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COVID-19 and the Law of Frustration

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By Angela Swan

We are flying blind into this storm. The pandemic is certain to affect, and has already affected, all kinds of contractual relations. I think it possible, even probable, that COVID-19 will be held to be an "Act of God" and available to excuse performance of all kinds of contracts, contracts of employment and contracts of sale or supply. That said, the application of Frustration, as an excuse for one or both parties' performance, will depend on the terms and details of each contract involved. The common law test is usefully described by Diplock L.J. in *Hongkong Fir Shipping Co. v. Kawasaki Kisen Kaisha Ltd*., [1961] EWCA Civ 7, [1962] 2 Q.B. 26, at 66, [1962] 1 All E.R. 474, at 485:

The test whether an event has this effect or not has been stated in a number of metaphors all of which I think amount to the same thing: does the occurrence of the event deprive the party who has further undertakings still to perform of substantially the whole benefit which it was the intention of the parties as expressed in the contract that [it] should obtain as the consideration for performing those undertakings?

What's important is that it's the event that provides the excuse, not the cause of the event. In other words, the test is as applicable to a breach by one party as it is to consequences of COVID-19. The phrase, "fundamental breach" is properly applicable to this situation.

First, with respect to deposits or pre-payments, it is likely that an immediate demand for repayment will not be sustainable. A court, even if one could get before one, is likely to say that a deposit, at least at the moment, can't be recovered. Of course, if actual performance under the contract is excused (and not just suspended), the deposit will be immediately recoverable, whether the contract provides for such repayment or not. If the contract does not deal with the return of a deposit or part-payment, any amount paid can be claimed in Restitution.

The more important aspect of Frustration is that it provides an excuse for non-performance. If the contract has a force majeure clause, the terms of the clause will govern. Many such clauses are standard and include a laundry list of events that provide an excuse for non-performance. Such clauses often contain a general excuse for "Acts of God". If a force majeure clause does not offer or list some event that is wholly unexpected and random, there is a risk that a court may say that such an event is not available as an excuse. In other words, by limiting the scope of a force majeure clause, the parties may have excluded the common law. Most such clauses I have seen offer some kind of general peg on which an argument can be hung. In the present circumstances, a court may even be moved to permit a common law frustration, even where there is a force majeure clause.

In the ordinary force majeure clause, a seller or supplier must give notice to the buyer that an event of force majeure has occurred and claim to be discharged from its obligation to perform. This notice excuses the buyer from its obligation to buy but not usually its obligation to pay for what it has already received. A typical clause may go on to say that, after some time, perhaps some months, either party may, by giving, say, not less than one month's notice, bring the relation to an end.

When the contract does not have a force majeure clause, COVID-19 will be a frustrating event will excuse the seller from its obligation to deliver, even as the buyer is similarly excused from its obligation to buy. The law has generally taken the position that obligations to pay money are not excused by frustration. An important and unknown factor is the duration of the present crisis.
All of this being said, I think that it is very important that parties behave in good faith. At a minimum, this obligation means that it will probably be better if both sides are able to act reasonably, in good faith and try hard to find some reasonable compromise. At a minimum, good faith requires the parties talk and try to work out a solution. The worst thing to do would be to act compulsively and unilaterally.

I do not know how this obligation will play out when one side is facing commercial death if some accommodation cannot be found. For all kinds of reasons, including the belief that we shall survive what's hitting us, we simply have to muddle through, trying to avoid, to the extent we can, the unreasonable position. I think that courts are likely to uphold or applaud actions or positions taken that are reasonable, that attempt to find some way out of the mess that is not, "every person for itself and the devil take the hindmost".

The bottom line is that unreasonableness is a very bad tactic now.

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