

## ***The Doctrine of Frustration and Force Majeure***

***The COVID-19 pandemic is a global and unprecedented event in modern times. Application of the doctrine of frustration to situations arising from it are untested. This Guidance Note, written by the LexisNexis team, is intended as a review of the fundamentals of the doctrine and a reflection on potential application of the doctrine of frustration to matters arising from the COVID-19 pandemic.***

***For further discussion of this topic and links to underlying case law see [Laws of New Zealand>Contract>\(34\)Part XIII Doctrine of Frustration](#)***

The global COVID-19 pandemic and New Zealand's Alert Level 4 lockdown have placed heavy restrictions on the operation of all but essential businesses, as well as on travel, both international and domestic. Parties who entered into contracts prior to the escalation of the crisis may be left unable to perform their obligations the way originally contemplated by the parties, if at all.

Coupled with challenging economic times, it is likely that there will be an increase in clients querying their ability to cancel or vary contracts entered into prior to the implementation of COVID-19 restrictions.

While some contracts will include provisions that contemplate circumstances where parties are unable to perform their obligations through no fault of their own (see *Force Majeure* below), many will not. In these circumstances, the doctrine of frustration will apply.

The doctrine of frustration applies where unforeseen events occur which render performance of a contract impossible or only possible in a radically different way from that originally contemplated.

### **Application of the Doctrine**

The effects of frustration on a contract are dealt with in Part 2, Subpart 4 of the [Contract and Commercial Law Act 2017](#), but what constitutes frustration and where the doctrine applies is not defined.

As a general rule, the doctrine operates to discharge the contract where:

- it appears from the nature of the contract and the surrounding circumstances that the parties have contracted on the basis that some fundamental thing or state of things will continue to exist, or that some particular person will continue to be available, or that some future event which forms the basis of the contract will take place; and
- an event in relation to this underlying basis of the contract renders performance impossible or only possible in a very different way from that contemplated, but without default of either party.

The party seeking to apply the doctrine needs to show that there has been a failure at the heart of the contract and that the relationship contemplated by the parties is fundamentally altered by events outside their control. It is not enough to demonstrate that the party has been deprived of some benefit or that the changed circumstances will create hardship or inconvenience.

In the context of COVID-19, questions to consider are:

- Is performance simply delayed for the duration of the Level 4 lockdown?
- Are parties able to resume the contracted relationship in substantially the same manner once lockdown is eased?
- Can the parties find an alternative means of carrying out the obligations in the contract?

### **Self-Induced Frustration**

The doctrine cannot be invoked for events which the parties are responsible for. If the other party to a contract wishes to enforce the contract, the burden of proof rests with them to demonstrate that the frustrating event being relied on was self-induced.

Questions to consider here may include whether the frustrating event being relied on was as a result of a specific government mandate, or whether it is the result of taking discretionary or precautionary action in response to the COVID-19 crisis. The essence of frustration is that it should not be due to the act *or election* of the parties.

It is possible that taking recommended best practice or cautionary action prior to the official Level 4 deadline of midnight Wednesday 25<sup>th</sup> March 2020 (such as closing premises or ceasing travel) will be deemed self-induced, though this would need to be borne out in the courts.

## Examples of Frustration

The doctrine of frustration applies to all types of contracts and has been successfully applied in cases involving, for example, contracts for:

- employment;
- building contracts;
- charter parties;
- carriage of goods;
- sale of goods;
- leases of land; and
- sale of land.

Application of the doctrine to contracts for Sale and Purchase, or Lease of Land is rare as often risk is allocated in the terms of the agreement.

While the effects of a global pandemic do not specifically feature in previous case law, it may still be possible to draw some inferences from the existing body of cases about how the doctrine may apply to the effects of COVID-19.

For further reading on the below examples and for all case references see [Laws of New Zealand>Contract>\(34\)Part XIII Doctrine of Frustration>370.Examples of Frustration](#)

### Cancellation of an expected event

The doctrine has been successfully applied to the cancellation of expected events (e.g. *Krell v Henry* [1903] 2 KB 740). Many events, large and small, have been cancelled or postponed as a result of the COVID-19 pandemic and it may be possible to apply the doctrine if risk was not adequately addressed in the contract.

To apply to contracts of this type, the event in question taking place must be the basis of the contract.

You may wish to consider questions such as:

- Has the event been cancelled or simply postponed? Many events have been rescheduled or a decision around new dates deferred until the duration of the COVID-19 restrictions is better understood.
- Does the timing of the original event play a fundamental role in the contract or can it be performed at any time with substantially the same outcome?
- Was the event cancelled because of a specific Government mandate (e.g. Level 4 lockdown or earlier prohibitions on gatherings of a certain size) or was it as a precautionary measure?
- Was the cancellation for some other reason (e.g. withdrawal of delegates or key sponsors)?

### Delay

Frustration very commonly arises through delay.

The delay must not be the fault of either party and must be so severe as to render what would eventually be delivered or performed to be fundamentally different to what was contemplated in the contract.

Uncertainty around the duration of a delay may not be enough constitute frustration. While specific COVID-19 circumstance may be unprecedented, parallels can be drawn with the treatment of contracts affected by the declaration of war. The uncertain duration of a war and any resulting delay will not necessarily be sufficient to frustrate a contract by itself.

Whether COVID-19 related delays are sufficient to apply the doctrine will depend on the duration of the mandatory restrictions of movement/operation of businesses and the particular circumstances of each contract.

See [Finelvet AG v Vinava Shipping Co Ltd \[1983\] 1 WLR 1469; \[1983\] 2 All ER 658](#).

### **Subsequent Legal Changes**

If there is a law change after a contract is entered into which renders performance of the contract impossible then the contract can be cancelled under the doctrine. This applies unless the legislation in question includes, for example, transitional provisions excluding its application to pre-existing contracts.

There are some limited circumstances where parties may expressly bind themselves to future law changes, but the presumption is that the parties intend to operate only under laws in force at the time the contract is made.

Law changes in this context include:

- Acts of Parliament;
- delegated legislation;
- exercise of statutory powers;
- act of State (e.g. declaration of war); and
- law change in another jurisdiction rendering performance illegal (where the contract requires performance in that jurisdiction).

With a raft of emergency legislation and emergency powers being utilised in the response to COVID-19, consideration should be given to whether any of these powers have the effect of rendering performance illegal. Many of the current powers are temporary and the effect of delay, discussed above, should also be factored in.

### **Death or Incapacity**

When a contract is for personal services which can only be performed by the parties, death or incapacity (physical or mental) of a party will generally discharge the contract, unless the contract expressly states otherwise.

The death of one of the parties does not affect a right of action which vested under the contract before the death of that party.

### **Where the doctrine does not apply**

Many businesses are facing reduced turnover and other challenges as a result of COVID-19, and there is significant volatility in the markets. However, hardship and inconvenience are not sufficient grounds for frustration by themselves.

A contract is not discharged under the doctrine merely because it turns out to be more difficult to perform or more onerous than anticipated.

Parties will not typically be released from their obligations (unless expressly agreed) solely on the basis of:

- a party's solvency or ability to obtain finance;
- price fluctuations;
- currency depreciation;
- obstacles affecting execution of contracts;
- inflation; or
- failure of a third party to perform an obligation under a separate contract.

These are considered to be ordinary risks of conducting business.

### **The element of surprise**

Much of the doctrine is based on the interfering event being totally unforeseen and unexpected. However, the doctrine may still apply where the parties foresaw, or ought to have foreseen, the frustrating event.

Where the parties have foreseen and make provision of the potential of the event in the contract, the doctrine will typically not apply. It may also be held that in failing to account for a foreseeable event, the parties have impliedly assumed the risk of that event. This will all depend on the facts of each case.

## **Force Majeure**

Many contracts contain express provision stating that performance will be excused if rendered impossible by unavoidable causes such as act of God, the Queen's enemies, or vis major, or force majeure.

Clauses of this type (often called generically force majeure clauses) are effective if they are drafted precisely and unambiguously. For sample wording see: [Practical Guidance Business Law - Boilerplate Clauses](#)

Whether the outbreak of COVID-19 constitutes a force majeure event will depend on the wording of the force majeure clause in question. In the absence of reference to a disease or pandemic in the clause, general terms such as "act of God" or "government restrictions" may apply (see *acts of God* below). Determining this will require careful consideration of the contract and surrounding circumstances.

Determining whether the pandemic crisis has prevented, hindered or delayed performance of the contract will also depend on the specific facts and terms of contract. Often force majeure clauses will require that performance is rendered legally or physically impossible, however some clauses have a lesser standard.

### **Acts of God**

The term "act of God" is a common legal term meaning an extraordinary occurrence or circumstance which could not have been foreseen or guarded against.

It is not necessary that the event has never happened before, only that it is extraordinary and could not reasonably be anticipated. To be an "act of God", and not merely an accidental circumstance, the effect must be wide reaching and overwhelming.

Some examples of what have been construed as Acts of God include:

- violent storms;
- extraordinarily high tide;
- unprecedented rainfall;
- fire caused by lightning;
- earthquake; and
- extraordinary snowfall.

The common theme being that the event is sudden or more severe than previous instances of the same event. A regular snowfall or fire is unlikely to be treated as an Act of God.