FRUSTRATION AND FORCE MAJEURE – EFFECT OF CONTRACTUAL RESPONSIBILITIES DURING COVID-19 CRISIS.

The Prime Minister of Malaysia has recently announced that that the Movement Control Order ("MCO") which came into effect on 18th March 2020 shall continue until 28th April 2020, excluding such businesses and premises related to "Essential Services." During this period, many other businesses throughout Malaysia that do not come under the category of "Essential Services" have fully ceased operations.

In addition to the direct financial effects and other economic pressures faced by these businesses, there is an increasing uncertainty regarding to the effect of the MCO and the willingness of businesses to meet their contractual commitments that has been assumed prior to the MCO, or about the legal right to be excluded or excused from the fulfillment of those commitments.

In this article, we shall explore the legal principles that are useful in this context according to the views and interpretations of the relevant laws by counsels at Messrs. Ram Reza & Muhammad. The said legal principles are:

1) The doctrine of frustration; and
2) Force majeure Clause.

Doctrine of Frustration

Section 57(2) of the Malaysian Contracts Act 1950 outlines the doctrine of frustration:

"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 present, unlawful, becomes void when the act becomes impossible or unlawful."

There is no definition of the word "impossible" in the Act, but it is usually not used exclusively in the context of actual or logical inability, but also involves circumstances when there is a "frustration of intent" or a drastic alteration in what the parties have agreed in the contract. Thus, referring to the judgment of Lord Denning MR in the case of ***Ocean Tramp Tankers v. V / O Sovfract [1964] 1 All ER 161 (CA)*** in which the wise judge explained the application of the doctrine of frustration, as follows:

"*It has frequently been said that the doctrine of frustration only applies when the new situation is 'unforeseen' or 'unexpected' or 'uncontemplated', as if that were an essential feature. But it is not so. It is not so much that it is 'unexpected', but rather that the parties have made no provision for it in their contract. The point about it, however, is that: If the parties did not foresee anything of the kind happening, you can readily infer that they have made no provision for it. Whereas, if they did foresee it, you would expect them to make provision for it. But cases have occurred where*

the parties have foreseen the danger ahead, and yet made no provision for it in the contract."

The Malaysian stance on the theory of frustration with non-performance due to the failure of an act has been summarized by the Federal Court case of ***Pacific Forest Industries Sdn Bhd & Anor v. Lin Wen-Chih & Anor [2009] 6 CLJ 430; [2009] 6 MLJ 293***, it was held as follows:

"*A contract does not become frustrated merely because it becomes difficult to perform. If a party has no money to pay his debt, it cannot be considered impossible to perform, as it is not frustration. Neither can he plead frustration because the terms of the contract make it difficult to interpret. If it cannot be performed or becomes unlawful to perform, then the party who is to perform his part of the bargain can plead frustration. The doctrine of frustration is only a special case to discharge a contract by an impossibility of performance after the contract was entered into A contract is frustrated when subsequent to its formation, a change of circumstances renders the contract legally or physically impossible to be performed."*

Can Covid-19 or the MCO trigger the defence of frustration?

In the case of **Guan Aik Moh (KL) Sdb Bhd & Anor v Selangor Properties [2007] 3 CLJ 695.** a party must demonstrate the three elements of the event which allegedly triggered frustration.

First, the event upon which the promisor relies as having frustrated the contract must have been one for which no provision has been made in the contract. If provision has been made then the parties must be taken to have allocated the risk between them.

Second, the event relied upon by the promisor must be one for which he or she is not responsible. Put shortly, self-induced frustration is ineffective.

Third, the event which is said to discharge the promise must be such that renders it radically different from that which was undertaken by the contract.

The first element above will be fulfilled under the basis that the contract in dispute does not compensate for an occurrence such as the MCO. It would also be fair to assume that the second element of frustration is fulfilled, for example, that no party to the contract is liable for the MCO. Nevertheless, in the third element, a contracting party will have to show that the MCO has culminated in a revolutionary deviation in the contractual responsibility from what has been performed, so that therefore it should not be just to implement it.

This third aspect is not readily fulfilled and will depend on the facts and circumstances concerning every individual contract. Especially in the tenancy agreement, the court will have to be convinced that the affected party is in such

grave financial difficulty that is just impossible to pay rent and there is no way to remedy the party's situation.

In the Hong Kong case of **Li Ching Wing v Xuan Yi Xiong [2004] 1 HKLRD 754,** it was argued by a tenant that his tenancy agreement was frustrated during the outbreak of SARS, as he was not allowed to stay in the premises for 10 days due to an isolation order issued by the Hong Kong Department of Health. The District Court held, inter alia, that the tenancy agreement was not frustrated because the isolation order was only for a short duration in the context of the lease at issue, i.e. a period of 10 days out of a 2-year tenancy, and such event did not significantly change the nature of the contractual rights and obligations from what the parties could reasonably have contemplated at the time of the execution of the tenancy agreement.

In light of the above cases, facts of the particular tenancy will have to be considered to determine whether the MCO amounts to a frustrating event. It may be contended that the purpose of the tenancy agreement has temporarily ceased since business premises close down due to the government directives. Nonetheless, the courts may still refuse to consider the MCO as a frustrating event following the Hong Kong case since it is a comparatively short (hopefully) duration as compared to the normal two to three year tenancy span.

Another risk that companies growing actually face is that the MCO has forced interruptions of production chains, potentially contributing to disruptions in the distribution and shipping of products. Consequently, customers can refuse to accept their goods due to late delivery.

If there is no "force majeure" or any related provision in the Contract between the parties, the issues in question are firstly, whether delivery or performance on time has been rendered impossible due to the MCO and secondly, whether time is of the essence in the said contract i.e. that performance or delivery can only be done within a specified time. If the answer is in the affirmative, then the contract is frustrated. As a result, all parties are discharged from its performance.

Outcome of frustrating events

When the contractual party is able to show that the contract is null and void under section 57(2) of the Contracts Act 1950, any person who has received any benefit under the contract is obliged to recover the contract or to pay the individual from whom the contract was received.

In addition, Section 15 of the Civil Law Act 1956 provides for the following remedies where the contract has become impossible to perform or has otherwise been frustrated;-

1. All sums paid or payable to any party in pursuance of the contract before the time when the parties were so discharged, shall, in the case of sums so paid, be recovered from him or cease to be payable.

2. If the party to whom the sums were so paid or payable incurred expenses before the time of discharge, the court may, if it considers it just, allow him to retain or recover the whole or any part of the sums so paid or payable.

3. Any party to the contract who has obtained a valuable benefit before the time of discharge, there shall be recoverable from him by the other party such sum, as the court considers just.

Force Majeure Clause

Under Malaysian law, there is no generally applicable concept of "force majeure"; however, there is nothing in Malaysian law that prohibits parties from providing for force majeure events, ie, that certain external events may have the effect of suspending performance, or releasing the parties from performance altogether. The question of what events will qualify; whether they must be unforeseeable; whether they must have permanent effect; and the extent of the effect that they must have, will depend on a construction of the force majeure provisions read in light of the contract provisions as a whole.

In most well-designed contractual contracts, there would be a clause generally referred to as "force majeure" to deal with the respective rights, duties and compensation of the contracting parties when a frustrating occurrence occurs. The contractual provisions relating to contingencies will generally take effect provided that there is no ambiguity in the terms. Therefore, if the contract does not include such a provision, you would only be able to rely on the doctrine of frustration as mentioned above.

While force majeure clause is commonly used, it is not a compulsory rule on all forms of contracts. a force majeure provision is typically used in long-term contracts where circumstances outside the control of the parties to the contract can occur.

Can the Covid-19 or the MCO be enough to trigger force majeure?

In this regard, it should be noted that the Malaysian courts would interpret the force majeure clause in the contract to see whether the circumstances giving rise to a force majeure event are indeed within the scope of the force majeure clause in the contract. The court also is mindful that a party relying on a force majeure clause must prove the facts bringing the case within the clause. (**Intan Payong Sdn Bhd v. Goh Saw Chan Sdn Bhd [2004] 1 LNS 537; [2005] 1 MLJ 311)**

Consequently, whether a party would invoke the force majeure clause on the basis of Covid-19 and/or the MCO will depend on the language of the force majeure clause and the details in each case. The force majeure clause should not be viewed in isolation, but as a whole, along with the other clauses of the contract. The court should then evaluate the fundamental intent of the contract to see what measures

had been taken to alleviate the condition before authorising the defaulting party to draw on the force majeure provision.

A contracting party wishing to rely on the outbreak of COVID-19 as a force majeure case will first decide if the contract has a force majeure clause and, if so, if the provision is sufficiently large to cover the outbreak of COVID-19.The other negotiating party must be informed of the force majeure provision. In addition, it is necessary for such a contracting party to show that it has taken appropriate measures to mitigate the effect.

Conclusion

Invoking force majeure is one of the ways in which the parties to an arrangement can relieve themselves of fulfilling their obligations at the time of COVID-19. Parties to a contract which do not contain a force majeure clause, or where the force majeure clause does not include incidents such as COVID-19, can depend on the doctrine of frustration. It is best to obtain legal guidance when trying to rely on both the doctrine and/or the provision, as misinterpretation or misapplication can constitute a serious breach of the contract.