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COVID-19 as a frustrating event under Singapore contract law

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1. COVID-19 as a frustrating event under Singapore contract law

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Introduction

COVID-19 has had an unprecedented impact on commercial arrangements around the world. This would appear to fit the textbook definition of a frustrating event under Singapore contract law. Alternatively, one might expect COVID-19 to be covered by the doctrine of force majeure. This commentary will provide a brief overview of the contractual issues arising from COVID-19.

Contractual allocation of risk

If it is argued that COVID-19 has disrupted commercial arrangements such that the parties should be freed of outstanding contractual obligations, the first port-of-call is to ask whether COVID-19 is covered by a force majeure clause.

Broad characteristics of a force majeure clause

Under Singapore law, and similar with English law, a force majeure clause is meant to suspend or discharge the contractual obligations of one or more parties to a contract, upon the occurrence of a stipulated event.[2] In many instances, there is a coincidence between the events that trigger off a force majeure clause and those that attract the operation of the doctrine of frustration. However, it must be recognized that a force majeure clause is conceptually distinct from the doctrine of frustration.[3] As the High Court noted in *Precise Development Pte Ltd v Holcim (Singapore) Pte Ltd*,[4] frustration applies by the external operation of law. This occurs when the law deems that a contractual obligation has become incapable of being performed external circumstances have rendered it radically different from what was agreed to before. In contrast, a force majeure clause derives its force solely from the intention of the contracting parties; in that sense, it might be said to be 'internal' to the contract itself. The relief provided for under such clauses is available regardless of whether the triggering event would have been sufficient to frustrate the contract at common law.

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[2] *Precise Development Pte Ltd v Holcim (Singapore) Pte Ltd* [2010] 1 SLR 1083 ("*Precise v Holcim*"), [24].
[3] See *Glahe International Expo AG v ACS Computer Pte Ltd* ("*Glahe v ACS*") [1999] 1 SLR(R) 945, [26]; and *RDC Concrete Pte Ltd v Sato Kogyo (S) Pte Ltd* [2007] 4 SLR(R) 413 ("*RDC v Sato Kogyo*"), [56]. Cf. *Holcim (Singapore) Pte Ltd v Kwan Yong Construction Pte Ltd* [2009] 2 SLR(R) 193, [84].
[4] *Precise v Holcim* (n 2), [24].

Since such clauses derive their effect from the parties' intentions, they can be drafted so as to supersede the effects of frustration at common law. Most prominently, the effect of a force majeure clause may be different from that of frustration, which is to discharge the contract altogether. In contrast, a force majeure clause may provide for a different kind of relief such as suspension of the obligations, extension of time for performance, or some other variation to the contract.[5] This will all depend on how the parties have crafted the force majeure clause.

Specific example of a force majeure clause and relevant issues

The International Chamber of Commerce issued an updated *force majeur*e clause in March 2020 (an update to the 2003 version) in response to the pandemic and recommended its use in international commercial contracts. This is reproduced as follows:

1. "Force Majeure" means the occurrence of an event or circumstance that prevents or impedes a party from performing one or more of its contractual obligations under the contract, if and to the extent that that party proves: [a] that such impediment is beyond its reasonable control; and [b] that it could not reasonably have been foreseen at the time of the conclusion of the contract; and [c] that the effects of the impediment could not reasonably have been avoided or overcome by the affected party.

2. In the absence of proof to the contrary, the following events affecting a party shall be presumed to fulfil conditions (a) and (b) under paragraph 1 of this Clause: (i) war (whether declared or not), hostilities, invasion, act of foreign enemies, extensive military mobilisation; (ii) civil war, riot, rebellion and revolution, military or usurped power, insurrection, act of terrorism, sabotage or piracy; (iii) currency and trade restriction, embargo, sanction; (iv) act of authority whether lawful or unlawful, compliance with any law or governmental order, expropriation, seizure of works, requisition, nationalisation; (v) plague, epidemic, natural disaster or extreme natural event; (vi) explosion, fire, destruction of equipment, prolonged break-down of transport, telecommunication, information system or energy; (vii) general labour disturbance such as boycott, strike and lock-out, go-slow, occupation of factories and premises.

3. A party successfully invoking this Clause is relieved from its duty to perform its obligations under the contract and from any liability in damages or from any other contractual remedy for breach of contract, from the time at which the impediment causes inability to perform, provided that the notice thereof is given without delay. If notice thereof is not given without delay, the relief is effective from the time at which notice thereof reaches the other party. Where the effect of the impediment or event invoked is temporary, the above consequences shall apply only as long as the impediment invoked impedes performance by the affected party. Where the duration of the impediment invoked has the effect of substantially depriving the contracting parties of what they were reasonably entitled to expect under the contract, either party has the right to terminate the contract by notification within a reasonable period to the other party. Unless otherwise agreed, the parties expressly agree that the contract may be terminated by either party if the duration of the impediment exceeds 120 days.

This sample clause shows us that there are at least three important issues to consider when dealing with the application of a force majeure clause in the context of COVID-19.

[5] *Precise v Holcim* (n 1), [25]. See also *RDC v Sato Kogyo* (n 3), [60].

First, whether COVID-19 is a force majeure event as defined by the clause. This is covered by the first paragraph, which, when read with the second paragraph, defines force majeure rather widely. In particular, paragraph two explicitly refers to a 'plague' and 'epidemic'.

Second, whether the party seeking to rely on the force majeure clause needs to have taken reasonable steps to avoid the force majeure event. This is alluded to in the first paragraph, which provides that the force majeure event must be beyond the affected party's reasonable control.

Third, what is the effect on the parties' contractual obligations if a force majeure event has taken place. This is covered by the third paragraph, which lays down extensively the effect of the clause, such it be triggered. Let us explore each of these issues more closely.

First issue: whether COVID-19 is a force majeure event

This first issue is really a question of interpreting the force majeure clause concerned. The Court of Appeal in *RDC Concrete Pte Ltd v Sato Kogyo (S) Pte Ltd*[6] held that the precise interpretation of a force majeure clause is paramount as this would define the precise scope and ambit of the clause itself. Precisely because the very basis of such clauses is the parties' freedom of contract, a court is to give effect to the intention of the parties insofar as that intention is embodied within the clause by way of interpretation.[7] Everything depends on the precise language *and* actual facts of the case at hand.[8] The same Court reiterated this general principle in *Holcim (Singapore) Pte Ltd v Precise Development Pte Ltd*.

These general points of application will need to be applied specifically to the force majeure clause concerned. While it is not possible to provide specific guidance, some broad issues include whether a clause that refers to a 'epidemic' also covers a 'pandemic'. Also, a clause that does not refer to a pandemic or epidemic but refers to an effect of COVID-19, for example, the shutdown of global supply chains, can also be covered by a relevant clause. Finally, a catch-all clause such as 'any other event beyond the control of the parties' will probably cover COVID-19.

[6] *RDC v Sato Kogyo* (n 4).
[7] ibid, [54].
[8] ibid, [58].

Second issue: whether the affected party needs to have taken reasonable steps to avoid COVID-19

Further, a party who relies on a force majeure clause must usually show that it has taken all reasonable steps to avoid its operation, or mitigate its results.[9] As the Court of Appeal held in *RDC Concrete Pte Ltd v Sato Kogyo (S) Pte Ltd,*[10] this principle is consistent with the very nature and function of a force majeure clause since such a clause presupposes that events falling within its scope and ambit are beyond the control of the contracting parties and that language to this effect will invariably be utilized in the clause itself.[11] This can be seen in the sample clause above.

As such, in *RDC Concrete* itself, the shortage of aggregates in Singapore owing to the Indonesian government's ban on sand exports was not sufficient to trigger the force majeure clause concerned because the defendant could still purchase aggregates at a higher price from the market. Although the contract had become more onerous for the defendant to perform, the circumstances clearly did not constitute force majeure within the relevant clauses in the contract.[12] In the context of COVID-19, it must therefore be considered whether the effect of the pandemic, be it more expensive supplies or transport, are so onerous that they cannot be reasonably avoided by the affected party.

A related issue is whether the affected party can even foresee the pandemic in the first place. In this regard, Bill Gates has prominently warned of a pandemic for several years before 2020. President Barack Obama had similarly warned of the dangers of pandemics in 2014. It might even be argued that, with the SARS, MERS and other epidemics of the past, it must be reasonably foreseeable that the world will be confronted with a pandemic like the present one caused by COVID-19. However, such a view may be too far-reaching. Indeed, while it is possible to foresee that the world will be affected by a pandemic at some point, it is quite a different matter to say that the speed at which COVID-19 affected the world, together with the devastating effect on economies, is specifically foreseeable.

Third issue: event of a force majeure clause in the context of COVID-19

The relief available under a force majeure clause will be determined by the specific content of that clause itself. In a situation where the doctrine of frustration is sought to be excluded, the clause concerned would expressly stipulate that the contract is *not* to be discharged *despite* the fact that the situation would otherwise be one that would have frustrated the contract.[13] An example of such

[9] ibid, [64], applying the English Court of Appeal decision of *Channel Island Ferries Ltd v. Sealink UK Ltd,* [1988] 1 Lloyd's Rep. 323, 327.
[10] *RDC v Sato Kogyo* (n 4).
[11] *RDC v Sato Kogyo* (n 4), [64].
[12] ibid [70].
[13] ibid [60].

a clause can be found in the Court of Appeal case of *RDC Concrete Pte Ltd v Sato Kogyo (S) Pte Ltd.*[14] The force majeure clauses in that case provide that, if those clauses are triggered, the contract 'shall be suspended or limited until such circumstance ceases'.[15] This is different from a contract which is frustrated at common law, which would be automatically discharged forthwith, and the effects to be determined pursuant to the Frustrated Contracts Act.

Frustration

Frustration is the common law doctrine that is most talked about in relation to COVID-19, along with force majeure clauses.

The generally accepted test at present is what is often referred to as the 'radical change in obligation' test. In the oft-cited words of Lord Radcliffe in the House of Lords decision of *Davis Contractors Ltd v Fareham Urban District Council*:

> [F]rustration occurs whenever the law recognizes that, without the default of either party, a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing *radically different* from that which was undertaken by the contract.[16]

This juridical basis has been accepted in Singapore. [17]

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[14] ibid.
[15] ibid [61].
[16] *Davis Contractors Ltd v Fareham Urban District Council* [1956] AC 696, 729 (emphasis added). See also the general thrust in the House of Lords case of *National Carriers Ltd v Panalpina (Northern) Ltd* [1981] AC 675, although some Lords of Appeal were of the opinion that any juridical basis would do! Cf. also the Singapore High Court decision of *Sherrifa Taibah bte Abdul Rahman v Lim Kim Som* [1992] 1 SLR(R) 375, reversed (but not on this point), [1994] 1 SLR(R) 233.
[17] See the Singapore Court of Appeal decisions of *Chiang Hong Pte Ltd v Lim Poh Neo* [1983-1984] SLR(R) 346, [21]; *Glahe v ACS* (n 4), [27]; and *RDC v Sato Kogyo* (n 3), [59], as well as the Singapore High Court decisions of *Goh Chin Kiat v Dorothy Ong* [1992] SGHC 243; *Seow Lee Kian @ Seow Lee Kian Terence v Wong Kok Hong @ Wong Henry* [1998] SGHC 194, [43]; *Shenyin Wangou-APS Management Pte Ltd v Commerzbank (South-East Asia) Ltd* [2001] 3 SLR(R) 108, [14]; and *Oakwell Engineering Ltd v Energy Power Systems Ltd* [2003] SGHC 241, [96]. See further the Singapore Court of Appeal decision of *Glahe v ACS* (n 3), [26], which adopted Lord Simon's similar statement in *National Carriers Ltd v. Panalpina (Northern) Ltd,*[1981] AC 675, 700. Frustration of a contract takes place when there supervenes an event (without default of either party and for which the contract makes no sufficient provision) which so significantly changes the nature (*not merely the expense or onerousness*) of the outstanding contractual rights and/or obligations from what the parties could reasonably have contemplated at the time of its execution that it would be unjust to hold them to the literal sense of its stipulations in the new circumstances; in such case the law declares both parties to be discharged from further performance. [emphasis added]

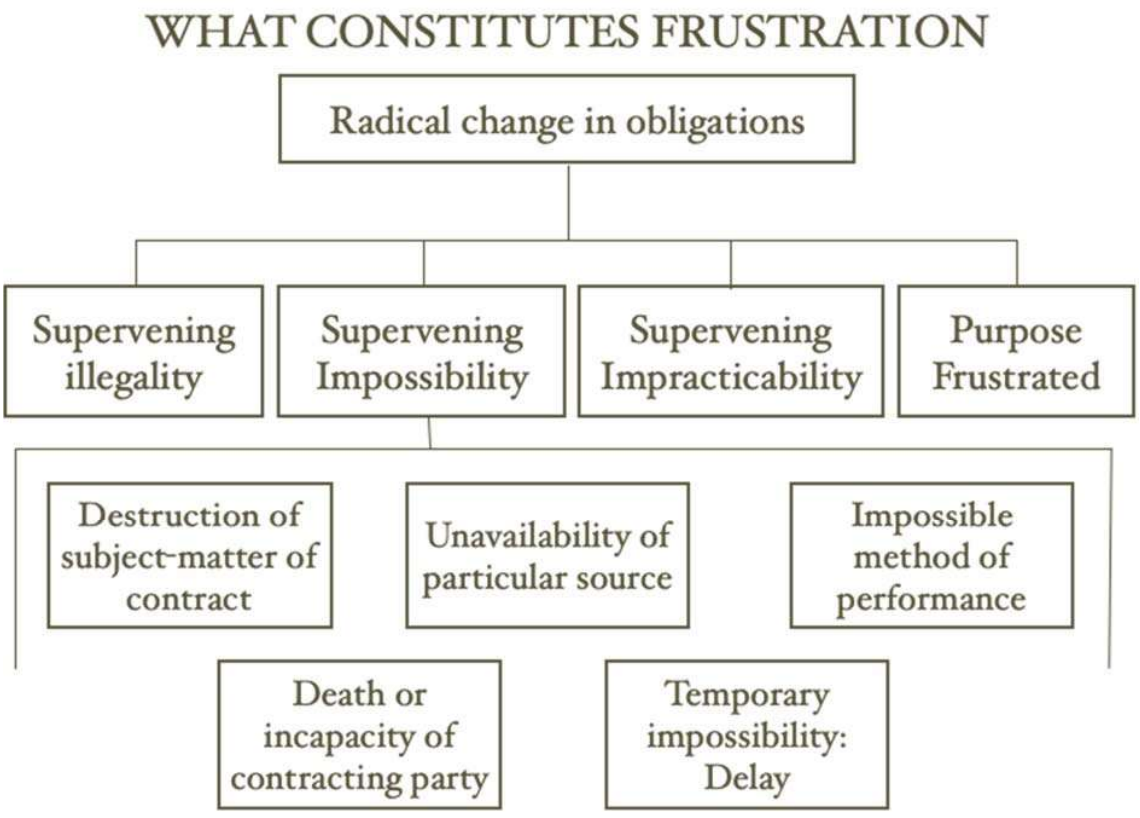
Timing: when did COVID-19 start?

Because frustration applies to supervening events after the conclusion of the contract, it is important to determine just when the supervening event happened. If the alleged supervening event actually occurred before the contract was signed, this may preclude the operation of frustration.

In the context of COVID-19, this requires us to consider whether the point at which the pandemic started can be taken as when the World Health Organisation (WHO) declared it to be such on 11 March 2020, or whether it ought to be earlier, when its effects were beginning to be felt in February 2020? Indeed, there are some who argued that the WHO had taken too long to declare a pandemic. This will have a practical bearing in case a party argues that the pandemic had commenced before the relevant contract was formed. For example, if a contract was concluded in early March 2020, before 11 March 2020, might it be possible to argue that the effects of the pandemic had already been felt by then?

Is COVID-19 a frustrating event?

There are different situations that constitute frustration, as can be seen below:



Rather than ask whether COVID-19 is a frustrating event in and of itself, it might be more worthwhile to ask whether the *effects* of COVID-19 are frustrating.

For example, COVID-19 led to countries imposing restrictions on the operation of certain businesses. It became, for example, illegal to operate a dine-in eatery for some months in Singapore. In this situation, a contract might be frustrated by virtue of illegality. Frustration operates to discharge a contract validly formed if performance of it becomes illegal after formation.[18] Performance of the contract can become illegal because of the enactment of a new law. A law (or public policy consideration) that had existed prior to the formation of a contract can also make performance of that contract illegal after it had been validly formed if the circumstances have changed. The changed circumstances would, in accordance with the pre-existing law (or public policy consideration), render such performance illegal.

COVID-19 has also disrupted supply chains. It might have made certain supplies more expensive to obtain, with a concomitant increase in production costs. The Court of Appeal in *Alliance Concrete Singapore Pte Ltd v Sato Kogyo (S) Pte Ltd*[19] spelt out three situations concerning the unavailability of a source:

> Scenario (a): Where the source is expressly referred to in the contract
>
> 49 Where the source is referred to in the contract, and that source fails through no fault of either party, the contract is generally discharged by the doctrine of frustration.
>
> Scenario (b): Where only one party intended an unspecified source
>
> 51 Where only one of the contracting parties intended for a particular source such that the source is not provided for in the contract, then the contract will not be discharged when that source fails. This is illustrated by the oft-cited English Court of Appeal decision of *Blackburn Bobbin Co Ltd v TW Allen & Sons Ltd* [1918] 2 KB 467.
>
> Scenario (c): Where both parties contemplated an unspecified source
>
> 53 As for the scenario where the source is not referred to in the contract but both parties contemplated that unspecified source, there is no conclusive English authority. The English High Court decision of *Re Badische Co Ltd* [1921] 2 Ch 331 appears to support the proposition that where both parties contemplated an unspecified source and that source fails, the contract would be discharged.

[18] See *Ritchie v Atkinson*, (1808) 10 East 295. We are presently dealing with *supervening* illegality; on illegality, see generally paras 761–991 *supra*. See also *Murugesan v Krishnasamy*, (1957) 3 MC 93.
[19] *RDC v Sato Kogyo* (n 4).

Thus, where parties to the contract anticipated the use of a certain source material that has been disrupted by COVID-19, the contract can be frustrated.

Limitations on the operation of frustration

If the parties ought to have foreseen the alleged frustrating event, they must be taken to have assumed the risk of this event happening, and that there should therefore be little room to invoke frustration.

For example, in *Housing & Development Board v Microform Precision Industries Pte Ltd*,[20] there was a contract for the lease of a plot of land from the plaintiff to the defendant. The defendant had intended to build a factory on the land. However, the land was 'land-locked' and had no ostensible access.[21] When the plaintiff sued for the rent, the defendant argued that the contract had become frustrated as it was unable to secure access to the plot to build the factory. The High Court rejected this argument. It held that the defendant had been aware of the risk that the relevant authorities would not grant access to the plot of land before the contract had been concluded. As such, the defendant had taken the risk of a foreseeable event eventuating, and now cannot say that the contract was frustrated.

In the context of COVID-19, the issue of whether the pandemic is appropriately foreseeable will also be relevant here.

In addition, it is a clear rule of law that self-induced frustration is *no* frustration. This rule is commonsensical enough, having regard to the fact that the doctrine operates on the assumption that *neither* contracting party is at fault. Further, it would be odd, to say the least, to allow a party to benefit from his or her own wrongful act. In the context of COVID-19, the limited scenario where this might occur is if a party intentionally becomes affected by COVID-19, thereby leading to an incapacity argument. Otherwise, and more plausibly, a party might choose to devote its limited supplies caused by COVID-19 to one party than another.

[20] *Housing & Development Board v Microform Precision Industries Pte Ltd* [2003] SGHC 214.
[21] ibid [1].

What should be done in the future?

Looking forward, it is clear that the doctrine of frustration is limited.

Indeed, in a joint commentary, I had argued that even if a contract is frustrated, the courts' ability to adjust the parties' rights and liabilities is fairly limited. The Frustrated Contracts Act, based on identical English legislation, allows the courts to allocate the losses caused by the frustration between the parties, but it does not allow them to adjust the parties' rights against each other. This is underpinned by the deference accorded by the common law to the parties' 'freedom to contract', that is, the freedom to enter into any contractual arrangement which will be enforced if it is not illegal or immoral.

Therefore, the relative rigidity of the common law, the uncertainty in how it might be applied, coupled with the limited ways to deal with a contract affected by COVID-19, may create legal choke points as parties line up for a binding determination. What might be done to mitigate a legal epidemic flowing from these problems? VK Rajah and I had proposed a three-pronged approach that goes beyond the provision of breathing space.

First, rather than wait for the common law's response to the pandemic, Parliament should legislate beyond the COVID-19 (Temporary Measures) Act to empower the courts to deal with commercial disputes directly affected by the pandemic more flexibly. From a systemic perspective, such legislation would give the business community immediate certainty and more predictability. This is important as businesses assess their present positions and rebuild for a post-COVID-19 economy. This will also be more efficient than the common law system. Unlike the courts which can only deal with discrete cases before them, Parliament can enact far-reaching legislation that can anticipate the various issues that can arise.

Second, such legislation could draw inspiration from the civil law systems. These systems allow the courts greater latitude in adjusting the parties' rights against each other. For example, the German Civil Code, pursuant to the '*rebus sic stantibus*' principle, allows the contract to be modified on the satisfaction of three conditions. First, if the parties would not have entered into the contract at all or on different terms, had they had known of the change in circumstances. Second, the change in circumstances must be so serious that the affected party can no longer be reasonably expected to remain bound to the contract. Third, the affected party must not have assumed the risk of the change in circumstances. More broadly, however, this principle only applies in very limited circumstances, since a subsequent change to contractual terms must be limited to extreme cases. If, however, the principle applies, the affected party may request for the

contract to be modified. While the affected party can suggest a modification to the courts or tribunal, there remain a wide variety of modifications the decision-maker can impose on the parties.

Similarly, French civil law allows a party affected by changed circumstances to plead hardship or *'imprévision*'. The notion of *imprévision* was introduced into the French Civil Code in the 2016 French contract law reform. It therefore only applies to contracts concluded after 1 October 2016. This allows a party to a commercial contract to request for the renegotiation or termination of a contract if three conditions are satisfied. First, similar to the common law doctrine of frustration, there must have been an unforeseeable change of circumstances beyond the parties' control. Second, the change of circumstances must have made excessively burdensome for a party to perform its obligations under the contract. Third, the party relying on *imprévision* must not have accepted the risks of the change in circumstances. In the event of *imprévision*, the affected party can ask the other party to renegotiate the contract. If renegotiation fails, the parties may cancel the contract or ask a court or tribunal to modify the contract.

While the common law has traditionally shied away from interfering in the parties' contractual arrangements like the civil law has, this approach needs to be reconsidered from a policy perspective in light of the unprecedented COVID-19 pandemic. Businesses will need all the help they can to survive the current crisis. Thus, the law should allow for proactive steps to be taken not only to adjust contracts, but to allow for just and equitable solutions to be found where contractual relationships have broken down. The courts should be empowered to do so, when parties can show that contractual obligations have been materially affected by COVID-19. While these measures will affect the parties' contractual rights retroactively, this extraordinary measure can be justified by the unprecedented impact of COVID-19. However, if parties have already addressed how such an unprecedented event like COVID-19 is to be dealt with, then their legitimate expectations must be honoured.

Thirdly, an authoritative judicial restatement of the law of frustration may be attempted in lieu of legislation.

To its credit, the Singapore Government, like other countries, has acted quickly to create much-needed relief for individuals and businesses affected by COVID-19 by passing the COVID-19 (Temporary Measures) Act. In the interim, this will provide temporary and targeted protection for businesses and individuals who cannot perform particular types of contractual obligations due to COVID-19. The Act gives parties precious 'breathing space' to negotiate and resolve their differences, thereby preserving liquidity. But, after the legal 'circuit breaker' concludes, we will need to be prepared for a legal epidemic that will pose unique challenges for our legal system. Similar

to the current health pandemic, a legal epidemic will pose unprecedented challenges that need to be addressed immediately, effectively and creatively.