COVID-19, THE LAW OF FRUSTRATION AND HUMAN GOODWILL

1. The Covid-19 (Corona) virus has impacted on the World Economy more than any event since the Second World War. The effect on businesses from multi-national corporations to small business enterprises may prove as significant as the Great Depression of 1929. Public companies are protecting their balance sheets by cancelling payment of dividends, Pension Institutions are suspending property dealings in their portfolios, High Street corporations seek waiver of rent and business rates, international contracts for supply are cancelled, companies that are highly leveraged are postponing payments or terminating contracts to minimise prospects of insolvency, refunds to consumers are being withheld, government assistance is not open to all, employees are furloughed and many face the prospect of redundancy. Worse still, some families have lost their breadwinner to the virus and the lost chance of income to retirement. The question is; Can businesses or tenants rely on the contractual doctrine of frustration to assert that the Covid-19 Pandemic has ended existing contracts?

2. In respect of leases, sections 81 and Schedule 29 of the Coronavirus Act 2020 offers a temporary protection from eviction for residential tenancies and section 82 provides a moratorium for payment of rent and protection from forfeiture to the 30th June 2020 or such further date as may be specified.

3. The recent case of Canary Wharf (BP4) T1 Limited & ors v European Medicines Agency [2019] EWHC 335 (Ch) (20th February 2019) examined the English law of frustration in detail. In a long (92 pages) but indexed and eminently readable judgment, Mr. Justice Marcus Smith considered the long-term underlease of 25 years without a break clause ("the Lease") commenced in 2014 from Canary Wharf companies ("CW") to the European Medicines Agency ("EMA"). Following the Referendum on 23rd June

2016 and the European Union (Notification of Withdrawal) Act 2017, by letter dated 2nd August 2017 the EMA wrote to CW stating;

> "*Having considered the position under English law, we have decided to inform you that if and when Brexit occurs, we will be treating that event as a frustration of the Lease*."

4. CW issued proceedings seeking a declaration that the withdrawal of the UK from the EU would not cause the Lease to be frustrated and that the EMA would remain bound by the covenants and obligations for the remainder of the 25 year term. The EMA contended that under the Treaty of the European Union ("*TEU*") and Treaty on the Functioning of the European Union ("*TFEU*") the Lease would be frustrated upon the "*actual withdrawal*" of the UK from the EU (paras 7 & 13). The judgment assumed that withdrawal from the EU would, at that time, occur on 29th March 2019.

5. The EMA relied upon five grounds of frustration individually and collectively;

   (1) "Ground 1": The loss, to the EMA, of the protection conferred on it pursuant to Protocol 7 to the Treaty on the European Union ("TEU") and the Treaty on the Functioning of the European Union ("TFEU").

   (2) "Ground 2": The legal inability (on the part of the EMA and any other European Union entity) to use the Premises. The EMA contends that, after the withdrawal of the United Kingdom from the European Union, as a matter of law neither it – nor any other agency of the European Union – can use the Premises.

   (3) "Ground 3": The legal inability on the part of the EMA to make use of the Premises. Ground 3 is a counter-point to Ground 2. In Ground 2, the contention is that neither the EMA nor any other European Union entity could themselves use the Premises. The substance of Ground 3 is that the "EMA will…be unable

safely or legally to make profitable use of the Lease". The Lease contains provisions entitling the EMA to assign or transfer the Lease.

(4) "Ground 4": The future performance of the EMA's obligations under the Lease would be ultra vires and unlawful. Ground 4 is predicated upon the success of one or more of Grounds 1 to 3.

(5) "Ground 5": Future payment of "double rent" would impair the EMA's capacity, effectiveness and independence. Ground 5 is predicated upon the success of one or more of Grounds 1 to 3.

In addition to the Frustrating Grounds, a further point emerged in the EMA's written opening submissions; "Separate Argument: Performance of the Lease would be ultra vires and domestic law must provide a remedy"

6. **English Law of Frustration;** Paragraphs 21 to 46 of Part B of the Judgment reviewed the English doctrine of frustration and the central proposition that the doctrine of frustration operated to bring a contract prospectively to an end because of the effect of a supervening event.

7. In paragraph 22, the Judge referred to Davis Contractors Ltd v. Fareham UDC [1956] 1 AC 696 at 729 where Lord Radcliffe framed the following general test for frustration, which has stood the test of time:

> "… *frustration occurs whenever the law recognises that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract. Non haec in foedera veni. It was not this that I promised to do*."

8. In paragraph 23 the Judge referred to "Another formulation that has stood the test of time is that of Lord Simon in National Carriers Ltd v Panalpina (Northern) Ltd ("the Panalpina") [1981] 1 AC 675 at 700;

> "*Frustration of a contract takes place where 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."

9. In paragraph 28 the Judge then set out five propositions identified by Bingham LJ in J Lauritzen AS v. Wijsmuller BV, The "Super Servant Two" [1990] 1 Lloyd's LR 1 at 8, established by the highest authority, which he considered were not open to question. He set them out substantially quoting from Bingham LJ, but omitting the authorities cited:

> "*(1) The doctrine of frustration was evolved to mitigate the rigour of the common law's insistence on literal performance of absolute promises. The object of the doctrine was to give effect to the demands of justice, to achieve a just and equitable result, to do what is reasonable and fair, as an expedient to escape from injustice where such would result from enforcement of a contract in its literal terms after a significant change in circumstances.*
> *(2) Since the effect of frustration is to kill the contract and discharge the parties from further liability under it, the doctrine must not be lightly invoked and must be kept within very narrow limits.*
> *(3) Frustration brings the contract to an end forthwith, without more and automatically. It does not require an act by the parties to the contract.*
> *(4) The essence of frustration is that it should not be due to the act or election of the party seeking to rely on it.*
> *(5) A frustrating event must take place without blame or fault on the side of the party seeking to rely on it.*"

10. In paragraph 30 the Judge stated

> "CW contended for an approach to the doctrine of frustration which equated "common purpose" with contractual construction. In other words, CW contended for the construction of the contract theory described in paragraph 26(4) above. That, as I have noted, is not the approach that has found most favour since (at least) Panalpina. Moreover, I do not consider that it is an approach that is open to me to take (even if I were inclined to do so). In Edwinton Commercial Corporation v. Tsavliris Russ (Worldwide Salvage and Towage) Ltd, The "Sea Angel" [2007] EWCA CA Civ 547 Rix LJ said this:
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> > *"In my judgment, the application of the doctrine of frustration requires* ***a multi-factorial 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 the 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."* (my emphasis in bold)

11. After review of certain approaches, in paragraph 36, the Judge refers to Treitel, Frustration and Force Majeure, 3rd ed (2014) at 7-001 and the "Coronation Cases" of Krell v Henry [1903] 2 KB 740 and Herne Bay Steam Boat Company v Hutton [1903] 2 KB 683 which arose following the postponement of the coronation of King Edward V11 because of illness of the King. As the Judge states in paragraph 37, "The coronation cases provide a concrete illustration of what does, and what does not, amount to common purpose."

12. At paragraph 37(3), the Judge stated;

> "In the Herne Bay case, the defendant hired a boat from the plaintiff in order to take fare-paying passengers to view the naval review and for a day's cruise around the fleet. The defendant paid a 50l deposit but declined to pay the balance and repudiated the contract on the ground that it had been frustrated when the review was cancelled due to the King's illness. … As the Court of Appeal said, the venture was the defendant's alone, as was the risk of the venture failing. As in the case of the cab driver, the interests and purposes of the parties to the contract were in essence opposed: each, in his own way, was trying to make a profit out of the occasion."

In this Coronation case, the Defendant was bound by the contract as it had not been frustrated.

13. At paragraph 37(4) the Judge stated

> "In Krell v. Henry, the defendant agreed to hire the plaintiff's flat in Pall Mall for 26 and 27 June (days, but not nights). These were the days it had been announced that the Coronation processions would take place and pass along Pall Mall. What the parties were buying and selling was, quite literally, a room with a view. Their common purpose was just that: whilst the parties surely would have been in opposition in bargaining on price, the thing that they were bargaining about was predicated on the procession taking place. Matters would have been very different had the room been a hotel room charging a higher rate because of the higher demand for rooms on that particular day due to the Coronation."

Conversely, in this Coronation case, the Defendant was released from the contract as the "common purpose" of the hiring had been frustrated.

14. At paragraph 38, the Judge summarised;

> "The coronation cases show that where the supervening event causes one party to appreciate – with the benefit of hindsight – that he or she has made a bad bargain, there will be no frustration of a common purpose. If the only effect of the supervening event is to cause the price for the bargain to appear – in hindsight – to be too high, the contract will not be frustrated. (By "price" I should stress that I mean more than simply the consideration agreed to be paid, but all of the terms that go to define the benefit one party to the contract confers on the other.) That was the position both in the case of Vaughan Williams LJ's cab driver and in the facts of the Herne Bay case. In both of those cases, one party paid more due to market conditions that subsequently changed: the passenger paid more because of the high demand due to the races; the defendant in Herne Bay paid more because of the naval review. In each case, were the price bargained for to be adjusted in the light of the new, supervening, market conditions, neither party would be able to complain. That demonstrates that there was, in these cases, no common purpose to be frustrated: one party was simply complaining that he had made what was, in retrospect, a bad bargain. By contract, even if the price paid by the licensee in Krell v. Henry were to be dramatically reduced, the purpose of the contract would still be undermined. In Krell v. Henry, the point of the contract was the purchase and sale of a room with a view: the view never came to pass."

15. Having reviewed the authorities, in paragraph 39 the Judge referred back to the authority of Edwinton Commercial Corporation v. Tsavliris Russ (Worldwide Salvage and Towage) Ltd, The "Sea Angel" and adopts the **multi-factorial approach** emphasising that the doctrine "is one of justice" referring to further passages of the judgment of Rix LJ including at paragraph 112; (my emphasis in bold)

> " … *Ultimately, the application of the test cannot safely be performed without the consequences of the decision, one way or the other, being measured against the demands of justice. Part of that calculation is the consideration that the frustration of a contract may well mean that the allocation of risk is reversed."*

16. At paragraph 41 the Judge considers the categories of frustration relied upon by the EMA: First, Frustration of Common Purpose and, secondly, Subsequent Legal Changes and Supervening Illegality. In the ensuing paragraphs, the Judge considered particular facts concerning the Lease, relevant provisions of the EU Treaties and Protocol 7 in some detail including the fact that the Lease was governed by English Law and contained clauses regarding alienation, assignment and underletting, sharing and sub-

letting parts of the Premises. In paragraph 145 the Judge states that the EMA has the capacity to hold and dispose of property outside the EU. At paragraph 159 he finds that it would not be *ultra vires* for the EMA to pay rent pursuant to the Lease after the withdrawal of the UK from the EU.

17. At paragraph 190 the Judge stated "I have concluded that:

(1) The EMA does not (contrary to its contentions) lack the vires to continue the performance of its obligations under the Lease, and
(2) Even if the EMA did lack the capacity to continue performance by reason of supervening illegality under European Union law, this is not a matter that the English law of frustration will have regard to.

For these reasons, I conclude that this is not a case of frustration by supervening illegality. Assuming that I am wrong on both these points, the question arises as to whether the supervening illegality relied upon by the EMA amounts to circumstances capable of frustrating the Lease."

18. At paragraph 191 the Judge referred to the Court of Appeal decision of London and Northern Estates Company v Schlesinger [1916] 1 KB 20 where, before the outbreak of World War 1, the plaintiffs had let a residential flat to an Austrian subject for 3 years. On war breaking out the defendant became an alien enemy and, by an Order in Council, alien enemies were prohibited from residing within certain areas including the area of the flat. The plaintiffs sought to recover unpaid rent and the defendant contended that the Lease was frustrated. The Court of Appeal rejected his contention and stated;

> "*By the lease, the defendant had a right to personal occupation of the premises, and the right to assign or sub-let them to another person in the absence of any reasonable ground of objection. The latter right was of value and might even enable the defendant to let the premises at a profit to himself, and this right was not affected by the Aliens Restriction Order*."

19. In paragraph 194 the Judge notes the authority of the Panalpina where the House of Lords held that, "*at least in theory, a lease that continued to subsist as a property interest could nevertheless be frustrated.*" In paragraph 195 the Judge summarises the Court of Appeal judgments in London and Northern Estates Company v Schlesinger and states;

"for supervening illegality to frustrate, it must remove all or substantially all of the benefit that one party receives from the contract."

20. In paragraph 208 the Judge concludes;

"I find that the Lease has not been frustrated by reason of supervening illegality:

(1) In the first place, I have found no constraints on the EMA's capacity or vires such as to cause the Lease to be frustrated.

(2) Secondly, even if those constraints on capacity existed, I find them irrelevant to the question of frustration by reason of supervening illegality. For the reasons I have given, even if the EMA was constrained by its capacity from continuing to be able to use the premises or from continuing to perform its obligations under the Lease, such supervening illegality is not a matter that the English law of frustration takes into account.

(3) Thirdly, if I am wrong on these points, this is a case where the legal effects on the EMA of the United Kingdom's withdrawal from the European Union could have been, but were not ameliorated by the European Union. This failure to do so is relevant to the question of frustration and, in my judgment, renders the frustration of the Lease self-induced."

21. In paragraph 244 the Judge stated;

"In this case, I find no common purpose beyond the purpose to be derived from a construction of the Lease. This is not a case like Krell v Henry where the parties had a common purpose going beyond their agreement, which was thwarted. The parties approached the Agreements as counterparties, and they bargained hard – if amicably – to get what they wanted."

22. In paragraph 249 the Judge considered the question of "relative justice" and stated;

*"*It follows that questions of relative justice in the context of a frustrating event do not really arise.*"*

23. **Human Goodwill;** This High Court judgment makes clear that parties to Leases and other commercial contracts, where the contract is governed by the law of England and Wales, are unlikely to succeed in legal proceedings by asserting that the Covid-19 Pandemic is a supervening event that has frustrated and ended their contract unless;

(1) The contract had a defined "common purpose" that can no longer occur as anticipated like the Coronation case of Krell v Henry; or

(2) It can be cogently argued that the Covid-19 Pandemic satisfies the conjunctive test of the Multi-Factorial approach and the Interests of Justice that the Pandemic has effectively ended the contract.

24. However, there already exists a readiness by many Lessors and parties to commercial contracts to acknowledge the economic impact of the Corona virus on business profitability and to refund, postpone or partially waive liability under existing contracts. Commercial reality sometimes dictates that where neither party is at fault and both wish the commercial relationship to continue, a temporary modification to the terms and conditions is negotiated to avoid either or both parties succumbing to the prospect of administration or insolvency where far greater losses would be incurred.

25. **Guarantees, Waiver and Variation in Writing;** Many commercial contracts are supported by Personal Guarantees of a Director or by the board of Directors. Commercial contracts often stipulate that the written terms and conditions of the contract constitute the whole of the contract and that any oral or implied waiver or variation is void and of no effect unless reduced to writing and signed by the parties.

26. It is recommended that any agreed postponement, variation or waiver of a Lease or commercial contract is reduced to writing and be the subject of a formal Variation of the Lease or Contract. Where a co-existing Guarantee is related to the Lease or contract, a Variation of such Guarantee would also be required. Drafting of such Variations will need to incorporate a defined consideration for the agreed Variation that cannot be considered "past consideration."

27. Parties to Leases and Contracts will soon learn the extent of any amity and Human Goodwill in their legal relations.

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