Coronavirus: a frustrating situation?

Introduction

1. The UK is currently grappling with what is hoped to be the peak of the Coronavirus crisis. Landlords and tenants have both been hit: government guidance and legislation has prevented many tenants from using premises as they expected, and prevented landlords from forfeiting leases or seeking possession. Both may feel that they are locked into a bargain that they could not have anticipated and want to escape from. But can they?

2. We already have a steady stream of clients wanting to invoke the doctrine of frustration: if, due to the occurrence of an event after the contract's formation, performance would be radically different from what was envisaged by the parties at the date of the contract's execution, the contract is frustrated and can be discharged by either party.

3. Traditionally, frustration has played almost no role in the landlord and tenant sphere. While we know that frustration can in principle apply to a lease (*National Carriers Ltd v Panalpina (Northern) Ltd* [1981] AC 675), it will be an extremely rare occasion when it in fact does. To our knowledge, no party has (yet) argued successfully that a lease has been frustrated.

4. But if it is possible for a lease to be frustrated, there must be a set of factors that would make that possibility a reality. In this article we give pointers to what factors might help a claim of frustration, and which will likely prove fatal. We also consider the related questions of when specific covenants in leases might be suspended, and when property contracts other than leases might be frustrated.

Frustration of leases

5. The reason it is so difficult to frustrate a lease in its entirety is that in order for frustration to bite, the supervening event must defeat the 'main purpose' of the contract. In the recent case of *Canary Wharf (BP4) T1 Ltd v European Medicines Agency* [2019] EWHC 335 (Ch), the EMA, an agency of the EU, tried unsuccessfully to argue that Brexit would frustrate its lease of part of the Canary Wharf estate. Marcus Smith J explained that it is necessary for the event to remove "*all or substantially all of the benefit that one party receives from the contract*".

6. The core of the benefit received by a tenant under a lease is the right to possession of the demised premises. A landlord is likely to have a good argument that the core of the benefit which the tenant derives from the bargain subsists (because ultimately the tenant will still have the right to possession of the land). Indeed, it was a similar argument which initially led two members of the House of Lords in *Cricklewood Property and Investment Trust v Leighton's Investment Trust* [1945] AC 221 to reject the possibility of frustration of a lease entirely.

7. A consequence of this is that any claim for frustration of a lease will not be based on impossibility (as might the case when a unique item to be sold under a contract is destroyed) or what Treitel terms "frustration of the adventure" (when performance has not become permanently impossible, but has been merely affected by temporary obstacles which are later removed). Even in the current extreme situation, there is no bar to a tenant being given possession of land and paying rent to the landlord, and so the core performance is still possible. Frustration of a lease will instead be based on "frustration of the purpose": where landlord and tenant had a shared common purpose for entering into the lease and that purpose has become impossible.

8. Importantly, frustration, if it applies, has a symmetric effect: the tenant would no longer have to pay rent, but would also have to vacate the premises. It does not allow the tenant to stay in possession without paying rent. We consider the possibility of an asymmetric suspension of the rent only separately below.

Force majeure and cesser clauses

9. It is important to note as a preliminary point that there will be no room for frustration to operate where the contract makes provision for the relevant supervening event. Many commercial contracts contain lengthy or widely drafted force majeure clauses, although they are rarer in modern leases. More common in leases are provisions which allow the tenant to stop paying rent where the premises are unfit for occupation on the occurrence of an insurable event. Where a lease does contain a force majeure or rent cesser clause, the first question must be whether the particular supervening event at hand falls within it. That is a conceptually straightforward question of contractual interpretation, albeit its application to any particular lease may prove difficult in practice. Only if on its true construction does the contract make no provision for the relevant event, can the parties move on to the question of whether it (or possibly a part thereof) has been frustrated.

10. Conversely however, the fact that a particular contract contains a force majeure or rent cesser clause which covers certain types of event and not others will not inevitably preclude the operation of frustration on the basis of events outside the relevant clause's scope. This is because frustration is conceptually distinct from the exercise of contractual interpretation. In other words, the fact that the parties did not intend for the relevant event to fall within force majeure clause ought not to exclude the possibility of frustration, because frustration operates upon the occurrence of an event which the parties simply did not foresee happening.

11. However, the courts have not always kept these issues distinct. It might be thought that express provision for interruption by one cause would strengthen the case that interruption by another cause was foreseen. But in the ***National Carriers*** case, weight was placed on the fact that the parties had provided for suspension of rent in the case of fire and for termination in the event the premises were required by British Railways, with Lord Simon concluding that "*the parties can hardly have contemplated that the expressly-provided-for fire risk was the only possible source of interruption of the business of the warehouse - some possible interruption from some cause or other cannot have been beyond the reasonable contemplation of the parties.*"

Length of term

12. The most basic common purpose that landlord and tenant have is that the tenant will be able to make some use of the premises over the course of the term. If the tenant was completely precluded from deriving any practical benefit from the premises (by occupying or subletting them, or by assigning the lease) for the entire term by an unforeseen event, the argument for frustration might well be strong.

13. Such a situation would however be rare in the current crisis: the lockdown may feel like it is going on forever, but even the gloomiest forecasts indicate that it will be lifted, probably this year. Where a particular lease has a considerable amount of time left to run, frustration will almost certainly be precluded, because the tenant will still be able to derive benefit from the lease once things return to normal. This sort of reasoning is apparent in the first instance decision in Hong Kong, *Li Ching Wing v Xuan Yi Xiong* [2003] HKDC 54, in which a tenant of a flat in a block from which the residents were evacuated for ten days pursuant to an isolation order after other residents contracted SARS argued unsuccessfully that his two-year tenancy agreement had been frustrated.

14. Where the tenancy at hand is particularly short however, and the lockdown has eaten into a considerable proportion of it, there is likely to be more room for argument. It seems that what is important is the ratio of the portion of the agreement that can be performed as expected to the whole performance originally envisaged. In *BTP Tioxide Ltd v Pioneer Shipping Ltd* [1982] A.C. 724 the House of Lords did not interfere with an arbitrator's decision that a charter party was frustrated when only three out of the planned seven voyages could be completed, but in *FA Tamplin Steamship Co Ltd v Anglo Mexican Petroleum Products Co Ltd* [1916] 2 A.C. 397 when a ship was requisitioned two years into a five year charter, the contract was not held frustrated because "*there may be many months during which this ship will be available for commercial purposes before the five years have expired*."

15. The same approach is taken to the terms of leases. In *ACG Acquisition XX LLC v Olympic Airlines SA* [2012] 2 C.L.C. 48, a five-year lease of an aircraft was held not to be frustrated when the plane's airworthiness certificate was suspended because the period of suspension was less than one year. In the *National Carriers* case itself an

important reason for holding that a 10-year lease or a warehouse was not frustrated by a 20-month closure of the only access road was that "*the interruption would be only one sixth of the total term*".

16. Taking a very broad-brush approach, it seems that interruptions of much less than half of the total term are unlikely to frustrate a lease. Given the disruption will probably last less than a year, this probably rules out most commercial leases. Many shorter residential leases may be of suitable length, but are less likely to have been disrupted in the first place.

User covenants

17. There are two interrelated reasons a restrictive user covenant may assist a tenant arguing in favour of frustration. First, the existence of such a clause is powerful evidence that both parties intended that the premises would only be put to some particular use (i.e. use within the scope of the covenant).

18. This is important because, as noted above, a tenant will need to establish that what has been frustrated is the parties' common purpose. It is insufficient that one of the parties had envisaged the demised premises being put to a particular use, which has now been defeated. The parties must have shared such an intention. Where no common purpose can be found or inferred, the parties will be considered to have allocated the risk of the event under the contract, and will be held to their bargain (even if it turns out to have been a bad one).

19. Although it may be impossible to infer a common purpose from the circumstances which surrounded the parties' entry into the lease, the tenant's case will be much stronger if this is clear on the face of the lease.

20. A good illustration of this is provided by a number of American cases which arose out of the prohibition on sales of liquor throughout the US. In *Industrial Development and Land Co v Goldschmidt* 206 P.134 (1922), the lease contained a tenant covenant against user other than as a liquor business. It was held that when the ban on selling alcohol came into force, the lease (and accordingly the obligation to pay rent) came to an end.

This can be contrasted with *Grace v Cronginger* 55 P.2d 940 (1936), where the user covenant permitted the premises to be used for additional purposes which had not become illegal, and where frustration was held not to occur.

21. Second, if the only permissible user has become unlawful, that greatly restricts the use to which the tenant can practicably put the premises. By way of illustration, in the *National Carriers* case, it was a factor in favour of frustration that "*no other substantial uses, permitted by the lease and in the contemplation of the parties, remained possible to the lessee*."

22. The Health Protection (Coronavirus, Restrictions) (England) Regulations 2020/350 provide[1] at Schedule 2 a list of types of premises that must close (Part 1: e.g. restaurants, cafes, bars and pubs) and a list of types of business that must not be carried on (Part 2: e.g. theatres, casinos, and gyms). Premises let as a restaurant would have to close, but premises let as a gym could remain open if they could instead be used for other, permitted purposes.

Alienation

23. In theory, similar reasoning applies to alienation: if the lease permits underletting[2] or assignment, the tenant can make use of its interest by taking advantage of those provisions, and it is therefore unlikely that the common purpose (i.e. occupation by the tenant or by a suitable sub-tenant or assignee) would be considered to have been thwarted. Conversely, if the tenant cannot assign or sublet, there is a stronger argument for frustration.

24. In the *Canary Wharf* case, the learned judge held that one of the various reasons why the lease had not been frustrated was that assignment was permitted, albeit in limited circumstances. These provisions indicated that the parties' "*common purpose never amounted to a mutual contemplation that one of the purposes of the Lease was to*

[1] At the date of writing, but care is needed: the predecessor Health Protection (Coronavirus, Business Closure) (England) Regulations 2020/327 were only in force for 4 days before being repealed and replaced as the crisis worsened.

[2] Unless that would constitute provision of accommodation contrary to regulation 5 of the Health Protection (Coronavirus, Restrictions) (England) Regulations 2020/350

provide a permanent headquarters for the EMA for the next 25 years and that if that could not be achieved, the common purpose of the Lease had failed". The true common purpose therefore was still possible and there was no frustration.

25. However, it seems to us that alienation provisions are less likely to be relevant when considering whether there has been frustration of common purpose due to the pandemic, as generally the legislation prohibits type of user rather than use by a particular person. Nonetheless, this argument may affect some tenants, perhaps those who cannot reach the premises because of the restrictions on non-essential travel.

Degree of prohibition

26. Close scrutiny of the legislation said to frustrate the common purpose will also be required, in order to ascertain whether the contemplated user has in fact been rendered unlawful, either directly, or possibly indirectly (e.g. by virtue of the ban on gatherings of more than two people, save in limited and closely defined circumstances). Tenants are likely to face a steeper uphill battle where the relevant user is not unlawful, but merely contrary to government guidance (the discrepancy between them having been highlighted this week by Lord Sumption's comments on the policing of walkers).

Summary

27. Unless the courts are willing to break with a long pattern of decisions, even in these extreme times it seems unlikely that a lease will actually be found to have been frustrated. However, a tenant with a short lease with narrow user covenants allowing only user that has been made unlawful would have a very arguable case. Against a backdrop where landlords cannot practically bring possession proceedings for at least three months, and where replacement tenants are thin on the ground, arguing for frustration could prove a powerful negotiating lever in such a case when seeking to secure rent holidays or reductions.

Temporary discharge of particular lease covenants

28. Although (as far as we are aware) no English Court has ever held that a lease has been frustrated, parties have on occasion successfully argued that particular leasehold covenants have been prospectively discharged. An early example is *Baily v De Crespigny* (1869) LR 4 QB, in which a landlord was held not liable for breach of a leasehold covenant that neither he nor his successors in title would build on land adjoining the demised premises after the land was compulsorily acquired and built on.

29. In addition, the Courts have previously held that a supervening event, whilst insufficient for frustration, may have the effect of temporarily suspending the operation of discrete leasehold obligations. *John Lewis Properties Plc v Viscount Chelsea* [1993] 2 EGLR 77 is one such example. In that case, the tenant was under an obligation to demolish and develop the demised premises in accordance with approved plans. Subsequent to the execution of the leases pursuant to which the tenant held the premises, part of the site was designated Listed Grade II*, and it was clear that consent would not be granted for the proposed works. After the deadline for completion of the development, the landlord served s146 notices. The tenant sought a declaration that the landlord was not entitled to forfeit, and the landlord counterclaimed for possession and damages. The Court held that the landlord was not entitled to forfeit, because the tenant was not in breach. It had a "*lawful excus[e]*" for its non-performance. Mummery J emphasised two things however. First, the suspension of the covenant was temporary; it would last only so long as building was in fact prevented. Second, whilst the principle provided a defence to an action for forfeiture for breach of that covenant, it had no effect on the tenant's obligation to pay rent, which would continue unaffected. By a similar logic, another category of covenant which may well be considered to have been temporarily discharged by virtue of the lockdown are 'keep-open' clauses of commercial premises ordered to close by the new legislation.

30. We are conscious however that the covenant likely to be of most concern to tenants is that to pay rent. Ultimately, it seems to us that it is difficult to envisage circumstances which both fall short of the whole lease being frustrated but nonetheless discharge the obligation to pay rent, even only temporarily, not least because the obligation to pay rent and the legal estate granted to the tenant have historically been so closely connected

that the former was considered to be a "*profit issuing out of the land*" (Woodfall, at 7.001).

31. This principle is of such long standing and high authority that it is surprising to see it being questioned by some practitioners[3]. In the Civil War case of *Paradine v Jane* (1646) Aleyn 26 (expressly approved by the House of Lords in *Matthey v Curling* [1922] 2 AC 180) it was held that being forcibly removed from the property by an invading army does not remove the obligation to pay rent. Nor does dying relieve a residential tenant from the obligation to pay rent: see *Youngmin v Heath* [1974] 1 WLR 135.

32. Matters are different north of the border, where Scots law does allow for temporary suspension of rent. In the Inner House case of *Tay Salmon Fisheries Co. v Speedie* 1929 S.C. 593, Lord Sands helpfully set out the difference:

> *"In this view it might be suggested that, if during the currency of the term the fishery rights through external interference have become worthless, they have perished to the person to whom for the term they belonged, and, as this has happened through no action of the landlord, the tenant remains liable in payment of the annual sum stipulated. This, I understand, is the view to which the law of England gives effect. But this is not how the law of Scotland treats the contract of landlord and tenant. Each year's rent is payable in respect of enjoyment of possession for the year, and, where enjoyment becomes impossible, no rent is payable."*

33. This Scots view does not apply to English law. *Tay* was cited in argument in the *National Carriers* case and was roundly dismissed by Lord Roskill: "*Nor, with respect, is any assistance to be gained from the Scottish case of Tay Salmon Fisheries Co. Ltd. v. Speedie, 1929 S.C. 593 which was decided under a system of law different in the crucial respect from that applicable to Matthey v. Curling.*"

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[3] See for example, *Kynoch* Can tenants who are forced to close suspend their rent during the lockdown? https://selbornechambers.co.uk/coronavirus-closure-can-tenants-who-are-forced-to-close-suspend-their-rent-during-the-lockdown/

34. Absent express provision in the lease it is hard to imagine that the obligation to pay rent would be suspended by the current crisis, dire as it is.

Frustration of other property contracts

35. If one moves away from leases to consider contracts such as agreements for lease, contracts for sale or management agreements, frustration may be slightly easier to argue. A landlord who has just engaged a managing agent on a one-year contract to service an office building that has been ordered to close and is sitting vacant may have a reasonable case that the agreement has been frustrated.

36. However, care must be taken to show that it is the parties' common purpose, and not just the desire or intention of one of them, that has been thwarted. In *Amalgamated Investment & Property Co v John Walker & Sons* [1977] 1 W.L.R. 164 a contract for the sale and purchase of a warehouse at a high price that reflected its development potential was not frustrated when the warehouse was designated at a listed building, preventing development: this was deemed a risk, albeit a remote one, that any purchaser has taken on. The development was the purchaser's intention only.

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