COVID-19: DOCTRINE OF FRUSTRATION: IMPLICATIONS FOR CONTRACTS IN AUSTRALIA

Date: 27 March 2020

Australia Corporate/M&A alert

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**This information is accurate as of 6.30pm Friday 27 March 2020 and is subject to change as this situation evolves.*

Contracts in Australia and around the world are being impacted by the extraordinary measures and restrictions that governments are putting in place to slow the spread of the COVID-19 Virus.

It may be the case that parties have expressly dealt with force majeure events in the contract terms. For further analysis of force majeure provisions in Australian contracts, please see our related article "COVID-19: What to Do About Your Supply Chains?".

However, the doctrine of frustration can also affect contracts in Australia even in the absence of a force majeure clause. In this article, we examine further this doctrine and its implications for parties to a contract that is affected by a frustrating event.

WHAT IS THE DOCTRINE OF FRUSTRATION?

Frustration is a common law doctrine which recognises that an event may occur through no fault of either party which makes it impossible to perform or radically changes the nature of any obligations under a contract[1]. Even if there is no force majeure provision in a contract, a party may be relieved from the performance of certain contractual obligations if they can establish that the relevant contract has been frustrated.

The doctrine generally operates to discharge the contract prospectively: meaning that the parties are discharged from performing future obligations when frustration occurs.

WHAT IS A FRUSTRATING EVENT?

The cases relating to frustration do not contain an exhaustive definition of a frustrating event. Accordingly, whether or not a particular contract has been frustrated is therefore largely dependent on the drafting of that contract and the surrounding facts. The threshold for establishing the occurrence of such an event – such as the COVID-19 crisis – is onerous as a business would need to prove that:[2]

a) through no fault of either party;

b) an unforeseen event occurs; and

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c) this event renders performance of a contract impossible or radically different from that originally contemplated by the parties.

ILLEGALITY

Historically, governments have implemented numerous restrictions on trade and commerce in times of crises and made changes to the law that impact on the performance of contracts. A contract is illegal under statute if it is expressly or impliedly prohibited by statute. In addition, a contract may become frustrated if it becomes illegal during the course of its performance.

In the context of COVID-19, given the recent restrictions imposed on international/ domestic travel and "non-essential" gatherings for instance, a contract party may no longer be able to fulfil their contractual obligations without contravening the imposed restrictions. However, the change of law may not be sufficient to result in the contract becoming frustrated or discharged by reason of supervening illegality in all circumstances, particularly if (for instance) the state of affairs is brought about by the default of the party seeking to rely on the frustration.

THE FRUSTRATING EVENT CANNOT BE FORESEEABLE

If the event in question was foreseen by the parties or addressed in the contract in the form of a force majeure clause then parties will be deprived of relying on this doctrine.[3] Accordingly, the time of entry into the contract may be significant depending on the level of knowledge regarding the impact of COVID-19 at the relevant point in time.

INCREASED DIFFICULTY OR INCONVENIENCE IS NOT SUFFICIENT

The mere fact that an event has rendered performance more difficult or inconvenient will not constitute a frustrating event.[4] Consequently, in circumstances where a business experiences delays or increased costs as a result of travel restrictions or other measures arising from COVID-19, it could be difficult to rely on frustration as although performance may be substantially more difficult it is unlikely to be impossible in many cases.[5]

SNAPSHOT OF CIRCUMSTANCES THAT MAY CONSTITUTE FRUSTRATION

In the context of the COVID-19 crisis, the following circumstances may be deemed sufficient to frustrate a contract in particular cases (for instance):

- **Absence of essential personnel:** Where a contract provides that an individual's personal capacity is a necessary prerequisite for performance and that individual is prevented from performing the contract due to measures imposed as a consequence of COVID-19 then frustration may be deemed to have occurred.[6]
- **Inability to perform time sensitive obligations:** Where a contract provides for the performance of obligations within a specific timeframe and performance during this period is essential for the contract, measures which postpone or delay performance may frustrate the contract.[7]

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- **Method of performance impossible:** Where a contract specifies a method of performing obligations under a contract and the method specified is essential to the contract, then measures which render this method impossible may constitute a frustrating event.[8]

This is not an exhaustive list but gives a snapshot of the kinds of circumstances that may constitute frustration.

INTERNATIONAL PERSPECTIVE

In circumstances where a party's ability to perform is merely temporarily hindered by COVID-19 related restrictions, a Court is unlikely to conclude that a frustrating event has occurred which ought to result in the discharge of the parties from their contractual obligations.

In the case of *Li Ching Wing v Xuan Yi Xing* which addressed legal issues arising from mandatory isolation orders, a Hong Kong court concluded that a tenant who was held in quarantine for 10 days was unable to rely on frustration (resulting from the SARS outbreak) to discharge his lease which still had nine months left in its term. The Court reasoned that the duration of the isolation order was minimal in the context of the entire agreement.[9] It remains to be seen though how Australian courts may address disputes which arise from a failure to perform in circumstances where a defendant is subjected to an isolation order.

Another foreign decision which is of interest in this context is the case of *Alliance Concrete Singapore Pte Ltd v Sato Kogyo (S) Pte Ltd*. In this case, Indonesia had banned the exportation of sand to Singapore. The Court ultimately held that the legislative prohibition constituted a frustrating event as it fundamentally altered the obligations imposed on the parties.[10] As a result, the parties were discharged from their obligations under the contract upon the commencement of the ban. It will be interesting to see if Australian Courts adopt a similar approach if the COVID-19 crisis were to result in bans on the importation or exportation of particular goods.

WHAT IF I HAVE ALREADY MADE PAYMENTS OR PERFORMED OBLIGATIONS UNDER THE CONTRACT BEFORE IT WAS FRUSTRATED?

Unfortunately, the common law position with respect to frustration can result in a harsh outcome for parties as the general principle is that "losses lie where they fall".[11] Under the common law, it may be difficult for a party to recover payments made or seek recompense for services performed before the occurrence of the frustrating event as no party is at fault.

In order to address the unfairness that may arise as a consequence of frustration, several Australian States (New South Wales, Victoria and South Australia) have put in place legislation to create scope for money paid under certain kinds of frustrated contracts to be recovered. Similarly, this legislation also makes provision for potential recovery of compensation with respect to obligations that have been performed without payment prior to the occurrence of the frustrating event. However, parties may elect to contract out of this legislation if they wish.[12]

WHAT ARE SOME KEY TAKEAWAYS IN RELATION TO FRUSTRATION IN AUSTRALIA?

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In light of the above, some takeaways in this context are:

- As a first step, it is important to consider the terms of the contract (particularly any force majeure provision) to determine the express contractual rights of the parties where the contract is affected by the COVID-19 crisis.
- Frustration can be a basis on which a contract can be discharged but careful analysis is required in this context, noting the risks which can apply in relation to repudiation and breach of contract in particular.
- Even where some obligations are made more difficult to perform as a result of the COVID-19 crisis or changes of law resulting from it, this may not in all cases mean that parties are discharged from all obligations under the relevant contract.
- Where a contract is frustrated, it will be necessary to consider which obligations are being discharged and what scope (if any) there may be to recover monies already paid or to seek compensation for obligations performed prior to payment being made. The position in this regard will differ depending on the terms of the agreement and the relevant Australian jurisdiction.
- In general, it is prudent to seek advice regarding the status of any Australian contracts that are significantly impacted by COVID-19 events, including as to whether the contract is frustrated or likely to remain on foot.

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1. *Brisbane City Council v Group Projects Pty Ltd* (1979) 145 CLR 143.
2. *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337; *Brisbane City Council v Group Projects Pty Ltd* [1979] HCA 54.
3. *Davis Contractors Ltd v Fareham Urban District Council* [1956] UKHL 3.
4. *Ocean Tramp Tankers Corp v V/O Sovfracht* [1964] 2 QB 226.
5. *Yara Nipro Pty Ltd v Interfert Australia Pty Ltd* [2010] QCA 128.
6. *Poussard v Spiers* (1876) 1 QBD 410.
7. *Codelfa Construction Pty Limited v SRA of New South Wales* (1982) 149 CLR 337.
8. *Davis Contractors Ltd v Fareham Urban District Council* [1956] AC 696; *Tsakiroglou & Co Ltd v Noblee Thorl GmbH* [1962] AC 93.
9. *Li Ching Wing v Xuan Yi Xiong* [2004] 1 HKLRD 754.
10. *Alliance Concrete Singapore Pte Ltd v Sato Kogyo (S) Pte Ltd* [2014] 3 SLR 857.
11. *Fibrosa SA v Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32.
12. *Frustrated Contracts Act 1978* (NSW), *Frustrated Contracts Act 1988* (SA); *Australian Consumer Law and Fair Trading Act 2012* (Vic).

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