

Diagram 7B

A contract is frustrated by the happening of an unforeseeable and catastrophic event, for which neither party is responsible- An event that makes the contract **radically different** from the one that the parties originally entered into.

The situation is simple if the contract is executory; that is, if neither party has started to perform the contract. The contract simply disappears and each party is released from its obligations.

Things get more tricky when the contract is partly executed; that is, if one or both parties have started performing the contract.

In these circumstances, When a contract is frustrated, what happens to the gains and losses resulting from that performance? Diagram 7B sets out the situation under the common law and under Law Reform (Frustrated Contracts) Act 1943 which has replaced the common law.

1. Take a contract where party A is to pay £50,000 in exchange for 10 musical performances from party B. The parties start to perform, and then the contract is frustrated by some unforeseen disaster befalling the concert venue or the band.
2. The relevant factors to be taken into account are:
 - 2.1 A\$: any sum that A has already paid to B, the performers
 - 2.2 A\$ due: any sum that has already fallen due for payment from A to B, but not yet paid,
 - 2.3 B expenses: B's wasted expenses, eg in preparing for the concerts.
 - 2.4 B non-\$: the value of any benefits B has already conferred on A, for example promotional videos,
 - 2.5 but taking into account:
 - how those benefits are valued in the contract,
 - the impact of the frustrating event (eg if it is reduced or wiped out) and
 - whether B kept or returned any money paid by A.

2.6 Again, also relevant is A's expenses: A's expenses other than in payments to B eg in advertising the concerts, which is now wasted as a result of the frustration.

3. Can A recover any payments he has made to B?
4. At Common Law (now superseded by the 1943 Act), the general approach was to let losses lie where they fall. So, A can't recover any payments made.
5. An exception was recognized in the *Fibrosa* case in 1943: A can recover his payment but only if there is a 'total failure of consideration' from B. That is, if A has received nothing of the performance that he was entitled to under the contract from B. In this case, A can recover all of his payment.
6. In the same year, the Law Reform (Frustrated Contracts) Act changed the rule completely. Under section 1(2), A can recover his payment without having to prove 'total failure of consideration'.
7. But, the amount A can reclaim can be reduced to take into account B's 'just expenses' in performing the contract, if it is 'just to do so in all the circumstances'. Note that no express account is taken of A's wasted expenses.
8. The Act does not say how B's 'just expenses' should be calculated. There are 3 options set out in the *Gamerco* case:
 - 1st, B can deduct **all** his expenses from the sum to be returned; this puts all the loss resulting from the frustration on A.
 - 2nd, we could let B deduct **half** his wasted expenses, but this may still does not redress the imbalance of taking no account of A's wasted expenses.
 - 3rd, we could allow the courts a **broad discretion to do justice** in the circumstances. This was the approach adopted in the *Gamerco* case, where a performance by Guns N' Roses was frustrated before any performances were given- the band had to return the £412,000 it received from the promoters. The

band was not allowed to deduct any of its wasted expenses of £50,000 since the promoters had wasted a further £450,000 due to the frustration.

So one criticism of the act is that it does not take account of the payor's wasted expenses. In *BP v Hunt*, Goff J said that actions under the LRFCA were **restitutionary** in nature. Its purpose is not to apportion the wasted expenses between the parties, but to respond to unjust enrichment when a contract is discharged by frustration.

9. But, the Act **does** allow limited loss apportionment in its recognition of the payee's 'just expenses'. This is limited because B can only set off his just expenses against what he has received. If he has spent more than he has been paid, then that is just tough... unless, B, the payee, shows that he is owed a *further* sum from A.

10. At Common Law, if A owes B a sum at the time of frustration, then A must still pay it, even after the frustrating event.

11. Under the Frustrated Contracts Act, A need not pay this. But, B can claim it as part of his 'just expenses'. If B's expenses exceed the amount he has received, he can offset it against the sum owing but not yet paid. If B has not received any payment, B can make a fresh claim for the sum payable. Again, if B's expenses exceed the amount paid and payable, that is too bad. He must shoulder that loss.

12. What about B's claim for non-money benefits conferred on A in performance of the contract?

13. The common law did not allow such a claim; losses lay where they fell. B could only claim any sums which were 'due' but not yet paid.

14. But under section 1(3) of the Frustrated Contracts Act, B can claim what's called a 'just sum'. This is potentially rather complicated, as the *BP v Hunt* case shows. Goff J presented it as a two stage process:
At stage 1 we have to work out the value of the benefit received by A.
With goods, we assess its market value. With services, we have to value the end product, if there is one (eg building a house). Only if there is no end product (eg a violin performance), do we value the services themselves.

If the performance is partial and not complete, it may be very difficult to value (eg half a hair cut is not worth half of a whole haircut), so some discretion has to be exercised here.

The frustrating event may reduce or completely destroy the benefit B transfers to A. Goff J says that we must take this into account at stage 1. But, this is inconsistent with the actual wording of the Act which makes it just one of the factors to be taken into account at Stage II when the court assesses the 'just sum' to be awarded to B. An advantage of putting this factor at stage II is that even if the frustrating event does completely destroy the benefit, B may still get something rather than nothing.

15. The court must also take into account the following factors at Stage II: The value of B's expenses and services. In *BP v Hunt*, the court took this as the value that the contract put on B's services. This means that section 1(3) claims will usually amount to the proportion of the contract price which corresponds to the proportion of contractual performance up to the date of frustration.

The court should also take account of A's expenses in performing the contract including any claim A may have under section 1(2) for sums paid to B. So we can roll B's claim and A's counter claims into one.

The assessment should be made as at the date of frustration.

16. In sum, B's section 1(3) award will be a sum not exceeding B non \$ (the value of the benefit conferred on A)- taking account of:

- The effect of frustration on this value;
- The contract valuation of B's expenses and services;
- Whether any payments from A to B has been returned to A or retained by B; and
- A's wasted expenses.