Contracts and Coronavirus Part 2: frustration of leases on grounds of illegality in Scotland and England

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In the second of two articles, the author considers the specific issue of the frustration of leases on grounds of illegality and the contrasting approaches in Scots and English law.

Illegality

A contract for a purpose which is illegal at the time of contractual formation has long been held to be void *ab initio, Holman v Johnson* (1775) 1 Cowp 341, *Barr v Crawford*, 1983 S.L.T. 481, although the law in this area has been placed into some confusion by the Supreme Court decision of *Patel v Mirza* [2016] UKCS 42; [2017] A.C. 467; [2016] 3 W.L.R. 399, but with frustration we are concerned with supervening illegality, that is a contract that was legal when formed but whose performance has subsequently become illegal due to a change in the law. Supervening illegality is a ground for frustration of a contract under the fundamental principle that the courts will not enforce an illegal contract.

"It is plain that a contract to do what it has become illegal to do cannot be legally enforceable. There cannot be default in not doing what the law forbids to be done."1

Supervening illegality is an easier ground for a court to apply than impossibility or radical change of performance (see Part 1 of this article at 2020 S.L.T. (News) 99) because while those grounds are often a matter of degree, illegality is binary: a matter is either illegal or it is not.

A common example of supervening illegality is where the outbreak of war makes it illegal to do business with a party based in a foreign country which has become an enemy state, see e.g.,

Cantiere San Rocco SA (Shipbuilding Co) v Clyde Shipbuilding & Engineering Co Ltd, 1922 S.C. 723; 1922 S.L.T. 477; [1924] A.C. 226 and discussed in Part 1. Another common effect of Britain being at war was that numerous pieces of emergency legislation made previously lawful activities unlawful. The leading case example is *Denny Mott & Dickson Ltd* where a lease for a timber yard business was frustrated because it had been made unlawful to trade in imported timber:

"Here is an agreement between two parties for carrying on dealings in imported timber. By emergency legislation the importation of timber has been rendered illegal. Neither party can be said to be in default. The further fulfilment of their mutual obligations has been brought to an abrupt stop by an irresistible extraneous cause for which neither party is responsible."2

This is precisely the situation faced today by many businesses in the "war" against Coronavirus. In mid March 2020 in response the ever increasing spread of Covid-19 infections the United Kingdom Government moved swiftly to take powers to close many categories of business providing services to the public in order to minimise social interaction and facilitate its policy of social isolation to try and slow the spread of the highly infectious virus. To this end the UK Government enacted the Coronavirus Act 2020, in force from 25 March 2020, which conferred many new powers upon the UK Government and the devolved administrations. For present purposes the most relevant parts of the Act are s.49, which is headed "health protection regulations: Scotland", and Sch 19, which contains provisions enabling the Scottish Ministers to make regulations for the purpose of preventing, protecting against, controlling or providing a public health response to the incidence or spread of infection or contamination in Scotland (whether from risks originating there or elsewhere).

The other relevant provision is s.52 and Sch 22, which confers powers on the UK Government to issue directions in relation to events, gatherings and premises. These authorise the Secretary of State, Scottish Ministers, Welsh Ministers and Executive

1 *Denny Mott & Dickson Ltd v James B Fraser & Co Ltd* [1944] A.C. 265; 1944 S.C. (H.L.) 35; 1945 S.L.T. 2 per Lord MacMillan at p.41 (p.272; p.3).
2 *Denny Mott & Dickson Ltd*, supra, per Lord MacMillan at p.41 (p.272; p.3).

Office in Northern Ireland to restrict or prohibit gatherings or events and to close and restrict access to premises during a public health response period (which is determined by Ministers based on criteria defined in the schedule).

Prohibiting regulations

For present purposes the most important pieces of prohibiting legislation are two statutory instruments; one English, one Scots. The Health Protection (Coronavirus, Business Closure) (England) Regulations 2020 which came into force at 2 pm on 21 March 2020 in England. The Scottish Government had to wait until the Coronavirus Act came into force on 25 March before it could enact similar legislation acting under the powers granted to it by s.49 and Sch.19 to the Act. The next day the Scottish Government enacted very similar regulations to the English provisions in the form of the Health Protection (Coronavirus) (Restrictions) (Scotland) Regulations 2020, which came into force at 7.15 pm on 26 March 2020 in Scotland. For the duration of the "emergency period" under these regulations both the English and Scots statutory instruments forbid an extremely wide variety of businesses from providing services to the public until the government declares that the emergency period has ended. Under reg.2(2) of the Scottish Regulations, the Scottish Ministers must review the need for restrictions and requirements imposed by the regulations at least once every 21 days, with the first review being carried out by 16 April 2020. It seems likely that the emergency period may well last several months or longer but as of early May that was impossible to predict.

The Scottish Regulations, regs 3 and 4 and Sch 1 Pt 1, forbid the opening of cafes, restaurants and bars and Sch 1 and Pt 2 forbids the following long list of other kinds of businesses from opening:

- Cinemas;
- Theatres;
- Nightclubs;
- Bingo halls;
- Concert halls;
- Museums and galleries;
- Casinos;
- Betting shops;
- Spas;
- Nail, beauty, hair salons and barbers;
- Massage parlours;
- Tattoo and piercing parlours;

• Skating rinks;
• Indoor fitness studios, gyms, swimming pools, bowling alleys, amusement arcades or soft play areas or other indoor leisure centres or facilities;
• Funfairs (whether outdoors or indoors);
• Playgrounds, sports courts and outdoor gyms.

So under the Health Protection (Coronavirus) (Restrictions) (Scotland) Regulations 2020 and the Health Protection (Coronavirus, Business Closure) (England) Regulations 2020 the conduct of many normally lawful businesses has been made illegal, for example cafes, pubs, cinemas and hairdressers. On a practical level these "prohibited businesses" now have zero income but nevertheless face the ongoing liability to pay rent for their premises Payment of rent on a lease is often one of the most expensive obligations occurred by a commercial business like a pub or hairdresser and typically payment is due in advance on quarterly terms. Commercial properties are rented out for periods of time ranging from months to centuries, but if a rented property suddenly and unexpectedly cannot be used for the purpose for which it was leased (e.g. as a pub or cafe, because that purpose is now illegal) then unless the landlord waives the rent the tenant will face the fundamental problem of a contractual obligation to pay rent despite receiving no income from the business located in the leased premises. This is precisely a situation where a lease might reasonably be expected to be held to be frustrated by illegality, as clear an example of Lord Radcliffe's *non haec in feodera veni* criteria in *Davis Contractors v Fareham Urban DC* [1956] A.C. 696 at p.729 (discussed in Part 1) as can be imagined.

Differing approaches of English and Scots law on frustration of leases

Frustration of leases is an area where Scots and English Law differ radically: Scots law allows frustration of a lease for good cause on much the same basis as any other kind of contract (e.g. of sale or services) but, at least in the past and quite possibly the present, English law has made this almost impossible by setting the bar for frustration of leases much higher than in Scots law. A lease for property located in Scotland is governed by Scots Law and those located in England by English Law.

English leases

English law is very reluctant to find a lease to be frustrated, indeed there is no reported case where this has occurred. In *Cricklewood Property and*

Investment Trust Ltd v Leightons Investment Trust Ltd [1945] A.C. 221; [1945] 1 All E.R. 252 the House of Lords decided unanimously that on the facts there had been no frustration of a long term building lease by the imposition of building restrictions following the outbreak of war. On the question of principle, the House of Lords was evenly divided with Viscount Simon and Lord Wright willing to consider the possibility that on very rare occasions a lease may be frustrated, as, for instance, if some vast convulsion of nature swallowed up the property altogether, or buried it in the depths of the sea. By contrast, Lord Russell and Lord Goddard thought that on principle it is simply impossible for a lease to be frustrated. They reached this conclusion because they held that a lease is more than a mere contract in that it creates an estate in the land vested in the lessee, and that this estate in the land could never be frustrated, even though some contractual obligations under the lease might be suspended by wartime regulations. This precedent in *Cricklewood* points strongly to the non frustration of English leases, notwithstanding that the Coronavirus emergency legislation has made the use of the premises illegal, but English law has moved a little since then. In *National Carriers Ltd v Panalpina (Northern) Ltd* [1981] A.C. 675; [1981] 2 W.L.R. 45; [1981] 1 All E.R. 161, the majority in the House of Lords agreed with the reasoning of Viscount Simon and Lord Wright in the *Cricklewood* case, and thus held that the doctrine of frustration is, in principle, applicable to leases, although several of their Lordships considered that the doctrine would "hardly ever" be applied to a lease. Lord Hailsham of St. Marylebone LC invoked Gilbert and Sullivan to explain the position at p.688:

"The point, though one of principle, is a narrow one. It is the difference immortalised in H.M.S. Pinafore between 'never' and 'hardly ever,' since both Viscount Simon and Lord Wright clearly conceded that, though they thought the doctrine applicable in principle to leases, the cases in which it could properly be applied must be extremely rare.
With the view of Viscount Simon and Lord Wright I respectfully agree."

It will be interesting to see if the English courts are more sympathetic to frustration of leases in the current context, perhaps now is the occasion for the "hardly ever" to actually occur! After all, even in H.M.S. Pinafore the "exceedingly polite" Captain Corcoran, despite his claim to never use a "big, big D" in the first act of H.M.S. Pinafore, in the second act eventually says "damme"!

Two further points can be derived from the judgment in *National Carriers*, one making it easer to find frustration, the other harder. The following passage in *Corbin, Contracts* was cited with approval in the House of Lords by Lord Simon of Glaisdale in *National Carriers*:

"If there was one principal use contemplated by the lessee, known to the lessor, and one that played a large part in fixing rental value, a governmental prohibition or prevention of that use has been held to discharge the lessee from his duty to pay the rent. It is otherwise if other substantial uses, permitted by the lease and in the contemplation of the parties, remain possible to the lessee."

This would seem to make it easier to hold a commercial lease for a shop or a pub frustrated where the lease specifies that a pub or shop is the principal use of the premises contemplated in the lease.

On the other hand, the English authorities, to a far greater degree than the Scots authorities, take the duration of the unexpired term of the lease set against the likely duration of the frustrating event into account. The English authorities tend to the view that a potentially frustrating event which causes an interruption in the enjoyment of expected use of the premises by the lessee, will nevertheless not frustrate the lease unless the interruption is expected to last for the whole of the unexpired term of the lease, or, at least, for a significant portion of that unexpired term. We might call this the "double duration" test: the court considers both the certain fact of the lease's future length in the context of the uncertain fact of the likely duration of the frustrating event. This is a test which is favorable to upholding the lease and to denying the application of the doctrine of frustration. This result can be seen in the two leading cases of *Cricklewood* and *National Carriers.*

In *Cricklewood*, the lessee under a 99 year building lease claimed that wartime building restrictions had frustrated the lease. The House of Lords held that there had been no frustration, since the lease had over 90 years to run when the war broke out, and that it was unlikely that the war would last for more than a small fraction of the whole term. Likewise, in *National Carriers Ltd v Panalpina (Northern) Ltd*, the tenant held a 10 year lease of a warehouse and the frustrating event was that a temporary order made by the City Council closed the street which gave the only access to the warehouse, so making it impossible to use as a warehouse. However, the House of Lords held that on the facts the lease was not frustrated because the closure was expected to last

only for a year or a little longer, which would still allow the lease to run for three more years after the street re-opened. As Lord Simon of Glaisdale remarked that for a court when deciding if frustration applies: "In a lease, as in a licence or a demise charter, the length of the unexpired term will be a potent factor." On the facts of this case however his lordship concluded that the lease was not frustrated as, "the interruption would be only one sixth of the total term." A recent non English case applying this approach arose out of the 2003 SARs epidemic. In *Li Ching Wing v Xuan Yi Xiong* [2004] 1 HKLRD 754, a Hong Kong court rejected a tenant's claim that a tenancy agreement was frustrated because the premises were subjected to an isolation order by the HK Department of Health which meant that it could not be inhabited for 10 days. The court held that a 10 day period was insignificant in view of the two year duration of the lease, and that whilst SARS was an unforeseeable event, it nevertheless did not "significantly change the nature of the outstanding contractual rights or obligations" of the parties.

On the other hand, in the recent case of *Canary Wharf Management Ltd v European Medicines Agency* [2019] EWHC 335 (Ch) Marcus Smith J made comments at para.194 which indicate that the English courts may now be more willing to allow leases to be frustrated:

"It may be doubted whether Lush J's second point — namely, that the defendant had acquired a property interest, in the form of a lease, which was unaffected by the supervening illegality — remains good or reliable law in light of *Panalpina*, where the House of Lords held that, at least in theory, a lease that continued to subsist as a property interest could nevertheless be frustrated."

More generally, the concept of the legal estate, which prior to *National Carriers* provided such a conceptual obstacle in the minds of the English judiciary to the extension of the doctrine of frustration to leases, is no longer viewed as the foundation of that relationship but merely one of its incidents. Indeed, the judicial trend in English law appears to be towards a general assimilation of leases with other contracts. It is interesting, for example, to observe that the doctrine of disclaimer of a landlord's title has been held to be analogous to the doctrine of repudiation of contract, see *WG Clark (Properties) Ltd v Dupre Properties Ltd* [1992] Ch. 297; [1991] 3 W.L.R. 579; [1992] 1 All E.R. 596.

Scots leases

Scots Law, by stark contrast with English Law, has no inherent difficulty with recognizing that leases may be frustrated like any other kind of contract, not least because it has no doctrine of separate estates in land to confuse the contractual issue. In *Tay Salmon Fisheries Co Ltd v Speedie,* 1929 S.C. 593; 1929 S.L.T. 484, a 19 year lease of salmon fishings was held frustrated when the RAF using statutory powers took over the land for target practice, thus making the fishings incapable of possession for the purpose of the lease even although target practice was only occasional. In a similar vein in *Denny Mott & Dickson Ltd* (supra) a long lease on a timber yard was held frustrated by a 1939 emergency order arising out of the war. Lord Macmillan in *Denny Mott & Dickson Ltd* at p.41 (p.272; p.3) made remarks which are very relevant to the current prohibition on pubs, cafes and other businesses:

"... many of the recent cases have arisen from the supervention of emergency legislation rendering the implement of the contract illegal. It is plain that a contract to do what it has become illegal to do cannot be legally enforceable. There cannot be default in not doing what the law forbids to be done. The present case belongs to the latter category. It seems to me a very clear one for the application of the principle I have just enunciated. Here is an agreement between two parties for carrying on dealings in imported timber. By emergency legislation the importation of timber has been rendered illegal. *Neither party can be said to be in default. The further fulfilment of their mutual obligations has been brought to an abrupt stop by an irresistible extraneous cause for which neither party is responsible ... the operation of the agreement having been compulsorily terminated, neither party can thereafter terminate it voluntarily. You cannot slay the slain*." [italics added for emphasis]

The duration of the current Covid-19 emergency regulation prohibitions is inevitably uncertain and unknowable and on such situations of uncertainty Lord Wright made the following very useful remarks in *Denny Mott & Dickson Ltd* at p.46 (p.278; p.6):

"It is true that the agreement [the lease] was for an indefinite time, and that the war might end within a comparatively short period. The position must be determined as at the date when the parties came to know of the cause of the prevention and the probabilities of its length as they appeared at the date of the Order, but subsequent events ascertained at or before the trial may assist in showing what the probabilities really were (as Lord Sumner said in *Bank Line Ltd v Arthur Capel & Co*). In addition, there is to be remembered the principle

stated by Lush, J, in *Geipel v Smith*, that 'a state of war must be presumed to be likely to continue long, and so to disturb the commerce of merchants, as to defeat and destroy the object of a commercial adventure.' It is true that Lush, J, was there referring to a single definite adventure, not to a continuous trading, *but the real principle which applies in cases of commercial responsibility is that business men must not be left in indefinite suspense. If there is a reasonable probability from the nature of the interruption that it will be of indefinite duration, they ought to be free to turn their assets, their plant and equipment and their business operations into activities which are open to them, and to be free from commitments which are struck with sterility for an uncertain future period*. Lord Shaw emphasised this principle in the *Bank Line Ltd* case, and so did Lord Sumner. This, I think, is the true basis of the rule. It does not depend simply on the consideration that, when the interruption ceases, conditions of performance may be different, though that may also be worth dwelling on in certain cases, as in *Metropolitan Water Board v Dick Kerr & Co Ltd*, where it was said that the interruption destroyed the identity of the performance contracted for."[italics added for emphasis]

The Scots approach in *Denny Mott & Dickson Ltd*, which we might call for convenience the "sterility from uncertainty" test, is in complete contrast with "double duration" test approach applied by the English courts in *Cricklewood* and *National Carriers* discussed above, although duration is obviously a factor considered by the Scottish courts it is not decisive, see *Duff v Fleming* (1870) 8 M. 769 and especially *Allan v Markland* (1882) 10 R. 383. It is submitted that the Scots approach is fairer to the parties and fits better with the general operation of the doctrine of frustration within contract law.
If we consider the impact of the Health Protection (Coronavirus) (Restrictions) (Scotland) Regulations 2020 and the Health Protection (Coronavirus, Business Closure) (England) Regulations 2020 respectively on prohibited businesses we can see the likely difference outcomes in the two different jurisdictions.

In Scotland it is submitted that, as of May 2020, in the words of Lord Wright in *Denny Mott & Dickson Ltd* there is "a reasonable probability from the nature of the interruption," viz the continued prohibition by the regulations of services to the public such as running pubs, cafes, restaurants and many shops and other businesses in order to inhibit the spread of Covid-19 "that it will be of indefinite duration," and accordingly for both tenants and landlords that "they ought to be free to turn their assets, their plant and equipment and their business operations into activities which are open to them, and to be free from commitments which are struck with sterility for an uncertain future period."

Accordingly, if a Scots property is let for the express purpose of conducting a prohibited business such as a pub or cafe then there is a strong argument that such leases were ended by a frustrating event in the form of the Health Protection (Coronavirus) (Restrictions) (Scotland) Regulations 2020 which came into force at 7.15 pm on 26 March 2020. The effect of such frustration is that the tenant of the frustrated lease would have no obligation to pay for future occupation of the premises, but can claim back any sums paid in advance under the principle of unjust enrichment. With leases there is always an issue of how much of a delay constitutes frustration, but it is submitted that the "sterility through uncertainty" principle discussed above would apply in current circumstances thus creating a rebuttable presumption in favour of frustration of the lease. Moreover, even if or when a probation on trading is lifted that does not mean the relevant lease cannot have been frustrated by the prior illegality. If a lease has already been killed by frustration it cannot be revived merely by the cessation of the frustrating event of illegality. If "You cannot slay the slain." It is equally true that you cannot resurrect the slain! The courts will have to decide on the facts when a period of prohibition was sufficiently long as to have frustrated any particular lease.

By contrast, if a lease is governed English law (and also lacks provisions covering an eventuality such as Covid-19) then, even if the property cannot be used for its contractual purpose as a pub, cafe, etc., frustration is unlikely to be available to the tenant, who will probably continue to be obliged to pay the rent because of the "double duration" test so far favored by the English courts in *Cricklewood* and in *National Carriers*. On the other hand, given the cataclysmic economic impact of the frustrating event that is Covid-19 and its associated legislation on thousands of businesses by making trading as a pub, cafe, etc., illegal it is possible that the English courts might finally adopt a less strict approach to the frustration of leases. This could be done by the judges escaping from the focus on estates in land and rather focusing on the purpose of the doctrine of frustration; which is to avoid unfairness by providing justice in unforeseen circumstances which, without the fault of either contracting party, have had a catastrophic effect on the possibility of performing a contract concluded on terms that do not provide for the unforeseen event.

In practice if the English courts will not allow frustration of leases then, in the face of the harsh economic reality situation of high rents and no income, it is likely many owners of prohibited businesses will simply put their business into administration or declare themselves bankrupt to escape their liability for rent on premises from which they can no longer trade. It is to be hoped that the

English judges will opt to follow their Scots brethern and will set aside their historical obsession with the abstract idea of estates in land and their general reluctance to allow leases to be frustrated, and instead recognise that the Health Protection (Coronavirus, Business Closure) (England) Regulations 2020 have made the trading activities of pubs, cafes, etc., illegal for an uncertain indefinite period.

Conclusion

As stated at the beginning of Part 1, the "Coronation cases" of *Krell v Henry* [1903] 2 K.B. 740, *Chandler v Webster* [1904] 1 K.B. 493 and *Herne Bay Steamboat Co v Hutton* [1903] 2 K.B. 683 were crucial in the development of the modern law of frustration. As one American jurist pertinently observed: "When Edward VII's appendicitis caused the delay of his Coronation processions the postponement was only temporary, but its impact on contract doctrine was enduring."3 It is certain that the next couple of years will generate "Coronavirus cases" and it will be interesting to see if the courts respond to this catastrophe by merely applying the existing law or by creatively developing it still further especially in the matter of remedies.

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