Frustration of leases: is now the right time?

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Frustration is a word on many lawyers' lips right now: and not just because we are all thoroughly fed up with being in close proximity with other members of our household and distant from all our friends. Frustration is the contractual ejection seat, allowing an escape from liabilities which have become unexpectedly onerous when something unforeseen occurs. And what could be less foreseeable than a worldwide pandemic and the closure by law of many businesses?

But whilst the House of Lords held in *National Carriers Ltd v Panalpina* ([1981] AC 675, [1981] 1 All ER 161, [1980] UKHL 8) that it is theoretically possible for a lease to be discharged by frustration, there has been no case in England and Wales in which such a claim has ever succeeded. The question is whether, 40 years on, the circumstances are right for a groundbreaking decision.

In *Panalpina,* the test for frustration was set out by Lord Simon as follows:

"*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*"

Two members of the House of Lords, Lords Hailsham and Russell, said that a lease can "*hardly ever*" be frustrated and then only, according to Lord Hailsham, in "*exceedingly rare*" circumstances. Hypothetical examples of such circumstances included a "*vast convulsion of nature*" such as property falling into the North Sea, or off a cliff, or an explosion destroying the property in the case of a short lease. Whilst the long-term effects of Covid-19 on people remain uncertain, it seems pretty clear that it won't cause buildings to explode.

One reason why leases are so difficult to frustrate is their relative length compared with other types of contract. Leases are long-term legal relationships and the parties enter into them accepting the risks of ups and downs along the way. In *Panalpina*, the lease was for a term of 10 years. About half-way through, the only vehicular access to the premises – a warehouse – was closed for a period of 20 months. That was held not to be sufficient to frustrate the lease, given the length of time which the tenant would have left of the lease after the interruption had come to an end. Another reason is that leases are marketable property. Even if the tenant cannot use the premises, it can usually assign or sublet to someone who can.

So, in *London v Northern Estates Co v Schlesinger*, an Austro-Hungarian subject took a three-year tenancy in March 1914 of a flat at Westcliffe-on-Sea. On the outbreak of the First World War, the tenant became an enemy alien and was barred from living in the flat. The lease however was not frustrated: the tenant could assign or sub-let, which were valuable rights in themselves. Similarly the ability to assign or sub-let was one of the reasons that the European Medicines Agency's 25-year lease of premises in Canary Wharf was not frustrated by Brexit and the Agency's move to Amsterdam (and it did, in fact, sub-let to WeWork).

What makes the current pandemic potentially different is that certain business uses have been prohibited by law for the period of the lockdown. If you have a lease of, say, a restaurant and have covenanted not to use the premises otherwise than as a restaurant, then you cannot run your business from the premises but nor can you, in practice, assign or sublet to anyone else, since nobody else can run a restaurant from those premises either. The law does not make it unlawful to hold the lease, but it makes it unlawful to use the premises for the one use which is permitted by the user covenant. Just as certain US leases of saloons and bars were held to be frustrated when Prohibition came in, there might be scope for arguing that the restaurant lease is frustrated. The difficulty for a tenant thinking of pulling the emergency cord may well be the length of time it has left in its lease term, as in *Panalpina*. There is also a dilemma for the tenant: if the lease has been frustrated then it must leave the premises. It will not look good to stay on and trade – perhaps as a takeaway – whilst the frustration arguments rumble through the courts. And chains can't consistently claim that the leases on some of their less profitable premises have been frustrated and keep the rest: if the pandemic has frustrated one lease then it has surely frustrated all.

The view of some real estate lawyers is that the real bloodbath in commercial property is yet to come. A large part of the 2020 March quarter's rent roll went unpaid, in circumstances where businesses had had almost a whole quarter of usual trade. What will the June quarter look like? And will some be so desperate to rid themselves of liabilities that they will be prepared to roll the dice on a frustration claim?