

HOW DOES THE CORONAVIRUS AFFECT YOUR BUSINESS CONTRACTS?

Doctrine of Frustration Explained

As many businesses are affected by the escalating coronavirus pandemic, they need to assess what legal or contractual avenues might be available to them if it becomes impossible to perform their obligations under contracts.

One potential remedy may be contractual *force majeure* provisions, which we discuss in detail in [this guide](#). Another is the *doctrine of frustration*, which may be relevant if the contract contains no force majeure clause, or the force majeure clause is incomplete or vague.

What is the doctrine of frustration?

The doctrine of frustration allows a contract to be terminated when an unforeseen event occurs after the contract has been formed through no fault of the parties, which:

- renders the performance of the contract *impossible*, or
- transforms a contractual obligation into a *fundamentally different obligation*.

In other words, frustration operates to bring a contract to an end in circumstances where the contract performance becomes *impossible or radically different*. To assess this point, all relevant factors must be taken account of, including the contractual terms and the factual background.

Examples of situations where frustration has arisen include:

- A change in the law rendering performance illegal;
- Physical destruction of the subject matter of the contract;
- Restraint by a court injunction;
- The outbreak of war.

A contract will generally not be frustrated if:

- It has an operative force majeure clause that can deal with the relevant issue.
- Performance has become more *onerous or expensive* but not impossible or radically different.
- The change is *temporary or transient*.

One Hong Kong case arising from the SARS epidemic illustrates this issue. In *Li Ching Wing v Xuan Yi Xiong*, a tenant the subject of a 10-day isolation order due to SARS, who was 13 months into a 24-month lease, sought to invoke frustration to discharge a lease to which he was a party. The Court rejected the tenant's argument on the basis that the isolation order was only of relatively short duration in the context of the entire lease.

How legislation impacts the doctrine of frustration?

The doctrine of frustration is a common law concept, i.e. it's been developed by court cases over many years.

However, NSW, Victoria and South Australia have legislation that affects how the doctrine operates.

Each State's regime is different but overall the legislation is designed to provide for a *fairer result*. For instance, the *Frustrated Contracts Act 1976* (NSW) allows for the repayment of money paid before frustration, payment for a new benefit that a party may have received under the contract, and payment of part of all reasonable costs incurred in performing the contract. The Act also gives the court broad discretionary powers to make just and equitable orders in a number of contractual situations.

What happens in the event of frustration?

In the event of frustration, the contract is automatically terminated without any action required by the parties. However, in practical terms, a party claiming that a contract is frustrated would need to notify the other party and explain why it believes so. The other party may choose to dispute this in which case the parties would need to go through the dispute resolution process contained in the contract.

Under the common law (which operates in Tasmania, Queensland, Northern Territory, ACT and Western Australia), where a contract is frustrated all obligations from the point of frustration cease for both sides, including payment obligations and losses lie where they fall. This may result in harsh economic and financial outcomes, and parties may seek recovery in restitution for unjust enrichment (in itself, a complicated legal avenue).

Will the Coronavirus outbreak frustrate your contract?

The key question is whether the COVID-19 outbreak makes the performance of a contract impossible or transforms a contractual obligation into a fundamentally different obligation from that contemplated by the parties. Or whether COVID-19 merely makes the contractual performance more difficult or expensive. The latter will not result in the contract being frustrated.

If COVID-19 caused significant labour force issues (due to quarantine etc) or supply disruptions, it is probably unlikely that this alone will amount to frustration.

Will the Coronavirus outbreak frustrate your leases?

In the context of leases, while frustration could technically apply to a lease (like any other contract), this is likely to be very difficult to argue in practice. In the lease context, frustration generally occurs where the property is destroyed (provided through no fault of the parties and there is no provision to deal with this in the lease), where the property becomes uninhabitable, where the use of the property becomes unlawful, or the property is compulsorily acquired.

If a business merely follows the government guidelines and requires its employees to work from home (even if such guidelines become mandatory), frustration is unlikely to apply. If there is a mandatory and prolonged closure (for example, this may happen to pubs and licensed venues), there could be a possible argument for frustration but this is a somewhat uncharted legal territory.

How does the doctrine of frustration interact with a force majeure clause?

If there is a force majeure clause in the contract, it *may oust* the operation of the doctrine of frustration, as the force majeure clause may demonstrate that the parties have already considered how to deal with unforeseeable events like an epidemic. However, if the force majeure clause is not full, complete or specific enough (for example, there is room for debate on whether it covers the event in question), it may still be possible to invoke frustration.

For new contracts, we would recommend including COVID-19 as an express ground in a force majeure clause (as discussed previously in [this guide](#)) or extension of time clause (or both) as the doctrine of frustration is unlikely to be of assistance for new contracts since COVID-19 is now the reality (and hence, foreseeable at the time of the contract).

Should you argue frustration?

The key practical question is whether and when you should argue frustration.

As can be seen from the above, the doctrine of frustration is challenging to establish. There is also a risk in incorrectly alleging frustration because if the other party disagrees that the contract has been frustrated, it could consider the party alleging frustration to be in a serious breach of contract by 'refusing' to continue with the contract and sue for its losses.

Even more importantly, if the parties want to continue working together in the future, good communication and understanding on both sides will be required. Perhaps, a small silver lining in the current situation is that the government, businesses and community are working together to overcome this unprecedented situation. Businesses focus on working collaboratively and openly together instead of resorting to difficult and expensive legal battles.



Need help?

We are always happy to help with advising on your contracts. Contact [Stanislav Roth](#) if your business needs assistance.

Check out other COVID-19 Employer Response resources on the Source website:
<https://www.sourcelegal.com.au/covid-19-response/>