

## Practice questions for Chapter 11 – Discharge of the contract

### Essay question

'The overriding concern within the classification of contractual terms is ensuring the remedies available equate to the severity of the breach.'

Discuss.

### Introduction

- Point out that contracts are made up of various terms, differing in character and importance. The parties may regard some as vital, others as subsidiary. State this in this essay, you will discuss to what extent the severity of a breach determines the remedies available.

### Conditions

- A condition is regarded as a major term, an essential term, that is, one which goes to the root of the contract. If such a term does go to the root of the contract, the courts will likely classify it as a condition.
- In some cases, the court may be bound to classify a term as a condition. In some industries, parties trade on standard terms, and therefore a court decision that a particular term is a condition will not only affect that contract, but all other contracts within the industry.
- The parties themselves may expressly classify a particular term as a condition and, whilst such a classification is not binding on the court, it is usually followed (self-classification is discussed a later problem question).
- Statute may expressly define certain implied terms as being conditions or warranties. Judicial decisions have classified certain types of term as conditions.
- If a party breaches a condition, the consequence is serious since it entitles the other party not only to sue for damages, but also to terminate the contract. He can also, if he wishes, simply affirm the contract.
- The point to note is that where a term is classified as a condition or warranty by statute or binding precedent, then the severity of the breach may bear no relevance to the remedy involved, and a party may be able to terminate, even where the effects of the breach are minor.

### Warranties

- A warranty is regarded as a more minor term of the contract, that is, one which imposes a term that is ancillary to the contract. One case has described it as 'an agreement which refers to the subject matter of a contract, but, not being an essential part of the contract either intrinsically or by agreement, is collateral to the main purpose of such a contract.'<sup>1</sup>
- Ordinarily, breach of a warranty only gives a party the right to sue for damages only (that is, the non-breaching party cannot terminate the contract). Due to the development of the innominate terms, classification of a term as a warranty these days is rare.

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<sup>1</sup> *Dawsons Ltd v Bonnin* [1922] 2 AC 413 (HL) 422 (Lord Haldane).

## Distinguishing between conditions and warranties

- Distinguishing between conditions and warranties can be problematic in practice because the test used by the courts is based upon the parties' intentions. In the absence of the parties classifying a particular term, the test used was set out in the case of *Bentsen v Taylor, Sons & Co (No 2)*.<sup>2</sup> Here, Bowen LJ stated:

There is no way of deciding that question except by looking at the contract in the light of the surrounding circumstances, and making up one's mind whether the intention of the parties, as gathered from the instrument itself, will best be carried out by treating the promise as a warranty sounding only in damages, or as a condition precedent by the failure to perform which the other party is relieved of his liability.

- Traditionally, the difference between conditions and warranties has been demonstrated by comparing two cases with similar facts.
- In *Poussard v Spiers and Pond*,<sup>3</sup> an actress was employed to play the leading role in an operetta for a season. However, she was unable to take up her role until a week after the season had begun, with the result that the producers had to engage a substitute. When she eventually appeared, the producers refused her services and purported to terminate the contract. The actress sued for breach of contract and lost her case.
- It was held that since the opening night of the operetta was regarded as of the utmost importance, her absence amounted to a breach of condition which entitled the producers to terminate the contract.
- This case can be contrasted with the case of *Bettini v Gye*,<sup>4</sup> which also concerned a singer employed for a season. Part of the contract required him to appear six days before the start of the season to engage in rehearsals, but he only arrived three days in advance. The producers sought to treat his absence as breach of a condition and therefore considered that they had a right to terminate the contract.
- The singer sued for breach of contract and was successful. The court held that the terms regarding rehearsals were only ancillary to the main terms of the contract (that is, they were only warranties). The producers were therefore only entitled to sue for damages.
- One final point to note. There are statutory exceptions to the above. The Sale of Goods Act 1979 was amended by the Sale and Supply of Goods Act 1994. It inserted a new s 15A which deals specifically with breach of the implied conditions contained in ss 13-15 of the 1979 Act.
- Section 15A states that breach of the above implied conditions will be classed as a mere breach of warranty if the buyer does not deal as a consumer and the breach was so slight that it would be unreasonably to reject the goods. Obviously, the principle embodied in s 15A is in line with the quote in our question – that the remedy should match the extent of the breach.

## Advantages and disadvantages of the traditional condition/warranty distinction

- The obvious advantage of classifying a term as a condition or warranty approach is certainty. If the parties know what type of term has been breached, they will also know what action is appropriate. For example, if the term breached is a condition, the parties will know for certain that they have a right to terminate.

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<sup>2</sup> [1893] 2 QB 274 (CA).

<sup>3</sup> (1876) 1 QBD 410 (DC).

<sup>4</sup> (1876) 1 QBD 183 (DC).

- However, this need for certainty must be weighed against the need to reach a fair decision in individual cases. Since *any* breach of a condition gives rise to a right of termination, the non-breaching party could terminate the contract even though the breach is trivial, and even though there has been little suffering as a result.
- For example, in certain shipping contracts, the goods must be shipped within a shipment period specified in the contract. If the goods are shipped one day later, or even earlier, than the specified shipping period, the buyer is entitled to repudiate the contract and reject the goods, even though the breach has caused no loss.
- Because of the unfairness of this approach, the traditional approach of classifying terms as conditions or warranties has fallen out of favour. Emphasis is now placed on a more flexible test, which bases the right of termination on the seriousness of the breach. This is the concept of the innominate term.

### Innominate terms

- An innominate term is one that defies classification. The effect of breach of an innominate term depends on the effects of the breach. If the effects are serious, the breach will be repudiatory. If not, only damages will be available.
- This is evidenced in the case of *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd*<sup>5</sup> - the case that devised the concept of the innominate term. Here, the defendant had chartered a ship from the claimant for a period of two years. The charter contract contained a term which required the claimant to provide a ship that was 'in every way fitted for ordinary cargo service.' However, the engine crew were incompetent and the ship was poorly maintained – the unseaworthiness of the ship was even admitted by the claimant. As a result of these deficiencies, 20 weeks use of the ship was lost.
- The defendant regarded this as a breach of condition and terminated the contract. The claimant argued that the term was not a condition and therefore the termination was not valid – it therefore brought an action for wrongful termination.
- The claimant's action for wrongful termination succeeded. Lord Diplock stated:

There are many contractual undertakings of a more complex character which cannot be categorised as being 'conditions' or 'warranties.' ... Of such undertakings all that can be predicted is that some breaches will, and others will not, give rise to an event which will deprive the party not in default of substantially the whole benefit which it was intended that he should obtain from the contract; and the legal consequences of the breach of such an undertaking, unless provided for expressly in the contract, depend on the nature of the event to which the breach gives rise and do not follow automatically from a prior classification of the undertaking as a 'condition' or 'warranty.'

- This became known as the innominate term and breach of it would not give rise to the right to terminate unless it deprived the non-breaching party of substantially the whole benefit of the contract. In other words, the right to terminate was based on the severity and effects of the breach. In *Hong Kong Fir*, the breach did not deprive the non-breaching party of substantially the whole benefit of the contract – it lost 20 weeks out of two years.
- The effect of this decision is not to abandon the traditional distinction between conditions and warranties. Remember, it is always open to the parties to specifically classify what a term is to be and if a term is classified as a condition or warranty, then it will go a long way towards establishing what a term is.

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<sup>5</sup> [1962] 2 QB 26 (CA).

- However, where a term is not specifically classified or it is not obvious what type of term it is, the courts now tend to classify it as an innominate term. Accordingly, the effect of the breach becomes all important. The innominate term therefore exemplifies the principle embodied in the quote in the essay question.

### Usefulness of the innominate term

- There is no doubt that the use of the innominate term gives the court a flexibility that it did not have before. If a term is a condition, then, absent the statutory exception noted earlier, even a trivial breach will justify the innocent party in terminating. Thus, there is no connection between the factual consequences of the breach and the legal consequences.
- This can result in seemingly harsh decisions. In *Arcos Ltd v EA Ronaasen & Sons*,<sup>6</sup> there was a contract for the sale of barrel staves half an inch thick. The staves delivered were nine-sixteenths of an inch thick. Despite the fact that the variation made no factual difference to their use, the House held that this was breach of a condition which allowed the party to terminate.
- Thus the party in breach lost the entire contract due to a breach of contract which had no practical effect. This is obviously not the case where the term is innominate, where the factual consequences of the breach are directly related to the availability of the right to terminate. This allows the law to be much more flexible.
- Another benefit of this rule is that it stops the non-breaching party from escaping a contract because it has ceased to be a 'good deal.' In *Hong Kong Fir*, the owners of the ship received substantial damages for the charterer's wrongful termination. This was because the charter market had dropped. Any substitute charter had to be at a much lower rate than that provided by the relevant contract.
- The drop in the market explains why the charterer was so eager to escape from the contract. He could obtain another ship at a much lower price. Had the term been a condition, he would have been able to do this. The use of the innominate term prevents a minor breach from being used this way.
- The case of *The Hansa Nord*<sup>7</sup> provides a good example of the flexibility of the innominate term. This case concerned the sale of citrus pulp pellets to be used as animal feed for a price of £100,000. Shipment was to be made in good condition.
- On arrival, it was discovered that some of the pellets were damaged and the buyers rejected the entire cargo on the basis that it amounted to a breach of condition (also by this time, the market price for such goods had dropped to £86,000 – this was the main reason the buyers wanted to reject). The sellers then resold the pellets to an importer and the importer resold them to the original buyers who used the pellets for the original purpose of animal feed.
- The Court of Appeal held that the term requiring good shipment was innominate, and as the cargo was ultimately used for its intended purpose, the effects of the breach were not serious. Therefore, the buyers had wrongfully repudiated the contract. This gave the sellers (the party who had made the breach in the first place) a remedy.
- Here, the buyers wanted to terminate the contract, not because the pellets were not of sufficient quality (they ultimately ended up using them), but because they wanted to take advantage of the drop in the market. Had the term requiring 'good condition' been a condition, they would have been able to terminate, even though their decision was based solely on economic interests. The damage to the goods barely affected the buyer's ability to use them, and the use of the innominate term gave the court the flexibility to acknowledge this.

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<sup>6</sup> [1933] AC 470 (HL).

<sup>7</sup> [1976] QB 44 (CA).

### Problems with the use of the innominate term

- Whilst the use of the innominate term does give the court a significant amount of flexibility, it does so at the expense of certainty. It is important that business people know what type of terms they are dealing with. They need to know before they take any action. If they terminate a contract because they believe they have a right to terminate, but in fact they do not, the terminating party will themselves be in breach for wrongful termination. In the case of innominate terms, the right to repudiate is not known for certain until an action is brought.
- Accordingly, the non-breaching party cannot terminate with certainty. It will have to wait and see what the effects of the breach are. The courts have acknowledged this uncertainty and have indicated that the use of the innominate term will not be appropriate in all cases – see Megaw LJ's comments in *The Mihalis Angelos*.<sup>8</sup>

#### Problem question

In mid-2016, Partay Productions Ltd (PPL) began their preparations for a New Year music concert (known as 'the Concert in the Castle') to be held in the grounds of Cardiff Castle on January 1<sup>st</sup> 2017. In June 2016, it entered into a contract with Cardiff Council, who were responsible for the castle and its grounds, to use it as the venue for the concert.

In July 2016, PPL was able to engage the famous pop group 'Queens of Louis' to appear at the concert as the main performer and in August 2016 it engaged the services of Xtra Ltd, an advertising agency, to advertise the concert and the groups that would be appearing. This advertising contract contained the following clause:

It is a condition of this contract that the advertiser will place newspaper advertisements in all the national, daily and Sunday tabloid newspapers between 10<sup>th</sup> August and 20<sup>th</sup> December 2016.

On the 15<sup>th</sup> September, PPL discovered that Xtra had not placed any advertisements in two of the Sunday tabloid newspapers on Sunday 12<sup>th</sup> September. On the 18<sup>th</sup> September, PPL terminated the advertising contract with Xtra and the same day employed another advertising company, PR Advertising Ltd. The new agreement required PR Advertising to engage in an intense advertising campaign between the 20<sup>th</sup> September and the 20<sup>th</sup> December. However, by the 22<sup>nd</sup> September, all 50,000 tickets for the concert (at a cost of £30 each) had already been sold so PPL cancelled its contract with PR Advertising. PR Advertising were very annoyed as it considered that being associated with the promotion of 'the Concert at the Castle' would bring in further advertising work from other sources. It therefore decided to carry on and undertake the three-month long advertising campaign and ignore the cancellation.

On the 21<sup>st</sup> December, PPL received an invoice from PR Advertising for the sum due under the terms of its contract. Furthermore, Xtra Ltd has issued a writ in the High Court for damages for wrongful termination by PPL.

Advise PPL.

#### Introduction

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<sup>8</sup> [1971] 1 QB 164 (CA).

- Identify that this problem question requires a discussion of the law relating to breach of contract. Also identify that there are two contracts here that require discussion, namely (i) the contract between PPL and Xtra, and (ii) the contract between PPL and PR Advertising. Your task is to determine whether or not PPL has acted in breach in relation to these two contracts.
- As there are two contracts to be discussed, use this as the basis for the structure of your answer. Unlike essay questions, where the structure is largely a matter for the student to decide, problem question often implicitly give you the correct structure to use.

### The contract between PPL and Xtra Ltd

- The term in question has been branded as a condition by the parties. Accordingly, the principal issue to be discussed is whether or not the parties are free to classify the terms of the contract in this way and to what extent is such a classification binding.
- The most common type of case concerns parties classifying terms as conditions because breach will give them a right to terminate the contract and claim damages. However, parties will also try to classify terms as 'warranties' to deny the other party the right to terminate the contract.
- The first case to look at is *Lombard North Central plc v Butterworth*.<sup>9</sup> Here, clause 2(a) of the agreement made punctual payment of each instalment *of the essence* of the agreement, and under clause 5, failure to make due and punctual payment entitled the claimant to terminate the agreement. The defendant was late in paying several instalments so the claimant terminated the agreement and sought to recover damages for breach of contract.
- The Court of Appeal stressed that parties are free to classify the importance of the terms of the contract. Clause 2(a) made prompt payment a condition of the contract, so that any late payments were a breach of the agreement entitling the claimant to terminate the contract and recover damages, even though the breach itself was not regarded as giving rise to serious consequences.
- However, that does not mean that the court will always accept the parties' classification of terms. In *L Schuler AG v Wickman Machine Tool Sales*,<sup>10</sup> Wickman, an English company, was given the sole selling rights to sell Schuler's product for four and a half years. Clause 7(b) of the contract provided that it was a condition that Wickman should send a representative to visit the six largest UK motor manufacturers at least once a week to solicit orders. Wickman failed to make a number of these visits and Schuler terminated the agreement on the basis that Wickman had breached a condition.
- The House of Lords held that clause 7(b) was not a condition that would entitle the injured party to terminate the agreement. The said that use of the word 'condition' was indicative, but not conclusive. According to Schuler, under clause 7(b), if Wickman missed just one visit, that would permit Schuler to terminate the contract, even if it were not the fault of Wickman. The House believed such an argument to be wholly unreasonable.
- Applying this to our problem, it would appear that it would be unreasonable to permit PPL to terminate because Xtra missed one or two advertisements. Accordingly, the classification of the term as a condition will not be binding on the court, and the court will need to determine whether or not the term is of a kind that can justify termination.
- The relevant test to determine this is whether or not, based on the intentions of the parties and looking at the term in the context of the entire contract, the term goes to the root of the contract. If it does, it will most likely be a condition.
- The case of *Bannerman v White*<sup>11</sup> provides a good example of this test in practice. Here, the parties were negotiating for the sale of hops. Before the negotiations, the defendant had indicated that he

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<sup>9</sup> [1987] QB 527 (CA).

<sup>10</sup> [1974] AC 235 (HL).

<sup>11</sup> (1861) 10 CBNS 844.

did not wish to purchase hops that had been treated with sulphur. The same desire was indicated when samples were produced and the claimant stated that sulphur had not been used. The defendant discovered that 5 out of 300 acres had been treated with sulphur and promptly terminated the contract.

- The defendant argued that he had made clear the importance that the hops were untreated and since the claimant must have known that the hops were treated, it was a term of the contract which allowed them to terminate it should it be breached. The claimant argued that the issue regarding the treatment of hops arose in preliminary negotiations and therefore did not constitute a term of the contract.
- The jury found that the claimant's statement was understood by both the parties to be part of the contract and therefore the defendant was entitled to terminate the contract. This was affirmed on appeal.
- Unfortunately, the facts of the current problem are not as clear-cut as in *Bannerman*. There is nothing to indicate whether or not the parties intended the term to go to the root of the contract. In such cases, the courts are likely to classify the term as innominate, in which cases, the right to termination will only exist if the non-breaching party was deprived of substantially the whole benefit of the contract.
- Here, it is clear that Xtra's breach has not deprived PPL of substantially the whole benefit of the contract. Accordingly, PPL had no right to terminate the contract, and Xtra are likely to obtain damages for wrongful termination.

#### **The contract between PPL and PR Advertising**

- Here, PPL have cancelled the contract against the wishes of PR Advertising. By doing this, PPL are clearly in breach. However, PR Advertising have decided to go ahead with performance anyway.
- The case to look at here is *White and Carter (Councils) Ltd v McGregor*.<sup>12</sup> Here, White, an advertising contractor, entered into a contract with McGregor, a garage proprietor, to display advertisements on litter bins for 3 years. On the same day as the agreement was entered into, McGregor refused to perform and wrote to White informing it that the contract was cancelled. White refused to do so and elected the contract as still continuing. It made no effort to relet the space to another advertiser. It display the advertisements as agreed and then sued for the full amount due.
- The House of Lords, by a bare majority, held that White was entitled to the full contract amount.
- However, this case has been criticized because it encourages wasteful and unwanted performance. However, in certain areas, the general rule will not apply, notably where it can be shown that 'a person has no legitimate interest, financial or otherwise, in performing the contract, rather than claiming damages.'
- Therefore in our case, PR Advertising will be able to claim for the full amount due, unless it can be shown that it has no interest in performing. Here, it clearly do have an interest, so it appears that it will be able to claim for the contract price.

#### **Essay question**

'The effects of frustration under the Law Reform (Frustrated Contracts) Act 1943 are considerably fairer than under the common law'

Discuss.

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<sup>12</sup> [1962] AC 413 (HL).

## Introduction

- You should begin by briefly defining why the doctrine of frustration is needed (namely, to provide a lawful excuse for certain acts that would normally amount to a breach of contract), and what is meant when we say that a contract has been frustrated. You should also point out that, in many cases involving the doctrine of frustration, both parties are completely innocent and so the issue of who should bear any loss caused by the frustration is a difficult and controversial one.

## The effects of frustration at common law

- In order to appreciate the effects of frustration under the 1943 Act, it is essential to discuss the effects of frustration at common law. It is worth noting at the outset that the effects of frustration at common law are extremely harsh and do not provide a fair allocation of loss.
- The effects of frustration at common law were three-fold:
  1. The contract is automatically discharged. As the discharge is automatic, the parties cannot elect to continue the contract.
  2. Any rights or liabilities that arise after the frustrating event are discharged.
  3. Any rights or liabilities that arose before the frustrating event remain enforceable.
- You should provide an example of the harshness of these three rules and the case of *Chandler v Webster*<sup>13</sup> provides an excellent example. Normally, you would not need to provide the facts of a case, but providing that facts of *Chandler* would clearly demonstrate the harshness of the position at common law, namely that the claimant received no benefit whatsoever from the contract, yet was still liable to pay the full contract price.
- It would appear that the courts were aware of the harshness of the position in *Chandler* and in 1943, the House of Lords sought to introduce a measure of fairness to the common law in the case of *Fibrosa*.<sup>14</sup> Again, briefly provide the facts of the case and show how the courts decision partially remedied the law by allowing a party to claim payments made before the frustrating event.
- However, you should note that *Fibrosa* only partially remedied the deficiencies of the common law. Two problems still existed, namely:
  1. The principle in *Fibrosa* only applied where there was a 'total failure of consideration.' In other words, where a party gained any benefit from the contract, no matter how small, then *Fibrosa* would not apply.
  2. Allowing a party to recover advance payments might be harsh where the other party has incurred expenses in preparing to perform. *Fibrosa* took no account of such expenses.
- These two criticisms convinced Parliament that legislative intervention was needed. Accordingly, it passed the Law Reform (Frustrated Contracts) Act 1943.

## The effects of frustration under statute

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<sup>13</sup> [1904] 1 KB 493 (CA).

<sup>14</sup> [1943] AC 32 (HL). The full case name of *Fibrosa* is long and complex, and it is perfectly acceptable for you to refer to the case in an exam as *Fibrosa*.



- There is little doubt that the effects of frustration under the 1943 Act provide for a fairer allocation of loss than under the common law. The key provision is s 1(2) which lays down three rules designed to overrule *Chandler v Webster*, and remove the limitation established in *Fibrosa*.
  1. any sums payable before the occurrence of the frustrating event cease to be payable, irrespective of whether or not there has been a total failure of consideration. This effectively overrules the decision in *Chandler v Webster*.
  2. any sums paid before the occurrence of the frustrating event are recoverable, irrespective of whether or not there has been a total failure of consideration. This removes the limitation established in *Fibrosa*.
  3. where one party is seeking recovery of sums paid, and the other party has incurred expenditure before the contract is discharged, then the court has a discretion to set off any expenses incurred against any sums that can be recovered.
- A good way to demonstrate the fairness of these rules would be to apply them to the case of *Chandler v Webster* to demonstrate how a fairer allocation of loss would have been achieved (that is, the claimant could have recovered the £100 he already paid, and would not be liable to pay the remaining £41 15s).
- The 1943 Act goes further and s 1(3) provides that where a party (A) to a contract that has been frustrated, obtains a valuable benefit from the other party (B) in performing or preparing to perform, then B may be able to recover from A a sum not exceeding the value of the benefit.
- Finally, you should point out that the 1943 Act does not apply to all contracts and certain types of contract are excluded from its operation. For such contract, the common law rules will apply.

### Conclusion

- Conclude based on the arguments made. However, it is difficult to disagree with the quote in the question. There is little doubt that the effects of frustration under the 1943 Act provide for a much fairer allocation of loss than under the common law.