

Restitutionary Principles and The Frustrated Contracts Act 1944

by

Pauline Moran

It is possible to state in a few words the main provisions of the Frustrated Contracts Act 1944. It provides for the return of money already paid, subject to the Court's discretion to allow for the payee's expenses, and for the payment of a just sum for any valuable benefit obtained by one party from the contractual performance of the other. It does not define frustration or give any substantive law as to when contracts will be held to be frustrated; but once a Court finds that a particular contract fits into section 3(1) then the Act applies to regulate the consequences of frustration.

The doctrine of frustration allows the parties to be discharged from future contractual performance thus lessening the harshness which had resulted from the *Paradine v. Jane*¹ rule of absolute contracts. But since frustration does not make a contract void *ab initio* there was still the problem of losses already suffered and performances partly given. At Common Law the loss was said to lie where it fell; no new rights could accrue after the frustrating event but accrued rights remained unaffected, and the rule in *Chandler v. Webster*² disallowed, where the contract had been frustrated, recovery in quasi-contract for money paid under a consideration that had failed.

The Frustrated Contracts Act 1944 enacts and extends the decision of the House of Lords in the *Fibrosa Case*³ which revised the *Chandler v. Webster* rule. It not only alters the old solution of leaving the loss where it had fallen, but gives certain principles to guide the Courts in

¹ (1648) Aleyn 26.

² [1904] I.K.B. 493.

³ *Fibrosa Spolka Akeyjna v. Fairbairn Lawson Combe Barbour Ltd.* [1943] A.C. 32.

their task of adjusting rights and losses of the parties to a contract to which the Act has been found to apply. It does not give a completely free rein to them for some limits are placed on whether an award can be made and on what can be awarded; but within those limits it should be possible for a court to exercise its discretionary powers to achieve a just and equitable result.

The problem with the *Fibrosa* decision, in allowing B to recover money he had paid to A, was that it was not a just result if A had begun performing and had thereby incurred expenses and losses, unless of course he had been able to use the product of his performance to compensate himself for that loss. Yet it is difficult to see why it was any more just for A to suffer loss in having to return the money paid, than for B to suffer loss if he were not permitted to recover it. It would seem that a fairer solution would be for them to share the loss, as presumably they would have shared the advantages had the contract been carried out. But since the Common Law did not allow apportionment, sharing the loss was not possible unless the Legislature did something about it; but according to Goff and Jones⁴:

The Act does not contemplate the possibility that loss should be apportioned between the parties . . . there is only a limited jurisdiction to make to either party any allowance for expenses incurred. Nor is the Act conceived to put the parties in the position in which they would have been if the contract had been performed or, conversely, to restore the parties to the position they were in before the contract was made. The fundamental principle underlying the Act is quite simply the principle of unjust enrichment.

If unjust enrichment is the basis for restoring benefits conferred by one party under a frustrated contract, then the first duty of the Court in applying the Statute will be to identify any such benefit gained. Sometimes this task will be easy. If A has received money from B under the contract then A has obviously been enriched. Moreover that enrichment to A will usually equal the loss suffered by B so that as long as A restores the money to B equilibrium is again reached. By following section 3(2) the Court's task of dealing with money benefits will be straight forward. Where under the contract one party has paid money to the other before the time of discharge he can recover that money. If money should have been paid before that time, and was not, it need no longer be paid.

A more difficult task faces the Court in deciding whether, and how, to exercise its discretionary power to give effect to the proviso to this subsection, which permits the payee to receive an allowance for expenses he may have incurred. McNair⁵ describes the proviso as equipping the party who was, according to the contract, due to receive some money prior to the frustrating event, with both a shield and a

⁴ The Law of Resitution, (2nd Ed. 1968), 565.

⁵ (1944) 60 L.Q.R. 160.

sword—allowing him to retain all or part of the money already paid; if not yet paid, allowing him to recover all or part of that money which otherwise B would not be required to pay. The important point is that in neither situation can A recoup his losses as of right for the Act does not make it mandatory for the Court to allow the payee to retain or recover his expenses. To begin with the Act gives certain criteria to be satisfied. The expenses must have been incurred before the time of discharge, and in the performance of the contract or for the purpose of that performance. Although this last part is not entirely clear presumably there must have been something more than expenditure which was merely in preparation for a contract. An example could be where a manufacturer, having made a contract to produce particular items, pays for and installs in his factory special machinery necessary to manufacture them.

If the Court does decide to allow A to retain or recover something towards his expenses incurred, it must then decide how much, and this will not necessarily equal the losses he has incurred. The Act sets an upper limit—no more than his expenses, and if the money has not yet been paid no more than had been payable. In considering A's expenses the Court would also have to take into account the amount to which such loss has been reduced e.g. if A has sold the ordered machines left on his hands in a *Fibrosa* situation. It is A's net loss rather than the quantum of his expenses which is relevant. Other than that, it is up to the Court to decide how much, in effect, B should be asked to share A's losses and it can in fact prevent B from recovering any of the money he has already paid or ask him to hand over the whole amount payable before discharge. From the wording it seems also that if B had paid money in advance, even though he was not required to do so under the contract this could also be caught by the proviso making him liable for A's losses.

In his book⁶ on the United Kingdom Statute, Williams points out that much is left to the Court's sense of justice and he writes⁷:

In thus expressly turning "justice" into law the Act leaves much scope for argument as to what "justice" requires. The situation with which the Act is concerned is the familiar one in which one of two parties has to suffer loss for which neither is responsible. In my submission, natural justice does not indicate either of such parties as the one to bear the whole of the loss. Natural justice neither says that the loss shall lie where it falls, nor yet says that the loss shall be picked up from where it happens to fall and transferred to the shoulders of the other party who would otherwise not have borne it.

The effect of the proviso to section 3(2) seems to be that if one party suffers loss in beginning to carry out his contractual obligation, whether or not that loss will be left with him depends on whether the contract contained a stipulation for some payment in advance. If there

⁶ G. L. Williams, *Law Reform (Frustrated Contracts) Act (1943), (1944)*.

⁷ *Ibid.*, 35.

has been, then the Court may, “if it considers it just to do so”, allow that loss to be shared by the other party or even wholly transferred to him. The Act appears to assume that in stipulating for an advance payment the parties intended A to be protected against such losses should the contract be frustrated, by being able to shift that loss, or part of it, to B. Yet there may have been quite different reasons for such a stipulation—A may have been worried about B’s solvency, or he may have needed an advance in order to begin carrying out his side of the contract. In *Fibrosa* Lord Porter said⁸:

... probably it is possible to say that the seller . . . prudent enough to stipulate for payment in advance should reap the advantage of his foresight but to do so is to speculate as to the object for which the advance was obtained, not to ascertain what his legal remedies are upon the facts as known.

Yet by linking recovery for expenses with advance payments the Act is in fact making that speculation.

In this respect the Frustrated Contracts Act appears to have a similar defect to the *Chandler v. Webster*⁹ rule, making the final rights of the parties depend on whether advance payment had been a term of the contract or not. If it were not, then the party incurring loss through his part performance gets no help, at least not from section 3(2). If the Court does decide that it is just for A to receive some allowance for his expenses, it would perhaps be fairer to limit his retention or recovery of B’s money to half his losses incurred. This would mean that both parties would restore any benefits obtained, and would share equally in expenses incurred by either. An alternative but less fair solution would be for them to restore any benefits but to leave any loss from expenses where it fell. The real problem with the proviso is that A’s loss arising from his expenditure may not be balanced by any gain to B so that allowing A to retain or recover perhaps even up to the full amount B has prepaid, is not a proper application of the principle of unjust enrichment.

The other subsection under which a Court will be asked to deal with a claim is section 3(3) which protects the restitutionary interest of the partial performer—where A’s loss has led to B’s enrichment then it is only just that A should recover. The subsection is independent of the previous one and applies regardless of whether money was paid or payable before discharge. It allows the partial performer, of a contract which is held to be frustrated, to recover a just sum, if, by his performance, the defendant has “obtained a valuable benefit other than a payment of money”.

Certain guidelines are given to the Court to help it, after deciding that a benefit has indeed been conferred, to assess the amount to be

⁸ *Supra* at 78.

⁹ *Supra*.

awarded to the plaintiff. As well as being limited to the value of the benefit received the sum awarded must be a just one having regard to all the circumstances. The Act makes particular mention¹⁰ of any expenses incurred by the defendant in his performance of the contract including what he may already have had to allow to A under the proviso. If A, receiving an advance payment, had incurred expenses *and* had conferred a benefit on B, he would be able to claim those expenses or part of them, but he would not be compensated twice for his losses. In making any award to him relating to B's benefit the Court is to take into account what he may have already received. It is also¹¹ to have regard to how the circumstances which led to the contract being frustrated affect the benefit received by B. The meaning of this is not entirely clear—it could mean that if those circumstances have themselves increased or decreased B's benefit then to that extent the Court should increase or decrease the award to A. Such an interpretation could lead to the fact of frustration allowing A to be awarded more than he would have received had the contract been completed. However this paragraph is construed, it should not be allowed to fetter the Court's discretion to award a just sum. Another point here is that although the Act directs the Court to award a "sum", a money payment, it is presumably possible in appropriate circumstances for the return of the benefit itself to be returned in specie.

The effect of section 3(3) is to abrogate the rule in *Appleby v. Myers*¹² in respect of a frustrated contract, and thus allow a partial performer to recover if it is found that his performance has conferred a benefit on the defendant. The task for the Court is to decide whether in fact a benefit has been conferred and if so, what would be a just sum to award. The first difficulty for the Court is to identify and value the benefit. This value will not necessarily be the amount awarded but it has to be assessed since it forms the upper limit to what can be awarded to the plaintiff. A further difficulty will arise where the benefit is conferred on B as a result of A's services. Is the value of the benefit, the value of the services rendered or is it the end product of those services? The latter could be expressed as the actual benefit which B derives from them or the extent to which it can be said that B's assets have been increased by A's services. It would seem that the plaintiff is making a quasi contractual claim against a benefit conferred at the defendant's request which it is unjust for the defendant to keep. If so, should not recovery rest on a quantum merit basis, reasonable remuneration for services given? But this does not appear

¹⁰ Section 3(3)(a).

¹¹ Section 3(3)(b).

¹² (1867) L.R. 2 C.P. 657.

to be the principle intended by the Frustrated Contracts Act where the emphasis is on the value of the benefit to the defendant rather than the value of the plaintiff's performance.

In the only case in which the United Kingdom Statute Act has been applied, *B.P. Exploration Co. (Libya) Ltd v. Hunt*¹³ Goff J. referred to these difficulties and said that they could all have been avoided¹⁴

... if the legislative had thought it right to treat the services themselves as the benefit. In the opinion of many commentators, it would be more just to do so; after all the services in question have been requested by the defendant, who normally takes the risk that they may prove worthless from whatever cause.

However, he held that the legislative intended the value of the benefit to be the end product (at least where the service was of the kind that resulted in an end product) and the Court's job was to construe the Act.

A further difficulty arises in the *Appleby v. Myers*¹⁵ factual situation where work done by the plaintiff to the defendant's property is destroyed along with the property. There are conflicting views among academic writers as to whether in such a situation B has actually received any benefit against which A can claim. Keener¹⁶ finds no benefit; Woodward's view is that in carrying out such work at the defendant's request the plaintiff has conferred a benefit.¹⁷

... every writ or particle of material which, in accordance with the defendant's wish, is irrevocably appropriated to the improvement of the defendant's property, and every stroke of labour performed upon such material or upon the property improved, constitutes a benefit to the defendant and the failure of the defendant to use or occupy such improvement ... clearly cannot affect the right of recovery.

In support of this view that in such a situation a benefit has been conferred one could argue that if, just before its destruction, B had sold his property, he would have received an increased price as a result of A's work. Moreover if B had adequately insured his property the benefit accruing from A's work would be reflected in the value of B's claim on this policy. Against this of course is the argument that the benefit must be valued at the time the contract is frustrated which here is the moment of destruction. Cheshire and Fifoot contend that "a notional benefit is not a valuable benefit"¹⁸ and that if the legislative had wanted to allow recovery in the *Appleby v. Myers*¹⁹ situation it would have made the right to recovery depend on the work done by the plaintiff rather than the benefit obtained by the defendant. The New Zealand Supreme Court decided this was the correct way to apply their Act, in a case where under an entire contract the plaintiff

¹³ Unrep. 1978, Q.B.D.

¹⁴ Quoted in Goff & Jones, *op.cit.*, 570.

¹⁵ *Supra*.

¹⁶ *Quasi Contracts*, (1926).

¹⁷ *Quasi Contracts*, (1913).

¹⁸ *Law of Contract* (4th Ed. 1974), 480.

¹⁹ *Supra*.

had partly installed plumbing and heating equipment in the defendant's hotel before the building was burnt down. The Court held that the Statute quite clearly allowed them to make an award "related solely to the value of the benefit and not to the value of the work done".²⁰

If the Court decides that a benefit has been conferred so that it then has the further task of assessing a just sum to award the plaintiff, the question arises whether it should look to the contract price which both parties had agreed would be paid if the contract had been completed. It could often happen that the value of the work done has altered considerably by the time of discharge or assessment, or it may be that one party has made a particularly good, or bad, bargain when the contract was made. This point was considered at some length in the *B.P. Exploration* case.²¹ Goff J. decided that the contract is evidence of what is a rateable part of the fee promised and would show what would be considered a reasonable sum for the plaintiff's performance and thus a fair amount to award him. He also thought that if the contract showed that it was intended that the plaintiff would get something more than just a contract fee, e.g. a share in the concession to the successful prospector, then it would be right for the Court to consider this and perhaps increase its award to the plaintiff.²² Furthermore it can be argued that it is just for a Court to limit its award to a rateable part of the contract price regardless of the value of the benefit to the defendant, because at the time the contract was made the parties did not intend that in any circumstances, including frustration, the plaintiff should recover more than he had contracted to receive, nor the defendant to pay more. Goff J. stated²³ that in most cases the contract consideration will impose a limit on the sum the Court should award which "may well be the most relevant limit to an award under section 1(3) of the Act".

Any acceptance by the Court of such limitation to the award by reference to the contract, as has been suggested, is not to be confused with the Court's application of section 4(3), by which it must give effect to any express provision included in the contract and intended to operate under the circumstances which have arisen. Here the Court must decide whether in fact the parties have provided for the allocation of risk of loss arising from a frustrating event, or whether a party has modified its statutory right to restitution of the benefits conferred under a frustrated contract. Possibly a Court should be more ready to find that the parties have contracted so as to exclude parts of section

²⁰ *Parsons Bros Ltd v. Shea* (1965) 53 D.L.R. (2d) 86, at 92.

²¹ *Supra*.

²² This argument is compared to that in *Way v. Latilla* [1937] 3 ALL E.R. 795.

²³ Quoted in Goff & Jones, *op.cit.*, 575.

3(2) than to find that they intended to exclude section 3(3) (unless of course it is expressly excluded). If it is held that that subsection has been excluded by the contract then the parties will be back with the rules of Common Law which could then result in an arbitrary forfeiture of all payments by one party while the other party may have received and can keep the valuable benefit of the former's services.

After looking at the difficulties a Court faces in dealing with claims under this Act it is interesting to see how similar situations are dealt with in the United States' jurisdictions, according to a recently published text.²⁴ In the *Appleby v. Myers* type problem where the contract is to add to or improve existing buildings, whether the builder can recover in quasi contract depends on the "incorporation test"—whether the labour and materials are held to have been wrought into the owner's property before its destruction. If they have not been then the loss falls on the builder. This seems to be much like the concept of passing of risk with passing of property in the sale of goods and Palmer does point out that the cases show that so far the test has been applied only where the claimant has performed services and supplied materials, but not where the claim is for services only e.g. for a builder rather than an architect.

The meaning given by most United States' jurisdictions to "benefit" in the circumstance of contracts discharged by frustration is allied to the "bargained for performance" concept, as work done at the request of the defendant, with the associated idea of the benefit accruing as the performance occurs, an ongoing thing. This concept can also be applied to the previous situation so that even if the frustrating event destroys the end product of the performance A can recover because he has been conferring a benefit on B while he has been supplying B with the bargained for performance i.e. according to B's request. In Palmer's analysis of American cases he finds that most emphasise this concept of benefit rather than the pecuniary advantage aspect, to what extent B's assets have been increased.²⁵

When the plaintiff's performance was designed to produce a product or a result, the recoverable benefit is the performance itself not the product.

This concept of benefit as the bargained for performance simplifies the assessment of what the plaintiff can recover. If he is entitled to restitution of the benefit conferred on the defendant, the performance itself, then according to Palmer the measure of his recovery is the fair market value of that performance but this may be altered by reference to the actual contract price. In his opinion this would mean if the reasonable value of A's performance is more than the proportion of the contract price (for the part performed) recovery will be limited to

²⁴ Palmer, *The Law of Restitution*, (1978).

²⁵ *Ibid.*, ii, 123.

the latter, but if the value of the benefit conferred is less than the contract price the plaintiff should be able to recover the higher amount. His argument is that value should be finally assessed not by general market standards but by the standards adopted by the parties in their contract. He admits that this is not the principle enunciated in the Restatement; it adopts the pro rata formula, with reference to the contract consideration to limit recovery, but not to allow an excess amount over the value of the performance. Palmer does concede that even using his assessment principle, an excess award should be allowed only when it is just to do so, and it would not be so in the situation where recovery was allowed to A even though the actual benefit had been destroyed.

Many of the shortcomings of the Frustrated Contracts Act have been referred to in the preceding pages: the linking of the proviso with the accident of stipulations for payment in advance, which can result in a transfer of loss which is no more just than to leave it where it fell; the difficulties stemming from the Act's emphasis on benefit to the defendant as the basis for recovery, rather than the reasonable value of the plaintiff's performance. Another shortcoming is that the Act makes no provision for the Court to consider the time value of money. Even though money may have been paid or benefit conferred long before the date of frustration, yet the sum recoverable may be no greater despite the defendant having had the use of that money for several years. Perhaps one could argue that although the Act makes no reference to the time value of money, it is open to the Court to consider it as another circumstance to be taken into account in reaching a just result.

A further shortcoming could be that section 3(2) makes no allowance for recovery of money paid after the time of discharge, perhaps paid because the payer was unaware of the frustrating event, or did not know that this was sufficient to frustrate the contract. However in the first situation he would possibly recover in quasi contract for mistake of fact; in the second, if found to be mistake of law, help could be given under section 94A of the Judicature Amendment Act 1958.

In 1961, writing on the reform of the law of Restitution, Goff pointed out²⁶ another shortcoming—that the Act gives such a wide discretion to the Court that it is extremely difficult for a lawyer to be able to advise a client, with any certainty, on whether he is likely to succeed in a claim under the Act. I prefer to see this wide discretion as a merit rather than a shortcoming. It will allow a Court, after complying with the limits placed on it by the Act, to exercise those discre-

²⁶ (1961) 24 M.L.R. 85.

tionary powers according to the restitutionary principles which will achieve the most just solution.