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THE IMPACT OF COVID-19 ON CONTRACTUAL OBLIGATIONS IN MALAYSIA

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ABSTRACT

The widespread Covid-19 pandemic has significantly impacted business and commerce across the globe, including Malaysia. As a result, businesses throughout Malaysia may face the inability to perform their contractual obligations and may seek to determine whether they or their counterparty have any legal basis for the non-performance of those contractual obligations. This research used content analysis by categorizing the same theme and discussing the wording adopted in Temporary Measures for Reducing the Impact of Coronavirus Disease 2019 (COVID-19) Act 2020, force majeure clause, and the doctrine of frustration in Malaysia. The Temporary Measures for Reducing the Impact of Coronavirus Disease 2019 (COVID-19) Act 2020 is one of the defenses available to excuse the non-performance of contractual obligations due to Covid-19. However, the Covid-19 act is relatively new, and no precedent has been established to interpret the vague language adopted in the act. It was found that financial hardship can be a ground for non-performance of contractual obligations. Alternatively, contractual parties may invoke the force majeure clause

that is provided in a contract. However, the ability to seek relief for force majeure events depends on the precise wording adopted in the clause. In the absence of a force majeure clause, the contractual parties may consider the doctrine of frustration. However, frustration is not a straightforward doctrine to reckon with. This research will provide insight into contractual parties on their rights, remedies, and repercussions if they choose to terminate the contract due to the widespread Covid-19 pandemic.

Keywords: Covid-19 pandemic, contracts, force majeure, frustration.

INTRODUCTION

On 11 March 2020, the World Health Organization (2020) officially declared the widespread coronavirus (Covid-19) as a pandemic. As of 17 September 2021, there were 226,844,344 cases across the globe, with 4,666,334 casualties reported (WHO, 2021). In addition to the calamitous impact on human life, the widespread Covid-19 also caused massive disruption to commercial activity worldwide. In Malaysia, measures such as Movement Control Order (MCO), Conditional Movement Control Order (CMCO), and Recovery Movement Control Order (RMCO) (Vivien & Ryan, 2020) which encompass travel restrictions, quarantines, lockdowns, and government-ordered closures were taken to combat the outspread of this deadly virus (Wikipedia, 2020). As a result, businesses throughout Malaysia may face practical inabilities in performing their contractual obligations and may seek to determine whether they or their counterparty have any legal basis for the non-performance of those contractual obligations.

The enactment of the Temporary Measures for Reducing the Impact of Coronavirus Disease 2019 (COVID-19) Act 2020 [Act 829] (Covid-19 Act) provides short-term measures that soften the impact of Covid-19 outbreak which include temporary alter the relevant statutes as mentioned in the preamble. Accordingly, the Covid-19 Act offers businesses ‘temporary relief’ from legal actions arising from the incapability of parties to perform their contractual obligations. The Covid-19 Act is relatively new, and some of the authors have criticized the key relief in Part II of the Covid-19 Act as too ambiguous due to the vague language adopted (Foo, 2020). Therefore, this article emphasizes the interpretation and application of Part II of the Covid-19 Act.

Force majeure is one of the defenses available for parties to seek non-performance of their contractual obligations (Clark, 2020). However, this defense does not apply automatically in all circumstances (Chong et al., 2020). The contractual parties need to review the entire contract, particularly the language, scope, and extent of the relevant contractual provisions. Thus, precise wording used in the clause is crucial in determining whether the party can invoke the force majeure clause.

Alternatively, parties can seek the doctrine of frustration to discharge their contractual obligations. However, there are conflicting views as to whether Covid-19 would frustrate a contract. Furthermore, frustration is not a straightforward doctrine as it construes considerably narrow limits by the Malaysian Court (Jayabalan, 2020). Thus, whether Covid-19 could give rise to frustration requires an examination of the recent Malaysian case laws, relevant facts, and circumstances that the Court would take into account. As such, the motive of this article is to study and evaluate the possible alternative resolutions and the provided relief under the Covid-19 Act, force majeure clause, and doctrine of frustration for non-performance due to the Covid-19 pandemic.

INTERPRETATION AND APPLICATION IN PART II OF THE COVID-19 ACT

Upon close examination of Part II of the Covid-19 Act, its application is subjected to the following three conditions: -

- (a) the contract in question must be performed starting from 18 March 2020 until 22 October 2022 (Contract relief period);
- (b) the contract in question must be arising from one of the categories of the contracts as described in the Schedule [Section 7] of the Covid-19 Act (Exempted contracts); and
- (c) such inability in performing contractual obligations due to measures and restrictions imposed under the Prevention and Control of Infectious Diseases Act 1988 (PCID Act) to curb the outspread of Covid-19 (inability to perform contractual obligations due to measures and restrictions imposed under PCID Act).

Contract Relief Period

The relief was available starting from 18 March 2020 to 31 December 2020 upon the Covid-19 Act came into force. The minister has the

discretion to extend the operation of the Covid-19 Act more than once by order published in the gazette. However, such an extension order must be made within the two years period. There are four extension orders have been made, namely, Temporary Measures for Reducing the Impact of Coronavirus Disease 2019 (COVID-19) (Extension of Operation) Order 2020, Temporary Measures for Reducing the Impact of Coronavirus Disease 2019 (COVID-19) (Extension of Operation) Order 2021, Temporary Measures for Reducing the Impact of Coronavirus Disease 2019 (COVID-19) (Extension of Operation) (No. 2) Order 2021, and Temporary Measures for Reducing the Impact of Coronavirus Disease 2019 (COVID-19) (Extension of Operation) (No. 4) Order 2021. At present, Part II of the Covid-19 Act has been extended from 1 January 2022 to 22 October 2022. It is pertinent to note that all the extension orders only extended on the operation of Part II of the Covid-19 Act.

Exempted Contracts

The inability to perform contractual obligations must arise from one of the categories of the contracts as illustrated in Schedule [Section 7] of the Covid-19 Act. Thusly, this is not a blanket immunity to all contracts. The authors opine that Section 7 protection also encompasses new exempted contracts that concluded during the Covid-19 outbreak. The exempted contracts under Schedule [Section 7] are as follows: -

- (a) Construction contracts.
- (b) Performance bonds permitted in relation to a construction or supply contract.
- (c) Professional services contract.
- (d) Lease or tenancy of the commercial immovable property.
- (e) Event contracts.
- (f) Contract by a tourism enterprise.
- (g) Contract in relation to a religious pilgrimage.

Recently, an order gazette by the minister, namely, the Temporary Measures for Reducing the Impact of Coronavirus Disease 2019 (Covid-19) (Amendment of Schedule) Order 2020 (Amendment Order), which included two additional categories of contracts: -

- (h) Hire-purchase contracts defined under the Hire-Purchase Act 1967 or leasing contracts entered by micro-enterprises.
- (i) Credit sales-related contracts under the Consumer Protection Act 1999.

However, the above list is subject to criticism. For example, the term “contract for professional service” is broadly drafted and is silent on what the legislature intends for this specific type of contract to be covered (Emily & Jessie, 2021). Hence, the line is far from clear, as the type of exempted contracts could fall within Section 7 protection.

Inability in Performing Contractual Obligations due to Measures and Restrictions Impose Under PCID Act

The Covid-19 Act is silent on what constitutes as “inability to perform,” and at present, no case law has defined this. For circumstances of “inability to perform,” inference can be drawn in the case of *Damansara Realty Bhd v Bungsar Hill Holdings Sdn Bhd & Anor.*¹ The Court held that an anticipatory breach is based on “inability to perform,” where it obligates the defaulting party to establish impossibility to perform, i.e., a “radical change” to what the contractual parties agreed in the contracts. Hence, mere difficulty or inconvenience would not be sufficient. The authors wish to highlight that both “impossibility to perform” and “inability to perform” may excuse a party’s non-performance of contractual obligations. It is apparent that the differences would be “impossibility to perform” imposes a higher threshold than “inability to perform”. The defaulting party can rely on Section 7 protection if he is able to establish the impossibility of performing. Nonetheless, the burden of establishing such an “inability” depends on the facts of each case (Tan et al., 2020).

It is important to highlight that the inability to perform any contractual obligation must be “due to” the measures and restrictions imposed under the PCID Act to curb the outspread of Covid-19 infections. If the default is non-related to such measures, the defaulting party could not avail itself of the relief under the Covid-19 Act. In this regard, a causal link must be established. In other words, a party seeking relief under Section 7 of the Covid-19 Act would have to show that its inability to perform the contractual obligation is materially caused by the measures and restrictions imposed under the PCID Act. This position rather does not depart from the stance in the tort of negligence; even if there is a breach of the duty of care by the defendant, it does not mean causation has been established (Mokhtar, 2016). As such, the defaulting party needs to prove causation and fulfill the “but for” test

¹ [2011] 6 MLJ 170

under the case of *Bolam v Friern Hospital Management Committee*² so that he can be entitled to Section 7 protection.

It was observed that a dispute could arise where the defaulting party claims to be the inability to pay due to financial hardship caused by the measures and restrictions imposed under the PCID Act (Gan & Kang, 2020). Therefore, does Section 7 of the Covid-19 Act applicable in this situation? Two inferences can be drawn here. Firstly, the measures taken to combat the outspread of Covid-19 infections include imposing MCO, which inevitably affected the operation of businesses and caused the issue of cash flow. Second, the inference that can be drawn is the passing of the Amended Order was a targeted measure primarily assisting micro-enterprises in B40 and M40 groups.

Hence, it is arguable that Section 7 of the Covid-19 applies if the inability to pay due to measures and restrictions imposed under PCID Act. Accordingly, financial hardship is usually not perceived as a force majeure event or ground to trigger the doctrine of frustration; thus, a different approach ought to be made in construing the Covid-19 Act, which is a piece of social legislation with the objective of giving a helping hand to the impacted parties. This elucidation of Section 7 of the Covid-19 Act is, in fact, in line with the other Sections 23, 26, 30, and 34 of the Covid-19 Act, which provides “temporary relief” in terms of financial hardship for defaulting parties in a contract.

Restriction of Section 7 of the Covid-19 Act

In the event, the defaulting party had proven its inability to perform contractual obligations under the contract consequent to the measures and restrictions imposed under the PCID Act. The saving provision under section 10 needs to be read in conjunction with Section 7. Section 10 of the Covid-19 Act provides any contract terminated, or any legal proceedings carried out during the period between 18 March 2020 to 23 October 2020 remain valid or carried out.

FORCE MAJEURE CLAUSES IN MALAYSIA AMID COVID-19 PANDEMIC

The concept of force majeure or superior force has its origin in French law, where there are explicit provisions for the non-performance of contractual obligations. However, unlike the French Civil Code, this

² [1957] 1 WLR 582

concept is not a statutory right in Malaysia. It is trite that the force majeure clause must be explicitly stated in the contract, as according to the Contract Act 1950 (CA 1950), it cannot be implied into a contract. This position was confirmed in the Court of Appeal case of *BIG Industrial Gas Sdn Bhd v Pan Wijaya Property Sdn Bhd and Another Appeal*³ where it was held that the consensus of parties must be found within the ambit of the contract. Hence, the precise wording used in the clause is crucial in determining whether the party can trigger the force majeure clause due to Covid-19.

Interpretation of Force Majeure Clauses in Malaysia

The standard form of commercial documents usually embodied a force majeure clause as one of their terms. (Chitty & Beale, 2017). Under such clause, will commonly seek for non-performance of those contractual obligations in particular force majeure events (FME), after that concludes with a catch-all phrase.

FMEs generally can be classified into two categories, namely, Natural Force Majeure Events (NFME) and Political Force Majeure Events (PFME) (World Bank Group, 2021). The NFME, as the name implies, widely comprises “Act of God”. A force majeure clause mentions “Act of God,” which usually encompasses floods, plague, fire, earthquakes,

and other natural disasters. On the other hand, PFME may include terms like the act of war, terrorism, riots, civil disturbances, acts of government, and changes of law or regulations that materially affect contract performance. It is pertinent to note that the relevant FMEs need not necessarily be Covid-19 itself (Kaur, 2020). It is the repercussions of Covid-19 that affect the parties’ non-performance of the contractual obligations. Events construed as FMEs are highly fact and jurisdiction-specific (Schramek, 2020). At present, FME has not been expounded in any Malaysian statute. However, in the case of *Intan Payong Sdn Bhd v Goh Saw Chan Sdn Bhd*⁴, where the court explained force majeure as occurrences of events referred to in a clause that impeded parties from performing those contractual obligations.

Thence, it is prudent to scrutinize whether the language, scope, and extent found in standard force majeure clauses may be construed widely to encompass Covid-19 as FME. A feasible way to approach

³ [2018] 3 MLJ 326

⁴ [2005] 1 MLJ 311

this issue is by understanding the nature of the force majeure clause to determine whether the wording used can be construed to include Covid-19 as FME (Lak, 2021). In this regard, four key points need to be addressed (Lak, 2021):-

- (a) The classification of Covid-19 as epidemic or pandemic.
- (b) Broadening the ambit of “Act of God” to include Covid-19.
- (c) Treating the recent enforcement of Prevention and Control of Infectious Diseases (Declaration of Infected Local Areas) Order 2020 (PCID Order) as a change of law amounting to FME.
- (d) The status of Covid-19 within the scope of the catch-all phase.

The Classification of Covid-19 as an Epidemic or Pandemic

Undeniably, Covid-19 is a pandemic (WHO, 2020). However, can the term “epidemic” provided in the boilerplate clause be construed broadly to include pandemic? In the case of *re (Swine Flu Immunization) Products Liability Litigation*⁵, the Court construed epidemic as “a situation where a disease attacks many people in the same region” whereas pandemic as “a widespread of an epidemic”. For instance, the outspread of Covid-19 was initially confined to Wuhan, China; hence, it was an epidemic (Intermountain Healthcare, 2020). However, the geographic spread changed it into a pandemic (Intermountain Healthcare, 2020). Thus, if a force majeure clause has specifically referenced an epidemic or pandemic, the contractual parties may successfully invoke the force majeure clause for non-performance due to Covid-19.

However, only a minority of the contracts concluded outside the healthcare industry have such a specific reference (Schramek, 2020). This is evident from a recent LexisNexis search returned with two Malaysian cases that involved force majeure and a “pandemic” (LexisNexis, 2021). A similar search for force majeure and “epidemic” returned only 6 Malaysian cases (LexisNexis, 2021). Drawing a comparison, a simple LexisNexis search for “force majeure” returned with 147 Malaysian cases (LexisNexis, 2021). Consequently, this leaves parties to argue on the terms: “Act of God,” “change of law clause,” or the “catch-all” phrase for non-performance of those contractual obligations.

⁵ 495 F. Supp. 1188

Broadening the Ambit of “Act of God” to Include Covid-19

The Federal Court case of *Kwan Sun Ming v Chak Chee Hing*⁶ explained “*vis major*” or “Act of God” as a circumstance “due to natural causes, directly and exclusively without human intervention and which could not have been avoided by any amount of foresight and pains and care reasonably to be expected of the person sought to be made liable for it. Hence, two requirements need to be satisfied for Covid-19 to fall within the ambit of the term “Act of God”:

- (a) The act has to be an entirely natural cause, not a human agency.
- (b) The act could not be avoided by taking any amount of foresight and reasonable care by the impacted party.

The first limb requires the act to be entirely a natural cause, not a human agency. The Federal Court defines natural cause as “exclusively without human intervention”. In *Nugent v Smith*⁷ where the Court described nature cause as an “elementary force of nature unconnected with the agency of man or other cause.” An act that is caused by elementary forces includes extraordinary floods⁸, heavy snowfall,⁹ storms, lightning, and tempests.¹⁰ However, it is vital to note that the English Court also construed illness as an “Act of God” (Ashurst, 2020). In *Boast v Firth*¹¹ it was held that “only illnesses that are not the fault of the person in question can be considered an Act of God.”

There are two possible ways to construe that Covid-19 amounts to “Act of God”. Firstly, an extraordinary flood is still an Act of God, as per *Nichols v Marsland*¹², even if partially a consequence of human actions or factors causing floods (Senbeto, 2012). Secondly, WHO stated that people affected by Covid-19 would experience respiratory illness, and on that basis, some researchers have defined Covid-19 as an illness (Cennimo, 2021). Thus, the first limb of the test arguably has been fulfilled.

⁶ [1965] 1 MLJ 236

⁷ [1876] 1 CPD 423

⁸ *Tan Soon Ngin v Seng Tat Properties Sdn And Third Party* [1997] MLJU 253

⁹ *Briddon v Great Northern Rly Co* (1858) 28 LJ Ex 51

¹⁰ *Oakley v Portsmouth Steam Packet Co* 11 Ex. 623

¹¹ [1868-69] L.R. 4 C.P.1.

¹² [1874-80] All ER Rep 40

The second limb test requires contracting parties to establish that the act could not be avoided by taking any amount of foresight and reasonable care.¹³ Again, inference can be drawn from the English Courts. It was held that the contractual parties are not reasonably expected to foresee any acts that emerge from natural causes.¹⁴ Likewise, parties for non-performance of those contractual obligations due to the outspread of Covid-19 are not reasonably expected to foresee. Hence, the second limb can arguably be fulfilled as well.

Henceforth, upon applying the two limb tests set out by the Federal Court, the contractual parties may successfully invoke the force majeure clause under the term “Act of God” for non-performance of contractual obligations due to Covid-19.

Treating the Recent Enforcement of PCID Order as a Change of Law Amounting to Force Majeure Event

The MCO refers to the PCID Order issued by the Malaysian government under the PCID Act with the objective of flattening the pandemic curves. The PCID Order empowers the government to restrict movement, prohibit gatherings, and order the closure of businesses except essential services to combat the outspread of Covid-19. As such, parties can argue that the recent enactment of the PCID Order is to be construed as a change of law amounting to FME for non-performance of those contractual obligations due to Covid-19.

It is pertinent to highlight the recent case of *SN Akmida Holdings Sdn Bhd v MTD Construction Sdn Bhd (and Another Originating Summons)*,¹⁵ where the party sought to rely on the PCID Regulations as an FME. However, the High Court rejected the party’s contentions on two main grounds, i.e., the action accrued before the enforcement of the regulations, and the contract did not explicitly include the terms like the change of law clause or pandemics as FME. In light of the above, the measures imposed by the government under the PCID Order can be considered a change of law amounting to FME because it materially affects the parties in performing their contractual obligations, especially those not listed as essential services.

¹³ *Kwan Sun Ming v Chak Chee Hing* [1965] 1 MLJ 236

¹⁴ *Nichols v Marsland* [1874-80] All ER Rep 40

¹⁵ [2021] 1 LNS 1819

The Status of Covid-19 within the Scope of the “catch-all” Phrase

The majority of the force majeure clauses consist of a “catch-all” phrase regarding the events that are “beyond the reasonable control of such party.” However, even with a wide force majeure clause consisting of a “catch-all” phrase, the issue of whether Covid-19 falls within the scope of the clause has no clear answer because, to date, there is no precedent determining such an issue.

One feasible way to tackle this point is by construing the ambit of the force majeure clause within the contract by relying on the interpretation provided by the Malaysia Court. The term “force majeure” refers to an extraordinary unforeseeable event upon the conclusion of a contract that impedes the parties from performing contractual obligations under the contract (Bortolotti & Ufot, 2018). In the case of *Universiti Teknologi Malaysia v Maraya Sdn Bhd*¹⁶ where the judge elaborated that force majeure “is not intended to enable a party to renege on its obligations. Rather it is intended to protect each party from strikes, lockouts, breakdowns, or other circumstances beyond the control”. Therefore, it would be fair, just, and reasonable to construe Covid-19 as an FME within the scope of “beyond the reasonable control of such party” as the occurrence of the Covid-19 outbreak or the measures such MCO imposed by the government is not within the parties’ control.

Other Considerations to Invoke Force Majeure Clauses

Foreseeability

In Malaysia, the relevant circumstance for invoking the force majeure must be unforeseeable during the contract’s formation and beyond the parties’ control (Hussain, 2020). The principle of “beyond the control of the parties” is illustrated in the case of *Oxbridge Heights Sdn Bhd v. Farah Qurashiyah Armia & Anor.*¹⁷ The Court held that the increase in the cost of materials, lack of supply materials, and rainy weather could not be construed as FMEs. This is because these FMEs were within the contemplation of the party. The focal point of the analysis of the element of reasonable foreseeability is whether the outbreak of Covid-19 could not have been foreseen when the contract was

¹⁶ [2009] MLJU 295

¹⁷ [2011] MLJU 1126

concluded such that it falls within the ambit of the “catch-all” phrase and constitutes a valid defense to trigger the force majeure.

Mitigation

The force majeure clause usually includes the term “good faith efforts” or “commercially reasonable efforts,” which requires the party to take reasonable steps to prevent or mitigate the effects of the force majeure clause (Ashurst, 2020). Even if the clause does not explicitly impose a duty on the parties to take reasonable steps to mitigate, the parties may still need to prove that it could not mitigate and FME adversely affects the parties in performing their contractual obligations (Ashurst, 2020). In the case of *Crest Worldwide Resources Sdn Bhd v Fu Sum Hou dan Satu Lagi*,¹⁸ the Court held that parties needed to demonstrate that reasonable steps had been taken to mitigate the event to invoke the force majeure clause.

Causation

Contractual parties who seek to invoke the force majeure clause must establish a causal link between the non-performance of the contract and force majeure (Thiru & Sanghvi, 2020). It is trite that a party who wishes to invoke the clause must demonstrate the facts bringing the case for non-performance of their contractual obligation as per *Intan Payong Sdn Bhd v Goh Saw Chan Sdn Bhd Bhd*.¹⁹ What must be proven by the parties is that their contractual obligations have become impossible due to the FME, and such non-performance would not have become impossible “but for” the occurrence of FME (Thiru & Sanghvi, 2020). In *Pacific Forest Industries Sdn Bhd & Anor v Lin Wen-Chih & Anor*²⁰ it was held that merely difficult to perform parties’ contractual obligations would not be sufficient to establish the contract is physically or legally impossible to perform. In Malaysia, government measures such as MCO could be construed as an event that has affected the contractual obligations to be both “physically impossible” and “legally impossible” to perform.

Notice

A defaulting party who seeks to rely upon the force majeure clause usually requires notifying the counterparty that the FME obstructs its

¹⁸ [2019] MLJU 512

¹⁹ [2004] 1 LNS 537

²⁰ [2009] 6 MLJ 293

contract performance (Ashurst, 2020). The notice requirement varies in contracts as some notice imposes a specified timeframe, whereas others only require prompt or reasonably prompt notice (Schramek, 2020). Commonly, the notice requirement will be an essential condition to the party who seeks the relief provided for under the clause (Ashurst, 2020). Therefore, the defaulting party who fails to comply with the notice requirements may create a reasonable belief that he could perform the contract amid Covid-19 and thus affects his chances to invoke the force majeure clause as a defense to discharge his contractual obligations.

Doctrine of Frustration in Malaysia Law Contracts Amid Covid-19 Pandemic

The general rule is that when parties enter into a contract, they and their counterparty have to perform their contractual obligations as per CA 1950. However, the doctrine of frustration is an exclusion of this rule (Kumar, 2019). While the force majeure clause is a “creature of contract” (Rajan & Lim, 2020), conversely the doctrine of frustration in Malaysia is a “creature of statute” that is codified under Section 57(2) of the CA 1950. Therefore, the doctrine of frustration is implied by law, and such defense would only be contemplated if a contract does not incorporate a force majeure clause (Jayabalan, 2020).

Section 57(2) of the CA 1950 is only germane for situations where the performance of a contract becomes impossible “after” the contract is concluded. In the case that the performance of a contract becomes impossible “before” the conclusion of the contract, then it will be dealt with by Section 57(1) of the CA 1950. It is crucial to note that the defense of frustration is not applicable if the supervening event is foreseeable or within the parties’ contemplation after the contract has been concluded (Muhammad, 2020). From the wording of Section 57(2) of the CA 1950, there are two circumstances that give rise to frustration, namely, when a contract becomes impossible or unlawful, as per the case of *Ramli Bin Zakaria & Ors v Government of Malaysia*.²¹

However, frustration is not a straightforward doctrine to reckon with as it is reliant on construing the actual construction of the terms of a contract and the relevant facts and circumstances when the contract concluded (LexisNexis, 2020). Thence, it is prudent to examine the

²¹ [1982] 2 MLJ 257

terms impossible and unlawful found in Section 57(2) of CA 1950. Relevant case laws, facts, and circumstances surrounding each contract can be construed widely to include Covid-19 or the imposition of MCO as a supervening event or supervening illegality.

While the phrase “unlawful” is self-explanatory, the CA 1950 is silent on what constitutes “impossible,” and case laws have given some guidance. Reference is made to the case of *Hong Leong Bank Bhd v Tan Siew Nam & Anor*,²² where the Court of Appeal acknowledged that circumstances in the sense of physical or literal impossible could give rise to frustration. The majority of the local Courts have applied the “radical change in obligation test” developed by the House of Lords in *Davis Contractors Ltd v Fareham UDC*²³, where it held that frustration happens when the contractual parties are unable to perform their obligations due to a supervening event, which either party was not at fault and the occurrence of such event renders it “radically different” from what the contractual parties had agreed to perform. Meanwhile, the Federal Court, in the case of *Ramli Bin Zakaria*, adopted the decision of *Tsakiroglou & Co Ltd v Noble Thorl GmbH*,²⁴ where it was held that the contract must be “fundamentally altered” before the parties can rely on the doctrine of frustration. In essence, the foundation of the contract must be considerably “altered.”

In Malaysia, the doctrine of frustration concerning non-performance due to an impossible act was encapsulated by Gopal Sri Ram JCA in the case of *Guan Aik Moh (KL) Sdn Bhd & Anor v Selangor Properties Bhd*²⁵ whereby a party must establish the three crucial elements to give rise to frustration: -

- (a) the supervening event in question must be one not stated in the contract;
- (b) the supervening event in question for which either party was not at fault, and
- (c) the supervening event in question must render the contract “radically different” from what the contractual parties have agreed to perform. The Court must view that it is practically unfair to give effect the original promise.

²² [2014] 5 MLJ 34

²³ [1956] AC 696

²⁴ (1962) AC 93

²⁵ [2007] 4 MLJ 201

Application of Doctrine of Frustration to Covid-19

For the purpose of determining whether a contract becomes frustrated due to Covid-19 or the imposition of MCO, the three limbs test set out in *Guan Aik Moh* must be satisfied. Firstly, the contract consists of termination rights or a force majeure clause. If the contract consists of a clause for the supervening event in question, then it will be dealt with according to the clause (Azni et al., 2021). Assuming that the contract in question does not have termination rights or a force majeure clause, then arguably, the first limb would be satisfied.

Secondly, the supervening event must be one for which either party was not at fault. In a nutshell, it cannot be self-induced frustration. It would be fair to argue that the second limb is fulfilled as no party was responsible for the occurrence of the Covid-19 outbreak or the imposition of MCO.

Lastly, the party who seeks to rely on the defense of frustration must establish that the Covid-19 and/or the imposition of MCO renders the contract “radically different” from what the contractual parties have agreed to perform, and it is unfair to carry out the original promise or contractual obligations. The third limb is the trickiest part and not easily satisfied, which depends on the facts and circumstances of each case (Muhammad, 2020), as illustrated in the following.

A Contract is Not Deemed Frustrated if the Supervening Event Occurs in a Short Duration

With reference to the case of *Li Ching Wing v Xuan Yi Xiong*²⁶ where the Hong Kong Court held that a tenancy contract with two years terms was not deemed frustrated as the tenant was ordered to evacuate the premises for merely ten days isolation order due to the outbreak of “SARS”. Albeit it was acknowledged that the SARS outbreak was unforeseeable, such supervening event did not radically alter the nature of the contractual parties’ obligations. Further, ten days out of two years lease was quite insignificant duration for the contract to be frustrated. Research conducted by Padil et al. (2020) and Jayabalan (2020) opined that the Covid-19 outbreak and imposition of MCO would not frustrate a contract; however, such views and the decision in *Li Ching Wing* should be distinguished from the current Covid-19 situation in Malaysia.

²⁶ [2004] 1 HKC 353

The research done by Padil et al. (2020) and Jayabalan (2020) was published in August 2020, and at that time, the Covid-19 situation was less severe, and the duration of MCO was significantly shorter than in the year 2021. As of 28 June 2021, the imposition of MCO, CMCO, and RMCO lasted over 464 days, arguably a long duration, as illustrated in the chart (World of Buzz, 2021).

Description	Date	Duration
MCO	18.3.2020 – 3.5.2020	47 days
CMCO	4.5.2020 – 9.6.2020	37 days
RMCO	10.6.2020 – 13.10.2020	126 days
CMCO	14.10.2020 – 12.1.2021	91 days
MCO 2.0	13.1.2021 – 4.3.2021	51 days
CMCO 2.0	5.3.2021 – 6.5.2021	63 days
MCO 3.0	7.5.2021 – 31.5.2021	25 days
FMCO	1.6.2021 – 28.6.2021	28 days
Total		464 days

Further, the parties also need to establish that Covid-19 and/or the imposition of MCO renders the contract “radically different” from what the contractual parties have agreed to perform, as per the case of *Guan Aik Moh*. Therefore, the crucial issue is whether the contract in question falls under essential services. For instance, a tenancy contract is rented to carry out business such as a nightclub could successfully trigger the doctrine of frustration because such business does not fall under essential services and, in fact, is listed as prohibited activities under PCID regulations 2021 that disallowed to operate since the first MCO, on 18 March 2020. Since MCO caused businesses such as pubs and nightclubs to be shut down (Bavani, 2020), arguably, the contract has become “radically different” as the tenant cannot use the premises for its purpose. In contrast with an example of a tenancy contract rented to provide veterinary services, it is unlikely to argue that the contract is frustrated because the healthcare and medical industry falls under essential services as stipulated under PCID Regulations 2020.

Based on the above analysis, the doctrine of frustration is applied narrowly by the Court, and there is no straightforward answer that the doctrine will be applicable to all contracts. To illustrate, the non-defaulting party could argue that 464 days of the supervening event (MCO) is not a significant duration for a ten-year tenancy contract. On the other hand, a two-year tenancy contract that is affected by 464 days of the supervening event (MCO) is a significant duration.

Nonetheless, the authors' view is that due to the severity of the current Covid-19 situation in Malaysia, the parties could potentially invoke the doctrine of frustration.

A Contract would Not be Merely Frustrated because it is More Difficult to Perform

The case of *Pacific Forest Industries Sdn Bhd & Anor v Lin Wen-Chih & Anor*²⁷ clarified that a contract merely more onerous, expensive, or difficult to perform would not be considered a ground to trigger frustration. Again, the circumstances stated in *Pacific Forest Industries* should be distinguished from the current Covid-19 situation in Malaysia. Arguably, the impossibility has been created due to the strict enforcement of MCO by the government, and only essential services are allowed to perform their contractual obligations, which renders the contract has been “radically different” from what the contractual parties have agreed to perform.

According to the case of *Kim Nam Development Sdn Bhd v Khaw Daw Yau*²⁸ it was held that a contract would be frustrated when there is a change of circumstances that renders the contract “physically impossible” and “legally impossible” to perform. Hence, a change of circumstances, such as the widespread Covid-19 and the imposition of MCO, has affected the parties' contractual obligations to be both “physically impossible” and “legally impossible” but not merely difficult to perform.

A Contract would be Frustrated Attributable to a Government Order

In *Yew Siew Hoo & Ors v Nikmat Maju Development Sdn Bhd And Anor Appeal*²⁹, the parties entered a contract to construct a central sewage treatment plant to clean wastewater from pig farms. However, occurrences of the outbreak of “Japanese Encephalitis” caused the government of Negeri Sembilan to ban the rearing and sales of pigs in the affected area that was occupied by the plaintiffs. It was held that the outbreak of “Japanese Encephalitis” constitutes a supervening event that resulted in the contract entered between parties being void on the ground of frustration. Similarly, the outbreak of Covid-19, which led to the government order to impose MCO under the PCID

²⁷ [2009] 6 MLJ 293

²⁸ [1984] 1 MLJ 256

²⁹ [2014] 4 MLJ 413

Act to curb the outspread of Covid-19 (Muthiah, 2021). In view of this, the parties can argue that the outbreak of Covid-19 constitutes a supervening event that renders the contract “radically different” from what the contractual parties have agreed to perform, especially those not listed under essential services.

A Contract Will be Frustrated if the Performance of the Contract becomes Unlawful

Another instance that would give rise to frustration is when the performance of a contract becomes unlawful. In the case of *Danga Bay Sdn Bhd v Hamimah bt Hussain & Anor (Affin Islamic Bank Bhd, third party)*,³⁰ where the Court of Appeal held that “If it cannot be performed or becomes unlawful to perform, then the party who is to perform his part of the bargain can plead frustration”. In the lockdown situation in Malaysia imposed under the laws PCID Act, some businesses were prohibited from operating (Ong, 2021), interstate and inter-district travel were banned (Hassan, 2021), and the majority of the businesses were restrained from operating during the specific hours of the day (Achariam, 2021).

Hence, to perform contractual obligations in such circumstances or in certain contracts may be frustrated on the basis that performance would be no longer lawful. Section 8 of the Emergency (Prevention and Control of Infectious Diseases) (Amendment) Ordinance 2021 provides that “any person who commits an offense under the PCID Act shall be liable to a fine not exceeding RM100,000 or to a term of imprisonment not exceeding seven years or both”. Therefore, such circumstances or certain contracts can plead frustration as a defense.

Relationship between Force Majeure Clauses, Doctrine of Frustration and Covid-19 Act

The occurrence of the Covid-19 outbreak has adversely impacted the Malaysian economy (Lee, 2020). In the case of *Global Destar (M) Sdn Bhd v Kuala Lumpur Glass Manufacturers Co Sdn Bhd*³¹ where the Court held that a severe downturn in the economy does not fall within the ambit of “other circumstance” in a force majeure clause. This is because “the ups and downs of business or economic climate are part of the risk of doing business.” This position was affirmed by

³⁰ [2021] 2 MLJ 22

³¹ [2007] MLJU 91

the Court of Appeal in *Malaysia Land Properties Sdn Bhd (formerly known as Vintage Fame Sdn Bhd) v Tan Peng Foo*.³² Therefore, a severe downturn in the economy cannot be construed as FME.

In the case of *Sentul Raya Sdn Bhd v Hiriram a/l Jayaram and Others*,³³ it was held that the financial crisis of 1997 did not render the execution of the construction work frustrated. The performance of the contract merely became commercially impossible but not frustrating. The Federal Court adopted the above view in *Pacific Forest Industries*, where the Court stated that “If a party has no money to pay his debt, it cannot be considered impossible to perform as it is not frustration.”³⁴ The above decisions seem to suggest that despite a party’s financial hardship being affected by Covid-19, the Court would unlikely construe such occurrence as FME or frustration.

Albeit financial hardship cannot be considered as FME as per *Global Destar (M) Sdn Bhd* or ground to invoke the doctrine of frustration as per *Sentul Raya Sdn Bhd*. However, Section 7 of the Covid-19 provides businesses “temporary relief” for non-performance of those contractual obligations that are financially impacted by Covid-19. Therefore, the researchers’ view is that Section 7 of the Covid-19 Act does not invalidate the FMEs expressly stated in the force majeure clause or undermine the doctrine of frustration but, in fact, they supplement each other. For instance, a party’s financial hardship encountered due to Covid-19 cannot be construed as an FME unless it is expressly provided as a term. Another instance whereby the performance of the contract that becomes unlawful cannot be a ground for non-performance of contractual obligations under the Covid-19 Act. However, Section 7 of the Covid-19 Act provides relief in such circumstances.

RECOMMENDATIONS

Mediation

As illustrated in Section 2, there will be inevitable disputes that arise due to the ambiguity of the Covid-19 Act. Further, the relief provided under force majeure clauses and frustration does not automatically

³² [2014] 1 MLJ 718

³³ [2008] MLJU 308

³⁴ [2009] 6 MLJ 293

apply as certain conditions need to be fulfilled. Thus, it is advisable for parties to resolve their differences via mediation. Mediation is an informal process in which the disputing parties appoint a mediator who assists the parties in reaching an amicable settlement (AIAC). Mediation is well suited to resolving disputes because it is confidential in nature, swift, cost-effective form of dispute resolution (Dahlan et al., 2021). In fact, Section 9 of the Covid-19 Act promotes and encourages parties who face practical inabilities in performing their contractual obligations due to Covid-19 to consider mediation in resolving any dispute. This is evident from the fact that the government has set up a Covid-19 Mediation Centre and is willing to subsidize mediation services for micro-enterprises in B40 and M40 groups as well as Small and Medium Enterprises (Legal Affairs Division, 2020).

It is noteworthy that mediation under Section 9 of the Covid-19 Act or Sections 4 and 5 of the Mediation Act 2012 is entirely voluntary and optional. It is arguable that the usage of the word “may” in Section 9(1) of the Covid-19 Act diminishes the effectiveness of promoting mediation as a mode of resolving disputes. In addition, mediation through the Covid-19 Mediation Centre is only confined to a disputed value lesser than RM300,000 (Legal Affairs Division, 2020), which again waters down the application of Section 9 of the Covid-19 Act as only limited cases can benefit from the subsidy of costs for the mediation services.

Therefore, the researchers’ recommendation is to impose a mandatory mediation process so that contractual parties can minimize costs and time and also offer a win-win situation. Alternatively, it is prudent to insert an alternative dispute clause in a contract. If a dispute arises, the contractual parties will opt for mediation as a step prior to litigation or arbitration.

Review and Renegotiation of Existing Contracts

Many businesses would have noticed that their existing contracts entered did not anticipate the phenomena of the Covid-19 outbreak or the imposition of MCO (Chee, 2020). As for long-term survival, it is opportune for the parties to consider the prospect of renegotiating the terms of the contract. However, contract renegotiation must mutually agree by both parties on any change or amendment as it is not a right provided under the CA 1950. Hence, it is crucial that all the amendments to modify existing terms should be reduced to writing.

The parties should consider the need to renegotiate their contracts for the following factors (Law Partnership, 2020): -

- (a) To preserve the long-term and ongoing business relationship.
- (b) Where the termination clause and the force majeure clause in the contract have not been satisfied or did not expressly provide in the contract.
- (c) The costs of termination outweigh the benefits of continuing the contract.

It is prudent for parties to conduct a comprehensive review of their existing contracts to identify and understand their rights, obligations, and commercial risks before engaging in contract renegotiation. Some of the examples of clauses that should be renegotiated or incorporated in the contract are as follows: -

- (a) Force majeure clause: includes references such as ‘epidemic,’ ‘pandemic,’ ‘Act of God,’ ‘change of law clause,’ or ‘catch-all’ phrase in a contract to cover the Covid-19 situation.
- (b) Suspension of obligation clause: includes the right to suspend contractual obligation without penalty should the FME prolong, i.e., the imposition of MCO (Borgese et al., 2020).
- (c) Payment terms clause: the right to payment can be suspended until obligations can be fulfilled or the payment can be made through installments.
- (d) Extension of time clause: established a new timeframe to be fulfilled.
- (e) Termination clause: the rights, liabilities, and obligations that parties wish to be covered must be specified in the contract (Law Partnership, 2020).
- (f) Waiver clause: a complete or partial waiver of the late payment interest and/or liquidated ascertain damages for non-performance of contractual obligations.
- (g) Alternative dispute resolution clause: incorporate mediation as a primary mode of resolving a dispute before parties process to litigation or arbitration.

Relief Provided Under Force Majeure Clauses

If the contractual parties are unable to resolve the dispute using the alternative resolutions, it is advisable to seek relief under the force

majeure clause. It is observed that the “catch-all” phrase, which covers events not stated in a contract, is commonly found under the standard force majeure clause (Ryan, 2020). In this regard, most of the contracts with the force majeure clause may be successfully invoked for non-performance of contractual obligations due to Covid-19. In contrast, the threshold for the frustration of a contract is high (Jayabalan, 2020), and the test laid down in the case of *Guan Aik Moh* can be difficult to be established.

The usual relief which may be articulated from a force majeure clause includes the complete discharge of parties’ contractual obligations and/or liability without penalty (Moore, 2020). Some of the force majeure clauses may explicitly provide for extension or suspension of time or even termination if the FME continues to be prolonged (Moore, 2020). Force majeure clauses may also provide a penalty to be imposed due to the non-performance of contractual obligations (Moore, 2020). In comparison, relief under Covid-19 Act only confines to a temporary suspension in the performance of contractual obligations, whereas if frustration is successfully invoked would be discharged the contractual obligations but render the contract void. Therefore, the relief provided under the force majeure clause would suggest being a better remedy.

However, the drawback would be the force majeure clause is a contractual right and cannot be implied under CA 1950. If the terms of the contract, including the force majeure clause, are not drafted carefully would adversely affect the rights, obligations, and relief of the parties and lead to an undesirable outcome if invoked (Bagger, 2021). In such circumstances, the parties would need to renegotiate the terms of the contract.

Relief Provided Under the Covid -19 Act

If a contract does not incorporate a force majeure clause, parties would most likely resort to relief under the Covid-19 Act or doctrine of frustration. Section 7 of the Covid-19 Act requires the parties to establish the “inability” to perform contractual obligations. On the other hand, the doctrine of frustration requires the contract to become “impossible” to perform. Therefore, it is easier to invoke relief under the Covid-19 Act than alternate reliefs pursuant to the doctrine of frustration for non-performance of contractual obligation.

Financial hardship could be a ground for the non-performance of contractual obligations consequent to Covid-19. However, financial hardship is typically insufficient to qualify as an FME or perceived as a ground to invoke frustration. Therefore, the contractual parties' financial hardship encountered due to Covid-19 would most likely resort to a claim for relief pursuant to Covid-19 Act.

However, the Covid-19 Act is in its infancy, with only two years in operation, between 23 October 2020 and 22 October 2022. If the inability to perform contractual obligations falls on 23 October 2022 then Covid-19 Act cannot be invoked. In addition, if Section 7 of the Covid-19 Act is successfully triggered, the relief would be a temporary suspension of contractual obligations. Thus, should parties intend to seek for complete discharge of parties from performing their obligations, then Covid-19 Act is not the panacea.

Relief Provided Under the Doctrine of Frustration

The doctrine of frustration operates within considerably narrow limits and is not a straightforward doctrine that can be easily invoked, as discussed in Section 4. The test laid down in the case of *Guan Aik Moh* can be difficult to satisfy, in particular, the last limb, as it depends on relevant facts and circumstances when the contract is concluded. In comparison, the threshold for invoking the Covid-19 Act is much lower.

In the event that frustration is successfully invoked would be discharged the contractual obligations but render the contract void, as mentioned under Section 57 CA 1950. It is pertinent to highlight that the termination of a contract applies to future contractual obligations; hence it is not void ab initio. The relief is provided under Section 66 of the CA 1950 provides that when a contract is void, any advantage received under the contract must be restored or make compensation to the other party from whom he received it. According to Section 15 of the Civil Law Act 1956 (CLA 1956), parties are entitled to recover any money paid or valuable benefits given for the purpose of the performance of a contract. However, it is inapplicable for carriage of goods by sea contracts, insurance contracts, and sales of perishable goods contracts, as highlighted in Section 16(5) CLA 1956. Therefore, only certain contracts can claim relief under the CLA 1956.

The threshold for frustration is high, and the relief available is only confined to restitution. In summary, CA 1950 or CLA 1956 disallows any parties to receive any advantage under a void contract. Therefore, frustration should be the last-resort remedy.

CONCLUSION

The Covid-19 pandemic has significantly impacted commercial activity across the globe. Such unprecedented measures meant businesses demand clarity and answers regarding the impact of Covid-19 on their contractual obligations and the possible alternative resolution and relief applicable to them.

The force majeure clause, the Covid-19 Act, and the doctrine of frustration could be potentially invoked for non-performance of contractual obligations due to the Covid-19 outbreak and/or imposition of MCO. Nonetheless, the availability of relief under force majeure clauses, the Covid-19 Act, and frustration is not automatically applied as certain conditions need to be fulfilled. Hence, the authors would first propose that the contractual parties opt for mediation or contract renegotiation. As both methods are quick and inexpensive, they allow for flexible solutions and settlement, and most importantly, they preserve the ongoing business relationship.

In respect of the three reliefs, the researchers would first recommend parties invoke the relief provided under the force majeure clause as it would suggest being a better remedy. In the absence of the force majeure clause, then it is advisable to seek relief under the Covid-19 Act, as financial hardship can be a ground for the non-performance of a contractual obligation. Lastly, the doctrine of frustration operates within considerably narrow limits, and the relief is confined to restitution. Hence, frustration should be considered a last-resort remedy.

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