achieve greater contractual certainty and avoid a potentially frustrating experience.

ENDNOTES

1. GHL Fridman, *The Law of Contract in Canada*, 5th ed (Toronto: Carswell, 2006).
2. (1903), 2 KB 740 (EWCA) [*Krell*].
3. (1863), 122 ER 309 (EWHC).
4. (1961), 2 All ER 179 (UKHL).
5. See *Paradine v Jane*, [1647] 82 ER 897, where the court expressed the view that contracts are "absolute" in the sense that impossibility is never an excuse unless expressly provided for in the contract.
6. [1981] 2 WLR 45 (UKHL) [*Panalpina*].
7. *Ibid* at 57.
8. (1922), 64 SCR 106.
9. 2001 SCC 58.
10. (1975), 61 DLR (3d) 385 (Ont CA).
11. 2000 BCCA 295.
12. 2007 BCCA 246.
13. *Ibid* at para 39.
14. See e.g. *Delta Food Processors Ltd v East Pac Enterprises Ltd* (1979), 16 BCLR 13 (SC).
15. *Supra* note 1.
16. See e.g. *Polia v Trelinski* (1997), 36 BLR (2d) 108 (BCSC).
17. See e.g. *Maritime National Fish Co v Ocean Trawlers Ltd*, [1935] AC 524 (PC).
18. See e.g. *Comm'r of Agricultural Loans v Irwin*, [1942] SCR 196.
19. See e.g. *Atlantic Paper Stock Ltd v St Anne-Nackawic Pulp & Paper Co*, [1976] 1 SCR 580 [*Atlantic Paper*], which involved a ten-year supply contract for the supply of waste paper utilized in the production of corrugation. Approximately one year into performance of the contract, the customer advised the supplier that it would no longer accept delivery of the waste paper. The Supreme Court held that the primary cause of the customer's failure to perform its obligations was its lack of an effective marketing plan for its product. Although the case is a force majeure case rather than a frustration case, the same reasoning would presumably apply if there were no force majeure clause and the party had pled frustration instead.
20. *Ottawa Electric Co v Ottawa (City)*, [1903] OJ No 520 (CA); *Dover Corp (Canada) Ltd v Maison Holdings Ltd*, [1976] AJ No 607 (CA).
21. *Atlantic Paper*, *supra* note 19.
22. *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd*, [1943] AC 32 (HL) [*Fibrosa*].
23. *Appleby v Myers* (1867), LR 2 CP 651 (Ex Ch) [*Appleby*].
24. *Ibid; St Catharines (City) v Ontario Hydro-Electric Power Commission* (1927), 61 OLR 465 (HC), aff'd [1928] 62 OLR 301 (CA).
25. *Fibrosa*, *supra* note 22.
26. *Witwicki v Midgley*, 1979 CarswellMan 100 at para 10 (CA), rev'ing 1976 CarswellMan 63 (QB).
27. RSBC 1996, c 166.
28. RSA 2000, c F-27; CCSM c F190; RSNB 2011, c 164; RSNL 1990, c F-26; RSNWT 1988, c F-12; RSNWT (Nu) 1988, c F-12; RSO 1990, c F.34; RSPEI 1988, c F-16; SS 1994, c F-22.2; RSY 2002, c 96.
29. *Debates of the Legislative Assembly* (18 March 1974) at 1299–1300.
30. For the more notable of the reported decisions, see e.g. *Pure v BC-Alta*, 2019 BCSC 390 at paras 81–84 [*Pure*]; *Fort St John Aircraft Maintenance Ltd v Canadian Indemnity Co*, 1983 CarswellBC 1366 at

paras 10–12 (SC); and *British Columbia v Cressey Development Corp*, 1992 CarswellBC 1133 at paras 9–13 (SC) [*Cressey*].

31. *Pure*, *supra* note 30 at paras 81–84.
32. *Moulton Contracting Ltd v British Columbia*, 2015 BCCA 89 at para 53.
33. Prior to the enactment of the Act, the common law permitted recovery on the basis of a total failure of consideration, which is a quasi-contractual concept more grounded in restitutionary principles. See e.g. the decision of the House of Lords in *Fibrosa*, *supra* note 22, which held that in situations involving a total failure of consideration, there could be recovery essentially on the basis of restitutionary principles.
34. *Cassidy v Can Publishing Corp* (1989), 41 BLR 223 (BCSC).
35. *Cressey*, *supra* note 30 at paras 9–13.
36. There is some support for this concept in the comments of Kerans JA of the Alberta Court of Appeal in *Atco Ltd v Continental Energy Marketing Ltd*, [1996] 6 WWR 274 (ABCA), where a distinction was drawn between the alleged supervening event and the "proximate cause" of the interruption of the supply arrangement, which was the supplier's decision to cut off supply to the buyer. Kerans JA emphasized that a force majeure clause is not just about the occurrence of an event, but about the effect of that event on the party seeking its protection. Arguably the same analysis ought to apply in frustration cases.
37. One interesting question is whether governments may obtain the benefit of the doctrine of frustration where it was in fact their decisions that resulted in the supervening event. Previous case law suggests that the doctrine will not be available in such circumstances: see e.g. *Wells v Newfoundland*, [1999] 3 SCR 199.