
The Legality of Doctrine of Frustration in the Realm of Covid-19 Pandemic

Sheela Jayabalan
Faculty of Law, Universiti Teknologi Mara, Shah Alam, Selangor-Malaysia
sheelaj.balan@gmail.com

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Abstract

The outbreak of the novel coronavirus (“COVID-19-Outbreak”) has a potential impact in the performance of a contract. If a contract does not contain a force majeure clause, a contracting party may look to the common law doctrine of frustration to relieve it from its obligations. Unlike force majeure clauses which focuses on the parties' express intention on how to deal with supervening events, frustration is implied by law and thus would only be considered in the absence of an express force majeure clause. In Malaysia, the doctrine of frustration is codified in section 57(2) of the Contracts Act 1957. A doctrinal analogy of the doctrine of frustration and section 57 of the Contracts Act 1950 indicates a pandemic such as the covid-19 would not frustrate a contract. Force majeure clause should be used as a protective tool to prevent losses to the contracting parties or alternatively the Principles of European Contract Law and the Unidroit Principles that make provisions for hardship as well as force majeure should be implemented.

Keywords: Frustration; Pandemic; Contract

I. INTRODUCTION

There are four ways by which the rights and obligations of the parties to a contract may come to an end, namely performance, agreement, frustration, and breach (Jayabalan, 2015). The doctrine of frustration however was in the limelight specifically in the very recent Covid-19 pandemic which brought most parts of the world to a lockdown situation as a measure to contain the deadly Covid-19 pandemic. The pandemic did not only claim many lives, but also affected the livelihood of many. The economy of the countries world over came to a standstill. As people are healing in very aspect from the impact of the covid-19 pandemic, a scrutiny of the laws also is being reviewed and evaluated as to its applications and limitations. Contract law doctrines such as the doctrine of frustration and force majeure clause was brought to the limelight because the disease and the movement control order (MCO) profoundly impacted many businesses and their underlying contractual relationships (Ogwu, 2020). For example Government directions, regulations, laws imposed prohibitions or restrictions on certain events such as travel prohibition; non-occurrence or cancellation of an activity or event which forms the basis of the contract for example functions, conferences or concerts; undue delay which renders the delayed performance commercially or fundamentally different from that contemplated in the contract for example construction projects. If a contract does not contain a force majeure clause, a contracting party may look to the common law doctrine of frustration to relieve them from their obligations. Unlike force majeure clauses which focuses on the parties' express intention on how to deal with supervening events, frustration is implied by law and thus would only be considered in the absence of an express force majeure clause. In Malaysia the doctrine of frustration is recognized in section 57 (2) of the Contracts Act 1950 which states that: “a contract to do an act which, after the contract is made, becomes impossible, or by reason of some event (which the promisor could not prevent), becomes unlawful, shall be considered to be void when the act becomes impossible or unlawful.” The circumstances under which frustration can be invoked are narrow, it is unlikely that there will be situations arising from Covid-19 that can lead to frustration of contracts. This depends on the individual circumstances of each case

including how seriously Covid-19 affected performance. This article discourses why the doctrine of frustration in the purview of section 57(2) of the Contracts Act 1950 is narrow and limited in its application. The common law doctrine of frustration will also be scrutinized because even though the law on frustration derives from a statute, the Courts' interpretation of the doctrine is similar in spirit to the English common law doctrine of frustration (Mohan, Murugavelu, Ray, & Parakh, 2020). The author encourages the use of force majeure clause to enable parties to allocate risk by making express provisions for what should happen to their bargain upon the occurrence of certain events such as Covid-19. Force majeure clause allows contracting parties the freedom and flexibility to specify a wide range of events, and to agree to relief that is tailored to their specific circumstances. Apart from the use of force majeure clause, the covid-19 pandemic necessitates a review of the Contracts Act 1950 to adapt Principles of European Contract Law and Principles of International Commercial Contracts, 1994, (UNIDROIT) which make provision for hardship as well as force majeure.

II. METHOD

Adapting a doctrinal analysis, firstly the historical synopsis of the doctrine of frustration is analyzed to reveal that the doctrine which is a Roman law originate is archaic and outdated. Secondly, the doctrine of frustration as in the Contracts Act 1950 is scrutinized to reflect the limitation of the doctrine in applying to a pandemic situation. Thirdly, proposals for reform are suggested benchmarking the Principles of European Contract Law and the UNIDROIT Principles that make provisions for hardship as well as force majeure.

III. RESULTS AND DISCUSSION

Historical Background Of The Doctrine Of Frustration

The doctrine of frustration originates from the Roman contract law. The doctrine was developed to extinguish obligations of innocent parties where the “thing is destroyed without the debtor’s act or default”, and the contract purpose has “ceased to be attainable” (Kiley, 1960). The doctrine was applied in situations such as where a slave dies before delivery date, a horse dies before it is delivered, or a painter or author of a book dies before completion of the painting or writing a book”(Kiley, 1960). The doctrine which originates from Roman law was first applied in England before it made its way to the United States of America. In England, the original rule undertook a strict approach to non-performance of a contractual obligation. A party who fails to perform his contractual obligations, for whatever reasons, is prima facie in breach of contract. As Professor Simpson has pointed out (‘Innovation in Nineteenth Century Contract Law’ (1975) 91 LQR 247, 270): “In pre-nineteenth century law general rule was that a change of circumstances after a promise was made did not excuse the promisor from performance, even if it made performance impossible; this view came to be known as the rule in *Paradine v Jane* (1647) or the rule as to absolute contracts. *Paradine v Jane* did not however deal with Acts of god, but with an Act of the Kings enemies and there remained some scope for the development of a defense of supervening impossibility through act of God and this was allowed where death, the most dramatic act of God, intervened.” The law has moved on from the strict approach taken in *Paradine v Jane*. The decisive case is generally considered to be the decision in *Taylor v Caldwell* (1863) 3 B & S 826. A more liberal approach was developed in cases such as *Jackson v Union Marine Insurance Co Ltd* (1874) LR 10 CP 125 and *Krell v Henry* (1903) 2 KB 740. While it is true to say that the doctrine of frustration is more liberal than the common law rule to be found in *Paradine v Jane*, it is important to stress that the doctrine continues to operate within very narrow limit. Twentieth century cases such as *Davis Contractors Ltd v Fareham Urban District Council* (1956) AC 696, *National Carriers Ltd v Panalpina (Northern) Ltd* (1981) AC 675. demonstrate a restrictive approach to the scope of the doctrine of frustration. While it is broader than the original common law rule, it remains a very narrow doctrine. The notion of the doctrine of frustration seems to be more suited in the Roman times to relieve contracting parties from the harshness of the doctrine of freedom of contract. The notion of this doctrine is predominantly, the exercise of freedom of contract between equal parties in markets of perfect competition is the key to individual welfare and the common good (Edwards, 2009). Freedom of contract is defined as the power to decide whether to contract and to establish the terms of the bargain. Which is why, the pre-nineteenth century contract law was that a change of circumstances after a

promise was made did not excuse the promisor from performance. To devoid the adversity of the strict approach rooted to the freedom of contract, the doctrine of frustration was developed to overcome the harshness of the freedom which can be adverse and unfair to the contracting parties. At the current era, the viability of the doctrine is debated because, it is stated that, “the doctrine of frustration is not likely to be needed by anyone except a party whose contract was unwisely made or inadequately drafted. The rejection means that careful thought in the making and drafting of a contract continues to be necessary (Anderson, 1953),” which is the current norm and practice in commerce or alternatively it should be formidable if Principles of European Contract Law and the UNIDROIT Principles that make provisions for hardship as well as force majeure be implemented.

Sec 57(2) Of The Contracts Act 1950

The common law doctrine of frustration was entrenched in the Malaysian legal system i.e. contract law as Malaysia was under the British rule. However, unlike in England, the doctrine of frustration is codified in the Contracts Act 1950, though the interpretation of the doctrine still refers to the common law position. In Malaysia the Doctrine of frustration is dealt with under Section 57(2) of Contracts Act 1950 as ‘a contract to do an act which, after the contract is made, becomes impossible, or by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful’. Essentially, there are 2 instances of frustration, namely, when a contract becomes impossible or when a contract becomes unlawful after the contract is made. The scope of Section 57 concerns 3 elements, namely:

1. the frustrating event must have not been provided in any provisions of the contract between the parties. Otherwise, the contract applies.
2. the frustrating event is not self-induced; and
3. the frustrating event has changed the circumstances to make the performance of the contract radically different from that originally undertaken. The court must find it practically unjust to enforce the original promise.

The test applicable to determine whether an event is a frustrating event within the ambit of Section 57 is the radical change in the obligation test. The test indicates that frustration of a contract will occur where there is a radical or fundamental change in circumstances which renders the performance of the contract to be legally and physically impossible. The change in the circumstances must be more than merely onerous or more expensive, it must be positively unjust to hold the parties to their bargain. The basis of Doctrine of Frustration are;

1. The implied term theory

This was introduced by the case of *Taylor v Caldwell* (1863) 122 ER 309 where the court read an implied term into the contract that had the parties anticipated and considered the event that in fact happened the contract would end. In *Taylor v Caldwell* the parties had entered into an agreement concerning the use of the Surrey Gardens & Music Hall for a series of concerts. 6 days before the planned date for the first concert, the building was burnt down, making it impossible for the concerts to go ahead. The party planning to put on the concerts was sued for breach of contract, but the action failed because performance was impossible. The Judge held that the continued existence of the music hall was essential to the performance of the contract and the parties contracted on this basis. Although there was no express provision to his effect, the court implied one as a matter of construction.

2. The theory of a just and reasonable solution

The implied term theory has been replaced by the theory that the court imposes upon the parties the just and reasonable solution that the new solution (Change of event) demands. In other words the court is imposing a fair solution in the event of foreseen circumstances rather than giving effect to the presumed contractual intention of implied term of the parties; *Denny Mott & Dickson Ltd v. James Fraser & Co. Ltd* (1944) AC 265. Rationale behind the Doctrine of Frustration; If the performance of a contract becomes impossible because of a change of events which makes the contract impossible or illegal to perform then the parties should be discharged from the promises. In other words, if the event is beyond the control of the parties and radically changes the circumstances contemplated by them. This was explained by the House of Lords in *Davis Contractor Ltd v Fareham UDC* (1956) AC 696 as

follows: -

“Frustration occurs whenever the law recognizes 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”.

Malaysian courts have followed the principle laid down in *Davis Contractors Ltd v Fareham UDC* despite the statutory provision pertaining to the Doctrine of Frustration in the Contracts Act; section 57 (2). The Federal Court in *Ramli bin Zakaria v Govt of Malaysia* (1982) 2 MLJ 257 states that s 57(2) embodies in substance the English law of frustration and adopted the test laid down in *Davis Contractors Ltd v Fareham UDC*.

In *Ramli Bin Zakaria v Govt of Malaysia*, the Federal Court held that an agreement which provides for a salary scale was not frustrated merely because a new salary scale was implemented to abolish the old scale. Abdul Haniff J agreed with the principle laid down in Davis case although he found that the changes circumstances in the case did not render a fundamental or radical change of the original obligation. His approach was followed by Lim Beng Choon J. in *Standard Chartered Bank v Kuala Lumpur Landmark Sdn Bhd* (1991) 2 MLJ 251 and in the case of *Dato Yap Peng v Public Bank Bhd* (1997) 3 MLJ 484

Though section 57(2) does not lay down the circumstances of when a contract is discharged by frustration nor the limitations to frustration i.e. circumstances when a contract is not frustrated, case analysis provides respective instances. **The Doctrine of Frustration or Subsequent Impossibility applies in the following circumstances:**

- Destruction of Subject Matter; The classic example is provided in *Taylor v Caldwell*. In *Gamerco SA v IMC/Fair warning (Agency) Ltd* (1995) 1 WLR 1226 football stadium to stage pop group concert declared unsafe, concert banned. Court held contract is frustrated.

Malaysian cases; See *Chiang Hong Pte Ltd v Lim Poh Neo* (1984) 1 MLJ 338. In *Berney v. vTronoh Mines Ltd* (1949) MLJ 4, a contract of employment was discharged by frustration on the outbreak of war when Japan invaded Malaysia. In that case the defendants European staff members were evacuated but plaintiff elected to remain and sued defendant for breach of contract.

- Death or personal incapacity; Where the contract is for some personal service to be rendered by a party to the contract, death or incapacity (illness) of that party will discharge the contract. In *Robinson v Davison* (1871) LR 6Ex 269 a concert was held to be frustrated when a person who had been engaged to play the piano at a concert, on a particular day, was unable to do so because of illness.

Also in *Notcutt v Universal Equipment Co. (London) Ltd* (1986) 1 WLR 641 a contract of employment was brought to an end under the doctrine, as a result of the employee’s chronic illness and his inability ever again to perform his contractual obligations.

- Illegality: A contract may be legal when formed but later owing to a change in the law, its performance may become unlawful. This is often described as “supervening illegality”.

E.g. A contract for the sale of certain goods will be discharged if after it had been made, a new law prohibits all dealings in such type of goods and governmental interference strikes at the root of the contract. In *Metropolitan Water Board v Dick Kerr & Co. Ltd* (1918) AC 119, H.L. the respondent in 1914 agreed to construct for the appellants a reservoir within 6 years. In February 1916, the Minister of Munitions ordered the respondent to stop work and to disperse and sell the plant. House of Lords held that the interruption by the statutory prohibition was of such a character and duration as to make the contract. If resume, in effect a radically different contract. Malaysian cases: In *Lee Kin v Chan Suan Eng* (1933) MLJ 197, a lease for 5 yearly renewals was held to be frustrated by the enactment of a new law prescribing annual renewals.

- Outbreak of war: A declaration of war would generally frustrate all contracts with enemy aliens (enemy countries).

In the leading case of *Fibrosa SA v Fairbain* (1943) AC 32 (commonly known as Fibrosa case) a contract for the sale of machinery which was to be shipped to Poland was frustrated because the port

was occupied by the enemy.

- The supervening event defeats the whole purpose or object of the contract; Something may happen after the contract is made which although it is still physically possible to perform the contract makes the performance radically different from what the parties had in mind. In such a case the contract may be treated as frustrated. For example, in **Krell v Henry** (1903) 2 KB 740 a room was hired for the sole purpose of watching the coronation procession of King Edward VII but owing to the King's illness, the procession was cancelled. It was held that Hendry could be excused from paying rent for the room as the contract was frustrated (although it was physically possible to sit in the room, the foundation of the contract had been taken away)

Krell v Henry is often contrasted with **Herne Bay Steam Boat Co v Hutton** (1903) 2 KB 683, another case arising from the cancellation of the coronation of King Edward VII.

In **Herne Bay Steam Boat Co. v Hutton**, the defendant hired a boat from the plaintiff "for the purpose of watching the Naval Review and a day's cruise round the fleet". Because of the King's illness, the Review was cancelled but the fleet was assembled. Court of Appeal held that the contract was not discharged because the holding of the Review as not the sole basis (or foundation) of the contract. To sail round the fleet which was an equally basis object of the contract was still possible.

Instances where a contract is not frustrated

- Where performance is rendered more difficult, more expensive or delayed. In **Davis Contractors Ltd v Fareham Urban District Council** (1956) the plaintiff agreed to build 78 houses for the defendants in 8 months for a fixed sum. Due to a shortage of labour and materials the work took 22 months to complete and cost plaintiff approximately £18,000 more than they had estimated. The Plaintiff claimed that the contract was frustrated so that they could ignore the contract price and claim the actual cost on a quantum meruit basis. The House of Lords held that the contract had not been frustrated. The parties had for a specific number of houses which had now been built as agreed. There was no change in the basic obligation under the contract. Mere hardship or inconvenience to one of the contracting parties was not enough to frustrate a contract. Given the uncertainty in the supply of materials and labour at that time the contractors (plaintiff) could have made some express stipulation about this in the contract but they did not.
- Where performance does not become impossible. For example, in **Tsakiroglou & Co. Ltd v Noble Thorl GmbH** (1962) AC 93, the House of Lords held that the closing of the Suez canal did not frustrate a contract to take a cargo of groundnuts from Port Sudan to Hamburg as it could have gone around the Cape of Good Hope. Such a journey would not be commercially or fundamentally different but merely more expensive.
- Interruption in performance is not substantial; In **National Carriers Ltd v Panalpina (Nothem) Ltd** 1 AER 161, Appellant had a 10-year lease of a warehouse from respondents. After 5 ½ years of the lease, the local authority closed the only access road to the warehouse for a period of 18 months.

Self-Induced frustration: The doctrine of frustration only applies if the frustrating event happens without the fault of either party. If a party by his own action makes performances of the contract impossible, he cannot claim that the contract is frustrated. In **Maritime National Fish Ltd v Ocean Travelers Ltd** (1935) AC 524, the charterers (appellants) hired a ship from the owners (respondents) which both parties knew needed a licence from the Canadian Government. The charterers had 4 of their own ships and they applied for 5 licences, they were only granted 3 licences and used these for their own ships, they had claimed that the charter was frustrated. It was held by the Privy Council that it was their own choice not to use a licence for the chartered ship and therefore they could not claim frustration.

The Federal Court in **Ramli Bin Zakaria & Ors v Govt of Malaysia** (1982) accepted the view that a self-induced frustration does not discharge a party of his contractual obligations.

- When supervening event is foreseen and provisions are made for it; The doctrine of frustration does not generally apply to situations where the supervening event was foreseen or foreseeable. It is assumed that the parties contracted in accordance with that risk. For example, in **Davis Contractors Ltd v Fareham UDC** [1956] A.C.696, the House of Lords said that the risk of increased costs due to various shortages was clearly foreseen by the company. It must therefore be assumed that it

accepted the risk at the time of contracting the possibility of getting enough labour and materials could have been the subject of contractual stipulation, but it was not so.

In the Malaysian case of *Khoo Thau Sui v Chan Chiau* (1976)1 MLJ 25, the defendant agreed to tow the plaintiff's logs from Sungai Sugut to his log pond in Sandakan. The defendant towed a total of 82 logs but due to sudden storm many logs broke loose. Only 11 logs were delivered, and 31 logs were subsequently recovered. The plaintiff claimed for the loss of 40 other logs. In defence to the plaintiff's claim, the defendant alleged that the logs were lost in a storm at sea. The court held that in a towing contract of this nature, naturally a storm must be expected and would have to be guarded against especially in the open sea and therefore the defense of frustration failed.

- Provisions in contract for frustration; The contract may contain a term dealing with what should happen if a frustrating event occurs. This is known a “force majeure” clause. In other words, parties may make express provision for supervening events such as strikes, closure of shipping routes, illness, floods, fires and other disasters. They can allocate the risk of such event as they see fit. E.g. proving for extension of time, compensation etc.

If there is a “force majeure” clause, the doctrine of frustration does not apply; the clause in the contract is followed. The only exception is if the contract becomes illegal (i.e. it involves trading with the enemy which is against public policy) then it will be treated as frustrated. Parties are free to specify a wide range of events such as a pandemic, and to agree to relief that is tailored to their specific circumstances. General principles of contractual interpretation apply when construing force majeure clauses. The burden of proof is on the party wishing to exercise the force majeure clause to bring itself “squarely within the clause” by showing that the relevant event occurred and that it had (or was anticipated to have) the stipulated effect on the affected party's contractual performance. Therefore, scrutiny of the law in Malaysia, section 57(2) read together with the circumstances when a contract is frustrated and not frustrated, displaces the application of the doctrine to a pandemic because a pandemic such as covid-19 does not frustrate the contract as a contract can still be performed unless the delay caused by the pandemic causes the contractual obligation 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. The implications of the Covid- 19 would have to be decided on the case by case basis.

Proposal For Reform

Though, “force majeure” clauses are principally a matter of contract law and it enables the contracting parties to allocate risk by making express provisions for what should happen to their bargain upon the occurrence of certain events, a comparison should be made to the Principles of European Contract Law and the UNIDROIT Principles that make provision for hardship as well as force majeure;

Article 6.111 of the Principles of European Contract Law– Change of Circumstances

1. A party is bound to fulfill its obligations even if the performance has become more onerous, whether because the cost of the performance has increased or because the value of the performance it receives has diminished.
2. If, however, performance of the contract becomes excessively onerous because of a change of circumstances, the parties are bound to enter into negotiations with a view to adapting the contract or terminating it, provided that:
 - a. The change of circumstances occurred after the time of conclusion of the contract,
 - b. The possibility of a change of circumstances was not one which could reasonably have been considered at the time of conclusion of the contract, and
 - c. The risk of the change of circumstances is not one which, according to the contract, the party affected should be required to bear.
3. If the parties fail to reach agreement within a reasonable period, the court may:
 - a. Terminate the contract at a date and on terms to be determined by the court, or
 - b. Adapt the contract to distribute between the parties in a just and equitable manner the losses and

gains resulting from the change of circumstances. In either case, the court may award damages for the loss suffered through a party refusing to negotiate or breaking off negotiations' contrary to good faith and fair dealing.

-Article 8.08 – excuse due to an impediment

1. A party's non-performance is excused if it proves that it is due to an impediment beyond its control and that it could not reasonably have been expected to take the impediment into account at the time of conclusion of the contract, or to have avoided or overcome the impediment or its consequence
2. Where the impediment is only temporary the excuse provided by this article has effect for the period during which the impediment exists. However, if the delay amounts to a fundamental non-performance, the obligee may treat it as such.
3. The non-performing party must ensure that notice of the impediment and of its effect on its ability to perform is received by the other party within a reasonable time after the non-performing party knew or ought to have known of these circumstances. The other party is entitled to damages for any loss resulting from the non-receipt of such notice.

-Article 7.1.7(1) of UNIDROIT Principles of International Commercial Contracts which provides: Nonperformance by a party is excused if that party proves that the nonperformance was due to an impediment beyond its control and that it could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.

The commentary to Article 6:111 of the Principles of European Contract Law states that 'the mechanism reflects the modern trend towards giving the court some power to moderate the rigours of freedom and sanctity of contract,' which is the way forward. Otherwise, the court must either uphold the contract according to the terms as decided by the parties or discharge it. The burden to protect falls on the due diligence of the contracting parties under the notion of freedom of contract to protect themselves against consequences such as brought by the covid-19 pandemic

IV. CONCLUSION

The provisions of Principles of European Contract Law and the UNIDROIT Principles should be bench marked for best practice in reforming the contract law in Malaysia, Contracts Act 1950, especially to address a contractual situation that the covid-19 and the MCO has sparked instead of relying on the archaic doctrine of frustration which does not give the court the power to adjust the contract to meet the changed circumstances.

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