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## Planning for Failure: Contract Design, Ineffective Bargains and Restitution

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### I. Introduction

Lawyers drafting contracts to facilitate complex commercial transactions have enough to think about without worrying that the contract itself might be ineffective. Nonetheless, there is a real possibility that the parties' dealings will not be governed from beginning to end by their carefully crafted contractual documents. A contract might cease to be effective due to termination for breach or frustration. Worse, the contract could be invalid from the start. What would this mean for parties who had performed their obligations and transferred value to each other?

The good news is that the default legal rules governing restitution of unjust enrichment will offer a remedy in these situations. Across these scenarios, the doctrine of failure of consideration can apply to enable a party to recoup value it has conferred under the bargain. In the case of frustration, English statute law provides for readjustment and loss sharing. These remedies are generally adequate to prevent one party from being left entirely out of pocket. However, the solutions they offer may not be very fine-tuned, notably because of the requirement of total failure of consideration.

The better news for contract drafters is that they can control the potential operation of the law of restitution to their dealings through their initial contract design. Even though restitution of unjust enrichment arises by operation of law, they have scope to influence it. They can tailor outcomes that respond better to their preferences and the specificities of their deal. They can achieve greater certainty and avoid potential pitfalls. In those cases where the contract is valid but later ceases to be effective, the parties can directly dictate mechanisms for restitution and protection of their reliance interest. Even where the contract is invalid, its contents are evidence of the parties' intentions. It will often affect the valuation of benefits, and will inevitably shape how the doctrine of failure of consideration is applied to the bargain.

This chapter aims to assist contract drafters by showing how the default rules governing restitution can interact with choices they make in constructing the transaction. This will enable them purposefully to exert the capacity for control that they necessarily possess. The chapter will focus on three principal ways in which contract drafters can control the operation of restitution law to their deal. First, they can exclude restitution, where the contract justifies the act of performance. This also applies to multi-party situations. Second, they can provide expressly for the practical consequences of termination or force majeure. Third, they can structure their bargain in ways that ensure that the doctrine of failure of consideration will apply in a predictable, well-calibrated way that responds to the parties' own understanding of what is essential in their bargain.

## II. The Case for Planning for Unforeseen Eventualities

Nobody expects the Spanish Inquisition. It might seem paradoxical to suppose that people can plan for the unforeseen and unforeseeable. If people suspected their contract was going to be invalid, surely they could avoid the defect? In fact, it is entirely possible to provide for the three categories of situation with which we are concerned: force majeure, termination and invalidity. There is no need to predict the specific chain of events that will produce these conditions.<sup>1</sup> Contract drafters should employ foresight to answer a different question: if the contract ceases to be operative, how do the parties wish to provide for restitution and possible loss sharing? This will take careful planning where contracts are performed over time, and where performing parties incur costs ahead of delivery.

Transaction lawyers must drive this planning process. Their clients focus on the substance of a transaction. Sometimes significant transactions are planned with little input from lawyers, and this shows in contracts that do not provide for contingencies.<sup>2</sup> Commercial actors are alert to market risks and the risk of non-performance, but less so to possible termination or invalidity. Professional drafters routinely provide for foreseeable risks related to the nature of a transaction or the trading environment.<sup>3</sup> Those who regularly draft commercial contracts have the ability further to insulate their clients from risk by addressing legal risks like contractual invalidity.

The main reason not to make detailed provision for remote contingencies is the cost of planning. There is a trade-off between the costs of trying to provide in

<sup>1</sup> VP Goldberg, 'Impossibility and Related Excuses' (1988) 144 *Journal of Institutional and Theoretical Economics* 100, 114.

<sup>2</sup> T Daintith, 'The Design and Performance of Long-Term Contracts' in T Daintith and G Teubner (eds), *Contract and Organisation: Legal Analysis in the Light of Economic and Social Theory* (De Gruyter 1986) 164, 178.

<sup>3</sup> A Choi and G Triantis, 'Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions' (2010) 119 *Yale Law Journal* 848, 871.

advance for every remote contingency and waiting until the unexpected happens to find solutions, which might then involve litigation.<sup>4</sup> The costs of contingency planning are likely to be dissuasive in a one-off or low-value transaction.<sup>5</sup> However, in a more valuable or longer-term exchange, or for repeat players, the incentives look different.<sup>6</sup> Moreover, the cost of planning depends on the techniques used. Some planning for legal risk can be achieved through standard form contracts, though in many cases tailored plans are better.<sup>7</sup> Perhaps counterintuitively, vagueness can be an efficient choice when providing for the unexpected.<sup>8</sup> Vague contractual standards leave room for judicial discretion in interpreting them, but within agreed boundaries.<sup>9</sup> A strategic mix of precise and vague provisions can provide efficiently for the risks of contractual ineffectiveness.<sup>10</sup> Force majeure clauses typically illustrate this balance.

Another argument against dealing with these risks in the contract is that business people often respond collaboratively to disruptive events. Long-term contracts often build in flexibility and allow for contract variation to resolve difficulties.<sup>11</sup> Commercial actors with ongoing business relationships do not always stand on their legal rights. Even from this perspective, providing guidance in the contract for the practical resolution of unforeseen events is useful. It can help create a shared understanding to aid renegotiation or amicable variation.<sup>12</sup>

While planning for legal risks when designing contracts will benefit parties to significant transactions, it remains important that the law offers suitable remedies where the parties have not made active choices. Commercial entities are not equally empowered with legal expertise. Many of those engaged in commerce are unsophisticated legal actors, and not all commercial contracts are negotiated or reviewed by lawyers.<sup>13</sup>

<sup>4</sup>H Beale and T Dugdale, 'Contracts between Businessmen: Planning and the Use of Contractual Remedies' (1975) 2 *British Journal of Law & Society* 45; K Crocker and KJ Reynolds, 'The Efficiency of Incomplete Contracts: An Empirical Analysis of Air Force Engine Procurement' (1993) 24 *Rand Journal of Economics* 126, 126; RE Scott and GG Triantis, 'Incomplete Contracts and the Theory of Contract Design' (2005) 56 *Case Western Reserve Law Review* 187, 197.

<sup>5</sup>RA Hillman and JJ Rachlinski, 'Standard-Form Contracting in the Electronic Age' (2002) 77 *New York University Law Review* 429, 437.

<sup>6</sup>MR Miller, 'Contract Law, Party Sophistication and the New Formalism' (2010) 75 *MLR* 493, 532.

<sup>7</sup>MA Eisenberg, 'The Limits of Cognition and the Limits of Contract' (1995) 47 *Stanford Law Review* 211, 243.

<sup>8</sup>Choi and Triantis, 'Strategic Vagueness' (n 3) 854.

<sup>9</sup>RE Scott and GG Triantis, 'Anticipating Litigation in Contract Design' (2006) 115 *Yale Law Journal* 814, 856.

<sup>10</sup>Choi and Triantis, 'Strategic Vagueness' (n 3) 881.

<sup>11</sup>IR Macneil, 'Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical, and Relational Contract Law' (1977-1978) 72 *Northwestern University Law Review* 854, 865; A Al Faruque, 'The Rationale and Instrumentalities for Stability in Long-Term State Contracts' (2006) 7 *Journal of World Investment & Trade* 85, 96.

<sup>12</sup>CP Gillette, 'Commercial Rationality and the Duty to Adjust Long-Term Contracts' (1985) 69 *Minnesota Law Review* 521, 556; Daintith, 'Long-Term Contracts' (n 2) 187.

<sup>13</sup>Miller, 'Contract Law, Party Sophistication and the New Formalism' (n 6) 522; Beale and Dugdale, 'Contracts between Businessmen' (n 4) 47; LT Garvin, 'Small Business and the False Dichotomies of Contract Law' (2005) 40 *Wake Forest Law Review* 295, 312.

The focus of this chapter is on the interaction between restitution law and contract drafting. A preliminary question concerns choice of law. On its face, unjust enrichment falls under the Rome II Regulation.<sup>14</sup> However, the Rome I Regulation governs all the situations where restitution arises from a contractual relationship.<sup>15</sup> Its scope includes excuses from performance such as force majeure,<sup>16</sup> the consequences of breach<sup>17</sup> and the consequences of nullity.<sup>18</sup> The regulation cuts the Gordian knot by treating choice of law clauses in invalid contracts as if the contract were valid.<sup>19</sup> This means that when parties choose the law of their contract, they implicitly choose the same law for restitutionary questions arising from the relationship.<sup>20</sup> English law is a popular choice because of its certainty and commitment to upholding bargains.<sup>21</sup> As a result, English courts have decided many swaps cases involving international parties who chose English law and jurisdiction.<sup>22</sup> There is no compelling reason for parties to decouple the choice of law for contract and related restitution claims. Rather, coherence and simplicity favour keeping adjudications of restitutionary consequences together with the underlying contractual issues.

Those constructing commercial deals can also employ other strategies that fall beyond the scope of this chapter to guard against risks such as invalidity.<sup>23</sup> Warranties in a valid overarching agreement might create a contractual estoppel or entail damages for breach of warranty if a party lacks capacity for a specific transaction.<sup>24</sup> In addition, insurance or guarantees may provide necessary protection from contractual risks.

### III. Valid Contracts as Justifying Grounds

The first, highly significant way in which contracting parties control the application of restitution law to their interactions is by making a contract. When a person

<sup>14</sup> Art 10, Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II); SGA Pitel, 'Rome II and Choice of Law for Unjust Enrichment' in J Ahern and W Binchy (eds), *The Rome II Regulation on the Law Applicable to Non-Contractual Obligations* (Martinus Nijhoff Publishers 2009) 231.

<sup>15</sup> L Collins (ed), *Dicey, Morris & Collins: The Conflict of Laws*, 15th edn (Sweet & Maxwell 2015) [36-023]; Pitel, 'Rome II and Choice Of Law' (n 14) 240.

<sup>16</sup> Art 12(1)(b), Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

<sup>17</sup> Art 12(1)(c) Rome I.

<sup>18</sup> Art 12(1)(e) Rome I; G Schulze, 'Article 12 Rome I' in G-P Calliess (ed), *Rome Regulations. Commentary on the European Rules of the Conflict of Laws*, 2nd edn (Kluwer 2015) 307, 317-18.

<sup>19</sup> Art 10(1) Rome I.

<sup>20</sup> *Haugesund Kommune v Depfa ACS Bank* [2010] EWCA Civ 579, [2012] Bus LR 230 [60].

<sup>21</sup> PS Davies, 'Bad Bargains' (2019) *Current Legal Problems* 1, 1-2.

<sup>22</sup> J Braithwaite, 'Thirty Years of Ultra Vires: Local Authorities, National Courts and the Global Derivatives Markets' (2018) 71 *Current Legal Problems* 369, 390, 393.

<sup>23</sup> *ibid*, 400.

<sup>24</sup> *Credit Suisse International v Stichting Vestia Groep* [2014] EWHC 3103 (Comm), [2015] Bus LR D5.

performs an obligation required by contract, that performance is not 'unjust'.<sup>25</sup> The value transferred cannot be recovered in restitution unless and until the contract is avoided.<sup>26</sup> Furthermore, there may be a defence to unjust enrichment where a 'payment is made for good consideration', in particular to discharge a debt.<sup>27</sup> This putative defence seems to overlap with the orthodox proposition that a contract is a justifying ground that excludes unjust enrichment.

On the other hand, restitutionary remedies may be available in a contractual setting where a benefit is conferred outside the scope of the bargain, the contract is terminated for breach or frustrated, or the contract is invalid. Moreover, the boundary between contract and restitution is less clearly delineated than it might at first appear.

## A. Primacy of the Contractual Bargain

The law is shaped by a strong policy against subverting contractual bargains. In *The Trident Beauty*, Lord Goff stated that where a contract between the parties provides for a certain eventuality, it is both unnecessary and inappropriate for the law of restitution to intervene.<sup>28</sup> Where a contract stipulates the price due, the person who confers a benefit cannot seek an alternative measure of payment outside the agreement.<sup>29</sup> Judicial dicta state categorically that restitution is not available when contract damages might be awarded.<sup>30</sup> Although the case law on termination for breach suggests a more nuanced proposition, these dicta reflect the law's commitment to holding parties to their contractual bargains and preventing them from suing in restitution where this would be more advantageous.<sup>31</sup> This policy prioritises respect for contracting parties' choices. There are other reasons for judges to hesitate to intervene in contractual bargains. Commercial actors can make a sensible allocation of risk better than courts,<sup>32</sup> and the bargain as a whole may represent a subtle, multi-stranded allocation of risks.<sup>33</sup> Many commentators consider that the onus is on contracting parties to provide in advance for

<sup>25</sup> A Burrows, 'Is There a Defence of Good Consideration?' in C Mitchell and W Swadling (eds), *The Restatement Third: Restitution and Unjust Enrichment Critical and Comparative Essays* (Hart Publishing 2013) 165, 174.

<sup>26</sup> *Dimskal Shipping Co SA v International Transport Workers Federation (The Evia Luck) (No 2)* [1992] 2 AC 152, 165; *Kleinwort Benson Ltd v Lincoln CC* [1999] 2 AC 349, 407–08.

<sup>27</sup> *Barclays Bank Ltd v WJ Simms, Son and Cooke (Southern) Ltd* [1980] QB 677, 695; Burrows, 'Defence of Good Consideration' (n 25) 167.

<sup>28</sup> *Pan Ocean Shipping Co Ltd v Creditcorp Ltd (The Trident Beauty)* [1994] 1 WLR 161, 164.

<sup>29</sup> *Re Richmond Gate Property Co Ltd* [1965] 1 WLR 335; *Pavey & Matthews Pty Ltd v Paul* (1987) 162 CLR 221, 265.

<sup>30</sup> *Taylor v Motability Finance Ltd* [2004] EWHC 2619 (Comm).

<sup>31</sup> P Birks, *An Introduction to the Law of Restitution* (Clarendon, 1985) 47.

<sup>32</sup> Hillman and Rachlinski, 'Standard Form Contracting' (n 5) 432.

<sup>33</sup> LE Trakman, 'Frustrated Contracts and Legal Fictions' (1983) 46 *MLR* 39, 47.

arrangements such as loss sharing, rather than to expect a judge to interfere in their relationship.<sup>34</sup>

## B. The Scope of the Bargain

The first important point to note is that the fact that parties are contracting partners is not enough to prevent any restitution claims between them.<sup>35</sup> If there is no contractual obligation to make a particular payment, it might be recovered.<sup>36</sup> The same applies where a party does additional work that falls outside the scope of its contractual duty.<sup>37</sup> The key question is whether the scope of the bargain covers the enrichment conferred. This depends on the terms of the agreement. A surveyor cannot claim extra payment for supervising a bigger job than planned, if the contract required him to supervise all the work that would be done.<sup>38</sup> Similarly, negotiating an insurance claim may fall within a finance director's contractual duties.<sup>39</sup> By defining a party's obligation narrowly or broadly, drafters can make it more or less likely that some benefit that party confers might fall outside its contractual duties and may ground a claim for additional remuneration. Contracts for services, in particular, should define clearly what work is required under the contract.

## C. The Boundary Between Contract and Restitution

Second, the boundary between contract and restitution is not absolute.<sup>40</sup> Beatson has influentially argued that the reason we usually do not allow restitution where a contract is performed is to avoid 'inconsistency and circularity'.<sup>41</sup> This recognises space for restitution alongside a contract if it is not inconsistent with the terms of the contract and does not contradict the agreed allocation of risks.<sup>42</sup>

The termination of a contract due to breach or its frustration clears the way for restitution of value conferred before termination, for which the contractual

<sup>34</sup> VP Goldberg, 'After Frustration: Three Cheers for *Chandler v Webster*' 68 (2011) *Washington and Lee Law Review* 1133, 1136.

<sup>35</sup> S Waddams, *Sanctity of Contracts in a Secular Age: Equity, Fairness and Enrichment* (CUP 2019) 143.

<sup>36</sup> P Birks, *Unjust Enrichment* (Clarendon 2005) 121–22.

<sup>37</sup> MP Gergen, 'Restitution as a Bridge over Troubled Contractual Waters' (2002) 71 *Fordham Law Review* 709, 713.

<sup>38</sup> *Gilbert & Partners v Knight* [1968] 2 All ER 248, 250.

<sup>39</sup> *Taylor v Motability Finance Ltd* (n 30) [21].

<sup>40</sup> *Roxborough v Rothmans of Pall Mall Australia Limited* [2001] HCA 68; P Birks, 'Failure of Consideration and its Place on the Map' (2002) 2 *Oxford University Commonwealth Law Journal* 1, 5; Waddams, *Sanctity of Contracts* (n 35) 145ff.

<sup>41</sup> J Beatson, 'Restitution and Contract: Non-cumul?' (2000) 1 *Theoretical Inquiries in Law* 1, 4.

<sup>42</sup> *ibid*; Birks, 'Failure of Consideration' (n 40) 5.

right had not accrued. This remedy on termination is long established in the case law. It seems to be an exception to the proposition that unjust enrichment is not appropriate where a person has performed a valid contractual obligation. Indeed, restitution may here enable a person to avoid a bad bargain. However, restitution is a straightforward, intuitively appropriate response to fundamental breach, allowing the innocent party to walk away from the deal.<sup>43</sup> Beatson's analysis offers an explanation for why this is permissible.

The incompatibility criterion also has wider implications. It means that the relationship between contract and unjust enrichment depends on the terms of each specific bargain rather than general propositions. We must carefully interpret each contract to assess whether the agreement is incompatible with restitution in the circumstance that has eventuated.<sup>44</sup>

Often a contract is silent about a contingency. There may be a general obligation to perform, with no express exemption for some unforeseen eventuality. There are divergent views about what silence may mean about the allocation of risks. One view is that a contract implicitly distributes all risks to one side or the other. Then a loss lies where it falls.<sup>45</sup> Parties can make express provision for the unexpected, so their choice not to do so merits respect.<sup>46</sup> Certainly, silence sometimes represents a rational choice by the parties to assume a known risk, or even unknown risks.<sup>47</sup>

The alternative approach recognises that there may be contractual gaps, especially in long-term contracts.<sup>48</sup> Known risks will be tacitly or expressly allocated, but the bargain may not represent any sort of agreement about truly unforeseen contingencies.<sup>49</sup> There 'just is no agreement' about something that turns out to be important.<sup>50</sup> If contracts do not allocate all risks consensually between the parties, common law restitution rules might legitimately address genuine gaps. Where we cannot solve the problem by respecting the parties' agreement, Fried argues that we have no choice but to resort to external principles.<sup>51</sup> Where the parties have made no choice at all, we may legitimately apply default rules that give effect to justifiable values and principles, just as the default rules of contract law do.<sup>52</sup> Further, the silence of the parties might be understood as consent to such default rules.<sup>53</sup>

<sup>43</sup> C Fried, *Contract as Promise* (Harvard University Press, 1981) 114.

<sup>44</sup> S Waddams, 'Contract and Unjust Enrichment: Competing Categories, or Complementary Concepts?' in C Rickett and R Grantham (eds), *Structure and Justification in Private Law: Essays for Peter Birks* (Hart Publishing 2008) 175.

<sup>45</sup> Gillette, 'Commercial Rationality' (n 12) 534.

<sup>46</sup> Davies, 'Bad Bargains' (n 21) 6.

<sup>47</sup> Trakman, 'Frustrated Contracts' (n 33) 47; Gillette, 'Commercial Rationality' (n 12) 536.

<sup>48</sup> Beatson, 'Non-cumul?' (n 41) 12, 14.

<sup>49</sup> *Barton v Gwyn-Jones* [2019] EWCA Civ 1999 [62]; Waddams, *Sanctity of Contracts* (n 35).

<sup>50</sup> Fried, *Contract as Promise* (n 43) 59.

<sup>51</sup> *ibid* 60.

<sup>52</sup> RE Barnett, 'The Sound of Silence: Default Rules and Contractual Consent' (1992) 78 *Virginia Law Review* 821, 822.

<sup>53</sup> *ibid* 861–62.



Whenever we are required to determine if a specific contract implicitly allocates the risk in question to a party, we should be careful.<sup>54</sup> It can be tempting to interpret contractual silence as reflecting an agreement that no adjustment will occur in unexpected circumstances. However, saying that the contract assigns a risk is the conclusion of our reasoning process, not the beginning.<sup>55</sup> We can only decide that silence imposes a risk on one party or the other after we know what non-contractual remedies the law offers; and that is the question we are trying to answer.<sup>56</sup> Further, the meaning of silence depends on the parties' assumptions, including about background legal rules.<sup>57</sup> One business community may assume that losses due to unforeseeable events lie where they fall, and another that default legal rules will provide a fairer allocation of losses. These assumptions may change over time.

Some older authorities may have refused unnecessarily to consider restitution of overpayments because there was a contract in place.<sup>58</sup> If an element of the contract is externally imposed rather than negotiated by the parties, it is more likely not to form part of their agreed risk allocation.<sup>59</sup> English courts may now be becoming more willing to hold that restitution will not undermine a valid contract. In *Barton v Gwyn-Jones*, the contract stipulated a fee if a property sold at a certain price but was silent about payment if the selling price was lower. The Court of Appeal construed the contract carefully and allowed a claim in unjust enrichment because it did not subvert a contractual allocation of risk.<sup>60</sup>

*Roxborough v Rothmans of Pall Mall Australia* is a puzzling authority that shows the possible limits of the proposition that there cannot be restitution of money paid under a binding contract.<sup>61</sup> A buyer successfully recovered money paid under a valid contract to cover a licensing fee that turned out not to be due. Virgo condemns the decision as unjustifiable, because there was a continuing basis for the payment.<sup>62</sup> He considers that an exception to the rule would only be warranted

<sup>54</sup> Beatson 'Non-cumul?' (n 41) 4; Waddams, 'Competing Categories' (n 44) 173; Waddams, *Sanctity of Contracts* (n 35) 148.

<sup>55</sup> J Edelman, 'Liability in Unjust Enrichment where a Contract Fails to Materialize' in A Burrows and E Peel (eds), *Contract Formation and Parties* (OUP 2010) 159, 160.

<sup>56</sup> Fried, *Contract as Promise* (n 43) 64; F Wilmot-Smith, 'Replacing Risk-taking Reasoning' (2011) 127 *LQR* 610, 613.

<sup>57</sup> Barnett, 'The Sound of Silence' (n 52) 862.

<sup>58</sup> *Green v Portsmouth Stadium* [1953] 2 QB 190 (CA); *Orphanos v Queen Mary College* [1985] AC 761 (HL); Birks, 'Failure of Consideration' (n 40) 5.

<sup>59</sup> Birks, *Unjust Enrichment* (n 36) 124.

<sup>60</sup> *Barton v Gwyn-Jones* (n 49).

<sup>61</sup> *Roxborough v Rothmans of Pall Mall* (n 40).

<sup>62</sup> G Virgo, 'Demolishing the Pyramid – the Presence of Basis and Risk-Taking in the Law of Unjust Enrichment' in A Robertson and Tang HW (eds), *The Goals of Private Law* (Hart Publishing 2009) 477, 491; J Beatson and GJ Virgo, 'Contract, Unjust Enrichment and Unconscionability' (2002) 118 *LQR* 352, 355, 356.

if the bargain demonstrably placed the risk of invalidity on the seller.<sup>63</sup> In contrast, Burrows approves the outcome. He proposes that ‘the rule that one cannot have restitution for mistake where the mistaken payment was legally owed is not an absolute one, but permits limited exceptions.’<sup>64</sup> It is a heuristic; we can evaluate in each case whether the payment is unjust notwithstanding that it was owed. The failure of the condition in *Roxborough* outweighed the continued existence of the obligation. Besides, restitution did not interfere with the contractual allocation of risks because the levy was not part of the parties’ negotiated bargain.<sup>65</sup> In effect, the eventuality of the tax not actually being due was a contractual gap. That risk was not consensually allocated to either party.<sup>66</sup>

Implied terms might sometimes do the work of restitution when the unexpected happens in a contractual relationship. In *The Trident Beauty*, Lord Goff was willing to imply a contractual term for the repayment of advance hire paid for a period for which it was not due.<sup>67</sup> In *Barton*, the Court of Appeal accepted an implied term as an alternative avenue to remuneration for work done.<sup>68</sup> However, the standard for implying a term is hard to fulfil in cases where the parties did not envisage the eventuality that has occurred.<sup>69</sup> It may often be more difficult to establish an implied term than to show that the contractual obligation is not an obstacle to restitution.

## D. Multi-party Transactions

The law’s policy against allowing claims in unjust enrichment where there is a valid contract has distinct ramifications in multi-party transactions. In *MacDonald Dickens & Macklin v Costello*, a builder contracted with an intermediary company to erect houses on land owned by another individual.<sup>70</sup> When the company did not pay, the builder sued the landowners in unjust enrichment. Even though the

<sup>63</sup> Virgo, ‘Demolishing the Pyramid’ (n 62) 491; Beatson and Virgo, ‘Contract, Unjust Enrichment and Unconscionability’ (n 62) 356.

<sup>64</sup> Burrows, ‘Defence of Good Consideration’ (n 25) 177.

<sup>65</sup> A Burrows, ‘Restitution of Mistaken Enrichments’ (2012) 92 *Boston University Law Review* 767, 767–77; Burrows, ‘Defence of Good Consideration’ (n 25) 177.

<sup>66</sup> See also M McInnes, ‘Unjust Factors, Juristic Reasons and Contracts in Anglo-Canadian Law’ in P Giliker (ed), *Re-examining Contract and Unjust Enrichment: Anglo-Canadian Perspectives* (Martinus Nijhoff 2007) 23, 33.

<sup>67</sup> Waddams, *Sanctity of Contracts* (n 35) 153.

<sup>68</sup> *Barton v Gwyn-Jones* (n 49).

<sup>69</sup> *Pluczenik Diamond Co NV v W Nagel (A Firm)* [2018] EWCA Civ 2640 [34]; Waddams, ‘Competing Categories’ (n 44) 179.

<sup>70</sup> *MacDonald Dickens & Macklin v Costello* [2011] EWCA Civ 930; HLE Verhagen, ‘The Policies against Leapfrogging in Unjust Enrichment: A Critical Assessment’ (2018) 22 *Edinburgh Law Review* 55.

landowners were the owners of the company, and had interposed the company as the contracting party, the law treated them as fully separate. The Court of Appeal held that by knowingly contracting with the company, the builder had taken the risk of that company's not paying or becoming insolvent. The structure the parties chose for the transaction imposed those risks on the builder.<sup>71</sup> It would subvert the contractual allocation of risk to bypass the contractual counterparty and impose a restitutionary obligation on the recipient.<sup>72</sup> This judgment endorses a 'general policy of refusing restitutionary relief for unjust enrichment against a defendant who has benefited from the plaintiff's services rendered pursuant to a contract to which the defendant was not a party'.<sup>73</sup> This dispute was essentially one about contract performance, for which contract law's rules and remedies were best suited. This does not mean that there might not also be a concurrent remedy in unjust enrichment.

Undoubtedly, applying unjust enrichment law to a multi-party scenario like this is complex. One concern is that the transfer from the builder to the landowner might not be sufficiently direct because of the interposition of the contractual relationship. Factually, though, the builder's services directly increased the value of the defendant's land, which should count as a sufficiently direct transfer.<sup>74</sup> In addition, failure of consideration requires a shared understanding between the builder and landowner about the builder's expectation of payment. Even though the builder performed on condition that the intermediary paid, this should suffice, as the defendant was aware of this condition and that it was not fulfilled. Some multi-party scenarios present additional reasons not to allow a claim in restitution that were not present here.<sup>75</sup> A defendant who paid (or was liable to pay) the intermediate contracting party might not be enriched. If the defendant were contractually entitled to receive the benefit from the intermediary, that would likely justify his enrichment. Each of these issues might be addressed individually, if the claimant's choice of contracting partner were not viewed as imposing on him the risk of another party's receiving the benefit and nobody paying for it. Perhaps the law's policy concern not to subvert the contract would be diluted if a court considered there was collusion between the intermediary and the person who received the benefit.

*Costello* shows that in a multi-party scenario, the parties' choices of contracting partners can be vital. It will not be possible to obtain remuneration from a third party on whom a benefit is conferred in performance of a contract with somebody else. Parties should take care to avoid this trap, and seek guarantees from others involved in multi-party transactions.

<sup>71</sup> *MacDonald Dickens & Macklin v Costello* (n 70) [21].

<sup>72</sup> *ibid* [23].

<sup>73</sup> *ibid* [30]; *Lumbers v W Cook Builders Pty Ltd (in liq)* [2008] HCA 27.

<sup>74</sup> Verhagen, 'Leapfrogging in Unjust Enrichment' (n 70) 63.

<sup>75</sup> *ibid* 62.

## IV. Termination and Frustration: Scope for Provision in Valid Contracts

### A. Terminated Contracts

Some serious breaches of contract entitle the innocent party to terminate the contract.<sup>76</sup> Termination operates prospectively, releasing both parties from their obligations to perform.<sup>77</sup> The terms of a valid contract remain binding and continue to govern those rights that have accrued under the contract.<sup>78</sup> The innocent party is entitled to damages for breach. Where a right has accrued before termination, the promisee is entitled to its performance as a matter of contract law. However, if a party has paid or performed in advance and not received a benefit in return, she can claim restitution.<sup>79</sup> Even a contract-breaker can recover her advance payment, though she will be required to pay contract damages.<sup>80</sup> The unjust factor is total failure of consideration: her performance was conditional on counter-performance that will not take place.

Restitution of the value of a benefit conferred depends on the other party's contractual right to that benefit not yet having accrued.<sup>81</sup> The questions of whether a contractual right has unconditionally accrued and whether there has been failure of consideration are interconnected. The law avoids the circularity of ordering a contractual payment that could immediately be reclaimed for failure of consideration.<sup>82</sup> Consequently, an innocent party cannot claim payment of instalments that fell due before termination if it has not performed the corresponding work. It will instead have its contractual remedies, including damages for loss of bargain.

Because termination affects valid contracts, the parties prospectively enjoy the power directly to determine what repayments and adjustments will be made. Constructing the transaction, they control the central question of when rights accrue. They can also devise their own plan for the consequences of termination.

### B. Termination Clauses

Termination clauses are common in modern contracts.<sup>83</sup> They enable the parties to specify different, perhaps more permissive, triggering conditions than the

<sup>76</sup> *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26, 70.

<sup>77</sup> *McDonald v Dennys Lascelles Ltd* (1933) 48 CLR 457, 476–77; *Johnson v Agnew* [1980] AC 367, 396; *Lombard North Central Plc v Butterworth* [1987] QB 527, 535.

<sup>78</sup> Beatson, 'Non-cumul?' (n 41) 16.

<sup>79</sup> *McDonald v Dennys Lascelles* (n 77).

<sup>80</sup> *Dies v British and International Mining and Finance Corporation Ltd* [1939] 1 KB 724.

<sup>81</sup> *Mann v Paterson Constructions Pty Ltd* [2019] HCA 32 [176].

<sup>82</sup> *Stocznia Gdanska SA v Latvian Shipping Co* [1998] 1 WLR 574.

<sup>83</sup> Choi and Triantis, 'Strategic Vagueness' (n 3) 858.

default law. They may authorise termination as a response to breach or to protect against future commercial impracticability. They permit parties to allocate the burden of proof as they choose.<sup>84</sup> Termination clauses also enable parties to stipulate remedial consequences. Express contractual provision will displace the default rules on the consequences of discharge.<sup>85</sup> The contractual provision then justifies the retention of a benefit.

Contract drafters can provide for any adjustment that suits the needs of the parties and the nature of the transaction. This may mean a mix of restitution, protection of reliance expenditure and compensation. The clause may set out the basis on which repayments will be calculated.<sup>86</sup> If the parties provide for the retention of instalments already paid, this may be interpreted as requiring the payments of unpaid sums that had fallen due.<sup>87</sup> Where the cancellation is due to breach, they may choose to stipulate a compensatory element.<sup>88</sup> A clause may enable a buyer to take over partially-completed works.<sup>89</sup> A termination clause authorising the retention of payments does not prevent that party from availing itself of the common law rules to claim other payments that had accrued before termination.<sup>90</sup> It would require clear words in the contract to rebut the general presumption that a party does not wish to abandon the remedies offered by contract law. However, if the contract provides a 'complete code' of remedies, it may implicitly exclude recourse to common law restitution rules.

## C. Structuring Performance Obligations

### *i. Entire Obligations*

Those drafting a contract may choose to make one party's obligation an entire obligation, and this matters if the contract is interrupted. The contractual right to payment for an entire obligation does not accrue until that person's performance is complete.<sup>91</sup> Nor would the person who partially performs an entire obligation generally have a claim in restitution for the work done. There is an exception where the other party prevents the claimant from completing the work; then there can be termination and restitution.<sup>92</sup> McFarlane and Stevens explain entire obligations cases on the basis that the parties' shared understanding is that the performing party is only to be paid for his services when performance was

<sup>84</sup> Scott and Triantis, 'Anticipating Litigation in Contract Design' (n 9) 874.

<sup>85</sup> Beatson, 'Non-cumul?' (n 41) 18.

<sup>86</sup> M Fontaine and F de Ly, *Drafting International Contracts: an Analysis of Contract Clauses* (Martinus Nijhoff 2009) 335.

<sup>87</sup> *Hyundai Heavy Industries Co Ltd v Papadopolous* [1980] 1 WLR 1129.

<sup>88</sup> Beale and Dugdale, 'Contracts between Businessman' (n 4) 52.

<sup>89</sup> *Meritz Fire & Marine Insurance Co Ltd v Jan de Nul NV* [2011] EWCA Civ 827 [11].

<sup>90</sup> *Stocznia Gdanska SA v Latvian Shipping Co* (n 82).

<sup>91</sup> *Cutter v Powell* [1795] 101 ER 573; *Sumpter v Hedges* [1898] 1 QB 673, 674; *Cleveland Bridge UK Ltd v Multiplex Constructions (UK) Ltd* [2010] EWCA Civ 139 [137]–[138].

<sup>92</sup> *Giles v Edwards* (1797) 101 ER 920.

complete.<sup>93</sup> If the work is partially done, the condition of payment is not fulfilled.<sup>94</sup> However, the entire obligation clause is not understood as an agreement that there will be no remuneration if the customer repudiates the contract before work is complete.<sup>95</sup> The terms of each specific bargain will indicate whether the parties share the understanding that partial performance will not be paid for.<sup>96</sup> A lump sum payment is not enough to draw this inference.<sup>97</sup> Those drafting contracts should choose and clearly express whether they intend that partial performance must be remunerated.

### *ii. The Timing of Obligations*

Contracting parties have freedom to structure the timing of performance as they choose.<sup>98</sup> How drafters structure payments and phases of performance is very important in determining which rights accrue when. There are many commercial reasons to phase performance by one or both parties over a period of time.<sup>99</sup> It may finance stages of the work, reduce risk<sup>100</sup> or strike a compromise between ensuring a supplier receives payment while not excessively inconveniencing its customer. A contract may require instalments to be paid into an escrow account and used only for construction expenses.<sup>101</sup> If a contract is terminated or frustrated, the phasing will determine when rights to certain performances accrue. Accordingly, it is a very important way to ensure that parties' expenditure in performance of the contract will be compensated. Manufacturers of unique or customised goods have most acute need of this protection.<sup>102</sup> It makes sense to match reciprocal units of performance on each side within a larger transaction that is performed over time. In shipbuilding cases, the courts have deemed that each instalment corresponded to work done by the shipbuilder.<sup>103</sup> By pairing instalments with stages of performance, drafters can ensure that the contractual entitlement to payments accrues when each distinct phase of work is done.

### *iii. Advance Payments and Deposits*

Similarly, commercial buyers often make advance payments to assist their suppliers' cash flow or guarantee their commitment.<sup>104</sup> Normally even contract-breakers

<sup>93</sup> B McFarlane and R Stevens, 'In Defence of *Sumpter v Hedges*' (2002) 118 *LQR* 569.

<sup>94</sup> J Goodwin, 'Failure of Basis in the Contractual Context' (2013) 21 *Restitution Law Review* 24, 27.

<sup>95</sup> *Mann v Paterson Constructions Pty Ltd* (n 81).

<sup>96</sup> Waddams, 'Competing Categories' (n 45) 176.

<sup>97</sup> Beatson, 'Non-cumul?' (n 41) 23.

<sup>98</sup> Goldberg, 'After Frustration' (n 34) 1135.

<sup>99</sup> *ibid* 1146.

<sup>100</sup> Beale and Dugdale, 'Contracts between Businessman' (n 4) 52.

<sup>101</sup> *Meritz Fire & Marine Insurance Co Ltd v Jan de Nul NV* [2010] EWHC 3362 (Comm) [20].

<sup>102</sup> Goldberg, 'Impossibility and Related Excuses' (n 1) 113–14.

<sup>103</sup> *Stocznia Gdanska SA v Latvian Shipping Co* (n 82).

<sup>104</sup> S Mateut, 'Reverse trade credit or default risk? Explaining the use of prepayments by firms' (2014) 29 *Journal of Corporate Finance* 303, 304.

can recover advance payments, subject to their liability to pay damages.<sup>105</sup> To avoid this, parties can require deposits as a guarantee of performance, or make some payments unconditional by inserting a forfeiture clause.<sup>106</sup> Deposits cannot be recovered on the ground of failure of consideration when the payor does not complete his performance. They strengthen the position of the innocent party in a number of ways. It has the money in its pocket and the buyer will bear the burden of proof if there is a dispute.<sup>107</sup> In addition, a permissible deposit may provide greater compensation than contract damages. The terms of the contract indicate whether a payment is a deposit or a prepayment.<sup>108</sup> A seller who wishes a payment to be a deposit must make that clear, for example by labelling it 'non-refundable'.<sup>109</sup>

The law regulates deposits and forfeiture clauses. The courts will not recognise an advance payment as a deposit unless the sum is 'reasonable as earnest money'.<sup>110</sup> Where the purported 'deposit' is excessive and therefore a penalty, it may be recovered in full, and the purchaser will compensate the vendor for actual loss due to the breach. However, respect for the contract means that genuine deposits are upheld, even where they work harshly, as where 10 per cent of the price is forfeit for a 10-minute delay.<sup>111</sup> Like part payments, instalments can be subject to forfeiture clauses. The court can grant equitable relief if retention would be unconscionable, as where it is 'out of all proportion to the damage'.<sup>112</sup> However, courts will be slow to exercise this equitable power in a commercial case involving a freely-negotiated contract.<sup>113</sup>

## V. Frustration or Force Majeure

Historically, the common law allowed the loss to lie where it fell when a part-performed contract was frustrated.<sup>114</sup> In *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd*, the House of Lords established that advance payments could be returned on the ground of failure of consideration.<sup>115</sup> However, the case highlighted a problem that restitution of unjust enrichment did not address. The manufacturer of machinery had incurred costs in connection with performing the

<sup>105</sup> *Dies v British and International Mining and Finance Corporation Ltd* (n 80); *Stockloser v Johnson* [1954] 1 QB 476, 489.

<sup>106</sup> *Howe v Smith* (1884) 27 Ch D 89; *Dies v British and International Mining and Finance Corporation Ltd* (n 80).

<sup>107</sup> Scott and Triantis, 'Anticipating Litigation' (n 11) 867.

<sup>108</sup> *Howe v Smith* (n 106).

<sup>109</sup> *Dies v British and International Mining and Finance Corporation Ltd* (n 80).

<sup>110</sup> *Workers Trust & Merchant Bank Ltd v Dojap Investments Ltd* [1993] AC 573.

<sup>111</sup> *Union Eagle Ltd v Golden Achievement Ltd* [1997] AC 514.

<sup>112</sup> *Stockloser v Johnson* (n 105) 485; *Jobson v Johnson* [1989] 1 WLR 1026, [1989] 1 AER 621.

<sup>113</sup> *Cadogan Petroleum Holdings Ltd v Global Process Systems LLC* [2013] EWHC 214 (Comm) [38].

<sup>114</sup> *Chandler v Webster* [1904] 1 KB 493.

<sup>115</sup> *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32.

contract. When it returned the advance payment, it was left at a loss. Where parties incur expenditure prior to frustration, loss sharing may be needed.<sup>116</sup> In response to this concern, the common law rule was superseded in England by the Law Reform (Frustrated Contracts) Act 1943. Judges now have a discretionary power to make allowance for a party's reliance losses when awarding restitution, if they consider it just.<sup>117</sup> The judicial power under the Act to limit restitution is highly discretionary. When a concert was cancelled and the organisers sought restitution of the advance fee from the band, the court took account of both parties' wasted expenditure. There is vanishingly little case law applying the Act.<sup>118</sup> Commercial parties may prefer to use force majeure clauses in order to control the outcome themselves and avoid such broad judicial discretion.<sup>119</sup>

## A. Force Majeure Clauses

Like termination, frustration affects valid, effective contracts, and this enables drafters expressly to provide for its consequences. Force majeure clauses usually define what constitutes force majeure, provide for notice and stipulate consequences.<sup>120</sup> Parties tend to relax the requirements for force majeure compared to national laws, especially the narrow default rule in English law, by allowing a response even when events do not make performance impossible.<sup>121</sup> That response might involve suspending or cancelling performance obligations, or renegotiation or arbitration.<sup>122</sup>

A force majeure clause offers scope to control the financial effects when a contract is permanently frustrated. Where a contract is clearly intended to govern what happens in the event of frustration, it displaces the statutory adjustment regime.<sup>123</sup> Parties can avoid the judicial discretion concerning loss sharing authorised by the English Frustrated Contracts Act. In other jurisdictions, where there is no statute and unjust enrichment law still applies on frustration, a clause allows parties to fashion more flexible solutions reflecting reliance expenditure.

The range of options available is similar to termination clauses, and some contracts cross-refer to the termination clause. However, it is increasingly common to provide specifically for the practical consequences of termination resulting from

<sup>116</sup> Fried, *Contract as Promise* (n 43) 70.

<sup>117</sup> Law Reform (Frustrated Contracts) Act 1943, s 1(2) and (3).

<sup>118</sup> *BP Exploration Co (Libya) Ltd v Hunt (No 2)* [1979] 1 WLR 783, [1983] 2 AC 352; *Gamerco v ICM/Fair Warning (Agency) Ltd* [1995] 1 WLR 1226.

<sup>119</sup> Goldberg, 'After Frustration' (n 34) 1147.

<sup>120</sup> M Polkinghorne and C Rosenberg, 'Expecting the Unexpected: The Force Majeure Clause' (2015) 16 *Business Law International* 49.

<sup>121</sup> H Konarski, 'Force Majeure and Hardship Clauses in International Contractual Practice' (2003) 4 *International Business Law Journal* 405, 408; Fontaine and de Ly, *Drafting International Contracts* (n 86) 405; Polkinghorne and Rosenberg, 'Expecting the Unexpected' (n 120) 52.

<sup>122</sup> Fontaine and de Ly, *Drafting International Contracts* (n 86) 432.

<sup>123</sup> Law Reform (Frustrated Contracts) Act 1943, s 2(3).



force majeure.<sup>124</sup> One difference is that termination clauses may include some form of compensation for a wrongful breach, whereas force majeure clauses address situations where nobody is in the wrong. The focus is therefore on restitution, reliance and possible compensation for costs directly connected with the frustrating event. A simple clause may provide for a refund of advance payments.<sup>125</sup> If both sides have performed some of their obligations, the clause may authorise the retention of the benefits received and payment for them. Alternatively, the parties might permit the retention of some payments even if the payor has not actually received a benefit.<sup>126</sup> Some parties might prefer to exclude any settlement of accounts and require one party to obtain insurance.<sup>127</sup>

Contract drafters should tailor their plan to the specificities of the transaction rather than using boilerplate. The adjustment mechanisms should reflect the nature of the obligations concerned.<sup>128</sup> Contracts that are performed over time will require relatively complex provision. It is not just about reliance. The different reasons why the parties sought phased performance will affect what they want to happen if the contract is frustrated. Contract drafters should think ahead to how performance on both sides is scheduled to occur, and envisage whether significant losses would result if the contract were to be frustrated at various junctures in performance.<sup>129</sup> Sometimes, even if the parties agree a unit price as part of a large transaction, it would not be commercially viable for a divisible part of the overall performance.

Ideally, the parties should negotiate the plan for possible adjustments. They understand their deal and are better able than a judge to determine what will be a fair outcome.<sup>130</sup> Their interests may shift over the course of the contract's scheduled performance.<sup>131</sup> Some parties may be especially concerned about fixed costs at the outset. Involving both parties in planning can improve the prospects of an amicable resolution later.

An alternative strategy is to recognise an unquantified obligation for one party to pay the other a sum that is reasonable in the circumstances of the case.<sup>132</sup> The vagueness of the provision is economically efficient, as it saves the expense of detailed planning in advance for a remote contingency. The parties can make more informed decisions when they know what the effects of the frustrating event have

<sup>124</sup> Fontaine and de Ly, *Drafting International Contracts* (n 86) 435.

<sup>125</sup> P Thompson, 'A Practical Guide to Force Majeure and Frustration of Contract' (1997) 18 *Credit Control* 9, 12.

<sup>126</sup> *Dies v British and International Mining and Finance Corporation Ltd* (n 80).

<sup>127</sup> *BP v Hunt* (n 118) 806–07.

<sup>128</sup> Polkinghorne and Rosenberg, 'Expecting the Unexpected' (n 120) 50; Fontaine and de Ly, *Drafting International Contracts* (n 86) 450.

<sup>129</sup> Goldberg, 'Impossibility and Related Excuses' (n 1) 114.

<sup>130</sup> H Hunter, 'Commentary on Pitfalls of Force Majeure Clauses' (1991) 3 *Journal of Contract Law* 214, 217.

<sup>131</sup> Goldberg, 'After Frustration' (n 34) 1158.

<sup>132</sup> R Christou, *Drafting Commercial Agreements*, 6th edn (Sweet & Maxwell 2016) Precedent 2.1, cl 10.1.

been. Although it does not grant certainty and there will be room for disagreement in implementing it, many commercial actors in long-term relationships prefer to resolve difficulties collaboratively by modifying their obligations.<sup>133</sup>

## VI. Contractual Bargains and Unjust Enrichment Claims

The preceding sections considered how contract drafters can provide expressly for the consequences of termination and force majeure. More broadly, questions of restitution arising because a contract is ineffective will be governed by the common law of unjust enrichment. In order to establish a claim in unjust enrichment, a claimant must show that the defendant has been enriched at his expense, and that the transfer is unjust.<sup>134</sup> Defences are then considered. The unjust factor that is most relevant to claims arising from contract is failure of consideration. This is usually the ground of recovery in both termination and invalidity cases.

Unlike cases involving the termination of valid contracts, invalid contracts are not binding and cannot directly stipulate the consequences of unforeseen events. Yet they do affect how the common law rules apply to each case. The crucial point is that the default rules on restitution necessarily reflect the parties' own bargain even when that bargain is invalid. First, the parties' understanding constitutes evidence of the benefit's value. Moreover, the contractual bargain is central to the doctrine of failure of consideration in each case. This means that the drafting of the contract usually influences common law restitution, whether the parties realise it or not.

### A. Valuing the Enrichment

#### *i. Contract Price and Value*

The valuation of the enrichment transferred is central to an unjust enrichment claim. The contract price provides evidence of value in the circumstances of the case. It cannot be directly determinative because unjust enrichment is distinct from enforcing the contract.<sup>135</sup> *Benedetti v Sawiris* establishes the objective market value of the benefit as the starting point for valuing enrichment.<sup>136</sup> An arm's-length bargain between the parties is presumptive evidence of market value.<sup>137</sup>

<sup>133</sup> Macneil, 'Adjustment of Long-Term Economic Relations' (n 11) 865; Al Faruque, 'Stability in Long-Term State Contracts' (n 11) 96.

<sup>134</sup> *Banque Financière de la Cité v Parc (Battersea) Ltd* [1999] 1 AC 221, 227.

<sup>135</sup> *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* (n 115) 64.

<sup>136</sup> *Benedetti v Sawiris* [2013] UKSC 50.

<sup>137</sup> *ibid* [168]; *Way v Latilla* [1937] 3 AER 759; *Taylor v Motability Finance Limited* (n 30) [26].

However, there are a few qualifications to using the parties' bargain as evidence of value. The contract price may not be a useful benchmark, if it reflects altruistic considerations.<sup>138</sup> If an invalid contract is vitiated by duress or mistake, it is unlikely to offer persuasive evidence of the parties' preferences.<sup>139</sup> Furthermore, commercial contracts are usually more complex than simple exchanges of a specific item for an agreed sum. All the terms that the parties agreed as part of the overall transaction may have affected the agreed price, so that once some terms fall away, it cannot be inferred that the stated price equates to the parties' valuation of the item received.<sup>140</sup>

Once the market value of the enrichment is known, the defendant is entitled subjectively to devalue goods or services.<sup>141</sup> He can show that they are worth less to him than the market rate. This mechanism protects his freedom of choice: he will not be forced to pay more than he ever would agree to pay for this benefit. The defendant may point to the contract price as evidence of how much he believed the benefit was worth, if that is lower than the market value. The law does not recognise the converse proposition, that the value of the enrichment should increase if the defendant would be willing to pay more than market price.<sup>142</sup>

## *ii. Policy Concern: Contract Price as a Cap?*

Apart from the valuation question, there is a widespread policy concern that parties should not be allowed to use unjust enrichment to get more than they are entitled to in a contractual bargain.<sup>143</sup> This concern is most acute for services. It has been proposed that the contractual price must be imposed as a ceiling where a services contract is terminated for breach, and that restitution for partial performance should be proportioned to the overall contract rate.<sup>144</sup>

Older authorities allowed non-breaching parties to recover above the contract price for their performance.<sup>145</sup> However, contemporary English and Australian law is oriented towards limiting recovery to the contract price, or a proportion of it, in cases where a contract is terminated for breach. In *Taylor v Motability Finance*, Cooke J stated that even if restitution were possible where there was a valid contract, there could be 'no justification ... for recovery in excess of the contract limit'.<sup>146</sup> This question was central in *Mann v Paterson Constructions Pty*

<sup>138</sup> *Barton v Gwyn-Jones* (n 49) [50].

<sup>139</sup> S Arrowsmith, 'Ineffective Transactions and Unjust Enrichment: A Framework for Analysis' (1989) 9(2) *Legal Studies* 121, 129.

<sup>140</sup> *ibid* 131.

<sup>141</sup> *Benedetti v Sawiris* (n 136) [18].

<sup>142</sup> *ibid*.

<sup>143</sup> A Kull, 'Restitution as a Remedy for Breach of Contract' (1994) 67 *Southern California Law Review* 1465, 1472; Birks, *Introduction to the Law of Restitution* (n 31) 46–47.

<sup>144</sup> J Beatson, 'Benefit, Reliance and the Structure of Unjust Enrichment' (1987) *Current Legal Problems* 71, 84.

<sup>145</sup> *Lodder v Slowey* [1904] AC 442.

<sup>146</sup> *Taylor v Motability Finance Limited* (n 30) [26].

*Ltd.* There, builders had terminated a contract due to the other party's breach, and sought payment in restitution for the work for which rights to contractual payment had not accrued.<sup>147</sup> The contract price was less than the market value of the work done. The majority considered that the appropriate solution is to cap restitution at the contract price.<sup>148</sup> The work was done on the basis of the agreed price, and there is nothing inherent in termination that requires departure from that.<sup>149</sup> The dissenting judgment rejected the claim in restitution because of the same concern: the contract fixed a price for the work and the customer was entitled to rely on that bargain.<sup>150</sup> The proper remedy for the work done for which the right to payment had not yet accrued was damages for loss of bargain, reflecting the contract price.<sup>151</sup> It seems likely now that the contract price will constitute a ceiling in cases of terminated contracts. The need to keep the parties to their bargain is perhaps less compelling for invalid contracts. In *Rover v Cannon*, Kerr LJ deemed it incoherent to limit a claim to the amounts due under a contract whose invalidity was the reason for the claim.<sup>152</sup> Besides, if the contract is not valid then direct arguments about evading a contractual bargain lose their force.

## VII. Failure of Consideration and the Parties' Bargain

Failure of consideration is usually the unjust factor that justifies restitution of unjust enrichment following termination or invalidity. It operates whatever form the enrichment takes.<sup>153</sup> The underlying logic is that payment was made conditionally, and both parties knew the condition on which it was paid. If that condition is not met, it is recoverable.<sup>154</sup> To apply this test, we must identify what the claimant's intention was conditional upon. That condition must have been known by the other party, but this requirement is generally fulfilled where there is a contract between the parties. The terms of the contract will evidence what the parties understood each to be bargaining for, whether or not the contract is legally binding.

### A. The Contract and Conditions for Performance

There is no single definition of 'consideration' in this context. Usually, where there is a valid contract, we are concerned with the actual performance of the

<sup>147</sup> *Mann v Paterson Constructions Pty Ltd* (n 81).

<sup>148</sup> *ibid* [101], [215].

<sup>149</sup> *ibid* [205].

<sup>150</sup> *ibid* [37].

<sup>151</sup> *ibid* [20].

<sup>152</sup> *Rover International Ltd v Cannon Film Sales Ltd* [1989] 1 WLR 912, 927.

<sup>153</sup> *Cobbe v Yeoman's Row Management Ltd* [2008] UKHL 55; Wilmot-Smith, 'Replacing Risk-taking Reasoning' (n 56) 617–18.

<sup>154</sup> *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* (n 115) 65.

contractually-promised consideration.<sup>155</sup> The question is not whether the claimant received any benefit. The focus is on the other party's 'essential obligation under the contract'.<sup>156</sup> Sometimes, a person's performance may be conditional on a state of affairs.<sup>157</sup> It may implicitly be conditional on more than one thing, so that if either condition is not met, the performing party does not intend the recipient to have the benefit.<sup>158</sup> It is the parties who decide what the consideration for each person's performance will be. Judges will identify the core of the bargain objectively by interpreting the contract.<sup>159</sup> Ancillary benefits do not count.<sup>160</sup> A car buyer contracts for title, not mere possession.<sup>161</sup> For a film distributor, receiving copies of films to distribute is merely facilitative.<sup>162</sup> A racing driver bargains for test drives, not travel, pit passes and the right to sponsorship.<sup>163</sup> Every transaction has its essential purpose. Though the core of the deal might seem inherent in the substance of the transaction, drafters have the power to frame and structure the deal as they wish and to make any element a condition.

*Stocznia Gdanska v Latvian Shipping Co* indicates the scope for contracting parties to choose how to frame their transaction.<sup>164</sup> Consider a manufacturer who constructs and sells a unique product. The transaction could simply be a sale, or it could be a bargain to design, construct and deliver it. If it is simply a sale, there will be total failure of consideration unless the finished product is delivered.<sup>165</sup> In contrast, if the deal is to design and construct the product, performance of those stages means there will not be total failure of consideration. In *Stocznia Gdanska*, payment of the price in instalments supported the inference that the bargain encompassed design and construction. A choice to frame the bargain as for manufacture as well as delivery can assist the supplier if the deal is derailed before the product is delivered, because it will be able to retain some or all of the payments according to the work done.

Contracting parties can communicate in their bargain that their performance will be conditional on elements that they subjectively consider essential. Performance could be conditional on counter-performance being of a certain quality.<sup>166</sup> The lesson is to ensure that anybody reading the contract will know if there are particular elements or aspects of performance that are critical for

<sup>155</sup> *ibid* 48; *Stocznia Gdanska SA v Latvian Shipping Co* (n 82) 588; *Guinness Mahon & Co Ltd v Kensington and Chelsea Royal LBC* [1998] EWCA Civ 294, [1999] QB 215, 240.

<sup>156</sup> *Guinness Mahon & Co Ltd v Kensington and Chelsea Royal LBC* (n 155) 240.

<sup>157</sup> *Roxborough v Rothmans of Pall Mall* (n 40).

<sup>158</sup> F Wilmot-Smith, 'Reconsidering "Total" Failure' (2013) 72 *CLJ* 414, 434.

<sup>159</sup> *Giedo van der Garde BV v Force India Formula One Team* [2010] EWHC 2373 (QB) [285]–[286].

<sup>160</sup> *ibid* [285].

<sup>161</sup> *Rowland v Divall* [1923] 2 KB 500.

<sup>162</sup> *Rover International Ltd v Cannon Film Sales Ltd* (n 152) 924–25.

<sup>163</sup> *Giedo van der Garde BV v Force India Formula One Team* (n 159).

<sup>164</sup> *Stocznia Gdanska SA v Latvian Shipping Co* (n 82).

<sup>165</sup> *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* (n 115); *Stocznia Gdanska SA v Latvian Shipping Co* (n 82) 590.

<sup>166</sup> *Gartell & Son v Yeovil Town Football & Athletic Club Ltd* [2016] EWCA Civ 62.

these parties. Drafters can further express what each individual obligation is conditional upon. For example, they might specify that payments intended to meet government levies are for that purpose and conditional on the charge's being due.<sup>167</sup> They can avoid obligations being characterised as entire obligations by indicating that payment is conditional on completion of components of performance. Payment in instalments is evidence of this intention.<sup>168</sup> Equally, parties may provide that certain obligations are unconditional, or not conditional on counter-performance, as is the case with non-refundable deposits.<sup>169</sup>

### *i. Consideration in Invalid Contracts*

Historically, English law resisted granting unjust enrichment when a party performed an invalid contract.<sup>170</sup> The House of Lords later renounced this view because restitution does not indirectly enforce an ultra vires contract.<sup>171</sup> A person who performs an invalid contract might invoke the unjust factors of either mistake or failure of consideration. However, mistake is not always available: a person who pays money under protest, thinking it is probably not due, does not pay because he is mistaken.<sup>172</sup>

Consideration is understood in a distinctive way for invalid contracts. A person's performance is understood to be conditional not just on receiving counter-performance from the other party, but also on having a legal entitlement to that counter-performance.<sup>173</sup> In *Westdeutsche Landesbank Girozentrale v Islington London Borough Council*, Lord Browne-Wilkinson stated that 'the consideration for one party making a payment is an obligation on the other party to make counter-payments'.<sup>174</sup> Even though the parties received the intended benefits under the contract, the fact that the contract was invalid meant there was no consideration. This might seem counterintuitive. It is possible because a person's performance can be conditional on both legal entitlement and receipt of a benefit. If one of these conditions fails, the performing party does not intend the recipient to have the benefit.

This seems to establish a principle of general application: payments made under an invalid contract are 'necessarily made for a consideration which has totally failed and are therefore recoverable'.<sup>175</sup> People generally perform their

<sup>167</sup> *Roxborough v Rothmans of Pall Mall* (n 40).

<sup>168</sup> *Mann v Paterson Constructions Pty Ltd* (n 81); P Butler, 'Advance Contractual Payments' in Rickett and R Grantham (eds), *Structure and Justification in Private Law* (n 44) 225, 231.

<sup>169</sup> Beatson, 'Non-cumul?' (n 41) 20.

<sup>170</sup> *Sinclair v Brougham* [1914] AC 398.

<sup>171</sup> *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669, 687; *Haugesund Kommune v Depfa ACS Bank* (n 20) [87].

<sup>172</sup> *Marine Trade SA v Pioneer Freight Futures* [2009] EWHC 2656.

<sup>173</sup> *Westdeutsche Landesbank Girozentrale v Islington LBC* [1994] 1 WLR 938, 953; *Westdeutsche* (n 171) 711; *Guinness Mahon* (n 155).

<sup>174</sup> *Westdeutsche* (n 172) 711.

<sup>175</sup> *Guinness Mahon* (n 155) 230.

contractual obligations on condition that both parties are actually obliged. However, it may be that some people do not perform conditionally on there being binding contractual rights.<sup>176</sup> If so, the *Westdeutsche* solution might not apply to certain contracts. In *Haugesund Kommune v Depfa ACS Bank*, the court considered and rejected the argument that the bank took the risk of invalidity.<sup>177</sup> Commercial parties could protect themselves in case of invalidity by providing that each party makes its payment on condition both that the contract is valid and that the other side performs. Conversely, they could indicate that each side performs solely in order to receive counter-performance and that their performance is not conditional on the contract's being valid. The question is whether they would want there to be restitution if a fully-performed contract were discovered to be void.

## B. Total Failure of Consideration

The common law requires that consideration must fail totally to ground recovery. There must be 'a total failure of consideration, or a total failure of a severable part of the consideration'.<sup>178</sup> *Whincup v Hughes* indicates why this rule may have seemed appropriate.<sup>179</sup> When a master died near the start of an apprenticeship, the court found it impossible to value each stage of the apprenticeship and refused restitution of the premium. The relative value of the apprentice's labour and master's instruction would shift over time. However, the restriction is now almost universally criticised.<sup>180</sup> An all-or-nothing rule does not produce just results. In many cases, there is no reason why there cannot be mutual counter-restitution.

The courts long admitted restitution for partial failure where goods can easily be divided into units, of which the total price 'is merely the arithmetic sum'.<sup>181</sup> These days, they are increasingly willing to divide the overall considerations into parts, and allow restitution where some elements have failed.<sup>182</sup> In *Goss v Chilcott*, Lord Goff differentiated between a borrower's obligations to pay interest and repay the capital sum. Despite some interest payments, there was still a total failure of consideration for the loan capital.<sup>183</sup> In a striking example, a builder had been paid most of the total contract price, but the court allowed restitution for the excess

<sup>176</sup> C Mitchell, P Mitchell and S Watterson (eds), *Goff & Jones: The Law of Unjust Enrichment*, 9th edn (Sweet & Maxwell 2016) [13–32].

<sup>177</sup> *Haugesund Kommune v Depfa ACS Bank* (n 20) [143]–[153].

<sup>178</sup> *Mann v Paterson Constructions Pty Ltd* (n 81) [168].

<sup>179</sup> *Whincup v Hughes* (1870–71) LR 6 CP 78.

<sup>180</sup> Wilmot-Smith, 'Reconsidering "Total" Failure' (n 158) 417.

<sup>181</sup> SA Smith, 'Concurrent Liability in Contract and Unjust Enrichment: the Fundamental Breach Requirement' (1999) 115 *LQR* 245, 257.

<sup>182</sup> *David Securities Pty Ltd v Commonwealth Bank of Australia* (1992) 175 CLR 353, 383.

<sup>183</sup> *Goss v Chilcott* [1996] AC 788, 797–98.

work done.<sup>184</sup> Judges are willing to calculate net enrichments where it is easy to do so and order mutual counter-restitution.<sup>185</sup> The easiest case is where there have been monetary payments in two directions.<sup>186</sup> Plenty of case law allows restitution despite the claimant's having received part payments of the contract price. Birks understood these authorities to mean that total failure is not required when mutual counter-restitution is easy.<sup>187</sup> We already value non-monetary benefits as enrichments, and can do the same for counter-restitution.<sup>188</sup> Wilmot-Smith argues that the better interpretation of the law is that a claimant may only recover 'if a substantial part of the condition is unsatisfied'.<sup>189</sup> The total failure rule is now highly attenuated, and not likely to survive.<sup>190</sup>

### *i. Avoiding the Total Failure Restriction*

Business actors are unlikely to have an appetite for arbitrary legal risks, such as the all-or-nothing rule that total failure of consideration creates. We have a cognitive bias that feels the effect of losses more than gains.<sup>191</sup> This suggests that people would generally prefer to avoid a situation involving an equal chance of an arbitrary loss or windfall. A 'maximin' decision strategy, which focuses on minimising the risks of a worst-case scenario, favours avoiding an all-or-nothing rule like this.<sup>192</sup> It follows that commercial actors would generally prefer to draft their contract in a way that facilitates more finely calibrated solutions.

Despite the judicial trend towards allowing apportionment where possible, parties cannot depend on this happening. We have seen that how the parties frame their deal interacts with the question of whether consideration has failed totally.<sup>193</sup> Drafters should also construct their deals in ways that facilitate apportionment by making it easier to divide them into parts. In *Giedo van der Garde BV v Force India Formula One Team*, the complex bundle of entitlements made it impossible to determine how much of the contract price corresponded to specific test drives.<sup>194</sup> Where there are multiple elements of consideration within a transaction, the parties should itemise each element of the bargain and value them by attributing parts of the overall consideration to specific benefits. In transactions such as construction projects, parties can facilitate apportionment and the accrual of

<sup>184</sup> *DO Ferguson v Sohl* [1992] 11 WLUK 211.

<sup>185</sup> *David Securities* (n 182) 383; *Goss v Chilcott* (n 183) 798.

<sup>186</sup> *Westdeutsche* (n 173) 945.

<sup>187</sup> Birks, *Introduction to the Law of Restitution* (n 31) 242.

<sup>188</sup> J Edelman, 'Restitution for a Total Failure of Consideration: When a Total Failure is Not a Total Failure' (1996) 1 *Newcastle Law Review* 57, 64.

<sup>189</sup> Wilmot-Smith, 'Reconsidering "Total" Failure' (n 158) 422.

<sup>190</sup> Smith, 'Concurrent Liability' (n 181) 245.

<sup>191</sup> D Kahneman and A Tversky, 'Prospect Theory: an Analysis of Decision under Risk' (1979) 47 *Econometrica* 263, 279.

<sup>192</sup> JL Harrison, 'A Case for Loss Sharing' (1983) 56 *Southern California Law Review* 573, 597-98.

<sup>193</sup> *Stocznia Gdanska SA v Latvian Shipping Co* (n 82) 600.

<sup>194</sup> *Giedo van der Garde BV v Force India Formula One Team* (n 159).



contractual rights by dividing work into phases involving mutual performance.<sup>195</sup> Staged payments are likely to be interpreted as meaning that the corresponding performance obligations contain ‘divisible obligations of performance’.<sup>196</sup> This will allow accurate, controlled restitution depending on how many milestones have been reached.

Commonly, part of the contract price is attributable to transaction taxes. Parties can protect themselves against the risk that these are invalid. The person who pays taxes indirectly may need to reclaim them from his contracting partner because he cannot recover them directly from the state.<sup>197</sup> The obstacles he will face are the continuing validity of the contract and the need to show total failure of consideration. The High Court of Australia decision in *Roxborough* indicates a solution.<sup>198</sup> Because the tobacco licence fee was not negotiated and was listed as a distinct part of the contract price, the Court found that there was total failure of consideration for it. The structure of the deal indicated the parties’ shared understanding that this sum was specifically intended to pay the tax. This part of the price could be apportioned and the consideration for it had failed. It is important to identify taxes and external levies separately, distinct from the bargain price, so that restitution might be possible if they turn out to be invalid.<sup>199</sup>

## VIII. Conclusion

The default common law and statutory rules provide satisfactory remedies in cases where a contractual bargain goes awry. There is no gap in the law that requires parties to fend for themselves. However, they do have scope for direct and indirect control of restitution. Indeed, choices about contract design necessarily determine how failure of consideration will apply to every transaction. It follows that lawyers should consciously exercise this control.

Lawyers can assist their commercial clients by considering these issues when structuring bargains and drafting contracts. Alongside the risks they routinely consider, they can usefully take account of the legal risk of the contract’s becoming ineffective. It is easier than one might assume to plan for contractual ineffectiveness, because drafters do not need to predict the specific events that might lead to termination, impracticability or invalidity.<sup>200</sup> The real thinking that is required is

<sup>195</sup> See *Stocznia Gdanska SA v Latvian Shipping Co* (n 82); Butler, ‘Advance Contractual Payments’ (n 168) 232.

<sup>196</sup> *Mann v Paterson Constructions Pty Ltd* (n 81) [26], [176].

<sup>197</sup> *Investment Trust Companies (In Liquidation) v Revenue and Customs Commissioners* [2018] AC 275.

<sup>198</sup> *Roxborough v Rothmans of Pall Mall* (n 40).

<sup>199</sup> *Orphanos v Queen Mary College* (n 58).

<sup>200</sup> Choi and Triantis, ‘Strategic Vagueness’ (n 3) 865.

to identify the remedies that the parties will want depending on what performance has occurred when the contract becomes ineffective. Termination clauses and force majeure clauses are extremely common; they should address consequential financial readjustment, including restitution and loss sharing.

The interaction of the doctrine of failure of consideration with the structure of people's bargains may be less widely considered in practice. If those who draft contracts exert the control that the law allows them when designing contracts, they can achieve greater choice, control and certainty when restitutionary scenarios arise. Parties can calibrate when payments accrue and what adjustments will be required according to when performance is interrupted. They can make it clear what each party considers the core of the bargain and what each act of performance is conditional upon. They can ensure more nuanced solutions than the requirement for total failure of consideration might produce. Some general provisions are suited to routine inclusion. For example, parties could stipulate that each party performs its contractual obligations on the condition that this contract is valid. This would copper-fasten the likely inference that there is a failure of consideration where the contract is invalid. The parties could state that they consider that performance on both sides is divisible, so that part of the overall price corresponds directly to smaller components of each side's consideration. Similarly, they may indicate that they agree that there should be mutual counter-restitution for incomplete performance. To assist a judge further in valuing separate components, contract drafters should indicate which portions of the consideration on each side mutually correspond. This will require careful thought about how much money a party would need to receive to protect it from loss if the deal were interrupted at various milestones. Engaging with these issues at the contracting stage can enhance certainty by forestalling doubts about how the law might apply to the parties' deal. Ultimately, this may enable them to reduce or eliminate litigation costs if things go wrong.

