McLACHLAN THORPE
PARTNERS

COVID-19 AND YOUR BUSINESS – HOW TO SURVIVE

1. Introduction

1.1 One of the obvious implications of COVID-19, and the governmental response across the globe, is that a party's ability to perform or comply with its contractual obligations will be affected. It may also mean that compliance with its contractual obligations will become more expensive.

1.2 To this end, there are some options available to both parties, as follows:

(a) Suspend performance of contractual obligations;

(b) Terminate the contract; and

(c) Seek to vary the terms of the contract;

1.3 The following issues are also important:

(a) whether your business interruption insurance covers is an insurable event which covers loss arising from a pandemic; and

(b) the recent changes in creditor's ability to recover debts from debtors.

2. Suspension and Variation

2.1 These options are predominantly determined by agreement, that is, all parties to the contract agree to delay performance to some date in the future, or to vary the contract to accommodate the current uncertainty.

3. Termination – Force Majeure

3.1 As Australia is a common law system, parties do not have a right to terminate for a "force majeure" event unless the contract expressly provides for termination for a force majeure event. That is, a force majeure clauses is unlikely to be implied into contracts and, as such, the event must be expressly referred to and defined in a contract.

3.2 To rely on a force majeure clause, the performance of the contract must be impossible, not merely difficult, costly, or inconvenient.

3.3 Whether a force majeure event has occurred will depend entirely on the words of the contract uses to define a "*force majeure event*". It is common for a force

majeure clause to cover events such as acts of God, strikes, lockouts and other industrial disturbances, war, and hostilities. It is less likely that a clause will refer to pandemics.

3.4 If the contractual definition of "*force majeure event"* is limited to certain circumstances which do not mention pandemics, it may be difficult to argue that a pandemic is an event that falls within the scope of the force majeure clause. If, on the other had, the contractural definition of an event is not limited to certain circumstances (for example words such as "*for any reason outside the control of the parties*") this may give broader scope to terminate.

4. Termination – Frustration

4.1 For the doctrine of frustration to apply there must be a supervening event ("frustrating event") that arises without blame or fault of either party[1].

4.2 The frustrating event must significantly change the nature of the contractual rights and/or obligations of the parties, being entirely beyond what was contemplated by the parties when entering into the agreement[2]. In that respect, the event must not be reasonably foreseeable.

4.3 Before a frustrating event can terminate the obligations of the parties to a contract, the contract itself must be silent as to what is to happen in the circumstances that arise[3].

4.4 Some typical examples where a contract is frustrated include:

(a) Physical destruction of the subject matter of the contract[4];

(b) A change in the law rendering performance illegal[5];

(c) where performance becomes virtually impossible due to a change in the law;[6]

(d) Restraint by injunction[7];

(e) Non-occurrence of an event which formed the basis of the contract[8];

(f) Outbreak of war[9].

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[1] *Bank Line Ltd v Arthur Capel & Co* [1919] *AC 435* at 452; *Joseph Constantine Steamship Line Ltd v Imperial Smelting Corp Ltd* [1942] AC 154 at 160-161.
[2] Cricklewood Property and Investment Trust Ltd v. Leighton's investment Trust Ltd [1945] A.C. 221, 228, Viscount Simon L.C
[3] *The Eugenia* 1964 2 QB 226 at 239.
[4] *Taylor v Caldwell* (1863) 122 ER 309.
[5] *Scanlans New Neon Ltd v Tooheys Ltd* (1943) 67 CLR 169.
[6] *Scanlans New Neon Ltd v Tooheys Ltd* (1943) 67 CLR 169
[7] *Codelfa Construction Pty LTd v State Rail Authority of NSW* (1982) *149 CLR*.
[8] *Krell v Henry* (1903) *2 KB 740*.
[9] *Metropolitan Water Board v Dick, Kerr & Co Ltd* (1918) AC 969.

4.5 Furthermore, a contract is frustrated where, beyond the control of the parties, an event occurs which would indefinitely delay performance, for example, the indefinite postponement of an event. In *Denny v James B Fraser*[10] his Honour held that one ought to be able to be "free from commitments which are struck with sterility for an uncertain future period".

4.6 Frustration results in the termination of the contract and the terms of that contract cease to operate. The parties are exempt from any performance of future obligations, being those which did not become due before frustration. However, the parties remain liable for any obligations that had already been due or performed, prior to the frustration. [11]

4.7 Generally, as no party is at fault, neither party can claim damages from the other. However, *Frustrated Contracts Act 1978* (NSW)[12] (the **Act**) provides parties with some relief where a contract has been frustrated. For example:

(a) section 12 of the Act provides that where a contract is frustrated and a party to the contract has paid money, in consideration of performance of the contract, the same amount of money shall be repaid to the party who made the payment.

(b) section 13 of the Act provides that if a party has undertaken any act for the purpose of giving performance under the contract, and as a result of the frustration suffered a detriment, the performing party may be entitled to one-half of the amount that would be fair compensation for the detriment suffered

5. Real Property Leases

5.1 Real property leases generally do not contain any force majeure provisions. On the other hand, it is common that a tenant will be required under the lease to report any case of infectious deases to the landlord, and to comply with any directions or orders by the landlord or public authority. Therefore, if a tenant's business is closed by a public health order, it would be difficult for the tenant to claim rental relief.

5.2 Some leases also contain a clause allowing rent abatement if the leases premises is unusable by the tenant. However, to what extent a tenant can claim relief under these provisions, depends on the wording of the abatement clause. For example, some rent abatement clauses are only linked to physical damages to the building or premises.

5.3 If the leases premises are within a shopping centre, and if the shopping centre is closed, the tenant may be protected by the retail leases legislation in the relevant jurisdiction. For example, Section 34 of the *Retail Leases Act 1994* (NSW) provides that if the landlord inhibits access of the tenant to the shop, the tenant is entitled to reasonable compensation. However, this also depends on whether the landlord has acted reasonably to prevent the closure and to make the decision, and whether the landlord is following order or direction by a public authority.

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[10] *Denny, Mott & Dickson Ltd v. James B. Fraser & Co. Ltd* [1944] A.C. 265, 8 [1956] A.C. 696. 9. At p. 724

[11] *Hirli Malil v Cheong Yue Steamship Co. Ltd* [1926] A/C 497, 510.

[12] There is similar legislation in South Australia (*Frustrated Contracts Act 1988* (SA)), Victoria (*Frustrated Contracts Act 1959* (Vic)).

5.4 In absence of any express provisions or legislative protection, the tenant may still have a right to claim against the landlord for breach of the covenant to provide quiet enjoyment of the premises, and the implied obligation not to derogate from the grant.

6. Business Interruption Insurance

6.1 The purpose of this coverage is to protect businesses from loss arising from a disaster or emergency (**insurable event**). The usual trigger for an insurable event is when insured property sustains loss as a result of the insurable event.

6.2 As with force majeure, the terms of the insurance policy will dictate what events are covered as insurable events. It will depend entirely on the wording of your insurance policy as to whether pandemics are an insurable event. That is, if a pandemic is not included as an event, it is unlikely to be covered by the insurance policy.

6.3 Accordingly, close consideration needs to be given to the wording of the policy.

7. Changes to Australian Insolvency Regime

7.1 On 22 March 2020, the Australian Prime Minister announced a "*shield*" and "*flexibility*" in relation to personal bankruptcy and corporate insolvency, as follow:

(a) The minimum amount for which creditors can:

(i) Issue a creditor's statutory demand for payment of debt (against a company) will be increased from $2,000 to $20,000;

(ii) Issue a bankruptcy notice (against a person) will be increased from $5,000 to $20,000;

(b) The time to comply with either demand (i.e. a creditors statutory demand or bankruptcy notice) will be increased to 6 months instead of 21 days; and

(c) There will be protection for directors against personal liability for trading whilst insolvent.

7.2 These changes will be in place temporarily for 6 months from 25 March 2020. Further, the changes will only apply to bankruptcy notices and creditor statutory demands issued after 24 March 2020.