

FRUSTRATED LEASES: "NO TO NEVER—BUT RARELY IF EVER"

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While the number of articles contained in legal journals and the analyses proffered in legal texts pertaining to the doctrine of frustration are by no means few or cursory, there is a notable absence of literature pertaining to frustration within the leasehold context. The justification for this phenomenon lies in the fact that English and Canadian courts have generally claimed and adhered to the view that a lease of land could never be frustrated. However, in view of the recent decision of the House of Lords in *National Carriers Ltd v. Panalpina (Northern) Ltd*,¹ it is clear that the law governing the relationship between a landlord and his tenant will embrace the doctrine of frustration. Admittedly such a development is, of itself, neither innovative nor startling when one realizes that most of the provincial legislatures have enacted a statutory provision acknowledging that such is the law, albeit only with regard to "residential tenancies".²

Within the general framework of contract law the frustration issue has given rise to two questions: (1) why is a contract frustrated, that is, which of the various tests formulated by the courts is the true test to be utilized when determining whether or not a contract is frustrated and (2) when is a contract frustrated? For the most part judicial and academic attention has been focused on the former and thus relatively little consideration has been given to the problem of outlining the circumstances in which a contract may be prematurely terminated, by a supervening event. This problem is more pronounced in the leasehold situation because of the unwillingness of courts to recognize that a lease could be susceptible to the application of the doctrine. While the *Panalpina* decision dispenses with this issue and

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¹ [1981] 2 W.L.R. 45, hereinafter referred to as *Panalpina*.

² A number of the provinces have enacted a "Residential Tenancies Act" in order to redress many of the inequities which have arisen from the common law rules. The legislation does not affect premises which are demised for business purposes, i.e., commercial leases: see; S.A., 1979, c. 17, s. 32; S.N., 1973, No. 54, s. 10; R.S.S., 1978, c. R-22, s. 15; S.M., 1970, c. 106, s. 3; R.S.P.E.I., 1972, c. 25, s. 3; R.S.B.C., 1979, c. 365, s. 8(3); R.S.O., 1980, c. 232, s. 88. However, in British Columbia the doctrine has been extended to cover the latter type of lease (Commercial Tenancy Act, R.S.B.C., 1979, c. 54, s. 33).

despite the constructive dictum of Lord Wilberforce and in particular Lord Simon, one can justifiably maintain that the common law has failed to provide any definitive and acceptable criteria by which the doctrine can be applied to a lease of land.³ This article will outline the reasoning initially given to prohibit its application in this particular contractual setting and which has now been rejected (as expounded in the House of Lords decision) and further proposes a rationale framework for deciding the frustration question solely within the leasehold context.

I. *The Historical Problem.*

The employment of devices to avoid injustices, which could occur if judges were always to enforce a contract on the basis of its literal terms, is a technique of judicial decision-making well known in the history of common law. These devices, while generally enshrined as doctrines, are but in reality a means of providing flexibility within the decision-making process thereby avoiding unjustifiable hardships which would arise in too rigid an adoption of the rule oriented approach when resolving contractual disputes. One such rule emanates from the classic dictum in *Paradine v. Jane*⁴ that performance of absolute promises cannot be discharged by the fact that a supervening event makes it impossible for one party to perform.⁵ While courts were willing to recognize exceptions to the rule, its general application to all contracts continued until the decision of Blackburn J. in *Taylor v. Caldwell*,⁶ which is generally accepted as the initial source of the doctrine of frustration. The subsequent development and use of the doctrine to free parties from their contractual obligations and thus liability for damages has only after a somewhat protracted route been applied to leases of real property.

³ Although acknowledging that the doctrine does apply to leases, their Lordships, concluded that this was not a case in which it could be applied and thus relatively little discussion centered on the circumstances which would warrant its application.

⁴ (1647), Alewy 27, 83 E.R. 897. The *Paradine* decision clearly overrules the dictum in this case; see Lord Simon's judgment, *supra*, footnote 1, at p. 68.

⁵ Interestingly enough, the court was not dealing with a true case of impossibility of performance but rather an action by a lessor to recover rent for a three-year period over which time the tenant had been ousted out of possession by an invading army. Prevented from removing the profits from the land, the tenant was unsuccessful in arguing that the obligation to pay rent for this period had ceased.

⁶ (1863), 3 B.&S. 826, 122 E.R. 309 (Q.B.D.). The plaintiffs who had agreed to hire a music hall brought an unsuccessful action for damages when the hall was destroyed prior to their taking possession.

Exceptions to the rule are found in relation to contracts for personal services where one of the parties dies or where performance becomes illegal after the formation of the contract; e.g., death: *Cutler v. Powell* (1795), 6 T.R. 320; illegality: *The Teutonia* (1871), L.R. 3 A.&E. 394, 17 E.R. 366.

Prior to *Panalpina*, academics were of the consensus that the question relating to the applicability of the doctrine to leases had not yet been finally decided by the House of Lords.⁷ It had been raised in the House in 1945 in *Cricklewood Property and Investment Ltd v. Leightons Investment Trust Ltd*,⁸ but on the facts of that case it was unanimously held that even if the doctrine did apply, the lease in question was not frustrated. On the issue pertaining to the applicability of the doctrine, their Lordships were evenly divided⁹ and accordingly in subsequent cases the lower courts including the Court of Appeal, continued to be bound by the rule laid down by the Court of Appeal in the *Cricklewood* case that the doctrine is inapplicable to leases.¹⁰ The genesis, however, for any discussion of frustration within the leasehold context must lie in the conflicting views expressed by the divided House of Lords. Viscount Simon and Lord Wright maintained that, while a lease is susceptible to the application of the doctrine, only in "rare circumstances" could a lease be considered frustrated.¹¹ In the case of a simple lease of land for years at a rent, frustration would occur if "some vast convulsion swallowed up the property altogether or buried it in the depths of the sea".¹² Frustration in Viscount Simon's opinion occurred upon the happening of a supervening event or change in circumstances so fundamental as to strike at the root of the agreement which, in the case of a simple lease, would be the destruction of the site.¹³ In the case of a building lease, frustration would occur if a public body acting under statutory authority permanently prohibited building on the site.¹⁴ On the other hand, Lord Russell and Lord Goddard adopted the position that a lease could "never" be frustrated. The former law lord maintained that a

⁷ See Cheshire and Fifoot, *The Law of Contract* (9th ed., by M.P. Furmston, ed., 1976), p. 555; G. H. Treitel, *The Law of Contract* (5th ed., 1979), p. 669.

⁸ [1945] A.C. 221.

⁹ The fifth judge, Lord Porter, expressed no opinion on this question.

¹⁰ *Sub nom, Leightons Investment Trust Ltd v. Cricklewood Property and Investment Ltd*, [1943] K.B. 493 followed in *Denman v. Brise*, [1949] 1 K.B. 22 (C.A.); and see *Cusack-Smith v. London Corporation*, [1956] 1 W.L.R. 1368 (Q.B.D.) wherein it was held that it was not open for the court to consider the question of frustration. On two occasions the Ontario Court of Appeal has held that the doctrine is inapplicable to leases: *Merkur v. Shoom & Co. Ltd*, [1954] 1 D.L.R. 85; *Re Sells Tidy v. Merkur & Merkur* (1956), 4 D.L.R. (2d) 432.

¹¹ "I do not feel able to assert any *a priori* or absolute impossibility [why the doctrine should not apply to a lease of land] though the instances in which the doctrine might apply to such a lease are undoubtedly very rare." per Viscount Simon L.C., in *Cricklewood*, *supra*, footnote 8, at p. 229 with which Lord Wright is in agreement, at p. 241.

¹² Per Viscount Simon, *ibid.*, at p. 229.

¹³ *Ibid.*

¹⁴ *Ibid.*, Viscount Simon, at p. 229 and Lord Wright, at p. 241.

contract could only be frustrated because what is called the venture or undertaking in which the parties have contracted to engage can no longer be carried out and since in the lease situation it is the lease which is the venture, once it is granted there is no question of impossibility of performance.¹⁵ By similar reasoning Lord Goddard maintained that frustration only occurs where the foundation of the contract is destroyed and in the lease situation the foundation of the agreement is that the landlord parts with a proprietary interest which becomes vested in the tenant.¹⁶ On the basis of the conflicting dicta, one might conclude that frustration can only occur if a landlord is unable to part with a proprietary interest in the property or, if it is a situation in which the tenant is already in possession, a catastrophic event occurs. Rather than merely addressing the case before it, the House of Lords in *Panalpina* first considered the general issue regarding the inherent applicability of the doctrine to leases. Each of their Lordships answered the question affirmatively while differing in approach to the arguments which support such a conclusion.

In effect three of their Lordships summarily adopted the position that there is nothing in principle which ought to prevent a lease from being frustrated.¹⁷ However, the arguments for and against the application of the doctrine to leases were fully explored by both Lord Wilberforce and Lord Simon. The essence of the argument that a lease of real property is not subject to the doctrine is of a two-fold nature. Firstly, a lease is more than a contract being, as well, an interest or estate in land and secondly, that the risk inherent on the happening of a supervening event always passes to the lessee. Both necessitate the acceptance of the principle that a lease is primarily a conveyance of an interest in land, that is, any contractual obligations are merely incidental to the creation of the landlord and tenant relationship.¹⁸ Such a characterization involves a recognition that the allocation of risk should be determined in the same manner as it is under an agreement of purchase and sale for land, that is, inasmuch as the risk passes to the

¹⁵ *Ibid.*, at p. 233.

¹⁶ *Ibid.*, at p. 245.

¹⁷ Lord Hailsham maintained that there was no validity in distinguishing between real and chattel property or between a licensor-licensee and a landlord-tenant relationship (*supra*, footnote 1, at p. 54). Lord Roskill held that to maintain that a lease can never be frustrated must stem from some reason of policy which he felt is absent in the lease situation (*supra*, footnote 1, at p. 76). Lord Russell on the other hand, while prepared to accept that frustration could be involved in the termination of a lease adheres to the views expressed by Lord Russell of Killowen and Lord Goddard in the *Cricklewood* case "with minor qualifications", i.e., special consideration would have to be given to physical destruction of highrise apartments and in the event the "site" comprised in the lease disappears (*supra*, footnote 1, at p. 71).

¹⁸ This is the approach taken by Lord Russell in the *Cricklewood* case, *supra*, footnote 8, at p. 233.

purchaser, so too should it pass to the lessee, a conclusion premised on an assumption which is open to question if not criticism.¹⁹

The duality of the nature of a lease, that is, being both a contract and a conveyance of an interest in land has given rise to a number of anomalies if one compares general principles of contract law with those governing the landlord and tenant relationship; anomalies which justify one in maintaining that a lease is primarily a conveyance. For example, in a bilateral agreement contractual provisions are virtually interdependent and accordingly a substantial breach by one party will excuse the other party from further performance. In the lease situation, however, the opposite is true. Thus, unless there is an express provision in the lease to the contrary, a tenant cannot withhold payment of rent if the landlord were, for example, to breach his express covenant to repair.²⁰ Similarly, where a tenant fails to carry out repairs in accordance with the lease the landlord does not have an implied nor inherent right at common law to forfeit the lease.²¹ While the general law of contract requires a party who has suffered a breach to mitigate his loss, a tenant who prematurely abandons the lease premises and fails to honour his contractual obligations, will find that a landlord is under no obligation to find a new tenant but may, in fact, recover the rent as it falls due.²² These rules, of themselves, are consistent with the principle that a lease is primarily a conveyance. Accordingly, with regard to the doctrine of frustration within the leasehold context, the view is taken that insofar as a lease conveys and vests an interest in land then no question of impossibility of performance can arise; the tenant having received what in fact he has bargained for, namely a term of years. Of course, such an argument is premised on the assumption that the so-called object, venture, purpose or foundation of the agreement is for a term of years and nothing more. In *Panalpina*, Lord Wilberforce agreed that this may in fact be true yet there are as well cases where a tenant desires more than an estate, namely possession and use of the premises demised.²³

Why is it an answer, when he claims that this purpose is "frustrated" to say that he has an estate if that estate is unusable and unsaleable. In such a case, the lease or the conferring of an estate is a subsidiary means to an end, not an aim or end of itself.

¹⁹ See text, *infra*.

²⁰ *E.g.*, *Hart v. Rogers*, [1916] 1 K.B. 646, at p. 651. The tenant's remedy is to sue for damages or carry out the repairs and when sued for the rent counterclaim for the expense: *e.g.*, *Granada Theaters v. Freehold Investment*, [1959] 1 W.L.R. 570.

²¹ See generally, 1 Woodfall's Law of Landlord and Tenant (28th ed., by V. Welling, ed., 1978), p. 642, para. 1-1501. Yet it would, indeed, be a rare occurrence to find a written lease that does not contain a forfeiture clause in the event that a tenant breaches any covenant contained in the lease.

²² See generally, Woodfall, *op. cit.*, *ibid.*, p. 310, para. 1-0777.

²³ *Supra*, footnote 1, at p. 58.

Similarly, Lord Simon maintained that it is not realistic to argue that on the execution of a lease, the lessee got all that he bargained for. For example, in *Panalpina* the lessee did not bargain for a term of years but rather for the use of a warehouse owned by the lessor.²⁴

The second argument stems from the traditional analysis of frustration as being a question of which of the two parties must bear the loss occasioned by a supervening event, a question which necessitates finding an acceptable means of allocating a risk to one or the other of the parties. The argument that the risk on the demise of a term of years must be allocated to the lessee as on the sale of land it is allocated to the purchaser, once again reflects the view that a lease is primarily a conveyance. Lord Wilberforce avoids what in fact could be a substantial argument by merely holding that the analogy between conveyances of leasehold and freehold estates is not valid. In his view, the allocation of risk depends upon the terms of the lease and in the case of unspecified events, the courts should be able to decide on whom the risks will lie.²⁵ In a similar vein, Lord Simon maintains that automatically to pass the risk onto the lessee only begs the question. With regard to the inappropriate analogy, His Lordship maintained that while a fully executed contract for the sale of land cannot be frustrated, a lease which is only partly executed, that is, rights and obligations remain outstanding during its currency, is susceptible to the doctrine.²⁶ If one is to be consistent in applying this line of reasoning then it necessarily follows that an executory contract for the sale of land is susceptible to discharge by application of the doctrine. If it can be imputed that Lord Simon is tacitly accepting such a proposition, then his explanation lays to rest the axiomatic allocation of risk to the lessee argument. Further support for such can be found in *Amalgamated Investment & Property Co. Ltd v. John Walker & Son Ltd*²⁷ where the English Court of Appeal assumed that the doctrine did apply to an executory contract for the sale of land but concluded that on the facts of that case the doctrine could not be invoked. Indeed, it is clear from their Lordships' reasoning why the doctrine should be capable of application to leases that it must, as well, necessarily apply to agreements for the purchase and sale of land.

The above two arguments are central to the determination of whether or not a lease can be frustrated. Inevitably though, whenever any attempt is made to extend common law doctrine, the "flood-

²⁴ *Ibid.*, at p. 68. In disposing of this argument their Lordships effectively curtailed a number of sub-arguments by the respondent landlord; see Lord Simon's judgment, at p. 66 and Lord Roskill's judgment to the same effect, at p. 76.

²⁵ *Ibid.*, at p. 58.

²⁶ *Ibid.*, at p. 68.

²⁷ [1977] 1 W.L.R. 164. See footnote 55, *infra*, for references to Canadian cases.

gates" argument is advanced, premised on the belief that such an extension would, in the leasehold situation, "encourage unmeritorious litigation by lessees denying liability for rent which was plainly due".²⁸ Three of their Lordships in *Panalpina* felt that the argument was worthy of their consideration. Lord Roskill and Lord Hailsham maintain that such an argument should have little appeal and little weight in light of the fact that the doctrine could only be successfully invoked in rare cases.²⁹ Although the former judge thought that no useful purpose could be served in categorizing the cases in which it could, his Lordship did state that the doctrine would arise "most frequently though not necessarily exclusively where the alleged frustrating event is of a catastrophic character".³⁰ Lord Hailsham adopts a similar approach and while prepared to accept the reasoning of Viscount Simon and Lord Wright in *Cricklewood* extends their analysis to destruction by fire of the upper flat of a tenement building and destruction caused by coastal erosion.³¹ While such assurances may placate those who give credence to the "floodgates" argument, it is the simple reasoning of Lord Wilberforce that may well prove to be the sole basis upon which it will be dealt with in the future: "Be it so if that is the route to justice".³²

All of the arguments which sustain the acceptance of the principle that a lease is inherently susceptible to the doctrine, evidence an unwillingness to preserve historic rules which serve no useful purpose³³ and a rejection of Lord Wright's analysis in *Cricklewood* as to the importance of inflexible rules which govern the landlord and tenant relationship.³⁴ Lord Wilberforce maintains that inasmuch as, "the doctrine can now be stated generally as a part of the law of contract, as all judicially evolved doctrines it is, and ought to be, capable of new applications".³⁵ After considering the American experience, the approach taken by the Supreme Court of Canada and the view expressed by a judge of the High Court of Australia, Lord Simon

²⁸ Per Lord Roskill; in *Panalpina*, *supra*, footnote 1, at p. 76.

²⁹ *Ibid.*, per Lord Roskill, at p. 77; and Lord Hailsham, at pp. 55-56.

³⁰ *Ibid.*, at p. 77.

³¹ *Ibid.*, at p. 54.

³² *Ibid.*, at p. 60.

³³ "Historic considerations alone cannot justify the preservation of a rule if that rule has ceased to serve any useful purpose and is unlikely to serve any useful purpose in the years immediately ahead." Per Lord Roskill, *ibid.*, at p. 76.

³⁴ "The nature of a lease not only involves a tenure as well as a contract, but has become the subject of precise rules which must be taken to be settled law of at least general application and to be understood by those who enter into transactions of lease." Per Lord Wright in *Cricklewood*, *supra*, footnote 8, at p. 237.

³⁵ *Supra*, footnote 1, at p. 57.

advances four compelling reasons why the doctrine should apply to leases:³⁶

1. the doctrine developed as an expedient to escape from injustices which would result from enforcing the literal terms of the contract;³⁷
2. the doctrine of frustration is modern and flexible and is not subject to being constricted by an arbitrary formula;³⁸
3. the law should be founded on comprehensive principles: to compartmentalize the law can produce undesirable anomalies which lead to injustices;³⁹
4. if a lease can be prematurely terminated by an applied rule of law, there is no reason why a rule of law cannot declare that a certain lease is discharged by frustration.⁴⁰

The acknowledgement of the general principle that all contracts, including those which are coupled to an estate in land, are inherently susceptible to the doctrine of frustration, is neither difficult to justify nor to accept as a basic tenet of the common law. Yet the real issue and one which has not for the most part been acknowledged, particularly by law reform commissions, continues to be outlining the circumstances in which a contract may be discharged by frustration.⁴¹ Traditionally courts have not striven to develop a general framework for determining whether the doctrine is applicable in any one particular situation but rather to make inquiries as to the theoretical basis for the very existence of the doctrine itself. As the doctrine developed and

³⁶ Both Lord Simon and Lord Wilberforce referred to the analysis given by two noted American commentators — Williston (Williston On Contracts (3rd ed., by W. Jaeger ed., 1978, Vol. 18) and A. L. Corbin (Corbin on Contracts (1951)).

The decision of the Supreme Court of Canada delivered by Laskin, J. (as he then was) in *Highway Properties Ltd v. Kelly Douglas & Co. Ltd.*, [1971] S.C.R. 562, 17 D.L.R. (3d) 710, while not directly on point, was referred to because of its general reasoning in holding that the contractual doctrine of repudiation, with its remedies independent of the landlord-tenant relationship, is applicable to leases. The dissenting judgment of Isaacs J. (as he then was) in the Australian case of *Firth v. Halloran* (1926), 38 C.L.R. 261 rejects any rule of law that suggests that merely because a contractual obligation is created by an instrument of lease, the doctrine of frustration must necessarily be excluded.

³⁷ See Lord Simon's judgment in *Hirji Mulji v. Cheong Yue Steamship Co. Ltd.*, [1926] A.C. 497, at p. 510 to the same effect.

³⁸ See the judgment of Lord Wright in *Cricklewood*, *supra*, footnote 8, at p. 241, to the same effect; but see *supra*, footnote 34, where his Lordship appears to maintain a contrary position.

³⁹ E.g., to distinguish between a licensee/licensor and a landlord/tenant relationship as was done in *Krell v. Henry*, [1903] 2 K.B. 740.

⁴⁰ E.g., where the tenant denies the title of the landlord; see generally: Woodfall, *op. cit.*, footnote 21, pp. 922-926, paras 1-2045 to 1-2051.

⁴¹ E.g., The Interim Report of the Ontario Law Reform Commission on Landlord and Tenant Law (1968) devotes a page to the question of frustration while recommending its application to leases only in the event premises are destroyed by fire. As well, the Report only deals with residential tenancies and not commercial tenancies: see *supra*, footnote 2, for references to legislative provisions enacted in the various provinces.

was applied to various contractual arrangements, so too did the number of theoretical bases grow. Application of the doctrine has been rationalized on the basis of: an implied term; a radical change in obligation (the construction theory); a disappearance of the foundation, venture or undertaking of the contract; or a total failure of consideration. Thus, academic and judicial controversy over and preoccupation with the true theoretical basis of the doctrine has detracted from any substantial consideration of the real issue. As Professor Atiyah views it: "arguments about the true foundation of the doctrine of frustration do not by themselves tell us when a court will hold a contract frustrated".⁴² Yet even if one were to accept, for example, that the true test centers on the disappearance of the foundation of the contract, one would still be faced with deciding what is the "foundation". In *Panalpina*, Lord Simon referred to all of these theories as means by which the doctrine can be applied with "juristic respectability"⁴³ while Lord Wilberforce expressed the opinion that no one theory is the true basis for the doctrine: "they shade into one another and that a choice between them is a choice of what is most appropriate to the particular contract under consideration".⁴⁴ Whatever the true basis of the doctrine may be, the *Panalpina* decision does provide one with limited insight as to how future courts may decide the frustration question when dealing with a lease of land.

Here a building erected for use as a warehouse was demised to the defendants, *Panalpina Ltd*, for a period of ten years to commence on January 1st, 1974. The defendants occupied and continued to use the premises up until May 16th, 1979 when the local authority closed the sole vehicular access to the warehouse because of the dangerous condition of a derelict Victorian warehouse located across the road.⁴⁵ The evidence established that the access road would be closed for a period of approximately twenty months in order to allow for the demolition of the derelict building. The lease in question contained a covenant not to use the premises for any purpose other than that of warehousing in connection with the tenant's business, nor to assign, underlet or part with possession without the landlord's consent. As well, the covenant pertaining to use stipulated that the premises could not be utilized for residential, factory or warehouse purposes or in any manner which would constitute a change of use under the Town and Country Planning Acts. The rent payable for the ten year period was set at £6,500 for the first five years while the rent payable for the

⁴² P. S. Atiyah, *Judicial Techniques and The English Law of Contract* (1968), 2 Ott. L. Rev. 333, at p. 339.

⁴³ See *supra*, footnote 1, at p. 65.

⁴⁴ *Ibid.*, at p. 57.

⁴⁵ It was assumed that the proceedings to close the road were valid and legal.

remaining duration was to be based upon a fair yearly rent which could be obtained in the open market for a warehouse at the commencement of this period. The obligation to pay rent under the lease was unconditional with a sole exception limited to the case of fire, in which event the lease provided for a suspension of that obligation. The rent being in arrears for two quarterly installments, the plaintiffs brought an action for rent on July 9th, 1979. On a direct appeal to the House of Lords from a Judge in Chambers, the defendant's sole argument was that the lease was frustrated because of the supervening event.⁴⁶ All of their Lordships concluded that the lease in question was not frustrated.

Lords Hailsham, Roskill and Wilberforce found that the purely temporary interruption did not approach the "gravity of a frustrating event".⁴⁷ The same conclusion had been reached in *Cricklewood* where it was unanimously held that even if the doctrine did apply, temporary wartime restrictions on construction, did not frustrate a ninety-nine year building lease to erect shops which had some ninety years left to run. There the temporary interruption did not destroy the identity of the arrangement nor make it unreasonable to carry out the terms of the lease as soon as the war was over. However, the temporary nature of the closure of the road in *Panalpina* was of no significance to Lord Russell who maintained that the lease would not have been frustrated even if the road had been closed for the remaining duration of the lease.⁴⁸ Indeed, it is clear that his Lordship's willingness to accept as a matter of law the principle that a lease can be frustrated is a concession unduly restricted in scope.⁴⁹ On the other hand, the analysis given by the fifth Judge, Lord Simon, provides a framework from which the frustration issue can be examined without resorting to predetermined events which can be categorized as giving rise to frustration. In the opinion of Lord Simon frustration occurs:⁵⁰

... when there supervenes an event (without the fault 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 contem-

⁴⁶ The plaintiffs made an application for a summary judgment which was granted. The defendants appealed the order of the Master and Sheen J. in chambers by utilizing section 12 of the Administration of Justice Act 1969, c. 58, the leap-frogging provision to appeal directly to the House of Lords.

⁴⁷ Per Lord Wilberforce, *supra*, footnote 1, at p. 61, with whom Lord Roskill is in agreement, *ibid.*, at p. 78. Lord Hailsham's view of frustration is to the same effect: "... my approach to the question involves me in the view that whether a supervening event is a frustrating event or not is, in a wide variety of cases, a question of degree. . . ." (*ibid.*, at p. 52).

⁴⁸ See *ibid.*, at p. 71.

⁴⁹ See *supra*, footnote 17, pertaining to his Lordship's limited view of frustration.

⁵⁰ *Supra*, footnote 1, at p. 63.

plated 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.

Intermingled with this articulation of the theoretical basis of the doctrine are several salient factors which have played an important role in the resolution of the frustration question in other contractual settings. With regard to leases, Lord Simon refers to yet another factor in addition to the temporary nature of the frustrating event, namely whether other substantial uses which were in the contemplation of the parties, remain possible to the lessee. The inclusion of such a factor stems from the analysis given by the American commentator Corbin pertaining to contracts involving leases of saloons subsequently affected by the enactment of "prohibition" laws.⁵¹ At this point it may be convenient to summarize these factors:

1. The executory contract must make no provision for the frustrating event.
2. Are there any other substantial uses permitted by the lease and in the contemplation of the parties which remain possible to the lessee?
3. The frustrating event must not have been caused by the default of either party.
4. Frustration will not occur where merely the expense or onerousness of carrying out the contractual terms has arisen.
5. The frustrating event must have altered the contractual rights and obligations in such a manner as the parties could not have reasonably contemplated at the time the contract was entered into.
6. If the frustrating event is of a temporary nature, is it of such a duration as would be sufficient to justify application of the doctrine?

While one might have thought that any one of these factors could effectively preclude a contract from being discharged because of a supervening event, it is clear that Lord Simon perceives the resolution of the problem as involving a "weighing" process.⁵² Given the circumstances surrounding the supervening event and given the terms of the leasing document, one can readily conclude that factors one to

⁵¹ "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." Per Lord Simon, *ibid.*, at p. 65 quoting Corbin on Contracts, *op. cit.*, footnote 36, pp. 475-476.

⁵² See *supra*, footnote 1, at pp. 69-70.

four inclusive supported the position taken by *Panalpina*. Notwithstanding this, the tenant's liability for rent was sustained because of factors five and six. With regard to the foreseeability factor, Lord Simon held that inasmuch as the parties contemplated and expressly provided for interruption in the case of fire, interruption caused by the supervening event (closure of the road) could not have been beyond the reasonable contemplation of the parties. So far as the temporary nature of the interruption was concerned, Lord Simon was swayed by the fact that the appellant tenant could look forward to use and occupation of the premises for 5/6 of the life of the lease or viewed from another perspective, the tenant could look forward to use of the premises for nearly 3/10 of the original term after the interruption ceased. Accordingly, this was not a case in which it would be unjust to hold the tenants to the literal sense of the covenants contained in the lease.

As to the issue concerning the applicability of the doctrine of frustration to leases, the *Panalpina* decision conclusively answers this question in the affirmative. However; as to the circumstances in which a lease will be considered frustrated, one can only assert with certainty that it will not be frustrated if the frustrating event is of an insufficient temporary nature. Just as the decision of the House of Lords in *Cricklewood* was inconclusive on the issue of the applicability of the doctrine, so too is its decision in *Panalpina* on the issue as to the circumstances in which a lessor and lessee may be discharged of their contractual obligations. Admittedly the analysis given by Lord Simon greatly assists in establishing a framework for the resolution of the frustration issue, but further analysis is called for.

II. *Towards a Rational Approach.*

Traditionally, any resolution of the frustration issue within the leasehold context has been limited to an acceptance of either the "rarely" or "never" approach. Yet in rejecting the latter it becomes necessary to question why it is that a lease will be "rarely" frustrated. Admittedly the courts have attempted to limit the doctrine's applicability by indicating the types of supervening events which will warrant its application. But why must these events be limited to natural disasters such as earthquakes? One cannot help but feel that the English courts tend to view the application of the doctrine as a discretionary remedy which should only be exercised in the most unexpected and unfortunate of circumstances. To view frustration of a lease as being a question of "degree", as an inquiry into the "gravity" of the frustrating event or as a process in which a number of supposedly relevant factors must be "weighed" suggests that a lease will only be discharged when a court deems it "just and reasonable" to do so. Yet

such a theory has been rejected by the House of Lords⁵³ as being the sole basis upon which to invoke the doctrine. While the writer is prepared to accept that catastrophic events may, in appropriate circumstances, amount to frustration, they are not the only situations in which a lease can justifiably be terminated by application of the doctrine. If one can accept that the frustration issue involves more than ascertaining specific types of frustrating events, any analysis of the circumstances in which a lease will be prematurely terminated must begin with the formulation of a general test by which it can be determined that a change in circumstances brought about by a supervening event can be classified as a "frustrating event". Surely it is beyond question that not every change of circumstances, no matter how great the hardship occasioned by the strict enforcement of contractual obligations, will warrant application of the doctrine. Once the supervening event can be classified as a frustrating event, it then becomes necessary to consider various factors which may have the effect of denying the application of the doctrine.

A. A Frustrating Event—The General Test.

In many contractual settings the general test is spoken of in terms of impossibility of performance whether caused by supervening illegality, by destruction of the subject matter or by the death of one of the parties to a contract involving personal services. Aside from the example of a building lease referred to earlier, it is for the most part inappropriate to speak of frustration within the leasehold context in such terms.⁵⁴ Notwithstanding the fact that the lessee may be prohibited or prevented from utilizing leased premises one cannot maintain, for example, that it is impossible for the tenant to make rental payments.⁵⁵ Instances do arise, however, where it becomes impossi-

⁵³ *British Movietonews Ltd v. London & District Cinemas*, [1952] A.C. 116, at pp. 185-186 and 188. Lord Roskill in *Panalpina* noted that, "the doctrine is no arbitrary dispensing power to be exercised at the subjective whim of the judge by whom the issue has to be determined", *supra*, footnote 1, at p. 74.

⁵⁴ This is not to say, however, that a supervening event will not affect the ability of the lessee to pay rent where, for example, the rent was to be paid from profits which could have been earned had the lessee been able to carry on a business. In earlier cases such as *London & Northern Estates Co. v. Schlesinger*, [1916] 1 K.B. 20 and *Matthey v. Curling*, [1922] 2 A.C. 180, the respective lessees argued that performance of their covenant was rendered impossible because of a supervening event but were rebuked on the basis that the supervening event did not prohibit performance but only interfered with the enjoyment of the premises.

⁵⁵ With regard to agreements for the purchase and sale of land, it is evident that the courts are insisting that frustration be restricted to cases in which it becomes impossible to carry out the contract in accordance with its terms; see: *Amalgamated Investment*, *supra*, footnote 27, at p. 177 to this effect; *Capital Quality Homes Ltd v. Colwyn Construction Ltd* (1976), 61 D.L.R. (3d) 385 (Ont. C.A.), where the agreement was held to be frustrated by the enactment of planning legislation which prevented the

ble for one of the parties to a lease to comply subsequently with a particular covenant; the most troublesome of which relate to the obligation to obtain insurance. Although the law is unsettled as to the respective rights and obligations of the parties in such circumstances, it is apparent that the resolution of the matter does not involve a premature termination of the lease.⁵⁶

The approach of American courts and academics has been to distinguish between frustration caused by impossibility of performance and situations where a contract is discharged by "frustration of purpose". However, this is not to say that a lease will be prematurely terminated where the lessee's purpose in renting the premises has been frustrated. Without embarking upon a linguistic analysis of the subtle distinctions between motives, objects and purposes, it is evident that all three are irrelevant to a lessor whose primary concern is to receive the rent stipulated for under the lease.⁵⁷ Accordingly, American courts have required that the frustrated party's purpose in making the contract (lease) be known to both parties at the time they entered into the contract.⁵⁸ Nevertheless such a test is open to serious criticism and doubt. For example, a lessee may rent premises for use as a warehouse in relation to his construction business, a fact known to the lessor at the time the lease is executed and then subsequently be forced by a change in circumstances beyond his control to abandon such use. Despite this the lessee now proposes to use the premises as a retail outlet for the sale of "widgets", a change in use not prohibited by the

conveyance of individual building lots to the purchaser as per the agreement, although the vendor could still convey the entire plot to the purchaser; *Victoria Wood Development Corp. Inc. v. Ondrey et al.* (1979), 92 D.L.R. (3d) 229 (Ont. C.A.), where the enactment of planning legislation did not make it impossible to carry out the terms of the agreement and where the contract was held not to be frustrated.

⁵⁶ Where the covenant is impossible to perform at the time the covenant is entered into, it is said to be void; see generally, Woodfall, *op. cit.*, footnote, 21, p. 445, para. 1-1105. Where the impossibility arises subsequently, it has been held that the covenantor is in breach of the covenant and accordingly the covenantee may resort to his remedies for breach of covenant; *Moorgate Estates Ltd v. Trower*, [1940] Ch. 206, at p. 211; but see the *Cricklewood* case, *supra*, footnote 8, at pp. 233-234, where Lord Russell maintains that if during the currency of the term circumstances render it impossible for one party to carry out an obligation it may well afford a defence to a claim for damages for breach. The *Moorgate* decision, however, can be distinguished on the basis that in that case the tenant after having entered into the lease had failed to make diligent efforts to obtain coverage prior to the impossibility arising.

⁵⁷ The problems involved in distinguishing between the objects, motives or purposes of a party to a contract which is not incapable of actual performance are well recognized: *e.g.*, *Cheshire & Fifoot, op. cit.*, footnote 7, p. 547 distinguishing between object and motive; P.S. Atiyah, *An Introduction to the Law of Contract* (2nd ed., 1971), pp. 165-166.

⁵⁸ *E.g.*, *Hizington v. Eldred Refining Co. of New York* (1932), 257 N.Y. Supp. 64, but see T. W. Chapman, *Contracts — Frustration of Purpose* (1960-61), 59 Mich. L. Rev. 98, at p. 102, wherein the requirement is rejected.

lease. Surely the lessor could not successfully argue that as a result of this mutually contemplated purpose having been frustrated, so too is the lease. The rejection of a requirement pertaining to a mutually known purpose leads one to the analysis given by Lord Sumner in *Hirji Mulji v. Cheong Yue S.S. Co.*: "Evidently it is their common object that has to be frustrated, not merely the individual advantage which one party or the other might have gained from the contract."⁵⁹ What is the common object of both parties to a lease? Bearing in mind that the answer is not one necessarily acceptable to either a landlord or a tenant, but rather one which the courts must impute to the parties, Professor Atiyah suggests that the answer the courts have given involves a determination of whether the land [leased premises] can be used for "some purpose".⁶⁰ The fact that the tenant cannot use the premises for a particular purpose that he had in mind is immaterial. While the writer is in agreement, with this view, it would be presumptuous to proceed any further without first providing a plausible rationale for treating this as the common object of the parties.

First of all, it must be conceded that in the vast majority of cases, if not all, it will be the lessee who will be arguing frustration as a defence to an action for breach of a covenant(s) contained in the lease.⁶¹ There appears to be only one reported decision⁶² in which a landlord has ever argued that a lease was frustrated and while it is not beyond the realm of possibility that a landlord may argue this in the future, it would be unrealistic to pursue the problem from such a perspective. When one considers the problem from the viewpoint of a tenant who, due to circumstances brought about by a supervening event, is paying rent for premises which cannot be used in a beneficial or profitable manner, one realizes that this tenant, without considering the position of the landlord must feel that he is incurring liabilities which cannot be justified in terms of the benefits to be received if the contract were to be strictly enforced. Regardless of whether or not the lease were to be discharged on the basis of frustration, the lessee realizes that his expectation interests derived from any economic or social advantage in utilizing the premises has vanished. He can, however, minimize any loss arising from the obligation to pay rent and

⁵⁹ [1926] A.C. 497, at p. 507.

⁶⁰ *Op. cit.*, footnote 57, p. 166.

⁶¹ However, there may be occasions when the lessee brings an action for a declaratory judgment terminating the lease.

⁶² *Denman v. Brise*, *supra*, footnote 10. In 1940 a rented home was destroyed by enemy action and accordingly the tenant ceased to occupy the premises although there had been no surrender of the lease. The house was rebuilt and fit for occupation in 1948 but the tenant was unable to gain possession. As to the frustration argument, the court adhered to the view that a lease could not be frustrated as laid down by the Court of Appeal in *Cricklewood* and thus it was held that the tenant was entitled to possession.

to make expenditures pursuant to other covenants by maintaining that the lease in question is frustrated. If one were to view the problem, albeit superficially, as one of determining whether or not it is unreasonable or unjust that the tenant incur such a loss, then it would follow that if the tenant does not of necessity, have to incur a loss on the covenants, there would be no need to relieve him of these contractual obligations. There are two basic ways in which the tenant can avoid financial loss arising from the obligation to honour covenants: (1) by putting the premises to other uses, that is, a change in use by the lessee himself or (2) by assigning or subletting the premises in question. Accordingly, the applicability of the doctrine in any one set of circumstances can only be initially resolved by determining whether the premises can be used for some purpose either by the tenant or his assigns. Or in the words of Lord Wilberforce in *Panalpina*, are the premises "unusable and unsaleable"?⁶³ In effect it is not the lessee's purpose which has become frustrated but rather the lessee's ability to make use of the premises for any purpose whatsoever. Thus the word "use" becomes synonymous and interchangeable with the word "purpose".

There are two decisions of the English courts which lend some support to the foregoing analysis. In *London and Northern Estates Ltd v. Schlesinger*,⁶⁴ the Court of Appeal was confronted with a defendant, an alien tenant, who refused to pay rent for a flat leased from the plaintiff because of government legislation which rendered it unlawful for him to reside therein. While the court concluded that the legislation did not avoid the lease, Avory J. was swayed by the fact that the plaintiff had the right to assign or sublet the premises, perhaps at a profit, and as well to lend the flat to his friends if he so wished. Similarly, Lush J. concluded that "there is no ground whatever for saying that this personal residence was the foundation [object] of the contract".⁶⁵ In *Herne Bay Steam Boat Co. v. Hutton*⁶⁶ the plaintiffs were owners of a steamboat which the defendants wished to hire for

⁶³ Unfortunately Lord Wilberforce did not develop this line of reasoning in formulating a general test for circumscribing a frustrating event. It should be noted that if such a test were adopted, then in the event premises became unusable and unsaleable, any application of the doctrine would not detrimentally affect a mortgagee as it is the supervening event which has rendered the security valueless and not the fact that the lease is discharged. As well, if the party in possession is a sublessee, then it may well be that only this underlease is frustrated as opposed to the headlease. However, if the terms of the headlease and sublease are substantially identical, in particular with regard to any restrictions on use contained in the headlease, then both the lessee and sublessee may want to argue discharge by frustration: see Lord Goddard's judgment in *Cricklewood*, *supra*, footnote 8, at p. 245 wherein the effect which the doctrine might have upon these parties is used to support the view that it should not be applied to a lease.

⁶⁴ *Supra*, footnote 54.

⁶⁵ *Ibid.*, at p. 23.

⁶⁶ [1903] 2 K.B. 683.

the purpose of taking paying passengers to see the royal naval review at Spithead. The contract, however, specifically stated that the purpose of the hire was for viewing the naval review which was subsequently cancelled and for a day's cruise around the fleet. While the Court of Appeal concluded that the plaintiffs could recover the balance of money owing on the contract as there was not a total failure of consideration nor a total destruction of the subject matter of the contract, it is obvious that the steamboat could have been used for another purpose. It is submitted that even if the contract had not expressly provided for an alternative use, the same conclusion should have been reached on the basis that the defendants could have avoided or minimized their loss by using the steamboat for day cruises around the fleet. Whether or not the defendants could have made enough money to pay the contract amount of £250 is a question which lacks any relevance because of the speculative nature for which the defendant entered into the contract in the first place.

Any test which requires a lessee to show that the supervening event renders the premises unusable and unsaleable (that is, cannot be used for "some purpose") raises a number of questions. What is the position of the parties if the lessee is unable to assign or sublet the premises either because the lease prohibits such or the lessee is unable to find someone willing to assume the contractual obligations? Must the lessee put the premises to a use which he does not personally wish to undertake? What does one mean by the phrase "some purpose", or that the premises must be "unusable"?

The latter question must be dealt with because of the inherent injustice which could arise if one were to strictly interpret such a phrase. The American cases involving leases of saloons and the enactment of subsequent legislation prohibiting the sale and consumption of alcohol bear out this concern. While it can be said that there is no uniformity in the American decisions dealing with frustration, there is authority for the proposition that where a lessee is not restricted to making other uses of the premises, the defence of frustration will not be successful.⁶⁷ Yet courts in the saloon cases were willing to hold that lessees who were able to make other use of the premises, for example by selling cigars, were not entitled to relief from the payment of rent.⁶⁸ Corbin's treatment of such reasoning is curt:⁶⁹

⁶⁷ *E.g., Plaza Amusement Co. v. Rothenbert et al.* (1933), 65 F. 2d 254 (C.C.A. 5th), a case in which the demised premises were to be used as theatres unless the lessor consented to other uses. A subsequent city ordinance prohibited this use, nevertheless the tenant was obligated to pay rent in light of the fact that he had not made a request to put the premises to an alternate use.

⁶⁸ *E.g., Grace et al. v. Croninger et al.* (1936), 55 P. 2d 940 and *Stratford Inc. v. Seattle Brewery & Malting Co. et al.* (1916), 162 P. 31. In each case the lease restricted the tenants use of the premises to the business of a saloon and cigar store but allowed the tenant to assign and sublet "for bootblack and, or cigar store purposes".

⁶⁹ *Op. cit.*, footnote 36, p. 475.

If the case is one in which total frustration would discharge the lessee, he should not be held to the contract merely because he is permitted to sell peanuts and give away free lunches.

Thus, if one is to accept that a lease should not be discharged where the premises can be put to a use, by the tenant or his assigns, then these uses must be "substantial" in nature. A building erected for use as a warehouse, which commercial use is subsequently prevented, could not reasonably be expected to be used as residential accommodation even though such change of use is permitted under the terms of the lease. One factor American courts have taken into consideration when discussing the frustration issue is the manner in which the rental amount was determined. If the rental to be paid was calculated on the basis of the proposed use and this was the one principle use mutually contemplated by the parties, then the lease might be held to be frustrated.⁷⁰ Admittedly the amount of rent to be paid under a lease may indicate the principle use contemplated by the parties (as was the case in *Panalpina*) but more importantly, it may indicate the other substantial uses to which the premises may be put. Assume that premises are rented as a saloon at a monthly rental of \$1,000.00, which is the mean rent charged in the locality for similar premises and that the premises can be relet as a restaurant for a similar amount. In such circumstances, the tenant can minimize his loss either by undertaking a change in use himself or by assigning or subletting the premises in question. If, however, the premises could only subsequently be used as a coffee shop and the mean rental for such a use is \$100.00 per month, then one could reasonably conclude that the premises could not be put to a substantial use. Undeniably, whether or not other uses are substantial will, in some instances, be a question of degree to be determined by the courts on the basis of the evidence adduced.

An immediate and negative response to this analysis might be based on the fact the lessee is not engaged nor does he wish to engage in a type of business which other substantial uses might necessitate him to undertake. For example, a tenant whose sole use of the premises is centered on the sale of electrical appliances should not be expected to subsequently engage in the retail sale of alcoholic beverages. The analysis given of frustration cases involving the leasing of saloons by Corbin and referred to by Lord Simon in *Panalpina* requiring that the other substantial uses be contemplated by the parties, lends support to the argument that a lessee would not have to do so (unless the other substantial uses were expressly provided for in the lease). Nevertheless such a requirement must be rejected as was the requirement pertaining to a mutually contemplated purpose. First of

⁷⁰ See Corbin's analysis, *op. cit.*, footnote 51.

all, one has to ascertain whether the lessee is restricted by the terms of the leasing document from assigning or subletting the premises, as such a right is implied by law in the absence of an express provision.⁷¹ In the event the lease does not absolutely restrict this right any problem which the tenant might encounter in finding a party willing to enter into an underlease is irrelevant so long as the premises can be put to another substantial use. The situation would be no different than had the tenant desired more suitable accommodation or larger business premises elsewhere. In such cases the obligation to honour all express and implied covenants remains until a third party can be found who is willing to undertake or abide by them. Thus it is only in those situations where the lease contains an absolute prohibition against underletting, that it would appear unreasonable that a lessee be required to embark upon a business venture for which he may not be well suited. While such a covenant could be viewed as unreasonable in certain circumstances, it would be unwarranted to conclude that a lessor could never justify the necessity of having such a covenant in a lease.⁷² Admittedly, the fact that the tenant can minimize his loss might not, on the surface, seem a sufficient justification for denying the application of the doctrine. Yet it must be remembered that just as the tenant has the advantage of putting the premises to other uses if he so wishes (a change in use not prohibited by the lease) so too must he accept the disadvantage of incurring liabilities in the event he refuses to pursue an alternative use. In effect, it is not the supervening event which has given rise to the tenant's dilemma but rather the presence of an absolute covenant which has been freely entered into and which severely restricts the ability to minimize any subsequent loss caused by a change in circumstances.

Any problems encountered in establishing other substantial uses could, in many situations, be solved by examining the terms of the lease. Where the parties have agreed on the insertion of restrictive covenants as to the use or uses which the premises can be put, then by

⁷¹ E.g., *Doe D. Mitchinson v. Carter* (1799), 9 T.R. 57, at p. 60. If the lease provides that the lessee cannot assign or sublet the premises without the consent of the landlord, it is usually implied by statute, that such consent will not be unreasonably withheld.

⁷² In the English Law Commission's working paper pertaining to the law of landlord and tenant, the view was expressed that an absolute covenant against assigning and subletting can be justified on the basis of freedom of contract and good management and thus should not be restricted unless good reason can be shown. Although expressing no view as to whether statutory relief should be given in certain circumstances, it was felt that if such a provision were necessary, it should provide relief if there was an absolute covenant against assignment of the whole of the premises, a case in which the tenant may suffer the greatest hardship. See generally—The Law Commission's Working Papers Nos 1-64, Vol. 3—Working Paper No. 25 (1977), which also refers to the arguments which support the view that absolute covenants should not be allowed.

the agreement of the parties the other substantial uses can be severely restricted if not extinguished. In *Panalpina* the lessee covenanted not to use the premises as a factory, a residence or in any manner which would constitute a change of use under the Town and Country Planning Act. As well, the lessee covenanted not to use the premises for any purpose other than that of a warehouse in connection with its business. Lord Simon and Lord Wilberforce concluded, quite rightly, that the closure of the road made the warehouse unusable for the only purpose for which it could be used under the lease. Yet even if the terms of the lease had permitted other substantial uses, one could conclude that this would not have had any impact on the resolution of this issue inasmuch as the building was designed and erected for use as a warehouse. The subsequent closure of the road effectively precluded the lessee or his assigns from using the building for any and all substantial purposes.

While one may be willing to accept as a basic precept that the doctrine will only be of assistance to a tenant where premises cannot be put to a substantial use either by the lessee or his assigns, one must distinguish cases in which the supervening event has only the effect of rendering a lessee's use unprofitable. As noted by Lord Simon, frustration will not occur where the frustrating event has only the effect of making the lessee's obligation more expensive or onerous.⁷³ The most illustrative example of this "unprofitability aspect" is found in an American decision, *Essex - Lincoln Garage, Inc. v. City of Boston et al.*⁷⁴ The plaintiff tenant had leased a public parking facility from the Real Property Board of the City of Boston for a term of three years commencing November 30th, 1959. On January 20th, 1960 the Boston Traffic Committee amended its traffic rules which had the effect of diminishing the traffic flow and thus business profits. The court concluded that this was not a case in which the doctrine could be applied as the lessee must be taken to have known that traffic regulations change and, therefore, it was a risk that the lessee assumed upon entering into the lease. While the case can be cited as authority for the rule that where the risk of change in circumstances is foreseeable⁷⁵ the lessee must assume such risks, it is evident that the supervening event did not even frustrate the common purpose of granting and accepting a lease of land for use as a parking lot. The supervening event did not prevent or prohibit the land from being used as a parking lot. Had the governing authority blocked off access to the

⁷³ See quote, *supra*, footnote 50.

⁷⁴ (1961), 175 N.E. 2d 466; see also *Wood v. Bartolino* (1944), 146 P. 2d 883, where the duty to pay rent for a filling station was not affected by the fact that government rationing of petroleum and tires made the business more unprofitable than before.

⁷⁵ See text, *infra*, with regard to the foreseeability factor.

parking lot as was done to the warehouse in *Panalpina*, then within the framework provided the tenant's plea of frustration might have been successful.

B. *Relevant Factors.*

Once the conclusion is reached that leased premises cannot be utilized for a substantial purpose, then a *prima facie* case has been established for applying the doctrine. At this point it becomes incumbent to consider various factors which may warrant a court in arriving at an opposite conclusion. This approach is merely another way of stating that the problem of discharge by frustration is one of "allocation of risk" between the parties.⁷⁶ Whenever the lessee can utilize premises for a substantial purpose, the lessee must assume the risk of financial loss brought about by a supervening event. But it does not necessarily follow that once the opposite is true, that the lessor must assume the risk and the consequential financial loss. Of course the allocation of unspecified economic risk is masked behind the legal determination that the lease is or is not frustrated. To apply the doctrine is to place the risk of the occurrence of a supervening event on the lessor as opposed to the lessee and conversely when the doctrine is not applied the risk is necessarily assumed by the latter. It will become evident that the factors to be examined when allocating loss arising from inherent risks are really criteria to be met by the lessee if a defence of frustration is to be successful.

(i) *Foreseen and Foreseeable Events.*

Professor Treitel comments that one of the most difficult questions in the law pertaining to frustration is whether a contract can be frustrated by an event which was or should have been foreseen by the parties.⁷⁷ One American commentator notes that the requirement of unforeseeability is the most restrictive limitation when considering the application of the doctrine and one which the American courts have failed to apply with uniformity.⁷⁸ Professor Atiyah's analysis of frustration, within the general framework of contract law reflects the view that a person who undertakes to do something takes the risk that performance may prove impossible "as a result of changes in cir-

⁷⁶ The term "risk" is in itself an abstraction with which one may find difficulty in giving any true meaning; see E. W. Patterson, *The Apportionment of Business Risks Through Legal Devices* (1924), 24 Col. L. Rev. 335, at pp. 336-347, for an analysis of the factors involved in the notion of risk. Within the leasehold context, one can refer to the risk which the lessor must assume if rented premises are destroyed by fire; the risk the lessee must assume if he is obligated to continue making rental payments, and in any event the risk of having to relocate.

⁷⁷ Treitel, *op. cit.*, footnote 7, p. 663.

⁷⁸ Chapman, *op. cit.*, footnote 58, at pp. 103-104.

cumstances which are normal or merely slight deviations from the normal, whereas he does not take the risk of performance proving impossible owing to utterly abnormal or extra-ordinary occurrences".⁷⁹ But as he further points out this is merely a way of stating that the normal is always reasonably foreseeable while the utterly abnormal is unforeseeable.⁸⁰ With regard to leases, a requirement of non-foreseeability was considered by Lord Simon in *Panalpina*:⁸¹

The parties can hardly have contemplated that the expressly-provided-for fire risk was the only possible source of interruption of the business of the warehouse—some possible interruption from some cause or other cannot have been beyond the reasonable contemplation of the parties.

These few words leave one with the distinct impression that merely because a lease provides for only one type of contingency, such as destruction by fire, it must be negatively inferred that the lessee will assume all other risks whether foreseeable or not. In other words, the tenant must assume any risk of loss because of a failure to ensure that the lease expressly provided that the tenant would not assume such risks. Of course, this is impossible if the frustrating event is not foreseeable, unless his Lordship is suggesting that a clause of general application be drafted and inserted in the lease. Aside from the practical problems in drafting such a clause, the fact that most lessors would balk at even the suggestion of its insertion, the courts would undoubtedly be called upon sooner or later to interpret it as they have in the past where a supervening event has been expressly provided for in the contract.⁸² If, however, his Lordship is suggesting⁸³ that only other foreseeable risks should have been expressly allocated, it should not make any difference whether one type of foreseeable event is dealt with in the lease. If foreseeability is a factor to be dealt with in resolving the frustration question, then the issue must be limited to one of formulating the proper inference which can be drawn from the fact that a supervening event was foreseeable. Yet there is clear dictum that a non-foreseeability requirement plays no role in the

⁷⁹ Atiyah, *op. cit.*, footnote 57, p. 175.

⁸⁰ *Ibid.*, p. 176. With regard to a non-foreseeability requirement English courts in the case of supervening illegality, have held contracts to be frustrated even though the event was foreseeable: *e.g.*, *Ertel Bieber & Co. v. Rio Tinto Co Ltd*, [1918] A.C. 260. The contract was discharged even though it provided that in the event of war certain obligations of the parties were to be suspended. Such cases, however, may be considered to have been decided on the basis of public policy.

⁸¹ *Supra*, footnote 1, at pp. 69-70.

⁸² *E.g.*, *Metropolitan Water Board v. Dick, Kerr & Co.*, [1918] A.C. 119; *Bank Line Ltd v. Arthur Capel & Co.*, [1919] A.C. 435; *Jackson v. Union Marine Insurance Co.* (1874), L.R. 10 C.P. 125.

⁸³ It is highly unlikely that his Lordship meant to express such a view as the supervening event in *Panalpina* must be admitted as being unforeseeable.

doctrine of frustration. Lord Denning's treatment of the issue is summary:⁸⁴

It has frequently been said that the doctrine of frustration only applies when a new situation is "unforeseen" or "unexpected" or "uncontemplated" as if that were an essential feature. But it is not so. The only thing that is essential is that the [parties] should have made no provision for it in the contract.

For judicial support his Lordship cites *W. J. Tatem Ltd v. Gamboa*⁸⁵ a case in which the inherent risk although actually foreseen was not expressly provided for in the contract. The risk having materialized, Goddard J. held the contract to be discharged. In so doing, unforeseen circumstances were defined as those for which the contract makes no provision.⁸⁶

Professor Treitel, on the other hand, maintains that a distinction must be drawn between those contracts which parties have entered into knowing of an inherent risk and those which are entered into where the risk could only have been foreseeable within the limits of the test which the law imputes to a reasonable man.⁸⁷ In the former situation, Treitel suggests that the normal inference to be drawn is that the parties accept the risk of such known dangers occurring. With regard to the latter situation, however, reference is not made to any inference to be drawn from the fact that the supervening event could have been foreseeable but rather to the effect which such a requirement could have had on the highly controversial decision rendered in *Krell v. Henry*.⁸⁸ There the plaintiff brought an unsuccessful action to recover money owing on a contract in which the defendant had agreed to hire the plaintiff's rooms to view the coronation procession of Edward VII. The subsequent cancellation of the event because of the King's ill health led to the conclusion that the contract in question was frustrated. One can safely assert that a possibility existed, reasonably foreseeable, that the coronation procession might be cancelled and that although the requirement of non-foreseeability was not an issue, it could have easily altered the result of the decision had it been applied.⁸⁹

⁸⁴ *Ocean Tramp Tankers Corporation v. V/O Sovfracht (The Eugenia)*, [1964] 2 Q.B. 226, at p. 239.

⁸⁵ [1939] 1 K.B. 132.

⁸⁶ *Ibid.*, at p. 138.

⁸⁷ Treitel, *op. cit.*, footnote 7, pp. 664-666.

⁸⁸ *Supra*, footnote 39. The decision has been defended by P.A. Landon in (1936), 52 L.Q.Rev. 168; criticized by D. M. Gordon in (1936), 52 L.Q.Rev. 324; rationalized and explained by R. G. McElroy and G. Williams in (1941), 4 Mod. L.Rev. 241 and (1941-43), 5 Mod. L.Rev. 1 and more recently see John Swan, *The Allocation of Risk in the Analysis of Mistake and Frustration* in Reiter and Swan, eds, *Studies in Contract Law* (1980), p. 212, where it is maintained that the case was wrongly decided.

⁸⁹ Lord Wright in *Maritime National Fish Ltd v. Ocean Trawlers Ltd*, [1935] A.C. 524 did make reference to the fact that in the *Krell* case the possibility of the event relied

While the distinction between foreseen and foreseeable events is appealing, it is still necessary to determine the proper inference to be drawn in either of the situations. It should be noted that while both Lord Simon and Professor Treitel refer to "the parties" foreseeing the risk, the issue centers on whether the lessee should have foreseen or did in fact foresee the possible interruption and accordingly should have ensured that the lease expressly provided for such a contingency otherwise this party must bear the burden of any financial loss (that is, the lessee was negligent). But assuming that the event is foreseen or foreseeable, what is the proper inference which can be drawn from such a conclusion? Could it not be argued that the lessor has assumed the risk, that is, should not the lessor have inserted a clause which placed the risk on the lessee? For example, if in *Panalpina*, at the time of the letting it was known by both parties that efforts were being made to close the road because of the derelict condition of the neighbouring building, would the proper inference have been that the lessor assumed the risk? To proceed any further in this vein would provoke a discussion as to the presumed intention of the parties, a discussion from which the implied term theory was initially premised and which is now only of historical significance.⁹⁰ Even if one were to ask what inference could be drawn by a reasonable man in the circumstances, it is highly improbable that one would arrive at an acceptable or satisfactory answer to this question. Yet to reject the foreseeability requirement on the basis that a satisfactory inference cannot be drawn from the fact that the event was foreseen or foreseeable by both parties does not preclude consideration of the fact that only one of the parties may have actually foreseen the supervening event in question. Had only the lessor, in the above example, known of the efforts being made to close the road, it would not be unreasonable to assume that the lessor was to bear the risk. Conversely, had only the lessee known of the impending closure, then it may be reasonable for a court to allocate the risk to this party. Admittedly the door should not be closed hastily to the argument that a contract can be frustrated by a foreseen event. After all, the parties may have been engaged in a deliberate specula-

on as constituting a frustrating event was known to both parties when the contract was made, *i.e.*, foreseeable.

⁹⁰ The implied theory was first introduced in *Taylor v. Caldwell*, *supra*, footnote 6; adopted in the decision of Lord Loreburn in *F. A. Tamplin S. S. Co. Ltd v. Anglo-Mexican Petroleum Products Co. Ltd*, [1916] 2 A.C. 397, at pp. 403-404, on the basis of a presumed intention; modified to the extent that it does not involve an investigation as to what the parties intended but what as reasonable men they should have intended, *Joseph Constantine Steamship Line Ltd v. Imperial Smelting Corporation Ltd*, [1942] A.C. 154, per Lord Wright, at p. 185; and rejected in *Davis Contractors Ltd v. Fareham U.D.C.*, [1956] A.C. 696, on the basis that it would be difficult to say that a reasonable man would have agreed to a term which would frustrate a particular contract, per Lord Reid, at pp. 719-720 and Lord Radcliffe, at pp. 728-729.

tion with regard to its occurrence.⁹¹

As noted, the foreseeability test has met with varying success in the American courts. In *Lloyd v. Murphy*, Traynor J. of the Supreme Court of California rationalized the non-foreseeability requirement on the basis that, "the purpose of a contract is to place the risks of performance on the promisor".⁹² Thus, it would follow that when an event supervenes to cause the alleged frustration and it was foreseeable, it can be inferred that the promisor assumed the risk. But such an approach merely reinforces the notion that the promisor (lessee) must assume the risk because he was negligent in not having the foresight to provide against it by the insertion of an express provision in the contract. Nevertheless, in *Trans-Atlantic Financing Corporation v. United States of America*,⁹³ Wright J. of the United States Court of Appeals (District of Columbia Circuit) rejected the necessity of proving non-foreseeability in a most convincing manner:⁹⁴

Foreseeability or even recognition of a risk does not necessarily prove its allocation. Parties to a contract are not always able to provide for all the possibilities of which they are aware, sometimes because they cannot agree, often simply because they are too busy.

Perhaps the foreseeability factor will be of little concern to a lessee arguing frustration when one considers the nature of the intervening event as found in *Panalpina*, *Cricklewood* and the American saloon cases. Yet there are certain events that could occur during the term of the lease which are foreseeable, which have the effect of rendering premises unusable for any substantial purpose and which may not be expressly provided for in the lease. Premises which are subsequently destroyed by fire most obviously fit into this category. Although the lease may not expressly provide for such a contingency, consideration must be given to the effect of a covenant in which the lessee has undertaken "to keep the premises in repair". Such a covenant places a common law obligation on the tenant to rebuild and accordingly it is inappropriate to argue that the contract has been discharged.⁹⁵ But assuming that the oral or written lease makes no

⁹¹ For example, Professor Treitel, *op. cit.*, footnote 7, p. 664, suggests that "a contract is not necessarily at an end if the existence of a certain state of facts has come to an end: the parties may have been engaged in a deliberate speculation on this point". If in *Panalpina* the parties knew at the time the lease was being negotiated of the possible closure of the road and accordingly the rent was reduced on this basis so as to reflect that the lessee was wagering that the road would not be closed, then the defence of frustration should not have been available to the lessee.

⁹² (1944), 153 P. 2d 47, at p. 50.

⁹³ (1966), 363 F. 2d 312.

⁹⁴ *Ibid.*, at p. 318. As well, see Corbin, *op. cit.*, footnote 36, p. 471 where the requirement is said to have "long since ceased to be convincing".

⁹⁵ See generally, Woodfall, *op. cit.*, footnote 21, pp. 610 *et seq*; E. O. Walford, *Impossibility and Property Law* (1941), 57 L.Q.Rev. 339, at pp. 340 *et seq*.

In the case of short term leases, the obligation of a tenant to rebuild and continue to pay rent on the basis of a covenant to repair would undoubtedly be met with astonish-

provision for destruction by fire, nor provision from which it can be inferred by law that the tenant's obligations remain in force, can it be credibly maintained that the lease in question is not frustrated? It is unquestionable that the supervening event has effectively precluded the premises being used for any and all purposes. But should the doctrine of frustration be inapplicable merely because an event such as fire is reasonably foreseeable? Such a conclusion must be admitted in light of the fact that it would indeed be unusual not to find an express provision in a written lease pertaining to the parties respective obligations upon the occurrence of such an event. This problem is even more pronounced if the application of the doctrine was denied upon the destruction of a rented flat in the higher floors of a tenement building. While the reasoning of Viscount Simon and Lord Wright in *Cricklewood* envisaged frustration as arising upon the occurrence of restricted catastrophic events, it is evident that a majority of their Lordships in *Panalpina* would have considered a lessee's obligations discharged where premises have been destroyed by fire and in particular with regard to "flying leaseholds".⁹⁶ If the foreseeability test is to receive judicial acceptance in common law jurisdictions, then the basis for such must stem from a rationale other than that it can be reasonably inferred that one of the parties assumed the risk. Until such a rationale is given, the justification for the existence of a non-foreseeability requirement is lacking.

Any application of the doctrine of frustration must entail a preliminary determination with regard to two other factors. Firstly, if the frustrating event is of a temporary nature, consideration must be given to the effect of declaring the lease terminated and secondly, whether the frustrating event arose because of the "fault" of either party, that is, was "self induced".

(ii) *Temporary Frustration.*

In determining the applicability of the doctrine in situations where the supervening event is of a temporary nature, courts are cognizant of the fact that all rights and obligations under the lease will terminate automatically at the time of the frustrating event.⁹⁷ Both the

ment by the layman, whether he be a lessor or lessee unless, of course, the latter has covenanted to obtain fire insurance.

⁹⁶ See the judgment of: Lord Hailsham, *supra*, footnote 1, at pp. 53 and 55; Lord Wilberforce, at pp. 58 and 61; Lord Simon, at p. 69. Even Lord Russell felt that special consideration would have to be given to cases involving flying leaseholds; see *supra*, footnote 17. In 1948 the New Brunswick Court of Appeal held that even if the doctrine did apply to leases it would not discharge the obligation to pay rent where premises had been destroyed by fire: *Foster v. Caldwell*, [1948] 4 D.L.R. 70.

⁹⁷ *Hirji Mulji v. Cheong Yue Steamship Co. Ltd.*, *supra*, footnote 37. While "the legal effect of frustration does not depend upon the intention, opinions or knowledge of the parties" (per Lord Sumner, at p. 509), it would be unwise for either the tenant or the

landlord and the tenant (but in particular the landlord in such situations) lose any benefits they would have received over the unexpired term of the lease. As in *Cricklewood* and *Panalpina* the courts must consider the effect of declaring a lease frustrated where the supervening event will only temporarily restrict or interrupt the use of premises, after which time the tenant can theoretically but perhaps not practically resume use or occupation. From the *Cricklewood* decision, it is apparent that it is not necessary to ascertain with certainty the length of the interruption so long as it is reasonable to assume, for example, that temporary building restrictions would be lifted after a war of limited duration but before the expiration of a ninety-nine-year building lease which had some (*post-facto*) ninety years left to run.⁹⁸ In *Panalpina* the interruption arose after the tenant had been in possession for five years and given a twenty-month interruption the lease had yet another three years left to run on the ten-year term. In particular, Lord Simon's analysis involves a balancing of the benefits received, once the temporary restriction is lifted, with the burdens or hardships that each party may have to bear during this temporary period. This is accomplished by looking at the original term of the lease, the time remaining in relation to the original term and the time remaining in relation to the duration of the lease already executed in performance.⁹⁹ The fact that this approach provides flexibility within the decision-making process is not a matter to be regarded lightly. If one stated categorically that a supervening event of a temporary nature is not sufficient to discharge a lease, an injustice would necessarily follow if, for example, a ten-year term lease were interrupted by a frustrating event after the first year of occupation and could not be abated until the commencement of the ninth year.

(iii) *Intentional Frustration.*

A rule of law that a party cannot avoid liability under a contract where the frustrating event has been caused by the "fault" of that party, that is, self-induced, is difficult to reject. While such a rule has been interpreted as meaning that frustration should not be caused "by the act or election of the party",¹⁰⁰ it is unsettled whether mere

landlord to unilaterally assert that the lease has been discharged by frustration. For example, without a judicial inquiry into the matter a lessee who fails to honour obligations on the covenants may find himself liable for damages in addition to an award for the nonpayment of rent in the event a court holds that the lease was not frustrated; cf. *Matthey v. Curling*, *supra*, footnote 54.

⁹⁸ When it is impossible to foresee how long the interruption will last, but it is reasonable to assume that it will endure beyond the term of the lease, then a lease will be held to be frustrated; cf. *Metropolitan Water Board v. Dick, Kerr & Co.*, *supra*, footnote 82.

⁹⁹ See Lord Simon's judgment in *Panalpina*, *supra*, footnote 1, at p. 69.

¹⁰⁰ Per Lord Wright in *Maritime National Fish Ltd v. Ocean Trawlers Ltd*, *supra*, footnote 89, at p. 530, where reference is made to the speech of Lord Sumner in *Bank*

negligence on the part of the party relying on frustration will prevent its application.¹⁰¹ With regard to the negligent destruction of property, both Professors Atiyah and Treitel are in agreement that it would be unjust for a party to successfully plead frustration in the event the loss has been due to their negligence.¹⁰² Similarly then, where the lessee negligently omits to do something which could have prevented the occurrence of a supervening event, a defence of frustration should be ignored. In an American decision¹⁰³ the tenant had entered into a ninety-nine-year lease of land for the erection of a theatre house. Subsequent legislation prohibited construction but provided for an exemption, upon application by the tenant, if it could be shown that the prohibition worked an unreasonable hardship. The tenant, however, proceeded to sue the landlord for a declaratory judgment that the lease was frustrated. The complaint was dismissed on the basis that the tenant must first exhaust his administrative remedies.¹⁰⁴ Had there been a limited time in which to make such an application and the lessee had negligently missed the deadline, then a plea of frustration should not have been countenanced. The effect on the landlord of declaring a lease terminated cannot be justified where the lessee has had the opportunity, albeit only a possibility, of avoiding the consequences of the omission.

With regard to the approach that frustration must not arise as a result of an "election" by the tenant, consideration should be given to factual situations in which it is possible to alleviate the effects of a supervening event by undertaking expenditures. In *Hizington v. Eldred Refining Co. of New York*¹⁰⁵ the tenant leased premises for a term of five years for the distribution and sale of gasoline and petroleum products. After two years in possession, the Commissioner of

Line Ltd v. Arthur Capel & Co., *supra*, footnote 82, at p. 452: "frustration arises without blame or fault on either side."

¹⁰¹ The question was left open in *Joseph Constantine Steamship Line Ltd v. Imperial Smelting Corporation Ltd*, *supra*, footnote 90, although a majority of their Lordships were inclined not to preclude the doctrine in the event of a negligent act.

¹⁰² See: Atiyah, *op. cit.*, footnote 57, pp. 169-170; Treitel, *op. cit.*, footnote 7, p. 667 using *Taylor v. Caldwell*, as the basis of a hypothetical.

¹⁰³ *Gardiner Properties v. Samuel Leider & Son Inc., et al.* (1952), 111 N.Y. 2d 88.

¹⁰⁴ Cf. the *Amalgamated Property* case, *supra*, footnote 27. Property under an agreement of purchase and sale to be used for redevelopment was selected for inclusion in a statutory list of buildings of "special architectural or historic interest" subsequent to the execution of the contract. The evidence, however, indicated that the purchasers had a strong case for obtaining planning permission in order to proceed with the redevelopment; but see, *Capital Quality Homes Ltd* case, *supra*, footnote 55, where the court and parties assumed that planning approval to convey individual lots could not be obtained although it is questionable whether the subsequent legislation was retrospective in nature.

¹⁰⁵ *Supra*, footnote 58.

Public Safety for the city promulgated regulations governing the storage, handling and sale of gasoline, one of which required that all filling pumps must be located at least ten feet from the street. This regulation effectively precluded the tenant from carrying on its business. While the court concluded that the premises in question could not be used for the purposes for which they were rented (one can speculate with some certainty that they could not have been used for any other substantial purpose), the court noted that the pumps could not have been moved so as to comply with the legislation as they were already positioned against the building. If a tenant's concern is to minimize his loss by invoking the doctrine, then he should be called upon to make "reasonable" expenditures for in so doing he will be able to avoid all of the loss associated with his expectation interests, such as business profits and, as well, all of the financial loss arising from the continuing obligation to honour various covenants contained in the lease. Admittedly, any question as to what are or are not reasonable expenditures will be one of degree.

Once it can be determined: (a) that lease premises can no longer be used for a substantial purpose (unusable or unsaleable) because of a supervening event; (b) that a requirement of non-foreseeability is not or should not be in issue; (c) that the supervening event is not of a temporary nature or if it is, that the temporary nature is of such a duration as would justify the application of the doctrine; (d) that the frustrating event was not caused by the act, election or negligence of the tenant, one could reasonably conclude that the obligations of both parties should be discharged. Such a conclusion might have been reached in *Panalpina* had the road been closed permanently and provided that Lord Simon's analysis of a foreseeability requirement is rejected. Yet it is apparent that not all commentators would agree that a contract such as a lease should be discharged merely because the facts and circumstances surrounding a supervening event fit within the framework provided. As well, it is evident that the foregoing analysis does not address the question, "why should the lessor assume the risk"? Inasmuch as the frustration issue has been examined from the viewpoint of a tenant, it is inevitable that the applicability of the doctrine be considered from the perspective of a landlord.

C. Theories of Risk Allocation.

There are at least two theories proffered by academics which provide a framework for demonstrating how risks may be best allocated. The first to be discussed stems from an economic analysis of contract law by Professor Posner and A. M. Rosenfield.¹⁰⁶ While it is

¹⁰⁶ R. A. Posner and A. M. Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis* (1977), 6 J. of Leg. Studies on Law and Econ. 83.

not within the scope of this article to comment on the validity of their theory, it is worthy of consideration because of the problems which are encountered when it is applied to situations involving leases of land. The second theory is advanced by a Canadian commentator, Professor Reiter and involves a "recognition by the courts that they must ascertain the range of risks contemplated by the parties before they can turn to the remedial issue of frustration".¹⁰⁷ In other words, the parties may have implicitly allocated the risk to either the landlord or the tenant at the time they entered into the contract.

Posner and Rosenfield's economic analysis of frustration sketches a framework of why and when it is economically sensible to discharge a contract because of a supervening event. Their theory is premised on the acceptance of the principle that one of the main purposes of contract law is to reduce the cost of contract negotiation by supplying contractual terms that the parties would have agreed to had they the opportunity to negotiate over them—terms which the contracting parties would desire because they will maximize the value of the parties' exchange. Thus, the commentators maintain that the proper criterion for evaluating the rules of contract law is one of economic efficiency.¹⁰⁸ Accordingly, in frustration cases, the law ought to allocate the risk to the superior bearer of it because that is what the parties would have desired had they been able to expressly allocate the loss. In so doing, courts will provide cost efficient rules—otherwise the parties would conceivably alter the result by the insertion of contractual provisions in the future which would only increase transaction costs. As to which of the two parties is the superior risk bearer, the commentators suggest that consideration be given to: (1) whether the promisor (lessee) could not reasonably have prevented the event which rendered his performance uneconomical and; (2) whether the promisee (lessor) could have insured against the occurrence of the event at a lower cost than the promisor because the promisee was in a better position to estimate, (i) the probability of the event occurring, (ii) the magnitude of the loss and (iii) could have self-insured as opposed to the promisor who would have had to buy more costly market insurance.¹⁰⁹ Applying this analysis to the facts of the *Panalpina* case one could justifiably maintain that the lessee could not have reasonably prevented the frustrating event from arising, nor could the lessor have estimated the probability of its occurrence, nor the magnitude of the loss so as to obtain market insurance at a lower cost if such

¹⁰⁷ B. J. Reiter, *Real Estate-Agreement of Purchase and Sale-Down-Zoning Before Closing: How Frustrating?* (1978), 56 Can. Bar Rev. 98, at p. 115. Although the article pertains to frustration within the context of executory contracts for the sale of land the analysis offered is applicable to the leasehold situation.

¹⁰⁸ *Op. cit.*, footnote 106, at p. 89.

¹⁰⁹ *Ibid.*, at p. 92.

were available. The commentators recognize this type of dilemma and while not prepared to speculate on whether it would be more efficient to have a rule which would decide all lease cases, either in the lessee's or the lessor's favour, they are prepared to accept that other empirical evidence could aid in the determination as to which of the two parties is the superior risk bearer.¹¹⁰ For example, Posner and Rosenfield were able to obtain information from general counsel of one of the larger American real estate firms that the risk of loss caused by a change in circumstances in contracts between large diversified lessors and retail chain lessees is invariably and explicitly placed on the lessor.¹¹¹

Professor Reiter, on the other hand, rejects their solution on the basis that one is really asking whether the parties have implicitly allocated the risk. At the same time, he adopts their approach with regard to the value of adducing empirical evidence in order to show that the parties may have implicitly allocated the risk in question.¹¹² Reiter suggests that in real estate transactions between relatively sophisticated buyers and sellers, the purchase price is agreed upon so as to reflect a large number of foreseen risks such as supervening legislation which restricts the uses to which the land can be put. In these situations the purchase price is either discounted or inflated. It would be discounted if the purchaser was to assume the risk of supervening legislation or inflated if the vendor was to assume the risk. Similarly, where premises are destroyed by fire prior to the closing of the transaction, the parties ordinarily believe and contract on the basis that the vendor is responsible for fire loss.¹¹³ In the former situation the evidence necessary to show that the parties have implicit-

¹¹⁰ *Ibid.*, at p. 103.

¹¹¹ *Ibid.*, at p. 103 and see footnote 60.

¹¹² "Investigation of the 'context of the transaction' is essential if the court is to perform its appropriate task of supporting and promoting private law-making and risk-allocation by the parties, for the words of a contract are not designed to exist in vacuo, but rather to express intentions cryptically against a background of common understanding." *Op. cit.*, footnote 107, at pp. 110-111. This line of reasoning can be applied to the covenant pertaining to the right of a tenant to assign or sublet premises. Such a covenant can be viewed as an attempt by the parties to allocate many of the risks, which may subsequently materialize, to the tenant on the understanding that this party can seek to avoid much of its loss by finding a third party who can utilize the premises for a substantial purpose. If, on the other hand the premises are "unsaleable", then one might maintain that the parties have contracted on the basis that the lessor was to assume the risk.

¹¹³ Such reasoning of course runs contrary to the common law position that the purchaser, being treated in equity as the owner of the property, must bear the risk of fire damage prior to closing: see generally *Lysaght v. Edwards* (1876), 2 Ch. D. 499; *Amalgamated Property case*, *supra*, footnote 27, at p. 177; but see *Victoria Wood Development Corp. v. Ondrey et al.*, *supra*, footnote 55, at p. 242, where Arnup J. A. suggests that the common law method of allocating risks may not be satisfactory.

ly allocated the risk to either the vendor or the purchaser would be given by experts attesting to the industry practice, background and understanding with regard to the effect of price setting and allocation of risk.¹¹⁴ The evidence necessary to show that the vendor assumed the risk in the latter situation would come from testimony of knowledgeable individuals about the common understanding of vendors and purchasers who do not expressly provide for such a contingency. An appealing feature of this theory stems from the fact that courts do not have to embark upon an investigation as to the presumed intention of the parties nor determine whether a reasonable man would have allocated the risk accordingly. Rather it is an objective analysis of the contractual setting in which parties may often times implicitly allocate risk. Obviously any retrospective analysis of cases involving frustration would be futile unless counsel for the parties had adduced the necessary evidence. On the other hand, it is apparent that courts do take judicial notice of the fact that in certain situations parties do contract on the basis that one party is to assume most, if not all, supervening risks. In *Panalpina* three of their Lordships noted that it would indeed be a rare occurrence to find a 999-year lease frustrated.¹¹⁵ It is beyond debate that such leases will, in most cases,¹¹⁶ be treated in the same manner as a conveyance of freehold property. It would appear that Professor Reiter would only suggest that in a case of long-term leases rather than the courts deducing for themselves what risks may be reasonably allocated to one of the parties, that they rely on the evidence of experts in reaching a decision. At the same time, Reiter recognizes that parties do not always allocate risk, simply because the parties have not thought about them (unforeseeable) or because there is simply no "common understanding amongst similarly-placed parties about who is the proper party to bear the risk that ultimately materializes".¹¹⁷ In such circumstances, one might have expected that such risks must be assumed by the lessor provided it is a case that fits within the general framework previously outlined.

Yet this "all-or-nothing" solution has been criticized as one which only creates a substantial injustice for the parties concerned and

¹¹⁴ Reiter maintains that this evidence should not be based on testimony of counsel volunteered during argument nor should the court take judicial notice of the practice of land buyers and sellers. The belief that parties to a contract allocate risks when agreeing upon the purchase price is analogous to Treitel's observation that the parties may have been speculating on the possible occurrence of a supervening event (see *op. cit.*, footnote 91 and hypothetical outlined).

¹¹⁵ See the judgment of: Lord Hailsham, *supra*, footnote 1, at p. 55; Lord Wilberforce, *ibid.*, at p. 58; Lord Simon, *ibid.*, at p. 64.

¹¹⁶ If such a long term lease was a building lease then it is possible that the doctrine could apply; see *supra*, footnote 14 and preceding text.

¹¹⁷ *Op. cit.*, footnote 107, at p. 112.

accordingly it is maintained that the loss occasioned by the supervening event should be shared equally among the parties.¹¹⁸ Lord Simon in *Panalpina* indicates that consideration should be given to such a solution.¹¹⁹

I would, however, presume to suggest that consideration should be given to whether the English doctrine of frustration could be made more flexible in relation to leases. The Act of 1943 [Frustrated Contract Act] seems unlikely to vouchsafe justice in all cases. As often as not there will be an all-or-nothing situation, the entire loss caused by the frustrating event falling exclusively on one party whereas justice might require the burden to be shared.

Among those who have taken part in the debate, as to its appropriateness, are the commentators previously noted. Posner and Rosenfield argue against loss sharing generally while Reiter maintains that the courts must seek "distributive justice".¹²⁰ Admittedly in those situations where no superior risk bearer can be found, nor sufficient evidence can be adduced to show that the parties have implicitly allocated a risk, a fifty-fifty loss sharing solution is appealing. However, any attempt to split the "loss" does not detract from the fact that the contract is still discharged as a result of the frustrating event.¹²¹ Despite the alluring nature of a compromise which advocates apportionment of losses there are at least two compelling reasons for rejecting this solution.

Firstly, the proposed solution is premised on the belief that one cannot justify allocating the materialized risk solely to one of the parties. Given that the general framework outlined has developed from an analysis of the problem as viewed by a tenant, it now becomes incumbent to determine the basis on which a court can justify allocating the risk to the lessor, that is, why is the lease frustrated? Assuming that the supervening event has not been caused by his act, election or negligence, consideration must then be given to the fact that if the lease is to be held frustrated, the lessor would suffer an obvious economic loss. In addition to the loss of rent, the landlord could be

¹¹⁸ *E.g.*, Reiter, *op. cit.*, *ibid.*, at pp. 113-115 and see Posner and Rosenfield, *op. cit.*, footnote 106, at footnote 100 for reference to American commentators who advocate the adoption of the cost sharing solution.

¹¹⁹ *Supra*, footnote 1, at p. 70; but see Lord Russell's judgment, *ibid.*, at p. 71 where it is suggested that such a solution does not achieve justice.

¹²⁰ Posner and Rosenfield maintain that a splitting of the loss may have the effect of deterring the more efficient risk bearer from adopting "cost-justified risk avoidance or risk-minimization techniques" (*op. cit.*, footnote 106, at p. 113). Reiter on the other hand rejects this criticism on the basis that it assumes the parties are aware of the risk that materializes (*i.e.*, it was foreseeable) and of the way in which the law will allocate the risk (*op. cit.*, footnote 107, at p. 114).

¹²¹ The only exception would appear to arise in the case of an agreement for the purchase and sale of land where in order to share the loss equally it is necessary to make an order for specific performance with an abatement in purchase price; see Reiter, *op. cit.*, *ibid.*, at p. 113.

saddled with financial expenditures by virtue of covenants which the lessee had originally undertaken. Thus, the lesser will cry "unreasonable hardship" if the lease is said to be frustrated.

Courts have traditionally clothed their reasons for discharging a contract with "juristic respectability" by maintaining that it is implied that a reasonable man would have agreed to a term having that effect.¹²² Others have said that frustration occurs because the foundation of the contract, which the parties are deemed to have had in contemplation, has disappeared,¹²³ or because as discussed earlier, the parties' common object has been frustrated. Another theory holds that when a contractual obligation has become incapable of performance because of a change in circumstances which would render performance a thing radically different from that which was undertaken (*Non haec in foedera veni*: It was not this that I promised to do) the contract is discharged.¹²⁴ Within the leasehold context one could look upon the foundation of the contract or the object of the parties as being premises which can be used for a substantial purpose. Similarly one could say that the obligation of the landlord to provide a tenant with premises which can be used for a substantial purpose is incapable of performance because of a supervening event. Performance of the landlord's obligation has radically changed in that he can no longer provide usable premises but only a proprietary interest in land. Two of their lordships in *Panalpina* noted that the only theory which is incompatible with the doctrine when applied to leases is that based on a total failure of consideration.¹²⁵ American courts, on the other hand, have rationalized the doctrine in the leasehold situation on the basis of an "actual" but not "literal" failure of consideration.¹²⁶ In adopting such a position, one could assert the opinion that the purpose of the doctrine is to prevent a landlord from being unjustly enriched.¹²⁷ Whichever rationale one wishes to choose as the true basis for invoking the doctrine, it is clear that the lessor is no longer able to shelter behind

¹²² *Supra*, footnote 90.

¹²³ See Lord Hailsham's dissenting judgment in *Tamplin S.S. Co. Ltd v. Anglo-Mexican Petroleum Co.*, *supra*, footnote 90, at p. 406.

¹²⁴ *Davis Contractors v. Fareham U.D.C.*, *supra*, footnote 90, per Lord Radcliffe, at p. 729; and cited with approval by Lord Hailsham in *Panalpina*, *supra*, footnote 1, at p. 52.

¹²⁵ See Lord Hailsham's judgment, *ibid.*, at p. 51 and Lord Simon's judgment, at p. 65 and see *Vancouver Breweries Ltd v. Dana* (1915), 52 S.C.R. 134; *Cherrier v. McCreight*, [1917] 2 W.W.R. 8 (Alta C.A.) wherein the frustration argument was rejected on the basis of a total failure of consideration.

¹²⁶ E.g., *Lloyd v. Murphy*, *supra*, footnote 92.

¹²⁷ Cf. S. M. Waddams, *The Law of Contracts* (1977), pp. 214 *et seq.* Professor Waddams maintains that frustration cases are instances of relief being given because of the parties contracting on the basis of a mistaken assumption. In the event relief is granted, it is because the courts do not favour enrichment by mistake.

the argument that his sole obligation is to provide the lessee with an interest in land. Ultimately the legal justification for applying the doctrine must be predicated on a principle of law that the primary contractual obligation of a lessor is to provide the lessee with premises which can be used for a substantial purpose throughout the term of the lease. If this were not so, a landlord could make one final argument which arises from the fact that supervening events do not necessarily have to give rise to a financial loss to the tenant. In certain cases a subsequent change in circumstances could place the lessee in a very advantageous position. For example, the uses to which leased premises can be put could be initially restricted by planning legislation which is subsequently changed so as to broaden the permitted uses. In such a case, the tenant would obtain an obvious advantage, particularly if the rent had been determined on the basis of the restricted uses. Accordingly, the landlord could maintain that the tenant must accede to any loss arising as a result of a supervening event just as the tenant will willingly embrace any advantage which could possibly arise after having entered into the lease. If this argument is accepted, then it would follow that a lease might "never" be frustrated.¹²⁸

The second reason for rejecting a loss-sharing solution arises when one attempts to compute in monetary terms the loss which is to be shared. Advocates of loss sharing are careful to distinguish between reliance and expectation losses.¹²⁹ The latter being excluded from any apportionment formula because it would in effect mean that one party would receive a partial award for damages as though the contract had been breached.¹³⁰ Accordingly, both landlord and tenant must forego any expectation of sharing losses arising for example, from anticipated profits. Inasmuch as the lease is discharged the loss which is to be shared will stem from the loss suffered by the landlord and thus any margin of profit, which is invariably provided for in calculating the cost of rental, must be excluded.¹³¹ However, in many

¹²⁸ Admittedly the argument can be circumvented by maintaining that in the event subsequent legislation broadens the permitted uses, a lessor could invoke the doctrine to terminate the contract. However, the test for determining a frustrating event in such circumstances would revert to the notion of "frustration of a mutually contemplated purpose" which the writer has previously rejected. As well the lessor not having suffered a loss pertaining to its reliance interest will normally protect himself against such an occurrence by insisting that the rent be calculated periodically or more precisely upon the renewal of the lease as was the situation in *Panalpina*.

¹²⁹ See generally, P. D. Weiss, *Apportionary Loss After Discharge of a Burdensome Contract: A Statutory Solution* (1959-60), 69 *Yale L.J.* 1054.

¹³⁰ *Ibid.*, at pp. 1059-1060.

¹³¹ Presumably in the case of a simple lease the loss to be shared would be calculated by adding the landlord's expenses (based on covenants for which he was responsible) with those that were originally the tenants (which the landlord must

cases a tenant will be able to mitigate any expectation loss by obtaining other suitable premises. Nevertheless the landlord could be left with unusable and unsaleable premises and thus unable to even attempt to mitigate his loss.¹³² While the fifty-fifty proposal would most likely find acceptance with landlords faced with the prospect of the contract being discharged by the application of the doctrine, it is unlikely the proposed solution will ever achieve "distributive justice". Loss sharing may be appropriate in circumstances where one party has received benefits at the expense of another, as in building contracts which are subsequently frustrated. But where the loss results from future obligations such as the payment of rent, it is difficult to accept that a tenant must still incur a loss for something which is of no "real" value.¹³³ In cases of "true frustration" where risk cannot be allocated in accordance with an acceptable theory, the risk of financial loss must be allocated to the lessor.

III. Reality—"Rarely if Ever".

As a final appendage, any concern that might be expressed because of a seemingly unprecedented liberal approach to the frustration problem should be alleviated when one realizes that the factual situations giving rise to a defence of frustration will be exceedingly rare. Firstly, in situations where risks are foreseeable, such as destruction by fire, parties will invariably in the case of written leases expressly provide for such contingencies. In situations where parties under an oral lease make no provision for such, it is reasonable to speculate that neither landlord nor tenant will become embroiled in an argument pertaining to the continuing obligation to pay rent. In any event, litigation of a dispute would be both impractical and of little benefit to the parties. For example, a monthly tenancy could be easily terminated by a tenant giving the appropriate notice. Secondly, it should be observed that the vast majority of lease cases in which frustration has been argued have involved interruptions in use caused by: (1) government agencies acting under statutory authority in time of war;¹³⁴ (2) destruction of

undertake because of the contract being frustrated). The total sum would be calculated on the basis of the unexpired portion of the term and then halved so that the tenant could make a lump sum payment to the landlord.

¹³² In situations where premises can not be put to a substantial use because of restrictive covenants, then it is conceivable that the landlord could mitigate his loss.

¹³³ The New South Wales Reform Commission (Report on Frustrated Contracts (1976)), recommended the loss sharing approach in cases where one party has obtained a benefit under a contract which is later frustrated. In the lease situation this approach would necessitate the lessee sharing his loss with the landlord when, in fact, no benefit will be received.

¹³⁴ E.g., *Whitehall Const. Ltd v. Ettlinger*, [1920] 1 K.B. 680; *Swift v. MacBean*, [1942] 1 K.B. 375; *Matthey v. Curling*, *supra*, footnote 54, where the military acting under statutory authority requisitioned the tenant's premises during a time of war.

leased premises during a war and;¹³⁵ (3) the subsequent enactment of planning legislation.¹³⁶ As a final note, an American commentator points out that in the United States approximately one-half of the frustration cases have involved leases of realty and of these approximately two-thirds have arisen because of unexpected governmental action.¹³⁷

Conclusion

Since the decision in *Paradine v. Jane*¹³⁸ it has taken the courts over three hundred years to recognize as a matter of law that a lease can entail more than a mere conveyance of an interest in land. Yet it is not wishful thinking to expect courts to adopt a general framework for deciding the frustration question within a shorter time span, even though the cases in which the issue is apt to arise will be exceedingly rare. If the doctrine of frustration is to be flexible and not subject to being constricted by an arbitrary formula, such as catastrophic events, then the initial problem must be one of determining whether leased premises can be utilized for a substantial purpose. Such a requirement will surely deter lessees seeking to avoid their contractual obligations in the event that a change of circumstances merely causes the originally intended use to be unprofitable. In situations where the frustrating event is not "self-induced", nor of an insufficient duration, nor one which can be nullified by the tenant undertaking reasonable expenditures, a *prima facie* case for invoking the doctrine has been established. The fact that the event may not have been foreseeable or foreseen should not alter this conclusion unless the event was foreseen only by the tenant or the parties were deliberately speculating on its occurrence. However, the process of risk allocation should not end here. A strong argument can be made that contracting parties often times implicitly allocate risks by virtue of a common understanding prevalent among similarly placed landlords and tenants. It may well be the case that certain contractual provisions are determined on the basis that one of the parties is to assume the risk. In effect the risk will be assumed by the lessor unless evidence can be adduced to support a finding of implicit risk allocation to the contrary.

A solution which advocates a fifty-fifty loss sharing arrangement will only placate those who cannot justify allocating the risk to either party. Yet even if one were to reject allocating the risk to the lessor on the basis that a landlord must live up to his primary contractual obligation of providing the lessee with usable premises, it is not even certain that the loss can be shared so as to attain distributive justice.

¹³⁵ E.g., *Denman v. Brise* and *Cusack-Smith v. London Corporation*, *supra*, footnote 10, where leased premises were totally destroyed by enemy action.

¹³⁶ E.g., the *Panalpina* case, *supra*, footnote 1, and cf. *Amalgamated Investment*, *supra*, footnote 27.

¹³⁷ Chapman, *op. cit.*, footnote 58, at p. 99.

¹³⁸ *Supra*, footnote 4.