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## COVID-19 and the Doctrine of Frustration in Hong Kong

In our recent article we discussed the legal ramifications of the *force majeure* clauses to “excuse” parties from performing onerous or impossible contracts in the wake of the COVID-19 outbreak. Whilst it is not uncommon for commercial contracts to incorporate *force majeure* clauses, there remain circumstances under which a party may also consider to seek to relieve themselves from performing under the common law doctrine of frustration.

### *Frustration*

Under Hong Kong law, when an event for which no contractual party may be faulted occurs to significantly alter the parties’ rights and obligations originally intended under the contract, the doctrine of frustration operates to discharge the contract. Such “alteration” could come in many shapes and sizes. For instance, the contract could be rendered factually or commercially impossible to perform, or the parties’ rights and obligations could be transformed into something radically and fundamentally different. If no party could be blamed for the event and it could not have been reasonably foreseen at the time of the contract’s execution, the doctrine of frustration steps in to discharge the contract on the ground that it would be unjust to force the parties to continue.

### *How and when has a contract been frustrated?*

The doctrine of frustration has a narrow scope, and the Court will not casually intervene to discharge a commercial agreement. It is therefore up to the party seeking to excuse his performance to demonstrate precisely how his agreed right or obligation has been frustrated. Parties may consider whether their situation is similar to some of the more common situations where frustration arise:-

#### *Supervening illegality*

- The performance of the contract may be legal at the time of execution, but a subsequent change of the law may render it illegal. With the wide scale restrictions throughout the Mainland, Hong Kong, and

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Macau pertaining to travel, business operations, and other aspects of social life, new regulations, policies, and laws may have rendered certain (terms of) contracts illegal to perform.

- For instance, a contract for building constructions to be completed within a year may have been approved by relevant authorities, but if the area has now been quarantined and construction workers are not authorised to commence any work, completing the contract may now be impossible due to performance being contrary to local regulations and laws.

## *Cancellation of expected event*

- In some cases, performance is not rendered *physically* impossible by a frustrating event, but *commercially* impossible. When King Edward VII cancelled his coronation process in 1902, the defendant in *Krell v Henry* [1903] 2 KB 740, who hired the plaintiff's flat solely for the purpose of viewing the coronation, declined to pay the balance of the agreed rent. As it was understood between the parties that the flat was only hired for the viewing of the coronation, the Court discharged the agreement because the cancellation of the coronation process, which was the "*foundation*" of the contract, "*prevented the performance*" of the agreement. It was physically possible for the defendant to still rent the flat, but it was no longer commercially possible.
- In the same way, parties may find themselves in fundamentally changed circumstances where the contract has become commercially frustrated. A caterer who offered discounted prices to cater to a major convention for publicity, for example, may have a case of commercial frustration if the convention is cancelled, and he is instead asked to cater to some other function at the same rates.

## *Illness, incapacity, or death*

- Unfortunately, given the nature of COVID-19, the possibility of a party falling ill, becoming incapacitated, or even passing away cannot be ruled out.
- For example, a short-term employment contract may be frustrated if the employee falls ill, becomes incapacitated, or becomes quarantined. Much depends on, however, the nature and duration of employment, the terms of the contract (such as terms relating to sick leave and pay), and the expected prospect and rate of recovery. Aside from considering how long the employee will be away for, one must also consider whether the long-term effects of the illness may impact the employee's ability to efficiently work again. For example, if intensive physical activities are involved, one should consider whether the recovered employee may still be impaired by long-term post-recovery effects.

It must however be borne in mind that the doctrine will not rescue a party from a bad bargain. An increase of difficulty in performing does not by default frustrate the contract. What is required is a fundamental and radical change, or complete deprivation of commercial purpose.

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## COVID-19 and the situation in Hong Kong

It is yet to be seen whether any cases concerning COVID-19 arise, but in *Li Ching Wing v Xuan Yi Xiong* [2004] 1 HKLRD 754 the Court considered whether the Severe Acute Respiratory Syndrome (SARS) epidemic in 2003 operated as a frustrating event. There, a tenant of a 2-year lease sought to invoke the doctrine when he was subjected to a 10-day SARS-related isolation order.

This argument was rejected by the Court, which decided that a 10-day period was insignificant in view of the 2-year duration of the lease, and although SARS may arguably be an unforeseeable event, it did not “*significantly change the nature of the outstanding contractual rights or obligations*” of the parties in this case.

This case serves to illustrate the high threshold a party seeking to invoke the doctrine must meet, and the necessity for a truly significant and fundamental alteration to the parties’ contractual obligations and rights. It may also be worth noting that whilst SARS was formally declared a “pandemic” by the World Health Organisation, COVID-19 is currently only classified as a “public health emergency”.

Parties experiencing exceptional hardship in performing their contracts in light of the COVID-19 outbreak should therefore carefully scrutinise the circumstances in which their contracts may have been frustrated. The requirements are not lax, and parties should take steps to mitigate any risks and act commercially.

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