

## ARTICLE

## Is a Judicial Discretion Needed to Soften the “All or Nothing” Nature of the Doctrine of Frustration?

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An unforeseen event can seriously affect the obligations arising under commercial contracts. Typically, contracts which become radically different after a said event will be discharged under the doctrine of frustration. However, there are an increasing number of contracts that become onerous but remain on foot, as they do not meet the high bar for frustration. This article examines whether judges should have discretion to alter parties' contractual obligations if they become onerous. As a result, this will allow judges to allocate the loss caused by unforeseen events equitably, while allowing the contractual relationship to remain. Nonetheless, this article contends that keeping the doctrine is necessary to preserve much-needed commercial certainty found in the *all or nothing* nature of frustration. Further, judicial discretion would nullify the entire doctrine of frustration, rendering decades of case law unusable. Judicial meddling is particularly undesirable, especially in commercially significant long-term contracts, given that the whole purpose of many agreements is to allocate risk. The benefits of implementing a judicial discretion in cases of onerous contracts are therefore outweighed by the uncertainties it would create.

### I Introduction

Frustration of contract has resurged in academic discussion in the last decade. Many commercial agreements experienced difficulties when the doctrine was invoked during the 2008 financial crisis as well as after the 2010–2011 Christchurch earthquakes. There has been recent discussion, both internationally and nationally, concerning the

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consequences of frustrating a commercial contract.<sup>1</sup> It has been considered that the law is currently not in a state suitable to accommodate for this commercial reality.<sup>2</sup> Questions have been raised as to when a judicial discretion is warranted in frustration cases in order to soften the *all or nothing* nature of the doctrine of frustration.<sup>3</sup> Both the High Court and Supreme Court of New Zealand have released judgments attempting to clarify the doctrine.<sup>4</sup> However, both judgments declined to address either the application of a judicial discretion to lessen the harshness and *all or nothing* nature of frustration, or considerations relating to commercial contracts.

The law as it stands in New Zealand and the United Kingdom is that the frustrated contract is terminated with no chance to adjust the parties' obligations.<sup>5</sup> However, the most significant injustices lie with contracts that turn onerous, yet do not reach the threshold for frustration. There is an increasing school of thought that a duty of good faith should be imposed on commercial parties whose contract turns onerous. Numerous cases have illustrated the injustices caused by forcing one party to bear the full loss for a contract that is onerous but does not reach the threshold. This article focuses on whether a judicial discretion is warranted in cases of onerous contracts that do not meet the threshold for frustration; it will not consider the merit of any judicial discretion to supplement the Frustrated Contracts Act 1944 (a statute which deals with the consequences that arise when a finding of frustration is made out).

## II The Doctrine of Frustration

The doctrine of frustration is the common law response to contracts affected by an unforeseen event, and therefore provides the starting point for this research. Frustration may occur between parties to a contract when supervening circumstances prevent the agreement from being fulfilled. The Court will intervene and discharge the parties from their obligations should a contract be found frustrated.

The rule of absolute contracts (*pacta sunt servanda*) was dispelled in *Taylor v Caldwell*.<sup>6</sup> In *Taylor*, Lord Blackburn held that the doctrine of absolute contracts could not be invoked where there is an express or implied condition that was essential to the agreement and this condition was no longer achievable due to the supervening event. While the implied term test is now essentially outdated,<sup>7</sup> the doctrine of absolute contracts remains subject to the frustration exception.

Frustration in United Kingdom and New Zealand law “kill[s] the contract and discharge[s] the parties from further liability under it”.<sup>8</sup> The common law of England, New

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1 Simon Whittaker and Reinhard Zimmerman (eds) *Good Faith in European Contract Law* (Cambridge University Press, Cambridge, 2000) at 557–577.

2 John Burrows, Jeremy Finn and Stephen Todd (eds) *The Law of Contracts in New Zealand* (4th ed, LexisNexis, Wellington, 2012) at 815–816; and Andrew Rogers “Foreword” in Ewan McKendrick (ed) *Force Majeure and Frustration of Contract* (2nd ed, Lloyd’s of London Press, London, 1995).

3 Burrows, Finn, and Todd, above n 2, at 815–817.

4 *Planet Kids Ltd v Auckland Council* [2013] NZSC 147, [2014] 1 NZLR 149; and *Ridgecrest NZ Ltd v IAG New Zealand Ltd* [2012] NZHC 2954, (2013) 17 ANZ Insurance Cases ¶61–957.

5 *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32 (HL).

6 *Taylor v Caldwell* (1863) 3 B & S 826, 122 ER 309 (KB).

7 *National Carriers Ltd v Panalpina (Northern) Ltd* [1981] AC 675 (HL).

8 *Lauritzen AS v Wijsmuller BV* [1990] 1 Lloyd’s Rep 1 (CA) [*The Super Servant Two*] at 8. This reasoning was affirmed in *Planet Kids Ltd*, above n 4, at [9] per Elias CJ.

Zealand and Australia gives the judge no discretion to alter a contract once it has been deemed frustrated. Since the contract has completely ended, alteration cannot take place. Likewise, contracts that turn onerous but do not reach the threshold of frustration will remain on foot and unchanged by the judge. This is the *all or nothing* nature of the doctrine.

The threshold for satisfying frustration is set high because the Courts are wary of eroding certainty of contract. In *Edwinton Commercial Corp v Tsavlis Russ (Worldwide Salvage and Towage) Ltd (The Sea Angel)*, Rix LJ identified that frustration can only be invoked if the supervening event resulted in “radically different” circumstances than what the parties originally contemplated.<sup>9</sup> Furthermore the threshold needs to be high given that total discharge is such a drastic consequence to the agreement. Frustration is not a remedy but occurs automatically regardless of the intention of the parties.

Lord Simon of Glaisdale summarised the rationale for the doctrine in *National Carriers Ltd v Panalpina (Northern) Ltd*:<sup>10</sup>

Frustration of a contract takes place when there supervenes an event (without default of either party and for which the contract makes no sufficient provision) which so significantly changes the nature (not merely the expense or onerousness) of the outstanding contractual rights and/or obligations from what the parties could reasonably have contemplated at the time of its execution that it would be unjust to hold them to the literal sense of its stipulations in the new circumstances; in such case the law declares both parties to be discharged from further performance.

*Pacta sunt servanda* is normally overridden due to the changed circumstances that heavily burden the debtor.<sup>11</sup> Therefore, frustration’s ultimate rationale is to prevent holding parties to a contract in circumstances that make adhering to the literal obligations unjust. The doctrine also aims at preserving some certainty as well, hence the high threshold needed to establish frustration.

The injustice that frustration aims to remedy was displayed in a recent New Zealand case. In *Ridgecrest NZ Ltd v IAG New Zealand Ltd* a finding of frustration was made out.<sup>12</sup> This case was one of many cases relating to the 2010–2011 Christchurch earthquakes. There were four earthquakes relevant to this case. The issue was whether the insurer should be liable for the costs of repairs after the third and fourth earthquakes rendered the building in question irreparable. By the third earthquake, the insurer had paid NZD 125,000. His liability was capped at NZD 1.984 million. Dobson J found that the obligation of the insurer to meet the full extent of his liability contained in the contract was frustrated; the insurer was only liable to pay for the damage resulting from the first two earthquakes. The use of frustration here prevented the plaintiff from receiving a windfall.<sup>13</sup>

In light of this discussion, it is clear that frustration has the following attributes: it operates automatically, it uses an *all or nothing* approach, and it uses a high *radical*

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9 *Edwinton Commercial Corp v Tsavlis Russ (Worldwide Salvage and Towage) Ltd* [2007] EWCA Civ 547, [2007] 2 Lloyd’s Rep 517 [*The Sea Angel*] at [111].

10 *National Carriers Ltd*, above n 7, at 700F–G.

11 Knut Rodhe “Adjustment of Contracts on Account of Changed Conditions” (1959) 2 Scan St in Law 153 at 154.

12 *Ridgecrest NZ Ltd*, above n 4.

13 John Goddard “Earthquake cases” [2013] NZLJ 229 at 230.

*difference* threshold. The use of judicial discretion to vary an onerous contract due to an unforeseen event would alter these attributes.<sup>14</sup>

#### A *The nature of contract law and frustration*

The nature of contract law is that it involves risk taking. The exception to the rigid adherence to contractual sanctity is the doctrine of frustration, which serves to completely discharge the contract. Therefore, frustration conflicts with *pacta sunt servanda* (promises must be kept). Complete termination of contractual obligations is a “drastic solution”.<sup>15</sup> The rationale for absolute contracts is that it should be for the parties to the agreement to allocate risk.<sup>16</sup> Parties to an agreement cannot use frustration simply to escape a bad bargain.<sup>17</sup> Both scholars and business people continue to contend that the entire purpose of having a contractual relationship is to distribute risk.

Treitel terms the lack of discussion on the effects of frustration as “surprising.”<sup>18</sup> He identifies that in the United Kingdom there is generally considered to be no middle ground between a contract being totally discharged or totally bound.<sup>19</sup> Judicial expressions of frustration such as that in *Lauritzen AS v Wijsmuller BV (The Super Servant Two)* affirm this.<sup>20</sup>

### III The Mischief

A finding of frustration completely discharges all parties to the contract. There is no middle ground. Cases where the contract becomes onerous but not radically different will therefore remain on foot. In these cases a severe change of circumstance means that a contract becomes unduly burdensome for one party, but because of the high bar, that party is still fully bound to the contract. Here, often sharing the loss would be more equitable than placing it on one party.<sup>21</sup> Having one party to bear the full loss risks the other party receiving a windfall. Additionally, this effect would irreparably harm the business relationship between the parties. A party forced to complete work that has become significantly more expensive due to an onerous event would undoubtedly become disgruntled. Whether these problems are best addressed through a restricted judicial discretion or through other means is the focus of this article.

#### A *Cases where the contract became onerous and where the results were harsh*

The following cases show the high threshold of frustration has led to injustice. Frustration was pleaded in *Leiston Gas Co v Leiston-Cum-Sizewell Urban District Council*.<sup>22</sup> In this case, the defendants contracted with the plaintiffs who were to provide gas standards and lamps, as well as supply gas and maintain the lamps on an ongoing basis. The defendants

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14 For extended discussion see Part IV of this article.

15 Law Commission *Contract Statutes Review* (NZLC Rn 25, 1993) at 277.

16 *Planet Kids Ltd*, above n 4, at [47] per Glazebrook J.

17 Edwin Peel (ed) *The Law of Contracts* (13th ed, Sweet & Maxwell, London, 2011) at [1-005].

18 Guenter Treitel (ed) *Frustration and Force Majeure* (3rd ed, Sweet & Maxwell, London, 1994) at [15-009].

19 At [15-009].

20 *The Super Servant Two*, above n 8.

21 Law Commission, above n 15, at 286.

22 *Leiston Gas Coy v Leiston-Cum-Sizewell Urban District Council* [1916] 2 KB 428 (CA).

were required to pay quarterly instalments to pay for the gas. Partway through the contract's performance, the military prohibited further lighting of the streetlamps. The plaintiffs sued for the remaining three quarterly payments, and the defendants rejected this contention on the basis that the contract was rendered impossible.

The Appeal Court held that the military order did not make the contract fully impossible; therefore, the defendants had to pay. This is an example of the bluntness of frustration. In this case, the defendants had to pay full cost for a service they were not receiving. Professor Burrows identifies that a judicial discretionary power here could reduce the payments of the defendants until the plaintiffs are in a position to resume performing their full obligations.<sup>23</sup>

The classic case displaying the harshness of the doctrine of frustration's *all or nothing* nature is *Staffordshire Area Health Authority v South Staffordshire Waterworks Co*.<sup>24</sup> This case concerned the supply of water pursuant to a 1929 agreement. The agreement was to continue in perpetuity. Lord Denning MR's minority view was that the contract should be adjusted to take into account the drastic inflation. The inflation in this case meant that the payments for the water were 19 times below market value. Professor Burrows identifies that in this case "no one could seriously contend that it is fair and reasonable to enforce the contract to its letter."<sup>25</sup> Nonetheless, the majority held that the contract did not reach the high threshold to be found frustrated.

Another case criticised for its harsh result is *The Super Servant Two*.<sup>26</sup> In this case the defendants had agreed to transport the plaintiff's oil rig from Japan to Rotterdam. The parties agreed to use the Super Servant Two ship for the delivery. The Super Servant Two sank in 1981. The Court held that the defendants must bear the costs of transporting the oil rig. This decision has been described as particularly harsh and "open to criticism".<sup>27</sup> The harsh result of this case could be solved by lowering the threshold for frustration, or alternately empowering a judge with discretion to make payments more equitable and in line with good faith dealings.

The United States case of *Eastern Air Lines Inc v Gulf Oil Corp* also shows a harsh result.<sup>28</sup> Here, the Court could not find frustration in a case where the OPEC crisis caused dramatically increased oil costs; it found that Gulf Oil had to bear the burden. In these cases, there is little incentive for the party that does not receive the service but receives payment for it to bother negotiating or accepting a compromise. This would probably harm the previously amicable business relationship of the parties engaged in the agreement.

#### IV Arguments for the Restricted Judicial Discretion for Onerous Contracts

Much has been written about the merits of giving the judiciary discretion to vary the contract where it becomes onerous due to an unforeseen event. Contractual modification

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23 Law Commission, above n 15, at 290.

24 *Staffordshire Area Health Authority v South Staffordshire Waterworks Co* [1978] 1 WLR 1387 (CA).

25 Law Commission, above n 15, at 294.

26 *The Super Servant Two*, above n 8.

27 Guiditta Cordero-Moss (ed) *Boilerplate Clauses, International Commercial Contracts and the Applicable Law* (Cambridge University Press, Cambridge, 2011) at 176.

28 *Eastern Air Lines Inc v Gulf Oil Corp* 415 F Supp 429 (SD Fla 1975).

is well equipped for distinct individual circumstances given its potential flexibility.<sup>29</sup> There has been little judicial comment on any discretion Courts have in cases of frustration. However, in *British Movietonews Ltd v London & District Cinemas Ltd*, Denning LJ suggested the Courts could act with flexibility:<sup>30</sup>

In these frustration cases ... the Court really exercises a qualifying power – a power to qualify the absolute, literal or wide terms of the contract – in order to do what is just and reasonable in the new situation

Lord Denning propounded a similar view in *Staffordshire Area Health Authority v South Staffordshire Waterworks Co.*<sup>31</sup> His view was rejected by the New Zealand Court of Appeal in *The Power Co Ltd v Gore District Council*.<sup>32</sup> Here, inflation increased by a factor of 30.9 times from the creation of the agreement in 1927 until the establishment of the proceedings in 1997. However, there was less scope for injustice here than there was in *Staffordshire*. The Company gained great value from being the sole supplier of power to the Council.<sup>33</sup> The rationale for the Courts not allowing steep increases in price as grounds for frustration is they do not want to reallocate contractual risks in a way that gives one party a windfall.<sup>34</sup> An important rationale for this case (and all cases where frustration is argued) is likely to be preserving contractual certainty. Additionally, increases or decreases in market value can be predicted by the parties.<sup>35</sup>

Lord Denning's rationale has received fervent criticism. Burrows identifies that potentially millions of contracts are within the scope of the principle such as long-term (over 99 year) leases with fixed rents.<sup>36</sup> On the other hand, there has never been any notable risk of excessive litigation. Both common law and American Courts have been consistently reluctant to take such a liberal standing. For example, the United States doctrine of impracticability (which allows for a judicial discretion where an unforeseen event has altered the essential nature of the contract)<sup>37</sup> is rarely invoked. Therefore there is an argument that the criticism overemphasises the issue.

It is submitted that a judicial discretion would need to remedy the injustice while ensuring that the principle cannot be invoked too easily (the *floodgates* argument).<sup>38</sup> While a judicial discretion determining the justice on a case-by-case basis might be workable in these cases, Courts would need to be extremely aware of eroding contractual certainty. They would also need to recognise that any decision would have to be extremely well thought through given the commercial precedent it would set. These risks mean that it is possible that judges would so rarely alter the contract that a judicial discretion would not

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29 Theo Rauh "Legal Consequences of Force Majeure Under German, Swiss, English and United States' Law" (1996) 25 Denv J Int L & Poly 151–153.

30 *British Movietonews Ltd v London & District Cinemas Ltd* [1951] 1 KB 190 (CA) at 200.

31 *Staffordshire Area Health Authority*, above n 24.

32 *The Power Co Ltd v Gore District Council* [1997] 1 NZLR 537 (CA).

33 Burrows, Finn, and Todd, above n 2, at 761.

34 Jack Beatson "Increased Expense and Frustration" in Francis Rose (ed) *Consensus ad Idem: Essays on the Law of Contract in Honour of Guenter Treitel* (3rd ed, Sweet & Maxwell, London, 1996) at 133.

35 *The Power Co Ltd*, above n 32, at 554; and Beatson, above n 34, at 133–134.

36 Burrows, Finn, and Todd, above n 2, at 794.

37 American Law Institute *Restatement of the Law of Contracts* (2nd ed, Washington, District of Columbia, 1979), § 261.

38 Beatson, above n 34, at 133.

make a practical difference to this area of the law. This seems to be the case in the United States, discussed below at Part VI(C).

#### A *The impact on the doctrine of frustration*

Introducing a restricted judicial discretion to soften the *all or nothing* nature of frustration would be a remarkably bold move. It would mean the doctrine of frustration as we know it could no longer exist. Total discharge would still exist, but it would no longer be automatic in nature; the judge would use their discretion to determine if total discharge is warranted *or* if a variation is all that is required. At face value, it this does not seem like a tremendous change, however it would affect decades of legal precedent. Furthermore, a judicial discretion would alter the *all or nothing* nature of the doctrine, since it would act as a middle ground between letting the agreement stand and imposing total discharge. Discretion to remedy the injustice caused by contracts turned onerous, would also be effectively lowering the threshold as to when contract can be interfered with. The reformist literature surveyed by the author often did not recognise the fundamental doctrinal change that would result from modifying the application of frustration.

New Zealand is a young and independent country that has not been afraid to challenge the laws of its colonial power. Additionally, all three primary aspects of the doctrine have been consistently criticised. This is particularly seen in the pointlessness of the doctrine's automatic nature, even where the parties to long-term contracts wish for the agreement to continue.<sup>39</sup>

#### B *Standard business practice*

A judicial discretion would alter the nature of the doctrine of frustration. However, the nature of the doctrine could use reform; it is particularly ill-suited to both standard business practice and long-term contracts. Most business people would take issue with the rigidity of the common law rules.<sup>40</sup> Often compromise is more fiscally sensible than an absolute discharge of obligations.<sup>41</sup> Furthermore, business people to large contracts are usually concerned with maintaining cordial business relations rather than adhering to the rigid common law.<sup>42</sup> This being said, commercial fairness is arguably lost since the parties who volunteered to the agreement will no longer have control over it.<sup>43</sup> However, it seems likely that to most business people judicial termination of the agreement is less preferable than (for example) altering the agreement to account for an increase of price, delay in delivery, or curtailment of supply.<sup>44</sup> In certain industries—for example, the petroleum industry—the expectation of equitable adjustment is so common that parties rely on it.<sup>45</sup>

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39 Ewan McKendrick "The Regulation of Long-Term Contracts in English Law" in Jack Beatson and Daniel Friedmann (eds) *Good Faith and Fault in Contract Law* (3rd ed, Clarendon Press, Oxford, 1995) at 322.

40 Law Commission, above n 15, at 286.

41 Peel, above n 17, at 923.

42 Michael Aubrey "Frustration Reconsidered – Some Comparative Aspects" (1963) 12 ICLQ 1165 at 1169.

43 Andrew Kull "Mistake, Frustration, and the Windfall Principle of Contract Remedies" (1991–1992) 43 Hastings LJ 1 at 55.

44 Leon Trakman "Frustrated Contracts and Legal Fictions" (1983) 46 MLR 39 at 41.

45 Larry A DiMatteo "Equity's Modification of Contract: An Analysis of the Twentieth Century's Equitable Reformation of Contract Law" (1999) 33 New Eng L Rev 267 at 310.

Finally, in the United States, there are a large amount of transactions carried out based on “letters of intent” which by their nature demand flexible dealing.<sup>46</sup>

### C *Long-term commercial contracts*

This research was unable to find any conclusive definition of what encompasses a “long-term contract”. This is undoubtedly because the definition involves use of a continuum.<sup>47</sup>

It has been argued in the past that contract law has historically ignored agreements that establish on-going relationships, and instead focused on single transactions such as the “sale of goods”.<sup>48</sup> This is clearly not the case today because many of the cases referred to in this article deal with long-term, continuous relationships. The nature of long-term contracts makes them more vulnerable to unforeseen events that are outside of the parties’ contemplation. The length of the contract increases the risk of the agreement being subject to an unforeseen event and increases the risk of continuing loss from said event.

Business people engaged in a long-term contract usually have a greater interest in its continuation than its dissolution.<sup>49</sup> The complexity of long-term contracts has led to the perspective that they should be subject to the duty of good faith.<sup>50</sup> It is much more difficult for long-term transactions to be found subject to frustration.<sup>51</sup> Therefore, they are more at risk of the harsh results that lead to onerousness (but not frustration), as described in the case examples above. As one commentator stipulates:<sup>52</sup>

The longer the expected duration and the greater the uncertainty of a contract, the more difficult it is for the parties to expressly agree upon contingencies and excuses. It is increasingly left to the courts to imply such conditions and excuses into the contract.

There is a strong argument that the Courts should adapt to assisting parties to complex long-term transactions beyond the bare extent needed for the contract to be feasible. Other developments in contract law support this need. For example, interpretation of contracts is now based on a purposive model instead of the historic literal approach. This model favours “smooth working of long-term relational contracts”.<sup>53</sup> Furthermore, one commentator has observed that “relational contracts, by necessity, are incomplete and dependent on good faith adjustments after the time of formation”.<sup>54</sup> Under the *all or nothing* approach, a party to an onerous long-term agreement stands to make a windfall at the expense of the prejudiced party. There is generally more money at stake in complex long-term transactions, which increases the windfall risk.

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46 PHN Opas “What Happens When the Contract Becomes Unprofitable?” (1973) 1 Aust Bus L Rev 59 at 63.

47 Michael Zundel “Equitable Reformation of Long-Term Contracts – The “New Spirit” of ALCOA” (1982) 4 Utah L Rev 985 at 991.

48 John Burrows “Update on Contract” (paper presented to New Zealand Law Society, October 2003) at 41.

49 Rauh, above n 29, at 154.

50 Burrows, above n 48, at 42.

51 *National Carriers Ltd*, above n 10, at 691 per Lord Hailsham.

52 DiMatteo, above n 45, at 314.

53 Burrows, above n 48, at 42.

54 Richard Speidel “Afterword: the Shifting Domain of Contract” (1995–1996) 90 Nw U L Rev 254 at 264.

#### D Consistency with the New Zealand contract statute landscape

Amending the Frustrated Contracts Act 1944 to allow for a restricted judicial discretion for contracts that become onerous would assist in fostering consistency between New Zealand's contract statutes.<sup>55</sup> Additionally, New Zealand's contract statute landscape shows that using restricted judicial discretion to deal with "hard cases" (cases that follow proper legal application but lead to a harsh result)<sup>56</sup> is the direction in which the law is heading. The Illegal Contracts Act 1970, the Contractual Mistakes Act 1977, the Contracts (Privity) Act 1982, and the Contractual Remedies Act 1979 all bestow the Court with wide discretionary powers to either vary the contract or grant damages.<sup>57</sup> The rationales of each Act also bear noticeable similarities.<sup>58</sup> However, uniformity in statutes is not always a great rationale for legislative change. For example, the statutes modelled on the United Kingdom Frustrated Contracts Act have all received similar criticisms.<sup>59</sup>

A case decided in New Zealand with similar facts to those in *Krell v Henry* would allow the plaintiff to access relief under contractual mistake. Professor Burrows argues that it would be "logical to match the tests for, and the legislation regulating, frustration and mistake."<sup>60</sup> In that case, a finding of frustration was made out where a room was booked for the sole purpose of seeing the royal procession. The procession was subsequently cancelled which was found by the Courts to render the agreement changed so drastically that it was frustrated.

##### (1) Extending principles contained in the Contractual Mistakes Act 1977

The Contractual Mistakes Act provides the Court with wide-ranging powers of relief in cases where contracts are entered into under mistake.<sup>61</sup> It allows the Court under ss 7(3)(a)–(d) to make any order it deems just, including (but not limited to) declaring the contract valid, whole or in part; cancelling the contract; granting relief by way of variation to the contract; and granting relief by way of restitution or compensation. Interestingly, the relief sections in the Contractual Mistakes Act were intended to foster consistency with the Illegal Contracts Act 1970 and the Frustrated Contracts Act 1944.<sup>62</sup> Therefore the argument that implementing a judicial discretion would foster much-needed consistency in the New Zealand contract statutes landscape, has gained some strength in recent years.

On the other hand, the Courts have been reluctant to grant relief under s 7. There is uncertainty in what principles should guide the wide-ranging powers of relief.<sup>63</sup> Gault posits that, over time, the Courts will fashion a "landscape" around s 7, which will be

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55 Thomas Gibbons "A Contracts (Consolidation) Act for New Zealand" (2003) 11 Waikato L Rev 13 at 33.

56 Desmond Fagan "Uncertainty and Judicial Discretion in Commercial Law" (1990) Policy Magazine 9 at 11.

57 Illegal Contracts Act 1970, s 7; Contractual Mistakes Act 1977, ss 6–7; Contracts (Privity) Act 1982, s 7; and Contractual Remedies Act 1979, ss 6 and 9. For general discussion on this point, see Gibbons, above n 55, at 33.

58 Gibbons, above n 55, at 33.

59 John Burrows, Jeremy Finn and Stephen Todd "Discharge of Contract" in Cynthia Hawes (ed) *Introduction to Commercial Law* (3rd ed, LexisNexis, Wellington, 2010) at [8.1.6].

60 Law Commission, above n 15, at 290.

61 Contractual Mistakes Act, s 7.

62 Thomas Gault (ed) *Gault on Commercial Law* (online looseleaf ed, Brookers) at [CM7.03].

63 Law Commission, above n 15, at 354.

guided by the principle that a party should not take advantage of the mistake to escape the agreement which is still capable of performance; and the principle that:<sup>64</sup>

If the agreement is no longer capable of performance and they are not willing to substitute another agreement, the contract should be cancelled and the discretion employed to return the parties to the position they were in before the contract was entered.

If a judicial discretion similar to s 7 was implemented to deal with onerous contracts, then ideally a *landscape* of case law would be developed to provide certainty to the law. Whether this would be likely to happen is doubtful, given the rarity of supervening events which turn the contract onerous.

## (2) Extending principles contained in the Contractual Remedies Act 1979

As previously mentioned, under the Contractual Remedies Act the Court has wide-ranging power of relief. This discretion is contained in ss 9(1)–(4). The Court can vest in any party the whole or part of any real or private property that was subject to the contract, direct any party to pay the other such sums as the Court deems just and injunctive relief. The considerations the Court shall have regard to includes the expenditure incurred by one party in or for the performance of the contract (s 9(4)(c)); the value of any work or services performed pursuant to contractual obligation (s 9(4)(d)); any benefit or advantage obtained by a party by reason of anything done by another party pursuant to contractual obligations (s 9(4)(e)); and such other matters as the Court thinks proper (s 9(4)(f)).

Professor Burrows suggested that before implementing a judicial discretion to soften frustration's *all or nothing* nature, it may be wise to *wait a little* until the other contract statutes which grant discretion have had time to be judicially interpreted.<sup>65</sup> Professor Burrows said this in the context of the law in 1982; it is now 32 years later, and there has been some case law on this point in the context of the Contractual Remedies Act. There is no evidence that the wide discretion has impacted commercial certainty. It has been noted that the “remarkably broad”<sup>66</sup> discretion under the Act provides a new opportunity to review the nature and traditional hierarchy of damages in contract law.<sup>67</sup> The broad discretion was boldly used in *Herbert v Catley*, where the judge reopened a cancelled contract.<sup>68</sup>

Therefore, an argument can be made where onerous cases which do not meet the threshold for frustration should be subject to a judicial discretion in a way that is consistent with other New Zealand contract legislation. Perhaps a stronger argument is that the contract statutes are specific to their area of law, and do not extend to liberalise contractual principles in general. It is submitted that the latter interpretation is more consistent with the incremental and gradual development of the law. However, other contract statutes provide an indication as to what considerations are generally needed to suitably restrict a judicial discretion.

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64 Gault, above n 62, at [CM7.03].

65 Law Commission, above n 15, at 303.

66 Burrows, Finn, and Todd, above n 2, at 896.

67 This was the approach of Fisher J in *Newmans Tours Ltd v Ranier Investments Ltd* [1992] 2 NZLR 68 (HC).

68 *Herbert v Catley* HC Rotorua A 42/81, 11 July 1983.

## V Arguments against a Restricted Judicial Discretion

### A *Sanctity of contract*

The risk of eroding *pacta sunt servanda* presents what is probably the strongest challenge to implementing a restricted judicial discretion. The rationale for absolute contracts is that it is up to the parties to allocate contractual risk.<sup>69</sup> However, sanctity of contract is more at risk if the Court alters the parties' obligations than if the Court merely discharges both parties.<sup>70</sup> If the obligations are altered, the parties' contractual relationship remains intact. Admittedly, frustration does provide certainty in its straightforward *all or nothing* modus operandi.

The nature of contract as a risk allocation device is deeply ingrained into common law societies. Frustration challenges this already, and any further changes would not be taken kindly to by traditionalists. Nonetheless the contention that adjustment preserves certainty to a greater extent than total discharge is logically a compelling one.

### B *Insurance and other safety clauses*

Commercial parties to an agreement are not infallible. The mischief identified above could be avoided if the parties (or more likely, their lawyers) had thought to include an insurance provision or a more specific provision for certain circumstances that turn the contract onerous. The reality is that these are not always present, and it is submitted that not having these elements through personal negligence (or more likely through the negligence of a solicitor) is not enough to warrant the mischief identified above causing unnecessary hardship. However, an early New Zealand case opposes this view. In *The Hawke's Bay Electric-Power Board v Thomas Borthwick*,<sup>71</sup> premises were damaged in the Napier Earthquake. Blair J held that the contract was not frustrated for two reasons: earthquakes occur frequently in New Zealand, and that most businessmen of large companies either insure or let the business absorb the risk. It is submitted that Blair J's rationale is particularly harsh and best limited to its facts. It is impossible to predict everything in complex long-term agreements. Additionally, lawyers rather than business people are often tasked with drafting the contractual machinery.

### C *Commercial uncertainty*

If a judicial discretion was implemented, there may be uncertainty with what direction the Courts would take. This is undesirable in commercially significant long-term contracts. Goff and Jones have written that "in commercial law, it is undesirable that these questions should rest on the uncertain exercise of judicial discretion".<sup>72</sup>

The Law Commission of British Columbia agreed with this contention, commenting that people should know with clarity what their obligations and liabilities are.<sup>73</sup> There may also be an increased risk of litigation. This would be present where one party argues the

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69 *Planet Kids Ltd*, above n 4, at [47] per Glazebrook J.

70 Treitel, above n 18, at [15-035]. See also Rauh, above n 29, at 153.

71 *The Hawke's Bay Electric-Power Board v Thomas Borthwick And Sons* (Australasia) Ltd [1933] NZLR 873 (SC).

72 British Columbia Law Reform Commission Report on the Need for Frustrated Contracts Legislation in British Columbia (Project No 8) (LRC 3, 1971) at 38.

73 At 38.

contract is onerous and therefore warranting use of judicial discretion, while the other argues frustration and therefore total discharge. However, it is submitted that this risk would be small, given that the litigation on whether a contract is frustrated is already little in number. This is due to frustrating or onerous events being inherently rare.

Professor Burrows notes that if the Courts could grant variation (a lesser form of relief) instead of total discharge, they may be more willing to hold that onerous (as opposed to “radically different”) events negate strict adherence to the agreement.<sup>74</sup> If this were true, it would decrease commercial certainty. However, the overseas comparison at Part VI of this article finds that Courts of overseas jurisdictions who use the adjustment principle, remain highly reluctant to alter the parties’ agreements. New Zealand cases such as *Thomas Borthwick* show reluctance by the judiciary to sympathise with parties to contracts that become onerous.<sup>75</sup>

#### D *Judge as accountant or economist*

It goes without saying that if judges are required to act as business people and accountants, then “injustices are bound to occur”.<sup>76</sup> Judges lack the requisite knowledge to determine when to adjust the contract.<sup>77</sup> Furthermore judges trained in the law would lack proficiency to deal with complex long-term commercial agreements,<sup>78</sup> particularly so in New Zealand where the Court system only has specialist judges in the Youth, Environment, and Family divisions. Hillman argues that introducing a judicial discretion in cases of commercially impracticable contracts would increase costs of contracting parties, as they would need to plan the contract around the judge’s discretion.<sup>79</sup> With respect, his contention is doubtful. Unforeseen events that render the contract onerous occur so rarely that it is unlikely the contracting parties would waste expense drafting a contract that directly addresses judicial discretion.

The Courts are ill-equipped for dealing with a country’s economic policy. Commentators have contended that problems of economic policy are best to be addressed by the legislature.<sup>80</sup> Questions of economic character “can seldom be isolated but must be planned as part of a more complex whole.”<sup>81</sup> Moreover, taking capital from one class of person and distributing it to another is arguably political in nature and best kept away from the Courts.<sup>82</sup> In New Zealand, the Court of Appeal has identified that long-term contracts between public agencies that are affected by unexpected events are better dealt with by the “obvious means” of exercising legislative powers, rather than invoking the doctrine of frustration.<sup>83</sup> On the other hand, there is an argument that applying the above contentions to New Zealand would be artificial. New Zealand already has discretionary relief available for breach of contract, contractual mistake, and contracts that

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74 Law Commission, above n 15, at 277.

75 *The Hawke’s Bay Electric-Power Board*, above n 71.

76 Basil Markesinis, Hannes Unberath, Angus Johnston (eds) *The German Law of Contract: a Comparative Treatise* (2nd ed, Hart Publishing Oregon, 2006) at 346.

77 Robert Hillman “Court Adjustment of Long-Term Contracts: An Analysis under Modern Contract Law” (1987) 1 Duke LJ 1 at 2.

78 At 3.

79 At 3.

80 Rodhe, above n 11, at 157.

81 At 157.

82 At 157.

83 *The Power Co Ltd*, above n 32, at 555.

are made oppressive or onerous on their creation.<sup>84</sup> Therefore turning away from the consistent direction New Zealand contract statutes have taken, would upset the predictability of the law.

Regardless, it is likely that there will be certain cases that are too economically complex for a judge to be useful. Judges' training as lawyers is not appropriate in these cases. However, as Zundel identifies, less economically complex cases where the parties intended to share the risk may be assisted by equitable adjustment.<sup>85</sup> Given both the above discussion and the growing prevalence of long-term contracts, it is submitted that it would be very risky to give the judge, trained in law rather than economics, broad discretionary powers.

### E *Deterring planning*

Some commentators have identified that if the Court has broad discretionary powers, the parties could be deterred from planning a commercially sensible agreement.<sup>86</sup> Unrealistic long-term contracts could be made on the assumption that the judge will alter the terms if the contract becomes onerous.<sup>87</sup> It is submitted that if the discretion is appropriately restricted, there will be very little incentive to poorly plan a contract. Arguments that consider frustration are already rarely invoked in New Zealand, and any judicial discretion would probably also be invoked in rare circumstances. In particular, the United States, which uses the principle of judicial adjustment of contracts, rarely invokes it.<sup>88</sup>

## VI Jurisdictional Comparisons

### A *Germany*

German courts allow for a restricted judicial discretion in cases where the contract becomes onerous. German courts have discretion to alter the contract under the doctrine of *Wegfall der Geschäftsgrundlage* where the foundation of the contract has been lost. Unlike the French and English doctrines, which are based on unforeseeability, the German model is based on good faith.<sup>89</sup> The Court will interfere with the sanctity of absolute contracts when it deems it unreasonable for the obligor to perform the contract.<sup>90</sup> If the parties' relationship falls through, the Court will consider modifying the contract first.<sup>91</sup>

*Geschäftsgrundlage* was used in *Sp Co v F Co*.<sup>92</sup> This case involved a clause in a lease to require steam for industrial use. Due to inflation, performance of the contract became radically different from that which was originally intended. The disgruntled party propounded that the Court should adjust the contract, and that adjustment powers were

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84 Courts can reopen contracts that are onerous at their creation (as opposed to becoming onerous after an unforeseen event) under the Credit Contract and Consumer Finance Act 2003, ss 120 and 127.

85 Zundel, above n 47, at 1002.

86 Hillman, above n 77, at 2.

87 Aubrey, above n 42, at 1180.

88 See Part VI(C) of this article for a jurisdictional comparison with United States law.

89 Aubrey, above n 42, at 1180.

90 Rauh, above n 29, at 153.

91 At 153.

92 *Sp Co v F Co* Reichsgericht 100 ERG (Z) 129, 21 September 1920.

logical given that the Court already had the power to terminate the agreement.<sup>93</sup> The Court made the following findings in regard to altering the contract: both parties want the contract to be modified instead of discharged; there was an exceptional and unforeseeable change in situation; and that full modification was necessary so that the loss was not confined completely to one party.<sup>94</sup> *Geschäftsgrundlage* has faced criticism for its favouring vague equitable principles over the correct dispensation of contractual risk.<sup>95</sup>

### B *France*

French Courts have essentially the same discretion under its doctrine of *imprévision*.<sup>96</sup> The doctrine is restricted to the administrative Courts and applies in situations where a reasonable person could not have foreseen the altered circumstances.<sup>97</sup> *Imprévision* was first applied in *Compagnie Générale d'Éclairage de Brodeaux c Ville de Bordeaux*.<sup>98</sup> This case concerned a company's attempt to have its price for gas increased due to severe post-World War I inflation. The Conseil d'Etat recognised that inflation should be anticipated, yet granted relief in the form of adjustment of contractual terms. This discretion was utilised as it was in the public interest that the town be provided with gas.<sup>99</sup> In these cases, if the parties cannot reach agreement, the Court will secure an indemnity, and presumably the contract would continue.<sup>100</sup>

### C *United States*

In the United States there is support for reforming the contract after it has been found to be frustrated. Courts in the United States have a discretion to "protect the parties' reliance interests" if it is necessary to avoid injustice.<sup>101</sup> Friedmann identifies that in Anglo-American law, freedom of contract is only strictly adhered to regarding formation of contract, distinct from contractual remedies.<sup>102</sup>

The American Courts favour commercial reasonability over rules of automatic applicability. In *Transatlantic Financing Corp v United States* the Court held in the context of adjustment of contracts at the time of formation:<sup>103</sup>

The doctrine ultimately represents the ever-shifting line, drawn by courts hopefully responsive to commercial practices and mores, at which community's interest in having

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93 Aubrey, above n 42, at 1179.

94 At 1179.

95 Rogers, above n 2, at 373.

96 Treitel, above n 18, at [15-034].

97 Law Commission, above n 15, at 289.

98 *Compagnie Générale d'Éclairage de Brodeaux c Ville de Bordeaux Conseil d'Etat* (1916) III D 25, (1916) III S 17.

99 Aubrey, above n 42, at 1176.

100 Whittaker, above n 1, at 562.

101 American Law Institute, above n 37, as cited in Guenter Treitel "Some Comparative Notes on English and American Contract Law" (2002) 55 SMU L Rev 357 at 361.

102 Daniel Friedmann "Good Faith and Remedies for Breach of Contract" in Jack Beatson, Daniel Friedmann (eds) *Good Faith and Fault in Contract Law* (3rd ed, Clarendon Press, Oxford, 1995) at 401.

103 *Transatlantic Financing Corp v United States* 363 F 2d 312 (DC Cir 1966) at 315.

contracts enforced according to their terms is outweighed by the commercial senselessness of requiring performance.

This reasoning has been extended to contracts after formation. For example, in *Aluminum Corp of America v Essex Group Inc (ALCOA)* case a large cost increase was held to be impracticable.<sup>104</sup> The Court did not discharge the parties, it instead used its own method to fix the costs so that they were commensurate with the changed circumstances. The American Courts can therefore alter a contract whose terms were agreed to by the parties without mistake.<sup>105</sup> *ALCOA* is one of the rare cases of commercial impracticability where the Court has modified contractual obligations instead of ordering specific performance against the supplier.<sup>106</sup>

*ALCOA* has received large amounts of academic discussion. The Court's *modus operandi* was one of equitable reformation, which is used to prevent unjust enrichment from occurring in the future.<sup>107</sup> This contrasts to equitable restitution, which is concerned with correcting unjust enrichment that has already resulted. Equitable reformation has received some judicial support post-*ALCOA*.<sup>108</sup>

#### D *Scandinavia*

Scandinavian law has adopted the principle of adjustment of contracts.<sup>109</sup> In Sweden, the Courts have occasionally contended that intervening in the private contractual arrangement is necessary to prevent one of the parties from becoming unjustly enriched.<sup>110</sup> The Supreme Court applied this principle to cases involving an unreasonable rent increase owing to increased heating costs.<sup>111</sup>

## VII Options for Reforming the Application of the Doctrine

The solutions propounded focus on assisting parties to smoothly work through unforeseen events that render the contract onerous while retaining business cordiality and attempting to preserve contractual certainty.

#### A *Arbitration*

A helpful precondition to other forms of relief would be to impose mandatory negotiations between the parties to the frustrated contract.<sup>112</sup> This would be consistent with commercial methods of operation. A statutory duty to negotiate can only be a precondition to other forms of relief. This is because if the negotiation fails, then the mischief identified in Part III of this article will still be present. Arbitration is a typical route taken by business people wanting to preserve amicable dealings. By way of overseas example, arbitration is

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104 *Aluminum Corp of America v Essex Group Inc* 499 F Supp 53 (WD Pa 1980).

105 For comparison with other jurisdictions, see Treitel, above n 18, at [15–033].

106 Hillman, above n 77, at 2.

107 Zundel, above n 47, at 1001.

108 *National Presto Industries Inc v United States* 338 F 2d 99 (Ct Cl 1964); and *Parev Products Co v Rokeach & Sons* 124 F 2d 147 (2d Cir 1941).

109 Promissory Notes Act 1936 (Sweden), s 8.

110 Rodhe, above n 11, at 168.

111 At 184.

112 Burrows, above n 48, at 291–292.

expected in Japan, and additionally, many commercial contracts in France provide for arbitrators to act as *amiables compositeurs* (arbitrators with the power of equitable correction to depart from rigid legal standards).<sup>113</sup> Arbitrators in the International Chamber of Commerce have the power to declare that a substantial circumstantial change causing hardship has occurred, and if the declaration is made out, the power to alter the contract.<sup>114</sup> A judicial discretion to refer matters to arbitration would be a worthwhile reform. This will assist in ensuring business relationships are maintained and the problems of unforeseen circumstantial changes are quickly and efficiently remedied.

This would only be relevant if the parties to an agreement had neglected to insert an arbitration clause, which would come into effect if the agreement is stricken by substantial change in circumstances that leaves one party in severe hardship if bound by the literal terms of the agreement.

### B *Good faith*

Good faith was discussed by Thomas J in *Bobux Marketing Ltd v Raynor Marketing Ltd*.<sup>115</sup> The judge perceived the term as loyalty to a promise. He also accepted that good faith was “faithfulness to an agreed common purpose and consistency with the justified expectations of the other party.”<sup>116</sup> Importantly, the judge recognised that good faith does not correlate to abandonment of self-interest. However, implying a term of good faith in onerous contracts could be problematic. Good faith is “beset by agonising inquiries” into what the term means.<sup>117</sup> Nonetheless, Thomas J’s essential reasoning was that a term of good faith would assist parties in efficient dealing and overcoming unforeseen situations.<sup>118</sup>

Section 242 of the German Civil Code requires good faith in contracts and allows disgruntled parties possible access to relief without terminating the contract.<sup>119</sup> Moreover, the duty is also present in international trade and in the United States.<sup>120</sup> Thomas J identified that there was no evidence to suggest the use of good faith has made transactions unworkable or uncertain.<sup>121</sup> Agreements must also be performed subject to good faith in France<sup>122</sup> and Switzerland.<sup>123</sup>

Practically, if the unprejudiced party does not consider the prejudiced party’s offer to reasonably adjust the contract, the first party may be deemed to be acting in bad faith. This could then leave the Court to equitably adjust the contract.<sup>124</sup> Here, any adjustment would be restricted to deal with the presence of bad faith. It is submitted that giving the Court discretion to award damages for bad faith dealing may be preferable to granting the

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113 *Compagnie Générale d’Eclairage de Brodeaux*, above n 98, at 1177.

114 *Opas*, above n 46, at 62.

115 *Bobux Marketing Ltd v Raynor Marketing Ltd* [2002] 1 NZLR 506 (CA).

116 At [41].

117 At [41].

118 *Burrows*, above n 48, at 42.

119 Federal Ministry of Justice and Consumer Protection “German Civil Code” (2014) <[www.gesetze-im-internet.de](http://www.gesetze-im-internet.de)>.

120 The relevant United States law is American Law Institute, above n 37; and for international trade, the good faith requirement is found in UNIDROIT *Principles of International Commercial Contracts* (1994), art 1.7.

121 *Bobux Marketing Ltd*, above n 115, at [39].

122 *Code Civil* (France), art 1134.

123 *Zivilgesetzbuch* (Switzerland), art 2.

124 *DiMatteo*, above n 45, at 310.

Court powers to adjust the agreement. This is because an award of damages would not alter the nature of frustration as an adjustment power would. The doctrine of frustration would remain intact, thus preserving both commercial certainty and the large body of case law. Additionally, the body of New Zealand contract statutes discussed above already give the judiciary liberal powers to grant damages. This would assist with fostering legislative consistency. Awarding damages would serve a similar function to adjustment in that it would provide a more equitable way to distribute loss, but without the ramifications to the nature doctrine of frustration.

It may be too soon to introduce good faith into New Zealand, given the strong fears about possible wide-ranging implications to commercial certainty. This being said, good faith appears to be more in line with the actual business expectations of the contracting parties, particularly in long-term relational contracts. It could ultimately assist in preserving both amicable business relations and contractual relations. It would also encourage parties to sort out matters themselves rather than moving to litigation. It goes without saying that the term would require more certainty before good faith can be introduced to onerous contracts. A good starting point would be for the non-prejudiced party to the contract to have to reasonably consider the prejudiced party's offer to adjust the agreement. "Reasonably consider" is distinct from "accept the offer" for this would seriously interfere with commercial autonomy and be overly detrimental to the unprejudiced party.

While good faith is an uncertain term, defined restrictions like the starting point mentioned above would assist in increasing certainty. Furthermore, the exercise of one party's rights which inconveniences the other party is not generally contrary to good faith.<sup>125</sup> Defined lines are necessary, for it is unjust to hold a party in bad faith for not doing an act that they were not obliged to do.<sup>126</sup> A further (albeit less certain) line that could be drawn is that good faith would require "faithfulness to an agreed common purpose" and "consistency with the justified expectations of the other party."<sup>127</sup> Certainty here may be increased with reference to common commercial standards in the particular industry the agreement relates to. This is already used in Credit Contract and Consumer Finance Act 2003 (CCCFA 2003) cases. In these cases, expert evidence is brought in to ascertain the reasonable (and measurable) commercial standards of the industry to which the agreement relates. Additionally, if parties knew that they had to follow a duty of good faith they would be more inclined to negotiate and resolve their disputes on their own, which would ideally prevent matters from coming to the Court. This method also means that the parties retain control of their arrangement.

### *C Extending the oppressiveness provisions in the CCCFA 2003*

Extending the principles in the CCCFA could be a simple yet convenient way to impose a restricted judicial discretion. Professor Burrows, in propounding this novel solution,<sup>128</sup> notes that the CCCFA already has provisions to reopen a contract that was oppressive at the date of creation.<sup>129</sup> He submits that this principle could be applied to contracts that

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125 Friedmann, above n 102, at 401.

126 McKendrick, above n 39, at 316.

127 Robert Summers "The General Duty of Good Faith – Its Recognition and Conceptualization" (1982) 67 Cornell L Rev 810 at 821.

128 Law Commission, above n 15, at 290–291.

129 Credit Contract and Consumer Finance Act 2003, s 120.

become onerous later in their lifespan. This solution would assist in fostering consistency between New Zealand's contract statutes that Gibbons has observed is missing.<sup>130</sup> As this solution requires a judicial discretion, the arguments detailed above about the place of *pacta sunt servanda* apply.

#### D *Softening the threshold*

Softening the threshold required for an agreement to be frustrated is unlikely to sufficiently remedy the identified mischief. There is an argument that the law in NZ is moving towards a lower threshold. *Steele v Serepisos* provides support for this.<sup>131</sup> The facts of that case concerned a Council rule that sewage and drainage be connected to the appellant's property. The appellants expected the neighbours to grant an easement for this purpose. The neighbours denied this, forcing the appellants to the only other option; place the pipes through separate adjoining land which would disrupt both visual appearance and cost ten times more. While not directly on point with frustration, Tipping J provides useful dicta. He found that the denial of consent "come[s] close to [the] permitted escape of frustration." However, majority of the case law does not indicate that the bar should be lowered.<sup>132</sup> Additionally, it is unlikely that in light of the jurisdictional comparisons a lowering of the bar would return a practical difference in the way Courts treat onerous contracts. Both the German Courts and the Courts in the United States appear reluctant to interfere with contracts that are onerous. This is evidenced by the rarity of cases where the judicial discretion is invoked.

#### E *Formulating a workable restricted discretion*

If a judicial discretion were to become part of New Zealand law, the author's view is that the following restrictions would render it more viable:

The Court should have discretion to refer the matter to arbitration first. As Speidel identifies, "the appropriate response for a Court is to press aggressively for an *agreed modification* or to impose an adjustment as a condition to equitable relief."<sup>133</sup>

Professor Burrows suggests the following restrictions for discretionary relief of the Frustrated Contracts Act 1944: the judge must take into account the expense incurred by one party; the amount of unjust enrichment; and the degree to which the supervening event devalued the enrichment.<sup>134</sup> The first suggestion would be a direct adoption of s 9(4)(c) of the Contractual Remedies Act 1979. This would render the judicial discretion consistent with other contractual legislation. While Burrows mandated these changes be made in the context of the Frustrated Contracts Act 1944, it is equally applicable to onerous contracts which are a direct result of frustration's *all or nothing* nature. The Court also could have a discretion specifically related to contracts turned onerous due to massive

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130 See Gibbons, above n 55.

131 *Steele v Serepisos* [2006] NZSC 67, [2007] 1 NZLR 1 (SC).

132 See *The Power Co Ltd*, above n 32. See also Tim Clarke "Termination of Contracts" (2008) <[www.bellgully.co.nz](http://www.bellgully.co.nz)>. Clarke argues that the line of cases does not favour lowering the threshold.

133 Richard Speidel "Excusable Nonperformance in Sales Contracts: Some Thoughts about Risk Management" (1980) 32 SCL Rev 241 at 279 (emphasis added).

134 Law Commission, above n 15, at 302.

inflation or other financial crisis' by imposing a clause that deals fairly with price inflation.<sup>135</sup>

Finally, adjustment would be rare given that bad faith would need to be present before any discretion is invoked. Should a judicial discretion to adjust the contract be deemed too uncertain, there could be discretion to award damages for breach of good faith. This would assist in removing the issue of one party receiving a windfall. It would need to be given similar restrictions to those needed for a workable (i.e. restricted) judicial discretion.

## VIII Conclusion

The harsh results following onerous contracts that do not reach the threshold of frustration are well known. The tough consequences of the cases under analysis are a direct result of frustration's *all or nothing* nature. In the cases under analysis, a more equitable approach that distributed the loss between the parties would have remedied the identified injustices. However, this is easier said than done. The practical cost of implementing a restricted judicial discretion is high enough to counter most proposals, at least at this stage in New Zealand's judicial history. Having a restricted judicial discretion for the onerous contract cases would undermine the well-established nature of the doctrine of frustration. Moreover, overseas Courts have shown a strong trend against modifying the contract in onerous cases. Clearly, in common law and continental jurisdictions, the core purpose of the contract is to allocate risk. Additionally, judges are not qualified to deal with these particular questions of equitable distribution. Specialist training in accountancy and economics would be requisite, particularly when dealing with complex long-term commercial contracts. Theoretically a judicial discretion would successfully soften the doctrine's *all or nothing* nature, but practically its benefits would be outweighed by the uncertainties it creates.

### *A Future developments to consider*

The law is clearly in an unsatisfactory state and therefore requires some form of alteration. The *all or nothing* nature of frustration remains distant from the expectations of commercial parties engaged in complex transactions. In particular, long-term commercial contracts by their nature demand flexibility. Business people are often more concerned with maintaining cordial business relations than with the painstaking exactitude of the common law rules. The law should endeavour to reflect this reality. Any alteration to the law must also reflect the ever-present need for certainty of dealing. It is submitted that a judicial discretion to refer matters to arbitration is a useful starting point. This would keep the contract away from judicial interference while encouraging the parties to maintain their relationship. Arbitration is not a complete solution since the parties may fail to reach consensus. The other adjustment to the law which is necessary is to impose an obligation of good faith on parties to contracts that turn onerous after their creation. With clear guidelines, an obligation of good faith could potentially solve a great many onerous cases in a more equitable manner, while only invoking discretion rarely, or perhaps only for

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135 This kind of power would provide a more equitable form of relief to inflation cases like *Staffordshire Area Health Authority*, above n 24. Professor Burrows suggests that a price fluctuation clause might be appropriate for the Courts to import in these situations. See Law Commission, above n 15, at 294.

damages, as damages do not involve modifying the contract. This would leave the doctrine of frustration unchanged. Given the reluctance of New Zealand Courts to use good faith in other areas of contract law, using it in the rare onerous contract cases may be a good starting point to test its efficacy for other forms of commercial dealing in the New Zealand context.