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It's not about COVID - Force Majeure and Frustration

By Erin Priest, Associate
and Michael Byrom, Head of Property Services

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Most jurisdictions have laws that assist when supervening events occur and most commercial contracts seek to allocate risk and establish rights and obligations in the case of events beyond a party's control. English law and civil law jurisdictions have developed legal principles relevant to what we know as "frustration" and "force majeure".

This article discusses these principles in the Australian context (and other Asia Pacific jurisdictions) that have now seen further light because of the COVID-19 pandemic.

Force Majeure

The term "force majeure" originates from French civil law. Under common law (in countries like Australia) there is no doctrine of force majeure. Instead, force majeure clauses are drafted into contracts to cover times where a party may find itself unable to perform the contract terms due to events outside of its control and excuse that party from performing its obligations on time. This is usually confined to matters such as "Act of God", riot, war, storm, flood, explosion and similar events matters.

Commercial contracts often outline the rights and remedies of the parties when a force majeure event occurs and a party may be able to rely on the clause to justify a delay, temporarily suspend performance or terminate the contract.

The ultimate effect of a force majeure clause comes down to its drafting. First, there needs to be a concise definition of the force majeure events. Secondly, there needs to be an operative clause setting out the obligations of the parties if a force majeure event occurs.

To rely on a force majeure clause for relief, a causal connection between the event and the effect on performance must exist. The effect on performance

cannot be due to the conduct of the party seeking protection by way of the clause.

The agreement should include terms for the type of relief to be afforded to a party, for example, relief from liability for failure to perform on time (or at all) or relief against the effect of delay, by allowing an extension of time. The agreement should include an obligation on the affected party to give prompt notice to the other party. This allows the other party to make a determination about whether the force majeure provision ought be applied. A party giving notice will then ordinarily take steps to mitigate the effects of the force majeure event on its ability to perform the contract. The clause should generally only suspend performance of the obligation until the event has passed. However the right to terminate by either needs to be considered if the force majeure event is elongated. That depends on the likely impacts the force majeure event will have on the parties and any consequential issues such as third party contracts that depend on the successful performance of the agreement under force majeure.

Force majeure clauses are not used in land contracts in Australia, but these contracts do often contain sunset provisions, with the States or Territories sometimes regulating the length and operation of those provisions.

Frustration

In the absence of a force majeure provision, the parties may turn attention to the common law doctrine of frustration which operates to set aside obligations under a contract where a party or both parties are unable to perform those obligations due to an unforeseen event.

Here, the contract is held to automatically terminate from the point of frustration. Generally, frustration does not contemplate a pause in the performance of obligations. Under frustration, a party's future obligations under the contract can no longer be enforced. Performance of obligations arising before frustration still operate, but not after.

Frustration results in the whole commercial venture embodied in the contract to be discharged in full because of the frustrating event. It should be noted that the threshold for frustration is high, as established in *Planet Kids Ltd v. Auckland Council* [2013] NZSC 147. It is not the question of an election by the parties, but occurs automatically by operation of the law and brings the contract to an end at the time of the frustrating event.

There is a further qualification to the "all or nothing effect of frustration". At common law, where a contract contains several parts, each of which provide for one party's performance and the other party's corresponding payment for that performance, it may be possible for one of those stand-alone parts to be frustrated although the balance of the contract remains valid and enforceable.

The doctrine of frustration will not apply in circumstances where an event was foreseeable or foreseen at the time of entry into the contract.

In *Ooh! Media Roadside Pty Ltd v Diamond Wheels Pty Ltd* (2011) 32 VR 255 the applicant had billboard advertising on the side of a building in Melbourne. A new building commenced construction next door, permanently blocking visibility of the billboard. There was a clause in the licence agreement which allowed the licensee to terminate the agreement if "the Site becomes unsuitable for the Permitted use for any reason outside the reasonable control of the Licensee...". The Permitted use includes "use of the Site for the display of advertising and promotional material." In Nettle JA's view, the construction of another building was a foreseeable risk which should have been dealt with in the agreement. Therefore the agreement had not been frustrated and the lack of express clause dealing with the event meant the loss fell on the licensee.

The doctrine of frustration is only applied in exceptional circumstances where an external event has rendered further performance so radically different or fundamentally different from that originally contemplated.

In *Alliance Concrete Singapore Pte Ltd v Sato Kogyo (S) Pte Ltd* [2014] SGCA 35 (Singapore) the court at first instance considered whether a ban from importing sand from Indonesia, which was needed to produce the product the subject of the contract, was a supervening event rendering the contracts frustrated. The court at first instance decided the contracts had not been frustrated because it was not a term of the contracts that the sand had to come from Indonesia; it may have been sourced from other countries. There was a higher price involved, but that was the risk the applicant took in entering into a fixed price agreement.

The Court of Appeal overturned this decision, holding that the contracts had in fact been frustrated. The court was convinced on the facts that both parties contemplated the use of Indonesian sand, even though it was not expressed so in the contracts. The "sand ban" was determined to be a supervening event not within the parties' reasonable control.

Legislation

Victorian, New South Wales and South Australian legislation deals with frustration of contracts and regulates some types of restitutionary claims a party may be entitled to: Australian Consumer Law and Fair Trading Act 2012 (Vic), Frustrated Contracts Act 1988 (SA) and Frustrated Contracts Act 1978 (NSW).

The above Acts provide for an adjustment between the parties so that no party is unfairly advantaged or disadvantaged in consequence of the frustration.

If you want to discuss any property matters, please contact:

Michael Byrom | Head of Property Services
D (07) 3223 9109
E michael.byrom@brhlawyers.com.au

Erin Priest | Associate
D (07) 3223 9121
E erin.priest@brhlawyers.com.au