LEVEL TWENTY SEVEN CHAMBERS

# *Contracts & Coronavirus: Pathology & Prognosis of Frustration and Force Majeure Claims on Sporting and Cultural Events*

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1. COVID-19 (or simply "the Coronavirus") is here and is affecting our daily lives to a degree not one of us could have imagined. While it is far too soon to fully appreciate the impact, we can already see the legal issues developing as a result: many thousands have been stood down or are now unemployed; contracts for forward work put on hold; travel halted; and sporting and cultural events have been cancelled or played to empty venues (to name a few).

2. To take just the latter of those examples, if you have purchased season tickets to games now no longer played in front of spectators, or to a concert or major event, what are your rights? What is the effect of those events being cancelled or played to empty stadiums? The primary concern of this article is whether contracts affected by closures or cancellations are frustrated and whether COVID-19 is a *force majeure* event. The issues discussed here are, however, relevant to a far wider range of contracts, and especially commercial contracts, where performance is affected by the impact of the virus itself or the restrictions imposed as a result of it.

**THE PATHOLOGY OF FRUSTRATION**

3. The law describes frustration as an event or circumstance which has occurred after a contract has been made that makes the performance of the contract fundamentally different from that which was envisaged by the contract, and which has not been caused by any party to the contract.[1] An example of this can be seen in the 'coronation' cases of *Krell v Henry* [1903] 2 KB 740 ('*Krell*') and *Herne Bay Steamboat Co v Hutton* [1903] 2 KB 683 ('*Hutton*').

4. In *Krell*, the defendant had contracted to hire for two days a flat on Pall Mall. He wished to watch the coronation procession of King Edward VII and had been induced to contract by an announcement in the window to the effect that the flat was available to let for that purpose. The coronation never took place and the defendant refused payment arguing the contract had been frustrated. The plaintiff sued for the outstanding £50 while the defendant counter-claimed for return of the £25 already paid. The court found for the defendant and excused performance because the evident purpose for entering into the contract - watching the coronation procession of the King – was frustrated. While it was still possible for the flat to be used (the defendant could have remained in the flat), the defendant had lost foundation of, or the fundamental benefit for which he had bargained by the contract.

**IMMUNITIES TO FRUSTRATION**

5. In *Hutton*, the defendant had contracted to hire a steamship 'for the purpose of viewing the naval review and for a day's cruise around the fleet.'[2] Following the cancellation of the coronation , the naval review too was cancelled and the defendant refused payment. In contrast to *Krell* however, the Court of Appeal held the contract was not frustrated as the purpose of the contract was to view the naval review and a day's cruise around the fleet. As Stirling LJ explained at 692:

> the fleet was there, and passengers might have been found willing to go round it. It is true that in the event which happened the object of the voyage became limited, but, in my opinion, that was the risk of the defendant whose venture the taking the passengers was.

6. As *Hutton* demonstrates, not only are the facts behind each arrangement critically important, frustration is not readily found by the courts. Contracts are assumed to have been entered into it voluntarily by the parties and if the parties had wished to guard against an adverse event, the court may well conclude they would have done so by express stipulation. In the absence of any such express term, performance is not excused just because it becomes difficult or unprofitable.[3]

7. At common law, the effect of frustration is to automatically terminate the contract[4]: the effect of which is that future obligations under the contract are discharged. Generally, in the event of frustration, the 'loss lies where it falls' and neither recovery of money paid nor compensation for partial performance is allowed: *Re Continental C&G Rubber Co Pty Ltd* (1919) 27 CLR 194.

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1 *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337.
2 [1903] 2 KB 683, 692.
3 *Scanlan's New Neon Ltd v Toohey's Ltd* (1943) 67 CLR 169.
4 *Aurel Forras Pty Ltd v Graham Karp Developments Pty Ltd* [1975] VR 202.

8. Notwithstanding this, it may be possible, in some cases, to recover money paid under a frustrated contract on the basis of restitution. In *Baltic Shipping Co v Dillon*,[5] Mason CJ confirmed the common law position in Australia regarding the right to recovery money paid under a frustrated contract as that reflected in *Fibrosa Spolka Akcynja v Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32 ('*Fibrosa*'). In *Fibrosa*, the House of Lords held that payments made under a frustrated contract could be recovered 'where the consideration, if entire, has entirely failed, or where, if it is severable, it has entirely failed as to the severable residue.'[6]

9. As was seen in *Krell*, there was a total failure of consideration. In contrast, in *Hutton*, the plaintiff was not successful because there was only a partial failure of consideration and the part that failed was not severable.

**CASE STUDY**

10. In the case of sporting events, the playing of games behind closed doors (that is without spectators in the stadium) as a result of COVID-19 is an event beyond the control of the parties (or their reasonable control) and which they did not cause. What then is the position of the ticket holder, whether for one game of the season, or its entirety? We will assume the terms of either contract pursuant to which the tickets were issued are silent on the allocation of risk for this kind of circumstance.

11. The requirement to play games behind closed doors as opposed to postponement (or cancellation) is likely to make performance of the contract fundamentally different from that envisaged by the contact. If the game is postponed (and it was a one-off event), it is probable that the ticket holder would be able to use the tickets later when the match is rescheduled. However, if the match instead is played, but behind closed doors without spectators, the holder will have been denied that which had been bargained for: the right to watch his or her team play live.

12. The choice of the AFL, the NRL, the Super Rugby, and the NBL, initially to play matches behind closed doors (and indeed later to postpone matches indefinitely) would appear to alter the situation for season ticket holders in a fundamental way as to frustrate the contract between the ticketholder and selling authority (the club). The result is the value for which they have bargained (their season ticket) arguably will have been lost, or at the very least, substantially affected, depending on the timing in the season at which the decision was made. There are of course a number of factors that will affect the facts of each case: was the decision made in consequence upon a Government health directive, or merely precautionary; (as noted above) was the decision to postpone or to cancel; and was the decision made by the seller of the ticket (for example, the Club in the case of season tickets) or by a third party, such as Ticketek, or even the venue itself. At a local level the same questions will arise in relation to the prepayment of annual competition fees at local sporting clubs and for entry to concerts, or cultural events – what, for example, is to be made of the decision to cancel the Ekka and the cancellation of the multitude of contracts that sat behind its organisation?

13. The relevant issues will include, reverting to the sporting analogy:

    (a) *first*, an issue of construction as to the purpose of the contract (to hold a season ticket): was it to watch a sporting team play, or was it a more general purpose, such as for general supporting for team; and

    (b) *second*, has there been an entire failure of consideration or an entire failure of a severable portion of the consideration?[7]

14. In answer to the first issue above, if the purpose of the purchase of the season ticket was to watch live matches then it is almost axiomatic the contract will have been frustrated by the cancellation of in-person attendance. Conversely, if the purpose of the season ticket was simply to 'support' the team, then it may be the contract will not be frustrated as that possibility is still open and not contingent upon watching the game live and in-person.

15. As to the second issue, there would be a total failure of consideration if the purpose of the season ticket was to watch the team play live and the holder had not been allowed to do so (by government action or otherwise) since game 1 of the season. Accordingly, the person would be able to claim the cost of the ticket back. However, where they had already been able to attend several games and the season subsequently restarted, it is likely there will not have been a total failure of consideration and the loss would lie where it falls.

16. As the test is whether the performance of the contract is now fundamentally different from that envisaged by the contract, the effect of COVID-19 will vary contract to contract:

    (a) a contract for the purchase of a one-year season ticket to watch a local team play where those home games are now played behind closed doors is likely to be considered a frustrated contract;

    (b) a gym membership for 6 months beginning in March 2020, and paid up-front, is likely to be considered frustrated where the gym has now closed and the member has not been able to attend even once, and there is no sign of a reopening;

    (c) a long-term supply contract over 20 years by contrast is unlikely to be frustrated by an interruption of 6 months (or even longer) arising from the COVID-19 restrictions however; and

    (d) a contract for the construction of new building may be frustrated where the steel to be used in construction is expressly stipulated to come from a particular supplier, who is not able to supply that steel owing to COVID-19. However, if the contract merely stipulates that a certain amount of steel is to be supplied for that construction, the contract would not be frustrated simply because the supply of that steel became more onerous or expensive, or differently sourced.

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5 (1993) 176 CLR 344

6 [1943] AC 32 64-5 (Lord Wright). See also *Muschinski v Dodds* (1985) 160 CLR 583.

7 It is worth noting here frustration is contemplated by section 232 of the Property Law Act 1974 (Qld) in relation to 'rents, annuities, dividends and other periodical payments in the nature of income'.

**DIAGNOSING FORCE MAJEURE**

17. Many commercial contracts contain '*force majeure*' clauses. McCardie J said in *Lebeaupin v Crispin* [1920] 2 KB 714, the term '*force majeure*' is usually:

> …used with reference to all circumstances independent of the will of man and which it is not in his power to control, and such force majeure is sufficient to justify the non-execution of the contract.

18. A *force majeure* clause is a mechanism by which parties contractually agree to excuse performance (for some period consequent upon certain events). In this way, a *force majeure* clause recognises the existence (or possible existence) of certain risks as impacting strict performance and assigns the risk as the parties agree.

19. Whether a *force majeure* clause will relieve a party of their liability for strict performance depends upon the construction of the force majeure clause and, importantly, on a causal link between the risk event and performance of the contract. Finally, as is the case with the doctrine of frustration: parties cannot invoke a *force majeure* clause where the intervening event is caused by their own acts or omissions.[8]

20. Whether COVID-19 will fall within the definition of *force majeure* depends on the drafting of the clause. It is not likely COVID-19 has been expressly considered in any contract entered prior to December 2019 (when COVID-19 was unknown). Contracts generally set out a list of events defined as *force majeure* events: such as 'acts of God', 'acts of terrorism', and 'war', and also include a general phrase to the effect: 'an event beyond the control of the parties'. While it is preferable to expressly define what constitutes a *force majeure* event, this necessarily runs the risk that if the list of *force majeure* events is too specific, it will limit the construction of the more general clause to a certain kind of cause or event.

21. COVID-19 may constitute a force majeure event where the contract expressly contemplates terminology or circumstances similar to 'epidemic' or 'pandemic'. There will undoubtedly be a debate as to whether the particular contractually required performance is inhibited by the virus or the government reaction to it. However, contracts usually also include as a force majeure event 'government action', and so will apply to the government closing businesses and banning gatherings as has been done presently.

22. Where a force majeure event is correctly recognised, the effect of properly exercising that right is defined by the contract and the clause itself. One limit to the exercise of a *force majeure* clause is usually that the party affected by the intervening event must use reasonable endeavours to overcome the effect of the event.

23. However, where a party correctly exercises a *force majeure* clause, the obligations arising under the contract are (typically) suspended: for example, the obligation to supply goods under a supply contract is suspended and the other party's mutual obligation is also suspended (however this would not apply to the obligation to pay already accrued under the contract). Further, there are usually notice provisions in the contract relating to the exercise of that right. Finally, a *force majeure* clause may provide if the restrictions on the performance of the contract do not cease within a nominated time, either party may terminate the contract without fault and without liability.

**PROGNOSIS**

24. COVID-19 is likely to generate future legal disputes across numerous sectors. Whether a contract has been frustrated by COVID-19 is a question of fact to be determined on the individual circumstances. In such circumstances, whether a party may be entitled to recover money paid depends on there having occurred a total failure of consideration or total failure of consideration of a severable portion of the contract. Whether a party can successfully rely upon a force majeure clause depends upon the clause itself. What is abundantly clear already however is that COVID-19 will impact contracts in the construction industry, consumer market, the employment, sports and entertainment sector, energy and resources, and countless others.



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8 *Lebueapin v Crispin* [1920] 2 KB 714; Yzrazu v Astral Shipping Co (1904) 9 Com Cas 100.