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A2 GCE LAW

G156/01/RM Law of Contract Special Study

SPECIAL STUDY MATERIAL

Duration: 1 hour 30 minutes



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G156 LAW OF CONTRACT

SPECIAL STUDY MATERIAL

SOURCE MATERIAL

SOURCE 1

Extracts from Macdonald and Atkins, *Koffman & Macdonald's Law of Contract*, 8th Edition, OUP, 2014, pp 469–471

Until a little over a hundred years ago, the law was reluctant to excuse a party his or her performance of a contract even in cases where supervening events rendered that performance difficult or impossible. The rationale of this rule was that a party could always make express provision for unforeseen events and, if he or she did not do so, he or she should be bound by his or her contractual obligations. This is known as the 'absolute contracts' rule...

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This rigid approach has been mitigated, to some extent, by the gradual development of the doctrine of frustration. However, it must be emphasised that the doctrine operates within strict limits and does not provide an easy means of escape for those who have simply made a bad bargain (*Amalgamated Investment & Property Co Ltd v John Walker & Sons Ltd* [1976] 3 All ER 509). The famous case that marks the recognition of the doctrine is *Taylor v Caldwell* (1863) 3 B&S 826. The facts were as follows:

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On 27 May 1861, Taylor entered into a contract with Caldwell which gave T the use of the Surrey Gardens and music hall on four separate days later that summer. T was to use the premises for a series of four concerts, and for holding day and night fêtes on the days in question, and he was to pay £100 for each day. After the contract was concluded, but before the date of the first concert, the music hall was destroyed by fire. The fire was not the fault of either party and it made the performance of the contracts impossible. No express provision had been made by the parties to cover this contingency. T claimed damages for the money he had wasted in advertising the concerts.

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It was held that the defendants were not liable and T's claim for damages did not succeed. ... The judge held that the continued existence of the music hall was essential to the performance of the contract and the parties contracted on this basis. Although there was no express provision to this effect, the court implied one as a matter of construction. ... In other words the doctrine of frustration, as established in *Taylor v Caldwell*, was based on an effort to give effect to the presumed intention of the parties. ...

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Once the doctrine of frustration had been established, its scope had to be determined. *Taylor v Caldwell* dealt with the physical destruction of the subject matter of a contract, and its result was unexceptionable. Similarly, where a contract is made to do something which subsequently becomes illegal (for example, trading with a country against which war is later declared), there is no difficulty in treating the contract as frustrated. But a more common and problematic type of case is where the commercial purpose of a contract is drastically affected by unforeseen events, whilst the performance of the contract remains physically and legally possible. A good example is the famous case of *Krell v Henry* [1903] 2 KB 740.

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SOURCE 2

Extracts from *Herne Bay Steam Boat Company v Hutton* [1903] 2 KB 683, CA

Taken from Mckendrick, E *Contract Law, Text, Cases and Materials*, 5th Edition, OUP, 2012, pp 726–727

The Herne Bay Steam Boat Company owned a steamboat called *Cynthia*. Early in 1902 it was announced that there would be a Royal Naval review at Spithead on 28 June 1902. Hutton, the defendant, wanted to charter *Cynthia* to carry passengers to see the review. Herne Bay and Hutton signed an agreement on 23 May 1902 which stated that *Cynthia* would be at the disposal of Hutton on 28 June ‘for the purpose of viewing the naval review and for a day’s cruise around the fleet’ and on 29 June ‘for similar purposes’. ... On 25 June the naval review was cancelled. ... The Court of Appeal [held that the contract had not been frustrated].

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Vaughan Williams LJ:

Mr Hutton, in hiring this vessel, had two objects in view: first, of taking people to see the naval review, and, secondly, of taking them round the fleet. Those, no doubt, were the purposes of Mr Hutton, but it does not seem to me because, as it is said, those purposes became impossible, it would be a very legitimate inference that the happening of the naval review was contemplated by both parties as the basis and foundation of this contract, so as to bring the case within *Taylor v Caldwell*...

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Romer LJ:

The ship (as a ship) had nothing particular to do with the review or the fleet except as a convenient carrier of passengers to see it: any other ship suitable for carrying passengers would have done equally as well. Just as in the case of the hire of a cab or other vehicle, although the object of the hirer might be stated, the statement would not make the object any the less a matter for the hirer alone, and would not directly affect the person who was letting out the vehicle for hire. In the present case I may point out that it cannot be said that by reason of the failure to hold the naval review there was a total failure of consideration. That cannot be so. Nor is there anything like a total destruction of the subject matter of the contract. ... It follows that, in my opinion, so far as the plaintiffs are concerned, the objects of the passengers on this voyage with regard to sight-seeing do not form the subject matter or essence of this contract.

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SOURCE 3

Extracts from Davis Contractors Ltd v Fareham UDC [1956] AC 696 HL

Taken from Mckendrick, E *Contract Law, Text, Cases and Materials*, 5th Edition, OUP, 2012, pp 705–708

Davis Contractors Ltd was a firm of building contractors. They submitted a tender to Fareham Urban District Council in relation to a building scheme at Gudgeheath Lane, Fareham. ... The tender was successful and Davis and Fareham entered into a contract in July 1946 under which Davis was to build 78 houses for Fareham within eight months for £94,425. Without fault on the part of Davis or Fareham, adequate supplies of labour were not available and the work took 22 months to complete at a cost to Davis of £115,233. Fareham paid Davis the contract price. Davis claimed that they were entitled to be paid more than the contract price. ... they submitted that the delay attributable to the shortage of labour had frustrated the contract. The House of Lords rejected [that argument].

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Lord Radcliffe:

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... perhaps it would be simpler to say at the outset that frustration occurs whenever the law recognises that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract. *Non haec in foedera veni*. It was not this that I promised to do. ...

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I am bound to say that, if this is the law, the appellant's case seems to me to be a long way from a case of frustration. Here is a building contract entered into by a housing authority and a big firm of contractors in all the uncertainties of the post-war world. ...

Two things seem to me to prevent the application of the principle of frustration in this case. One is that the cause of the delay was not any new state of things which the parties could not reasonably be thought to have foreseen. On the contrary, the possibility of enough labour and materials not being available was before their eyes and could have been the subject of special contractual stipulation. It was not made so. The other thing is that, though timely completion was no doubt important to both sides, it is not right to treat the possibility of delay as having the same significance for each. The owner draws up his conditions in detail, specifies the time within which he requires completion, protects himself both by a penalty clause for time exceeded and by calling for the deposit of a guarantee bond, and offers a certain measure of security to the contractor by his escalator clause with regard to wages and prices. In the light of these conditions the contractor makes his tender, and the tender must necessarily take into account the margin of profit that he hopes to obtain upon his adventure and in that any appropriate allowance for the obvious risks of delay. To my mind, it is useless to pretend that the contractor is not at risk if delay does occur, even serious delay. And I think it is a misuse of legal terms to call in frustration to get him out of his unfortunate predicament.

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SOURCE 4

Extracts from McKendrick, Ewan, *Contract Law*, 10th Edition, Palgrave Macmillan, 2013, pp 255–258

What is it that explains the reluctance of the courts to invoke the doctrine of frustration?

It is suggested that there are two principal reasons which help explain the reluctance of the courts to invoke the doctrine of frustration. The first is that the courts do not want to allow the doctrine to act as an escape route for a party for whom the contract has simply become a bad bargain. ...

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The severity of the current economic downturn has caused some to doubt the virtue of a clear rule of this nature. Recent examples can be found of transactions in which contracting parties have suffered spectacular losses as a result of substantial movement in market prices. But the English courts have shown no sign of a willingness to provide relief to parties who otherwise will suffer substantial hardship. On the contrary, they have affirmed that the doctrine of frustration continues to operate within narrow confines and that it is not lightly to be invoked (see, for example, *Gold Group Properties v BDW Trading Ltd* [2010] EWHC 323 (TCC)). So, frustration can be invoked only where the supervening event *radically* or *fundamentally* changes the nature of performance: it cannot be invoked simply because performance has become more onerous. ...

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The second reason for the narrowness of the doctrine of frustration is that we all know that the future is uncertain; prices may suddenly increase, inflation may rise, labour disputes break out. Contracting parties are expected to foresee many such possibilities when entering into a contract and guard against them in the contract. Contracts today often make provision for the impact of unexpected events upon contractual performance. A clause which is frequently employed for this purpose is known as a 'force majeure' clause. ...

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Another clause which is often found in commercial contracts is known as a 'hardship clause'. Such a clause will generally define what constitutes 'hardship' (usually of an economic variety) and will lay down a procedure to be adopted by the parties in the event of such hardship occurring. Generally the clause will purport to impose an obligation on both parties to use best endeavours to renegotiate the contract in good faith in an attempt to alleviate the hardship which has arisen. ...

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It is suggested that the ability of contracting parties to make such provision in their contracts has had a significant impact upon the development of the doctrine of frustration. Indeed, at one point in its history, supervening or unforeseen events were not regarded as an excuse for non-performance because the parties could provide against such accidents in their contract. ... This absolutist approach was gradually relaxed during the latter half of the nineteenth century and, commencing with *Taylor v Caldwell* and culminating in cases such as *Jackson v Union Marine Insurance Co Ltd* (1874) LR 10 CP 125 and *Krell v Henry*, the courts developed a wider role for the doctrine of frustration and it became significantly easier to invoke the doctrine. Today, the courts have reverted to a more restrictive approach and it is rare to find frustration being pleaded successfully.

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SOURCE 5

Extract from Treitel, GH, *An Outline of the Law of Contract*, 6th Edition, OUP, 2004, pp 365–366

The Law Reform (Frustrated Contracts) Act 1943

At common law, frustration does not retrospectively annul the contract: it brings the contract to an end only as from the occurrence of the frustrating event. This rule gives rise to problems of adjustment where only one party has, or should have, performed some or all of his obligations before the time of frustration. Considerable powers to make such adjustments are given to the courts by the Law Reform (Frustrated Contracts) Act 1943.

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Prepayment of money

Suppose under a contract of sale payment is due on August 10 and delivery on October 10. The contract is frustrated on September 10, when payment has not yet been made. As frustration does not operate retrospectively one might suppose that the buyer would remain liable to pay, while the seller's obligation to deliver was discharged. But this result would often be very unjust. Section 1(2) of the 1943 Act therefore provides that money due but not paid before frustration ceases to be payable; and that, if the money has actually been paid, it must be paid back. Thus frustration is given some retrospective effect. But this may in turn lead to injustice where the person to whom the prepayment was due has incurred expenses, e.g. in manufacturing the goods, or in packing them up for despatch. The subsection therefore goes on to provide that a person to whom a prepayment was made (or due) may be allowed, at the court's discretion, to keep (or recover) a reasonable sum not exceeding the amount of the prepayment to cover his expenses. What is a reasonable sum depends on all the circumstances. The crucial question will be whether the expenses have not only been incurred but wasted. For example, where manufacturing expenses have been incurred, the test will be whether the thing that has been made could be readily sold to another customer. ...

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Other benefits

Payments of money before the time of frustration present relatively little difficulty, since money can be paid back. But greater difficulty can arise where, before frustration, one party has conferred on the other some benefit in kind. Suppose that A, a builder, agrees to install a central heating system in B's house under a contract providing for payment on completion; and that, when the work is nearly finished, the house is accidentally burnt down. In such a case the builder cannot recover *the agreed sum*. But he may have a remedy under s1(3) of the 1943 Act. This provides that if one party (B) has 'obtained a valuable benefit ... before the time of the discharge' as a result of anything done by the other party (A) in or for the purpose of performance of the contract, then A can recover from B such sum as the court thinks just, not exceeding the value of the benefit. ... A further problem in our example is that the benefit received by B was destroyed by the frustrating event. Although the contrary has been suggested, it is submitted that this fact is not relevant to the question whether B has obtained a valuable benefit; for in order to determine the question the Act requires the court to look at the position as it was *before* the frustrating event.

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SOURCE 6

Extracts from Morgan, J, *Great Debates in Contract Law*, Palgrave Macmillan, 2012, pp 124–126

- Frustration is often explained by pointing to notions of fairness and justice. ... Many leading judicial statements place fairness at the heart of the doctrine. Lord Sumner declared that frustration was 'really a device by which the rules as to absolute contracts are reconciled with a special exception which justice demands'. Lord Simon of Glaisdale said that the doctrine was 'an expedient to escape from injustice' which justifies departure from the literal terms in the contract in order to 'vindicate justice'. In an influential summary, Bingham LJ said that the proposition that frustration existed to 'mitigate the rigour' of absolute liability was 'not open to question' (*J Lauritzen AS v Wijsmuller BV ('The Super Servant Two')* [1990] 1 Lloyd's Rep 1, 8)...
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- Hard-nosed commercial lawyers would disagree that there is anything 'unjust' in holding parties to the unqualified words of their contract. Lord Diplock memorably observed that: 'The only merits of the case are that parties who have bargained on equal terms in a free market should stick to their agreements. Justice is done by seeing that they do so.' ...
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- It appears inconsistent for the common law to rediscover a concern with fairness and justice in the singular situation of change in circumstances. Indeed, as George Triantis asks, why regulate the unfairness of unusual losses when there is judicial unconcern over unexpected windfall *gains*?
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- Treitel observes that there has been unusually elaborate judicial discussion of the basis of frustration, compared with other important areas such as termination for breach. Treitel suggests that this betrays uneasiness about the effect of the doctrine on the binding nature ('sanctity') of contracts. It might also suggest a continuing inability to formulate the emotionally appealing idea of a 'concession to justice' in intellectually satisfying terms. Lord Hailsham LC once commented that this might admirably express the purpose of frustration but leaves the doctrine with no theoretical basis at all. Ewan McKendrick notes that the 'justice' formulation means that 'uncertainty is inherent in the doctrine of frustration'. This is worrying in any sphere of commercial law.
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