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# Frustration, COVID-19 and company voluntary arrangements

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Your world appeared to be collapsing. You had a good core business, but because of cash flow difficulties, you could not pay your debts as and when they fell due. You were then saved – or, at least, you thought you were- by a trading company voluntary arrangement ("CVA"), under which you are required to make regular monthly contributions of a certain amount. You thought that you would survive with the protection of your CVA - that is until Covid-19 struck. Now, as a non-essential business, you have been forced to close, albeit temporarily, by The Health Protection (Coronavirus, Restrictions) (England) Regulations 2020 ("the 2020 Regulations"). Alternatively, you are allowed to stay open, but because of Government Guidance about social distancing, you have had to reduce your workforce, or your workforce is much reduced because of sickness or self-isolation. Alternatively, for commercial, health and safety or other reasons, you have decided temporarily to close your business. All of this has stopped or reduced your turnover and as a result you are unable to meet the payment requirements of your CVA. Is it open, in these circumstances, for anyone to argue that the restrictions imposed on your business and your consequent failure to comply with your CVA have frustrated your CVA?

In this Article, I shall examine this issue. I shall do so first by summarising the law of frustration and then consider whether, in light of circumstances flowing from COVID-19, it has any application in relation to CVAs.

## Frustration

The doctrine of frustration is concerned with a supervening event that takes place after a contract has been entered into. It has been formulated in the following terms in two leading cases:

*"…frustration occurs whenever the law recognises that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different*

*from that which was undertaken by the contract. Non haec in foedera veni. It was not this that I promised to do"* (*Davis Contractors Ltd v. Fareham UDC* [1956] AC 696, 729).

*"Frustration of a contract takes place where there supervenes an event (without default of either party and for which the contract makes no sufficient provision) which so significantly changes the nature (not merely the expense or onerousness [my emphasis]) of the outstanding contractual rights and/or obligations from what the parties could reasonably have contemplated at the time of its execution that it would be unjust to hold them to the literal sense of its stipulations in the new circumstances: in such cases, the law declares both parties to be discharged from further performance"* (*National Carriers Ltd v. Panalpina (Northern) Ltd* [1981] AC 674,700).

In some more recent cases, the court has adopted a more multifactorial approach, stating that in order to decide whether or not frustration has occurred, it should balance the following factors against each other, namely, the terms of the contract, its factual matrix and the parties' mutual knowledge, expectations, assumptions and contemplations, in particular as to risk, at the time of the contract, in so far as these can be ascribed mutually and objectively (*Edwinton Commercial Corporation v Tsavliris Russ (World Savage and Towage) Ltd* [2007] EWCA Civ. 547).

The essence of frustration has been encapsulated by five propositions enunciated by Bingham LJ in *J Lauritzen AS v. Wijsmuller BV (The Super Servant Two)* [1990] 1 Lloyd's Rep. 1,8. These may be summarised as follows:

- first, the doctrine of frustration evolved to mitigate the rigour of the common law's insistence on literal performance of absolute promises. Its object was to escape injustice where such would be the result from enforcement of a contract in its literal terms after a significant change in circumstances;
- secondly, frustration operates to bring a contract to an end automatically, and forthwith, upon the intervening event;
- thirdly, as a result of its consequences, it cannot be invoked lightly, must be kept within very narrow limits and ought not to be extended;
- fourthly, the essence of frustration is that it should not be due to the act or election of the party seeking to rely on it. It must be some outside event or extraneous change of situation;
- finally, a frustrating event must take place without blame or fault on the side of the party seeking to rely on it.

The further following points should also be noted:

- frustration is not concerned with a radical change in circumstances, but on how those circumstances have affected the promises made under a contract. Is what is to be performed as a result of the supervening event radically different from what had been promised? Thus, frustration of contract will not occur whenever there is a change in circumstances, which causes hardship to one of the contracting parties (see, for example, *Movietonews Ltd v London & District Cinemas Ltd* [1952] A.C. 166 and

*Edwinton Commercial Corporation v Tsavliris Russ (World Savage and Towage)* Ltd [2007] EWCA Civ. 547 at [111]);

- where Government or another authority intervenes by legislative action, royal prerogative or the exercise of administrative powers so that further performance of the contract is impossible, then it will be discharged by frustration (see, for example, *R v Reilly* [1934] AC 176 and *Metropolitan Water Board v Dick, Kerr and Co. Ltd* [1918] AC 119);

- temporary measures imposed by Government may not have the effect of frustrating the whole contract, but may lawfully excuse one party of his obligation to perform a restricted contractual obligation until the restriction is lifted (*Cricklewood Property Trust and Investment Limited v Leighton Investment Trust Limited* [1945] A.C 221 (one of the lease cases));

- if the contract itself makes sufficient provision for the "frustrating event", then the contract will prevail;

- the purpose of frustration is not to enable parties to get out of what they may later consider to have been a bad bargain.

## The CVA

CVAs are a creature of statute. The Insolvency Act 1986 permits a debtor to reach an out-of-court formal and binding agreement with its creditors in respect of its pre-arrangement debts, which allows the debtor to satisfy those debts at something less than their full value and, if completed, then releases the debtor from those debts. A debtor will put a proposal to its creditors, which, if approved by them (whether with or without modifications), will bind all creditors entitled to vote on the proposal.

In a trading CVA it is normal for a CVA Proposal to provide for the company to make regular monthly contributions into the CVA and to incorporate R3's Standard Terms and Conditions for CVAs ("Standard Terms"). These ensure that a company is protected against proceedings by creditors and enforcement against its assets. As a CVA is a consensual arrangement between a company and its creditors, its terms and conditions will be construed in the same way as any other contract. In the event that there is a conflict between the terms of the Proposal and the Standard Terms, clause 2 of the Standard Terms provides that the terms of the Proposal will prevail. For the purposes of this article, it has been assumed that there is no such conflict.

## Frustration and the CVA

In essence, three different groups of cases need to be considered: first, those cases where companies cannot trade, at least, on a face to face basis with the public, because they are prohibited from doing so under the 2020 Regulations; secondly, those cases where turnover is reduced, because the workforce is reduced; and thirdly, those cases, where companies have voluntarily ceased trading on a temporary basis, pending an improvement in the situation.

In all of these cases, I am of the view that the CVA will not be held by a court to have been frustrated if the consequence of what has occurred is that a company can no longer meet its CVA payment obligations, whether in whole or in part. My reasons for this

conclusion are set out below.

The effect of the 2020 Regulations is not to stop a non-essential shop or public events business from trading altogether, but to limit their trading in two respects: first, as to the way that they can carry out their business; and (ii) secondly, as to the period of time for which the restrictions will last. Such businesses are forbidden by law to trade in a way that interfaces with the public at large, but not from carrying on their business in another way or, indeed, carrying on a different business altogether[1]. The regulations do not stop a company's ability either to earn money or to use such resources as a company has to make payments into its CVA. Therefore, whilst the 2020 Regulations will undoubtedly cause financial hardship to businesses affected by it and may make a company's obligations under its CVA much more onerous, it cannot be said that at the point that the regulations came into force, their effect was immediately to render the company's obligation to make payments into a CVA something radically different from what the company had promised to do.

In this respect the case of *Canary Wharf (BP4) T1 Ltd v European Medicines Agency* [2019] EWHC 255 is instructive. In that case, the defendant was an agency of the European Union ("EU") and the tenant of a property in Canary Wharf where its lease was expressed to last, without a break clause, until 2039 and the annual rent payable by it was £13 million. After the United Kingdom decided to leave the EU, the defendant announced that it would re-locate to Amsterdam as required by the EU Regulation 2018/1718, since it had to have a headquarters in the EU. The court held that no frustrating event had occurred, because the EU had the capacity to make an inter-governmental decision to maintain the defendant's headquarters in a non-EU country under article 341 of the Treaty on the Functioning of the European Union and the defendant itself retained capacity to deal with the property. Therefore, because the EU could have done something, but had not, it could not be said that the EU Regulation 2018/1718 was a supervening illegality which frustrated the lease.

As to businesses which do not fall within the 2020 Regulations, but who have either closed voluntarily or have reduced their workforces, these cases are even further removed from the doctrine of frustration than those covered by the 2020 Regulations. In such cases, it cannot, in my view, be said that COVID-19 is a supervening event, which renders the obligation of such companies to make payments into their CVAs as something radically different from what they promised to do. Again, whilst the virus may have caused hardship in such cases, this is not sufficient. Further, in those cases, where the company has the right to continue to trade, but, for commercial or other reasons, has chosen not to do so during the period of the virus, the court may very well hold that any "frustration" was self-induced.

Of course, it is obvious that it is not only Covid-19, which can seriously affect a company's business. There are many other external factors, outside a company's control, which during a company's lifetime may render it unable to comply with its payment obligations, either in whole or in part. Exchange rate fluctuations and recessions are but two examples. However, as far as I am aware, it has never been held that such external factors are

[1] Although unlikely, because the nature of the business carried on by the company is usually referred to in the background information in the CVA Proposal, the business to be carried on may be a term of the CVA, in which case, a variation to the CVA will be required if it is proposed to change the business.

sufficient to frustrate a CVA.

The second reason why it is unlikely that the court will hold that a CVA has been frustrated is because the Standard Terms cater for what is to happen in the event that payment is not made. As will be seen from below, primarily, it is for the creditors, who are bound the arrangement, to decide what should happen. Indeed, it would be strange, in relation to a restructuring tool designed to benefit creditors as a class, that they should have no say in the matter, which, of course, if frustration applied, would be the case, since the CVA would automatically terminate on the frustrating event.

The relevant provisions of the Standard Terms are first, clause 72(1), which provides that a debtor is to be regarded as being in breach of the arrangement if he fails to comply with any of his obligations under the arrangement. The failure to comply does not look to the cause of the failure, but merely to the fact of failure itself. Clause 72(2) then provides a procedure with a view to the breach being remedied. If the debtor does not do the things specified in clause 72(2), then the Supervisor must call a creditors' meeting to resolve to do one or more of the things specified in clause 72(3), namely: issue a Certificate of Termination by reason of the breach; present a winding-up petition against the company; vary the terms of the CVA under clause 75; and/or take no action. If the creditors resolve that the Supervisor should present a winding-up petition or issue a Certificate of Termination, then he must do this. If no resolution is passed, then the supervisor has a discretion as to what, if anything, to do. In light of the Government's wish to secure, in so far as possible, the survival of as many businesses as possible, and, if it appears that the Company might be able to survive and re-start or increase its business after the lifting of restrictions, then the more attractive option in the current situation might be for a Supervisor either to do nothing or to seek a variation of the CVA.

## Conclusion

We live in unprecedented times, where now unprecedented legal problems present themselves. Whether a CVA will be frustrated is as yet untested by any litigation. As shown above, the conclusion I have reached is that the doctrine cannot assist trading CVAs affected by the pandemic. However, only the future litigation of this issue will provide the definitive answer.

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