FRUSTRATING, ISN'T IT?

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The last five or six weeks have seen increasingly strong advice leading to legal restrictions on business, movement, social gatherings and so on which, as we all know, have had serious economic consequences. Most shops and all restaurants bars and entertainment venues have closed; sporting events have been cancelled; holidays have been involuntarily extended; people have been told to work from home if possible and not to receive visitors; construction projects have been halted; and the children of all but key workers have been sent home from school, with those who are still going to school receiving supervision rather than education. That is far from an exhaustive list, but it shows reach of the current crisis. But many of the early restrictions were advisory only, and whilst some have been given legal effect by regulations made under existing legislation (for example the Health Protection (Coronavirus) Regulations 2020 (SI 2020/129) and The Health Protection (Coronavirus, Business Closure) (England) Regulations 2020 (SI 2020/327) and The Health Protection (Coronavirus) (Amendment) Regulations 2020 (SI 2020/440), all made under the Public Health (Control of Disease) Act 1984), and we have also seen the passing of the Coronavirus Act 2020 which contains numerous emergency powers. But the social distancing "rule" under which we all have to stay at least 2m away from anyone not in our own households is a

matter of advice only, as are a number of other restrictions that we have become so familiar with.

All of this poses challenges for clients. FAQs on popular websites have tended to focus on whether consumers can get money back for cancelled travel plans and so on, and have addressed these issues in general terms and have often conflated the ability to make insurance claims (in particular where travel is concerned) with rights against the seller or provider of services.

Businesses have been characterised in the media as goodies (suppliers of essential services) and baddies: retailers who are not paying their suppliers, businesses owned and managed (or perceived to be owned and managed) by well-known tycoons (Virgin Atlantic) or celebrity entrepreneurs (Victoria Beckham) who have furloughed staff or otherwise sought government assistance, and landlords, whose so called "aggressive rent collection" is now to be curtailed for the benefit of tenants whose business closure means that they are unable to been generate income to meet their rental obligations.

But what are the legal implications of all this? It is probably too soon to give a comprehensive or definitive answer when the effects of the virus are spreading into so many fields of activity, but one thing we can be sure of is that we are all going to have to consider the doctrine of frustration of contracts and the effects of the Law Reform (Frustrated Contracts) Act 1943.

So when is a contract frustrated and what are the consequences?

When will a contract be held to have been frustrated?

As a general principle, frustration occurs where something happens which makes a contract either physically or commercially impossible to perform. It operates to end the contract and to discharge the parties from further obligation under it. It is a doctrine that is not lightly to be invoked and one which operates within very narrow limits that courts have, so far, been unwilling to extend.

It is not sufficient that the supervening event increases the burden or expense of the contractual obligation: it must significantly change the nature of the obligations from that which the parties expected at the time when the agreement was made, so that it would be unjust for the law to expect the parties perform them. It has been said that it is not hardship or inconvenience that calls the principle of frustration into play. There must be a radical change in the obligation. Typical events that have been held to frustrate a contract are destruction of the subject property, unexpected delay due to neither party's fault which renders the obligation radically different from that undertaken by the contract, cancellation of an event to which the contract is related or a change in the law that makes performance of the contract illegal.

You may recall the line of cases surrounding the cancellation of the coronation of Edward VII. For example in ***Krell v*** Henry [1903] 2 K.B. 740 the defendant agreed to hire rooms overlooking Pall Mall belonging to the plaintiff during certain hours on two days when processions were scheduled to take place. The Plaintiff sued for the hire charge. The question that arose in these cases was whether the cancellation of the event meant that the agreements had been frustrated. The property owner argued that their properties were still available for use and there was nothing to stop the other parties from occupying them and using them for some other purpose. The contracts were held to have been frustrated because the whole purpose of the agreement, shared by both sides, was to enable the hiring party to watch the event.

A different decision was reached in ***Herne Bay Steam Boat Co v Hutton*** [1903] 2 KB 683. In that case the Defendant had engaged a steamboat to take passengers from Herne Bay on June 28 and 29, 1902, "for the purpose of viewing the Naval Review at Spithead and for a day's cruise round the fleet." The hire was £250, of which £50 was paid in advance, the balance to be paid before the vessel left. On June 25 the review was cancelled. But the fleet was still anchored at Spithead and it was still possible to cruise round the fleet. This time the contract was *not* held to have been frustrated.

The distinction between the cases seems to have been gnat in ***Krell*** the only possible purpose of hiring the rooms for certain hours on the two days in question was to watch the parades, whereas the position in the ***Herne Bay*** case was not so clear cut and the contrast between the two cases demonstrates how narrowly the courts regard the doctrine of frustration.

The mere fact that an unforeseen change of circumstance increases the financial burden on one party will not suffice. So, for example, in the leading case of ***Davis Contractors Ltd v Fareham UDC*** [1956] AC 696 a contractor had agreed to build 78 houses at a fixed sum within a specified period. The contract price was circa £94,000, and the expected cost to the builder was around £86,000. In fact, as a result of various unforeseen matters and through no fault of either party, the project was delayed and the actual cost to the contractor was some £111,000. The builder asserted that the contract had been frustrated and that it was therefore entitled to be paid on a quantum meruit basis. The House of Lords held that neither the delays that led to the increase in costs nor the fact that the contract was rendered unprofitable were frustrating events.

In ***National Carriers v Panalpina (Northern) Ltd*** [1981] AC 675 the question was whether a ten year lease of a warehouse had been frustrated by the closure, five years into the term and for a period of about 20 months, of the road giving access to the property.

At p. 700 Lord Simon of Glaisdale expressed the general principle in the following terms:

> "Frustration of a contract takes place when there supervenes an event (without default of either party and for which the contract makes no sufficient provision) which so significantly changes the nature (*not merely the expense or onerousness*) of the outstanding contractual rights and/or obligations from what the parties could reasonably have contemplated at the time of its execution that it would be unjust to hold them to the literal sense of its stipulations in the new circumstances; in

such case the law declares both parties to be discharged from further performance" (emphasis added).

At p. 707 Lord Simon again made it clear that expense and inconvenience were insufficient. The correct question, he said, was "would the outstanding performance in accordance with the literal terms of the contract differ so significantly from what the parties reasonably contemplated at the time of execution that it would be unjust to insist on compliance with those literal terms?"

In ***United International Pictures v Cine Bes Filmcheck VE Yapimcilik AS*** [2003] EWHC 798 (Comm) the defendant had agreed to pay licence fees in US Dollars backed by a letter of credit. It was argued that a contract had been frustrated when the Turkish government withdrew from the "Crawling Peg Exchange Rate Mechanism" which had tied the Turkish Lira to a basket of currencies, causing a huge fall in the value of the Lira which made it very difficult for Turkish companies to obtain letters of credit for US dollars. The argument was rejected (again following Lord Simon's formulation of the rule in ***National Carriers v Panalpina***), because (a) the effect of the withdrawal from the Crawling Peg Mechanism was simply to increase the cost to the defendant, and (b) a prudent Turkish company dealing in US Dollars could have protected itself by maintaining dollar accounts.

Lord Simon's dicta in ***National Carriers*** were followed by Mr Justice Hamblen in *Tandrin Aviation* ***Holdings Ltd v Aero Toy Store LLC*** [2010] EWHC 40 (Comm). In that case it was held that a severe downturn in economic or market circumstances, affecting the profitability of a contract or the ease with which the parties' obligations could be performed, was not to be regarded as being a frustrating event.

An alternative argument was advanced that the continued existence of the exchange rate mechanism was fundamental to the agreement and that the defendant would not have entered into the contract but for its existence. Flaux J did not comment on whether those arguments might have been sufficient to bring about frustration, because the alternative case argument failed on the

facts: there was no evidence either that the defendant had in fact regarded the exchange rate mechanism as fundamental, or that the claimant had known of its importance to the defendant (it is what was in the contemplation of both parties that counts, which is what distinguishes that case from the coronation cases).

In ***The Sea Angel*** [2007] EWCA Civ 547 Rix LJ explained that whilst the test was whether the circumstances now meant that that a party would be required to perform something *radically different* (a phrase which meant that the doctrine was not to be lightly applied) how that test should be applied required a "multi factorial approach" which meant considering of a large number of factors the list being determined on the facts of each case having regard to

> "… the terms of the contract itself, its matrix or context, the parties' knowledge, expectations, assumptions and contemplations, in particular as to risk, as at the time of contract, at any rate so far as these can be ascribed mutually and objectively, and then the nature of the supervening event, and the parties' reasonable and objectively ascertainable calculations as to the possibilities of future performance in the new circumstances"

By definition frustration can only arise where the circumstances relied on is not one in respect of which the agreement can be said to have allocated the risk to one party (reflecting Lord Simon's criterion that the supervening event must be one which and for which the contract makes no sufficient provision).

Leases

Returning to ***National Carriers v Panalpina***, whilst the case did not lay down any new law or principles in relation to the law of contact generally, the case is of particular importance to property lawyers. It had been decided by the Court of Appeal in ***Leighton's investment Trust Ltd v Cricklewood Property and Investment Trust Ltd*** [1943] KB 493 (a case involving a

building lease) that the law of frustration could have no application to leases because the effect of frustration was to excuse the parties from future performance after the occurrence of the event, so it could only apply to executory contracts. Leases were not like ordinary contracts in that they created interests in land, and once that interest had been granted the doctrine of frustration could not apply because it would result in the destruction of a proprietary interest whose grant was not executory (i.e. a matter of future performance). In the House of Lords it (sub nom ***Cricklewood Property and Investment Trust Ltd v Leighton's investment Trust Ltd*** [1945] AC 221) it was held that even if the doctrine of frustration could apply to a building lease, the appeal would fail on the facts. The question of whether a lease could be frustrated was left open: two of their lordships held that a lease might be frustrated in certain circumstances, 2 held that a lease could never be frustrated and the fifth member of the panel (Lord Porter) didn't express a view because the question did it arise on the facts.

In ***National Carriers v Panalpina*** the case failed on the facts as the term still had a number of yeas to run but the property would only be unusable for a 5 months or so. The real importance of the case is at it was accepted that a lease could be frustrated and the decision in the Court of Appeal in ***Leighton's investment Trust Ltd v Cricklewood Property and Investment Trust Ltd*** was overruled.

The narrowness of the doctrine was again emphasised in In ***Canary Wharf (BP4) T1 Ltd v European Medicines Agency*** [2019] EWHC 335 (Ch). The EMA had taken a 25 year lease of premises in canary Wharf, expecting to operate from there for the duration of the lease. When then UK gave notice to leave the EU the EU passed a regulation under which the EMA would be relocated to Amsterdam. It sought to argue that the lease should come to an end so that it was released from its covenants in relation to rent and repairs on the ground of frustration when the UK left the EU. The argument failed for a number of reasons. First, the alleged frustration was self-induced: the EMA was an agency of the EU and the EU had passed the regulation requiring it to move.

Second, the continuation of the lease did not depend on the EMA's occupation: the lease was assignable and the whole of the premises could be sublet (albeit that all the alienation provisions were subject to detailed conditions); further whilst the lease could only be used for permitted purposes, the permitted purpose was any professional or commercial office. Over all, the lease clearly contemplated that the MSA might move at some point during the term, so whatever EMA's intentions might have been, it could not be said that the continued occupation of the premises for the duration of the term by that particular tenant was whole purpose of the lease, or that the purpose had been frustrated. Third, there was no supervening illegality. It was also argued that the regulation requiring the agency to move affected the agency's capacity: the law of frustration was concerned with the continued lawfulness of performance of the contract in the country where it was to be performed, not changes on the capacity of a contracting party under the foreign law of its incorporation.

How the courts will apply these principles in the current situation remains to be seen but the real question is whether the current circumstances has really made performance of the contract impossible or just caused delay or increased the expense.

In some cases events will have to be cancelled, or performance of the contract may be rendered pointless because it is linked to something else which cannot now happen. Where the issue is delay an important consideration will be whether performance is for some reason time sensitive, for example where it is linked to a particular event and that event is the *raison d'être* of and fundamental to the contract as in the Coronation cases, but the ***Herne Bay Steamboat*** case shows that that issue has hitherto been very closely examined.

In most cases time is not of the essence, so the effect of delay will be an important matter to be taken into account. Where time is not of the essence the obligation is to perform within a reasonable time, so even where time is not of the essence there will come a point where the delay is so great that by the time it is possible to perform the required act the moment will have passed so

that merely doing the act specified in the agreement in accordance with its literal terms cannot sensibly be regarded as performance of the contract in the sense of giving the other party what they have bargained for.

One of the difficulties that the current situation throws up is what happens where performance is not impossible or illegal but one party decides not to perform or to cancel the contract because it is concerned about the risk of infection, or of spreading infection. The decision may or may not be in accordance with government or other advice, but following advice is not the same as compliance with a legal requirement or prohibition. And what is the position where steps are or have been taken in anticipation of a legal restriction coming into force? Will the law allow parties to escape their obligations because of government advice or an announced change in the law that is yet to take effect, or will it take the view that following advice is voluntary and that it is up to the contracting party to take steps to mitigate the risk, for example by ensuring that personnel wear protective clothing or other equipment, however expensive that may be or however difficult it may be to obtain the equipment required?

In some cases the performance of a contract may have to be suspended. A contractor may have agreed to provide a service over period of a years, but be prevented from doing so because of the pandemic. *National Carriers v Panalpina* points to a conclusion that there will be no frustration, but there have been employment cases where the parties' obligations were held to be suspended due to the fact of the employee's illness. But if his illness meant that he would never be able to resume working for A then it would have been arguable that the contract was frustrated and had been terminated. Similarly wartime restrictions can temporarily suspend an obligation build under a building lease: ***Cricklewood Property and Investment Trust Ltd v Leightons Investment Trust Ltd*** .

Consequences of frustration

If a contract is frustrated then the common law position was that both parties were discharged from further performance and losses simply lay where they fell, subject only to the possibility of some sort of restitutionary claim such a quantum meruit claim for where work had been done that was of some value to the other party or some other claim based in unjust entrichment.

That position was changed by the Law Reform (Frustrated Contracts) Act 1943. Section 1 of his short act provides:

> (1) Where a contract governed by English law has become impossible of performance or been otherwise frustrated, and the parties thereto have for that reason been discharged from the further performance of the contract, the following provisions of this section shall, subject to the provisions of section two of this Act, have effect in relation thereto.
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> (2) All sums paid or payable to any party in pursuance of the contract before the time when the parties were so discharged (in this Act referred to as "the time of discharge") shall, in the case of sums so paid, be recoverable from him as money received by him for the use of the party by whom the sums were paid, and, in the case of sums so payable, cease to be so payable:
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> Provided that, if the party to whom the sums were so paid or payable incurred expenses before the time of discharge in, or for the purpose of, the performance of the contract, the court may, if it considers it just to do so having regard to all the circumstances of the case, allow him to retain or, as the case may be, recover the whole or any part of the sums so paid or payable, not being an amount in excess of the expenses so incurred.

(3) Where any party to the contract has, by reason of anything done by any other party thereto in, or for the purpose of, the performance of the contract, obtained a valuable benefit (other than a payment of money to which the last foregoing subsection applies) before the time of discharge, there shall be recoverable from him by the said other party such sum (if any), not exceeding the value of the said benefit to the party obtaining it, as the court considers just, having regard to all the circumstances of the case and, in particular,—

(a) the amount of any expenses incurred before the time of discharge by the benefited party in, or for the purpose of, the performance of the contract, including any sums paid or payable by him to any other party in pursuance of the contract and retained or recoverable by that party under the last foregoing subsection, and

(b) the effect, in relation to the said benefit, of the circumstances giving rise to the frustration of the contract.

(4) In estimating, for the purposes of the foregoing provisions of this section, the amount of any expenses incurred by any party to the contract, the court may, without prejudice to the generality of the said provisions, include such sum as appears to be reasonable in respect of overhead expenses and in respect of any work or services performed personally by the said party.

(5) In considering whether any sum ought to be recovered or retained under the foregoing provisions of this section by any party to the contract, the court shall not take into account any sums which have, by reason of the

circumstances giving rise to the frustration of the contract, become payable to that party under any contract of insurance unless there was an obligation to insure imposed by an express term of the frustrated contract or by or under any enactment.

(6) Where any person has assumed obligations under the contract in consideration of the conferring of a benefit by any other party to the contract upon any other person, whether a party to the contract or not, the court may, if in all the circumstances of the case it considers it just to do so, treat for the purposes of subsection (3) of this section any benefit so conferred as a benefit obtained by the person who has assumed the obligations as aforesaid.

So under subs (2) the general position is that sums paid before the frustrating event occurred are repayable, but the general rule is subject to qualifications:

(i) If the party to whom money was paid has spent money in the performance of the contract, the court has a *discretion* to allow him to keep a sum equal to the money he has spent, if it is just to do so in all the circumstances. It is important to note that this is discretionary: there is no right to retain money. Further, whilst the subsection refers to sums spent "*in, or for the purpose of, the performance of the contract"* which suggests that the party can only claim for money specially spent on performance of the contract itself, subs (4) provides that this can also include a sum in respect of overheads.

(ii) If a party received a benefit under the contract prior to frustration, then he is liable to pay a sum (to be assessed having regard to all the circumstances) not exceeding to the value of that benefit

Any insurance policy is to be ignored in assessing the position between the parties, unless there was an express requirement to ensure either under the contract itself or under any enactment.

Where a contract contains a number of severable parts, those parts that have already been fully performed are left out of account (section 2(4)).

The Act does NOT apply to certain charterparties or to contracts to which section 7 of the Sale of Goods Act 1979 (which avoids contracts for the sale of specific goods which perish before the risk has passed to the buyer) applies, or to any other contract for the sale, or for the sale and delivery, of specific goods, where the contract is frustrated by reason of the fact that the goods have perished.

Force Majeure Clauses

Many contracts will contain a force majeure clause under which one party on the other will seek to avoid any liability for failure to perform their obligations as result of acts beyond their control. On one view this can be seen as the consensual allocation of risk between the parties. In *National Carriers v Panalpina* it was said that the tenant could have stipulated for a rent free period in the event of closure of the road and the landlord could have insured against that risk, just as landlords and tenants frequently do in respect of risks such as fire.

But how a clause of that sort will operate will be a matter of construction of the clause in question. So, for example in *Classic Maritime Inc v Limbungan Makmur SDN BHD* [2019] EWCA Civ 1102 it was held that where clause provided that a charterer would not be liable for any failure to deliver a cargo "resulting from" an event which "directly affected" its performance of its contractual obligations the charterer would only be able to rely on the clause if it could prove that, but for the event, it could and would have fulfilled those obligations.

Force majeure clauses are in the nature of exemption clauses and are likely to be narrowly construed. So in consumer contracts they will have to be

transparent and meet the test of fairness in accordance with Part 2 of the Consumer Rights Act 2015, and in the event of any ambiguity will be construed in favour of the consumer (see s. 68 of the Act). In commercial contracts they will have to satisfy the requirement of reasonableness under the Unfair Contract Terms Act 1977.

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