FRUSTRATION OF CONTRACT IN THE HIGH COURT

The volume of legal literature on the subject of frustration of contract is fast reaching massive proportions, and is being constantly fed by decisions of the English courts. Perhaps the most exhaustive analysis of the application of the doctrine and of the various judicial theories which have been propounded to explain it is to be found in McNair's *Legal Effects of War* (2nd ed.) c. 6. The object of this article is in no wise to attempt to improve on that or any other analysis. The writer's only excuse for adding to the volume of literature on the subject is that, strangely enough, the High Court of Australia has rarely been called upon to apply the doctrine, and that therefore some examination of the case of *Scanlan's New Neon Ltd. v. Tooheys Ltd.* [1] is justified, as, so far as Australian decisions are concerned, it must be regarded as the leading case. It is worth noting that not one High Court decision is referred to in any of the judgments in that case.

The facts of the case, very briefly, were as follows. The neon company's business was the erection and servicing of neon signs for advertising purposes. Their practice was to enter into contracts with a person requiring a sign whereby the company, described as the lessor, erected a sign on the land or building of the other party, described as the lessee, and kept it in repair in return for an agreed rental. In this case signs were erected on several of Toohey's hotels. During the war and while the contracts were current, blackout regulations were proclaimed by the Government of New South Wales, as in other States, prohibiting the illumination of neon signs. Although the neon company was bound to keep the signs in order, nothing in the contracts required them to guarantee illumination, and nothing bound the lessee to keep the signs illuminated. The blackout regulations, therefore, did not make performance of the contracts in their express terms impossible. But clearly (and the trial judge so found) the illumination of the signs was a most important consideration in the minds of both parties. Tooheys claimed that the contracts were frustrated and that they were therefore no longer liable to pay the rent for the signs. The High Court, however, consisting of Latham, C.J., McTiernan, J., and Williams, J., held that the contracts had not been discharged by frustration, and remained in full force.

The most widely accepted theory by which the doctrine of frustration is fitted into the general principles of contract is that of the implied term, based on the presumed intention of the parties at the

[1] (1943) 67 C.L.R. 169.

time of entering into the contract. It is not proposed to discuss the various theories which have been advanced—they are examined very clearly and exhaustively in the judgment of Latham, C.J. The theory of the disappearance of the basis or foundation of the contract has often been put forward as a theory distinct from that of the implied term. It is submitted, however, that the view of certain writers [2] that the "foundation of the contract" theory is simply another aspect of the "implied term" theory is correct. On this view, the court will infer a term that the contract is to be discharged when it appears that supervening circumstances, unforeseen by the parties, have destroyed the foundation of the contract. According to *Cheshire and Fifoot* [3] the test to be applied in deciding whether any contract has been frustrated resolves itself into two questions:

(1) Having regard to all the circumstances, what was the foundation of the contract?

(2) Was performance according to the presumed intention of both parties prevented without the fault of either by the disappearance of the foundation?

This was the approach adopted by McTiernan, J., in the case under review. After an examination of all the terms and circumstances of the contracts in question, he concluded that the illumination of the neon signs was not the foundation of the contracts, and that therefore the blackout regulations could not be considered to have brought about their discharge.

Williams, J., [4] also favoured the "foundation of the contract" test, but to assist in its application he propounded three rules which, he said, must be borne in mind: [5]

(1) As said by Lawrence, J., in *Scottish Navigation Co. Ltd. v. W. A. Souter & Co.*, [6] and approved by Lord Summer in *Bank Line Ltd. v. Arthur Capel & Co.*, [7] "no such condition [of discharge] should be implied when it is possible to hold that reasonable men could have contemplated the circumstances as they exist and yet have entered into the bargain expressed in the document."

(2) "It is the performance of a common object which has to be frustrated, and not merely the individual advantage which one party or the other might have gained from the contract."

(3) "Although the fact that the contract has been partly executed is not crucial, nevertheless, as Lord Parker, in whose speech the Lord Chancellor concurred, said in *Tamplin's case*: [8] 'Some conditions

[2] E.g. McNair, 56 L.Q.R. 179; Cheshire and Fifoot, Law of Contracts, p. 368.
[3] Op. cit. p. 368.
[4] At 223.
[5] At 223-225.
[6] (1917) 1 K.B. at 249.
[7] (1919) A.C. at 460.
[8] (1916) 2 A.C. at 423.

can be more readily implied than others. Speaking generally, it seems to me easier to imply a condition precedent defeating a contract before its execution has commenced than a condition subsequent defeating the contract when it is part performed'."

This third rule (if such it can be called) is undoubtedly supported by the authorities, but stated merely as an adjunct to or qualification of the "foundation of the contract" test it is not very helpful. If a certain state of affairs constitutes the foundation of a contract while it remains executory, how does it cease to be the foundation when the contract has been partly executed? Moreover, the rule does not entirely preclude the application of the doctrine of frustration to partly executed contracts, yet no assistance is offered in deciding when it is to apply and when it is not.

Williams, J.'s, second rule raises the difficulty of how far the parties to a contract can be regarded as having a "common object," a difficulty which was recognised by Latham, C.J.: [9] "Contracting parties as such are not partners. They are engaged in a common venture only in a popular sense." As the learned Chief Justice points out, each party has certain individual advantages which he expects to get out of the contract, and it is only distorting the facts to speak of a "common object." Certainly, as Williams, J., emphasised, it is not enough that merely the individual advantage of one party should be frustrated—which would have been the result of the principle enunciated by the Supreme Court of New South Wales in the case —but it is not helpful to introduce the idea of frustration of a "common object."

It is submitted, then, that the second and third subsidiary rules propounded by Williams, J., are of little assistance in deciding when the doctrine of frustration is to apply. His first rule, however, it is submitted, is much nearer the heart of the problem. In fact, it is suggested that it provides the true test which should be applied in all cases when the doctrine is invoked. It was, indeed, the test applied by Latham, C.J., in his judgment.

Latham, C.J., [10] adopted the statement of the law as to frustration made by Russell, J. (afterwards Lord Russell of Killowen) in *Re Badische Co. Ltd.*: [11] "The doctrine of dissolution of a contract by the frustration of its commercial object rests on an implication arising from the presumed common intention of the parties. If the supervening events or circumstances are such that it is impossible to hold that reasonable men could have contemplated that event or those circumstances and yet have entered into the bargain expressed in the document, a term should be implied dissolving the contract upon the happening of the event or circumstances. The dissolution lies not in the choice of one or other of the parties, but results auto-

[9] At 196-197.
[10] At 201.
[11] (1921) 2 Ch. at 379.

matically from a term of the contract. The term to be implied must not be inconsistent with any express term of the contract." This statement is derived in its main proposition from the rule quoted by Williams, J., from the judgment of Lawrence, J., in the *Scottish Navigation Co.'s Case.* [12] Add to it the further observation that the supervening event or circumstances must not have been brought about by the act of one of the parties, and one has a wonderfully complete and succinct statement of the law as to when a contract has been discharged by frustration. Though Russell, J.'s, statement has been noticed occasionally in judgments and textbooks, [13] it has not been given the attention which, in the opinion of the writer, it deserves. Thanks are due to Latham, C.J., for reviving it and placing it in the forefront of Australian authority.

The simple test which is to be applied, then, is: Is it impossible to hold that reasonable men could have contemplated the event or circumstances which in fact supervened and yet have entered into the bargain as expressed? Nothing more than this test is required. It can be applied to all kinds of contracts, in all circumstances, and avoids the difficulties involved in the idea of a "common object." It has two great advantages over the "foundation of the contract" test as propounded by Cheshire and Fifoot and as applied by McTiernan, J.

In the first place, it places proper emphasis on the fundamental principle of contract, *pacta sunt servanda.* In the search for the foundation of the contract and the effort to decide whether it has been destroyed, there is a tendency to forget this fundamental principle. It is not suggested that the courts have not in fact paid due attention to the principle, but Russell, J.'s, test restores to the law as to frustration the true perspective which is distorted by the "foundation of the contract" test. A contracting party is bound by the terms of his contract, but if it is *impossible* to hold that reasonable men in the position of the parties could have contemplated the event or circumstances which came about and still have entered into the contract they did, then—and only then—is further performance of the contract excused.

In the second place, Russell, J.'s, test avoids altogether the quite unreal quest for the "foundation" of the contract. A contract may have many "foundations" some of which may be of far greater importance to one party than to the other. The important thing for each party is, as Latham, C.J., emphasised, the individual advantage which he hopes to gain from the contract. An infinite variety of circumstances not contemplated by the parties and not caused by their acts may supervene to prejudice or destroy the expected individual advantage of one or other party. But the question to be decided in all cases when considering if the contract has been legally frustrated, is whether the party who stands to lose

[12] *Supra,* note (6).
[13] See, for example, Pollock on Contracts, 11th ed., 227.

by the contract remaining in force must be held to have undertaken the risk of that loss or not. Every contract involves the parties in some risk of loss through unwelcome circumstances supervening before its final execution. If those circumstances are foreseen when the contract is made, and no provision is made for them, then the parties must be taken to have elected to run the risk of their occurrence. In the same way, where such circumstances are unforeseen, the question must still be answered, if the doctrine of frustration is invoked, whether the parties (or the party who stands to lose) must as reasonable men have intended to run the risk of their occurrence.

All the terms and circumstances of the contract must be taken into account in this enquiry. And one of the relevant factors—something which tends to be forgotten, but which is emphasised by Latham, C.J.—is whether the party seeking to enforce the contract can reasonably be taken to have elected to run the risk of the contract being frustrated at law. It is not enough to consider only the loss which will fall on the one party if the contract is enforced. The loss which will fall on the other party if it is held to be discharged must be considered too. Although it may perhaps not be entirely reasonable to suppose that the first party would have chosen to run the risk of the loss resulting from the supervening circumstances, yet the loss to the other party if the contract is held to be frustrated may be relatively so much greater that it would be utterly unreasonable to hold that he would have been prepared to contract on any terms other than those on which he in fact did. Such was the position, according to Latham, C.J., in the case under review. Certainly Tooheys expected that the neon signs would be illuminated, and they were of little value to them unlighted. But the neon company's whole business depended on the rentals from their signs, and if the contracts were held to be frustrated the result would be that they must go into liquidation. No such dire fate would befall Tooheys. It was therefore much more reasonable to assume that they would have been prepared to run the risk of blackout regulations being proclaimed than that the neon company would have been prepared to run the risk, in Latham, C.J.'s, phrase, of committing commercial suicide. How much simpler is this approach to the problem than the approach by way of the "foundation of contract" test!

Of course, the relative losses likely to fall on the parties according as the contract is held to be frustrated or not are by no means the only factors to be considered. The party who stands to lose far more by the enforcement of the contract than does the other party by its discharge may yet be deemed to have elected to run the risk of that loss, where, for example, his need for the benefits of the contract is so great that it must be held that if the supervening circumstances had been contemplated the other party could have forced him to undertake the risk. This is the explanation of the example given by Latham, C.J., [14] of a prospective bride ordering a wedding

[14] At 200-201.

dress from a dressmaker. As the learned Chief Justice says, no one would suggest that the woman should be excused from payment for the dress merely because the wedding is cancelled for some unforeseen reason, and independently of any act by her. Yet surely the expectation of the wedding is the "foundation" of the contract. Without such an expectation the contract would be quite meaningless. If, however, we apply Russell, J.'s, test, without going into the question of what the foundation of the contract was, the true explanation of the case is at once apparent. It is vital for a prospective bride to have a wedding dress. It is, normally speaking, by no means so vital for a dressmaker to be engaged to make a wedding dress. Hence, although the actual loss to the customer through the wedding being cancelled may be greater than the actual loss which would be suffered by the dressmaker if the contract is deemed to be frustrated, it is impossible to imagine that a reasonable dressmaker would have been prepared to contract on the basis that if the wedding should go off payment would be excused. It is not reasonable to assume that the dressmaker would have been prepared to run that risk, but it is, on the other hand, reasonable to assume that the prospective bride would have been prepared to run the risk of the wedding going off rather than go without a dress.

Let us examine some of the cases where the doctrine of frustration has been invoked in the light of Russell, J.'s, test. For convenience it is proposed to consider the five categories of cases where the doctrine has been applied which are distinguished by Cheshire and Fifoot. [15] Their first three categories are:

(i) where performance of the contract becomes illegal or impossible by a subsequent change in the law.

(ii) where performance of a contract for personal services is prevented or substantially affected by supervening ill-health of the performer.

(iii) where a particular physical thing essential to performance of the contract is destroyed.

In all these cases it is fairly easy to come to the conclusion that reasonable men could not possibly have contemplated the events or circumstances which transpired and yet have entered into the contract in its expressed terms. They are all cases in which performance of the contract has become either physically impossible or impossible in any practical sense. It is in these cases that the "foundation of the contract" test is adequate and easy of application. It must be the foundation of every contract that it will remain capable of performance in the terms in which it is expressed. Of course, as Cheshire and Fifoot point out, each case must be considered in the light of its own circumstances, and no term for dissolution of the

[15] Op. cit. 369-371.

contract will be inferred if the supervening event was one which might reasonably have been foreseen and guarded against.

When we come to consider cases where contracts have been held to be frustrated even though performance as expressly agreed is still possible, we have more difficulty in understanding the application of the doctrine, and it is in these cases that, it is submitted, the "foundation of the contract" test is inadequate or misleading. Cheshire and Fifoot's fourth and fifth categories cover such cases:

(iv) contracts discharged by discontinuance of a fundamental state of things.

(v) Contracts discharged by non-occurrence of an event.

Let us take these separately.

Contracts discharged by discontinuance of a fundamental state of things.

One of the commonest examples of discontinuance of a fundamental state of things is the outbreak of war and the introduction of the various restrictions on ordinary civil activity which a war produces. A leading case is ***Metropolitan Water Board v. Dick Kerr & Co. Ltd.,*** [16] where the House of Lords considered a contract made in 1914 between a construction company and a Water Board to build a reservoir for the Board within 6 years, subject to a proviso that the Board might grant an extension of time in case of any undue delay resulting from any cause whatsoever. In 1916 the Ministry of Munitions, acting under wartime powers, ordered the company to stop work on the project. There was every reason to suppose that this order would remain in force until the end of war. The Board granted an extension of time under the proviso in the contract, but the company claimed that the contract was discharged under the doctrine of frustration. It is clear that the Ministry's order did not prevent performance in the actual terms of the contract. But the company's argument was that the proviso for extension of time was only intended by the parties to cover minor delays, and that the contract was based on the continuance of pre-war peacetime conditions. The House of Lords held that this was the foundation of the contract, which had been swept away. The conditions as to labour and materials might well be vastly different after the war, and to insist on performance then would, in their Lordships' view, be to enforce a different contract from that originally entered into, and the contract was therefore discharged by the Ministry's order.

Applying Russell, J.'s, test to this case, the same result would be reached. It would be impossible to hold that reasonable contractors in the position of the company would, if they had contemplated the possibility of the conditions as to labour and materials

[16] (1918) A.C. 119.

being vitally affected through the outbreak of war, yet have entered into the contract as expressed. On the other hand, it would be quite reasonable to suppose that the Water Board would have been prepared to contract subject to a condition that the contract should be discharged in the circumstances which actually came about.

The disadvantage of the "foundation of the contract" test in such cases is, as has been already pointed out, that it induces a tendency to think that all contracts the performance of which is substantially affected by, say, war conditions, are frustrated in law. That this is not so is amply demonstrated by *Scanlan's New Neon Ltd. v. Tooheys Ltd.*

A leading case where the House of Lords held (by a three to two majority) that the contract was *not* frustrated by supervening circumstances brought about by war is *Tamplin S.S. Co. v. Anglo-American Products Co.* [17] A ship was chartered for five years from December, 1912, to December, 1917, to be used by the charterers for the carriage of oil. In February, 1915, it was requisitioned by the Government and used as a troopship. This took the ship out of the hands of the charterers, but it did not make performance of the actual contract impossible. All the charterers were *bound* to do was to pay the agreed freight. It was argued, however, that the foundation of the contract had gone, because the foundation of the contract was that the charterers should have the ship at their disposal until December, 1917. If one thinks in terms of the "foundation of the contract" test, it is difficult to avoid the conclusion that the contract was frustrated, and this was the decision of the minority Lords. But if one applies Russell, J.'s, test, then the decision of the majority becomes understandable. The question then is, is it impossible to hold that reasonable men would have agreed that the freight was to remain payable if they had contemplated the possibility of war breaking out and the ship being requisitioned during the currency of the charterparty? Of course, the answer to this question depends on all the terms of the charterparty, but it is not hard to conclude that reasonable men would have been prepared to run the risk of war and requisition.

Contracts discharged by non-occurrence of an event.

The most widely quoted case of this type is *Krell v. Henry,* [18] where a contract to hire a flat in Pall Mall from which to see the coronation procession of Edward VII was held to be discharged by the cancellation of the procession. The cancellation of the procession did not render performance of the contract as agreed impossible, but of course the whole point of it was gone so far as the lessee was concerned.

The case is very hard to distinguish from others where the doctrine of frustration has been held *not* to apply in spite of the non-

[17] (1916) 2 A.C. 397
[18] (1903) 2 K.B. 740.

occurrence of some event which the parties had in mind when they made their contract. [19] A distinction has often been drawn between the "object of the contract" and the "motives of the parties," but in the writer's opinion this is mere tautology. In his judgment in *Krell v. Henry,* Vaughan Williams, L.J., [20] gave a hypothetical example designed to illustrate the distinction between those cases where the non-occurrence of an event frustrated the contract and those cases where it did not. Suppose, he said, a hiring of a cab by a man for the purpose of going to the Derby, the purpose being known to the cabman who charges a specially high rate of hire for the occasion. According to his Lordship, such a contract would not be discharged by the unexpected cancellation of the Derby. McTiernan, J., in *Scanlan's New Neon Ltd. v. Tooheys Ltd.* [21] approved of Vaughan Williams, L.J.'s, distinction in these words: "The main distinction was that under the cab contract the hirer could say to the cabman that the cabman had nothing to do with the purpose for which he hired the cab, whereas in the other case [quoting Vaughan Williams, L.J.] 'there is not merely the purpose of the hirer to see the coronation procession, but it is the coronation procession and the relative position of the rooms which is the basis of the contract as much for the lessor as the hirer'." With the utmost respect, it is submitted that this is a distinction without a difference. Why is the lessor any more concerned with the use to which the hirer wishes to put the rooms than the cabman is with the purpose for which the hirer wants the cab? The cabman certainly is concerned with the purpose for which the hirer wants the cab, because he expects to make some extra money out of it. The chief interest of both lessor and cabman in the respective contracts is the profit they expect to make out of the anticipated occurrence of the respective events. Latham, C.J.'s, example of the prospective bride ordering a wedding dress belongs to this category. How could it be said that it is no concern of the dressmaker to what use the customer wishes to put the dress? The contract would not have been made at all if no wedding had been arranged.

It is particularly in this class of contract that the "foundation of the contract" test is misleading. The decision in *Krell v. Henry* has been criticised on numerous occasions, and Latham, C.J., made it fairly clear that he did not like it, though he did not say that he would not be prepared to follow it in a parallel case. If Russell, J.'s, test is applied to the facts of *Krell v. Henry,* the conclusion may well be reached that reasonable men in the position of the parties would indeed still have contracted in absolute terms even if they had contemplated the possibility of the procession being cancelled. The number of rooms available for hiring for the purpose of seeing the procession must have been very small compared with the number of people willing to pay high sums to obtain them. It would there-

[19] See, for example, *Herne Bay Steam Boat Co. v. Hutton,* (1903) 2 K.B. 683.
[20] At 750-751.
[21] At 216.

fore be by no means impossible to hold that a reasonable man wishing to hire rooms would be prepared to run the risk of the procession being cancelled.

In conclusion, therefore, it is submitted that the test propounded by Russell, J., and adopted by Latham, C.J., is likely to produce more consistent results in the application of the doctrine of frustration than any other test, particularly the popular "foundation of the contract" test. Not only this, but it has the virtue of simplicity. Latham, C.J.'s, judgment should be destined to become a classic on the law as to frustration. Perhaps one may be justified in drawing the inference from the decision in *Scanlan's New Neon Ltd. v. Tooheys Ltd.*, particularly from the judgments of Latham, C.J., and Williams, J., that so far as the High Court is concerned the onus of proof that a contract has been discharged by frustration may be heavier than it has at times been in the English courts. But this is only because a proper emphasis has been placed on the basic principle that a man is bound by the terms of his contract. The result in any event should be a more coherent doctrine.

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