Asif Tufal

DISCHARGE OF CONTRACT

A contract may be discharged by performance, agreement, breach, or frustration.

1. PERFORMANCE

THE GENERAL RULE

The general rule is that the parties must perform precisely all the terms of the contract in order to discharge their obligations.

For example, in contracts for the sale of goods, s13 Sale of Goods Act 1979 imposes the condition that the goods must correspond with the description. The precise requirement of s13 was illustrated in:

Re Moore and Landauer [1921] 2 KB 519.

The classic example of hardship caused by this rule is the case of:

Cutter v Powell (1795) 6 Term Rep 320.

MODIFICATION OF THE GENERAL RULE

The strict rule as to performance is mitigated in a number of instances:

A) *DIVISIBLE CONTRACTS*

A contract may be entire or divisible. An entire contract is one where the agreement provides that complete performance by one party is a condition precedent to contractual liability on the part of the other party. With a divisible contract, part of the consideration of one party is set off against part of the performance of the other. See:

Sumpter v Hedges [1898] 1 QB 673
cf. *Roberts v Havelock* (1832) 3 B. & Ad. 404.

B) *ACCEPTANCE OF PARTIAL PERFORMANCE*

Where the party to whom the promise of performance was made receives the benefit of partial performance of the promise under such circumstances that he is able to accept or reject the work and he accepts the work, then the promisee is obliged to pay a reasonable price for the benefit received.

But it must be possible to infer from the circumstances a fresh agreement by the parties that payment shall be made for the goods or services in fact supplied. See:

Christy v Row (1808) 1 Taunt 300.

C) *COMPLETION OF PERFORMANCE PREVENTED BY THE PROMISEE*

Where a party to an entire contract is prevented by the promisee from performing all his obligations, then he can recover a reasonable price for what he has in fact done on a *quantum meruit* basis in an action in quasi-contract. See:

Planche v Colburn (1831) 8 Bing 14.

D) *SUBSTANTIAL PERFORMANCE*

When a person fully performs the contract, but subject to such minor defects that he can be said to have *substantially* performed his promise, it is regarded as far more just to allow him to recover the contract price reduced by the extent to which his breach of contract lessened the value of what was done, than to leave him with no right of recovery at all. See:

Dakin v Lee [1916] 1 KB 566
cf *Bolton v Mahadeva* [1972] 2 All ER 1322.

E) *TENDER OF PERFORMANCE*

Tender of performance is equivalent to performance in the situation where party (a) cannot complete performance without the assistance of party (b) and party (a) makes an offer to perform which party (b) refuses. See:

Startup v M'Donald (1843) 6 M&G 593.

STIPULATIONS AS TO TIME OF PERFORMANCE

At common law, in the absence of contrary intention, time was regarded as being of the essence. Thus if a party did not perform on time he could not enforce the contract against the other party. Section 41 Law of Property Act 1925 modified this common law rule by providing that the equitable principle shall prevail with the result that if time is not of the essence, a right to damages accrues but not a right to terminate the contract.

In equity time was not regarded as being of the essence, except in three circumstances:

A) The contract expressly states that time is of the essence.
B) Time was made of the essence by the giving of notice (during the currency of the contract) to perform within a reasonable time.
C) Where from the nature of the surrounding circumstances or from the subject matter of the contract it is clear that time is of the essence.

2. AGREEMENT

The general rule is that what has been created by agreement may be extinguished by agreement.

An agreement by the parties to an existing contract to extinguish the rights and obligations that have been created is itself a binding contract, provided that it is made under seal or supported by consideration. Where the agreement for discharge is not under seal, the legal position varies according to whether the discharge is bilateral or unilateral:

BILATERAL DISCHARGE

Bilateral discharge occurs whenever both parties to the contract have some right to surrender, eg where there has been non-performance by either party, or is partly performed by one or both parties.

The agreement by the parties to discharge their contract may be designed to have one of several effects:

(A) *ACCORD AND SATISFACTION*
The parties may intend to rescind their present agreement and nothing more. Where there is an agreement mutually to release the other from the obligations under the first agreement, there is an accord and satisfaction.

(B) *RESCISSION AND SUBSTITUTION*
The parties may intend rescission of the original contract and substitution of a new contract.

(C) *VARIATION*
The parties may agree on the variation of an existing contract, ie modifying or altering the terms of the original agreement.

(D) *WAIVER*
Where one party voluntarily accedes to a request by another to forbear his right to strict performance of the contract, or where he represents to another that he will not insist upon his right to strict performance of the contract, the court may hold that he has waived his right to performance as initially contemplated by the parties.

UNILATERAL DISCHARGE

Unilateral discharge takes place where only one party has rights to surrender. Where one party has entirely performed his part of the agreement, he is no longer under obligations but has rights to compel the performance of the agreement by the other party.

For unilateral discharge, unless the agreement is under seal, consideration must be furnished in order to make the agreement enforceable, ie accord and satisfaction.

3. BREACH

A failure to perform the terms of a contract constitutes a breach. A breach which is serious enough to give the innocent party this option of treating the contract as discharged can occur in one of two ways:

- either one party may show by express words or by implications from his conduct at some time before performance is due that he does not intend to observe his obligations under the contract (anticipatory breach); or
- he may in fact break a condition or otherwise break the contract in such a way that it amounts to a substantial failure of consideration.

One preliminary question, in cases of anticipatory breach, is to ascertain whether, once repudiation has been communicated to the innocent party, that party accepts the repudiation or not. The question of whether silence/inaction can amount to acceptance of repudiation was considered in:

Vitol SA v Norelf Ltd [1996] 3 All ER 193.

The innocent party is not under any obligation to wait until the date fixed for performance before commencing his action, but may immediately treat the contract as at an end and sue for damages. See:

Hochster v De La Tour (1853) 2 E&B 678.

If within a reasonable time the innocent party does not indicate that he accepts the other party's repudiation so that the contract is discharged, then the contract remains open for the benefit of, and the risk of, both parties. The breach was not accepted in:

Avery v Bowden (1855) 5 E&B 714.

It appears that the right to keep the contract alive subsists even where the innocent party is increasing the amount, and not mitigating, the damages which he may receive from the party in breach. See:

White & Carter v McGregor [1962] AC 413.

Where the innocent party elects to treat the contract as continuing (ie, he affirms it) the affirmation can be regarded as a species of waiver. The innocent party waives his right to treat the contract as repudiated and may be estopped from changing his election. See:

Panchaud Freres SA v Establissments General Grain Co [1970] 1 Lloyd's Rep 53.

If the innocent party elects to affirm a contract after an anticipatory breach by the other party, he is not absolved from tendering further performance of his own obligations under the contract. Consequently, the repudiating party could escape liability if the affirming party was subsequently in breach of the contract. See:

Fercometal Sarl v Mediterranean Shipping Co [1988] 2 All ER 742.

Whether the anticipatory breach amounts to a repudiation depends on the actual circumstances of the case. Lord Selborne stated in *Mersey Steel v Naylor Benzon* (1884) 9 App Cas 434:

"you must examine what (the) conduct is to see whether it amounts to a renunciation, to an absolute refusal to perform the contract and whether the other party may accept it as a reason for not performing his part."

The difficulty that can arise in determining whether the conduct amounts to a repudiation is illustrated by a comparison of two decisions in the House of Lords:

Federal Commerce & Navigation v Molena Alpha [1979] AC 757
Woodar Investment v Wimpey Construction [1980] 1 WLR 277.

4. FRUSTRATION

The doctrine of frustration operates in situations where it is established that due to subsequent change in circumstances, the contract is rendered impossible to perform, or it has become deprived of its commercial purpose by an event not due to the act or default of either party.

Frustration is not to be confused with initial impossibility, which may render the contract void *ab initio*. See *Couturier v Hastie* (1856) 5 HL Cas 673 (Handout on Mistake).

TESTS FOR FRUSTRATION

There are two alternative tests for frustration:

(1) The implied term theory, as in:

Taylor v Caldwell (1863) 3 B&S 826.

Lord Loreburn explained in *FA Tamplin v Anglo-Mexican Petroleum* [1916] 2 AC 397, that the court:

'… can infer from the nature of the contract and the surrounding circumstances that a condition which was not expressed was a foundation on which the parties contracted … Were the altered conditions such that, had they thought of them, the parties would have taken their chance of them, or such that as sensible men they would have said "if that happens of course, it is all over between us".'

(2) The radical change in the obligation test. This was adopted by the majority of the House of Lords in:

Davis Contractors v Fareham UDC [1956] AC 696.

In *National Carriers v Panalpina* [1981] AC 675, Lord Wilberforce was reluctant to choose between the theories. He took the view that they merged one into the other and that the choice depends upon "what is most appropriate to the particular contract under consideration".

EXAMPLES OF FRUSTRATION

A) *DESTRUCTION OF THE SPECIFIC OBJECT ESSENTIAL FOR PERFORMANCE OF THE CONTRACT*

The destruction of the specific object essential for performance of the contract will frustrate it. See:

Taylor v Caldwell (1863) (above).

B) *PERSONAL INCAPACITY*

Personal incapacity where the personality of one of the parties is significant may frustrate the contract:

Condor v The Baron Knights [1966] 1 WLR 87
Phillips v Alhambra Palace Co [1901] 1 QB 59
Graves v Cohen (1929) 46 TLR 121
FC Shepherd v Jeromm [1986] 3 All ER 589.

C) *THE NON-OCCURENCE OF A SPECIFIED EVENT*

The non-occurence of a specified event may frustrate the contract. Compare the leading cases:

Krell v Henry [1903] 2 KB 740
Herne Bay Steamboat Co v Hutton [1903] 2 KB 683.

D) *INTERFERENCE BY THE GOVERNMENT*

Interference by the government may frustrate a contract. See:

Metropolitan Water Board v Dick Kerr [1918] AC 119.

E) *SUPERVENING ILLEGALITY*

A contract may become frustrated if it later becomes illegal. See:

Denny, Mott & Dickinson v James Fraser [1944] AC 265
Re Shipton, Anderson and Harrison Brothers [1915] 3 KB 676.

F) *DELAY*

Inordinate and unexpected delay may frustrate a contract. The problem is to know how long a party must wait before the delay can be said to be frustrating. See:

Jackson v Union Marine Insurance (1873) LR 10 CP 125.

LIMITATIONS OF THE DOCTRINE

- 'The doctrine of frustration must be applied within very narrow limits', per Viscount Simmonds in *Tsakiroglou* [1961] (below).
- Lord Roskill said that the doctrine of frustration was 'not lightly to be invoked to relieve contracting parties of the normal consequences of imprudent commercial bargains', in *Pioneer Shipping v BTP Tioxide* [1982] AC 724.

A) *EXPRESS PROVISION FOR FRUSTRATION*

The doctrine of frustration cannot override express contractual provision for the frustrating event.

B) *MERE INCREASE IN EXPENSE OR LOSS OF PROFIT*

The mere increase in expense or loss of profit is not a ground for frustration. See:

Davis Contractors v Fareham UDC [1956] AC 696
Tsakiroglou v Noblee Thorl [1961] 2 All ER 179.

C) *FRUSTRATION MUST NOT BE SELF-INDUCED*

See:

Maritime National Fish v Ocean Trawlers [1935] AC 524.

D) *FORESEEABILITY OF THE FRUSTRATING EVENT*

A party cannot rely on an event which was, or should have been, foreseen by him but not by the other party. See:

Walton Harvey Ltd v Walker & Homfrays Ltd [1931] 1 Ch 274.

EFFECTS OF FRUSTRATION

The Law Reform (Frustrated Contracts) Act 1943 was passed to provide for a just apportionment of losses where a contract is discharged by frustration. (For the previous inflexible common law rules see ILEx Textbook, 13.5.4)

(A) *RECOVERY OF MONEY PAID*

Section 1(2) provides three rules:

- Money paid before the frustrating event is recoverable, and
- Money payable before the frustrating event ceases to be payable, whether or not there has been a total failure of consideration.
- If, however, the party to whom such sums are paid/payable incurred expenses before discharge in performance of the contract, the court may award him such expenses up to the limit of the money paid/payable before the frustrating event.

For an example, see:

Gamerco v ICM/Fair Warning (Agency) Ltd [1995] 1 WLR 1226.

(B) *VALUABLE BENEFIT*

Section 1(3) provides:

- If one party has, by reason of anything done by the other party in performance of the contract, obtained a valuable benefit (other than money) before the frustrating event, he may be ordered to pay a sum in respect of it, if the court considers it just, having regard to all the circumstances of the case.

A case has discussed, *inter alia*, the meaning of the words 'valuable benefit'. See:

BP Exploration v Hunt [1982] 1 All ER 925.

(C) *SCOPE OF THE 1943 ACT*

Section 2(3) permits contracting out.

Section 2(4) provides that the Act does not apply where wholly performed contractual obligations can be severed from those affected by the frustrating event.

Section 2(5) provides that the Act does not apply to:

- Contracts containing a provision to meet the case of frustration;
- Charterparties (except time charterparties or charterparties by demise);
- Contracts for the carriage of goods by sea;
- Contracts of insurance;
- Contracts for the sale of specific goods, which perish before the risk has passed to the buyer.