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After Frustration: Three Cheers for *Chandler v. Webster*

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Abstract

Performance of a contract can be excused by a number of circumstances, notably impossibility, impracticability, and frustration. When performance is excused there remains the question of how to treat any payments or expenditures that were made prior to the occurrence of the contract-frustrating event. In Chandler v. Webster*, the English courts decided over a century ago that the parties should be left where they were at the time of the frustrating event. Forty years later that holding was overturned so that now recovery might be had both for restitution of payments made prior to the event and for expenditures made in reliance on the contract. American law, as embodied in the Restatement (Second) of Contracts, has also favored restitution with some concern for reliance. Both the English and the American responses emphasize the injustice of the Chandler solution.*

This Article argues that the English and American rules both got it wrong. By emphasizing ex post *justice rather than* ex ante *planning, they both propose default rules that are difficult to interpret and somewhat sticky. The Article first traces the development of the English rule from* Taylor v. Caldwell *through the most recent application of the Law Reform (Frustrated Contracts) Act. It then considers the American majority rule as presented in the Restatement, which focuses on a particular context: a contract to work on an existing structure that is destroyed prior to completion of the contracted work. After considering some of the problems with the Restatement resolution, I consider the contractual solution, which, it turns out, rejects the Restatement rule, opting instead for the Chandler Rule.*

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Table of Contents

I. Introduction

When Edward VII's appendicitis caused the postponement of his Coronation processions the postponement was only temporary, but its impact on contract doctrine was enduring. A number of disputes involving contracts for viewing the processions reached the House of Lords, which held that the purpose of those contracts had been frustrated and that any obligations due following the postponement were excused. What of obligations that arose before the frustrating event? Following *Taylor v Caldwell*,[1] the Law Lords let the losses lie where they fell. Absent any language to the contrary, no expenses incurred in reliance prior to the frustrating event would be shifted to the other party. The additional wrinkle added by the coronation cases, notably *Chandler v. Webster*,[2] was that there would be no restitution for any payments made prior to the frustrating event. If something had been done (or was owing) prior to the frustrating event, it would not be undone by the occurrence of that event. That stood as law in England for forty years despite frequent criticism. The critics finally won when *Chandler v. Webster* was overturned by *Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour, Ltd.*[3]

1. Taylor & Another v. Caldwell & Another, (1863) 122 Eng. Rep. 309; 3 Best & Smith 826.

2. Chandler v. Webster, [1904] 1 K.B. 493 at 495.

3. Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour, Ltd., [1943] A.C. 32 at 49–50 (H.L. 1942) (appeal taken from Eng.).

While the demise of *Chandler v. Webster* has met with widespread approval,[4] I will argue that this was a mistake. It provided a nice, clean default rule—award neither restitution nor reliance. It is administratively simple and, I believe, it corresponds reasonably well with what sophisticated parties actually do. Or, at least, try to do, since courts will on occasion read the parties' resolution out of the contract and substitute some alternative remedy. In *Fibrosa*, the Lords recognized the restitution claim, but explicitly refused to recognize any reliance interests. The Lords encouraged Parliament to rectify this. It did so with the Law Reform (Frustrated Contracts) Act,[5] which would recognize some claims in reliance. American courts have generally favored awarding restitution and on occasion have recognized reliance expenses as well.[6]

The central problem arises from the fact that the performance of the contracting parties does not necessarily coincide. The seller incurs costs (reliance) and the buyer makes payments (restitution) over time. Payments might be front-loaded or back-loaded. The phasing of performance is not dictated by nature; the parties can determine the appropriate phasing of their performance. Consider a simple example to which we will return a number of times. Smith promises to paint Brown's factory for $100,000, a fire destroys the factory after Smith has incurred costs of $30,000 and received progress payments of $20,000. Should Brown get back any of his $20,000? Should Smith be compensated for any of the costs that he has incurred? Leave aside for the moment that their contract would normally deal with such a contingency. My default rule (*Chandler*) would be to leave things alone. No restitution for Brown and no reliance for Smith.

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4. *See generally* G. H. TREITEL, FRUSTRATION AND FORCE MAJEURE (2004). In their articles on the coronation cases, R.G. McElroy and Glanville Williams reflect the negative perceptions of *Chandler v. Webster* on the eve of its overruling. *See* McElroy & Williams, *The Coronation Cases—I*, 4 MOD. L. REV. 241, 241 (1941) (describing the cases as "now [having] few apologists"). *See also* McElroy & Williams, *The Coronation Cases—II*, 5 MOD. L. REV. 1, 2 (1941) (stating that the decision "established a rule of English law which is generally acknowledged to be unjust"). Nor has *Chandler v. Webster* been treated kindly in American casebooks. Multiple editions of the Dawson & Harvey casebook say that "the absurdity of this solution is at once apparent." See, for example, DAWSON, HARVEY, & HENDERSON, CONTRACTS: CASES AND COMMENT 679 (8th ed. 2003). Likewise IAN AYRES & RICHARD E. SPEIDEL, STUDIES IN CONTRACT LAW 901 (7th ed. 2008) refer to the "dubious result." For one of the rare papers sympathetic to *Chandler v. Webster*, see Andrew Kull, *Mistake, Frustration and the Windfall Principle of Contract Remedies*, 43 HASTINGS L.J. 1 (1991).

5. Law Reform (Frustrated Contracts) Act, 1943, 6 & 7 Geo. 6, c. 40 [hereinafter Frustrated Contracts Act].

6. *See* RESTATEMENT (SECOND) OF CONTRACTS § 272 (1981) (describing the general acceptance of restitution claims and the occasional success of reliance claims).

The American and post-*Fibrosa* English default rule would return Brown's $20,000, and, *maybe*, require that Brown compensate Smith for at least some of his costs incurred in reliance.

The case law and commentary have generally approved the demise of *Chandler*, invoking loss-sharing, fairness, and justice.[7] This, I suggest, misses the point. If loss-sharing were indeed important to the parties, they are capable of saying so in their initial agreement. The focus should not be on *ex post* justice, but on *ex ante* planning. To be sure, parties, even very sophisticated parties advised by top-notch legal counsel, are not omniscient.[8] Circumstances could arise where, had they thought of it, the parties would have dealt with it differently. Nonetheless, the starting point for post-excuse remedies should be the *ex ante* concerns of the parties.

In particular, we should recognize that, in the face of changed circumstances, parties would like to be able to adjust their obligations. Termination of the agreement should be viewed as one form of adjustment. The parties could, for example, include force majeure and material-adverse-change clauses. Or they could rely on the excuse doctrines of impossibility, impracticability, and frustration. The agreement could determine what transfers, if any, would have to be made following the termination. The response, particularly with regard to the questions of reliance and restitution, need not be one size fits all. That is, even within a single contract the parties might choose, for example, to give restitution for some events but not others.

Case law and commentary on the excuse doctrines often emphasize the unlikely nature of the particular event. This is taken as license to impose a remedy, because the parties had not, and possibly could not have, considered the possibility of such an occurrence. I think this is wrong on two counts. First, parties do often contemplate events that outsiders would not expect them to. Second, if the excuse clauses are broad enough, they can include many low-probability, unanticipated events. But that is not the primary concern of this Article.[9] My concern is not with *why* performance might be excused, but with what should happen *when* it is excused.

I focus on English and American law. I should note that a casual survey of other legal systems suggests that they have many similarities with the English and American solutions. This presents an interesting puzzle.

7. *See* articles and books cited *supra* note 4 (describing various criticisms of *Chandler*).

8. My concern is with this subclass of contracting entities.

9. For more on this question, see Goldberg, *Excuse Doctrine: The Eisenberg Uncertainty Principle*, 2 J. LEGAL ANALYSIS 359 (2010).

Why do formal legal regimes approach the problem in a similar manner, emphasizing "justice" and "unfairness" while sophisticated economic actors designing their relationships within those regimes normally contract around the defaults?

In Part II, I will discuss the English cases, starting with *Taylor v. Caldwell*. At present, the English law is defined by two decisions interpreting the application of the Frustrated Contracts Act. Both decisions, I will argue, are contrary to what the parties would have wanted. While most American contracts scholars are aware of *Fibrosa* and the Frustrated Contracts Act, they know little or nothing about the details. The consensus view is that whatever the facts, the decision and statute together were an improvement. To appreciate the virtues of *Chandler v. Webster* it is necessary that we understand what has replaced it. I confess that there might be more detail here than most American contracts scholars would find necessary. The short version, for those who lack the time or interest, is that in the name of "justice," the English managed to produce a loose standard that contracting parties would almost certainly have rejected. In Part III, I turn to the American law, with emphasis on the Restatement (Second) of Contracts.[10] I focus on the class of cases described above in which a construction contract is excused because a structure has been destroyed, paying special attention to the disconnect between the Restatement and actual practice.

II. The English Cases

A. Taylor v. Caldwell

On May 27, 1861, Taylor, a promoter, entered into a contract for the use of the Surrey Gardens and Music Hall in which he would put on four grand concerts during the summer. He would pay £100 for each concert and pocket one hundred percent of the revenues. On June 11, before any of the concerts had been held, a fire caused by a careless plumber destroyed the Music Hall.[11] The concerts were canceled and Taylor sued. Taylor did not sue for expectation damages; he sued only for his reliance damages,

10. The Restatement (Third) of Restitution & Unjust Enrichment adopts most of the Restatement (Second) of Contracts.

11. Any facts not in the judgment are from G. H. TREITEL, FRUSTRATION AND FORCE MAJEURE 44–45 (2004).

£58, the costs incurred in preparation for the concerts.[12] Blackburn, J. held that "in contracts in which the performance depends on the continued existence of a given person or thing, a condition is implied that the impossibility of performance arising from the perishing of the person or thing shall excuse performance."[13] Impossibility would relieve both parties of their contractual obligations. The reliance expenses incurred by Taylor in preparation could not be recovered. Taylor had not, apparently, paid any of the £100 installments, so restitution was not an issue.[14]

Blackburn, J. held that the fire was not covered in the contract: "The parties when framing their agreement evidently had not present to their minds the possibility of such a disaster, and have made no express stipulation with reference to it."[15] Defense counsel pointed to the term "God's will permitting,"[16] but the Lords appeared to give it no weight. It is not clear why the contract would be silent regarding the possibility that a fire might destroy the premises. The possible unavailability without fault of the venue or artist is a predictable risk. The parties could excuse each other (the *Taylor* solution), insure against it, or require prepayment or restitution of some or all of any prepayment. Fires, after all, were not so rare that people could not anticipate the possibility. Fire insurance had been available in England since the Great London Fire, roughly two centuries earlier. Indeed, the Surrey Music Hall was covered by fire insurance. Taylor most likely did not have insurance to cover either his expected gains or his reliance losses, although nowadays such insurance would not be unusual.[17]

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12. I should note that £58 was not a trivial amount, because per capita annual income in England at the time was less than £30.

13. Taylor & Another v. Caldwell & Another, (1863) 122 Eng. Rep. 309 at 315; 3 Best & Smith 826 at 839.

14. Shortly after deciding *Taylor*, Blackburn, J. clarified the post-excuse picture: "We think that where . . . the premises are destroyed without fault on either side, it is a misfortune equally affecting both parties; excusing both from further performance of the contract, but giving a cause of action to neither." Appleby v. Meyers, (1867) 2 L.R.C.P. 651 at 659 (Exch.). *Appleby* was cited for the "English rule" in a number of nineteenth century American cases; *see, e.g.*, Butterfield v. Byron, 27 N.E. 667 (Mass. 1891) and The Tornado 108 U.S. 342 (1883). It was cited with approval as late as 1964 in Hipskind Heating & Plumbing Co. v. Gen. Indus., 194 N.E.2d 733 (Ind. App. 1964).

15. *See Taylor*, 122 Eng. Rep. at 313.

16. *Id*. I take this to be a variation on "act of God."

17. News accounts following Michael Jackson's death discussed the efforts of the tour packager, AEG, to obtain insurance. Because of questions regarding Jackson's health and his history of concert cancellations, those efforts were only partially successful. "Given the rumored decline of Jackson's health, British bookmakers—who apparently take bets on

It would also be common for parties nowadays to include in their agreements what should happen if some intervening event meant that either the artist or the venue were unavailable.[18] If the artists are popular (and therefore have a high opportunity cost) and have substantial pre-concert expenses, they are likely to require that the venue give them substantial compensation if the venue were to become unavailable. The amount of the compensation would likely depend on whether the artists had adequate time to find a satisfactory replacement gig. Indeed, they might even require that the venue pay some, or all, of their fee, regardless of the timing.[19] Likewise, a major venue might insist that the artist pay liquidated damages if it has to cancel. The magnitude of the damages could depend on both the timing of the cancellation and the reasons for it. All excuses, whether for the artist or the venue, need not be treated equally.[20]

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everything—are already giving odds that Jackson doesn't perform at all, or at least doesn't complete the run of 10 shows." Daniel Kreps, *Michael Jackson Announces 10-Concert Run at London's O2 Arena*, ROCK AND ROLL DAILY, (Mar. 5, 2009, 12:50 EST) http://www.rollingstone.com/music/news/michael-jackson-announces-10-concert-run-at-londons-o2-arena-20090305 (last visited Oct. 12, 2011) (on file with the Washington and Lee Law Review).

> It is thought the company was unable to get insurance for at least 30 of the concerts—which were due to start next month—after obtaining limited cover for between 10 and 20 of up to £130 million. Insurers declined to take on the financial risk of the shows not going ahead, apparently concerned that the singer, who appeared frail at the unveiling of the concerts in March, would not be able to complete the run.

Jon Swaine & Jamie Dunkley, *Michael Jackson's Death Leaves AEG Live Facing £300m Bill*, TELEGRAPH (London), June 26, 2009.

18. For one such case, see the discussion of *Gamerco S.A. v. ICM/Fair Warning (Agency), Ltd.*, [1995] 1 W.L.R. 1226 (Q.B.) (Eng.), discussed *infra* subpart E.

19. For a somewhat extreme case in which the artist would be paid her full fee, a Paula Abdul contract included this: "In the event that ARTIST is unable to perform during the period of time specified in the Contract due to no fault of her own, ARTIST shall be paid the full compensation agreed upon without the necessity of ARTIST'S performing." CONTRACTSPROF BLOG, (Nov. 15, 2004) http://lawprofessors.typepad.com/contractsprof_blog/2004/11/paula_abduls_ve.html (last visited Oct. 12, 2011).

20. The force majeure clause of Rod Stewart's contract with a Las Vegas hotel distinguished between the usual "acts of God" for which performance would be rescheduled at a mutually agreeable time and Stewart's incapacitation for which the contract would be canceled and Stewart would refund all money that he had been paid. Notwithstanding this clause, his failure to perform and refusal to repay the $2 million fee precipitated a nasty litigation that has been going on for about a decade. Rio Properties, Inc. v. Stewart Annoyances, Ltd., No. 02:01-CV-00459-LRH-PAL, 2008 WL 2512830, at *1 (D. Nev. June 19, 2008); *see also* Susan Butler, *Behind the Deal: Rio Properties vs. Rod Stewart*, BILLBOARD LAW NEWSLETTER, Sept. 15, 2005.

B. The Coronation Cases

Two days before his grand coronation procession was to take place, Edward VII had an attack of appendicitis and the procession had to be postponed. Many contracts had been made in anticipation of the great event and the postponement triggered a substantial amount of litigation. The received wisdom on the coronation cases is that the postponement of the processions was such an extraordinary event that reasonable people would (or could) not have anticipated it. As Vaughan Williams, LJ. put it in *Krell v. Henry*, "I think it cannot reasonably be supposed to have been in the contemplation of the contracting parties when the contract was made, that the coronation would not be held on the proclaimed days . . . or along the proclaimed route."[21] That someone might have thought about a possible postponement or cancellation, however, is not so far-fetched. After all, the unavailability of a heavy smoking, grossly overweight sixty-year-old who had been the target of at least one assassination attempt, was not a trivial possibility.

And, in fact, many people did think about it. Four days before the first procession (and two days before the king's appendicitis) the *New York Times* noted that "[m]any thousands of pounds sterling were underwritten [at Lloyds] on this basis. This shows to what extent public nervousness has grown in certain circles."[22] In an article the day after the postponement was announced, the *New York Times* provided an indication of the extensive insurance coverage:

> The loss of the British insurance companies, particularly those of London, which accepted risks on the coronation, will, it is estimated, run into the millions. . . . [T]housands of insurance policies have been issued during the past year to tradesmen and others who depended for their livelihood for some time to come upon the ability of the King to pass through the coronation ceremonies. The business took a great boom when active preparations were begun for the coronation, and nearly all classes of tradesmen who were directly or indirectly dependent upon the successful termination of the great event bought policies.
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> * * *
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> The companies at first promised large sums if the coronation should not take place. The rate was 10 guineas for each £100. This rate was due to the fact that Lloyds, with whom much of the insurance was taken, unlike

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21. Krell v. Henry, [1903] 2 K.B. 740 at 740.

22. The Associated Press, *The Coronation Gamble*, N.Y. TIMES, June 22, 1902 at 1.

> regular insurance companies, had no means of arriving at the state of health of the person insured. It was therefore age merely—the general allowance that would be placed on the average man at the age of the King—which was considered. Thus the premium for insurance of the late Queen Victoria at the time of the diamond jubilee was £14 per £100 for a year.
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> * * *
>
> Hotel proprietors, restaurant men, costumers, owners of grand stands, managers of places of amusement have all insured themselves against loss in the event of the failure of the coronation to take place.
>
> Many thousands of pounds sterling against the coronation were underwritten at Lloyds at long odds and the large amount of business done was taken as an indication of the extent of the public nervousness.[23]

My concern is not whether performance should have been excused, but with what happened next.[24] In *Krell,* Henry had agreed to pay £75 for the rooms and had already paid £25 before the postponement was announced.[25] Krell sued for the additional £50 and Henry counterclaimed for his prepayment. The trial judge held that both claims were covered by *Taylor v. Caldwell* and denied recovery for both.[26] Henry dropped his counterclaim, so the Lords did not have to deal with the restitution issue. Nor did they have to deal with the reliance issue, because there was no evidence that either party had made any expenditures in reliance upon the procession occurring.

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23. *Coronation Insurance Risks*, N.Y. TIMES, June 25, 1902, at 1. There were twelve pence in a shilling, twenty shillings in a pound, and twenty-one shillings in a guinea. Some contracts, including some of the litigated ones, specifically dealt with the possible postponement or rerouting of the processions. *See* Goldberg, *supra* note 9, at 365.

24. I think that the better rationale for allowing the excuse would have been to recognize from the context that what was sold was a room with a view of the procession. Because that no longer existed, *Taylor v. Caldwell* would apply.

25. Per capita annual income at the time was £45; the judgment does not say whether Henry was buying for his individual use or whether he intended to sell viewing spaces to others. Given the rates in other coronation cases, the price seems too high if Henry were indeed purchasing for his own use. *See* Goldberg, *supra* note 9, at 364–65.

26. The Times [London] Aug. 12, 1902, p. 5. Mr. Justice Darling posed some interesting hypotheticals. What if "the procession had gone by, but it was absolutely dark at the time so that it could not be seen?" Or, "[w]hen people used to take to the Magpie and Stump, opposite the Old Bailey, for the purpose of seeing a hanging, would the landlord be held to guarantee that there would be no reprieve?" Krell's counsel responded to the latter by claiming that his opponent "would have to say if there was a reprieve the defendant got no fun for his money and need not pay."

The restitution question was resolved in *Chandler v. Webster*.[27] Chandler rented a room for £141 15s for the first day with the intention of erecting a stand and selling tickets. The money was all due prior to the postponement and £100 had been paid. Chandler sued for return of his £100 and Webster counterclaimed for the remainder. The House of Lords held that the parties should be left where they were at the time of the frustrating event.[28] That is, the buyer would be responsible for any prepayments or money due prior to the event—there would be no restitution. Webster, therefore, could keep the £100 and also was entitled to the £41 and 15s that had not yet been paid.

In neither *Krell* nor *Chandler* did the contract give a hint as to the function of the prepayment. Nor did the courts ask. There was no evidence that either Krell or Webster had made any investments in reliance upon the contract. Indeed, in addition to promising to pay the entire amount up front, Chandler was going to erect a viewing stand and let seats. There is no evidence on whether Chandler had succeeded in letting seats, whether he had received any payment for them, and, if so, whether he had any obligation to return money. Most likely, the owners' primary concern was that the counterparty would walk away on the eve of the coronation, leaving them with a vacant room and the need to initiate a suit for payment. I suspect, although there is no direct evidence, that in the six months leading up to the coronation, entrepreneurs, in effect, took options, making modest down payments on one viewing site while searching for a more attractive one. As the date drew near, the option price increased. This is, I concede, speculation. There are a lot of reasons for prepayments. As we shall see, in overturning *Chandler v. Webster*, the House of Lords (Lord Porter) put the burden of explaining the purpose on the party that had received the payment. For my purposes, the relevant point is that the coronation cases established a clear rule, a rule that survived for forty years.

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27. Chandler v. Webster, [1904] 1 KB 493.

28. *Id.* at 497 ("[W]here the parties have made no express stipulation that money paid for viewing the procession shall be returned in the event of [cancellation], and where . . . no condition to that effect can be implied, . . . both parties are relieved from further performance [if the procession is prevented from taking place].").

C. Fibrosa *and the Frustrated Contracts Act*

Chandler v. Webster generated considerable criticism,[29] and it was finally overturned in *Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour, Ltd.*[30] In July 1939, a Polish company ordered flax-hackling machines from an English company at a price of £4800, with delivery to be in three to four months. One-third was supposed to be paid when the order was placed, although only £1000 had actually been paid. In September, Germany invaded Poland and Great Britain declared war on Germany. The purchaser sued for the return of its £1000.[31] The force majeure clause included a war contingency: "Should the despatch be hindered or delayed by your instructions, or lack of instructions, or by any cause whatsoever beyond our reasonable control, including strikes, lock-outs, war, fire, accidents, defective material or approval of drawings, a reasonable extension of time shall be granted."[32]

The Law Lords held that this clause did not cover the prolonged and indefinite delay of World War II (the decision came down in mid-1942), and they therefore had to fall back on the default rules of the common law. I cannot understand how a war clause in 1939 would not include the possibility that a war would go on for years; had they already forgotten the "War To End All Wars"? I would think that the sensible interpretation of the clause would be that it included this war and that, after a "reasonable time," the contract would terminate.[33] The notion that force majeure and

29. *See, e.g.*, Cantiare San Rocco S.A. v. Clyde Shipbuilding & Eng'g Co., [1924] A.C. 226 at 258–59 (H.L. 1923) (appeal taken from Scot.) (noting "in high legal quarters a feeling both of uneasiness and of disrelish as to the English rule," which "works well enough among tricksters, gamblers and thieves"); *see also* FREDERICK POLLOCK, PRINCIPLES OF CONTRACT 440 (8th ed. 1911) (criticizing *Chandler v. Webster*).

30. Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour, Ltd., [1943]. A.C. 32. Scottish law had rejected *Chandler* earlier. It attempted to restore the pre-contract situation, requiring the refund of money prepaid and also compensating the seller for at least some of its reliance costs. *See generally* Cantiare San Rocco S.A. v. Clyde Shipbuilding & Eng. Co., [1924] A.C. 226.

31. 1941 WL 14316 (CA), [1942] 1 K.B. 12, (1941) 70 Lloyd's Rep. 30, 31. "Counsel added that he was not counterclaiming for £600, the balance of the £1600, payment of which was a term of the contract, first, because he thought there might not be much chance of getting it, and, secondly, because it might have been used against him on the question of security for costs of the appeal."

32. Fibrosa Spolka Akcyina v. Fairbairn Lawson Combe Barbour, Ltd., (1941) 69 Lloyd's Rep. 97 at 98 (K.B.), *aff'd*, [1942] 1 K.B. 12 (C.A.), *rev'd*, [1943] A.C. 32 (H.L. 1942).

33. The defense argued that the force majeure clause did not apply and that the contract was frustrated. I suspect that it did so because it believed that frustration would put

frustration are not related strikes me as peculiar. However, the defense made just that argument, and made it emphatically:

> Frustration operates independently of the intention of the parties. The fact that an express term in the contract appears to provide for the actual occurrence leading to the frustration in no way prevents there being read into the contract the implied term the existence of which is the basis of the doctrine of frustration . . . . That frustration does not depend on the intention, opinion, or even knowledge of the parties is established . . . . Even where the contract seems to have provided expressly for what has happened in wide terms, it does not prevent frustration by the operation of law.[34]

This theme, we will see, is repeated in *B.P. Exploration Co. (Libya) v. Hunt (No. 2)*.[35]

Regardless, the Lords treated the force majeure clause as irrelevant and then held that the contract had been frustrated.[36] They then overturned *Chandler v. Webster*, holding that the £1000 should be returned.[37] What of the expenditures of the seller in the weeks before the deal was frustrated? There was considerable confusion as to the extent of the manufacturer's reliance. Counsel for the sellers argued that the "machines were of an unusual type."[38] That suggests that these were customized machines, and therefore, that their value to others would be reduced. The decisions

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it under *Chandler*, but it was less certain what would happen under force majeure. *See Fibrosa Spolka Akcyjna* [1943] A.C. at 39. The plaintiffs argued that the clause did operate and that performance would be suspended, perhaps indefinitely. *See Fibrosa Spolka Akcyjna* [1942] 1 K.B. 12 at 22. This, in fact, is what German courts did following the war. Dawson describes the case in which purchasers of Volkswagens in 1938–1939 prepaid a part of the price; the war intervened before delivery. Following the war, some purchasers sued and the court ruled in 1951 that they could receive a Volkswagen at a price to be fixed by the court. The trial court was directed to find the other 330,000 people who had ordered the pre-war VW to see if they had survived the war and still desired a VW. *See* John P. Dawson, *Judicial Revision of Frustrated Contracts: Germany*, 63 B.U. L. REV. 1039, 1083–88 (1983) (describing how German courts handled contracts frustrated by the war).

34. *See Fibrosa Spolka Akcyjna,* [1942] 1 K.B. at 23–24.

35. B.P. Exploration Co. v. Hunt (No. 2), [1979] 1 W.L.R. 783 (Q.B.), *available at* 1979 WL 69003, *aff'd*, [1983] 2 A.C. 352 (H.L. 1981) (appeal taken from Eng.).

36. *See Fibrosa Spolka Akcyjna*, [1942] 1 K.B. at 17 ("Now the point taken for the defendants is that this contract has been frustrated, to use the word that is applied to cases of this kind . . . .").

37. *See id.* at 28 ("If the House of Lords should find themselves able to overrule Chandler v. Webster and substitute a rule like the more civilized rule of Roman and Scottish law, presumably some inquiry will be necessary to determine how much, if anything, of the 1000l.").

38. *See id.* at 38.

suggest that this was probably not the case, but they are a bit murky on this point. Near the beginning of his judgment in the Court of Appeal, Mackinnon, L.J., suggests that there was not really a reliance problem:

> On Dec. 1 the solicitors for the defendants wrote to the solicitors for the plaintiffs that two of the machines had been completed before the war. They go on to say that the defendants can sell all the machinery, "which will leave them with no loss on these particular machines arising from the non-performance of this contract," and ask the plaintiffs to concur in this disposal.[39]

Near the end of his judgment, however, he disclaims any knowledge:

> We know nothing of the work done by the defendants on these machines, or how they disposed of them, or to what extent the £1000 has been a pure windfall to them. If the House of Lords should find themselves able to overrule *Chandler v. Webster*, and substitute a rule like the more civilised rule of Roman and Scottish law, presumably some inquiry will be necessary to determine how much.[40]

The Law Lords added some thoughts on the extent of the manufacturer's reliance, although it is not clear that there was any evidence on the point. Lord Roche concluded (apparently with no evidence) that in this instance there was no reliance issue:

> My Lords, I only desire to add that I am conscious that a conclusion relegating parties in cases of frustration to their contracts may not work out a completely just solution in the pecuniary sense. It happens that in this case it will do so, for the appellants, who did not get the goods or the documents, will get their money back, and the respondents have had the machines, which, so far as completed, were said by the respondents themselves to be realizable without loss.[41]

Lord Porter suggested a default rule—if the reason for the prepayment was unstated, it is returnable.

> It is possible to say that the seller in such a case who has been prudent enough to stipulate for a payment in advance should reap the advantage of his foresight, but to do so is to speculate as to the object for which the advance was obtained, not to ascertain what his legal remedies are upon the facts as known.[42]

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39. *Id.* at 32.
40. *Id.* at 34.
41. *Id.* at 76.
42. *Id.* at 78.

If, therefore, the seller had included in the contract an acceptable rationale for the down payment being nonrefundable were the contract excused, then the law would honor its intent.

As Lord Porter suggested, there are many reasons why a buyer might prepay some, or all, of the price. Here are a few of them. (1) If a dispute arises, it determines who has to sue to change the status quo. (2) The prepayment can give the buyer an option. If I book a hotel, for example, I typically have a free option until 24 hours before the date, after which they will then charge my credit card for one night; in certain high demand contexts (graduation day in a college town) the cancellation date might be earlier and the commitment greater. (3) The prepayment might establish the credibility of the buyer. Prepayment, or payment to a reliable third party (escrow), can ameliorate the credibility problem. (4) Opportunity cost. For example, Krell might have been concerned that Henry might walk away from the deal prior to the procession, leaving Krell with an unrented room. (5) Progress payments provide a seller with working capital. (6) They also provide some protection from opportunistic rebargaining. (7) The seller might have to make some relation-specific expenditures (e.g., customizing goods or advertising for a specific event). It is not clear to me why a plethora of reasons would lead to the conclusion that, absent specific language, we should ignore all of them.

Ultimately, the Lords did not care about reliance. It might be unfortunate, said Lord Chancellor Simon, if the seller had relied, but, absent specific language, the reliance would not be protected:

> While this result obviates the harshness with which the previous view in some instances treated the party who had made a prepayment, it cannot be regarded as dealing fairly between the parties in all cases, and must sometimes have the result of leaving the recipient who has to return the money at a grave disadvantage. He may have incurred expenses in connexion with the partial carrying out of the contract which are equivalent, or more than equivalent, to the money which he prudently stipulated should be prepaid, but which he now has to return for reasons which are no fault of his. He may have to repay the money, though he has executed almost the whole of the contractual work, which will be left on his hands.[43]

New legislation, he said, would be required. Parliament responded shortly thereafter by passing the Law Reform (Frustrated Contracts) Act 1943 which allowed for compensation for reasonable reliance.

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43. Fibrosa Spolka Akcyina v. Fairbairn Lawson Combe Barbour, Ltd., [1943] A.C. 32 at 49.

Section 1(2) provides for restitution of money paid before the discharging event subject to a key proviso. The repayment could be offset, in whole or in part, if that party had incurred reliance expenditures if the court "considers it just to do so having regard to all the circumstances of the case." Section 1(3) adds to this recovery of expenses incurred in reliance so long as they do not exceed any valuable benefits received by the counterparty prior to discharge. Two immediate problems arise. First, what, if anything, constrains the judge's notion of what is "just"? Second, what constitutes a benefit? Returning to the example in the Introduction, if Smith contracts to paint Brown's factory and the factory burns down after half has been painted, did Brown receive a "benefit"? Would the results be different if the painter had been paid progress payments along the way? That problem was addressed, in part, in sections 2(3) and 2(4). The former would allow the parties to contract out of the Act.[44] The latter applies if the frustrated part of the contract could be treated as severable from the rest; severability would mean that payments for work performed prior to the frustrating event would not be recoverable; severability would be sufficient but it would not be necessary. That is, even if the contract was not severable, a court might find that Brown could not recover.[45]

The dearth of case law following passage of the Act suggests that parties have contracted out of it—parties did not want to be at the mercy of the whims of judges pursuing their view of a just resolution.[46] In the sixty-plus years since its enactment, only two cases have litigated the meaning of the Act: *B.P. Exploration Co. (Libya) v. Hunt (No. 2)*[47] and *Gamerco v. I.C.M.*[48] Neither makes much sense.

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44. Section 2(3) says:

> Where any contract to which this Act applies contains any provision which, upon the true construction of the contract, is intended to have effect in the event of circumstances arising which operate, or would but for the said provision operate, to frustrate the contract, or is intended to have effect whether such circumstances arise or not, the court shall give effect to the said provision and shall only give effect to the foregoing section of this Act to such extent, if any, as appears to the court to be consistent with the said provision.

Frustrated Contracts Act, 1943, 6 & 7 Geo. 6, c. 40, § 2(3).

45. Mr. Justice Robert Goff's interpretation of the clause in *B.P. Exploration Co. (Libya) v. Hunt (No. 2)* will be discussed below. *See infra* text accompanying notes 55–58.

46. Virgo suggests that disputes dealing with frustration might have ended up in arbitration. *See* GRAHAM VIRGO, THE PRINCIPLES OF THE LAW OF RESTITUTION 356 (2006).

47. The most detailed analysis of the Act's application is in the trial court decision by Robert Goff, J. *See generally* B.P. Exploration Co. (Libya) v. Hunt (No. 2), [1979] 1 W.L.R. 783.

48. Gamerco S.A. v. ICM/Fair Warning (Agency), Ltd., [1995] 1 W.L.R. 1226 (Q.B.)

D. B.P. Exploration Co. (Libya) v. Hunt (No. 2)

The deal, a so-called farm-out agreement, was rather complicated, but all we need is a somewhat simplified version. Nelson Bunker Hunt received a fifty-year concession from the Libyan government to explore for oil in 1957. One condition of the concession was that he would have to start drilling within three years and so he teamed up with British Petroleum. British Petroleum would do all the exploration and development on its own account. BP made an up-front payment of $2 million in cash and 4 million barrels of oil (which, I presume, Hunt could resell immediately and convert into cash). Hunt would put up no cash. If oil in commercial quantities were discovered, the oil would be split 50:50. In addition, British Petroleum would recover its exploration and development expenses out of Hunt's 50% share; so, until BP had recouped 125% of its expenses, three-eighths of Hunt's share would go to BP.[49] Oil was discovered and production commenced in 1967. The contract was amended at that time so that instead of the 125% rule, BP's compensation would come from the first 50 million barrels. However, in 1969, the Libyan king was overthrown and Muammar Muhammad al-Gadaffi[50] came to power. Subsequently, Gadaffi became involved in a dispute with the British government; instead of breaking off relations with Britain, Libya expropriated BP's share. A few years later Hunt's share was also expropriated, but that is essentially irrelevant.[51] BP sued Hunt, arguing that the purpose of their agreement had been frustrated, and, invoking the Act, asked for compensation. After years of fighting over whether the dispute should be resolved in England or Texas, the case was heard in England. The trial lasted fifty-seven days and in a very lengthy judgment (over 40,000 words), Mr. Justice Robert Goff found for BP.

The agreement was spread over two documents, the letter agreement and the operating agreement. Before proceeding, I will reproduce some of the relevant terms:

> [*Clause 6 of the letter agreement.*] It is specifically understood and agreed that Mr. Hunt shall have no personal liability to repay the sums

(Eng.).

49. The expenses were not adjusted for the time value of money—the 25% premium was designed to approximate the interest costs.

50. This was the spelling used in the decision.

51. Libya paid compensation to both, but the compensation was based on the value of the equipment, not the value of the oil concession. BP was paid $42,000,000 and Hunt $20,000,000. A. v. United Kingdom, App. No. 10000/82, 6 Eur. H.R. Rep. 535 (1984).

> required in the operating agreement and this letter agreement to be advanced by B.P. for Mr. Hunt's account or paid to Mr. Hunt, but B.P.'s right to recover any such sums which B.P. is required to pay or advance for Mr. Hunt's account shall be limited to recovery solely out of three-eighths of Mr. Hunt's half of the production, and in the manner specified under section 9 of the operating agreement, if, as and when produced, saved and delivered at the Libyan sea terminal.[52]
>
> [*Clause 9 (e) of the operating agreement. Reimbursement of Payments.*] B.P. shall be entitled to take and receive as reimbursement three-eighths of Mr. Hunt's share of the oil production from the concession delivered f.o.b. Libyan seaboard until B.P. has received a quantity of crude oil equal to the sum of the following: (1) A quantity equal in value to 125 percent of all costs and expenses advanced by B.P. for Mr. Hunt's account on exploration, development or any other work performed in or in connection with the concession, then (2) a quantity equal in value to U.S. $2,500,000, and then (3) 5,000,000 barrels.[53]
>
> [*Clause 27 of the operating agreement.*] If any party is rendered unable wholly or in part by Force Majeure to carry out its obligations under this Agreement other than the obligation to make money payments, that party shall give to all other parties prompt written notice of the Force Majeure with reasonably full particulars concerning it. Thereupon the obligations of the party giving the notice, so far as they are affected by the Force Majeure, *shall be suspended* during, but no longer than, the continuance of the Force Majeure. The affected party shall use all possible diligence to remove the Force Majeure as quickly as possible. The requirement that any Force Majeure should be remedied with all reasonable despatch shall not require the settlement of strikes, lock-outs, or other labour difficulty by the party involved contrary to its wishes. How all such difficulties shall be handled shall be entirely within the discretion of the party concerned. The terms "Force Majeure" as here employed shall mean an act of God, strike, lock-out or other industrial disturbance, act of a public enemy, war, blockade, public riot, lightning, fire, storm and flood, explosion, *governmental restraint*, unavailability of equipment and any other cause whether of a kind specifically enumerated above or otherwise, which is not reasonably within the control of the party claiming suspension.[54]

Expropriation would, I should think, be covered in the force majeure clause under the rubric of "governmental restraint." Not so. Goff, J., in

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52. B.P. Exploration Co. (Libya) v. Hunt (No. 2), [1979] 1 W.L.R. 783 at 828.

53. *Id.* at 828–29.

54. B.P. Exploration Co. (Libya) v. Hunt, [1976] 1 Lloyd's Rep. 471 at 474 (emphasis added).

dismissing the clause, found it so irrelevant he did not even bother to reproduce the clause in his judgment:

> [S]ection 27 is the force majeure clause, but again that only applies during the subsistence of the contract—its effect is only to suspend a party's obligations during the continuance of the force majeure, and it makes no provision for what is to occur in the event of frustration.[55]

As in *Fibrosa*, the clause is interpreted as applying only during temporary suspensions. There, because the defendant believed that a finding of frustration would favor it, the defendant argued against finding the force majeure clause governing. Here, the positions were reversed. Farm-out agreements in the United States continue to refer only to "suspension," with no explicit acknowledgment of the possibility of a permanent termination.[56] My understanding is that had Texas law been binding, the force majeure clause would have terminated the agreement. Surprisingly, the contracts included neither a choice of law nor choice of forum clause,[57] and so the litigation ended up in the English courts using English law. Perhaps this was a result of the parties adopting a Texas form document without taking into account the possibility that a dispute would end up in England.[58]

Even without the force majeure clause, Hunt would seem to have a strong argument on the basis of clause 6. All expenses are to be paid by BP and BP's only compensation is to come from the produced oil. No oil, no money. That seems about as clear as possible. And that, like the force

55. *B.P. Exploration Co. (Libya)*, [1979] 1 W.L.R. at 830.

56. John S. Lowe, *Analyzing Oil and Gas Farmout Agreements*, 41 Sw. L.J. 759 (1987).

57. *See* B.P. Exploration Co. (Libya) v. Hunt, [1976] 1 Lloyd's Rep. 471 at 478

> Neither the 1960 agreement nor the 1967 amendment contains any express term about the governing law or the jurisdictional venue in the event of dispute. The operating agreement contains an arbitration clause providing for the appointment of an arbitrator by each of the parties and of a referee to be appointed, in default of agreement between the arbitrators, by the President of the International Court of Justice, but without any indication of the law to be applied or of the country in which the arbitration is to take place. Both parties have evidently ignored this arbitration clause, as they are entitled to do.

Hunt, apparently, did not fight the use of English law because he was "advised that, even if English law did govern the contract, since it excluded personal liability for restitution of the starting-up costs, he would not be ordered to pay restitution to BP." A. v. United Kingdom, App. No. 10000/82, 6 Eur. H.R. Rep. 535 (1984).

58. B.P. Exploration Co. (Libya) v. Hunt (No. 2), [1979] 1 W.L.R. 783 at 822 ("I understand that the present agreement is not very different from other farm-in agreements used in the oil industry, especially in the United States—indeed there are signs that the present agreement derives from a form which was adapted for use in the present case.").

majeure clause, would have yielded the same outcome as *Chandler v. Webster*, leaving the losses where they fell. However, Justice Goff found (and the Law Lords unanimously agreed) that once the contract was deemed frustrated, clause 6 no longer applied. "Generally speaking, when a contract is determined by frustration, the whole contract goes. . . . *It must never be forgotten that the policy of the Act is to prevent the unjust enrichment of the defendant at the expense of the plaintiff*."[59]

Having freed himself from the contractual language, Goff, J. then set about interpreting and applying the Act. In *Fibrosa*, the buyer sought restitution for a prepayment and the seller incurred some expenses, arguably, in reliance. That situation, covered by Section 1(2) of the Act, was quite different from this one. Before turning to the actual case, consider a simpler one. Suppose that BP had made a one-time cash payment of $50 million to Hunt and would receive 100% of the revenues. If BP was then expropriated, could it get restitution of any part of the $50 million? Unlike in *Fibrosa*, the reliance expenditures would have been made by BP, not Hunt. Rather than being an offset to the initial payment, they would be additional costs. Because Hunt would have no further stake in the operation, this might as well be an out-and-out sale. If indeed there had been a sale and subsequently Libya expropriated the field, there would be no rationale for BP getting any of its $50 million back from Hunt, regardless of how much (or little) oil BP had produced prior to the expropriation. But, if it remained only a contract, even though there would be no substantive difference from the outright sale, the Frustrated Contracts Act might allow BP to recover some of the $50 million. Recovery would depend on how much oil it had produced (and the costs it had incurred) and would be contingent upon whether a judge found recovery to be "just."

The facts here were more complicated, but the merits of BP's claim were no better. BP made a relatively small down payment, incurred substantial costs, and divided the revenue stream so that Hunt had received 5/16 of the oil revenue when the expropriation occurred. Goff, J. interpreted the statute as requiring Hunt to make restitution, with the amount capped by the benefits Hunt had received. Because the bulk of

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59. *Id.* at 829 (emphasis added). He continued:

> Mr. Alexander submitted that it was part of the general scheme of the contract that Mr. Hunt was never to put his hand in his pocket. However, quite apart from the fact *that such a proposition begs the question whether any such contractual scheme has any bearing on the situation when the contract has ceased to bind*, the proposition itself is too sweeping to be accurate.

Id. at 830 (emphasis added).

Hunt's benefits were in services, not cash, the first question was whether to evaluate them as the cost of the input or the value of the output. Because the field had turned out to be a productive one, the gap between the two was large. The judge opted for the value of the output. The value of the output exceeded the cost of the input in this instance, but that need not always be the case. In the class of excuse cases mentioned in the Introduction (the factory that was destroyed before completion of the paint job), Goff, J. argued that the value of the output would be zero.[60] The second question was how to value BP's reliance. Third, how should any costs incurred by BP be apportioned between BP and Hunt; and what credit, if any, should Hunt get for producing the benefits?

Because the contract was terminated eleven years after formation and the costs were heavily front-loaded, a fourth question concerned the treatment of the time value of money.[61] Goff, J. concluded, reluctantly, that the statute required that he ignore it. So a dollar in 1960 was the same as a dollar in 1970.[62]

The benefit received by Hunt included the prepayment, the oil received both before and after BP's expropriation, and the modest compensation Hunt received from Libya following its expropriation. Because the output was due to the efforts of both BP and Hunt, the court attributed half of Hunt's benefit to BP's efforts. (Hunt's "effort" apparently was the initial acquisition of the concession).[63] No justification was given

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60. A court could find that there was an addition to value prior to the fire; some American cases take that position. This matter will be considered in more detail in Part III.

61. A subsidiary question concerned which currency should be used. That question became relevant because the judge's reading of the statute convinced him that the time value of money should be ignored. The exchange rate changed over the life of the contract, the pound falling from $2.80 to $2.00 when judgment was rendered. Because some costs and benefits were in dollars, others in pounds, and still others in Libyan dinars, they could not simply be added together. If the time value of money had been recognized, the currencies could be converted into each other at each point in time so that the award could have been in a single currency.

62. *B.P. Exploration Co. (Libya)*, [1979] 1 W.L.R. at 820

> If it were open to me to take account of the time value of money for the purpose of assessing Mr. Hunt's benefit, I would have considered that the discounted net cash flow method of accounting provided an appropriate method for doing so. . . . I have come to the conclusion that, on a true construction of the Act of 1943, it is not open to me to make an allowance for the time value of money.

The Court of Appeal endorsed this reading of the Act. "This can only mean that what has been paid out must be paid back. There is no scope in this subsection for adding to the sum paid something extra to represent the time value of money." B.P. Exploration Co. (Libya) v. Hunt, [1983] 1 W.L.R. 232, 244.

63. B.P. Exploration Co. (Libya) v. Hunt (No. 2), [1979] 1 W.L.R. 783 at 816.

for this arbitrary allocation. Goff, J. then found that Hunt's net benefit was about $85 million. This, then, provided a ceiling for BP's compensation.

To determine BP's reliance costs, the court began with BP's prepayment; it then took the costs BP had incurred on Hunt's behalf (presumably, half of the actual costs being for BP and half for Hunt), and subtracted the market value of the reimbursement oil that it had received—about 33 million barrels. What of the half of the costs incurred on BP's account and the roughly 88 million barrels of oil it received on its own account? Those were ignored.[64] The costs plus the prepayments were approximately $98 million and the value of the reimbursement oil about $63 million, resulting in an award of roughly $35 million.[65] Because this was less than Hunt's benefit ($85 million), Hunt would have to return the entire $35 million to BP. To this, interest was added from the time the cause of action arose.

On appeal, Mr. Justice Goff's conclusion that neither the force majeure clause nor clause 6 survived frustration was upheld. Lord Justice Lawton in the Court of Appeals said:

> The legal effect of frustration is to bring a contract to an end forthwith, without more and automatically: . . . . It follows that clause 6 ceased to operate after December 7, 1971, unless, on its true construction, it was intended to have effect whether there was frustration or not. We can find no words in it to that effect. . . . . In order to sustain the defendant's submission the clause would have to be read as meaning that the defendant should have no personal liability under the contract or otherwise, including under the Act of 1943, to repay. In our judgment there is no reason why the clause should be read in these terms; and, if it is not so read, it ceased to have effect when the frustrating events occurred. What the defendant has been ordered to pay under the

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64. The Court of Appeal noted that BP would have shown a profit if the time value were ignored and a loss if it were taken into account:

> On a reimbursement basis, without the time value factor, the plaintiffs appeared to have made a profit of about U.S. $55,000,000 out of operating the concession; but, if it was taken into account, they had made a loss of about $11,000,000. Commercial men would regard this as a real loss.

B.P. Exploration Co. (Libya), [1983] 1 W.L.R. at 244. These numbers seem low to me. I calculate that BP received on its own account oil worth about $165 million; BP's share of the costs was about $87 million, which would yield a profit (ignoring the time value) of $78 million.

65. *B.P. Exploration Co.*, [1979] 1 W.L.R. at 838. Because the exchange rate changed and costs and benefits were in three different currencies, the court split the final judgment into a dollar and a sterling component.

> judgment is not what was due under the contract but what was recoverable from him as a just sum under the Act.[66]

Having satisfied themselves that Section 2(3) was inapposite, both the Court of Appeal and the House of Lords upheld Justice Goff's findings with little analysis. The law, said Lawton, J., grants the trial court considerable discretion: "What is just is what the trial judge thinks is just. That being so, an appellate court is not entitled to interfere with his decision unless it is so plainly wrong that it cannot be just."[67]

Hunt had one final shot, the European Commission of Human Rights. In rejecting his plea, the Commission noted that the fact that the Frustrated Contracts Law had never been litigated did not matter:

> In the present case the proceedings in the United Kingdom were based upon a statute which preexisted the Farm-In Agreement and of which the parties to that agreement may therefore be assumed to have been aware. However the applicant points out that the statute had never previously been interpreted by the Courts and that it could not have been foreseen to have applied to the Farm-In Agreement. Nevertheless the Commission cannot equate this position with that where the applicable law has been substantially changed by legislation which has affected the established rights of one party, because it is clear from the very fact that BP instituted proceedings against the applicant that it was arguable that the 1943 Act might be found to apply to the Farm-In Agreement.[68]

So, to recapitulate, Hunt brought one thing to the deal—a fifty-year concession to develop an oil field. We know not how he procured it, but we do know that once he had entered into the BP agreement he had no further responsibilities. BP, on the other hand, agreed to incur the heavy expenses of searching for oil and, if successful, building the infrastructure

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66. *B.P. Exploration Co. (Libya)*, [1983] 1 W.L.R. at 241. In the House of Lords, Lord Brandon added:

> [T]here is nothing in the terms of the contract between the parties, or in the circumstances surrounding the making of it as found by Robert Goff J., to indicate, either expressly or by necessary implication, that the parties, when they made the contract in 1960, had in contemplation political risks, such as expropriation of the concession in whole or in part by the Libyan government, which would operate to frustrate the contract; or that, having had such risks in contemplation, they included in the contract any provision which, expressly or by necessary implication, was to take effect in the event of such risks materialising.

B.P. Exploration Co. (Libya) v. Hunt (No. 2), [1983] 2 A.C. 352, 372.

67. B.P. Exploration Co. (Libya) v. Hunt (No. 2), [1983] 1 W.L.R. 232, 238.

68. A. v. United Kingdom, App. No. 10000/82, 6 Eur. H.R. Rep. 535, 540 (1984).

that would get it to market.[69] If the oil field were successfully developed, the parties would split the revenues evenly. Hunt would pay nothing out of pocket. He would contribute to the costs only out of his share of the produced oil—3/8 of his share going to BP until a particular hurdle was crossed (125% of BP's costs or, after amendment, 50 million barrels of oil). Libya expropriated the property and BP argued successfully that the contract had been frustrated. This, notwithstanding that the contracts had allocated some of the risks of government restraints in a force majeure clause. The court held that the force majeure clause applied only to temporary suspensions, not to a permanent expropriation.[70] It further held that the Frustrated Contract Act rendered irrelevant any contractual risk allocation that might otherwise have guided the court in fashioning a remedy.[71]

Thus unmoored, Mr. Justice Goff fashioned a remedy that made no sense. By interpreting the statute as precluding consideration of the time value of money, he assured that both Hunt's benefits and BP's reliance would be mismeasured. The artificial split of BP's costs between its account and Hunt's bore no relationship to anything. The apparent disregard of the net revenue from BP's 50% share likewise made no sense. All this in the name of "justice." After years of international jockeying,[72] fifty-seven days of trial, and two levels of appeal (three if we count the Commission on Human Rights), the net result was a mishmash that no one could have opted for *ex ante*. Nonetheless, Treitel speaks of it approvingly: "The machinery of the Act worked satisfactorily in *B.P. Exploration (Libya) Ltd. v. Hunt* because the value of the benefit, even when reduced in

69. B.P. Exploration Co. (Libya) v. Hunt (No. 2), [1979] 1 W.L.R. 783 at 816 ("B.P.'s task as operator . . . included the whole task, not only of exploration and appraisal, but of developing the field, creating the necessary facilities, pipeline, terminal, etc., bringing the field on production, and thereafter producing the oil and further developing the field and facilities.").

70. *See id.* at 830 ("[I]ts effect is only to suspend a party's obligations during the continuance of the force majeure, and it makes no provision for what is to occur in the event of frustration.").

71. *See id.* at 798–808 (explaining the way in which a court should handle a claim under the Frustrated Contracts Act).

72. In *B.P. Exploration Co. (Libya) v. Hunt*, [1976] 1 Lloyd's Rep. 471, the court ruled that Hunt could be served and that the English court had jurisdiction. In the interval between Goff's judgment and the House of Lords approval, the Fifth Circuit held that the English judgment would be recognized. Hunt v. BP Exploration Co. (Libya), 492 F.Supp. 885 (5th Cir. 1980). The final round was played out in the European Commission of Human Rights. A. v. United Kingdom, App. No. 10000/82, 6 Eur. H.R. Rep. 535, 540 (1984).

the light of the frustrating event, exceeded the just sum."[73] Virgo criticizes the judgment on totally different grounds from mine: "The judge should have considered *all of the circumstances* of the case, not just the value of services provided."[74] The open-ended invitation of whatever the judge thinks is just apparently was not enough for him.

It is ironic that the first case to interpret the Frustrated Contracts Act fits the pattern so poorly. The paradigm case involves restitution of a prepayment with partial offset for expenses incurred prior to the frustrating event. The time frame is short and the time value of money irrelevant. The only other case did fit that pattern, but the result was not any better.

E. From Taylor v. Caldwell *to* Guns N' Roses

The next case litigated under the Frustrated Contracts Act was a variation on *Taylor v. Caldwell*.[75] For its European tour in 1992, Guns N' Roses was to perform in twenty open-air concerts in twelve countries in less than two months. The last concert, scheduled for July 4, was to take place at the Vicente Calderon Stadium in Madrid. The contract with a Spanish promoter for the Madrid performance was for 90% of the net door receipts with a guaranteed minimum of $1.1 million. The promoter had arranged for the concert to take place and had prepaid the group $412,500. The promoter was "responsible for erecting the stage . . . the roof and generally preparing the venue." An engineering report on June 30 found the stadium unsafe and on July 2 the government banned the use of the stadium. Other Madrid venues were unavailable on such short notice and the concert had to be canceled, disappointing the 44,500 fans who had already purchased tickets.[76] The judgment is silent on whether ticket holders were reimbursed and, if so, who bore that burden. The contract between the Spanish promoter and Guns N' Roses did not include a force majeure clause.[77] I

73. G. H. TREITEL, FRUSTRATION AND FORCE MAJEURE 604 (2004).

74. GRAHAM VIRGO, THE PRINCIPLES OF THE LAW OF RESTITUTION 368 (2006) (emphasis added).

75. Gamerco v. I.C.M., 1995 WL 1082241 (QBD), [1995] C.L.C. 536, [1995] E.M.L.R. 263, [1995] 1 W.L.R. 1226, 5-03-1995 Times 1082,241.

76. There do not appear to have been any other problems with venues on the tour. However, during the tour health problems caused the postponement of one of the concerts and cancellation of another. *See* THE HISTORY OF GN'R 1992, http://www.heretodaygonetohell.com/history/history92.php (last visited Oct. 12, 2011) (cataloging all the band's activities during 1992) (on file with the Washington and Lee Law Review).

77. Gamerco v. I.C.M., [1995] 1 W.L.R. 1226 at 1232–33. "The contract became both

find the lack of any clause puzzling. The answer might be in the piecemeal way the contract was put together. There was a short document with a number of riders. For various reasons, the court chose not to recognize one of the riders. It is plausible that rider would have contained a force majeure clause, but of that, we cannot be certain.[78] While the parties did not, apparently, allocate the risk contractually between them, they both anticipated the possibility that the event would be canceled without the fault of either. As Garland, J. noted: "Both parties had insured against cancellation and had made recoveries under their respective policies."[79]

In any event, the promoter sued for the return of the $412,500. The defense argued that it had been ready, willing, and able to perform and that the contract had not been frustrated—the plaintiff had breached by not providing the stadium. That failed. In applying the Act, Garland, J. held that the money must be returned, subject to a possible offset for costs incurred by the defendant, as required by justice. He did note that the costs of a modern touring rock group could be substantial:

> [They] took with them on tour specialist contractors for sound, video, lighting, catering, and transport together with members of their own staff. Apart from the six members of the group there were 20 "band touring personnel" and 76 "crew touring personnel," of whom approximately 30 were either staff or self-employed under a corporate identity. The transport required was a Boeing 727 chartered from M.G.M. Grand Air for 53 days, ten articulated trucks, two generator trucks, four 12-berth sleeper coaches and one 14-berth, all hired with drivers for 53 days.[80]

The band's reliance expenditures directly attributable to the Madrid engagement were no doubt modest—perhaps they had to pay cancellation fees for some hotels. Their primary reliance costs were a share of the fifty-three-day tour's expenses. How should the costs be apportioned between the various engagements on a tour? Should they be prorated across the

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physically and legally incapable of performance: there was no force majeure or catastrophe clause, nor any provisions similar to those in some engineering contracts allocating the risks should the work become physically or legally impossible of performance."

78. The 1991 rider "is a mixture of extensive contractual provisions including the term relating to 'permits, licences, and certificates' . . . and *cancellation.*" *Id.* at 1231 (emphasis added). In their analysis of the case J.W. Carter and Gregory Tolhurst also question the Court's exclusion of the 1991 Rider from the contract. J. Carter & G. Tolhurst, *Gigs N' Restitution—Frustration and the Statutory Adjustment of Payments and Expenses*, 10 J. CONT. L., 264, 265 (1996).

79. *Id.* at 1235.

80. *Id.* at 1229.

twenty engagements? Should an accountant break out the costs specific to the Madrid show? Garland, J. took evidence on the band's reliance expenditures but was not persuaded. The band claimed about $180,000; the court figured that it was closer to $50,000, although it provided no rationale for so finding. At the same time, he concluded that the *plaintiffs* had incurred reliance expenditures, including payments to third parties, for work done in preparation of the stadium. The court found those costs to be about $450,000.

Garland, J.'s interpretation of the Act was that he should "do justice in a situation which the parties had neither contemplated nor provided for, and to mitigate the possible harshness of allowing all loss to lie where it has fallen."[81] Because both parties had insured against the contingency, the conclusion that neither party had contemplated the situation is not tenable. But that is just an aside. The grounds for excusing performance should not depend on the contemplation of the parties or the remoteness of the supervening event. Granted that performance should be excused, Garland, J. still had to deal with the plaintiff's claim for restitution. He concluded: "In all the circumstances, and having particular regard to the plaintiffs' loss, I consider that justice is done by making no deduction under the proviso."[82] That is, the band must repay the entire prepayment.

Lost in this exercise is any concern for why the prepayment in the first place. This interpretation of the statute presumes that the only legitimate ground for making an offset against restitution is the band's out-of-pocket reliance. The band's primary concern, almost certainly, was not the pro rata share of the tour costs, but opportunity costs—they were stuck in Spain earning nothing and not being paid the guaranteed $1.1 million (plus a share of the merchandising income). We cannot be sure about why the parties structured the contract as they did—counsel did not help on this score. The most plausible explanation is, I think, that when negotiating with promoters for the tour the band could take advantage of the competition amongst promoters and get assurance that it would receive a reasonable fraction of its expected earnings if a show had to be canceled even if neither party were at fault. The more attractive the act, the greater the nonrefundable fee. And, with per-show fees in excess of $1 million, Guns N' Roses was a very attractive act.

81. *Id.* at 1238.
82. *Id.*

III. Coming to America

While the English statute displaced the contract entirely, the American approach implied a term. "Since it is the rationale of . . . [the Restatement (Second)] that, in a case of impracticability or frustration, the contract does not cover the case that has arisen, the court's function can be viewed generally as . . . supplying a term to deal with that omitted case."[83] The majority rule in the United States is spelled out in the Restatement (Second) sections 272,[84] 371,[85] and 377.[86] The rules purport to soften the impact of the termination of the contract. "Because the rules . . . might otherwise appear to have the harsh effect of denying either party any recovery following the discharge of one party's duty based on impracticability or frustration, . . . several mitigating doctrines may be used to allow at least some recovery in a proper case."[87] The recurring theme is that the law should "avoid injustice." The Restatement (Third) of Restitution & Unjust Enrichment follows the Contracts rules: "This Restatement presents a substantially different organization of this common material, without altering specific outcomes."[88]

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83. RESTATEMENT (SECOND) OF CONTRACTS, § 272 cmt. c (1979).

84. *Id.* § 272.

> Relief Including Restitution[.] (1) In any case governed by the rules stated in this Chapter, either party may have a claim for relief including restitution . . . . (2) In any case governed by the rules stated in this Chapter, if those rules together with the rules stated in Chapter 16 will not avoid injustice, the court may grant relief on such terms as justice requires including protection of the parties' reliance interests.

85. *Id.* § 371.

> Measure Of Restitution Interest[.] If a sum of money is awarded to protect a party's restitution interest, it may as justice requires be measured by either (a) the reasonable value to the other party of what he received in terms of what it would have cost him to obtain it from a person in the claimant's position, or (b) the extent to which the other party's property has been increased in value or his other interests advanced.

86. *Id.* § 377.

> Restitution In Cases Of Impracticability, Frustration, Non-Occurrence Of Condition Or Disclaimer By Beneficiary[.] A party whose duty of performance does not arise or is discharged as a result of impracticability of performance, frustration of purpose, non-occurrence of a condition or disclaimer by a beneficiary is entitled to restitution for any benefit that he has conferred on the other party by way of part performance or reliance.

87. *Id.* § 272 cmt. a.

88. RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 34 (2011).

It is useful to focus attention on a particular problem. A contractor is working on an existing structure, but before completion of the job, the structure is destroyed by fire and the contractor is excused.[89] That problem is prominently featured in the Restatement. The owner might have made some payments to the contractor prior to the fire. The nineteenth century common law rule was that neither party would have an action against the other.[90] As the Restatement makes clear, that is no longer the case.

Before turning to the various American responses, I want to return to Mr. Justice Goff's interpretation of the Frustrated Contracts Act's treatment of this problem:

> Suppose that a contract for work on a building is frustrated by a fire which destroys the building and which, therefore, also destroys a substantial amount of work already done by the plaintiff. Although it might be thought just to award the plaintiff a sum assessed on a quantum meruit basis, probably a rateable part of the contract price, in respect of the work he has done, the effect of section 1 (3) (b) will be to reduce the award to nil, because of the effect, in relation to the defendant's benefit, of the circumstances giving rise to the frustration of the contract. . . . [T]he subsection therefore contemplates that, in such a case, the benefit is the end product of the plaintiff's services, not the services themselves.[91]

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89. For a review of the case law, see *Liabilities or Risks of Loss Arising Out of Contract for Repairs or Additions to, or Installations in, Existing Building which, without Fault of Either Party, is Destroyed Pending Performance*, 28 A.L.R.3d 788 (1969). While this would appear to be somewhat dated, my understanding is that there has been little or no subsequent litigation. Almost all the cases cited in this review were pre-World War I. For a modern variation on this problem, see *One World Trade Center LLC v. Cantor Fitzgerald Sec.*, 789 N.Y.S.2d 652, 6 Misc.3d 382 (N.Y. Sup. Ct. 2004), discussed *infra* note 112.

90. *See* Story on Bailments, § 426b. *cited with approval in* Krause v. Bd. of Trs., 70 N.E. 264, 269 (Ind. 1904)

> Suppose there is a contract to do work on a thing by the job (as, for example, repairs on a ship), for a stipulated price for the whole work, and the thing should accidentally perish, or be destroyed, without any fault on either side, before the job is completed, the question would then arise, whether the workman would be entitled to compensation pro tanto for his work and labor done, and materials applied, up to the time of the loss or destruction. It would seem that by the common law (independent of any usage of trade) the workman would not be entitled to any compensation, and that the rule would apply that the thing should perish to the employer and the work to the mechanic.

91. *See* B.P. Exploration Co. (Libya) v. Hunt (No. 2), [1979] 1 W.L.R. 783 at 801

> I add by way of footnote that all these difficulties would have been avoided if the legislature had thought it right to treat the services themselves as the benefit. . . . But my task is to construe the Act as it stands. On the true construction of the Act, it is in my judgment clear that the defendant's benefit

The owner's benefit could be determined by either the value of the services that had been provided before the fire or the value to the owner after the fire (when everything provided by the contractor had been destroyed). So, if the English courts followed Goff's reading of the Act, there would be no benefit and the contractors would get nothing. The approach in many American jurisdictions is, in effect, to consider the owner's benefit a nanosecond before the fire. The owner at that instant has been "unjustly enriched" and the contractor could be entitled to restitution. The Williston Treatise puts it this way:

> Generally, where full performance has been prevented by impracticability, the right of recovery does not depend on whether the defendant has received and still retains a benefit when further performance becomes impossible. Neither does recovery depend on whether, at any prior time, the performance which the defendant received was personally advantageous. It is enough that the defendant has actually received, in exchange for partial performance of the contract, something for which, when completed, it had agreed to pay.[92]

The Restatement (Third) of Restitution & Unjust Enrichment differs from the Restatement (Second) of Contracts in that it avoids the fiction of the owner receiving a benefit: "The necessary analysis does not require the court to determine the extent (if any) to which Owner was 'enriched' by Builder's interrupted performance."[93]

The relation between the owner's benefit and the contractor's costs is not perfect and that has resulted in divergent treatments of the owner's obligation to the contractor. While in some jurisdictions courts have stuck with the leave-the-losses-where-they-lie rule,[94] the majority position is that restitution should be made for work performed and money paid before the intervening event. The majority position can be further broken down. The Restatement (Second) Illustration is a good place to begin:

> must, in an appropriate case, be identified as the end product of the plaintiff's services, despite the difficulties which this construction creates, difficulties which are met again when one comes to value the benefit.

Id. at 802.

92. SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 77 (4th ed. 1993).

93. RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 34 illus. 15 (2011).

94. *See* Krause v. Bd. of Trs., 70 N.E. 264, 265 (Ind. 1904); Hipskind Heating & Plumbing Co. v. Gen. Indus., Inc., 194 N.E.2d 733 (Ind. App. 1963).

> A contracts with B to shingle the roof of B's house for $5,000, payable as the work progresses. After A has spent $2,000 doing part of the work and has been paid $1,800, much of the house including the roof is destroyed by fire without his fault, and the duties of performance of both A and B are discharged . . . . The work done before the fire increased the market price and the insurable value of the house by $1,500. A is entitled to restitution of $1,500 from B and B is entitled to restitution of $1,800 from A.[95]

Notice that there is no consideration of why *B* might have paid the $1800 in the first place. The gap between the $1,800 and the $2,000 is unexplained. Nor is there an explanation for why *A*'s costs exceed *B*'s value. It is hard to imagine an appraiser sifting through the ashes to ascertain the value of the partially completed job. Is *A* being compensated for its reliance or *B* for its loss? If *A*'s costs were all set-up costs so that at the time of the fire, nothing had been installed, would *A* get nothing? In the next illustration, the answer appears to be: Yes. "[T]he fire also destroyed shingles that had cost A $500 and that were piled near the house for the rest of the work. A is not entitled to restitution of this loss from B."[96]

The basis for this illustration is two early twentieth century decisions: *Young v. City of Chicopee*,[97] and *Carroll v. Bowersock.*[98] In the former, the contract was for the repair of a wooden bridge with the contractor to be paid for lumber wrought into the bridge. The court noted that "the contract provided that no work should be begun until material for at least one-half of the repairs contemplated should be 'upon the job.'"[99] The fire destroyed both the bridge and the lumber that had been stacked on the job site, as per contract, but had not yet been incorporated. The contractor sued. The defendant did not dispute liability for the material "wrought into" the bridge, but denied liability for the remaining lumber. The court agreed. This, I should note, is precisely the result that would have been reached under a *Chandler v. Webster* rule. Even though the contract required that material be stored on site, the contractor was to be *paid only if and when* lumber actually was wrought into the bridge; there would be no payment for the unincorporated lumber even though the contract required that it be

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95. RESTATEMENT (SECOND) OF CONTRACTS § 377 illus. 4 (1979).

96. *Id.* illus. 5. However, there is a cryptic proviso: "The court may, however, take this loss into consideration in deciding whether to allow A restitution of $1,500 or $2,000." *Id.*

97. Young v. City of Chicopee, 72 N.E. 63 (Mass. 1904).

98. Carroll v. Bowersock, 164 P. 143 (Kan. 1917).

99. *Young*, 72 N.E. at 63.

present. So, under *Chandler*, Chicopee's liability would have been limited to the contractually determined amount. That is not, however, how the court approached it. It argued that the owner had been unjustly enriched: the lumber had become a benefit to the owner as soon as it was wrought in.[100] Because it had not been enriched by the lumber that had not yet been wrought in, no restitution for those costs would be necessary. (The contractual treatment of money owed prior to the fire was irrelevant).

Building on *Young*, the *Carroll* court made clear that the "wrought-in" test rested on the owner's benefit, however ephemeral:

> A contractor may have purchased special material to be used in repairing a house, and may have had much millwork done upon it. If the material remain in the mill, and the house burn, there can be no recovery. If the milled material be delivered at the house ready for use, and the house burn, there can be no recovery. It takes something more to make the owner liable for what the contractor has done toward performance. The owner must be benefited. He should not be enriched at the expense of the contractor. That would be unjust, and to the extent that the owner has been benefited, the law may properly consider him as resting under a duty to pay. The benefit which the owner has received may or may not be equivalent to the detriment which the contractor has suffered. The only basis on which the law can raise an obligation on the part of the owner is the consideration he has received by way of benefit, advantage, or value to him.[101]

In *Carroll*, the contract payments were phased, a point the court ignores.[102] This is a recurring theme to which I shall return.

The wrought-in standard is a clever answer to a not-so-clever question. In effect, it treats the contract as conveying some property. The risk of destruction of the property conveyed is borne by the owner; the risk to the

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100. In *Albre Marble & Tile Co. v. John Bowen Co.*, 155 N.E.2d 437 (Mass. 1959), the court granted recovery for "preparation of samples, shop drawings, tests and affidavits" for tile and marble work, none of which had yet to be performed. The court distinguished *Young* holding that since the defendant was not entirely blameless, *Young* did not prevent recovery.

101. *Carroll*, 164 P. at 144.

102. *Id.* at 143.

> Payment for this work to be made as follows:
>
> $600.00 when footings and reinforcing steel are in place.
>
> $600.00 when concrete of floor slab is poured.
>
> $375.00 when work is completed.
>
> The balance of $250.00 to be retained for sixty days, and to be due and payable at that time providing contract has been satisfactorily completed.

Id.

property not yet conveyed is borne by the contractor. That still left the question of whether ownership had transferred. So, for example, when a building was destroyed after an elevator had been installed, but before completion, the contractor's claim was denied because the contract required that the work be accepted by an architect and that condition had not been met.[103] But that is an aside. The main point is that if the purpose is to protect the contractor's reliance, the wrought-in standard is irrelevant. The contractor's costs need bear no relation to whatever had been wrought in at the time of the fire. Reliance expenditures for planning, promotion, or off-site fabrication would all be disallowed. Returning to the English cases, there would be no recovery in *Taylor*, *Gamerco*, or *Fibrosa*.

Not all American jurisdictions accepted the wrought-in rule. *F.M. Gabler, Inc. v. Evans Laboratories, Inc.*[104] allowed for partial recovery. The contract was for installation of fire safety devices.[105] Before installation was complete, the building burned down. The contractor's costs at the time of the fire were roughly 40% for materials installed, 30% for materials brought to the site, but not yet installed, and 30% for materials ready to be supplied, but not yet delivered to the job site. The court went beyond the wrought-in standard, but fell short of reliance. It awarded compensation for the first two categories, but not the third.[106]

The litigated contracts in the repair cases often include some form of phased compensation, which is duly noted by the courts, and then often ignored. An early case, *Butterfield v. Byron*,[107] noted that if each installment were separate consideration, then no compensation would be necessary. But if the payments were merely advances toward a single sum, then actions for both the return of the payments and for the work done prior to the fire would be allowed. The court concluded (why, it is not clear) that

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103. Louisville Foundry & Mach. Co. v. Patterson, 93 S.W. 22 (Ky. 1906).

104. F.M. Gabler, Inc. v. Evans Labs., Inc., 223 N.Y.S. 408 (N.Y. App. Term 1927).

105. Ironically, a number of cases involved installation of fire safety equipment. It is hard to argue that the risk of fire was too remote, unforeseeable, or tacitly assumed not to exist when the raison d'etre of the contract was a concern over possible fire damage. *See* Schaeffer Piano Mfg. Co. v. Nat'l Fire Extinguisher Co., 148 F. 159 (C.C.A. 1906); Roughton v. Brookings Lumber & Box Co., 148 P. 539 (Cal. App. 1915); Hipskind Heating & Plumbing Co. v. Gen. Indus., Inc., 194 N.E.2d 733 (Ind. App. 1963), *transfer denied*, 204 N.E.2d 339 (Ind. 1965); H. G. Vogel Co. v. Reinhardt, 154 N.Y.S. 260, *aff'd*, 155 N.Y.S. 1113 (N.Y. App. Div. 1915).

106. If the materials not yet delivered to the job site could be used elsewhere there would have been no reliance.

107. Butterfield v. Byron, 27 N.E. 667 (Mass. 1891).

> the defendant was to receive an entire sum for the performance of the contract, and that the payments made were merely advances on account of it, and that, on his failure to perform the contract, there was a failure of consideration which gave the plaintiff a right to sue for money had and received, and that the like failure of consideration on the other side gave the defendant a right to sue on an implied assumpsit for work done and materials found.[108]

Some cases did, however, recognize the contractual risk allocation. *Hipskind* specifically rejected *Butterfield*, despite noting that *Butterfield* was the rule in most other American jurisdictions. In passing, it noted that the standard form of agreement between contractor and owner called for progress payments of 90% of the value based on the contractor's prices of labor and materials incorporated in the work, and of materials stored on site.[109] An earlier decision, *H.G. Vogel Co. v. Reinhardt*,[110] concerned the installation of fire extinguishers. There the contract specifically stated that in the event of fire or other excusing event the owner was to pay for all materials and labor furnished as of the date of destruction. Despite the fact that nothing had yet been attached to the building, the plaintiff was able to recover all its expenses. The parties specifically contracted around the wrought-in rule in two respects. First, the focus was on the contractor's costs incurred; the owner's "benefit," however reckoned, was irrelevant. Second, the contractor's compensation would not be determined by a court's *ex post* decision, but *ex ante* by the parties themselves. In both cases, the court honored the parties' risk allocation.

Case law in the last half century is sparse, the reason being that parties typically contract around the clunky Restatement rule. Before turning to the evidence of practice, I want to note a relatively recent case that follows

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108. *Id.* at 669.

109. *Hipskind*, 194 N.E.2d at 743–44 (Ind. App. 1963).

> [A] form of contract generally referred to as standard form of agreement between contractor and owner dated May 14, 1958, which, called for progress payments, 'on or about the 10th day of each month, to the extent of ninety (90%) percent of the value based on the contractor's prices of labor and materials incorporated in the work, and of materials suitable stored at the site thereof, up to the first day of that month, as estimated by the contractor, less the aggregate of previous payment; and upon substantial completion of the entire work, a sum sufficient to increase the total payments to ___% of the contract price.

110. H. G. Vogel Co. v. Reinhardt, 154 N.Y.S. 260 (N.Y. App. Term 1915), *aff'd*, 155 N.Y.S. 1113 (N.Y. App. Div. 1915).

the *Chandler* approach when the contract can reasonably be interpreted as assigning the risks in that manner.[111]

In *One World Trade Center LLC v. Cantor Fitzgerald Securities*,[112] a tenant signed a long-term lease renewal at the World Trade Center less than one year before 9/11. There was no dispute that the tragedy terminated the lease. In response to a claim that they owed rent for the August 1–September 10 period, the tenants argued for relief on the grounds of unjust enrichment. The rent payments, they argued, were front-loaded; the rent in the initial period was high, a payment for "future benefits including a fixed rental rate, restricted rights to terminate the lease,"[113] and so forth. The court rejected that argument: "The defendants are sophisticated commercial tenants and there is no reason to excuse them from the operation of the force majeure clause which they freely negotiated. Defendants bargained away their right to hold the lessor liable for non-performance in the face of the tragic, unanticipated events which destroyed the Building."[114] The court cited a century-old precedent: "[i]f by the terms of [the] lease rent is to be paid in advance, the tenant comes under an absolute engagement to pay it on the day fixed, and he is not relieved from that engagement by the fact that the property is destroyed . . . and [tenant] is liable to pay the rent due in advance even though the destruction takes place on the very day it falls due."[115]

The smattering of cases that mentioned, or at least hinted at, a contractual resolution to the post-excuse problem suggested that the contracting parties were by and large content to let the losses lie where they fell. That made me quite confident that contemporary standard construction contracts would embody similar terms. However, when I examined those documents I was surprised to see no reference at all to the problem, let alone a solution to it. A bit shaken, I met with construction law experts with decades of experience. They had never seen the problem arise, which I found even more puzzling. They patiently explained to me the reason

111. *See also* RNJ Interstate Corp. v. United States, 181 F.3d 1329 (Fed. Cir. 1999).

112. One World Trade Ctr. LLC v. Cantor Fitzgerald Sec., 789 N.Y.S.2d 652 (N.Y. Sup. Ct. 2004).

113. *Id.* at 654.

114. *Id.* at 655. The force majeure clause read: "The Port Authority shall not be liable for any failure, delay or interruption in performing its obligations hereunder due to causes or conditions beyond the control of the Port Authority. Further, the Port Authority shall not be liable unless the failure, delay or interruption shall result from failure on the part of the Port Authority to use reasonable care to prevent or reasonable efforts to cure such failure, delay or interruption." *Id.* at 654.

115. Werner v. Padula, 63 N.Y.S. 68, 69 (N.Y. App. Div. 1900).

why. The problem is handled in the *insurance clause*. The following excerpt from the AIA Standard contract spells this out:

> **§ 11.3.1** Unless otherwise provided, the Owner shall purchase and maintain, in a company or companies lawfully authorized to do business in the jurisdiction in which the Project is located, property insurance written on a builder's risk "all-risk" or equivalent policy form in the amount of the initial Contract Sum, plus value of subsequent Contract Modifications and cost of materials supplied or installed by others, comprising total value for the entire Project at the site on a replacement cost basis without optional deductibles. Such property insurance shall be maintained, unless otherwise provided in the Contract Documents or otherwise agreed in writing by all persons and entities who are beneficiaries of such insurance, until final payment has been made as provided in Section 9.10 or until no person or entity other than the Owner has an insurable interest in the property required by this Section 11.3 to be covered, whichever is later. This insurance shall include interests of the Owner, the Contractor, Subcontractors and Sub-subcontractors in the Project.
>
> **§ 11.3.1.1** Property insurance shall be on an "all-risk" or equivalent policy form and shall include, without limitation, insurance against the perils of fire (with extended coverage) and physical loss or damage including, without duplication of coverage, theft, vandalism, malicious mischief, collapse, earthquake, flood, windstorm, falsework, testing and startup, temporary buildings and debris removal including demolition occasioned by enforcement of any applicable legal requirements, and shall cover reasonable compensation for Architect's and Contractor's services and expenses required as a result of such insured loss.
>
> * * *
>
> **§ 11.3.1.4** This property insurance shall cover portions of the Work stored off the site, and also portions of the Work in transit.[116]

That last clause is a disavowal of the wrought-in rule. And so, it turns out, the *default rule* in the United States might be as stated in the Restatement (Second), but the *default clause* is written by the AIA.[117] *Chandler v. Webster* lives. Contracts scholars have just been looking in the wrong place.

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116. *See* AMERICAN INSTITUTE OF ARCHITECTS—CONTRACT DOCUMENTS, http://www.aia.org/contractdocs/index.htm (giving information on how to purchase and view the AIA standard contracts) (on file with the Washington and Lee Law Review).

117. A similar clause is in the Standard Agreement and General Conditions between Owner and Contractor (Where the Contract Price is a Lump Sum), a contract more favorable to contractors. According to my sources it is not used nearly as often as the AIA forms.

IV. Concluding Remarks

In a response to a paper of mine,[118] which was a criticism of his earlier paper,[119] Professor Melvin Eisenberg wrote:

> Most of [the coronation] cases held that the adversely affected party can't get back what he paid before the unexpected circumstance occurred. Professor Goldberg also takes that position, but there is no way that position can be justified in light of the principles of unjust enrichment. Think what this position would mean. *A*, located in New York, is a manufacturer of machinery. *A* agrees to manufacture a custom-made machine for *B*, located in Iran, for a price of $100,000. Because the machine is custom-made, *A* insists on payment of $50,000 up front. After *B* pays the $50,000, but before *A* has done any work on the machine, the United States places an embargo on sales of machinery to Iran. Under Professor Goldberg's rule, *A* can keep the $50,000 and walk away. . . . Not surprisingly, both the English courts and Parliament later completely repudiated this rule . . . and American courts never adopted it.[120]

I am guilty as charged. But I would argue that it is the "principles of unjust enrichment" that are out of step, not me. I do note that I am not alone—the *Cantor Fitzgerald* decision and the century-old precedent it invokes suggest that the New York court (the closest thing we have to a commercial court) would honor the contract language and let *A* keep the $50,000. Professor Eisenberg presumes that the responsibility for dealing with such a ban is the courts' *ex post*, not the parties' *ex ante*. It is his hypothetical and he can do with it as he sees fit.[121] Still, it might be worth asking whether competent businessmen would enter into such a deal in the first place and, if they did, why it might have been a reasonable business decision.

The cry of those in England bent on reversing *Chandler v. Webster* was the obvious injustice of it all. After decades of griping about *Chandler v. Webster*, they finally fixed it. That the fix was a failure does not seem to bother them. Professor Eisenberg's invocation of unjust enrichment

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118. Victor P. Goldberg, *Excuse Doctrine: The Eisenberg Uncertainty Principle*, 2 J. LEGAL ANALYSIS 359 (2010).

119. Melvin A. Eisenberg, *Impossibility, Impracticability, and Frustration*, 1 J. LEGAL ANALYSIS 207 (2009).

120. Melvin A. Eisenberg, *Impossibility, Impracticability, and Frustration—Professor Goldberg Constructs an Imaginary Article, Attributes it to Me, and Then Critiques It*, 2 J. LEGAL ANALYSIS 383, 387 n.7 (2010).

121. *See id.* at 392 ("It is, after all, a hypothetical, and the actors in a hypothetical can do whatever the author of the hypothetical (me) wants them to do. . . .").

parallels the Restatement (Second) of Contracts and Restatement (Third) of Restitution & Unjust Enrichment mantra that the law should "avoid injustice." Lip service is paid to the notion that the rules are only default rules, but no attention is paid to whether and why sophisticated parties contract around the commentators' notion of what would constitute a just resolution. The crucial point in understanding these cases is that the performance of both sides of a contract will not be simultaneous. Payments may be front-loaded (the coronation cases, *Cantor Fitzgerald*) or back-loaded (*BP v. Hunt*). The degree to which the obligations of the parties are out of phase is a decision variable. There are reasons, perhaps good, sound economic reasons, why the phasing takes the form that it does. The parties can determine whether any post-excuse payments need to be made in their initial agreement; they could make the type of payments vary for different types of excuse. I think that in many instances the parties would be content with a rule that leaves the losses where they fell. But, I hasten to add, this should only be a default rule. If parties think that some form of restitution would be in order, the law should accommodate that.

The basic rule of contract law, embodied in Restatement (Second) of Contracts Section 234, is work before pay. Of course, virtually nobody uses it. Construction contracts almost always contract away from it with progress payments. So, if the parties routinely contract around *that* default rule, we might ask what's the big deal if *this* other default rule is in place. It, too, can be disregarded. The difference, I believe, is that the work-before-pay rule is ethically neutral. It is a rule based on convenience, not notions of justice. I would argue that by couching their argument in terms of justice, courts and the restaters of both Contracts and Restitution have made the restitution-reliance default rule stickier.