COVID-19 – How frustrating is that?

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Introduction

The global COVID-19 pandemic has had a very significant effect on daily life for everyone in the UK. Its effect on business, including the legal sector, has been far-reaching, especially economically.

This article discusses the doctrine of frustration generally, but with particular focus on the effect of the virus.

Principles

Frustration is one of the rarer topics in practice, perhaps having last come to the fore 80 years or so ago during World War II. It is perhaps time to dust off the practitioner texts and remind ourselves what the position is.

What is it? Frustration is a mode of discharge of contractual obligations. Events, subsequent to formation of the contract, may render performance physically or commercial impossible, or render the obligation to perform radically different from that which was promised. It requires some 'outside event or extraneous change of situation' which takes place 'without blame or fault on the side of the party seeking to rely upon it'. As Lord Simon remarked in *National Carriers Ltd v Panalpina (Northern) Ltd* [1981] AC 675:

> *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 short, a position enabling a party to say '*Non haec in foedera veni*', or 'It was not this that I promised to do.': see *Davis Contractors Ltd v Fareham UDC* [1956] 1 AC 696.

Scope The scope is narrow. This is not a means of escaping a bad bargain. Further, if the contract allocates the risk of the event in question, then frustration has no role. Typical examples include *force majeure* clauses and the like.

Effect Frustration operates to 'kill the contract and discharge the parties from further liability under it'. This is one reason for the narrowness of scope. The effect is automatic, and not dependent on the act or election of any party.

Has there been frustration?

Construction of the contract

It is first necessary to construe the contract to establish what the obligations are (or were). Without that process, it is not possible to ascertain whether those obligations have been frustrated by the supervening event.

Construction of the contract works on the usual principles and is a question of law.

The test for frustration

The second stage, having understood the obligations which were agreed, is to determine whether there has been a radical change in the obligations, or the actual effect of the promises of the parties, construed in light of the new circumstances. Was performance 'fundamentally different in a commercial sense'?

The modern approach is 'multi-factorial' and takes into account all the circumstances of the case. See Rix LJ in *The Sea Angel* [2007] 1 CLC 876 (CA) at [111] [emphasis added]:

> *In my judgment, the application of the doctrine of frustration requires a multifactorial approach. Among the factors which have to be considered are 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. Since the subject matter of the doctrine of frustration is contract, and contracts are about the allocation of risk, and since the allocation and assumption of risk is not simply a matter of express or implied provision but may also depend on less easily defined matters such as 'the contemplation of the parties', the application of the doctrine can often be a difficult one. In such circumstances, the test of 'radically different' is important: it tells us that the doctrine is not to be lightly invoked; that mere incidence of expense or delay or onerousness is not sufficient; and that there has to be as it were a break in identity between the contract as provided for and contemplated and its performance in the new circumstances.

The test is objective, and does not depend on the subjective position of any party. If, objectively, there has been frustration then the legal consequences flow automatically.

Broadly, there are two ways of analysing frustrating events: by type of event (e.g. war), and by type of contract (e.g. personal service, leases, etc.). Illustrations include:

- Destruction of the subject matter of the contract (e.g. by fire, explosion, etc.), government intervention (e.g. requisition, seizure), incapacity or death of a person with personal obligations, and (in some cases) delay.
- Mere inconvenience, hardship, financial loss or delay within the commercial risk undertaken in the agreement are usually insufficient.

There are aspects of the pandemic which may arguably cause frustration. Each case turns on its own facts, but for example:

- Death of a personal contractor
- Enforced self-isolation for a sufficiently long period
- Government-enforced closure of premises of either a party, or all sources of some necessary supply (again, depending on what the nature of the contract is). (If parts or components *are* available but just more expensive, this is unlikely to be a frustrating event.)

Delay

Whether delay amounts to a frustrating event – in the pandemic context, perhaps arising from travel or carriage restrictions – can be a difficult matter. The root cause of the delay is not the question, however, but rather its effect on the performance of the obligations assumed by the parties: see *The Nema* [1982] AC 724 at 754 per Lord Roskill.

To amount to a frustrating event, the delay must be *abnormal* and *outside that which the parties could reasonably contemplate at the time of contracting*: *Blankley v Central Manchester and Manchester Children's University Hospitals NHS Trust* [2014] 1 WLR 2683 at [40], unchanged on appeal. Relevant factors include the nature of the contract and the expected duration of performance after the delay is likely to end.

In the pandemic context, frustration may well arise from self-isolation or illness of someone with personal obligations. In this context the delay-based principles are likely to apply: is the inability of, or reduced, performance likely to continue for such a period that future performance is either impossible or radically different from that envisaged?

The mere undesirability of performing a task is unlikely to be a frustrating event.

Perishable goods

In light of the availability of transport during the pandemic, this may not be so much of an issue (though shoppers at certain supermarkets with empty vegetable shelves may disagree). It is worth noting that the Sale of Goods Act 1979 s.7 provides a statutory rule in these cases: where (without fault on the part of the seller or the buyer) goods perish before risk passes to the buyer, the agreement is avoided.

Building contracts

This is a topic close to the heart of the writer. Obviously, the destruction and explosion-type instances referred to above are prime candidates for a finding of frustration. Similarly, government *prohibition of*, or *restrictions on*, building operations were found to be frustrating events in wartime.

However, as presently advised, the UK Government has said expressly that (i) workers can travel to work providing the work cannot be done at home, and

(ii) construction work can continue. Both are subject to social-distancing measures being observed.

A main contractor is unlikely to be able to rely on frustration just because labour or materials have become more expensive or harder to find, particularly where (as at present) there is no prohibition or restriction on construction work continuing.

The position may be different if a particular, necessary, part of the work is unable to be continued whilst observing social-distancing. There will doubtless be some law on this fairly soon.

Turning to the problem of whether the contract deals with the particular event, building contracts frequently deal with the effect of delay from specified causes by imposing a suspension. However, that is not necessarily an answer to the question, as Asquith LJ pointed out in *Sir Lindsay Parkinson & Co Ltd v Commissioners of Works* [1949] 2 KB 632 at 665:

> *A contract often provides that in the event of 'delay' through specified causes, the contract is not to be dissolved, but merely suspended, yet such a provision has been held not to apply where the delay was so abnormal, so pre-emptive, as to fall outside what the parties could possibly have contemplated in the suspension clause. In other words 'delay' though literally describing what has occurred, has been read as limited to normal, moderate delay, and as not extending to an interruption so differing in degree and magnitude from anything which could have been contemplated as to differ from it in kind.*

The extent to which the word 'delay' (or a synonym) in the contract covers the delay caused by the supervening event in question is a matter of construction and thus of law. Where examples are given, even something in the nature of the pandemic may be covered by virtue of the *ejusdem generis* approach to construction – and so the list of events may not be exhaustive.

Care is thus required when ascertaining what the contract does or does not deal with.

Leases and Tenancies

Frustration of leases is rare, but exists at least in theory. There is no reported case of a frustrated lease, although examples could be conceived of which involve, perhaps, the total destruction of the land in which the estate is held (e.g. by coastal erosion). Less radically, government prohibition on all of the uses to which the estate can be put may well amount to frustration, depending

on duration. There is a recent example of a case where the frustration argument *failed*: see *Canary Wharf (BP4) T1 Ltd v European Medicines Agency* [2019] EWHC 335 (Ch).

The impact of the pandemic is (at least hoped to be) relatively short in time. True it is that the Government has ordered the closure of a wide range of establishments. In the majority of cases, because the closure is likely to be short-lived compared to the unexpired term there is unlikely to be frustration: see, for example, the closure of a street which was the only access to a warehouse in *National Carriers* (above).

The position may be otherwise for those with very short leases or licenses (e.g. for a few weeks for a 'pop-up' shop or stall).

Does the contract allocate the risk of the supervening event occurring?

If the contract, properly construed, explains how the parties intend to deal with the supervening event in question, then that defines the position between the parties. It is thus not sufficient simply to establish that a frustrating event has occurred. If the parties have dealt with it (either by express or implied provision) then the event is not *unforeseen* and the doctrine has no role to play. A typical example is a *force majeure* clause.

There are, however, limits to the Courts' willingness to shut out the doctrine, and clauses which deal with such events are often construed narrowly. The requirement has been said to be that the provision for the event be 'full and complete' before the conclusion is reached that frustration is excluded. The more catastrophic the event, the less likely it will be that a clause will be held to cover it.

However, the (hoped for) effect of the pandemic in most cases will be delay. If the contract covers how delay arising from events with a duration of a few weeks, or perhaps months will be dealt with, then it is more likely that the Courts will hold that the parties have agreed on the course of action to be taken so that frustration has no role.

Effects of the pandemic which are more serious in nature and which render future performance (for example) 'unthinkable' are more likely to lead to a finding of frustration. Death of a personal contractor, or personal incapacitation for weeks on a time-sensitive project lasting days, might soon be real examples.

What if the contract does *not* deal with the event, but the parties *in fact* foresaw it?

This is really a well-disguised question of contractual construction: on its proper construction, did the parties (who must both have foreseen the event) intend by their silence in the contract that the contract would continue, or that the effect of the event would be subject to the usual legal rules?

Thankfully, it is highly unlikely that this question need be answered in the pandemic context. Even parties foresighted enough to realise that the reports from the far East may mean the virus may spread to the territory for contractual performance may not have foreseen its *effect* so as to be treated as having dealt with it in the agreement.

Self-induced frustration

Most readers will recall from law school that self-induced frustration is a misnomer: the essence of frustration is that it should not be due to the act or election of the party seeking to rely on it: see *The Super Servant Two* [1990] 1 Lloyd's Rep 1 at 8.

This is hopefully not going to arise in the pandemic context, save perhaps for those who deliberately seek to infect themselves. That ought to be unlikely.

The legal effects of frustration

Where a contract has become frustrated, the legal consequences in *most* cases will be governed by the Law Reform (Frustrated Contracts) Act 1943. However, its effect is limited in scope and its applicability should be carefully checked in each case. For example, the applicable law must be *English* law. The definition of 'frustration' at s.1(1) also excludes contracts which were *initially* impossible, and where the effects of the event in question are dealt with by the contract. There are other exceptions, including perishable goods (which are dealt with by the 1979 Act, above).

Where the Act applies

Severable and distinct obligations. Where, properly construed, the contract creates severable and distinct obligations (e.g. first the supply and payment for widget 'A', and then, separately, supply and payment for widget 'B'), then the Act treats them separately. Only those parts which remained partly or wholly executory at the time of the frustrating event will be subject to the Act. Parts

which have been wholly performed by that time (save for any payments of money due) are treated as not having been frustrated. Presumably the money owed remains recoverable as a debt on normal principles. See s.2(4) of the Act.

Contrary intention. If, properly construed, the parties have contracted out of the Act, then the contract will govern the effect of the event in question – and the provisions at s.1 of the Act (see below) will only be applied so as to be consistent with the contractual provisions. See s.2(3) of the Act. The burden of proving such a contractual intention is on the party wishing to rely upon it. The Courts are slow to draw the necessary inference without a clear indication in the express terms: see *BP Exploration Co (Libya) Ltd v Hunt (No.2)* [1979] 1 WLR 783 per Goff J at 829. In the same case, it was said that the Court will be reluctant to allow *implication* of a term to that effect, though the possibility is not excluded.

Care is obviously required: if there is express contracting out of the Act but no other provision in the contract for the frustrating event, the parties may be left with the potentially harsh consequences at *common law* – see below.

How the Act works. The concept underlying the 1943 Act is familiar to those with an interest in unjust enrichment. The Act does not seek to apportion loss, but to ensure as between the parties that none of them is unjustly enriched. The two concepts are different.

Firstly, in respect of money obligations, the overall effect of s.1(2) of the Act is broadly this:

- Sums which have been paid already are recoverable by the payer.
- Sums which fell due for payment before discharge by frustration but which were not paid need no longer be paid.
- Where it is *just*, the Court may allow the *payee* to retain (out of the money otherwise recoverable from him) *or* recover against the *payer* sums for his expenses incurred in or for the purpose of performance of the contract.
- Such retention or recovery, however, is *limited* to the total amount of the money paid and payable before discharge. Thus it cannot exceed the total of the sums which had fallen due from the *payer* before discharge.
- If no money had fallen due at all, then the *payee* cannot recover for his expenses under this section even if he has incurred them.
- What those expenses are is a matter of broad discretion, there being no guidance in the Act as to how to exercise it.

- In particular the Court has rejected notions that the amount was (i) half the loss incurred or (ii) all of the expenditure incurred: see *Gamerco SA v ICM / Fair Warning (Agency) Ltd* [1995] 1 WLR 1226 per Garland J.
- The burden on showing that retention or recovery is appropriate rests with the payee.

Secondly, for non-money obligations, there is a corresponding provision at s.1(3):

- There is a right by a party who has provided a valuable benefit to recovery of the value of that benefit – in old language, *quantum valebat*. This is *distinct* from a claim for loss or damage. Its wording is familiar to lawyers dealing with unjust enrichment: the valuation is of the benefit conferred, not the cost of providing that benefit nor any associated loss.
- However, the recovery is subject to the condition that the amount is that which the Court considers 'just having regard to all the circumstances'.
- Those circumstances *include* (s.1(3)(a)) expenses incurred prior to discharge by the party who has benefitted, *including* any sums paid or payable by him to any other party in pursuance of the contract and retained by that other party.
- Also included is the effect, in relation to the benefit in question, of the circumstances giving rise to the frustration of the contract (s.1(3)(b)).

This second sub-section gives rise to considerable difficulty.

First, what is the benefit? In this context, the benefit must be non-monetary. It will either be the end product of the contract, or the provision of services themselves. Usually it is the former. Examples where the services themselves should be regarded as the benefit to be valued include: where there is no end product (e.g. a transport service, in which case the question is to identify what the receiver has obtained under the contract), and also where the 'end product' has no objective value (e.g. re-decoration of a perfectly acceptably decorated room).

Second, valuation. A small service by an expert may create an end product of great value. Conversely, (in the decorating case above) lengthy and valuable labours may take a long time to generate something of negligible worth.

As above, therefore, it is generally the *end product* which is to be valued.

Where the end product is only partially brought about by the claimant's labours, the Court will apportion appropriately.

The valuation of commodities delivered is likely to be market price, consistently with the law of unjust enrichment: see *Benedetti v Sawaris* [2014] AC 938 at

[15]—[16], and [182]—[183]. That has been held to be the price *'a reasonable person in the defendant's [receiver's] position would have had to pay'*: *Benedetti* at [140]. Where the parties have agreed a higher or lower price for some reason, the position may be otherwise.

Where there is no general market for the benefit, then the price agreed between the parties for that benefit may well be the best evidence of its objective value: *Benedetti* at [168].

Valuation is to be done as at the date of the frustrating event and not trial or any other time: see *BP Exploration*. This is consistent with the law of unjust enrichment, which is the underlying rationale of the Act: see *Goff & Jones: The Law of Unjust Enrichment, 9th Ed.* at 36—04 and *Benedetti* at [18].

Third, deduction of expenses. In *BP Exploration*, Goff J held that expenses are to be deducted from the *value of the benefit*, and not from the "just sum" referred to in s.1(3), although the learned editors of *Chitty on Contract, 33rd edition*, disagree. The writer respectfully agrees with Goff J, though the point is probably still arguable.

Where the Act does not apply

The old common law rules persist where there has been a frustrating event not dealt with by the contract but to which the Act does not apply. In very broad summary they are:

- The contract is discharged forthwith and automatically. There is no power in the Court to allow the contract to continue. Discharge is *prospective* – there is no rescission *ab initio*.
- Money paid could be recovered on the basis of total failure of consideration, notwithstanding there had been no rescission: *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32.
- Where there has been only a *partial* failure of consideration (e.g. a part delivery, with the balance outstanding) it would appear the old common law position in *Chandler v Webster* [1904] 1 KB 493 applies, namely that the loss lies where it fell and pre-payments are unrecoverable.
- The same applies where no money is paid but goods are delivered in advance of payment: they are not recoverable.
- If the price is directly related to the quantity of goods and there are no other benefits provided then, given that the principles to be applied are rooted in unjust enrichment, it may be possible to recover on the *total failure* basis for those items *not yet* delivered: *Giedo van der Garde BV*

& others v Force India Formula One Team Limited [2010] EWHC 2372 (QB). The case repays careful reading: it would seem there must be a direct correlation between quantity and payment, and no other services of value delivered along the way. For reasons of that nature, Mr van der Garde's business did not recover from the defendant.

- Since the discharge is for the future only, parties remained liable on obligations (notably payment obligations) which accrued prior to the frustrating event.

Post-frustration events

Where the relationship of the parties after the frustrating event is governed by a new contract then self-evidently that agreement will govern matters.

Otherwise, since the 1943 Act has no application to benefits conferred after the frustrating event, the party conferring the benefit may be left to a claim in unjust enrichment (perhaps based on free acceptance by the receiver, i.e. conscious choice to accept performance which was non-gratuitous having had an opportunity to reject it) for the value of the services performed. A possible alternative basis for compensation is mistake, which is a whole complex area of its own.

Conclusion

The pandemic creates ample risk of events which are frustration. Death, long-term illness, and closure of premises all have the scope to fall into that category.

However, COVID-19 also has the risk of creating the illusion of frustration where, in truth, none exists – shortage of labour without some kind of prohibition in law, increased cost, and so forth.

It may be expected that a large number of contracts will deal expressly with events akin to this. That is all the more likely given the hoped-for relatively short duration of the crisis. Where the parties have agreed an allocation of risk which, on its proper construction, includes the pandemic, then the contract dictates the outcome.

Where the contract does not so dictate, then the law steps in to discharge the contract automatically. Whether the consequences arise from the 1943 Act or at common law depends on whether the contract falls within the four corners of the Act or not. Care is needed to establish whether the performance under the contract is severable, and whether (properly construed) the contract

excludes the operation of the Act. If it does, but does not otherwise deal with the event in question, then the parties may be left to the common law consequences.

Events happening after frustration occurs, if not subject to a fresh contract, are likely to leave the parties to remedies in unjust enrichment.

There is plainly scope for litigation in this field. The risk in such litigation will often be even higher than usual. That arises from the fact that it is not a well-known area of law, and because the questions of (i) whether *in the particular context of the contract* the pandemic has frustrated the question, and (ii) whether as a matter of law the contract deals with the risk between the parties, are potentially complex.

It follows that, even more so in this field than in general litigation, some form of ADR should be embraced by both sides, particularly in disputes where the sum in issue is significant.

Chris Royle, Enterprise Chambers, April 2020