

# CONTRACTING OUT OF DISCHARGE FOR BREACH

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*This article is concerned with the process and consequences of a discharge for breach of contract. It argues that the election to discharge arises because, as a matter of fact or construction, the breach relied on tends to deprive the innocent contracting party of the benefit of further performance. From that it follows that he is entitled himself to refuse further performance, and to recover in damages a substitute for the benefit he would have enjoyed had the other party performed his obligations under the contract. Further consequences follow: the innocent party, in releasing himself from future obligations of performance reciprocally releases the other party from performance of obligations dependent on the performance of obligations from which he has released himself. Sometimes the application of these rules gives rise to results which appear unfair. In the past courts have occasionally applied fallacious rules of law to remove the injustice. Now it seems that they tend instead to take liberties with the rules of construction to the same end. Either technique provides new breeding grounds for the kind of heresies that have frequently distorted the law of contract.*

## I INTRODUCTION

The principles of the law of contract are not all that difficult to understand, but they can be quite exceptionally hard to find. Even the House of Lords, digging its way through the "accumulated debris of decisions and textbook pronouncements"<sup>1</sup> to find the principles relevant to discharge for breach sometimes fails to state them with the precision that will prevent their words in turn nuturing fresh heresies; and just occasionally their Lordships seem to get the principles wrong.

Discharge for breach has notoriously provided a fertile breeding ground for heretical formulation of principle. The error was correctly diagnosed in semantic ellipse<sup>2</sup> and the magical process analysis of the doctrines that determined the existence of a right to discharge and its remedial consequences.<sup>3</sup> The judges, appalled by the bizarre conclusions that followed the application of the doctrine of fundamental breach,<sup>4</sup>

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<sup>1</sup> Per Lord Wilberforce in *Johnson v. Agnew* [1979] 2 W.L.R. 487, 490.

<sup>2</sup> J. Weir, "*Nec Tamen Consumebatur*—Frustration and Limitation Clauses" [1970] *C.L.J.* 189, 191 ff. See also the comments of Lord Diplock in *Photo Production Ltd v. Securicor Transport Ltd* [1980] 1 All E.R. 556, 565 on the "ambiguous and imprecise expressions" in leading judgments which have induced "disarray" into the law on breach of contract.

<sup>3</sup> Discussed in B. Coote, "The Effect of Discharge by Breach on Exception Clauses" [1970] *C.L.J.* 221, 231; B. Coote, *Exception Clauses* (1964).

<sup>4</sup> E.g., Lord Wilberforce and Lord Diplock in *Photo Production Ltd v. Securicor*

reminded themselves that the law of contract was about ensuring that people kept their promises or paid for it if they failed to<sup>5</sup> and proceeded to replace magical process with equally magical construction.

In accordance with the new techniques of construction, the right to damages for loss of bargain arises on discharge in substitution for the lapsed "primary obligations" of performance as a "secondary obligation" arising equally from the contract,<sup>6</sup> but yet by operation of law<sup>7</sup> on the basis of an implication as to the parties' intentions.<sup>8</sup> The parties' express words, in consequence, operate by way of exclusion of the incidents otherwise attached by law to the promised exchange of performance.<sup>9</sup> The exclusion need not be express. Indeed, it can be implied in the face of express contrary words. In *Woodar Investment Development Ltd v. Wimpey Construction Ltd*<sup>10</sup> a rescission notice was deprived of repudiatory force because the party issuing intended to rely on rather than resile from the contract. In *Hyundai Heavy Industries Co. Ltd v. Papadopoulos*<sup>11</sup> by construction the House of Lords implied an exclusion of the ordinary incidents of discharge to bail out businessmen (who failed to expressly exclude) because they were businessmen who could not have intended not to exclude.<sup>12</sup> It is one thing to look beyond the four corners of a document in order to read it in the matrix of surrounding circumstances,<sup>13</sup> but it is surely another to regard the parties' words as inoperative to the extent that sensible people similarly placed would have said otherwise. The peril inherent in the new techniques of construction is that they can work against freedom of contract in much the

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*Transport Ltd*, note 2 *supra*, 559-565 on the effect of *Suisse Atlantique Société d'Armement Maritime S.A. v. N.V. Rotterdamsche Kolen Centrale* [1967] A.C. 361; *Harbutt's Plasticine Ltd v. Wayne Tank & Pump Co. Ltd* [1970] 1 Q.B. 447; and *Wathes (Western) Ltd v. Austins (Menswear) Ltd* [1976] 1 Lloyd's Rep. 14 (C.A.). Note particularly the comments of Lord Wilberforce at 563 on the "impossible acrobatic . . . necessarily engendered by the doctrine" that a contract could be terminated by fundamental breach notwithstanding affirmation.

<sup>5</sup> E.g., Lord Diplock in *Moschi v. Lep Air Services Ltd* [1973] A.C. 331, 346-347 and Lord Wilberforce in *Photo Production v. Securicor Transport* note 2 *supra*, 563.

<sup>6</sup> Lord Diplock in *Moschi v. Lep Air Services Ltd*, note 5 *supra*, 350; approved by Lord Wilberforce in *Photo Production v. Securicor Transport*, note 2 *supra*, 563; and refined by Lord Diplock in *Photo Production v. Securicor Transport*, note 2 *supra*, 566.

<sup>7</sup> Lord Diplock in *Moschi v. Lep Air Services Ltd*, note 5 *supra*, 350.

<sup>8</sup> Lord Diplock in *Photo Production v. Securicor Transport*, note 2 *supra*, 566-568.

<sup>9</sup> *Ibid.*

<sup>10</sup> [1980] 1 All E.R. 571, 574 *per* Lord Wilberforce.

<sup>11</sup> [1980] 2 All E.R. 29.

<sup>12</sup> *Id.*, 47 *per* Lord Fraser of Tullybelton.

<sup>13</sup> The liberal, contextual approach to construction permits implication of words consistent with the express words as far as is necessary to ensure that the fundamental purpose of the contract is not aborted: *Prenn v. Simmonds* [1971] 1 W.L.R. 1381; *Reardon Smith Line Ltd v. Yngvar Hansen-Tangen* [1976] 1 W.L.R. 989; *B.P. Refinery v. Shire of Hastings* (1977) 16 A.L.R. 363; *D.T.R. Nominees Pty Ltd v. Mona Homes Pty Ltd* (1978) 19 A.L.R. 223.

same way as the doctrine of fundamental breach did. The only difference is that, instead of the contract being consumed by the flames of its subject-matter,<sup>14</sup> it is devoured, as the cases considered below demonstrate, by its matrix of surrounding facts and circumstances.

## II THE GENERAL PRINCIPLES

Stated simply, a breach of contract is a non-compliance with the terms of a contract by one of the parties. The normal remedy for the innocent party is an assessment of damages to compensate him for the losses arising from the breach.<sup>15</sup> Those losses are usually measured as at the date of breach, on the basis that the innocent party is obliged from that date to mitigate his losses.<sup>16</sup> Sometimes, however, the parties will have expressly provided a remedy for the event which has happened.<sup>17</sup> If this is so, subject to the law relating to penalties,<sup>18</sup> that remedy will be enforced although not necessarily to the exclusion of common law damages. As a matter of construction, unless the parties have clearly indicated that their words provide exhaustively for the consequences of the event, the common law remedy in damages assessed on the basis of actual loss remains as an alternative mode of relief.<sup>19</sup> This is because by contract parties promise an exchange of performance, modifying as they wish the incidents the law would otherwise, by construction of their intentions, attach to the agreed exchange.<sup>20</sup> The contractual agreement thus states the promised exchange, "the primary obligations",<sup>21</sup> but it

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<sup>14</sup> *E.g.*, *Harbutt's Plasticine Ltd v. Wayne Tank & Pump Co. Ltd*, note 4 *supra*, and noted by J. Weir, note 1 *supra*.

<sup>15</sup> The losses are measured by loss of the expectation engendered by the promise, subject to the rules relating to remoteness and mitigation.

<sup>16</sup> That rationalisation of the breach-date rule emerges *per* Lord Wilberforce in *Johnson v. Agnew*, note 1 *supra*, 499 as developed and refined in *Dodd Properties (Kent) Ltd and Another v. Canterbury City Council and Others* [1980] 1 All E.R. 928, 933-934 *per* Megaw L.J.; 938-940 *per* Donaldson L.J. In accordance with those decisions, where some date other than the date of breach provides the earliest reasonable opportunity for mitigation, that date will provide also the date for assessment to ensure that the quantum conforms with the object of compensation.

<sup>17</sup> *Holland v. Wiltshire* (1954) 90 C.L.R. 409, approved by Lord Wilberforce in *Johnson v. Agnew*, note 1 *supra*, 495-496, and *Hunt v. Hyde* [1976] 2 N.Z.L.R. 453.

<sup>18</sup> *Per* Lord Dunedin in *Dunlop Pneumatic Tyre Co. Ltd v. New Garage & Motor Co. Ltd* [1915] A.C. 79, 87; *per* Dixon J. in *McDonald v. Dennys Lascelles Ltd* (1933) 48 C.L.R. 457, 478.

<sup>19</sup> Note 17 *supra*.

<sup>20</sup> *Per* Lord Diplock in *Photo Production v. Securicor Transport*, note 2 *supra*, 566-568.

<sup>21</sup> Lord Diplock analyses the obligations of performance as "primary obligations" which may be express or implied, and the obligation to pay damages for breach as "secondary obligations" arising by implication, and subject to the express or implied modification of the parties: see *Photo Production v. Securicor Transport*, note 2 *supra*, 566-568. He refined his statements to the same effect in *Moschi v. Lep Air Services*, note 5 *supra*, 350. Lord Wilberforce expressed his approval, of Lord Diplock's analysis, in *Photo Production v. Securicor Transport*, note 2 *supra*, 563.

may also supplement or exclude "the secondary obligations"<sup>22</sup> such as the liability to pay common law damages.

If the breach is serious rather than minor the law relating to damages and other secondary obligations is, with one qualification, unchanged.<sup>23</sup> The qualification is that where the parties expressly or impliedly intended different secondary obligations to arise from a serious breach that intention will be ascertained and honoured.<sup>24</sup> A serious breach is also, usually at the election of the innocent party,<sup>25</sup> capable of affecting primary obligations. The innocent party may elect either to "affirm" the contract or to "discharge" it. If he affirms it, the primary obligations are unchanged by the breach.<sup>26</sup> If he discharges it, he accepts the breach as relieving him and the other party from future performance of obligations which have not already accrued under the contract.<sup>27</sup> Obligations which have already arisen in terms of the contract do not lapse, except where their performance was conditional upon reciprocal performance by the other party of an obligation which is now discharged.<sup>28</sup>

The event of discharge affects secondary obligations as a necessary consequence of its impact on primary obligations. Liability in damages extends beyond the losses occasioned by the breach which justified discharge to embrace additional liability for net losses<sup>29</sup> arising from the non-performance of the discharged obligations.<sup>30</sup> Those additional losses are commonly described as injury resulting from "loss of bargain"

<sup>22</sup> *Ibid.*

<sup>23</sup> *Per* Lord Diplock in *Photo Production v. Securicor Transport*, note 2 *supra*, 566.

<sup>24</sup> On this basis the deviation cases are explained, see *e.g.*, Lord Wilberforce in *Photo Production v. Securicor Transport*, note 2 *supra*, 563.

<sup>25</sup> With the possible exception of the deviation cases, exercise of an election is essential to effect discharge: *per* Lord Wilberforce in *Photo Production v. Securicor Transport*, note 2 *supra*, 563; see also B. Coote, "The Effect of Discharge by Breach on Exception Clauses" note 3 *supra*, 225. The alternative view that repudiation operates automatically to bring a contract to an end unless the innocent party chooses to waive the right to discharge is explained by J. Thomson, "The Effect of a Repudiatory Breach" (1978) 41 *Mod. L. Rev.* 137 and J. Thomson, "Unacceptable Acceptance" (1979) 42 *Mod. L. Rev.* 91 and is inconsistent with principle. See also discussions of the authorities and commentaries by A. Shea, "Discharge from Performance of Contracts by Failure of Condition" (1979) 42 *Mod. L. Rev.* 623, 632 ff. and R. Benedictus, "Repudiation of Employment Contracts" (1979) 95 *L.Q.R.* 14.

<sup>26</sup> *Per* Lord Diplock in *Photo Production v. Securicor Transport*, note 2 *supra*, 566.

<sup>27</sup> *Per* Lord Porter in *Heyman v. Darwins Ltd* [1942] A.C. 356, 399 adopted in *Photo Production v. Securicor Transport*, note 2 *supra*, 562-563 *per* Lord Wilberforce; 566 *per* Lord Diplock.

<sup>28</sup> *Per* Dixon J. in *McDonald v. Dennys Lascelles Ltd*, note 18 *supra*, 476-478, and approved by Lord Wilberforce in *Johnson v. Agnew*, note 1 *supra*, 495.

<sup>29</sup> *I.e.*, after appropriate allowance for the opportunity to mitigate losses and costs, including the costs the discharging party would have incurred in performing the obligations from which he is now released: *Hydraulic Engineering Co. Ltd v. McHaffie, Goslett, & Co.* (1878) 4 Q.B.D. 670; *T.C. Industrial Plant Pty Ltd v. Robert's Queensland Pty Ltd* [1964] A.L.R. 1083.

<sup>30</sup> *Johnson v. Agnew*, note 1 *supra*; *Moschi v. Lep Air Services Ltd*, note 5

or "loss of the contract".<sup>31</sup> They are not recoverable on breach alone because, until discharge, the continuing existence of the reciprocal obligations to perform mean that the value of the bargain is not as a matter of fact lost and is not therefore assessable in damages.<sup>32</sup> By discharge, the benefit of the performance of the *in futuro* obligations is necessarily lost, and the innocent party is able to obtain a substitute for that benefit in damages.<sup>33</sup> Although it is the discharge rather than the breach which justified discharge that appears to be the immediate cause of the loss of bargain, the seriousness of the breach is such that its causal force is not interrupted by the event of discharge.<sup>34</sup> To put it another way, in order to warrant the drastic consequences that flow from a discharge for breach, the breach must of its nature tend to deprive the innocent party of the benefit of his bargain through performance, and the innocent party must as a result elect to cut his losses on performance. Therefore, because the justification for and the consequences of discharge are inextricably intertwined it is necessary as a first step to consider the characteristics essential to take a breach into that category.

### III A BREACH JUSTIFYING DISCHARGE

A breach which justifies discharge can arise in any number of ways.<sup>35</sup> Typically it arises by an anticipatory repudiation<sup>36</sup> or failure to perform

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*supra*, 345 per Lord Reid; 350 per Lord Diplock; 356 per Lord Simon of Glaisdale; further expounded by Lord Diplock in *Photo Production v. Securicor Transport*, note 2 *supra*, 566-567.

<sup>31</sup> *Ogle v. Comboyuro Investments Pty Ltd* (1976) 136 C.L.R. 444; *Horsler v. Zorro* [1975] 1 Ch. 302; and G. Treitel, *The Law of Contract* (5th ed. 1979) 692.

<sup>32</sup> Per Lord Wilberforce in *Johnson v. Agnew*, note 1 *supra*, 492 and the Australian authorities therein relied upon. In *Ogle v. Comboyuro Investments Pty Ltd*, note 31 *supra*, Gibbs, Mason and Jacobs JJ. at 458 and Barwick C.J. at 450-455 suggested that loss of bargain damages might be recovered without discharge of the contract, a view which is inconsistent with the view adopted in this article. See also M. Hetherington, "He who Comes to Common Law Must Come with Clean Hands" (1980) 9 *Syd. L. Rev.* 71, 82 and n. 64; and R. Goff and G. Jones, *The Law of Restitution* (2nd ed. 1978) 370.

<sup>33</sup> *Ibid.* See also *Moschi v. Lep Air Services Ltd*, note 5 *supra*, and the analyses of Lord Reid at 345-346 and Lord Diplock at 350.

<sup>34</sup> This proposition follows from Lord Diplock's definition of the circumstances that justify discharge for breach in *Photo Productions v. Securicor Transport*, note 2 *supra*, 566-567 and discussed *infra*; It can also be justified on the theory that the effect of discharge is to "truncate" the contract, *i.e.*, it notionally takes the parties directly from the point of termination to the point where completion is due: see B. Coote, "The Effect of Discharge by Breach on Exception Clauses", note 3 *supra*, 226.

<sup>35</sup> A list of possible circumstances is provided by A. Shea, "Discharge from Performance of Contracts by Failure of Condition" note 23 *supra*, 623-624. See also Lord Wilberforce in *Photo Production v. Securicor Transport*, note 2 *supra*, 561.

<sup>36</sup> *E.g.*, by issue of rescission notice as in *Heyman v. Darwins Ltd*, note 27 *supra*. Note the view of Lord Russell in *Woodar Investment Development Ltd v. Wimpey Construction U.K. Ltd* [1980] 1 All E.R. 571, 583.

on a specified date.<sup>37</sup> The essential quality which unites all such breaches is their tendency to deprive the other party of the benefit of further performance. The conclusion that the tendency exists can be reached on one of two bases: either the parties have expressly or impliedly said so, or the court finds that in fact the tendency has materialised in deprivation. In *Photo Production Ltd v. Securicor Transport Ltd*<sup>38</sup> Lord Diplock described the two bases in the following way:

(1) where the event resulting from the failure by one party to perform a primary obligation has the effect of depriving the other party of substantially the whole benefit which it was the intention of the parties that he should obtain from the contract, the party not in default may elect to put an end to all primary obligations of both parties remaining unperformed (if the expression 'fundamental breach' is to be retained, it should, in the interests of clarity, be confined to this exception);

(2) where the contracting parties have agreed, whether by express words or by implication of law, that any failure by one party to perform a particular primary obligation ('condition' in the nomenclature of the Sale of Goods Act 1893) irrespective of the gravity of the event that has in fact resulted from the breach, shall entitle the other party to elect to put an end to all primary obligations of both parties remaining unperformed (in the interests of clarity, the nomenclature of the Sale of Goods Act 1893 'breach of condition', should be reserved for this execution).<sup>39</sup>

In that case the House of Lords was obliged to revisit the graveyard of fundamental breach, on a fact situation hauntingly reminiscent of *Harbutt's Plasticine*<sup>40</sup> and contracts engulfed in the flame of their subject-matter,<sup>41</sup> in order to restate the proposition that no breach, fundamental or otherwise, destroyed a contract in the sense necessary to support the fallacious reasoning on which the doctrine had been constructed.<sup>42</sup> The House also described the impact of exception clauses on contractual obligations and thus on the existence, quality or consequences of their breach:

My Lords, an exclusion clause is one which excludes or modifies an obligation, whether primary, general secondary or anticipatory secondary, that would otherwise arise under the contract by

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<sup>37</sup> *E.g.*, by failure to pay a sum of money on a specified day as in *Hyundai Heavy Industries v. Papadopoulos* [1980] 2 All E.R. 29; and *Moschi v. Lep Air Services*, note 5 *supra*.

<sup>38</sup> [1980] 1 All E.R. 556.

<sup>39</sup> *Id.*, 566-567. To the same effect see also Lord Diplock in *Hong Kong Fir Shipping Co. Ltd v. Kawasaki Kisen Kaisha Ltd* [1962] 2 Q.B. 26, 72 and Buckley L.J. in *Decro-Wall International S.A. v. Practitioners in Marketing Ltd* [1971] 1 W.L.R. 361, 380.

<sup>40</sup> *Harbutt's Plasticine Ltd v. Wayne Tank & Pump Co. Ltd* [1970] 1 Q.B. 447.

<sup>41</sup> See J. Weir, note 2 *supra*, 191.

<sup>42</sup> Note 38 *supra*, 560-561 *per* Lord Wilberforce; 565-567 *per* Lord Diplock; 568-570 *per* Lord Salmon.

implication of law . . . Since the presumption is that the parties by entering into the contract intended to accept the implied obligations, exclusion clauses are to be construed strictly and the degree of strictness appropriate to be applied to their construction may properly depend on the extent to which they involve departures from the implied obligations. Since the obligations implied by law in a commercial contract are those which, by judicial consensus over the years or by parliament in passing a statute, have been regarded as obligations which a reasonable businessman would realise that he was accepting when he entered into a contract of a particular kind, the court's view of the reasonableness of any departure from the implied obligations which would be involved in construing the express words of an exclusion clause in one sense that they are capable of bearing rather than another is a relevant consideration in deciding what meaning the words were intended by the parties to bear.<sup>43</sup>

Thus, exception clauses provide one mode of qualifying obligations. If the clause affects only secondary obligations, it will not remove a right to discharge for breach.<sup>44</sup> However, if it qualifies primary obligations, its effect may be to render that which would otherwise be a breach not a breach, or that which would otherwise be a serious breach justifying discharge, a minor breach sounding only in damages.<sup>45</sup>

Another more controversial mode of qualifying obligations lies in the parties' conduct in relation to the act which would otherwise constitute a serious breach justifying discharge. It was with this question that a differently constituted House of Lords was concerned in *Woodar Investment Development Ltd v. Wimpey Construction Ltd*.<sup>46</sup> Woodar agreed to sell Wimpey fourteen acres of land for £1,000,000. The contract contained a condition under which Wimpey enjoyed a power to "rescind" the contract on the happening of certain events. Before completion was due the property market collapsed with the result that the contract became unfavourable to Wimpey. Wimpey took legal advice as to how it might lawfully avoid its obligations, and was advised that a specified event had happened. Wimpey then arranged to see Woodar's representative, explained its position as regards the application of the condition, proposed a renegotiation of the contract, failing which it indicated the intention to serve notice of rescission. Woodar's represen-

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<sup>43</sup> *Id.*, 567-568 per Lord Diplock.

<sup>44</sup> *E.g.*, the limitation clauses in *Suisse Atlantique Société d'Armement Maritime S.A. v. N.V. Rotterdamsche Kolen Centrale*, note 4 *supra*; and *Harbutt's Plasticine Ltd v. Wayne Tank & Pump Co. Ltd*, note 40 *supra*.

<sup>45</sup> *E.g.*, the exclusion clause in *Photo Production v. Securicor Transport*, note 38 *supra*. See also *Suisse Atlantique Société d'Armement Maritime S.A. v. N.V. Rotterdamsche Kolen Centrale*, note 4 *supra*, 431 per Lord Wilberforce: "An act which, apart from the exceptions clause, might be a breach sufficiently serious to justify refusal of further performance, may be reduced in effect, or made not a breach at all, by the terms of the clause."

<sup>46</sup> [1980] 1 All E.R. 571.

tative contested the correctness of Wimpey's position, and expressed the intention of taking the matter to court to determine the validity of the rescission notice if it was issued. Wimpey served notice of rescission two weeks later in the expectation which was promptly realised that Woodar would initiate proceedings. Wimpey entered a defence and counterclaim alleging that they had validly rescinded. The parties remained in correspondence. The letters from Woodar's representative contained statements including these: "both parties from the legal point of view, must now await the decision of the court . . .", and "we will retire to our battle stations and it goes without saying I am sure that you will abide by the result as I will". Subsequently Woodar issued proceedings claiming that the notice of rescission and the defence and counterclaim amounted to a repudiation which they accepted and which consequently entitled them to damages for loss of bargain.

The trial judge held that Wimpey had erred in believing that the circumstances specified in the condition had arisen. Therefore, their attempted rescission was a wrongful repudiation of the contract entitling Wimpey to discharge for breach and recover loss of bargain damages. The Court of Appeal by a majority agreed. However, the House of Lords held, also by a majority decision, that the attempted rescission was not repudiatory. The majority, Lords Wilberforce, Keith and Scarman, thought that the effect of the rescission notice had to be determined with reference to the circumstances in which it was issued. Lord Wilberforce's opinion (with which Lord Scarman agreed) was that an attempt to rescind pursuant to express contractual provision was a reliance on rather than a refusal to be bound by the contract. Accordingly, for the purpose of identifying a repudiatory act it was "neutral". Therefore, it was necessary to supplement the rescission notice with evidence showing an intention on the part of Wimpey to refuse to complete when completion fell due. On the facts, "Wimpey manifested no intention to abandon, or to refuse future performance of, or to repudiate the contract".<sup>47</sup> Lord Keith (correctly, it is suggested) emphasised that it was the interaction of both parties' conduct in relation to the attempted rescission that prevented a finding that it was repudiatory. His Lordship appears to suggest that there was a tacit understanding between the parties that the rescission notice would not amount to a repudiation, but would instead constitute a mutually convenient initiating mechanism for the ascertainment of respective rights in court:

The doctrine of repudiatory breach is largely founded on considerations of convenience and the opportunities which it affords for mitigating loss, as observed by Cockburn CJ in *Frost v. Knight*.<sup>48</sup> It enables one party to a contract, when faced with a clear

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<sup>47</sup> *Id.*, 574-575 per Lord Wilberforce; Lord Scarman expresses his agreement at 589.

<sup>48</sup> (1872) L.R. 7 Exch. 111, 114.

indication by the other that he does not intend to perform his obligations under it when the time for performance arrives, to treat the contract, if he so chooses, as there and then at an end and to claim damages as for actual breach. Where one party, honestly but erroneously, intimates to the other reliance on a term of the contract which, if properly applicable, would entitle him lawfully to rescind the contract, in circumstances which do not and are not reasonably understood to infer that he will refuse to perform his obligations even if it should be established that he is not so entitled, legal proceedings to decide that issue being in contemplation, I do not consider it in accordance with ordinary concepts of justice that the other party should be allowed to treat such conduct as a repudiation. Nor, in my opinion, are there any considerations of convenience which favour that course.<sup>49</sup>

The approach of Lord Keith approximates most nearly the relevant considerations of principle and policy. An unjustified notice of rescission tends to be repudiatory because it is a statement that the party issuing it does not intend to fulfil his contractual obligations. That tendency is not diminished for the reason that the rescission is attempted pursuant to express contractual provision: the question is not one of relying on the contract but one of unjustifiably resiling from the promise to perform under it.<sup>50</sup> Ordinarily, the other party could rely on the notice to discharge although performance was not yet due in order to maximise his chance of mitigating the losses which would arise from failure of performance of the primary obligations. To the extent that his mitigation was imperfect he might recover damages. However, here the parties had agreed, before the notice was issued, that it was modified. Instead of saying "I will not perform" Wimpey had said "I will perform only if a court tells me I will be in breach if I don't". The subsequent acts of both parties in issuing and responding to proceedings to test the validity of the rescission were consistent with this statement. That is, the rescission notice was not a repudiation because it was not in fact an attempt to rescind. On that basis, the case also falls outside Lord Diplock's categories which on the view taken in this article are definitive of the tendency to deprive the other party of the benefit of performance. A statement "I will not complete unless a court tells me I am bound to" does not tend to deprive the other party of the benefit of further performance.

The difficulty, of course, lies in justifying analysis on this basis. If the express words of a party are "I will not perform" it is difficult to understand how their interpretation in the matrix of surrounding circumstances can transform them into "I will perform . . .".

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<sup>49</sup> Note 46 *supra*, 588.

<sup>50</sup> There is nothing in principle to distinguish a rescission attempted pursuant to express contractual provision and any other attempt to resile from the obligations of the contract. The essence of repudiation lies in communicating an unequivocal intention not to perform, and to this the particular means employed are irrelevant.

#### IV THE EFFECT OF DISCHARGE ON CONTRACTUAL OBLIGATIONS

If, as is suggested above, the election to discharge arises because of the tendency of the breach to deprive the innocent party of the benefit of further performance it follows that he is entitled himself to refuse further performance and to recover in damages a substitute for the benefit he would have enjoyed had the other party performed.<sup>51</sup> Further consequences in turn follow. The innocent party, in releasing himself from future obligations of performance reciprocally releases the other party from future performance of obligations dependent on the performance of the obligations from which he has released himself.<sup>52</sup> The status of obligations which accrued under the contract before discharge is determined by their connection with the discharged obligations. An accrued obligation dependent on a discharged obligation lapses with the result that benefits conferred by its performance must be restored and liabilities incurred through its non-performance lapse.<sup>53</sup> If the accrued obligation was not so dependent it is unaffected by the discharge.

The apparently inflexible rule that on discharge of future obligations accrued dependent obligations lapse generally, but not invariably, produces fair results. It was with this rule that the House of Lords was concerned in *Hyundai Heavy Industries Co. Ltd v. Papadopoulos*.<sup>54</sup> Hyundai contracted to build a cargo ship for Pitria Pride Navigation, the purchase price to be paid in five instalments during the period of construction. Petros Papadopoulos, Charalambos Paraskevopoulos and George Papanastassopoulos agreed to "guarantee the payment in accordance with the terms of the Contract of all sums due or to become due by the Buyer to you under the Contract, and in case the Buyer is in default of any such payment, we will forthwith make the payment in default of the Buyer". Pitria Pride defaulted in paying the second instalment, and after several weeks Hyundai exercised its right to "rescind" under article 11 of the contract. In accordance with that article, Hyundai was entitled also to retain instalments already paid for the purpose of meeting its "loss and damage" including reasonable

<sup>51</sup> Lord Reid's statement to this effect in *Moschi v. Lep Air Services Ltd*, note 5 *supra*, 345, "it appears to me that when a contract is brought to an end by repudiation accepted by the other party all the obligations in the contract come to an end and they are replaced by operation of law by an obligation to pay money damages", is refined by Lord Diplock, both in that case at 350 and in *Photo Production v. Securicor Transport*, note 38 *supra*, 566 to show that the secondary obligations arise "from the contract" and "by implication of law" to provide a substitute for the benefit of the performance which the innocent party disentitles himself from accepting on discharge.

<sup>52</sup> F. Dawson, "Fundamental Breach of Contract" (1975) 91 *L.Q.R.* 380, 394-395.

<sup>53</sup> *Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour Ltd* [1943] A.C. 32, 49-50 *per* Viscount Simon; *per* Lord Atkin at 54-55. *McDonald v. Dennys Lascelles Ltd*, note 18 *supra*, 470 *per* Starke J.; 477-478 *per* Dixon J.

<sup>54</sup> [1980] 2 All E.R. 29.

estimated loss of profit arising from the default and cancellation. Hyundai issued a writ against the guarantors claiming the amount of the unpaid second instalment with interest as provided by the main contract. They succeeded at trial, in the Court of Appeal, and by a unanimous decision in the House of Lords. Cancellation of the contract did not deprive Hyundai of the accrued right to payment by the buyers of the second instalment, and even if it did that event would not defeat the accrued right against the guarantors.

On orthodox doctrine the opposite conclusion is irresistible. By the contract Pitria Pride promised to pay for the ship only if Hyundai built and delivered it. The liability to make the instalment payments accrued conditionally on Hyundai's completing and handing over the ship.<sup>55</sup> On the discharge of Hyundai's obligation to hand over the ship the condition failed and so did Pitria Pride's accrued obligation to pay. The first instalment would have been recoverable but for the express retention clause.<sup>56</sup> The obligation to pay the second instalment lapsed. Therefore, there was after discharge no "sum due" or "default" to guarantee. Determining the same questions of law on an analogous fact situation the High Court of Australia had no hesitation in reaching those conclusions:

[W]hen a contract . . . is dissolved at the election of one party because the other has not observed an essential condition or has committed a breach going to its root, the contract is determined so far as it is executory only and the party in default is liable in damages for its breach. . . It does not, however, necessarily follow from these principles that when, under an executory contract for the sale of property, the price or part of it is paid or payable in advance, the seller may both retain what he has received, or recover overdue instalments, and at the same time treat himself as relieved from the obligation of transferring the property to the buyer. When a contract stipulates for payment of part of the purchase money in advance, the purchaser relying only on the vendor's promise to give him a conveyance, the vendor is entitled to enforce payment before the time has arrived for conveying the land; yet his title to retain the money has been considered not to be absolute but conditional upon the subsequent completion of the contract.<sup>57</sup>

The letter of guarantee had no "independent and absolute operation".<sup>58</sup> It was merely a "collateral or secondary undertaking securing the fulfilment of the principal or primary liability under the contract"<sup>59</sup> that died with the liability of the primary debtor to pay.<sup>60</sup>

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<sup>55</sup> *Per* Dixon J. in *McDonald v. Dennys Lascelles Ltd*, note 18 *supra*, 477-478.

<sup>56</sup> *Ibid.*

<sup>57</sup> *Ibid.*

<sup>58</sup> *Id.*, 468 *per* Rich J.

<sup>59</sup> *Id.*, 481 *per* Dixon J.

<sup>60</sup> *Id.*, 480-481 *per* Dixon J.

There were at least two possible ways in which Hyundai might have excluded by contract the application of these orthodox rules. They could have insisted that the main contract state that sums due before cancellation remained due afterwards, in which case the liability of the guarantors would have survived along with the liability of Pitria Pride. Alternatively, they could have required that the guarantors guarantee payment of compensation for losses arising from default and cancellation. Hyundai had done neither.

However, the House of Lords by reliance on dicta in cases which it is respectfully suggested were not analogous, interpreted the contract as impliedly excluding the processes of law that normally follow the failure of the condition upon which an obligation has accrued. In particular, their Lordships made analogy with *Moschi v. Lep Air Services Ltd*<sup>61</sup> and other cases involving contracts of hire<sup>62</sup> and building<sup>63</sup> where the condition upon which an obligation accrued had not failed. The decisions in those cases were irrelevant because, whereas Pitria Pride received and would receive nothing that it had promised to pay for, there the parties subject to the accrued liabilities had received what they had been promised in exchange for their money.<sup>64</sup> *Moschi v. Lep Air Services* provides the most comprehensive example. In consideration of the creditor relinquishing a lien over and promising to release the debtor's goods, the debtor agreed to pay the £40,000 he owed by weekly instalments of £6,000 and Mr Moschi personally guaranteed "performance" of the "obligation to make the payments". The debtor defaulted in his obligations. The creditor treated his default as repudiation and discharged the contract. He then sued the debtor for damages and Mr Moschi for the unpaid amount of the weekly instalments. When Mr Moschi appealed to the House of Lords, their Lordships construed the guarantee contract as one in terms of which the guarantor promised that the debtor would pay; if he failed to do so the guarantor was in breach of his contract and liable in damages measurable by the sum unpaid.

The decision appears susceptible of analysis in the following way. The consideration promised by the creditor was executed at formation or soon afterwards by the relinquishing of the lien and release of the goods. At the time of discharge the creditor had fulfilled all his obli-

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<sup>61</sup> Note 5 *supra*.

<sup>62</sup> *Hyundai Heavy Industries v. Papadopoulos*, note 54 *supra*, 34-35, 39-40, 45-46 relying on *Brooks v. Beirnsstein* [1909] 1 K.B. 98 and *Chatterton v. Maclean* [1951] 1 All E.R. 761.

<sup>63</sup> Note 54 *supra*, 45 relying on *Government of Newfoundland v. Newfoundland Rwy Co.* (1888) 13 App. Cas. 199 and cases referred to in an extract quoted from I. Duncan Wallace (ed.) *Hudson on Building Contracts* (10th ed. 1970) 255.

<sup>64</sup> At least such a substantial part of what they had been promised that it cannot be said that the condition failed or, as it is sometimes put, that there had been a total failure of consideration: discussed in R. Goff and G. Jones, note 32 *supra*, ch. 23.

gations on which payment of the weekly sums was conditional. The debtor had received what he had been promised, and thus his obligation to pay was absolute. Therefore, the discharge could have no effect on the accrued obligations to pay. However, the creditor was obliged to free the debtor from the obligation to tender payment of the future amounts as a matter of reciprocity in consequence of his election to discharge himself from the obligation to receive weekly payments.<sup>65</sup> Thus, reciprocal performance by the creditor prevented failure of the debtor's accrued obligations to pay, but it did not inhibit the ordinary impact of discharge on the future obligations. The primary obligations to pay the instalments were, of course, replaced by secondary obligations to pay damages.

If liability to pay the sums due had been guaranteed by a third party, the creditor would have been able to claim against the debtor and the guarantor for the accrued sums, but against the debtor only for damages for the loss arising from the breach.<sup>66</sup> However, in this case the guarantor had promised that the debtor would *perform*, with the result that on the debtor's breach the guarantor was also in breach, and the damages arising from his breach was a sum equal to the total amount due.

In the circumstances of *Moschi v. Lep Air Services* the construction of the guarantee contract in this way was entirely reasonable. Mr Moschi was the managing director and owner of all but one of the shares in the debtor company. He was in a position to ensure performance, and it was therefore likely that he intended to do so. Further, the words of the guarantee clause itself "Mr Moschi has personally guaranteed the *performance* by [the debtor] . . . of its obligations to make the payments . . ." were not inconsistent with the implication of such an intention.<sup>67</sup>

The facts in *Hyundai* are distinguishable on two bases. The first is that the accrued obligation to pay the second instalment lapsed on discharge of the contract because it was conditional upon the completion and handing over of the ship. Lord Fraser's answer to this argument and the authorities on which it was founded was that because the shipbuilders were bound to incur expenses in constructing the ship before the final sale the case was not comparable with a simple contract for the sale of land or goods.<sup>68</sup> With respect this is not so. In most commercial contracts including those for the sale of land and goods the seller will incur the expense of purchase before he completes his sale. The factor which does set those contracts apart from the *Hyundai* contract is the superior opportunity for mitigation which the seller of a

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<sup>65</sup> This follows from the general principles explained above and is stated by Lord Diplock in *Moschi v. Lep Air Services*, note 5 *supra*, 350-351.

<sup>66</sup> *McDonald v. Dennys Lascelles*, note 18 *supra*; *Moschi v. Lep Air Services*, note 5 *supra*, 350-351 *per* Lord Diplock.

<sup>67</sup> [1973] A.C. 331, 343.

<sup>68</sup> Note 54 *supra*, 44.

whole and complete item enjoys, and that is a factor relevant only to the assessment of damages for the breach not to the obligation to perform the promise. Further, in the cases on contracts for hire and building the accrued obligations survived discharge not because the hirer or builder had incurred expenditure but because the other party had received the benefit for which he had promised to pay.<sup>69</sup>

The second ground of distinction lies in the character of the letter of guarantee. On its words it was a contract of the kind dealt with by the High Court in *McDonald v. Dennys Lascelles Ltd.*,<sup>70</sup> that is one whose obligations were co-extensive with the principal debtor's obligation to pay. The House of Lords, by what is respectfully suggested was a misapplication of Lord Reid's statement in *Moschi*,<sup>71</sup> and resort to "common sense" and the unlikelihood of commercial men intending "that the guarantors were to be released from their liability for payments already due and in default just because the builders used their remedy of cancelling the shipbuilding contract for the future",<sup>72</sup> construed the guarantee as one giving rise to an absolute obligation to pay.

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<sup>69</sup> *E.g.*, in *Brooks v. Beirne* [1909] 1 K.B. 98, Bigham J. justified recovery of rent by a hirer, although the goods hired had been reclaimed thus:

If it could be said that by taking away the goods the owners had deprived the hirer of all consideration for the rent, then I could understand that the accrued cause of action would be gone.

Similarly, in *Chatterton v. Maclean* [1951] 1 All E.R. 761 at 764 Parker J. said:

If he remained liable for the accrued liability—and, of course, it was only right that he should remain liable, because he had had the benefit of the car for the period relating to it—*prima facie*, he being liable and the sum not having been paid, the guarantor is liable under his guarantee.

<sup>70</sup> (1933) 48 C.L.R. 457.

<sup>71</sup> [1973] A.C. 331, 344-345 *per* Lord Reid quoted by Lord Fraser in *Hyundai*, note 54 *supra*, 46 is not particularly easy to follow. Lord Reid appears to suggest that where a guarantee is of the *Hyundai* kind, *i.e.*, where liability arises only on the default of the principal debtor, the guarantor's liability is not extinguished by discharge for breach:

If for any reason the debtor ceased to have any obligation to pay the instalment on the due date then he could not fail to pay it on that date. The condition attached to the undertaking would never be purified and the subsidiary obligation would never arise.

These words were read by Lord Fraser to mean that the guarantor's liability was not discharged by breach even where the principal debtor's liability to pay the sum was dependent on a discharged obligation. Whatever Lord Reid meant, it could not have been that, because the factual context in which he made his observations was one where the payment was not dependent.

The statement of Megaw L.J. at [1971] 1 W.L.R. 934 at 941 (quoted by Viscount Dilhorne at [1980] 2 All E.R. 29, 35) to the effect that the fact of discharge and the consequential increased damages liability does not *per se* remove liability in respect of accrued obligations more accurately states the position, and is not inconsistent with the proposition that survival of obligations is determined by dependence on already performed reciprocal obligations.

In any event, the statements of both judges, as has been observed above, were made in the context of obligations for which reciprocal performance had been fully rendered.

<sup>72</sup> *Hyundai*, note 54 *supra*, 47 *per* Lord Fraser; 36 *per* Viscount Dilhorne. See

## V CONCLUSION

One can happily concede that Hyundai would have been greatly disadvantaged, especially at a time of downturn in international trade, by ending up with a part completed ship on their hands and with their only remedy lying in an action for damages against a presumably impecunious foreign company. Indeed, it was just that kind of injustice which an earlier House of Lords foresaw as a likely consequence of the inflexible formulae that determine the fate of accrued obligations when those on which they are conditioned fail.<sup>73</sup> But it is also a contingency against which commercial men have the resources to protect themselves by express contractual provision. If they fail to do so they have failed to exclude the consequences which the common law routinely attaches to a discharge for breach. It is surely preferable that they should be required to do that than for the rules of construction to be stretched to meaninglessness to protect them *ex post facto*. When the courts have over a period of time gone to considerable pains to make it clear that the express words of a contract operate by way of exclusion of the incidents normally attached, and to insist that clear and express words be used for that purpose, the decision and its reasoning is also unfortunate from the point of view of the consistent development of the common law.<sup>74</sup> To ask for perfect consistency may be to "cry to the moon"<sup>75</sup> but to nurture inconsistency for the benefit of parties well able to protect themselves provides a new breeding ground for the kind of heresies that have frequently distorted the law of contract. If the House of Lords did not like the rule that accrued obligations and conditional guarantees fail with the obligations on which their performance depends, there were plenty of precedents for saying so.<sup>76</sup>

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also Lord Edmund-Davies' reliance on "the matrix of facts" and "sound commercial reasons" for inhibiting the ordinary operation of the relevant doctrines, *id.*, 39.

<sup>73</sup> *Fibrosa Spolka Ackyjna v. Fairbairn Lawson Combe Barbour Ltd* [1943] A.C. 32, 49 *per* Viscount Simon L.C.; 54-55 *per* Lord Atkin; 56 *per* Lord Russell; 72 *per* Lord Wright; 76 *per* Lord Roche; 78 *per* Lord Porter.

<sup>74</sup> *E.g.*, Lord Diplock's exposition of the construction of exemption clauses in *Photo Production v. Securicor Transport*, note 2 *supra*, 567-568 is premised on the assumption that because contracting parties are assumed to have undertaken to perform subject to the ordinary incidents implied by law to the particular kind of contract, they must clearly and expressly exclude any they do not want to apply, to the extent that ambiguous words of exclusion are construed *contra proferentem*.

<sup>75</sup> *Photo Production v. Securicor Transport*, note 2 *supra*, 562 *per* Lord Wilberforce.

<sup>76</sup> The House of Lords is not shy of destroying doctrines which are incorrect (*e.g.*, *Johnson v. Agnew* [1979] 2 All E.R. 487) and/or inappropriate to current conditions (*e.g.*, *Photo Production v. Securicor Transport*, note 2 *supra*; *Miliangos v. George Frank (Textiles) Ltd* [1976] A.C. 443).