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DISCHARGE OF CONTRACT

In this chapter we shall consider the four methods by which a contract can be discharged or terminated.

The discharge of a contract means in general that the parties are freed from their mutual obligations. A contract may be discharged in four ways: *lawfully* by agreement, by performance or by frustration, and *unlawfully* by breach.

Discharge by agreement

Obviously, what has been created by agreement may be ended by agreement. Discharge by agreement may arise in the following ways.

Out of the original agreement

Thus the parties may have agreed at the outset that the contract should end automatically on the expiration of a fixed time. This would be the case, for example, with a lease of premises for a fixed term. Alternatively, the contract may contain a provision entitling one or both parties to terminate it if they wish. Thus a contract of employment can normally be brought to an end by giving reasonable notice. This area of the law is, of course, subject to statutory minimum periods of notice laid down by s 86 of the Employment Rights Act 1996. They are one week after one month's service, two weeks after two years' service and an additional week for each year of service up to 12 weeks after 12 years' service. Section 86 provides that the employee must, once he has been continuously employed for one month, give at least one week's notice to his employer to terminate his contract of employment. This is regardless of the number of years of service. Individual contracts may provide for longer periods of notice both by employer and employee.

Change of control clauses

When entering into a contractual arrangement many companies will have carried out research into the ability of the other party to carry through the contract in terms of finance and general stability. These matters can, of course, be badly affected by a change in the shareholder control of the other party particularly where the contract is a continuing one for, e.g., the supply of goods over a period. Therefore, the contract when made could be drafted to

allow one party to terminate the agreement where the controlling shareholder (if any) in the other party is changed by a transfer of shares. Such a clause would not normally operate to automatically discharge the contract but it does give the party who may be adversely affected the right to terminate if he so desires. Such a clause *which operates as a discharge by agreement* is particularly useful if the new controlling shareholder is a corporate competitor.

Out of a new contract

If the contract is *executory*, i.e. a promise for a promise, and there has been no performance, the mutual release of the parties provides the consideration and is called bilateral discharge. The only difficulty here is in relation to the form of the release. The position is as follows:

(a) contracts which are required to be in writing under the Law of Property (Miscellaneous Provisions) Act 1989 (see further Chapter 11), i.e. contracts involving a sale or other disposition of land, can be wholly discharged (or rescinded) by an oral agreement but variation requires a written document containing the variation and signed by both parties. For example, a revised completion date on the sale of a property requires a written document containing the variation and signed by both parties (as decided in *McCausland* v *Duncan Lowrie* (1996) *The Times*, 18 June);

Under the provisions of the Electronic Communications Act 2000 the relevant signatures may be electronic signatures and will increasingly be so in the developed future.

(b) written contracts other than the above may be rescinded or varied by an oral agreement (see *MSAS Global Logistics Ltd* v *Power Packaging Inc* (2003) *The Times*, 25 June);

(c) deeds may be rescinded or varied orally;

(d) contracts required to be evidenced in writing, i.e. guarantees, may be totally discharged by oral agreement but variations must be in writing.

If the contract is executed as where it has been performed or partly performed by one party, then the other party who wishes to be released must provide consideration for that release unless it is effected by deed. This is referred to as unilateral discharge. In other words, the doctrine of accord and satisfaction applies. This matter has already been dealt with and is really an aspect of the law relating to consideration (see Chapter 10).

Discharge by performance generally

A contract may be discharged by performance, the discharge taking place when both parties have performed the obligations which the contract placed upon them. Whether performance must comply exactly with the terms of the contract depends on the following.

Construction of the contract as entire

According to the manner in which the court construes the meaning, the contract may be an entire contract. Here the manner of performance must be complete and exact.

Bolton v *Mahadeva*, 1972 – Where the contract is entire (**215**)

Entire agreement clauses

In addition to the possibility that the court will *construe* a contract as entire, the parties may seek to achieve an entire contract by the use of entire agreement clauses that are *set out expressly* in the contract. A typical clause has two parts as follows:

- an express statement that the written agreement (and often other documents that the agreement expressly refers to) contain the whole agreement of the parties regarding the transaction and supersedes all previous agreements;
- an acknowledgement by the parties that they have not relied on any representation that is not set out in the agreement.

These clauses are subject to interpretation by the courts in terms of what exactly they cover and, for example, the second limb is unlikely to exclude liability for fraudulent misrepresentation.

There is obviously some hardship when the entire contract rule is applied because sometimes work is done by A for B which B does not pay for and certain other approaches have been worked out by the judiciary as follows.

Substantial performance

If the court construes the contract in such a way that precise performance of every term by one party is not required in order to make the other party liable to some extent on it, the claimant may recover for work done, though the defendant may, of course, counterclaim for any defects in performance. In this connection it should be noted that in construing a contract to see whether a particular term must be fully performed or whether substantial performance is enough, the court will refer to the difference between conditions and warranties. A condition must be wholly performed whereas substantial performance of a warranty is often enough. (*Poussard* v *Spiers and Pond* (1876) and *Bettini* v *Gye* (1876) – see further Chapter 14.)

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Hoenig v *Isaacs*, 1952 – Where there is substantial performance (**216**)

Acceptance of partial performance

If, for example, S agrees to deliver three dozen bottles of brandy to B and delivers two dozen bottles only, then B may exercise his right to reject the whole consignment. But if he has accepted delivery of two dozen bottles he must pay for them at the contract rate (Sale of Goods Act 1979, s 30(1)). It is worth noting here that s 30(2A) of the Sale of Goods Act 1979 (inserted by the Sale and Supply of Goods Act 1994) provides that a commercial buyer as distinct from a consumer may not reject goods for the delivery of the wrong quantity where the seller can show that the excess or shortfall is so slight that it would be unreasonable to do so. In the above example the shortfall is not slight and a commercial buyer (as well as a consumer) could reject the goods.

However, the mere conferring of a benefit on one party by another is not enough; there must be evidence of acceptance of that benefit by the party upon whom it was conferred. The acceptance must arise following a genuine choice.

Sumpter v *Hedges*, 1898 – Has partial performance been accepted? (**217**)

Full performance prevented by the promisee

Here the party who cannot further perform his part of the contract may bring an action on a *quantum meruit* (a claim for a payment for work done) against the party in default for the value of work done up to the time when further performance was prevented.

De Barnardy v *Harding*, 1853 – Where full performance is prevented (**218**)

Time of performance

Section 41 of the Law of Property Act 1925 provides that stipulations as to the time of performance in a contract are not construed to be of the essence of the contract and therefore need not be strictly complied with, unless equity would have regarded them as such. There are the following exceptional situations in which time was of the essence even in equity.

(a) The contract fixes a date and makes performance on that date a condition.

(b) The circumstances indicate that the contract should be performed at the agreed time. These cases are:

- *contracts for the sale of land or a business* because uncertainties as to ownership of land have traditionally been regarded as undesirable and uncertainties as to the ownership of a business can affect its goodwill;
- *commercial contracts* such as a sale of goods;
- *contracts for the purchase of shares* because share values are often volatile, which could affect the price at which it was agreed to sell them.

(c) Where the time of performance was not originally of the essence of the contract or has been waived but one party has been guilty of undue delay, the other party may give notice requiring that the contract be performed within a reasonable time.

Bowes v *Shand*, 1877 – Sale of goods: time is of the essence (**219**)
Chas Rickards Ltd v *Oppenhaim*, 1950 – Waiver of time of delivery (**220**)

Tender

With regard to the manner of performance, the question of what is good tender arises. Tender is an offer of performance which complies with the terms of the contract. If goods are tendered by the seller and refused by the buyer the seller is freed from liability, given that the goods are in accordance with the contract as to quantity and quality. As regards the payment of money, this must comply with the following rules.

(a) It must be in accordance with the rules relating to legal tender. By s 1(2) and (6) of the Currency and Bank Notes Act 1954 a tender of a note or notes of the Bank of England expressed to be payable to bearer on demand is legal tender for the payment of any amount. A tender of notes of a bank other than the Bank of England is not legal tender, though the creditor may waive his objection to the tender if he wishes. As regards coins, s 2 of the Coinage Act 1971, as amended by the Currency Act 1983, provides that coins made by the Mint shall be legal tender as follows:

(i) Certain gold coins for payment of any amount. We are referring here to the gold sovereign. These are legal tender if struck after 1837. Even though the sovereign contains just under $^1/_4$ ounce of gold it is valid only for £1 although it is worth much more as a collector's item.
(ii) Coins of cupro-nickel or silver of denominations of more than 10 pence, i.e. 20p, 50p, £1 and £2 coins are legal tender for payment of any amount not exceeding £10.
(iii) Coins of cupro-nickel or silver of denominations of not more than 10 pence (in practice, the 5p and 10p coins) are legal tender for payment of any amount not exceeding £5.
(iv) Coins of bronze, i.e. the 2p and 1p coins, are legal tender for payment of any amount not exceeding 20 pence.

There is power of proclamation to call in coins which then cease to be legal tender or to make other coins legal tender.

(b) There must be no request for change.

(c) Tender by cheque or other negotiable instrument or by charge card or credit card is not good tender unless the creditor does not object. It should be noted that if a proper tender of money is refused the debt is not discharged, but if the money is paid into court the debtor has a good defence to an action by his creditor and the debt does not bear interest.

In connection with payment by credit card or charge card, the consumer normally discharges his obligation to the seller by payment in this way. If the card company cannot pay the seller as where that company is insolvent, the seller has no redress against the consumer subject always to the terms of the contract (*Re Charge Card Services* [1988] 3 All ER 702).

Discharge by receipt

A method of proving payment is by a receipt signed by or on behalf of the person paid. Proof may, however, be given orally and a court may be satisfied with this. A receipt is not conclusive evidence of payment and oral evidence is acceptable to the court to prove, e.g., that it was given in circumstances of fraud. In addition, a receipt given in 'full discharge' does not release the person paid unless there is 'accord and satisfaction'. Receipts are not normally given in business today since the passing of s 3 of the Cheques Act 1957 which provides that 'an unendorsed cheque which appears to have been paid by the bank on whom it is drawn is evidence of the receipt by the payee of the sum payable by the cheque'. This, again, is not conclusive evidence and, since banks do not return used cheques with monthly statements these days, evidence of payment through the clearing system would have to be sought from the bank, e.g. by a certified copy of the cheque. The receipt is thus in many ways more straightforward.

Appropriation of payments

In connection with performance, it is important to consider the rules governing appropriation of payments. Certain debts are barred by the Limitation Act 1980 and money which has

been owed for six years under a simple contract or 12 years under a specialty contract without acknowledgement may not be recoverable by an action in the courts. Where a debtor owes several debts to the same creditor and makes a payment which does not cover them all, there are rules governing how the money should be appropriated. These are as follows.

(a) The debtor can appropriate either expressly by saying which debt he is paying or by implication as where he owed £50 and £20 and sends £20.

(b) If the debtor does not appropriate, the creditor can appropriate to any debt, *even to one which is statute-barred* (see further Chapter 18). However, if the statute-barred debt is £50 and the creditor appropriates a payment of £25 to it, the balance of the debt is not revived and cannot be sued for (*Mills* v *Fowkes* (1839) 5 Bing NC 455).

(c) Where there is a current account, there is a presumption that the creditor has not appropriated payments to him to any particular item. The major example is a bank current account. Appropriation here is on a chronological basis, i.e. the first item on the debit side of the account is reduced by the first item on the credit side: a first in first out principle. This follows from the rule in *Clayton's* Case (1816) 1 Mer 572.

Deeley v *Lloyds Bank*, 1912 – *Clayton's* Case applied (**221**)

Discharge by frustration generally

If an agreement is impossible of performance from the outset, it is void at common law (*Couturier* v *Hastie* (1856) – see Chapter 12). This is also at the root of s 6 of the Sale of Goods Act 1979 which provides that where there is a contract for the sale of specific goods and the goods, without the knowledge of the seller, have perished at the time when the contract is made, it is void. However, some contracts are possible of performance when they are made but it subsequently becomes impossible to carry them out in whole or in part and they are then referred to as frustrated.

The judges developed the doctrine of discharge by frustration, which applies, as the House of Lords decided in *Davis Contractors Ltd* v *Fareham UDC* [1956] 2 All ER 145, in the restricted set of circumstances where there has been such a change in the significance of the obligation that the thing undertaken would, if performed, be a different thing than that contracted for. The subject is considered under the following heads.

Contracts for personal service

Such a contract is discharged by the death of the person who was to perform it; thus if A agrees to play the piano at a concert and dies before the date on which the performance is due, his personal representatives will not be expected to go along and play in his stead.

Incapacity of a person who has to perform a contract may discharge it. However, temporary incapacity is not enough unless it affects the contract in a fundamental manner (*Poussard* v *Spiers and Pond* (1876) – see Chapter 14).

If a contract of employment has been brought to an end by reason of frustration, the parties cannot agree afterwards that the contract continues to exist. Thus, in *G F Sharp & Co Ltd* v *McMillan* [1998] IRLR 632 a joiner lost the use of his left hand and could never work for the employer as a joiner again. Nevertheless, the parties agreed to keep him 'on the books' so that he could get access to greater pension benefits. The Employment Appeal Tribunal ruled that this did not amount to a continuation of his contract of employment. The contract had been terminated by his injury. In consequence, he was not entitled to notice from the employer or a payment in lieu of notice.

The doctrine of frustration will usually only apply where there is no fault by either party. Where performance of the contract is prevented by the fault of one party, that party is in breach of contract and that is the proper approach to the problem.

Storey v *Fulham Steel Works*, 1907 – Illness did not frustrate the contract (**222**)
Norris v *Southampton City Council*, 1982 – Frustration and breach in a personal service contract (**223**)

Government interference

In times of national emergency the government may often requisition property or goods in the national interest. This will have the effect of frustrating relevant contracts.

Re Shipton, Anderson & Co and Harrison Bros' Arbitration, 1915 – Frustration by government action (**224**)

Destruction of the subject matter of the contract

Physical destruction of the subject matter of the contract operates to frustrate it.

Taylor v *Caldwell*, 1863 – A fire at a concert hall (**225**)

Non-occurrence of an event

Where the taking place of an event is vital to the contract, its cancellation or postponement will, in the absence of a contrary provision, frustrate it. However, if the main purpose of the contract can still be achieved, there will be no frustration.

Krell v *Henry*, 1903 – A coronation is cancelled (**226**)
Herne Bay Steamboat Co v *Hutton*, 1903 – Cancellation of a naval review (**227**)

Commercial purpose defeated

Physical destruction of the subject matter is not essential to frustration. It extends to situations where although there is no physical destruction the essential commercial purpose of the contract cannot be achieved – a rule referred to as 'frustration of the common venture'.

Jackson v *Union Marine Insurance Co*, 1874 – A ship is stranded (**228**)

Situations in which the doctrine does not apply

It is now necessary to consider the three situations where the application of the rules relating to frustration are limited.

Express provision in the contract

In such a case the provisions inserted into the contract by the parties will apply. Thus in some of the coronation seat cases, e.g. *Clark* v *Lindsay* (1903) 19 TLR 202, the contracts provided that if the procession was postponed the tickets would be valid for the day on which it did take place or that the parties should get their money back with a deduction for the room owner's expenses. These took effect to the exclusion of the principles of frustration.

Self-induced events

The rules relating to frustration do not apply where the event making the contract impossible to perform was the voluntary act of one of the parties.

Leases and contracts for the sale of land

Judicial opinion has been divided as to whether leases and contracts for the sale of land can be frustrated since these create an interest in land which survives any frustrating event.

Maritime National Fish Ltd v *Ocean Trawlers Ltd*, 1935 – Effect of a self-induced frustration (**229**)

Cricklewood Property and Investment Trust Ltd v *Leighton's Investment Trust Ltd*, 1945 – Frustration where a title to land is acquired (**230**)

The Law Reform (Frustrated Contracts) Act 1943

This important statute has laid down the conditions which will govern the rights and duties of the parties when certain contracts are frustrated.

Before 1943

The common-law doctrine of frustration did not make the contract void *ab initio* (from the beginning) but only from the time when the frustrating event occurred. Thus money due and not paid could be claimed and money paid before the frustrating event was not recoverable.

Chandler v *Webster*, 1904 – A startling application of the common-law rules (231)

After 1943

The position under the Act is as follows:

(a) Money paid is recoverable.

(b) Money payable ceases to be payable.

(c) The parties may recover expenses in connection with the contract or retain the relevant sum from money received, if any.

(d) It is also possible to recover on a *quantum meruit* (a reasonable sum of money as compensation) where one of the parties has carried out acts of part performance before frustration, provided the other party has received what the Act calls 'a valuable benefit' under the contract other than a money payment 'before the time of discharge', i.e. to the time of the frustrating event. There are difficulties in regard to the expression 'valuable benefit', particularly where the work is destroyed, since the Act is not clear as to whether a sum can be recovered by the person conferring the benefit where there has been destruction of his work. In *Parsons Bros* v *Shea* (1965) 53 DLR (2d) 86 a Newfoundland court, in dealing with an identical provision under the Newfoundland Frustrated Contracts Act 1956, held that the carrying out of modifications to a heating system in a hotel subsequently destroyed by fire could not be regarded as conferring any 'benefits' upon the owner. However, in *BP Exploration Co (Libya)* v *Hunt (No 2)* [1982] 1 All ER 125 the claimants were engaged to develop an oil field on the defendant's land and were to be paid by oil from the wells. After the wells came on stream but before BP had received all the oil which the development contract provided they should have, the wells were nationalised by the Libyan government which gave the defendant some compensation. The contract was obviously frustrated but Goff, J, who was later affirmed by the Court of Appeal and the House of Lords, gave BP a sum of 35 million dollars as representing the 'benefit' received by the defendant prior to the frustrating event.

Clearly, here there was a surviving benefit conferred before the frustrating event and at the time of it, i.e. the value of the oil already removed by Mr Hunt before nationalisation and, of course, his claim for compensation against the Libyan government. None of these things would have been available to him before BP's discovery and extraction of oil on his land. Since the benefit conferred up to the time of frustration clearly survived the frustrating event, i.e. the nationalisation, the case does not resolve the problems posed by *Parsons Bros* v *Shea* (above) where the benefit did not survive the frustrating event.

However, it is the better view that there is no need for the benefit conferred to survive the frustrating event. The court can make an award provided benefit was once conferred. The fact that it did not survive the frustrating event can be taken into account by the court when assessing (and probably reducing) how much it gives to the claimant.

The *force majeure* clause

It is unwise in business to rely on the court to declare that a contract is frustrated. If the court rules that there is no frustration, the defendant may be required to pay damages for breach to the other party. It is common, therefore, to include in business contracts what are known as *force majeure* clauses. The expression means 'irresistible compulsion or coercion' and a typical clause will contain events likely to impede performance such as strikes, accidents to machinery,

government restrictions in terms of licences, wars, epidemics and so on. The contract will go on to provide that the parties may suspend the contract or cancel it should one or more of the events happen and there will be no frustration. Why? – because as Lord Denning said in *The Eugenia* [1964] 1 All ER 161, 'The contract must govern'.

Discharge by breach

This occurs where a party to a contract fails to discharge it lawfully but instead breaches one or more of the terms of the contract. There are several forms of breach of contract as follows:

(*a*) Failure to perform the contract is the most usual form as where a seller fails to deliver the goods by the appointed time or where, although delivered, they are not up to standard as to quality or quantity.
(*b*) Express repudiation which arises where one party states that he will not perform his part of the contract.
(*c*) Some action by one party which makes performance impossible.

Any breach which takes place before the time for performance has arrived is called an *anticipatory breach*. Thus the situations described in (*b*) and (*c*) above are anticipatory breaches.

Where the breach is anticipatory the aggrieved party may sue at once for damages. Alternatively, he can wait for the time for performance to arrive and see whether the other party is prepared at that time to carry out the contract.

Hochster* v *De la Tour, 1853 – An express repudiation (**232**)

Omnium D'Enterprises and Others* v *Sutherland, 1919 – An implied repudiation (**233**)

White and Carter (Councils) Ltd* v *McGregor, 1961 – Anticipatory breach: where a party carries on with the contract (**234**)

Anticipatory breach and supervening events

It may be dangerous to wait for the time of performance to arrive since the contract may, for example, have become illegal, thus providing the party who was in anticipatory breach with a good defence to an action.

Avery* v *Bowden, 1855 – Anticipatory breach: where the second breach was excused (**235**)

Effect of breach on contract

Not every breach entitles the innocent party to treat the contract as discharged. It must be shown that the breach affects a vital part of the contract, i.e. that it is a breach of condition rather than a breach of warranty (contrast *Poussard* v *Spiers and Pond* (see Chapter 14) with *Bettini* v *Gye* (see Chapter 14)) or that the other party has no intention of performing his

contract as in *Hochster* v *De la Tour* (see above) or has put himself in a position where it is impossible to perform it as in *Omnium D'Enterprises and Others* v *Sutherland* (see above).

Other matters relevant to breach

Two further points arise in connection with breach of contract. The first is that the concept of contributory negligence does not apply. In *Basildon District Council* v *J E Lesser* (*Properties*) *Ltd* [1985] 1 All ER 20 the claimant sued for breach of contract in regard to the building of dwellings which had become unfit for habitation without repair. There was a defence that the damages payable should be reduced on the basis that the council's officers were guilty of contributory negligence. It was said that they should have noticed the lack of appropriate depth in foundations on seeing the building contractors' original drawings. It was decided by the High Court that the defence of contributory negligence did not apply in contract but only in tort.

It should be noted, however, that the obligation in the above case was entirely contractual. If the claimant could have sued, either in contract or in tort, as where the damage arises from a breach of contract and a tort, then even if the injured party decides to sue for breach of contract only the damages can be reduced if he is contributorily negligent (see *Forsikrings Vesta* v *Butcher* [1988] 2 All ER 43).

The Law Commission in its report made in 1993 entitled *Contributory Negligence as a Defence in Contract* recommends that the availability of apportionment of damages for breach of contract should be extended from the field of tort to cases where the claimant who complains of breach of contract has contributed to his own loss.

Second, the Drug Trafficking Act 1994, s 50 brought in what is called a 'laundering' offence under which anyone knowingly assisting with the retention, control or investment of drug-trafficking proceeds could be liable to a term of imprisonment. Banks, building societies, accountants, solicitors and other advisers are given protection by the Act if they disclose their suspicions about their client's finances if these seem to be connected with drug trafficking. However, the Act ensures that they cannot be sued for breach of contract if they pass on to the appropriate authorities their suspicions that any funds or investments may be connected with drug trafficking. Section 50 is repealed and replaced by provisions in the Proceeds of Crime Act 2002.

Impact of the introduction of the euro

The immediate problem to be looked at is that of ensuring that commercial contracts affected by the arrival of the euro in much of the EU on 1 January 1999 do not operate where required beyond that date. The main reason for this will be that, as we have seen, a wide variety of contracts governed by English law provide that where a party is unable to perform his contractual obligations through factors beyond his control (such as in this case the abolition (eventually) of the currency in which he is required to tender payment), the contract is automatically discharged by frustration – a concept which has no direct equivalent in the rest of the EU, where law is based on Roman Law – or under a *force majeure* clause. The Maastricht Treaty deals with this by providing that, in the absence of an express contrary intention by the parties, the introduction of the euro will not: