



The Application of the Doctrine of Frustration to Commercial Leases

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

MARCH 2020

It is not often that lawyers are asked to look at the question of whether a contract has been frustrated by external events. COVID-19 brings this question into sharp focus.

The consequences of the current pandemic are significant for the property industry and landlords and tenants alike are affected. Consequently, it will be a question of whether the parties have allocated risks for this type of event in their contractual relations and, if not, whether the law currently grants any relief, either by the application of some statutory provision or through common law principles.

Lease documents are usually comprehensive and set out the many rights and obligations of the parties but where the lease is silent about the allocation of risk when an event like COVID-19 occurs, what happens?

Various government announcements to shut down bars, clubs, restaurants and other premises have already had a direct impact upon employment. How do the landlord and the tenant manage their relationship from here? Must the tenant continue to pay rent? Is the landlord still able to supply the premises that are being rented? It is unlikely that landlords will agree to terminate leases

or take steps to terminate the lease for default, because the opportunity to find a new tenant simply won't exist.

Obligations of the Parties

One of the principal covenants in a lease is the tenant's obligation to pay rent or other moneys due on time. The usual consequences if the tenant does not do so are a demand for payment, a notice to remedy breach of the covenant to pay and the threat of lease termination.

In commercial leases, a landlord may have an obligation to maintain common areas, keep a building open and



attend to necessary repairs to keep the building functioning, such as lifts and air conditioning.

However, a building owner may also be faced with the prospect of closing access to its building due to an emergency such as contamination or managing the risk of infection. It may do this as a matter of prudence or because a law is passed requiring the building to close.

In most cases, the lease terms do not give a tenant an opportunity to stop paying rent or to terminate the lease. Most leases don't contemplate what happens in an event like COVID-19.

Government Intervention

How government responds to offer relief to landlords and tenants remains to be seen and until then it is important to understand the principles that apply, when considering what to do.

The good news for landlords is that where it cannot perform its obligations under a lease, there is no automatic right for the tenant to terminate the lease. For example, termination of the lease by a tenant for breach of the covenant for quiet enjoyment will not be available where an interruption is temporary.

We have already seen some relief for retail tenants with the Shopping Centre Council of Australia calling on its members to ensure there are no lease terminations for non-payment of rent for small to medium sized businesses.¹ This will no doubt bring some relief to those retail tenants who are already feeling the strain from a significant loss of sales. Following the government's stimulus package announcement, the Council has stated that it is committed to further supporting retailers

Damage and Destruction

One type of "force majeure" provision in a lease is the damage or destruction clause. This type of clause outlines the rights and obligations of both parties where the leased premises are damaged or destroyed during the term or if the

building in which the premises are situated is damaged or destroyed.

The tenant's rent will abate (unless the tenant has caused the damage), either in whole or in part. This depends on the extent of the damage and when the premises or the building will be reinstated. Under these provisions the landlord has obligations to notify a tenant about whether the landlord intends to reinstate, and, if so, under an agreed timeframe. Specific termination rights are agreed between the parties under this type of clause.

It is questionable whether the tenant's inability to use the premises because of building closure due to government directive is such an event that constitutes "damage" or "destruction".

If the premises are unusable due the presence of a virus or the premises are contaminated and otherwise unfit for occupation there may be a question raised about whether this constitutes "damage" or "harm". Again, it will be a matter of reviewing a specific provision in a lease.

It is doubtful that, where premises are temporarily unable to be used due to contamination and are closed for sanitisation and cleaning, this constitutes damage within the meaning of the clause allowing the rent to be abated.²

Force Majeure

Force majeure clauses are often drafted into contracts to cover those 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 riot, war, storm, flood, explosion and such matters (including Acts of God, which might raise some eyebrows).

A lease is unlikely to contain a force majeure clause of the type seen in other commercial contracts. Even if such clause is contemplated, it is equally unlikely that it will cover termination or



suspension of the lease for a declared pandemic. Each lease must be reviewed as to its terms and conditions and the observations made above must be read in the context of the lease document in question.

Frustration

In the absence of a force majeure provision in a lease, 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, under the doctrine, 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.

The doctrine of frustration may apply to leases but the law is not especially clear. Although there have been findings that the principles of frustration may apply to leases, a further question is raised as to whether frustration can apply where there is only a temporary inability for the parties to perform their obligations under the lease. Frustration results in the whole commercial venture embodied in the lease to be discharged in full because of the frustrating event. It should be noted that the threshold for frustration is high.³ It is not the question of an election by the parties, but occurs automatically by operation of law and brings the contract to an end at the time of the frustrating event.⁴

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.⁵ It is difficult to see that a lease, which creates contractual obligations as well as proprietary interests in land, will be seen as a severable agreement (for instance, for the payment of rent by monthly instalments). It could not be said that the rest of the lease remains valid and enforceable but that the obligation to pay rent is frustrated by COVID-19.

Conclusion

Although the law of frustration may apply to leases in Australia, it is doubtful that it applies in circumstances of pandemic. Some lease provisions may adequately protect the rights of the parties in such circumstances, but many will not.

There is more to come on this issue as the government and industry grapple with the damage that COVID-19 has brought to every element of human activity. Commercial leasing is but one aspect of the uncertainty ahead. However we are bound to see some overhauling of lease documents.

To discuss your situation or seek advice about your options, please contact one of our experienced property lawyers.

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

¹ 2016 SCCA members agree to no lease terminations for non-payment of rent, commo.com.au, accessed 27 March 2020, <<https://www.commo.com.au/news/2020/03/27/scca-members-agree-no-lease-terminations-non-payment-rent/1585261096>>.

² *Re Precision Street Industrial Property* (1994) 2 Qd R 614 at 617.

³ *Planet Kids Ltd v Auckland Council* [2013] NZSC 147.

⁴ *Ibid.*

⁵ *Ibid.*, para [36].