Frustration of Purpose, Brexit, the COVID-19 Pandemic and Commercial Contracts

Mitja Kovac* and Paul Aubrecht**

* Professor of civil and commercial law at the University of Ljubljana School of Economics and Business, Slovenia, e-mail: mitja.kovac@ef.uni-lj.si

** Junior researcher at the Erasmus University Rotterdam School of Law, Rotterdam Institute of Law and Economics, The Netherlands, e-mail: paul.aubrecht@emle.eu

ABSTRACT

Lawyers and commercial contracting have been stressed by extraordinary uncertainty over the past four years. Brexit and the Covid-19 pandemic's uncertain outcomes and the debate on the appropriate application of the frustration doctrine represent one of the most challenging issues for contract law scholars and practitioners. This paper contributes to the extensive scholarly debate on whether Brexit and Covid-19 constitute frustration of purpose events in contracts by exploiting the findings of the economic literature on the consequences of supervening events. It offers a conceptual framework for an improved legal intervention in case of supervening events in which a court must decide whether a certain event classifies as frustration of purpose and whether to discharge the promisor's obligations.

1. INTRODUCTION

Brexit and the COVID-19 pandemic have been generally portrayed as unexpected, unforeseeable events that represent ongoing uncertainty. One of the multitudes of uncertainties currently facing contracting parties potentially affected by a hard Brexit[2] and the COVID-19 pandemic is the effect on their existing commercial contracts, specifically whether the new circumstances provide an event that frustrates the contract.

Some welcome clarity has now been provided by the English High Court's judgment in *Canary Wharf (BP4) T1 Ltd v European Medicines Agency*.[3] In delivering its judgment, the High Court provided notable guidance on the application of the relevant principles to determine whether Brexit (and also COVID-19 pandemic) is likely, in a particular case, to constitute a frustrating event in contracts governed by English law. Namely, the High Court found that 'the involuntary departure of the EMA from its headquarters in the Premises, due to the circumstances beyond its control, was something which - on the face of it - the Lease expressly provided for' and the contracts alienation 'provisions draw no distinction between the reasons why the EMA might abandon its headquarters' but rather 'simply deal with the fact' of the EMA leaving the Premises at for seemingly any reason, including Brexit.[4] This article investigates whether, from the economic perspective, such a decision is the correct one or whether the

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[2] Hard Brexit' was a phrase used during the Brexit process to capture the anticipated economic, social and political impact of a sharp break in relations between the UK and the EU as a result of the UK leaving the bloc. A 'hard' Brexit came to mean a future relationship with the UK outside the EU's single market and customs union and trading with the EU based on a free trade agreement.

[3] [2019] EWHC 335 (Ch) (*Canary Wharf*).

[4] In *Canary Wharf* [2019] EWHC 335 (Ch) at [241].

economic principles would lead to a different decision. Undoubtedly, future cases will be litigated concerning the nature of Brexit and the COVID-19 pandemic regarding its interpretation as frustration of purpose.

The current debate on the appropriate application of the frustration doctrine represents one of the most challenging issues for current contract law scholars and practitioners. Shooter, Speed, and Baxter, for example, argue that, if Brexit is to have an underlying effect on contracts and on the commercial bargain made by the parties (e.g., where import tariffs are increased), express provisions will need to address these impacts.[5] On the other hand, Araujo examines the negotiation, conclusion, and implementation of trade agreements concluded by the UK post-Brexit and proposes a significant reform of existing inter-governmental cooperation mechanisms to ensure that the devolved administrations are given a meaningful voice in the shaping of future trade agreements.[6] Ribas suggests that Brexit may have significant implications for interpretative, applicable law, and termination aspects of contracts.[7] Moreover, Woods argues that if the wording of the particular clauses allows for termination in the event of a significant regulatory or legislative change, for example, then such a clause could also apply in the Brexit case.[8] Additionally, Pertoldi, Blake, and Kay suggest that the restriction, suspension, or withdrawal of any licences connected to Brexit might also be covered by a general force majeure clause.[9] Conversely, Pertoldi et al. note that 'a change in economic or market circumstances which makes the contract

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[5] S Shooter, J Speed, and K Baxter, *Does Brexit Constitute a Force Majeure Event in Supply Chain Contracts?*, Bird & Bird, London, 2019.

[6] B A Melo Araujo, 'UK Post-Brexit Trade Agreements and Devolution' (2019) 39 *LS* 4.

[7] A R Escobar, 'And here Remain with your Uncertainty: The Consequences of Brexit for Business Law' (2017) *Working Paper IE Law School* AJ8-239. See also J W Cartwright, *Contract Law. An Introduction to the English Law of Contract for the Civil Lawyer*, 3rd ed., Hart, London, 2016, p 270; and M Sonnentag, *Die Konsequenzen des Brexits fur das Internationale Privat- und Zivilverfahrensrecht,* Mohr Siebeck, Munich, 2017.

[8] Jane Woods, 'Impact of Brexit on Contract Law' (2016) 79 *Student Law Review* 15. See also Jeremy Heymann, 'Impact of Brexit on European Company Law: A French Private International Lawyer Perspective' (2018) *European Papers*.

[9] Anna Pertoldi, Neil Blake and Alex Kay, 'English Law Contracts post-Brexit: What Changes should Commercial Parties Expect?' (2016) *Contract Disputes Practical Guides Issue* 7, Herbert Smith Freehills. In addition, High Court has in the *Tandrin Aviation Holdings v Aero Toy Store* [2010] EWHC 40 (Comm) ruled that an 'unanticipated, unforeseeable and cataclysmic downward spiral of the world's financial market' is not sufficient to trigger a force majeure clause. Such a clause under English law would be triggered merely if one party's performance of the obligations under the contract became either impossible or extraordinarily difficult.

less profitable or performance more onerous is not generally regarded as sufficient to trigger a force majeure clause.'[10] Finally, MacMillan discusses the issues of post-Brexit settlements and thoroughly investigates different types of possible effects upon the practice and substance of English contract law.[11]

First, this paper contributes to the extensive scholarly debate on whether Brexit and Covid-19 should constitute a frustration of purpose event in contracts by exploring the findings of the economic literature on the consequences of supervening events. Second, it offers suggestions about how courts in the UK (and around the world, including common law jurisdictions such as Singapore, Canada, and Australia) could approach contractual claims that attempt to rely on a COVID-19 related frustration, given the nature of lockdowns, government edicts, and closed borders. Third, this paper adds an economically inspired conceptual framework; and fourth, it critically evaluates the impact of the *Canary Wharf* judgment.[12] However, it should be emphasized that this paper does not discuss the impact of Brexit on the boilerplate clauses in commercial contracts and omits the discussion on the intertwined problem of restitution.

In addition, the sole nature of the 'COVID-19' pandemic and its relation to standard force majeure and hardship doctrine, which exert a significant impact on the development of contract law, call for a rigorous interdisciplinary analytical treatment capable of offering a set of normative suggestions for informed policymakers, judiciaries, and practitioners.

In this article, the analysis is as positive as it is normative. The analytical approach employs a classic law and economics methodology,[13] which follows the classical comparative law and economics approach.[14] This classical comparative law and economics approach serves as a bridge between facts and normative conclusions, between economic theory and

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[10] Pertoldi et al., above, n 6, at 6. See also Nick Thody and Victoria Gwynedd-Jones, 'How might Brexit Impact your Commercial Contracts and what, if anything, can you do about it?' (2017) Osborne Clark, London.

[11] Catherine MacMillan, 'The Impact of Brexit on English Contract Law' (2016) 27 *King's Law Journal* 420. For a broad impact assessment of Brexit, see M Dougan, *The UK after Brexit: Legal and Policy Challenges,* Intersentia, Cambridge 2017.

[12] [2019] EWHC 335 (Ch).

[13] For a synthesis of law and economics scholarship, see G De Geest, *Contract Law and Economics – Encyclopaedia of Law and Economics*, Volume 6, 2nd ed., Edward Elgar, Cheltenham, 2011. Also see R A Posner, *Economic Analysis of Law*, 8th ed., Wolters Kluwer Law Publishers, New York, 2011.

[14] R Bergh Van den, *The Roundabouts of European Law and Economics*, Eleven International Publishing, Den Hague, 2018, p 21-28.

policy proposals for an improved legal system.[15] It seeks to complement other legal disciplines by uncovering the underlying economic logic and the social effects of the assessed legal institutions.[16] In looking for transparency in the law, the employed approach connects to what 'the best traditional legal scholarship aims to do: clarifying the underlying order of law as it is; offering tools for fashioning law to cope with novel situations.'[17] However, several caveats should be stated. Namely, the paper aims not to impose a final word on the matter but to undertake an exploratory analysis of the relationship between the development of contract law and its economic effects. Moreover, there are further factors and issues that might drive the observed results (and that call for further investigation), for example, issues of (i) political biases of courts, (ii) political neutrality of economic approaches, (iii) behavioral pandemic state of emergency effects, (iv) underlying sociological and psychological phenomena, and (v) fairness qualities.

This paper is structured as follows. The first part outlines the optimal foreseeability threshold and provides an economically inspired conceptual framework for categorizing frustrating events. Moreover, this part also investigates the issue of whether Brexit and the COVID-19 pandemic should constitute supervening events and whether they should be regarded as events that frustrate the purpose of the contract. The second part examines recent case law. The third part discusses the implications of risk preferences on foreseeability, renegotiation, frustration, and the COVID-19 pandemic. Finally, some brief conclusions are presented.

2. ECONOMICALLY INFORMED CONCEPTUAL FRAMEWORK

This section considers an economically informed conceptual framework as an alternative, supportive analytical tool for instances of supervening events where a court must decide whether a specific event should be classified as a frustrating one and whether to discharge the promisor's obligations.

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[15] Bergh Van den, above, n 14, p 27.

[16] This methodology complements traditional legal disciplines by bringing to light a logic that decision-makers follow without necessarily expressing it in their reasons for judgment, yet which constraints their results. It also seeks to make this logic transparent to outside observers; A Ogus, *Costs and Cautionary Tales: Economic Insights for the Law*, Hart Publishing, Cambridge, 2006, p 11-16. See also G Calabresi, *The Future of Law & Economics,* Yale University Press, New Haven, 2016; and R A Posner, *Divergent Paths: The Academy and the Judiciary*, Harvard University Press, Cambridge, 2016.

[17] E MacKaay, *Law and Economics for Civil Law Systems*, Edward Elgar, Cheltenham, 2013, p 6.

2.1. PRELIMINARIES

Most of the economic literature on contractual excuse discusses notions of 'impossibility,' 'commercial impracticability,' and 'frustration of purpose' side by side. In their seminal article on impossibility and related doctrines in contract law, Posner and Rosenfield[18] suggest that the question of whether to excuse the promisor from his obligation is one of choosing which party should bear the risk of increased costs of performance. They suggest that, in the absence of any express contractual provision to such effect, risk should be assigned to the superior risk bearer. If the promisor is the superior risk bearer, then non-performance should be treated as a breach of contract; if the reverse is true, discharge should be allowed.[19] Others focus their analysis on the allocation of risks and resources, and argue that what matters is the design of efficient remedies for a breach of a contract.[20] They conclude that a remedy of expectation damages achieves or approximates Pareto efficiency and is superior to the zero damages rule.[21]

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[18] R A Posner and Andrew M Rosenfield, 'Impossibility and Related Doctrines in Contract Law: An Economic Analysis' (1977) 6 *J Leg Stud* 83. See also M P Gergen, 'A Defense of Judicial Reconstructions of Contracts' (1995) 71 *Ind LJ* 45; P L Joskow, 'Commercial Impossibility, the Uranium Market and the Westinghouse Case' (1977) 6 *J Leg Stud* 119; and V P Goldberg, *Rethinking Contract Law and Contract Design*, Edward Elgar, Cheltenham, 2015, pp. 137-180.

[19]See C L Bruce, 'An Economic Analysis of the Impossibility Doctrine' (1982) 11 *J Leg Stud* 311; H B Schäfer and V Goldberg, *Framing Contract Law: An Economic Perspective*, Harvard University Press, Cambridge, 2006, p 327-376; M J Trebilcock, *The Limits of Freedom of Contract*, Harvard University Press, Cambridge, 1993, p 130; C Ott, *Lehrbuch des Ökonomischen Analyse des Zivilrechts*, Springer, New York, 2012, p 250-58; T M Roberts, 'Commercial Impossibility and Frustration of Purpose: A Critical Analysis' (2003) 16 *Canadian Journal of Law and Jurisprudence* 1, p 129-145; M A Eisenberg, 'Impossibility, Impracticability and Frustration' (2009) 1 *Journal of Legal Analysis* 1, p 207-261; J Camero, 'Mission Impracticable: The Impossibility of Commercial Impracticability' (2015) 13 *The University of New Hampshire Law Review* 1, p. 1-34; and to some extent Joskow, above, n 17.

[20] Steven Shavell, 'Damage Measures for Breach of Contract' (1980) 11*Bell J Econ* 466; M A Polinsky, 'Risk Sharing through Breach of Contract Remedies' (1983) 12 *J Leg Stud* 427; Steven Shavell, 'The Design of Contracts and Remedies for Breach' (1984) 99 *Q J Econ* 121; and M J White, 'Contract Breach and Contract Discharge due to Impossibility: A Unified Theory' (1988) 17 *J Leg Stud* 353.

[21] See A O Sykes, 'The Doctrine of Commercial Impracticability in a Second-best World' (1990) 19 *J Leg Stud* 43; G G Triantis, 'Contractual Allocation of Unknown Risks: A Critique of the Doctrine of Commercial Impracticability' (1992) 42 *Univ Toronto L J* 450; Andrew Kull, 'Mistake, Frustration, and the Windfall Principle of Contract Remedies' (1991) 43 *Hastings LJ* 1; C Fried, *Contract as a Promise: A Theory of Contractual Obligation*, Harvard University Press, Cambridge, 1981, p 59-73; and J M Perloff, 'The Effects of

However, in addition to previous literature, we argue that, to invoke the frustration doctrine, the following preconditions should be fulfilled:

First, if the contract is an aleatory one (aleatory contracts), where the risk is part of the contract itself, implying an implicit agreement on risk allocation, then enforcement of such contracts is suggested, regardless of how unforeseeable or onerous they become.[22]

Second, if the risk was assigned expressly by the parties' agreement or by well-established rules of law on one of the parties, then wealth-maximization requires enforcement of such an agreement.[23] If the substance of the contract became illegal, then efficiency requires a discharge of such contract.

Third, if the contract was not an aleatory one and if the risk has not been assigned expressly by the parties' agreement or by well-established rules of law, then the question of whether such an event should be regarded as an unforeseeable or foreseeable one should be addressed. Obviously, in order to invoke the frustration doctrine, the event should be *ex ante* unforeseeable and *ex post* verifiable. We define an unforeseeable event in a novel way: as an *ex post* verifiable event where the *ex ante* processing/description cost exceeds the *ex ante* expected benefits of having provided for such a contingency (i.e., a sort of a *processing trade-off*).[24] Namely, this processing trade-off only implies some contingencies in which expected benefits, due to low materialization probability, do not justify drafting expenditures, thus making it is *ex ante* cost efficient to ignore them. The novelty of our argument is in identifying both the increasing marginal costs of providing and processing for remote contingencies and the discounting effect of low probability on benefits, setting the threshold for *ex post* identification of which risks should be foreseeable and which not. It may be argued that parties, due to imperfect information, would not be aware of the possibility of some remote risks since, for example, they may not be aware of the possible devolution or

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Breaches of Forward Contracts due to Unanticipated Price Changes' (1981) 10 *J Leg Stud* 221.

[22] If the contract was purely aleatory – i.e., with the risk of ruinous losses as part of the contract itself -, the contracting parties in effect were betting on the future materialization of risks, and no excuse of performance should be granted.

[23] In such a circumstance, there is no occasion to inquire which party is the superior risk bearer since it is one that has expressly accepted the risk and should thus bear it. See Posner and Rosenfield, above, n 17.

[24] Hence, the application of the optimal rule requires that the risk in concern be an unforeseeable one, where *ex ante* processing/description costs exceed the expected benefits of having processed such a contingency.

dissolution of the EU in the next ten years.[25] It may also be argued that, although parties are remotely aware of the chance of such a contingency, the *ex ante* discounted benefits compared to costs of processing for them simply do not justify express contractual provision (prohibitive description costs). Parties facing *ex ante* this processing trade-off simply decide rationally not to provide for those contingencies. However, from an *ex post* perspective, after risk materializes and performance becomes excessively onerous, this may seem a very irrational decision. This provides additional insight as to why some events should indeed be regarded as *ex ante* unforeseeable. In other words, due to the increasingly uncertain occurrence of most obscure events, parties have decreasing experiences encountering with and providing for those events. Thus, the costs of processing (information, describing, calculating) increase for each additional unit (contractual term). Approaching infinite uncertainty of an event always raises the costs of an additional unit (term) more than the previous ones. Hence, there must be a point where negotiating, processing, calculating, and drafting contract terms for all possible contingencies makes no more sense.

Fourth, if all previous preconditions are satisfied, then the further requirement is that neither party is clearly the superior risk bearer (superior risk bearer capacity). If the risk was preventable or insurable, then wealth-maximization requires shifting this burden to the party which is in a better position to prevent the risk from materializing (at a lower cost than the other party) or if they are in a better position to insure against the risk (the superior/cheaper insurer).[26]

Fifth, the exogeneity of an event (exogenous contingency) should be considered a necessary precondition for operating the provided optimal rule. If the contingency in question was due to one party's fault and was thus not an exogenous one, then no frustration excuse should be granted.[27] This requirement ensures precaution and that mitigation decisions are not distorted; besides, it also provides the contracting parties with an incentive to curtail their reliance investments and hence deters opportunism and moral hazard.

The fulfilment of these conditions for invoking the frustration excuse deters moral hazard and opportunism, induces optimal reliance,

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[25] Although this might seem highly unlikely, all events can be regarded as foreseen in one way or another.

[26] As a result of lower risk-appraisal and transaction costs, through self- or market insurance; see Posner and Rosenfield (n 17).

[27] Gerhard Wagner, 'In Defence of the Impossibility Defence' (1995) 27 *Loy U Chi LJ* 55.

provides incentives for the optimal mitigation of damages, achieves optimal risk allocation, and decreases transaction cost.

2.2. MODEST INCREASE IN PERFORMANCE COSTS

Consider a contract in which the promisor agrees to supply the promisee with one unit of a specialized good or service. The net value of the contract to the promisee is the difference between the value and the price, whereas the net benefit to the promisor is the difference between the price and the costs of performance. This assumes that the value of performance exceeds the contractual price, and the price exceeds performance costs. Thus, it can also be assumed that the promisor and promisee negotiate a Pareto-efficient contract.[28] Such a contract would require the promisor to perform if and only if the costs of performance were no greater than the value of performance. Having said all that, now assume an unforeseen event causes a rise in costs of performance for such a magnitude that they exceed the contract price, whereas the value of performance remains unchanged and is still above the new costs of performance. From the economic point of view, such a contract is still efficient and should be upheld. The promisor should either perform or breach the contract and pay expectation damages.[29] Parties must consider when a breach becomes efficient, or in other words, performance becomes inefficient given their estimation of expectation damages. Hence, in cases of frustrating events resulting in a slight increase in performance costs, courts should not grant any relief and should enforce such contracts.

2.3. EXCESSIVELY ONEROUS PERFORMANCE

We continue our discussion of the situation in which a frustrating event results in excessively onerous costs of performance. To illustrate the situation, assume the net value of performance after the materialization of a frustrating event remains fixed, but this same event now increases the cost of performance so significantly that it exceeds the net value of performance. In such circumstances, economically speaking, the contract should not be performed, since the performance costs are well above the net value of performance. The contract should be discharged, or the

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[28] See A Ogus, *Costs and Cautionary Tales: Economic Insights for the Law*, Hart Publishing, London, 2006, p 27; and J Leitzel, *Concepts in Law and Economics: A Guide for the Curious,* Oxford University Press, Oxford, 2015, p 4-7.

[29] The expectation damages remedy provides an incentive to perform if and only if doing so is economically efficient. See Shavell, above, n 19, and P G Mahoney, 'Contract Remedies: General' in B Bouckaert and G De Geest, eds., *Encyclopaedia of Law and Economics*, 2nd ed., Edward Elgar, Cheltenham, 2011.

promisor should, according to efficient breach theory, breach the contract and pay expectation damages to the promisee.[30] However, we argue that the discharge of the promisor's obligation is a superior remedy in cases of frustrating events that increase the value of performance due to its risk-sharing function by letting each party bear the risk of not attaining its initial expected profit.

Moreover, if the remedy of specific performance is not given, then the promisor could, according to 'efficient breach theory,'[31] breach the contract and pay expectation damages. In this case, such a party will sustain losses amounting to the difference between the value and the performance cost with respect to their initial expectancy. This will also limit their risk exposure. However, if due to the same frustrating event which increased the cost of performance, the value of performance also increases, but still does not exceed the increased costs of performance, then the situation becomes much more complicated. As an illustration, consider events such as slight increases, which do not merely affect an individual promisor but causes an extraordinary change in market price, and where the promisee's benefit expressed in monetary terms also normally increases. In these circumstances, the limit of the promisor's risk in the case of expectation damages has increased too. The promisor now bears the entire risk of the increased cost of performance[32] and the promisee gains his benefit[33] with certainty. In such an instance, as Trimarchi indicates, the promisor acts not just as an insurer of the promisee's initial expectancy but also as an insurer of the promisee's windfall benefits.[34] The principles of insurance would simply not warrant imposing a monetary transfer on the promisor in order to grant a promisee

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[30] On the efficient breach theory see Leitzel, above, n 27, at 33; Ogus, above, n 27, at 205; MacKaay, above, n 16, at 403; H B Schaefer and C Ott, *The Economic Analysis of Civil Law,* Edward Elgar, Cheltenham, 2004, p 329; and S Shavell, *Foundations of Economic Analysis of Law,* Harvard University Press, Cambridge, 2004, p 304.

[31] On efficient breach see J H Barton, 'The Economic Basis of Damages for Breach of Contract' (1972) 1 *J Leg Stud* 277; P A Diamond and Eric Maskin, 'An Equilibrium Analysis of Search and Breach of Contract' (1980) 10 *Bell J Econ* 282; P A Diamond and Eric Maskin, 'An Equilibrium Analysis of Search and Breach of Contract II. A Non-steady State Example' (1981) 25 *J Econ Theory* 165; and Shavell, above, n 19.

[32] Sykes indicates that the expectation damages measure fails to implement another potentially important feature of that contract, namely risk-sharing between parties; Sykes, above, n 20.

[33] Equal to the difference between increased value of performance and the price.

[34] Pietro Trimarchi, 'Commercial Impracticability in Contract Law: An Economic Analysis' (1992) 11 *Int Rev Law Econ* 1, p 68.

a windfall gain.[35] Hence, in such circumstances, a discharge of a contract features as a superior remedy.[36]

The potential windfall of having a contract's value change over time is a factor that parties can consider when *ex ante* assessing the risks of contracting. However, it may not be worth much time to consider a potential windfall, as the information costs of assessing such a scenario may be excessive and arguably speculative.

The parties to a contract may anticipate the possibility of the contract leading to a windfall for one of the parties or at least anticipate changed circumstances in market values which the parties may value. In some cases, contracts are entered into specifically to spread risk for one or both of the parties to the contract or are entered into in speculation about the future value of performance. This may also complicate option contracts, which are also a mechanism used in private contracting to spread risk.[37] Courts should be particularly cautious when applying the doctrine of frustration to these types of contracts that specifically anticipate a certain amount of uncertainty and specifically allocate risk among the parties regarding this uncertainty.

2.4. PERFORMANCE USELESS

Suppose that after the conclusion of the contract, an unforeseen contingency materializes, causing a sharp drop of the promisee's value of performance to zero, whereas price and cost of performance remain unchanged. In this case, performance for the promisor is perfectly possible, since there were no increases in the cost of performance, whereas, for the promisee, it becomes useless. However, the mere fact that performance became less valuable for the promisee should not provide for any excuse of performance. The contract should be upheld, and the

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[35] Trimarchi, above, n 33, at 69.

[36] Moreover, behavioural studies show that the efficient breach theory might not be supported in experimental findings (i.e., identified mismatch between efficient breach hypothesis and people's perception of contracts). See, e.g., Daphna Lewinsohn-Zamir, 'Can't Buy me Love: Monetary versus In-kind Remedies' (2013) 2013 *Univ Ill Law Rev* 151; Lisa Bernstein, 'Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms and Institutions' (2001) 99 *Mich L Rev* 1724; and Stewart Macaulay, 'Non-contractual Relations in Business: A Preliminary Study' (1963) 28 *Am Sociol Rev* 55.

[37] Suppliers may contract to take into account market variations or how a firm with unknown future input needs may contract for an option to purchase the input in the future at a set price which may inevitably be at a different price than the daily price, like how airlines purchase fuel, i.e., fuel hedging. These contracts are specifically designed for one, if not both parties, to spread risks.

promisee should either perform or should breach the contract.[38] Excuse of performance in such instances may create serious moral hazard problems; provide incentives for opportunistic behaviour; sub-optimal contract entry; sub-optimal precaution and damage mitigation; increased transaction costs, and assignment of risk upon the party who is not the superior risk bearer.

The only possible exemption could be the case where the promisee would also act as an insurer of the promisor's windfall gains. For example, it may happen that, after the promisee's breach, the promisor negotiates the contract with another party, using the same object as in the previous contract. The promisor would thus gain a share of the total benefit from the transaction, which is unlikely to differ much from what he would have gained under the initial contract, thus earning profit twice over. The promisor would earn profit through damages as well as through a substitute contract with another promisee. Then the promisee's 'insurance' of initial expectancy would give the promisor an 'unjustified' gain. It is, then, only in these rare cases that the discharge of such an inefficient contract may be allowed.

2.5. Simultaneous Dramatic Increase in Performance Costs and Value

Finally, assume that, due to a supervening event, both cost and value of performance have increased dramatically, but the value for such a magnitude exceeds even the new costs of performance, whereas price remains unchanged. Although a supervening event caused the dramatic rise in the cost of performance, the value of performance for the promisee has risen by an even more considerable proportion, so that contract performance is still justified. However, who shall then bear the risk of the exceptionally increased cost of performance? Should the promisor bear all the ruinous losses, acting as an insurer of the promisee's unexpected, exceptional windfall benefits? Should the promisor resort to breach, or is a discharge or adjustment of a contract by a third party a better remedy?[39]

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[38] Contrary to the previously discussed issue of excessively onerous performance, the promisee is now the one who bears the risk of unforeseen contingencies and who acts as *the de facto* insurer of the promisor. However, the main difference is that he only insures the promisor's initial expectancy and not, as before, also his windfall gains. The promisee now bears the unpreventable risk for which he was offset by the *ex ante* discount in price and where the principle of insurance would then apply.

[39] If the contingency was due to the promisor's fault, or if the risk was assigned to them by well-established legal rules or express provisions, or the promisor was clearly the superior risk-bearer, then no excuse should be allowed.

Since the new value exceeds even the new costs of performance, the promisor is caught between the performance of the contract and the 'expectation damage' remedy. In other words, either the promisor must perform the contract and, due to a sharp increase in performance cost, sustain ruinous losses or pay even more significant expectation damages.[40] The promisor is now bearing the entire risk of the increased cost of performance, and the promisee gains contractual benefit with certainty. The promisor thus acts not just as the *de facto* insurer of the promisee's initial expectancy but also as an insurer of his windfall gains. Furthermore, since he has no way of avoiding those ruinous losses, they may even go bankrupt in the most extreme case. The financial shock harms the promisor's planning and organization, which implies that the destruction of value is not offset by any corresponding additional gain to the promisee. In such instances, rational, risk-averse parties will prefer risk-sharing. Also, the notion that the promisor would be compensated for his insurance of the promisee's gains by an *ex ante* increase in price (insurance premium) cannot sustain critical assessment.[41] In such circumstances, the discharge of a contract, which implies risk sharing, is an optimal solution.

However, one may argue that, if we discharge such a contract, the valuable result of the transaction would also be lost. Nevertheless, this may be achieved by a voluntary *ex post* renegotiation of such a contract.[42] An *ex post* renegotiation may enable both parties to gain from performance, thus solving a problem of lost social benefits from trade when efficient breach leads to suboptimal social outcomes.

3. *CANARY WHARF* CASE

A recent legal dispute involving the EU and a private UK firm might shed some light on what the future interpretation of a contract without a specific Brexit clause may look like. The case involves the lease of a

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[40] Since the new value exceeds the new performance costs, they would even exceed the dramatically increased cost of performance. The amount is the difference between the new value of performance and the contractual price.

[41] In addition, Sykes and Goldberg stated that the promisee may lack incentives to mitigate damages and may also over-invest in performance reliance; Sykes, above, n 20, at 63. See also V P Goldberg, 'Impossibility and Related Excuses' (1988) 144 *J Inst Theor Econ* 100; and V P Goldberg, *Rethinking Contract Law and Contract Design*, Edward Elgar, Cheltenham, 2015, p 138.

[42] Trimarchi even proposes a rule, entitling the party seeking relief to discharge and the other party to prevent it by offering an adjustment to the contract price, and then transaction costs would be lower than those of free re-negotiation, and presumably much lower than the loss which would result from performing the initial contract: Trimarchi, above, n 33, at 75.

property by the European Medicines Agency (hereinafter EMA) from Canary Wharf Ltd. The High Court's judgment in *Canary Wharf*[43] identifies the most likely interpretation of the unforeseeable character of the Brexit. Namely, contracting parties who did not directly contract over an unforeseeable event may still have indicated how the parties would perform if something had frustrated the contract. For instance, parties could determine what would happen if other events were to occur, such as the assignment of a lease in the event the lessee no longer needed or wanted to continue using the leased property.

This approach of contractual interpretation is what Mr. Justice Marcus Smith points to in his ruling in favour of Canary Wharf Ltd., finding that the lease was not frustrated because of Brexit. According to Mr. Justice Marcus Smith, 'the involuntary departure of the EMA from its headquarters in the Premises, due to circumstances beyond its (or, indeed, the European Union's) control was something which – on the face of it – the Lease agreement, in its clause 4.21.1(c), expressly provided for.'[44] The EMA leaving the Premises under any circumstances is expressly provided within the contract, and the High Court relies on these provisions to make their ruling.

While the High Court considers several issues identified by the EMA and Canary Wharf, it is helpful to focus on the core arguments surrounding the question of whether the doctrine of frustration applies to the dispute. The EMA argued before the court that the 25-year lease it had with Canary Wharf Ltd. to rent office space was frustrated under five separate arguments. First, the loss of legal protections under protocol 7 of the TFEU[45] to the EMA. Second, the inability of the EMA to legally use the property as a matter of EU law. Third, the inability of the EMA or the EU to make economic use of the property due to the restrictive transfer provisions of the contract. Fourth, the 'future performance of the EMA's obligations' are both unlawful and *ultra vires*, meaning the EMA would not

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[43] *Canary Wharf* [2019] EWHC 335 (Ch).

[44] Mr. Justice Marcus Smith reached this conclusion by looking at the provisions which the EMA and Canary Wharf included in the contract in the event that the EMA would no longer occupy the premises. The lease contract between the EMA and Canary Wharf 'contained detailed provisions regarding alienation', including provisions that permitted EMA to share, assign or sub-let the rented premises; in *Canary Wharf* [2019] EWHC 335 (Ch) at [92(4), (c)].

[45] Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union – Consolidated version of the Treaty on the Functioning of the European Union – Protocols – Annexes – Declarations annexed to the Final Act of the Intergovernmental Conference which adopted the Treaty of Lisbon, signed on 13 December 2007, Official Journal C 326, 26/10/2012 P. 0001 – 0390.

have any legal authority to continue performing. Fifth, the payments of double rent by the EMA for both the property in London and the current headquarters in Amsterdam would 'impair the EMA's capacity, effectiveness and independence'.[46]

The primary counterargument of Canary Wharf Ltd. against the arguments of the EMA was that, even if a 'frustrating event' were established, from either Brexit or the relocation of the EMA to Amsterdam, it 'could not (whatever the consequences) amount to an event capable of frustrating the lease'.[47] The High Court has partly followed the Canary Wharf's arguments and found that the Lease has not been frustrated by reason of supervening illegality. Moreover, it concluded that the withdrawal of the United Kingdom from the European Union was on, the relevant date, 5 August 2011, theoretically foreseeable but not relevantly foreseeable when the Agreements were entered into.[48]However, High Court also found that "over this long period of time, there might be some development that would require the EMA involuntarily to have to leave the Premises due to circumstances beyond its control."[49] Hence, if the contractual provisions of the Lease agreement would be drafted in a different way, then withdrawal of the United Kingdom from the EU might be regarded as an event capable of frustrating the Agreements.

3.1. THE DOCTRINE OF FRUSTRATION OF PURPOSE UNDER ENGLISH COMMON LAW

In making his judgment, Mr. Justice Marcus Smith pointed to the most relevant precedent in English Common law pertaining to the doctrine of frustration of purpose and generally argued that the arguments of the EMA were unpersuasive. He points to three formulations for the test in applying the doctrine of frustration.

The first formulation is that of Lord Radcliffe in the *Davis Contractors*

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[46] In *Canary Wharf* [2019] EWHC 335 (Ch) at [7].

[47] In *Canary Wharf* [2019] EWHC 335 (Ch) at [8].

[48] This highlights the importance of timing concerning the doctrine of frustration; In Canary Wharf [2019] EWHC 335 (Ch) at [216].

[49] "What is more, the parties appear to have catered for this possibility in the Lease agreement: the Lease contemplated the EMA would be committed to the premises subject only to the alienations provisions of the Lease agreement; In *Canary Wharf* [2019] EWHC 335 (Ch) at [226]. In other words, "whilst the United Kingdom's withdrawal from the European Union was not contemplated by the parties as a potential cause of the EMA's relocation, the question of wholesale relocation of the EMA away from the Premises and the Property (whether within or outside the United Kingdom) was contemplated and was provided for in the Lease;" in Canary Wharf [2019] EWHC 335 (Ch) at [239].

Ltd v Fareham UDC case[50], which held that the doctrine of frustration can be applied when, 1) 'the law recognises that without default or either party', 2) 'the contractual obligation has become incapable of being performed' 3) due to circumstances where performance would result in something 'radically different from that which was' contracted over.[51]

The second formulation considered is the one of Lord Simon from the *National Carriers Ltd v Panalpina (Northern) Ltd*.[52] Under Lord Simon's test, the doctrine of frustration applies when: 1) there are supervening events, 2) 'without default of either party', 3) the contract fails to make sufficient provisions for, 4) and which 'significantly changes the nature (not merely the expense or onerousness) of the outstanding contractual rights', 5) which the parties would reasonably not have contemplated at the time of entering the contract, and 6) it would be unjust to enforce the contract literally under the current circumstances.[53]

Finally, the third formulation considers the maxims of the doctrine of frustration which must be addressed according to Bingham LJ in the *J Lauritzen AS v Wijsmuller BV* (The Super Servant Two).[54] Under the Bingham LJ criteria; 1) the doctrine of frustration is designed to 'mitigate the rigor of the common law's insistence on literal performance' of contracts in order to 'give effect to the demands of justice', to find an equitable outcome, to achieve what is 'reasonable and fair', in order to expedite the administration of justice and avoid injustice which would result of literal enforcement under changed circumstances; 2) 'must not be lightly invoked and must be kept within narrow limits' due to the contract being fully discharged under the doctrine; 3) has the effect of ending the contract; 4) must not be due to the action of the party seeking to invoke the doctrine, and; 5) the 'frustrating event must take place without blame or fault' of either party involved.[55]

Considering the previous juridical basis for the doctrine of frustration, the High Court in *Canary Wharf* found that the 'performance rendered radically different by fundamental change in circumstances' approach as the 'best' of the theories to use.[56]

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[50] [1956]1 AC 696 at 729.

[51] *Canary Wharf* [2019] EWHC 335 (Ch) at [22].

[52] [1981] 1 AC 675 at 700.

[53] [1981] 1 AC 675 at 688 (Lord Hailsham LC), at 717 (Lord Roskill).

[54] [1990] 1 Lloyd's Rep. 1.

[55][1990] 1 Lloyd's Rep. 1.; *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 at 912-13 (Lord Hoffmann); *Prenn v Simmonds* [1971] 1 WLR. 1381 (HL); and *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989 (HL).

[56] Under this approach, 'whether a contract is frustrated depends upon a consideration of the nature of the bargain of the parties when considered in the light of the supervening

3.2. THE DOCTRINE OF FRUSTRATION AND CONTRACTUAL CONSTRUCTION

The High Court in *Canary Wharf* suggests that in the vast majority of cases, the 'construction of the contract will resolve the issue between the parties, including whether a subsequent 'unforeseen' event has allocated a risk to one party (by requiring that party to perform in more onerous circumstances) or to the other party (by an interpretation bringing the contract to an end because of those onerous circumstances).'[57]

Furthermore, the judgement considers the 'multi-factorial approach' delineated in *Edwinton Commercial Corp v Tsavliris Russ (Worldwide Salvage & Towage) Ltd (The Sea Angel)* by Rix LJ,[58]. This multifactorial approach takes into account several factors, including 'the terms of the contract itself, its matrix or context, the parties' knowledge expectations, assumptions, and contemplations, in particular as to risk, as at the time of the contracts, at any rate so far as these can be ascribed mutually and objectively, and then the nature of the supervening event, and the parties' reasonable and objectively ascertainable calculations as to the possibilities of future performance in the new circumstances'.[59] The multifactorial approach identifies that both the knowledge and contemplation of risk between the parties and the contemplation of possible future must be considered when applying the doctrine of frustration. These two factors have an inherent economic attribute which law and economics methodologies are uniquely qualified to incorporate to the doctrine of frustration, and are addressed in our conceptual framework.

3.3. COMMENT ON THE *CANARY WHARF* CASE

Comparison with the criteria for the frustration excuse found in the English common law reveals a surprisingly substantive alignment. Namely,

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event said to frustrate that bargain' and '[o]nly if the intervening event renders the performance of the bargain 'radically different', when compared to the considerations in play at the conclusion of the contracts, will the contract be frustrated;' in *Canary Wharf* [2019] EWHC 335 (Ch) at [27]. On the role of precedents in the construction of contractual terms see, e.g., J W Carter, John Eldridge and Elizabeth Peden, 'The Role of Precedent in the Construction and Implication of Terms in Contracts' (2021) 37 *JCL* 1.

[57] In the view of Mr. Justice Marcus Smith 'when one seeks to describe what a party promised, one does not recite the individual terms and conditions, but has regard to something much more elemental, that cannot necessarily be captured in the precise terms used by the parties in their contract, but which requires reference to what I will term the parties' 'common purpose'; in *Canary Wharf* [2019] EWHC 335 (Ch) at [29].

[58] [2007] 2 Lloyd's Rep 517; [2007] EWCA Civ 547 (*Edwinton*).

[59] In *Canary Wharf* [2019] EWHC 335 (Ch) at [39], quoting *Edwinton* [2007] 2 Lloyd's Rep 517; [2007] EWCA Civ 547.

English law in the first stage of a 'frustration inquiry' investigates whether the frustrating event is covered by a term of the contract,[60] was not self-induced (endogenous), and was not covered by well-established rules of the law.[61] Namely, the traditional general rule is that an event cannot normally amount to frustration if the contract terms cover it.[62] Moreover, an event cannot be treated as frustrating a contract if it was foreseen or foreseeable at the moment of the formation of the contract, and therefore within the contemplating scope of the parties.[63] Thus, a party cannot treat as a frustrating event a risk which could have been foreseen and against which provision could have been made.[64] However, it should be emphasized that, as McKendrick points out, English jurisprudence has an apparent difficulty with this formula, namely identifying what is and what is not foreseeable at the moment of entry into the contract.[65] Bell argues that the doctrine of frustration applies when it would not be reasonable to have expected the parties to have made specific provision for a risk or treated it as an ordinary risk they expected to have materialized.[66] However, McKendrick argues that the question of how foreseeable an event has to be before it prevents reliance being placed upon the doctrine of frustration is one of degree.[67] On the other hand, Beatson argues that

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[60] A Burrows, *A Casebook on Contract,* 5th ed., Hart Publishing, Cambridge, 2016, p 731; P A McDermott, *Contract Law*, Butterworths, London, 2001, p 1021. See also E McKendrick, *Force Majeure and Frustration of Contract*, 2nd ed., Routledge, London, 2014, p 7; and J H Baker, 'Frustration and Unjust Enrichment' (1979) 38 *CLJ* 266.

[61] A Burrows, *A Restatement of the English Law of Contract,* Oxford University Press, Oxford, 2016, p 164; E McKendrick, *Contract Law: Text, Cases and Materials*, 7th ed., Oxford University Press, Oxford, 2016, p 849; J Bell, 'The Effect of Changes in Circumstances on Long-Term Contracts' in D Harris and D Tallon, eds., *Contract Law Today, Anglo-French Comparisons,* Clarendon Press, Oxford, 1989, p 208. See also M H Whincup, *Contract Law and Practice*, 3rd ed., Kluwer Law International, New York, 1996; S A Smith, *Atiyah's Introduction to the Law of Contract*, Clarendon Press, Oxford, 2005, p 182; R Upex and G Bennett, *Davies on Contract*, 9th ed., Sweet & Maxwell, London, 2004, p 256; J W Carter, *Carter's Breach of Contract*, 2nd ed, LexisNexis, Sidney, 2018; J W Carter, Contract Law in Australia, 7th ed, LexisNexis, Sidney, 2018; and J Beatson, *Anson's Law of Contract*, 29th ed., Oxford University Press, Oxford, 2006, p 530.

[62] McDermott, above, n 59, at 1021.

[63] Bell, above, n 60, at 208. See generally C G Hall, 'Frustration and the Question of Foresight' (1984) 4 *LS* 300.

[64] G H Treitel, *Frustration and Force Majeure,* Sweet & Maxwell, London, 1994, p 466.

[65] McKendrick, above, n 59, at 862.

[66] Bell, above, n 60, at 208.

[67] McKendrick illustrates this with an example of an earthquake which is foreseeable since we are all aware they may take place. But in some parts of the world, they are more foreseeable than in others: McKendrick, above, n 59, at 862.

this is just a question of contract construction.[68] In *McGuill v Aer Lingus & United Airlines Inc.,*[69] McWilliam J., for example, spoke in terms of an unexpected event and held that if a party anticipated or should have anticipated the possibility of an event, he should not be permitted to rely on the happening of the event as causing frustration.[70] In the *Ocean Tramp Tankers Corp v V/O Sovfrach,*[71] Lord Denning MR suggests that the requirement that the event should not have been foreseen essentially means that the parties should not have made a provision for it in the contract. He states:

It has frequently been said that the doctrine of frustration only applies when the new situation is 'unforeseen' or 'unexpected' or 'uncontemplated,' as if that were the essential feature. But it is not. It is not so much that it is 'unexpected,' but rather that the parties should have made no provision for it in their contract."[72]

Insightfully, comparison with our conceptual framework, despite invoked criticism,[73] reveals that Lord Denning's criteria correspond with an economically inspired foreseeability threshold. One should also note that it is correctly made in the first steps of the inquiry.

It is also well established that a party may not rely on an event as frustrating the contract if it is due to his own conduct or to the conduct of those for whom he is responsible (self-induced).[74] In order to raise a plea of frustration, it is essential that the event is outside the control of either party, with no fault of any kind; even negligence would suffice.[75]

However, one may wonder whether the fulfilment of these preconditions should automatically trigger the employment of the frustration doctrine. We argue that after this first stage of inquiry, one has to turn the analytical attention towards the problem of increased or decreased performance cost. This issue of the increased-decreased costs of performance forms the second part of our novel conceptual framework,[76] to which we devote our attention in the following subsections.

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[68] Whether the contract was intended to continue to be binding in that event or whether, in the absence of any express provision, the issue has been left open and thus allowed to be determined by the law of frustration: Beatson, above, n 60, at 548.

[69] (1983) IEHC 71; quoted in McDermott, above, n 60, at 1020.

[70] McDermott, above, n 60, at 1020.

[71] (1964) 1 All ER 161.

[72] (1964) 1 All ER 161 at 166.

[73] Treitel, above, n 63, at 468.

[74] Treitel, above, n 63, at 682 *et seq*. See also McKendrick, above, n 59, at 866; Beatson, above, n 59, at 550; Smith, above, n 59, at 186; and Whincup, above, n 59, at 266.

[75] McDermott, above, n 60, at 1024. See also Bell, above, n 59, at 209.

[76] It should also form the second stage of frustration's investigation,

The issue of whether Brexit should be regarded as an unforeseeable event depends upon the facts of each case and should be assessed on a case-by-case basis. The proposed foreseeability threshold should serve as an additional tool and a substantive guideline for an optimal judicial application and interpretation of individually assessed cases. Moreover, the *ex ante* parties' contracting efforts (balancing marginal benefits and costs) would depend on how courts interpret missing and vague terms. As Hermalin, Katz and Craswell point out, the question of how the courts enforce incomplete contracts is essential to an analysis of the effort that parties should make to provide for contingencies in question.[77] Thus, the proposed conceptual framework, which provides courts with economically inspired criteria of whether an event should be *ex post* regarded as foreseeable or unforeseeable, is designed to incentivize the parties' efficient *ex ante* contracting efforts. Notably, the proposed conceptual framework offers valuable insights into how courts should interpret some contingencies and what remedies should apply to achieve *ex post* efficient allocation of risks and resources.[78]

Hence, processing trade-offs only implies there are some contingencies, in which expected benefits, due to low materialization probability, do not justify drafting expenditure, are *ex ante* efficient for the parties to ignore. For example, this also provides an additional insight as to why a Brexit before 2010 might indeed be regarded as an *ex ante* unforeseeable event.[79]

Summarizing our conceptual framework, we can see that the High Court emphasizes that foreseeability is merely one of the factors to be considered. Their ruling is also in line with the proposed conceptual framework. The first stage of their inquiry determined that the withdrawal of the United Kingdom from the EU was not relevantly foreseeable when the Agreements were entered into and that it was only later than 2011 that

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[77] B E Hermalin, A W Katz and R Craswell, 'The Law and Economics of Contracts,' in M A Polinsky and S Shavell, eds, *The Handbook of Law and Economics,* North-Holland, Amsterdam, 2008, p 95.

[78] On the direct and indirect effects of the correct interpretation, and on the evaluation of contract interpretation, see Shavell, above, n 19, at 301.

[79] At this point, one should also discuss the problems of verifiability and informational asymmetry of contracting, which may lead to distortions in the written contract. As to the latter, Spier points out that those asymmetries may well lead to contractual incompleteness; Kathryn E Spier, 'Incomplete Contracts and Signalling' (1992) 23 *RAND J Econ* 432. However, this does not in any way hinder our definition of unforeseeable events; the parties still make an *ex ante* perfectly rational, efficient decision when deciding not to provide for those contingencies. It merely stresses the imperfect information problem and the fact that contracts are necessarily imperfect.

the withdrawal of the UK from the EU could have been foreseeable.[80] As to the issue of foreseeability, Mr. Justice Marcus Smith insightfully comments: 'there will, no doubt, be many cases where something can be foreseen as a theoretical possibility, but where neither party can be criticised for failing to take it into account'.[81] Rather, as he comments in footnotes, 'relevantly foreseeable' means 'sufficiently foreseeable that a court could draw the sort of inference' and 'that it should have informed the manner in which the parties framed their agreement'.[82] This categorization of foreseeability is perhaps intentionally open to interpretation,[83] though its ratio is aligned with the proposed conceptual framework.

However, the employed approach on questions of foreseeability leaves room for future judicial review of questions concerning the nature of Brexit in terms of foreseeability when applied to contracts that were entered into prior to the Brexit vote. Nevertheless, the failure of parties' post-referendum to renegotiate their contracts entered before the Brexit vote in order to consider the outcome of the Brexit vote may also be a relevant factor to consider. After all, the judgment identifies how 'the failure of the parties to a contract, post-referendum, to consider the inclusion of a 'Brexit clause', might be considered relevant to the allocation of risk'.[84] Suppose the court can infer the intentions of parties as to the allocation of risk from a failure to include a 'Brexit clause' in contracts entered into post-referendum. In that case, a court may perhaps be equally capable of inferring the parties' intentions as to the allocation of risk in pre-Brexit contracts where the parties do not renegotiate post-referendum to account for risk emanating from Brexit.

In many instances, if not most, the parties to contracts are capable of further contracting over 'Brexit' post-referendum. This fact may also be relevant as to the doctrine of frustration concerning the parties' actions which contribute to the intervening event in question, especially in light

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[80] '…no inference from the parties failure to' address the possibility in the contract can be drawn; in *Canary Wharf* [2019] EWHC 335 (Ch) at [216].

[81] In *Canary Wharf* [2019] EWHC 335 (Ch) at [211].

[82] In *Canary Wharf* [2019] EWHC 335 (Ch) at [211].

[83] After all, Mr. Justice Marcus Smith characterizes foreseeability as 'something of a slippery concept, that needs careful handling;' *Canary Wharf* (2019) EWHC 335 (Ch) at [213]. Mr. Justice Marcus Smith cautions courts from 'framing questions of foreseeability too closely to the exact, specific, nature of the supervening event that ultimately occurred' as 'what the 'frustrating event is…will in most cases, be capable of being framed in a number of ways;' in *Canary Wharf* [2019] EWHC 335 (Ch) at [212].

[84] In *Canary Wharf* [2019] EWHC 335 (Ch) at [215].

of this ruling, which identifies the problem of framing within the doctrine of frustration. Could the counter party's unwillingness to renegotiate when approached for renegotiation by the counterparty be framed as the supervening event, as according to Mr. Justice Marcus Smith, '[i]t might equally be said that the change in circumstances is the EMA's involuntary need to leave the Premises due to the circumstances beyond its control'? Indeed, one party cannot be said to have control over the other party if the contracts were entered into at arm's length and absent some other type of power, economic or otherwise, one party has over the other.

3.3.1. Explicit Risk Allocation, Superior Risk Bearer, and Supervening Illegality

The four corners of the contract contain the information which the High Court identifies as getting to the heart of the question over frustration. Namely, in line with our conceptual framework, the judgment in the next stage of inquiry addresses the issue of supervening illegality and correctly concludes that there is no supervening illegality. Furthermore, the judgment also addresses the question of explicit risk allocation and superior risk bearer capacity. According to the High Court, 'the involuntary departure of the EMA from its headquarters in the Premises, due to the circumstances beyond its control was something which- on the face of it- the Lease expressly provided for' and the contracts alienation 'provisions draw no distinction between the reasons why the EMA might abandon its headquarters' but rather 'simply deal with the fact' of the EMA leaving the Premises at for seemingly any reason, including Brexit.[85] The judgment further finds there was 'no common purpose beyond the purpose to be derived from a construction of the Lease' as '[t]here was no common view or expectation between the parties that the risk of the consequences of the EMA abandoning its headquarters should be differently visited according to the reason for the EMA's departure'.[86]

The High Court's determination addresses how the contract directly addressed with specificity the allocation of risk related to the EMA no longer occupying the Premises and the future relationship between the EMA and Canary Wharf Ltd. in the event of the EMA no longer occupying the leased property.[87] Moreover, the contract did not contain a

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[85] In *Canary Wharf* [2019] EWHC 335 (Ch) at [241].

[86] In *Canary Wharf* [2019] EWHC 335 (Ch) at [244].

[87] The court's decision is in line with the conceptual framework in that, although the Brexit was out of the contemplating scope of both parties (and hence unforeseeable), the risk of involuntary departure of EMA from its headquarters, due to circumstances

specific break clause, which analytically allocates the risk of a change upon EMA as a superior risk bearer.[88] In addition, Canary Wharf did obtain insurance against non-payment of rent in the event that EMA would be entitled to cease to pay the rent, and such an insurance policy suggests, as correctly stated by his Justice, the risk of uncertain future events leading to the EMA no longer occupying the Premises had been allocated by parties in the agreement. Saying all that, it is evident that the first part of the court's judgment addresses all the necessary first steps suggested by our conceptual framework.

3.3.2. ONEROUS PERFORMANCE COSTS, EXCUSE AND DIVESTITURE

Insightfully, the High Court also embarks on the second stage of the proposed inquiry and investigates the issue of whether the materialization of Brexit increased the costs of performance to such a level that performance would become excessively onerous. The decision correctly observes that EMA would incur additional costs, but this increase was not a dramatic one, rendering performance excessively onerous or impossible. Instead, as the facts of the case suggest, the performance became merely more onerous. The reasoning is in line with our conceptual framework that no excuse should be granted.[89] Moreover, EMA could completely divest itself of the premises through assignment or sub-letting of the whole of the premises.[90] This implies the onerous cost of performance could be decreased unilaterally by the EMA's divestiture, and the lack of such a divestiture leading to increased cost has been endogenously, at least in part, caused by EMA's inaction.[91]

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beyond its control was expressly provided for and allocated upon EMA; in *Canary Wharf* [2019] EWHC 335 (Ch) at [241].

[88] The absence of a break clause suggests the risk of a change over a 25-year lease duration has been allocated upon EMA, and the parties allocated such risk by contemplating that EMA would be committed to the premises subject only to the alienation provision of their contract.

[89] Recall that in cases of frustrating events resulting in a slight increase in performance costs, courts should not grant any relief and enforce such contracts. Moreover, courts should not discharge such contracts even if the contingency satisfied all previously discussed conditions of exogeneity, superior risk bearer capacity, unforeseeability, non-assignment of risks, and non-aleatory character of contract (above, text at n 14 ff).

[90] Such option was expressly provided by the lease agreement between Canary Wharf Ltd. and EMA; in *Canary Wharf* [2019] EWHC 335 (Ch) at [239].

[91] As established by Mr. Justice Marcus Smith, the parties agreed precisely what would happen in such a case: the EMA would assign the lease or sub-let the whole. If it could neither assign nor sublet the whole according to the terms of the lease, it would retain the premises and would be obliged to pay the rent; in *Canary Wharf* [2019] EWHC 335 (Ch) at [239]. Such express provision should be analytically regarded as an explicit risk

The ruling of the High Court is proper to the maxims which the common law requires from questions concerning the doctrine of frustration. It is kept within very narrow limits, but it also aligns with the proposed conceptual framework. There is no doubt that many subsequent cases concerning Brexit and the doctrine of frustration will be substantially different in terms of the four corners of the parties' contracts and will pose a substantially different 'matrix of fact' for the court to consider.

Moreover, economically informed discussion suggests that it might be very likely that the English courts will continue to find ways to resolve similar disputes over who bears the risk via interpretation of the contract (as High Court ultimately did) rather than via the doctrine of frustration. Namely, underlying mechanisms of economic efficiency,[92] *ex ante* incompleteness of frustration doctrine, and *ex post* superior availability of information advances an interpretation of the contract to common law judges as a more attractive, pragmatic, and economically more effective tool to resolve such disputes.[93]

Finally, it has to be emphasized that most of the disputes where Brexit might be invoked as a frustrating event might primarily be about increased costs (i.e., tariffs, non-tariff barriers) and thus analytically much more straightforward than the *Canary Wharf* case, where the status of the EMA indeed raised several political and constitutional-type considerations that would not ordinarily arise in standard commercial contracts.

4. The Implications of Risk Preferences on Foreseeability, Frustration, and the COVID-19 Pandemic

Presumably, prior to the June 2016 Brexit vote, some contracting parties with profoundly analytical foresight envisioned that Brexit could occur in the future, and they contracted over the prospect of Brexit.[94]

allocation upon EMA of instances where the premises cease to be the EMA's headquarters. Such an explicit risk allocation implies that a contract should not be discharged, and such an event should not be regarded as a frustrating event.

[92] On the common law efficiency hypothesis, see Isaac Ehrlich and R A Posner, 'An Economic Analysis of Legal Rulemaking' (1974) 3 *J Leg Stud* 257; and P H Rubin, 'Why is the Common Law Efficient?' (1977) 6 *J Leg Stud* 51.

[93] See, e.g., R A Posner, 'What do Judges and Justices Maximize?' (1994) 3 *SCER* 1; and G L Priest, 'The Common Law Process and the Selection of Efficient Rules' (1977) 6 *J Leg Stud* 65.

[94] When considering the foreseeability of the Brexit by the EMA and Canary Wharf when they entered into a lease contract, Mr. Justice Marcus Smith comments that 'As at the relevant date, 5 August 2011, I conclude that the withdrawal of the United Kingdom from the European Union was foreseeable as a theoretical possibility, but that I can draw no inference from the parties' failure to cater for this specific possibility in the Lease.

Many, if not most, parties were not so visionary and did not include a Brexit clause in their contracts prior to the Brexit vote.[95] The High Court comments that 'the failure of the parties to a contract, post-referendum, to consider the inclusion of a 'Brexit clause', might be considered relevant to the allocation of risk."[96] This highlights a significant difference between force majeure, MCS clauses, and Brexit clauses, as a more specific and foreseeable event needs to be addressed explicitly in the contract. Thus, in the instance that a specific contract lacks a Brexit clause, and the parties would like to be discharged from their obligation, courts should be reluctant to grant it and should regard such an event (in the absence of specific provision) as a foreseeable one for parties to contracts entered into post Brexit referendum.[97] Moreover, if one compares the COVID-19 pandemic with Brexit, then COVID-19 pandemic was initially an unforeseen event, but soon after first cases appeared, it became a foreseeable one. Both Brexit and the COVID-19 pandemic are identical in nature – i.e., unforeseen at a particular stage but foreseeable at a later stage.

4.1. RISK PREFERENCES AND UNCERTAINTY

The behavioural law and economic literature[98] offers examples of

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These days, and for the last two or so years, parties to contracts have no doubt been considering with some care what their contracts should say as regards the United Kingdom's withdrawal from the European Union.' However, Mr. Justice Marcus Smith ultimately determined 'the withdrawal of the United Kingdom from the European Union was not relevantly foreseeable when the Agreements were entered into;' *Canary Wharf* (2019) 2 WLUK 275; [2019] EWHC 335 (Ch) at [215].

[95] Less visionary parties may have still considered unforeseen circumstances in their contracts, which, if worded sufficiently, could include the unique circumstance of the Brexit, using MCS or force majeure clauses, or other contractual terms which allocate for risk among the parties. For contracts entered into after the vote, Brexit was sufficiently foreseeable, and contracting parties could no longer rely on vague and broadly worded MCS or force majeure clauses to include it.

[96] In *Canary Wharf* [2019] EWHC 335 (Ch) at [216].

[97] A survey of daily business contracting also reveals that law firms tend to advise their clients that some standard provisions should also be included in a commercial contract which could help if a Brexit-related risk materializes and affects the contract adversely. These standard provisions include a force majeure clause, material adverse change clause, compliance with the law clause, hardship clause, change control clause, and a unilateral termination clause. Thus, lawyers drafting contracts for firms conducting business across borders in different jurisdictions have found new ways to address these risks in their contracts using the so-called 'Quitaly' or 'Brexit' clauses.

[98] For an excellent synthesis on the behavioural scholarship, see, for example, C R Sunstein, *Behavioural Law and Economics,* Cambridge University Press, Cambridge, 2000. See also H A Simon, *Models of Thought,* Yale University Press, New Haven, 1979; H A

how risk-averse individuals are willing to take a certain loss in the face of potentially ruinous loss.[99] While firms are not individuals, many of the parties who have renegotiated their existing contracts to include some form of Brexit clause have done so in order to mitigate what they perceive as an unknown and potentially significant risk. The uncertainty likely means that, no matter what happens in the future of the Brexit, some contracts will be brought before courts for interpretation either due to a failure to renegotiate (which High Court alluded to)[100] or because of renegotiation. Because of the risk preference of one of the parties, some contracts which will be frustrated by Brexit have not been renegotiated, and some contracts which will not be frustrated by Brexit have been renegotiated. If the default rules are inadequate, then the recent efforts in private law to renegotiate existing contracts not only reflect those contracts with a duty to renegotiate but also reflect the risk preference of contracting parties who, having no duty to renegotiate, are unsatisfied with how current default rules assuages their worries about the court's inadequacy.

Because of the different approaches toward the duty to renegotiate in contract laws across the globe, one might expect to see divergent judicial rulings concerning factually similar disputes.[101] A divergence of approaches across states may lead to a suboptimal reallocation of risks when there is an opportunity to renegotiate.[102] Moreover, in relation to the

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Simon, *Models of Bounded Rationality,* MIT Press, Cambridge, 1982*;* Daniel Kahneman and Amos Tversky, 'Prospect Theory: An Analysis of Decisions under Risk' (1979) 47 *Econometrica* 263; Richard Thaler, 'Toward a Positive Theory of Consumer Choice' (1980) 1 *J Econ Behav Organ* 39.

[99] According to Guthrie 'prospect theory predicts that people generally make risk-averse decisions when choosing between options that appear to be gains and risk-seeking decisions when choosing between options that appear to be losses', since 'people are often willing to take risks to avoid losses but are unwilling to take risks to accumulate gains;' Chris Guthrie, 'Prospect Theory, Risk Preference, and the Law' (2002) 97 *Nw U L Rev* 3, p 1115-1164, at 1116.

[100] In *Canary Wharf* [2019] EWHC 335 (Ch) at [216].

[101] See, e.g., A O Sykes, 'Economic 'Necessity' in International Law' (2017) 109 *Am J Int L* 296.

[102] For example, the new Article 1195 of the French Code Civil lacks any operational definition of 'unforeseeable circumstances', and the current definition depends on what the law tells parties that is unforeseeable (tautology). Parties may reasonably expect that the law is applied, and therefore the law has to better define 'unforeseeable circumstances.' Moreover, there is no explanation of whether these circumstances must be outside of the parties' control. The exogeneity of an event should be, as we argue, besides the unforeseeability, verifiability, and superior risk bearer (prevention, insurance) capacity, considered as a necessary condition of any provision on change circumstances. Furthermore, there is no requirement that an adaptation or discharge of a contract is not

application of Art 79(1) of the CISG[103] where the CISG governs a contract, Brexit might or might not be (i.e., factual analysis) regarded as an impediment beyond parties' control. The precise operation of Art 79(1) of the CISG is uncertain, due to its shortcomings and vague criteria. [104]

4.2. THE COVID-19 PANDEMIC AND FRUSTRATION OF PURPOSE

Although the impact of the *Canary Wharf* case might be limited in its application to future disputes involving Brexit, its impact upon COVID-19 related cases might be substantial. From the face of it, the judgment resolves the dispute without having to rule on what the impact of Brexit is on the doctrine of frustration of purpose for subsequent cases by finding a solution to the dispute within the four corners of the agreement under the existing terms and existing rules of contractual interpretation.

The past and present uncertainty over the efficiency or application of default rules may result in an overinvestment in renegotiating existing contracts which will not materially benefit from renegotiation to reflect the risks of Brexit or COVID-19, and an underinvestment in renegotiation when contracting parties fail to appreciate the inadequacy of current default rules given the specific risk inherent in their existing contracts. If it is uncertain how courts will apply existing default rules, then contracting

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possible if the contractual relationship was an aleatory one, if the risk in question was assigned expressly by the parties' agreement or by well-established rules of law, if the event was foreseeable, endogenous, preventable, or insurable. There is also no guidance as to when performance should be considered as 'excessively onerous.' Another drawback of the French law in relation to English and German approaches is the absence of any clear hierarchy between adaptation and discharge. If the adaptation would be regarded (as in the German jurisprudence) as the first remedy and the discharge as merely a secondary option, then it should be criticized as a source of potential inefficiencies. Last but not least, the 'renegotiation' requirement in Article 1195 might induce opportunism, hold up problems, and moral hazard. Thus, it is not so difficult to contemplate a scenario where there are excessive levels of renegotiation under a French rule, especially when there is uncertainty over if the change circumstances caused by Brexit will result in an excessively onerous performance and contracting parties are risk-averse.

[103] Article 79 (1) CISG provides: A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences; United Nations Convention on Contracts for the
International Sale of Goods, United Nations Commission on International Trade Law, United Nations, New York, 2010.

[104] Namely, Article 79(1) CISG lacks an operational definition of an 'impediment beyond control,' and lacks any guidance as to when performance should be considered as excessively onerous or commercially impracticable; above, n 103.

parties may want to consider this uncertainty in their contracts. The *Canary Wharf* ruling only mitigated some of the uncertainty which contracting parties must deal with. The remaining uncertainty must still be addressed.

While the High Court identifies how a failure to renegotiate a contract to reflect the risk of Brexit may indicate the party's intention to allocate Brexit risks, the impact of *Canary Wharf* ruling on the risk attitudes of contracting parties concerning COVID-19 may be reflected in the party's willingness to enter into an efficient renegotiation of existing contracts or willingness to refrain from entering into inefficient renegotiations. However, if renegotiation is only possible when bilaterally agreed upon, the failure of parties to renegotiate might only reflect the risk preference of one of the parties, and additional factors may need to be considered by judges in their effort to efficiently allocate risk into the contract. These efforts must also takes into account the possibility of moral hazard on the part of parties seeking to induce a breach through refusal to renegotiate.[105]

Moreover, the proposed economically inspired conceptual framework and its stages of inquiry offer valuable insights into how courts should interpret the COVID-19 pandemic and how courts in the UK[106] could approach contractual claims that attempt to rely on frustration, as well as what remedies they should apply in order to achieve efficient allocation of risks and resources *ex post*. As emphasized, processing trade-off implies that, given the nature of lockdowns, closed borders, and governments edicts, COVID-19 might be regarded as a contingency in which expected benefits, due to low materialization probability, do not justify drafting expenditure, are *ex ante* efficient for the parties to ignore.[107] This also provides an additional insight as to why COVID-19 before February 2020, when the Bergamo outbreak happened, might indeed be regarded as an *ex ante* unforeseeable event.[108] Moreover, after addressing the issue of foreseeability (and other preliminary inquiries), courts should

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[105] In this regard, it is crucial to identify the possibility that a party who is unwilling to renegotiate, even when faced with the knowledge of the risk of Brexit, is doing so in order to behave strategically or opportunistically in order to take advantage of the changed circumstances, and may unilaterally frustrate the possibility for efficient renegotiations which reflect the risk of Brexit.

[106] Including courts around the world and in common law jurisdictions such as Singapore, the US, Canada, and Australia.

[107] Recall that if the substance of the contract became due to governmental lockdowns, edicts, closed borders Illegal (i.e., legally impossible to perform), then efficiency requires a discharge of such contract.

[108] After that outbreak in Italy and super-fast transmission across Europe, the Covid-19 pandemic could no longer be regarded as an unforeseeable event.

then embark on the second stage of the proposed inquiry and investigate the issue of whether the materialization of Covid-19 increased the costs of performance to such a level that performance would become excessively onerous. Hence, the issue of whether COVID-19 should be regarded as a frustrating event depends upon the facts (time sequence and increased costs) of each case and should be assessed on a case-by-case basis. As shown, English courts will likely continue to find ways to resolve COVID-19 related disputes over who bears the risk via interpretation of contract rather than via vague doctrine of frustration.

Although UK and US cases as not interchangeable, one may note that in a recent opinion, Massachusetts Superior Court Judge Kenneth Salinger, for example, ruled that a retail tenant (operating a café/coffee establishment) was excused from paying rent while indoor dining was paused under a state-wide executive order to halt the spread of COVID-19.[109] Moreover, in Salam Air SAOC v LATAM Airlines Group plc[110] The court is in line with the proposed economic framework, finding that due to the explicit allocation of risk, the obligation to pay rent was "absolute and unconditional irrespective of any contingency whatsoever."[111] To our knowledge, these were some of the first cases since the commencement of the COVID-19 crisis where a court in line with the proposed conceptual framework actually excused the payment of rent (i.e., excessively onerous costs of performance) due to the doctrine of frustration of purpose.[112] However, it has to be emphasized that, in instances where the COVID-19 pandemic induced merely a modest increase in the costs of performance, courts have, in line with discussed economic principles, held that the frustration of purpose doctrine was not applicable.[113]

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[109] 'Under the doctrine of frustration of purpose, Caffé Nero's obligation to pay rent was discharged while it was barred from letting customers drink or eat inside the leased premises, at least from March 24 to June 22, 2020;' *UMNV 205–207 Newbury LLC v Caffe Nero Americas Inc.* [2020] 2084CV01493-BLS2 (Mass. Superior Ct.). See also *Simon Property Group L.P. v Pacific Sunwear Stores LLC* (2020) WL 5984297 (Ind. Super.)(Trial Order)).

[110] Salam *Air SAOC v LATAM Airlines Group plc* [2020] EWHC 2414 (Comm).

[111] See also *Wilmington Trust SP Services (Dublin) Ltd v SpiceJet Ltd* [2021] EWHC 1117 (Comm); *Bank of New York v Cine-UK Ltd* [2021] EWHC 1013 (QB); *Commerz Real Investmentgesellschaft mbH v TFS Stores Ltd.* [2021] EWHC 863 (Ch) and *TKC London Limited v Allianz Insurance plc* [2020] EWHC 2710 (Comm).

[112] Of course, as of speaking, it is unclear whether the court's ruling will be appealed and whether or not other courts will follow Judge Salinger's lead.

[113] The reduction of foot traffic to the Louboutin store, due to an unforeseen economic force, does not permit a court to "simply rip up a contract signed between two sophisticated parties;" *35 East 75th Street Corporation v Christian Louboutin LLC* (2020) WL 7315470 (N.Y. Sup.). Likewise, the court also held that the impossibility defense is not

5. CONCLUSIONS

Business lawyers and commercial contracting have been stressed by political and medical uncertainty over the past several years. Brexit and the COVID-19 pandemic pose several challenges for those who advise commercial practices. The withdrawal of the UK from the EU, as well as the COVID-19 pandemic, creates several questions, some involving novel legal dilemmas, which legal scholarship, practitioners, and lawmakers must consider. This paper contributes to this extensive scholarly debate on whether the Brexit and the COVID-19 pandemic constitutes a frustration of purpose event in contracts by exploiting the findings of the economic literature on the consequences of supervening events. As argued, the problem of unforeseen contingencies should be seen as an *ex post* efficiency-enhancing, welfare-maximizing, and risk-sharing problem. While discussing this risk-sharing mechanism, an additional set of criteria for applying the optimal excuse rule has been offered.

Thus, as argued, wealth-maximization requires granting to the third party (judge), under severe preconditions, the power to discharge or enforce a contract in case of excessively onerous performance. Focusing, instead of on *ex ante*, on *ex post* allocation of risks and resources is the preferable option. Once remote risks materialize and render performance excessively onerous, the court is in the second-best position to discharge the performance of the contract to relieve the contracting parties from ruinous, unexpected losses that they never accepted or provided for in the contract. Furthermore, according to the provided model, all the incentives would be preserved undistorted, opportunistic behaviour would be deterred, transaction costs would be saved, and welfare maximization would be achieved. In addition, legal certainty, contracting, cooperation, and relation-specific investments would be enhanced. Gambling on future, supervening, unforeseen, disastrous losses is (leaving purely aleatory contracts aside) beyond a realistic scenario for the behaviour of rational, self-interested, risk-averse, and wealth maximizing parties.

The assessed judgments correspond to the proposed economic framework. It is also evident that the first part of the High Court's judgment in the *Canary Wharf* case addresses all the necessary first steps suggested by proposed conceptual framework. Moreover, addressed decisions can be seen as judgments representing an efficiency-minded approach, which leads to the enforcement of contracts that have

applicable as the store is still intact and it is still permitted to sell its products. See also *CAB Bedford LLC v. Equinox Bedford Ave Inc.* (2020) WL 7629593 (N.Y. Sup.); and *1140 Broadway LLC v Bold Food LLC* (2020) N.Y. Slip. Op. 340178(U) (N.Y. Sup. Ct.).

contemplated the risks and remedies for a breach due to the Brexit or any other contemplated, even if imprecisely, event (i.e., COVID-19). The analysed cases also show that we are witnessing a skilful judicial approach to the problem, which, if followed in other European jurisdictions, may tend to decrease the risk of uncertain application of default rules across Europe.

Moreover, recent cases show that the common law judiciary might be perfectly capable of dealing with Brexit's and COVID-19 risks and that we are not dealing with an emergence of a new legal paradigm but rather an encyclopaedical, practitioner's way to decrease the risk of uncertain application of default rules.