

## ANSWERS - SELF TEST - RISK ALLOCATION: EXCUSES FOR NON-PERFORMANCE - FRUSTRATION AND MISTAKE

1. Is the following statement true or false? (1)

If the parties have provided for their own allocation of the risk in the contract, then the doctrines of frustration and mistake cannot apply.

It is true. See express provision as limitation on operation of frustration and the decisions of Sindall plc v Cambridgeshire C.C., McRae v Commonwealth Disposals Commission and Great Peace Shipping v Tsavlis Salvage (International) Ltd. (1)

2. What is the general effect of frustration on a contract at common law? (2)

Frustration automatically **discharges both parties from performance of their future obligations** under the contract (2). It may therefore operate to excuse a breach of contract.

3. How do courts decide whether frustration has occurred? (2)

Nowadays the courts adopt a construction approach (1), i.e. they first assess the terms of the contract as a whole and then assess the effect the extraneous events, which have occurred, have upon the nature and terms of that contract. "...the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract" (Lord Radcliffe in Davis Contractors) (1). This position on juridical basis was also reaffirmed in Great Peace Shipping

4. Name the three basic frustratory events. (3)

Impossibility (1), Illegality (1) and Destruction of the common purpose (foundation of the contract) for both parties (1).

5. Distinguish *Krell v Henry* and *Griffith v Brymer*. (2)

In Krell v Henry the cancellation of the coronation procession meant that the foundation or purpose of the letting contract for both parties was frustrated. The impossibility was subsequent since it did not occur until after the formation of the letting contract. (1)

Griffith v Brymer concerned the same factual event - letting a room to view the coronation procession. However, the legal treatment was entirely different because in Griffith, unknown to both parties, at the time they made the contract the procession had already been cancelled. This is an example of initial impossibility and a common mistake (*res extincta*) as to underlying basis of the contract. (1)

Why is this distinction important? (2)

If a contract is discharged for frustration, future obligations are excused and (if the 1943 Act applies) advance payments can be recovered (subject to possible retention for expenses) and a just sum might be recovered for a valuable benefit conferred before the frustration. (1)

On the other hand, if a contract is void for mistake, it is automatically of no effect from the very beginning, i.e. both parties hand back what they have received. There is no means, however, to recompense if expenditure has been incurred, i.e. it is not possible to retain sums from an advance payment in order to cover expenses (compare frustration) and there is no damages award for mistake. (1) This was recognised by the CA in Great Peace Shipping "Just as the Law Reform (Frustrated Contracts) Act 1943 was needed to temper the effect of the common law doctrine of frustration, so there is scope for legislation to give greater flexibility to our law of mistake than the common law allows".

6. On what basis can *Krell v Henry* and *Herne Bay Steam Boat v Hutton* be distinguished? (2)

In Herne Bay there was no frustration of the common purpose of both parties because there were two common purposes and only one of them had ceased to be possible. (2)

7. In what circumstances is it not possible to rely on the frustration doctrine despite the fact that it appears that a frustratory event has occurred? (3)

(a) If the event in question is one which is attributable to the fault (or choice) of one of the parties (self-induced frustration) - since frustration depends upon there being an event which is outside the control of **both** parties. (1)

(b) If the contract has expressly allocated this risk by providing for what is to happen in the event of this occurring (express provision). (1)

(c) If *one* party foresaw or should have foreseen the event and failed to provide for it (it is at his risk). It is not, however, clear what the position is if *both* parties foresaw or should have foreseen the event and failed to cover it (1). The House of Lords in Davis Contractors was of the opinion that this would prevent reliance on the frustration doctrine.

8. Explain the effect of s.1(2) Law Reform (Frustrated Contracts) Act 1943. (3)

(a) Advance payments made before frustration are recoverable. (1)

(b) Any payment which should have been made before frustration ceases to be payable. (Compare with Chandler v Webster). (1)

(c) BUT the court MAY allow the recipient of the advance payment to retain a sum to cover his expenses (as the court decides) up to the maximum of the advance payment (1).

9. What is the philosophy underlying Robert Goff J's approach to the 1943 Act in *BP v Hunt (No 2)*? (1)

He considered that the Act was concerned to prevent unjust enrichment (the restitution philosophy) (1).

Explain how this philosophy might relate to s.1(2) and (3). (1)

s.1(2) prevents a party keeping a deposit where the contract had not been fully performed. However, this sub-section does accept that there is not the same degree of unjust enrichment where the recipient of the deposit has incurred expenses in seeking to perform pre-frustration. That person ought, in such circumstances, to be allowed to keep some (or all) of the advance payment to cover this.

s.1(3) also operates to prevent unjust enrichment by requiring a party who has received a benefit for which he has not paid, to compensate the other party for that benefit based on the value of the benefit to the recipient of it (and no more). This is intended to prevent the recipient from being unjustly enriched at the expense of the performing party. N.B. No unjust enrichment if the end product of the benefit is not there because it has been destroyed by the frustrating event. (1)

10. Explain the significance of the decision of Garland J in Gamerco v ICM (1).

It confirms the court's discretion when determining whether to allow retention of expenses out of any advance payment under s.1(2). The judge rejected suggested

approaches of allowing total retention and equal division (apportioning loss) in favour of a broad discretion approach i.e. look at all the circumstances and losses of both parties and use this information to determine whether it was “just” for the recipient of the advance payment to keep all or any of the advance to cover expenses. On the facts not allowed anything for expenses. (1)

11. What is the alternative philosophy suggested by some academics - and why? (4)

The alternative suggested philosophy is that the Act should be based on a philosophy of apportioning losses (2).

The idea behind this is that the 1943 Act was intended to remedy the problems at common law (that the loss should lie where it fell) because this had harsh consequences. This philosophy also argues that the basic problem with frustration is that the event is outside the control of the parties and therefore they should share the loss equally (2). It is suggested that the problem with Goff's approach is that it concentrates only on benefits and forgets to account for losses suffered.

12. Explain how the courts would assess the just sum to award under s.1(3) of the 1943 Act. (4)

The case authority on this is the decision of Robert Goff J in BP v Hunt

(a) Identify the benefit (as end product of services and not the services themselves) and value that end product benefit to the party receiving it (1) after having taken account of any monies already paid for that benefit and the effect of the frustration on the benefit.(1) If the end product is destroyed by the frustration then the award must be nil. (1)

(b) Ascertain the just sum to award by fixing a reasonable value to award the party conferring the benefit and award that sum (up to the maximum of the value of the end product to the party receiving it). (1)

13. Distinguish what is meant by a contract that is void for mistake from a contract that is merely voidable. (2)

Void means that the contract is automatically of no effect from the very beginning.(1) Voidable means that one party has a remedy of rescission and, unless one of the bars to rescission applies, he can exercise that remedy to set aside the contract which is then treated as being of no effect from the very beginning, i.e. not automatic - action is required. (1)

14. Explain the decision of *McRae v Commonwealth Disposals Commission* in the context of common mistake. (3)

McRae is an example of risk allocation preventing the operation of the mistake doctrine which would otherwise render the contract void. (1) The court *implied* a term whereby the risk of the existence or non-existence of the tanker was placed on the Commission which was taken to have been promising its existence. Non-existence was therefore a breach of contract by the Commission and damages were payable. (1)

If, however, there had been a mistake, the contract would have been void and the purchaser could have recovered the price paid. However, he would not have been compensated for the sums spent on the wasted salvage expedition because no damages are payable in respect of a claim in mistake. (1)

15. Why is it generally the case that a common mistake as to quality does not render the contract void ? (1)

It is not a fundamental mistake in that it does not make performance as originally agreed impossible (compare with *res extincta* and *res sua*). See Denning LJ Leaf v International Galleries - the parties are agreed in the same terms on the same subject matter. (1)

16. Can a party who made a common mistake as to quality ever avoid the contract he has made ? (3)

(a) It is unlikely that the contract will be void at common law for mistake as to quality (Bell v Lever Bros, as explained in Great Peace Shipping v Tsavliris Salvage). Lord Atkin stated that the mistake had to be as to the existence of some quality which makes the thing without the quality essentially different from the thing as it was believed to be" - but this is narrowly interpreted. See Lord Atkin's own examples of situations that would not make the contract void. The CA in Great Peace has now reformulated this test as a test of impossibility of the agreed performance or contractual adventure which also suggests a very narrow scope for such a doctrine at law (2).

(b) The Court of Appeal in Great Peace Shipping denied the existence of any equitable jurisdiction based on Solle v Butcher and cases following this authority, to

rescind (possibly on terms) for fundamental mistake in equity. (1) Bell v Lever Bros represents the entire picture on the effect of common mistake as to quality.

Points scored [maximum of 40] =